
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

1. The tax credit system: drivers for development

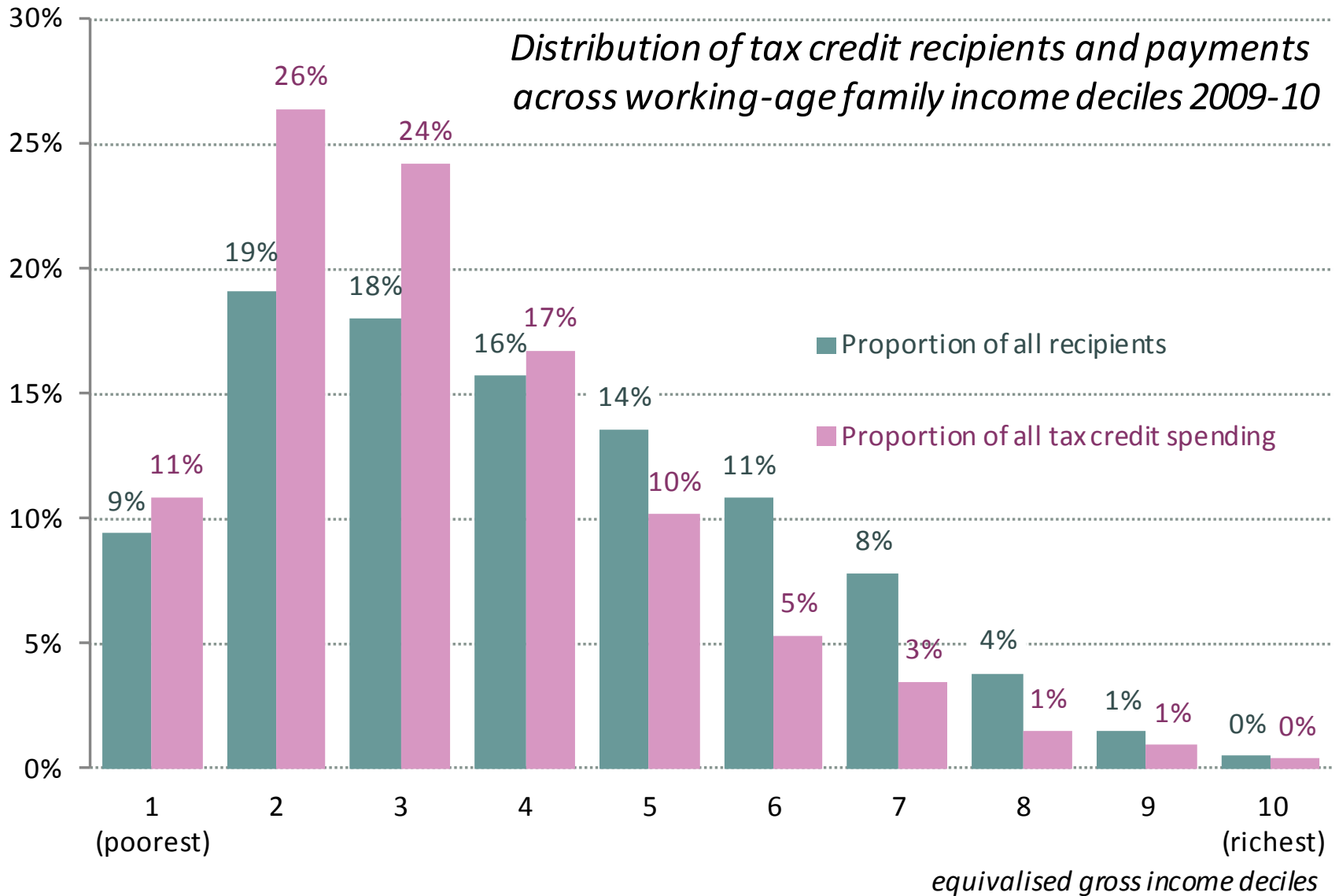
Tax credits designed to:

- 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



1. The tax credit system: coverage and awards

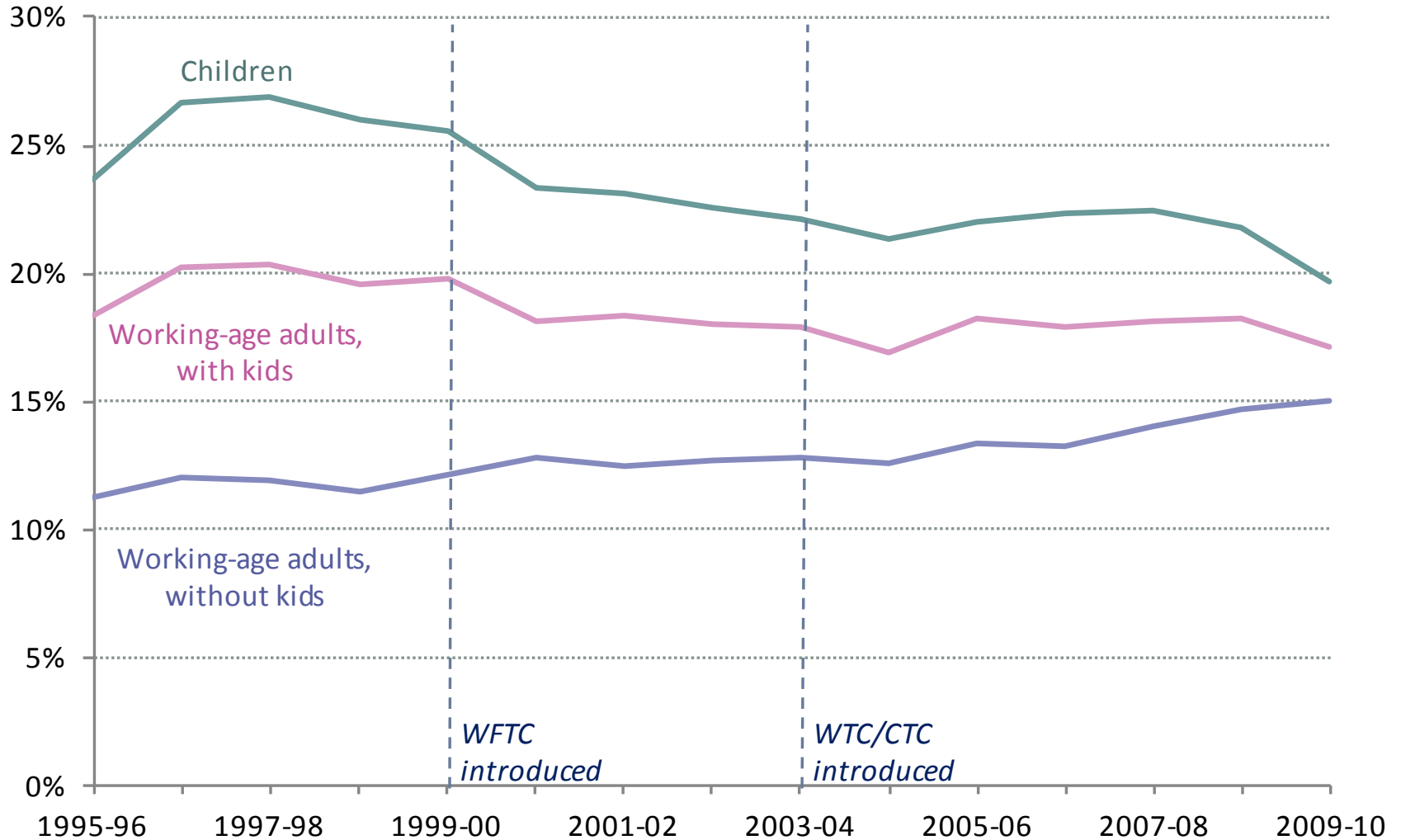
Tax credit receipt among families by income group: UK 2009-10

