POLICY NOTE 2: UPRATING AND THE VALUE OF CHILDREN'S BENEFITS December 2014

1. Introduction

This policy note considers the effect that uprating decisions have had on the real value of children's benefits over the course of this parliament. Specifically, it calculates the amounts which our two key children's benefits –child benefit and child tax credit – have lost over the last five years. It has been written to coincide with Autumn Statement 2014, the point in the fiscal year when decisions about benefit uprating have conventionally been made.

2. How have children's benefits been uprated over time?

While uprating may seem an obscure, technical issue, decisions as to how the value of benefits is maintained over time are of critical importance. In essence, there are three bases on which benefits can be uprated:

- With reference to a price index – which ensures benefits keep pace with the cost of living;
- With reference to changes in average earnings – which ensures that those in receipt of benefits do not drift away too far from the mainstream;
- By using a nominal figure – which can achieve a particular policy end such as increasing generosity through over-indexation, or making savings through under-indexation.

All three methods have been employed at various points since the introduction of child benefit (CB) and child tax credit (CTC). Child benefit in particular has had a chequered history with respect to uprating. In its early days, its value failed to keep pace with prices and as a result, by 1989 it was worth less in real terms than its predecessor benefit family allowance had been in the 1950s. The 1990s saw a turnaround in its fortunes, however, when John Major's government chose slowly to restore its value. This upward trend continued through the Labour years during which the benefit was uprated broadly in line with RPI, and on occasion was subject to over-indexation.[1]

[1] For a full history of child benefit see R Farthing, *'Save child benefit',* CPAG 2012 Appendix 1 available at http://www.cpag.org.uk/sites/default/files/SaveChildBenefit.pdf

Child tax credit has historically benefitted from a more generous and stable settlement. From its introduction in 2003 to 2010, the children's element of CTC was explicitly linked to average earnings[2], although CPI was subsequently used as the index of choice when wages collapsed after 2008. Moreover, the children's element has also on occasion gained from additional uplifts in value over earnings.[3] It is worth noting, however, that the family element of CTC has never benefitted from any form of uprating since 2003.

3. Children's benefits in the current parliament

At its Emergency Budget in June 2010, the Coalition made three key changes to the way children's benefits were uprated as follows:

- First, it decided to employ CPI rather than RPI as the default basis for uprating all benefits in the future;
- Second, it announced a freeze in CB for the first three years of the parliament, with an expectation that it would be uprated by CPI thereafter;
- Third, it announced that the children's element of CTC would be uprated by CPI in the future, but would also benefit from a significant over-indexation in 11/12 and 12/13. This uplift was increased still further for both years in a commitment made at the Comprehensive Spending Review in October 2010.[4]

These changes constituted a substantial cut to the value of children's benefits. While the shift from RPI to CPI as the default index looks like a technicality, in truth the change from one to the other is highly significant given that RPI almost always outpaces CPI by some margin.[5] Moreover, with prices running high in 2010 the plan to freeze the value of CB was significant. However, the decision to cut CB in real terms was tempered by the promise to increase the value of CTC, a shift in resources that was explicitly linked to holding the child poverty rate constant. As the documents stated at the time:

> *"This budget includes measures to reduce welfare spending … Steps have been taken to protect low income families with children from the impact of these changes, by freezing the rate of Child Benefit to partly fund above indexation increases to the Child Tax Credit. This ensures that the overall impact of all modelled Budget changes on child poverty in 2012-13 is statistically insignificant".*[6]

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[2] HM Treasury, *Budget 2003*

[3] See, for example, HM Treasury, *Budget 2007* and HM Treasury, *Budget 2008*

[4] Budget 2010 announced that the child element of CTC would be increased by £150 in 11/12 and £60 in 12/13 above indexation; CSR 2010 committed the government to increase the child element of CTC by an additional £30 in 11/12 and £50 in 12/13

[5] The ONS estimates that since its introduction, inflation (over a 12 month period) measured by the CPI has been lower than RPI inflation by an average of 0.9 percentage points. See ONS, *International comparison of the formula effect between the CPI and RPI*, March 2012 available at http://www.ons.gov.uk/ons/guide-method/user-guidance/prices/cpi-and-rpi/index.html

[6] HM Treasury, *Budget 2010*, 69

This decision to increase the value of CTC began to unravel at Autumn Statement 2011, however, when the chancellor retreated on his commitment to over-index the benefit for 2012/13. This was followed in Autumn Statement 2012 by the announcement that the majority of working age benefits including CTC would be uprated at a below inflation 1 per cent for the subsequent three fiscal years. Table 1 summarises these changes over time.

