Credit Worthy

Tax credits: a help or a hindrance?
Tax credits: a help or a hindrance?

1. The tax credit system
   – Drivers for development
   – Coverage

2. Assessing the impact
   – Child poverty
   – In-work incomes
   – Employment
   – Wages
1 The tax credit system
1. The tax credit system: drivers for development

- Shift to individual taxation in 1990
- General drift towards family-based welfare
- Growing wage inequality
- Changing family structures

→ Little support for low-paid working families
High level of worklessness
Growth in poverty
Tax credits designed to:

- Tackle child poverty
- Make work pay
1. The tax credit system: drivers for development

- Family Credit (1971) means-tested benefit for families with an adult working

- WFTC (1999) more generous, wider eligibility, but still highly targeted

- WTC/CTC (2003) extended coverage and reintroduced family-based progressivity

- Universal Credit (2013) roll in-work and out-of-work benefits and credits together
1. The tax credit system: coverage and awards

Distribution of tax credit recipients and payments across working-age family income deciles 2009-10

Proportion of all recipients
Proportion of all tax credit spending

equivalised gross income deciles
### 1. The tax credit system: coverage and awards

**Tax credit receipt among families by income group: UK 2009-10**

<table>
<thead>
<tr>
<th>Proportion in receipt of tax credits</th>
<th>Benefit-reliant</th>
<th>Low to middle income</th>
<th>Higher income</th>
<th>All family units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single parent</td>
<td>79%</td>
<td>88%</td>
<td>62%</td>
<td>80%</td>
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<tr>
<td>Couple with children</td>
<td>68%</td>
<td>71%</td>
<td>36%</td>
<td>54%</td>
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<tr>
<td>Single without children</td>
<td>10%</td>
<td>19%</td>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>Couple without children</td>
<td>5%</td>
<td>5%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>All family units</td>
<td>33%</td>
<td>38%</td>
<td>12%</td>
<td>24%</td>
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</table>
2 Assessing the impact
2. Assessing the impact: poverty

Proportion within each family type living in households below 60 per cent of contemporary median income (BHC)

Source: IFS
2. Assessing the impact: in-work incomes

Change in average household incomes in the low to middle income group 2000-01 to 2009-10

2000-01 = 100
2012-13 prices

WTC & CTC introduced

wage growth
wage stagnation
crisis/recession

Net earnings
Net income
All state support
2. Assessing the impact: employment

• Controlling for general employment trends, number of UK studies find positive employment effect

• Especially for single parents
  – employment rose by 4-6 per cent more than for control group

• Overall impact is smaller, but positive
2. Assessing the impact: employment

Proportion of children living in workless households

- UK (under-16s)
- Ireland
- Australia (under-15s)
- Spain
- France
- Italy
- Netherlands

WFTC introduced
WTC/CTC introduced
2. Assessing the impact: employment

Millions of in-work heads of families affected by high marginal effective tax rates (METRs)

Source: HMT

- 60-80 per cent
- 80-100 per cent
- Over 100 per cent

WFTC introduced
WTC/CTC introduced

Source: HMT
2. Assessing the impact: wages

(indices of gross weekly pay) 1984 = 100

FT employees

WFTC introduced
WTC/CTC introduced
2. Assessing the impact: wages

• Two means of depressing wage growth
  – Deliberate reaction among employers
  – More general increase in labour supply

• Might expect to see
  – Eligible workers experiencing slower wage growth than non-eligible ones
  – Lower paid/tax credit target workers experiencing slower wage growth than higher paid ones

• Studies in US (EITC) and the UK (WFTC) find negative impact on wages at the bottom of the distribution
2. Assessing the impact: wages

• Current UK system has two key differences
  – Longer reach up the earnings distribution
2. Assessing the impact: wages

Distribution of in-work adults living in tax credit recipient families

- 2001-02 (WFTC)
- 2009-10 (WTC & CTC)

Gross wage deciles (all employees)
2. Assessing the impact: wages

Distribution of tax credit spending across in-work families

2001-02 (WFTC)

2009-10 (WTC & CTC)
2. Assessing the impact: wages

• Current UK system has two key differences
  – Longer reach up the earnings distribution
  – Stronger wage floor provided by NMW
2. Assessing the impact: wages

Main minimum wage rate as a proportion of median wage

- UK National Minimum Wage
- US Federal Minimum Wage

WTC/CTC introduced

2. Assessing the impact: wages

Test impact in two ways

1. Compare eligible and non-eligible workers at same point in distribution
   
   *i.e. are workers with kids faring differently from those without?*

2. Compare eligible and non-eligible parts of the distribution
   
   *i.e. are low paid workers generally losing ground?*
2. Assessing the impact: wages

*Indices of real terms wage growth, 1997-98 = 100*

*Families situated at 15th percentile in overall distribution at start of period*

- **With kids**
- **Without kids**

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*WFTC introduced*

*WTC and CTC introduced*
2. Assessing the impact: wages

Indices of real terms wage growth, 1997-98 = 100
Families situated at 50th percentile in overall distribution at start of period

With kids
Without kids

WFTC introduced
WTC and CTC introduced

All families
2. Assessing the impact: wages

Indices of real terms wage growth, 1997-98 = 100
Families situated at **75th percentile** in overall distribution at start of period

With kids
Without kids

<table>
<thead>
<tr>
<th>Year</th>
<th>With kids</th>
<th>Without kids</th>
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<td>1997-98</td>
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<td>100</td>
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<td>1999-00</td>
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<td>2001-02</td>
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<td>2007-08</td>
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WFTC introduced
WTC and CTC introduced

All families
2. Assessing the impact: wages

Pay ratios between various points in the overall distribution

WFTC introduced

WTC and CTC introduced


75-25
2. Assessing the impact: wages

Pay ratios between various points in the overall distribution

WFTC introduced

WTC and CTC introduced
2. Assessing the impact: wages

Pay ratios between various points in the overall distribution

- WFTC introduced
- WTC and CTC introduced
2. Assessing the impact: wages

- No differences between earners with children (tax credit eligible) and those without

- No differences across the income distribution (except reduced inequality at the bottom)
2. Assessing the impact: conclusions

- Some success in tackling child poverty
- Very positive role in supporting incomes among low to middle income households
- (Small) positive impact on employment
- With inevitable disincentives for some to increase hours, pay and skills
- Little evidence of any significant downward pressure on earnings