	Benefit-reliant	Low to middle income	Higher income	All family units
Proportion in receipt of tax credits				
Single parent	79%	88%	62%	80%
Couple with children	68%	71%	36%	54%
Single without children	10%	19%	5%	10%
Couple without children	5%	5%	1%	2%
All family units	33%	38%	12%	24%

2 Assessing the impact

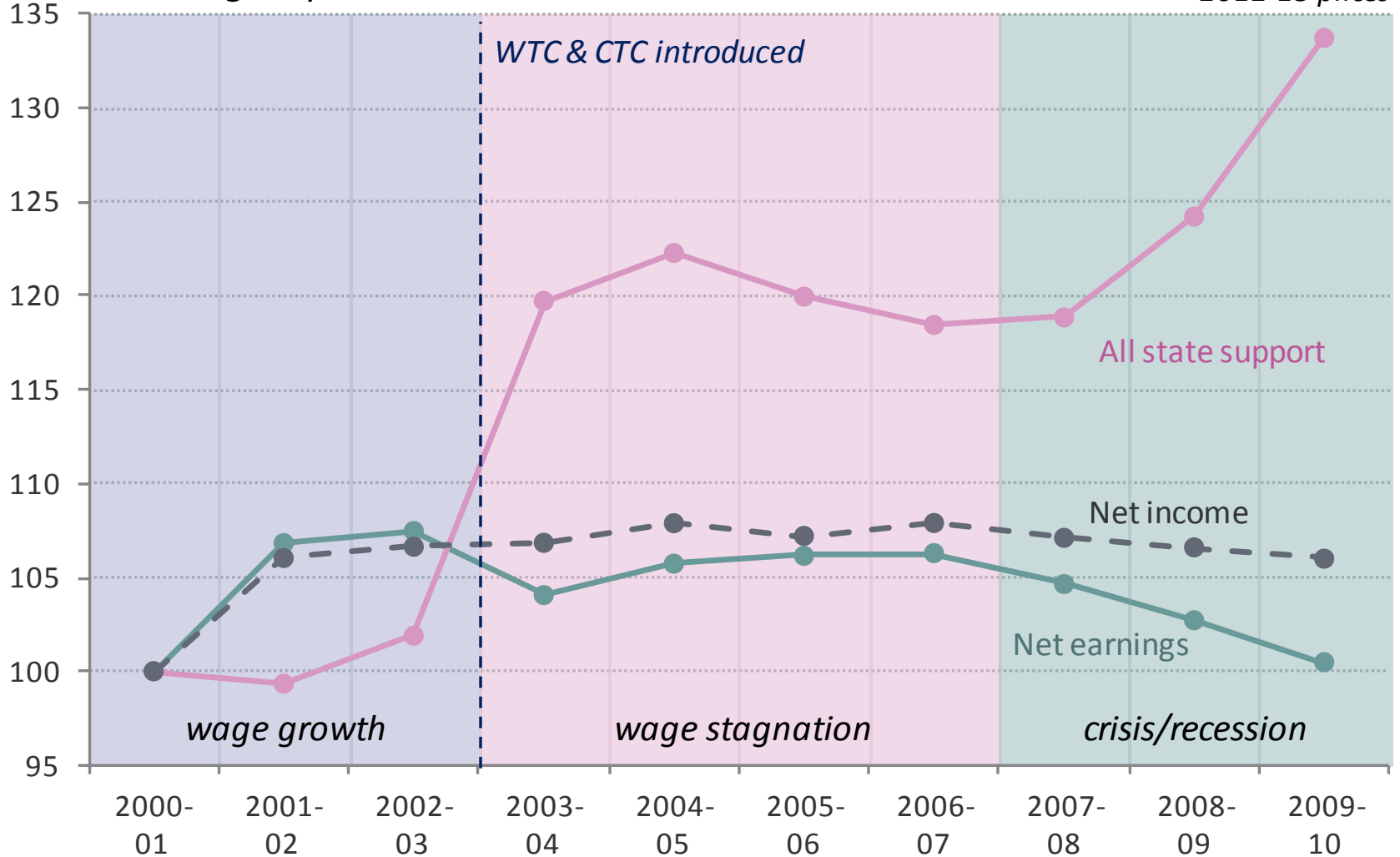
2. Assessing the impact: poverty

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



2. Assessing the impact: in-work incomes

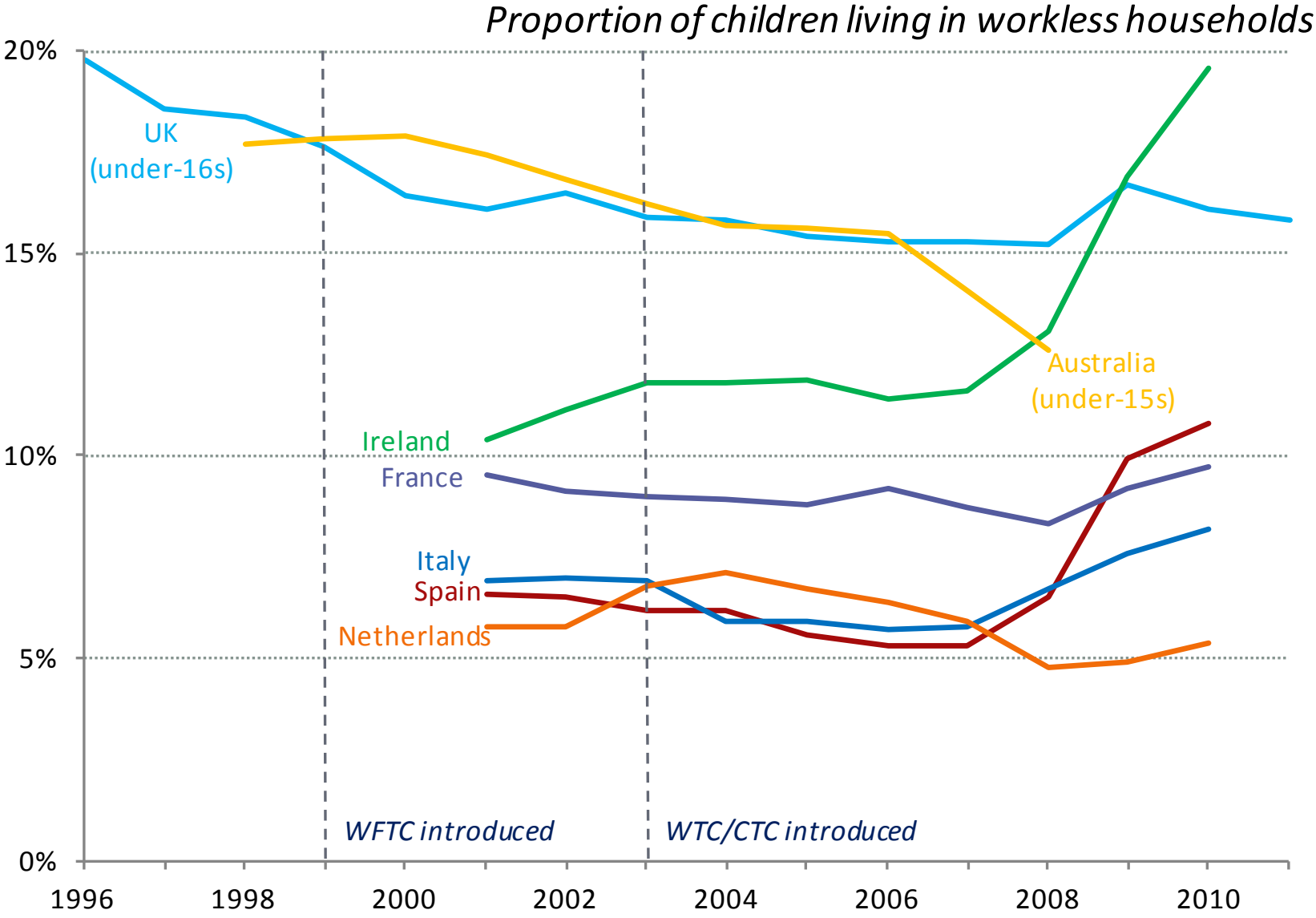
Change in average household incomes in the low to middle income group 2000-01 to 2009-10
2000-01 = 100
2012-13 prices