Table 1: Children's benefit uprating decisions 2010-2015

	11/12	12/13	13/14	14/15	15/16
Budget and CSR 2010					
Child benefit	0%	0%	0%	CPI	CPI
Children's element of child tax credit	CPI plus £180	CPI plus £110	CPI	CPI	CPI
Autumn statement 2011					
Child benefit	0%	0%	0%	CPI	CPI
Children's element of child tax credit	CPI plus £180	CPI	CPI	CPI	CPI
Autumn statement 2012					
Child benefit	0%	0%	0%	1%	1%
Children's element of child tax credit	CPI plus £180	CPI	1%	1%	1%

As a result, while the government's stated aim in 2010 was to protect the value of children's benefits at least for those with lower incomes, by the end of this parliament, both CB and CTC are worth considerably less than promised at the outset, in large part because of decisions about how their real value would be maintained.[7] The scale of these losses is the question to which we now turn.

4. The effect of uprating decisions

Establishing the amount of support that families have lost as a result of uprating decisions requires choosing a plausible counterfactual against which the lost value can be measured. Here, we consider two possibilities for CB: that it had been uprated in line first, with RPI and second, with CPI. For the children's element of CTC, we consider how the benefit has fared compared to both inflation measures, as well as a further scenario in which the government's plans to uprate the benefit by CPI and over-index it for two years had been fully followed through.

[7] Both child benefit and child tax credit have, of course, lost value through policy choices other than uprating over this parliament. For example, from April 2013 CB has been tapered away from those earning over £50,000 p.a. and is unavailable to parents earning over £60,000 p.a. Likewise, CTC has been cut through the removal of the baby element and an increased withdrawal rate from 11/12.

Child benefit

As Table 1 shows, CB has lost over 15 per cent of its value over this parliament compared to its worth had it been uprated using RPI. In practical terms, this means a family with one child has lost £543 of support over the five years, and a two-child family has sustained losses of £900.

Table 2: Annual value of child benefit (actual and if uprated by RPI)

	10/11	11/12	12/13	13/14	14/15	15/16
Actual value						
1st child	£1,056	£1,056	£1,056	£1,056	£1,066	£1,077
2nd and subsequent children	£697	£697	£697	£697	£705	£712
Value if uprated by RPI						
1st child	£1,056	£1,091	£1,141	£1,170	£1,210	£1,240
2nd and subsequent children	£697	£720	£753	£772	£799	£819
Losses						
1st child	£0	£36	£85	£115	£144	£164
2nd and subsequent children	£0	£24	£56	£76	£94	£107
Cumulative loss in value (%)	**0**	**3.4**	**8.1**	**10.9**	**13.6**	**15.5**

Note: Figures may not sum due to rounding

Table 3 show the losses if instead we use CPI as the index of choice. Again, the losses are significant: CB has been devalued by over 13 per cent in five years, with a one-child family losing £512 of support and a two child family £848.

Table 3: Annual value of child benefit (actual and if uprated by CPI)

	10/11	11/12	12/13	13/14	14/15	15/16
Actual value						
1st child	£1,056	£1,056	£1,056	£1,056	£1,066	£1,077
2nd and subsequent children	£697	£697	£697	£697	£705	£712
Value if uprated by CPI						
1st child	£1,056	£1,088	£1,145	£1,170	£1,202	£1,216
2nd and subsequent children	£697	£718	£756	£772	£793	£803
Losses						
1st child	£0	£33	£89	£115	£136	£139
2nd and subsequent children	£0	£22	£59	£76	£89	£91
Cumulative loss in value (%)	**0**	**3.1**	**8.5**	**10.8**	**12.9**	**13.2**

Note: Figures may not sum due to rounding

Child tax credit

Table 4 tells a different and interesting story, showing as it does the actual value of the children's element of CTC against the value it would have if uprated by RPI and CPI over this parliament. As the table illustrates, the real value of the children's element of CTC has increased over the last five years, despite three years of under-indexation. The reason for this is simple: the benefit received a significant uplift in 11/12 and the enduring benefit of this discretionary choice has offset the erosion in value caused by subsequent under-inflation uprating.