2. Assessing the impact: employment

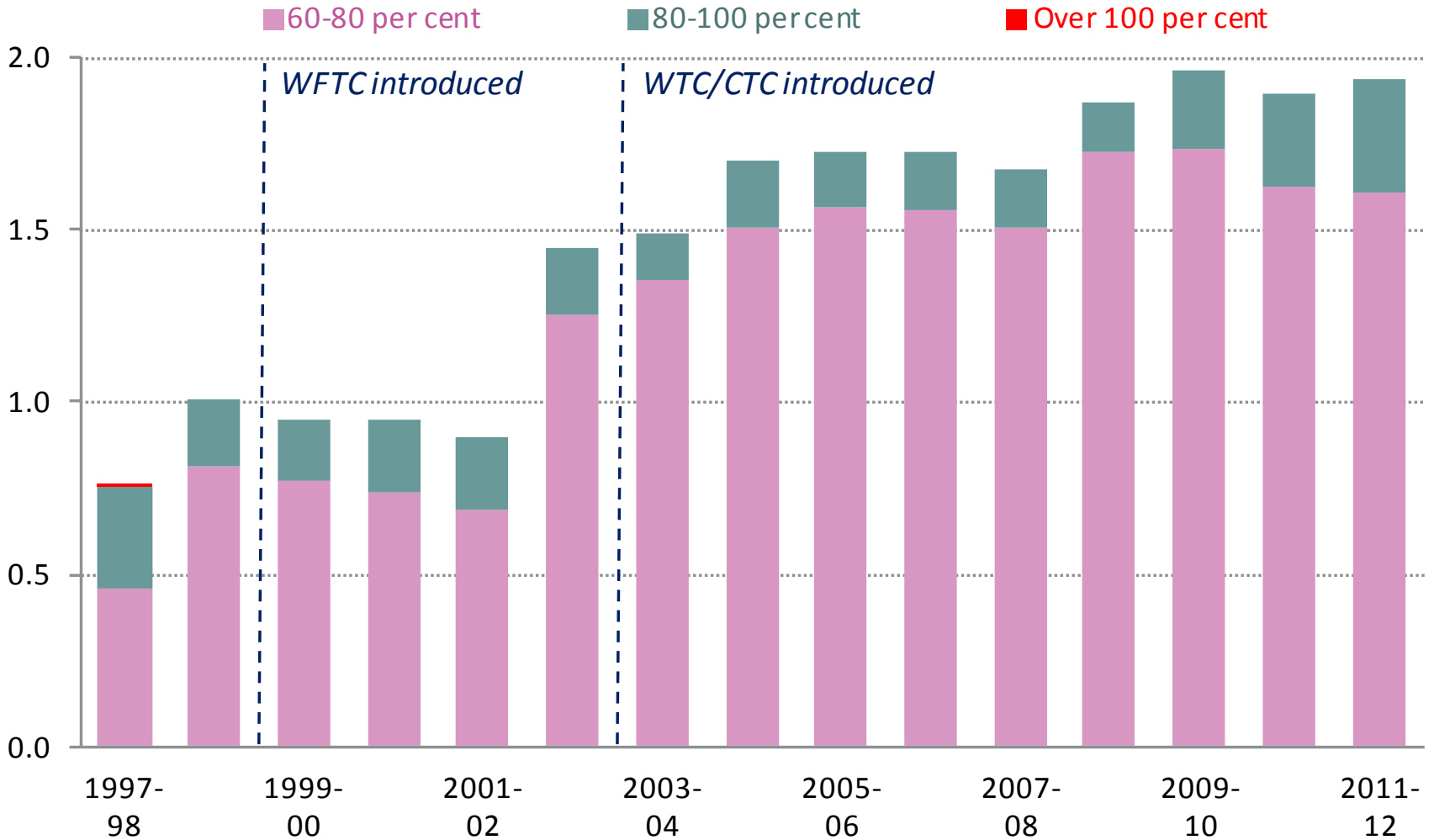
- Controlling for general employment trends, number of UK studies find positive employment effect
- Especially for single parents
 - employment rose by 4-6 per cent more than for control group
- Overall impact is smaller, but positive

2. Assessing the impact: employment



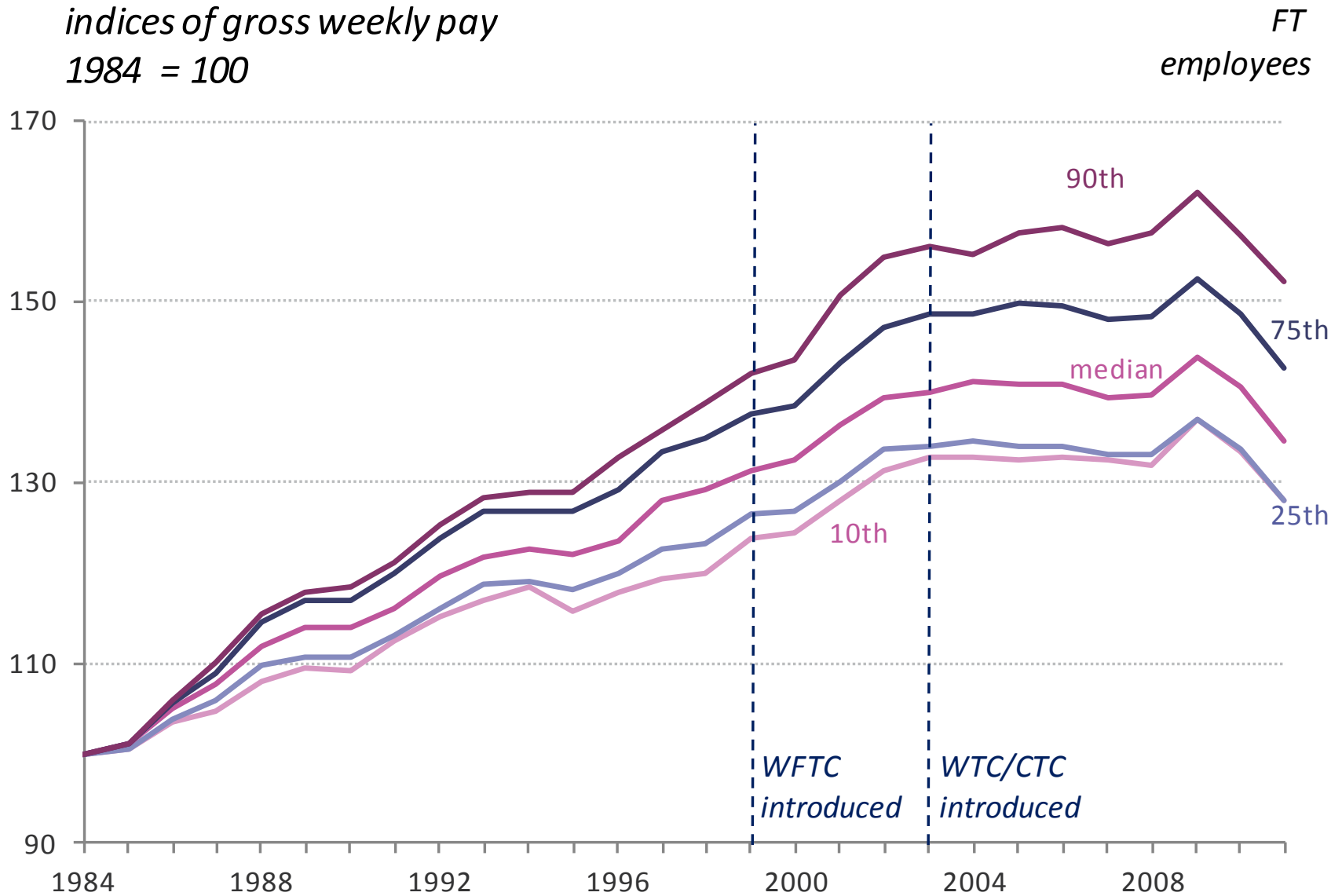
2. Assessing the impact: employment

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



Source: HMT

2. Assessing the impact: wages



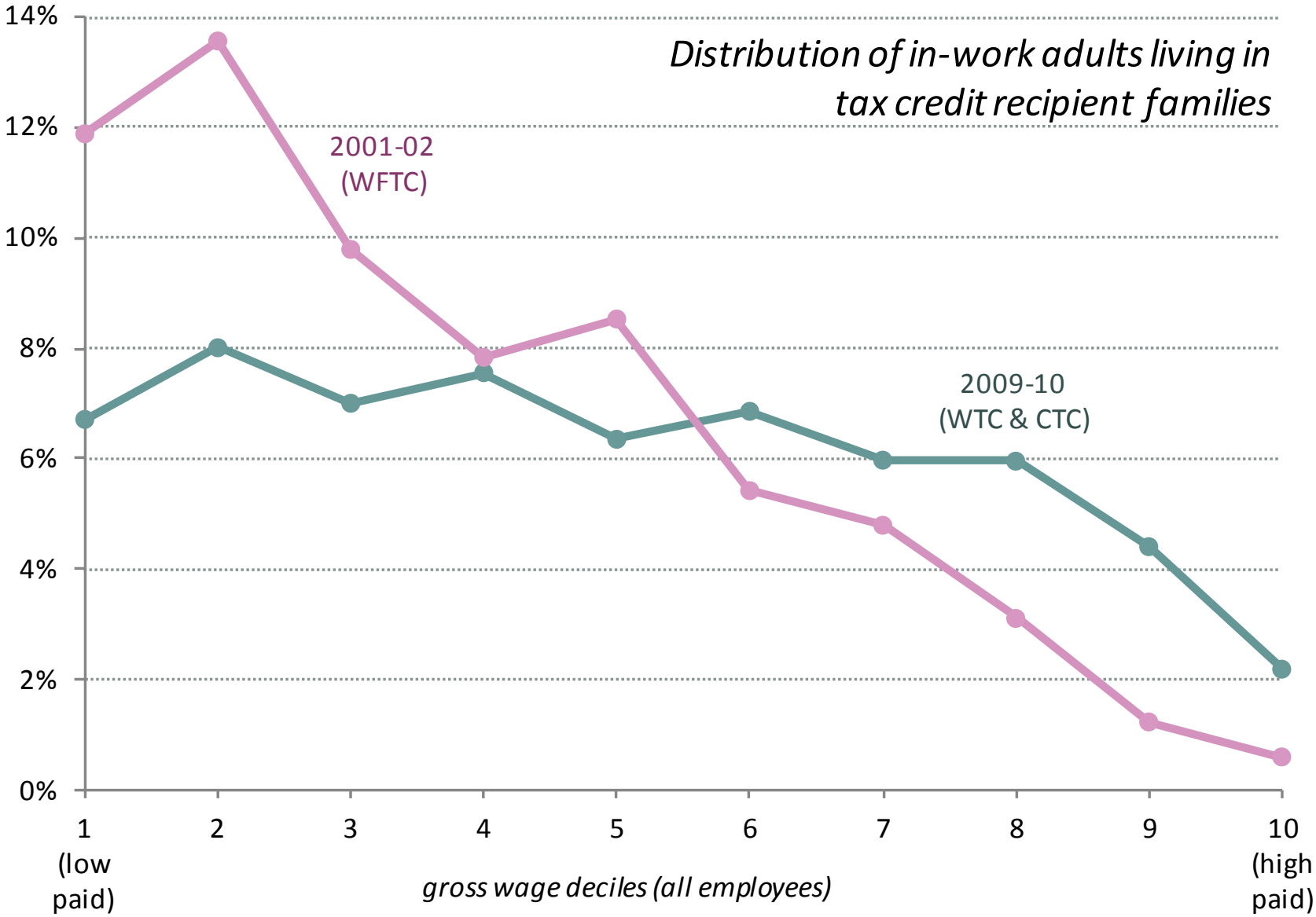
2. Assessing the impact: wages

- 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

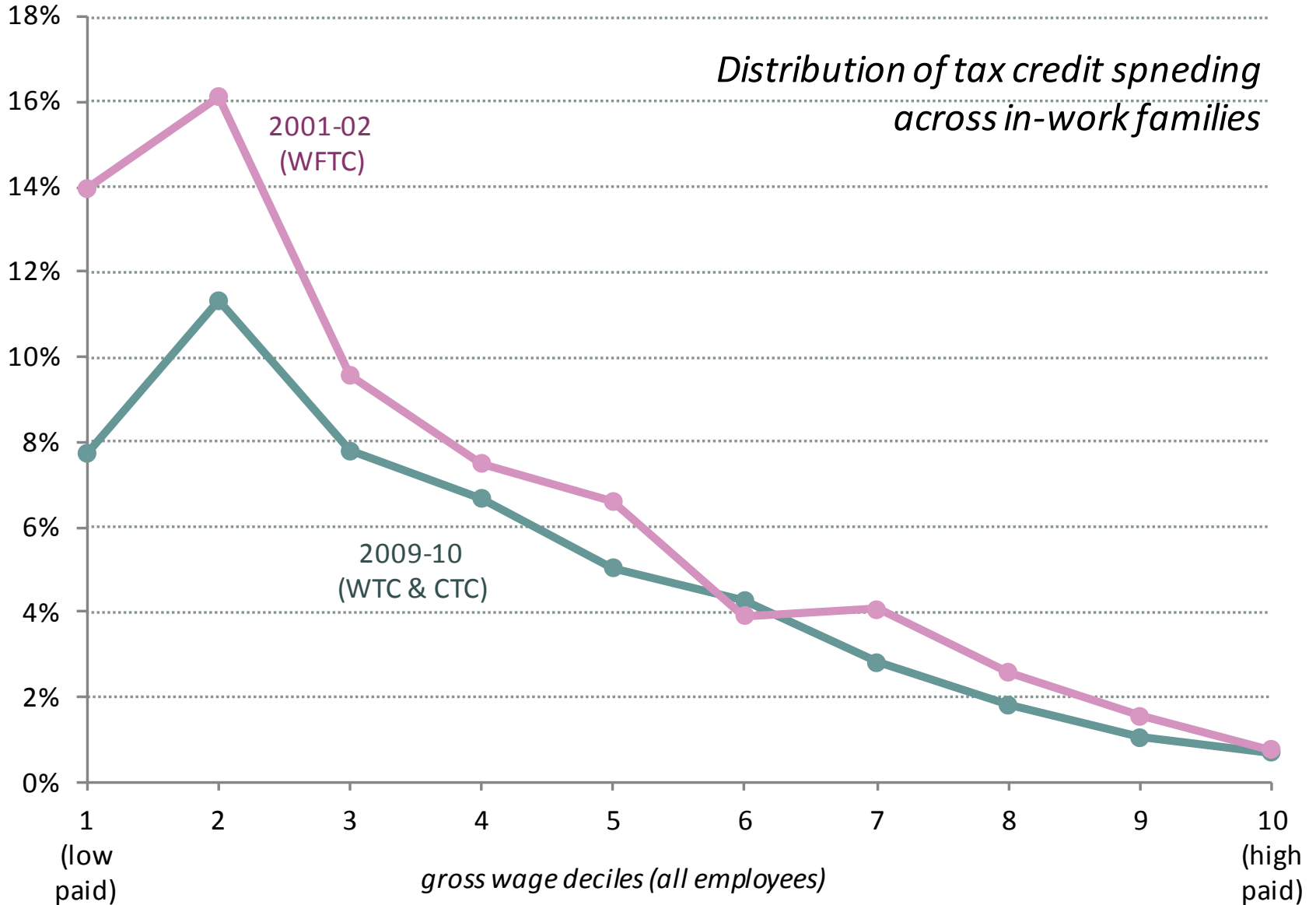