Table 4: Annual value of the children's element of child tax credit (actual and if uprated by RPI and CPI)

	10/11	11/12	12/13	13/14	14/15	15/16
Actual	£2,300	£2,555	£2,690	£2,720	£2,750	£2,778
uprated by RPI	*£2,300*	*£2,378*	*£2,485*	*£2,550*	*£2,637*	*£2,702*
uprated by CPI	*£2,300*	*£2,371*	*£2,495*	*£2,549*	*£2,618*	*£2,650*
difference in value (£)						
if uprated by RPI	*£0*	*-£177*	*-£205*	*-£170*	*-£113*	*-£75*
if uprated by CPI	*£0*	*-£184*	*-£195*	*-£171*	*-£132*	*-£128*
difference in value (as %)						
if uprated by RPI	*0*	*-7.7*	*-8.9*	*-7.4*	*-4.9*	*-3.3*
if uprated by CPI	*0*	*-8.0*	*-8.5*	*-7.4*	*-5.7*	*-5.6*

Note: Figures may not sum due to rounding

Finally, Table 5 shows what would have happened had the promised 12/13 over-indexation been implemented and the children's element uprated by CPI thereafter. It shows that uprating decisions made over the course of this parliament will have reduced the real value of the children's element of CTC by 8.5 per cent against this counterfactual. As a result, a family with one child will therefore have lost £628 in the last five years, and a two-child family double this (£1256).

Table 5: Annual value of children's element of CTC (actual and if uprated by CPI and over-indexed)

	10/11	11/12	12/13	13/14	14/15	15/16
Actual amount	£2,300	£2,555	£2,690	£2,720	£2,750	£2,778
12/13 over-indexation and CPI	£2,300	£2,555	£2,798	£2,859	£2,937	£2,972
Losses	£0	£0	£108	£139	£187	£194
Cumulative losses (%)	**0**	**0**	**4.7**	**6.1**	**8.1**	**8.5**

Note: Figures may not sum due to rounding

Overall, then, a low income family in receipt of both CB and the full amount of CTC has seen their children's benefits eroded by £1,140 over the course of the parliament, while a two-child family has lost to the tune of £2104, simply because of uprating decisions.

5. Conclusions and recommendations

As the preceding analysis shows, small changes to the basis by which children's benefits are uprated make a big difference to value over time. Uplifts have an enduring protective effect, while under-indexing results in cumulative losses that cannot be recovered without an active decision to over-index in the future.[8] Perhaps most worrying, these losses happen stealthily and do not attract the same type of notice from commentators or the public as more explicit or easily named cuts. Over time, however, they are a key explanatory factor of the UK's rates of poverty.[9]

The uprating story over the course of this parliament with respect to children's benefits is one of broken promises. A reduction in the real value of CB was linked explicitly to greater investment in CTC in 2010. Instead, while CB has been cut significantly in real terms, ministers have subsequently reneged on their commitments with respect to CTC, impoverishing families in the process.

In light of this, CPAG recommends that the government:

- Considers how it could increase the children's element of CTC by 8.5 per cent, thereby restoring its value to what it would be worth had it delivered on its 2010 promise to over-index the benefit for two years and uprate its value in line with CPI thereafter;
- Sets out a plan showing how it will restore CB to the value it had in 2010;
- Institutes a stable settlement for children's benefits in the future by committing to a triple lock, uprating their value by CPI, average earnings or 2.5 per cent annually, whichever is higher.

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[8] For example, the triple-lock for the basic state pension was introduced as a response to the long term decline in the value of the BSP that followed its break from earnings in 1980

[9] See, for example, M Brewer, J Browne and R Joyce, *Child and Working-Age Poverty from 2010 to 2020*, IFS Commentary C121 2011