- Current UK system has two key differences
 - Longer reach up the earnings distribution

2. Assessing the impact: wages



2. Assessing the impact: wages

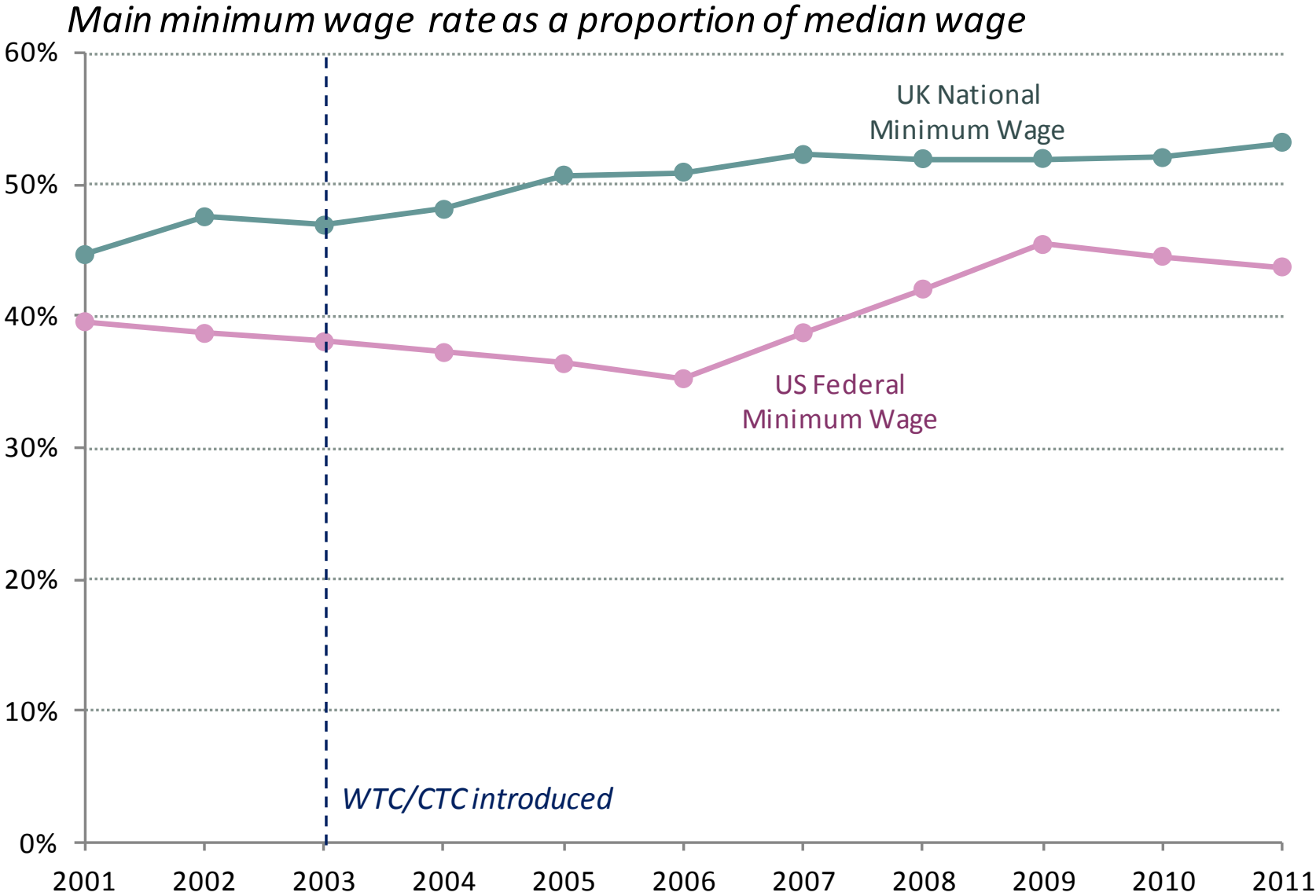
*Distribution of tax credit spending
across in-work families*



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



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?

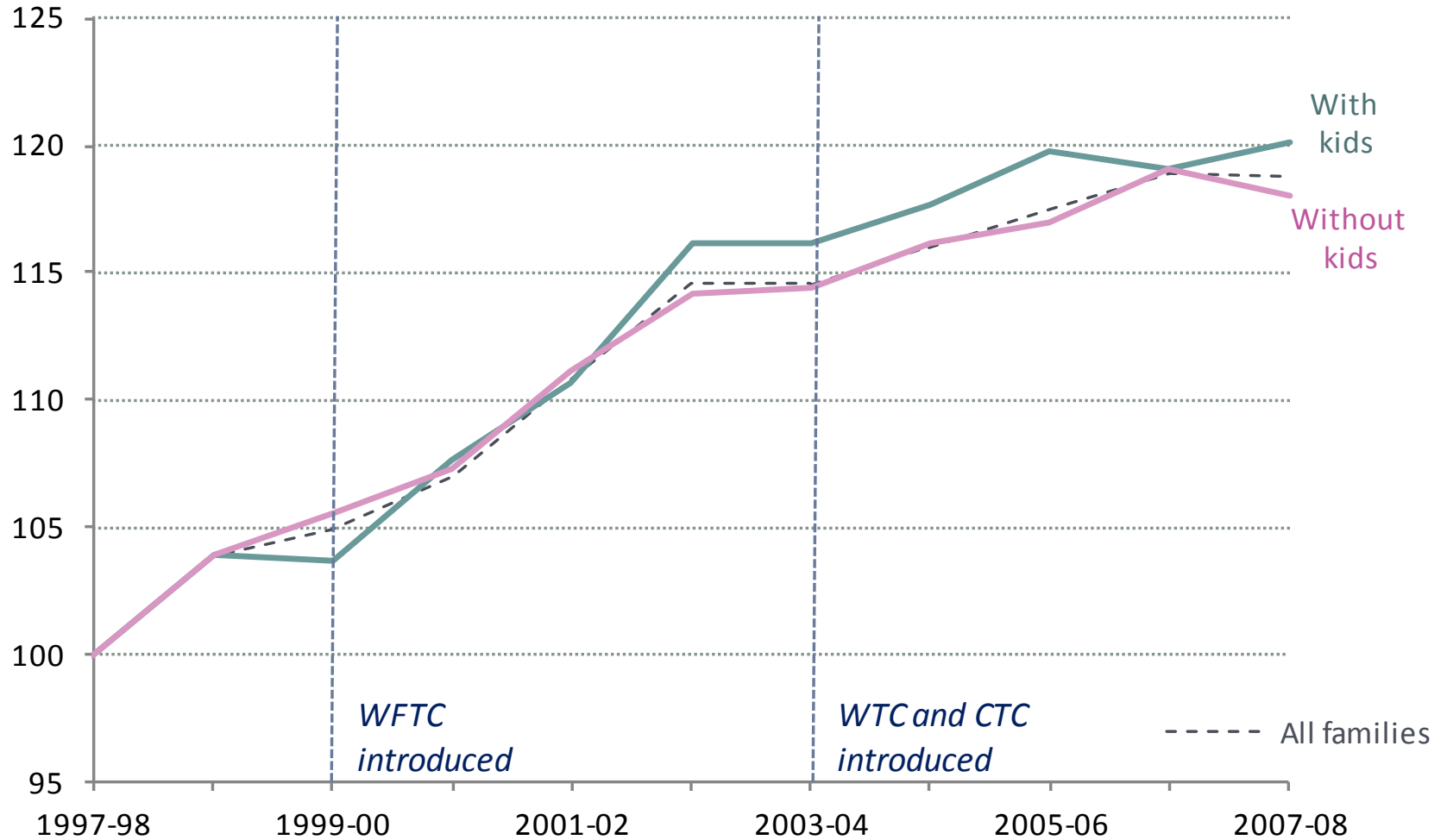
2. Compare eligible and non-eligible parts of the distribution

i.e. are low paid workers generally losing ground?

2. Assessing the impact: wages

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

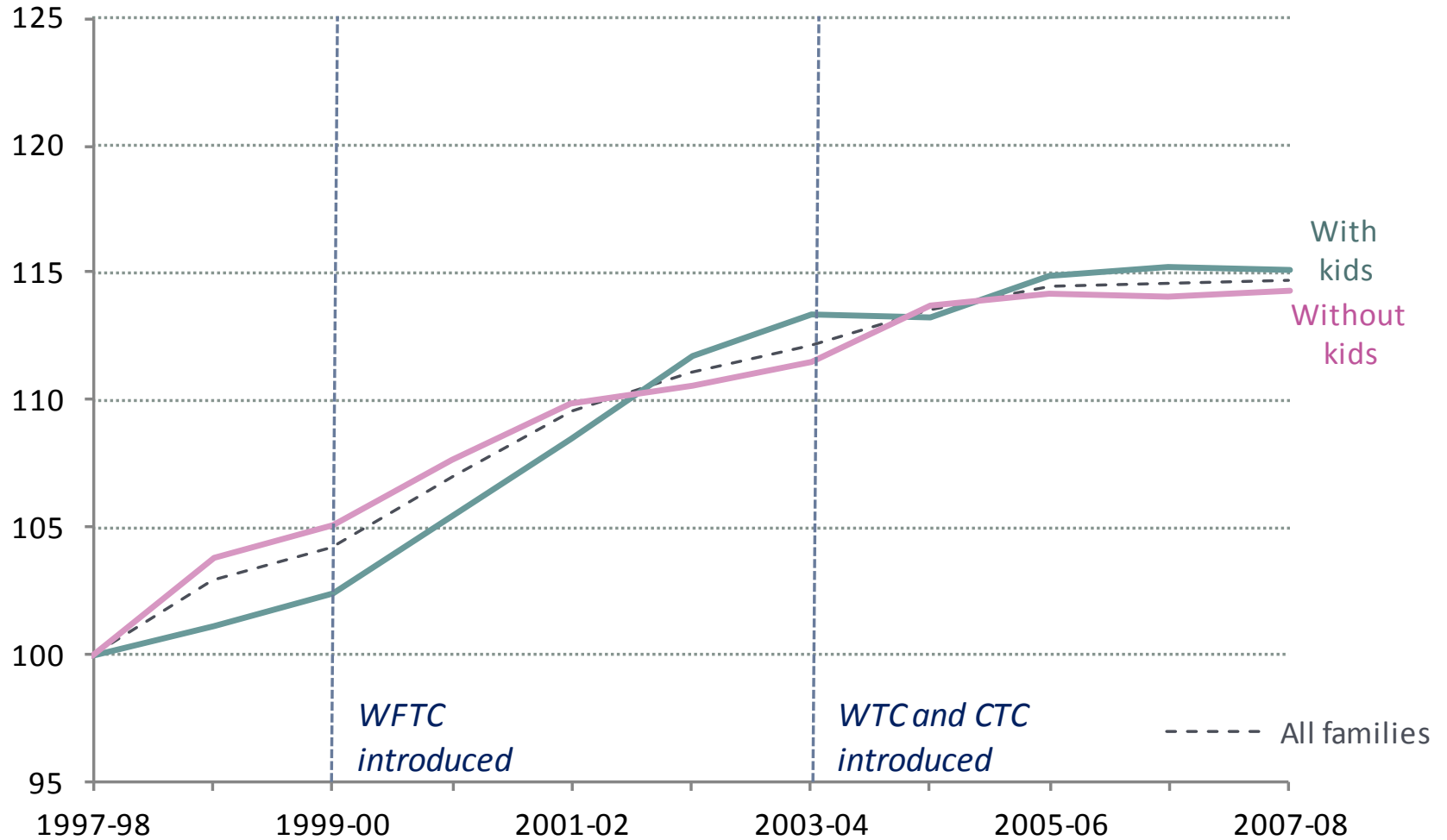
Families situated at **15th percentile** in overall distribution at start of period



2. Assessing the impact: wages

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

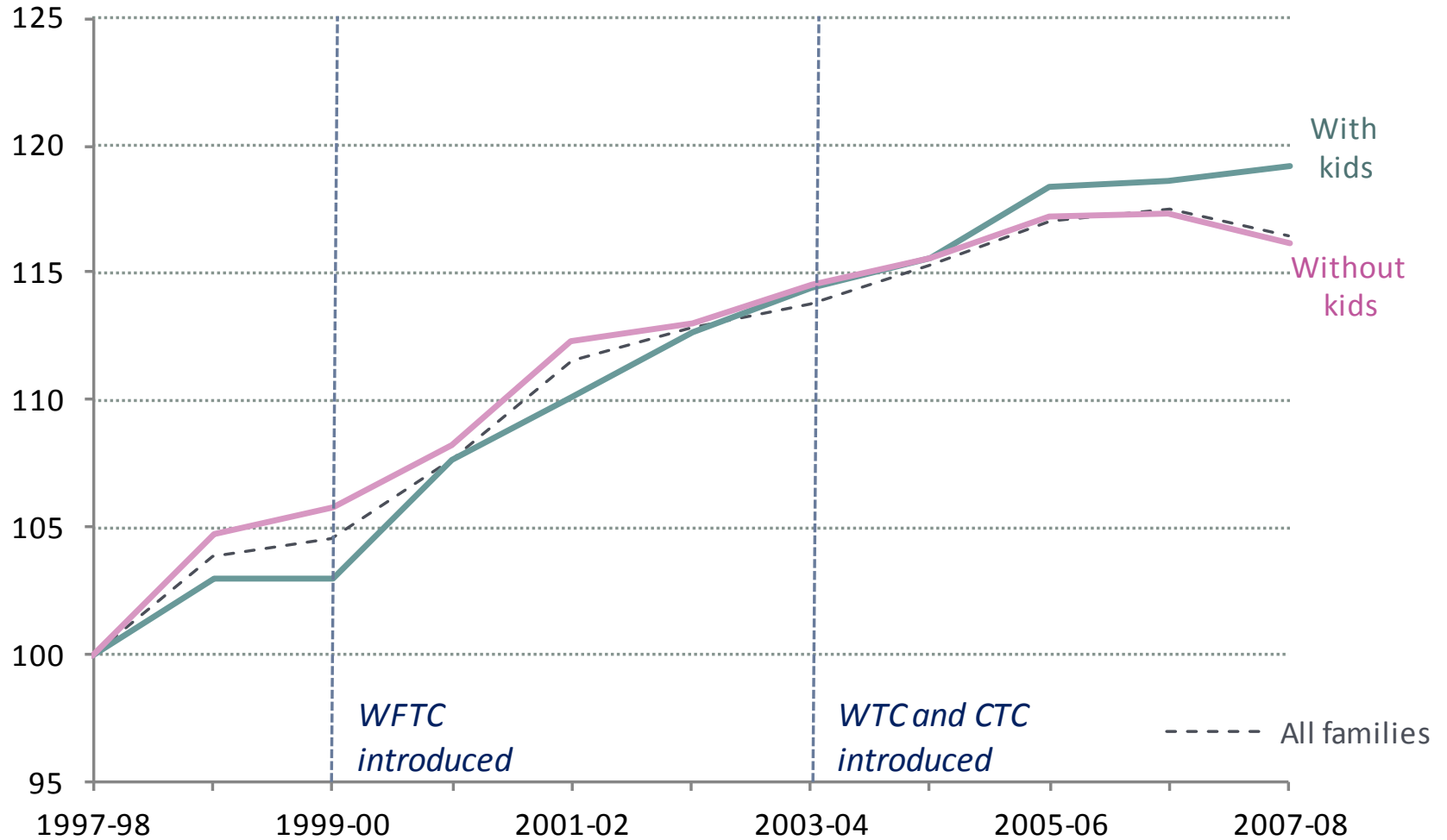
Families situated at **50th percentile** in overall distribution at start of period



2. Assessing the impact: wages

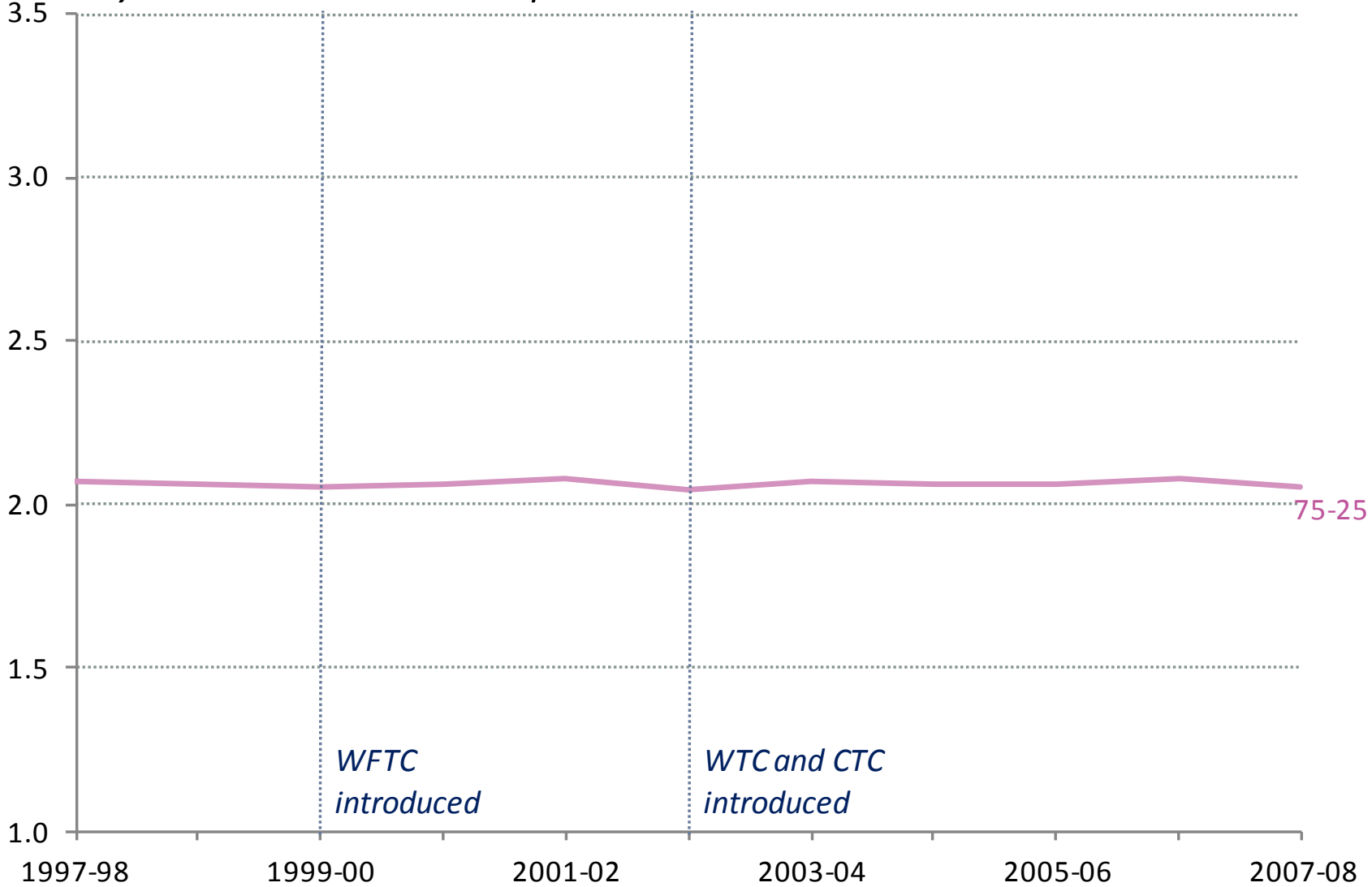
Indices of real terms wage growth, 1997-98 = 100

Families situated at **75th percentile** in overall distribution at start of period



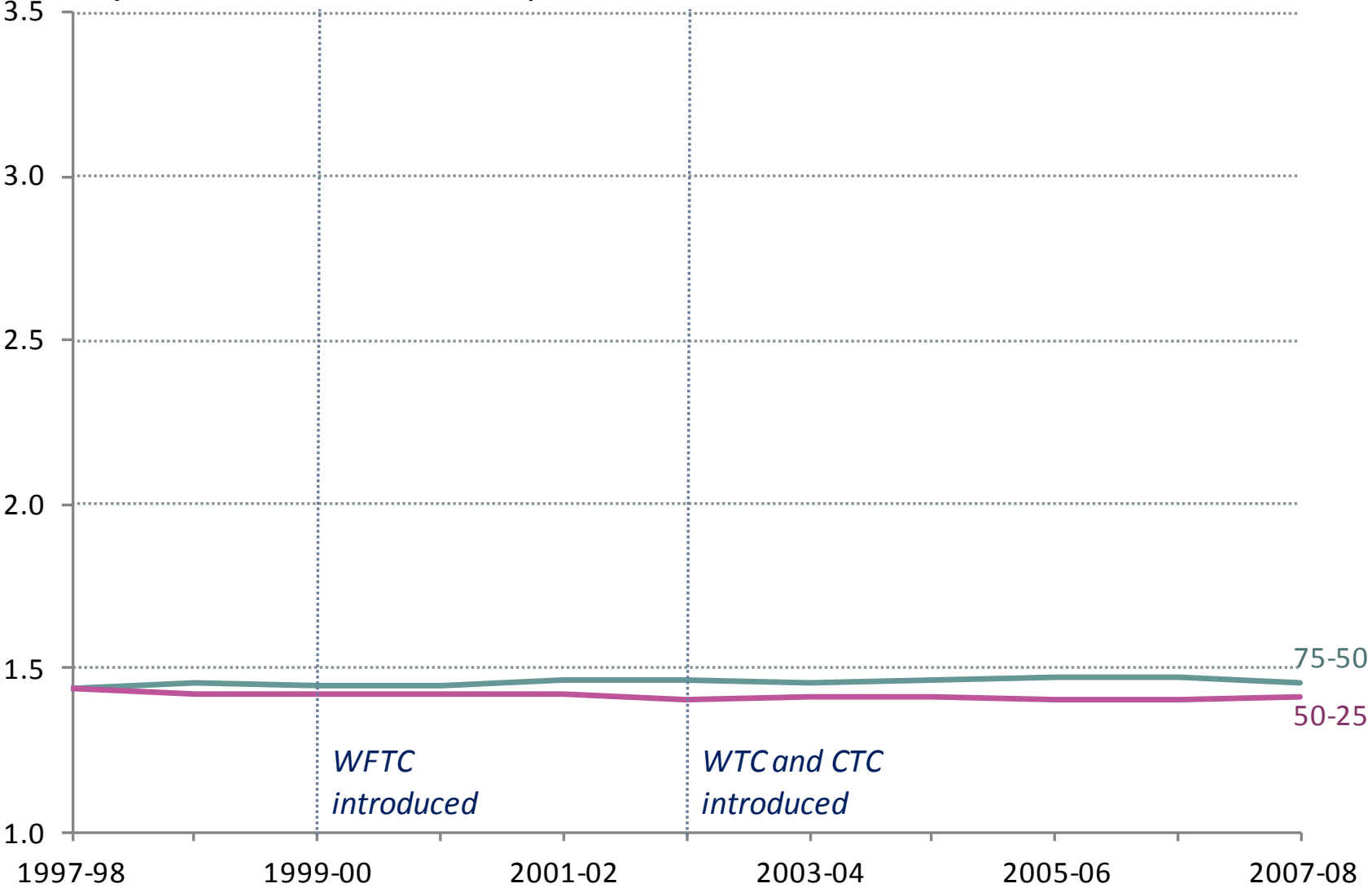
2. Assessing the impact: wages

Pay ratios between various points in the overall distribution



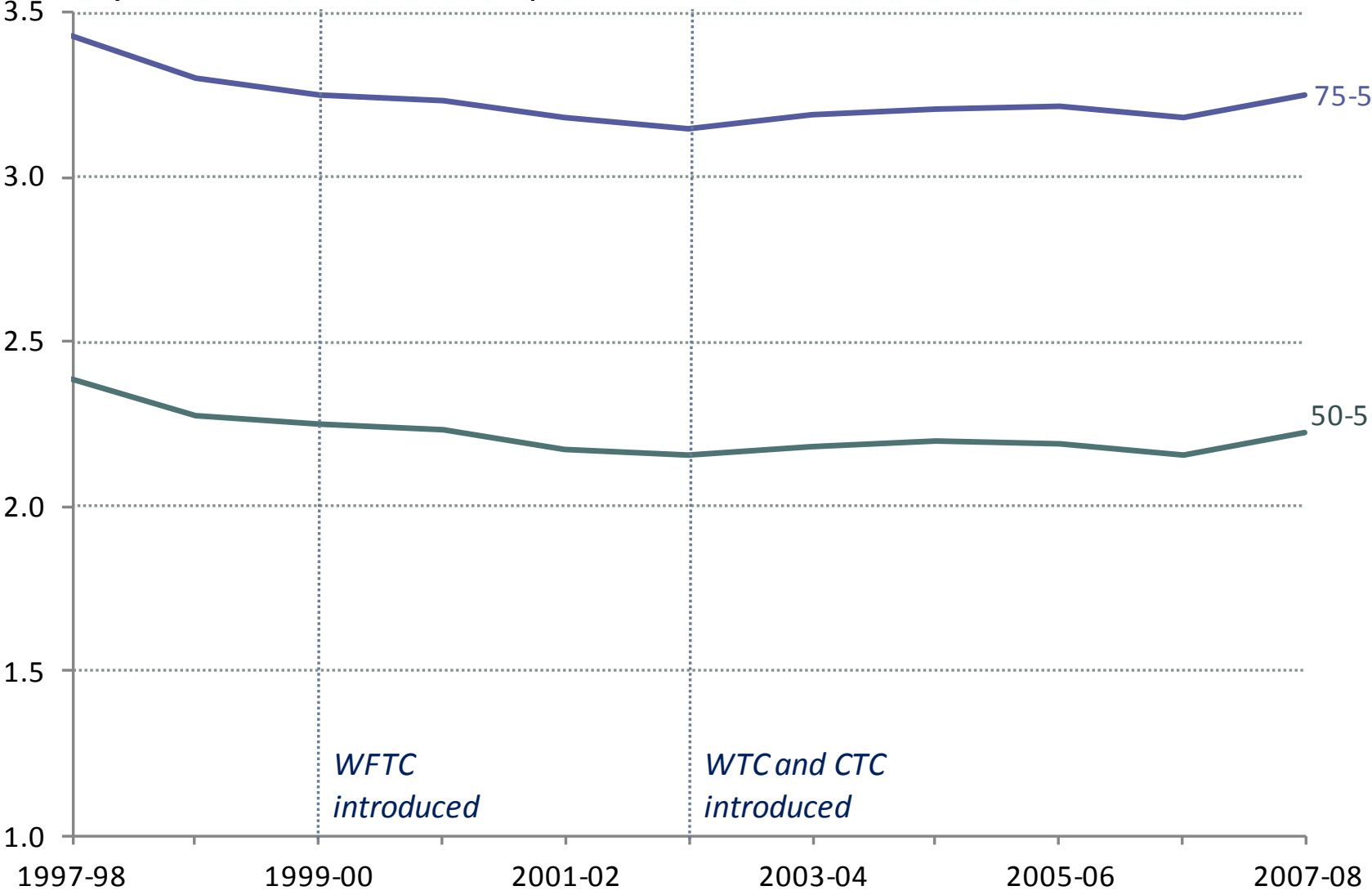
2. Assessing the impact: wages

Pay ratios between various points in the overall distribution



2. Assessing the impact: wages

Pay ratios between various points in the overall distribution



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