Notes and Brief Reports

Social Security Abroad

Children's Allowances in the United Kingdom*

The new children's allowances[1] ("child benefit") program in the United Kingdom recently completed its 3-year phase-in period, begun in 1977. The new program is the first major reform of family support since the introduction of children's allowances in 1946. It merges two kinds of allowances that previously benefited families with children— the taxable social security cash payments made to all families with children and the income tax deductions for dependent children (child tax allowances)—into a single tax-free payment for all children. Like children's allowances previously, the new benefit is financed from general revenues.

Before the reform, weekly cash children's allowances, expressed as a given amount per child, were paid to all families with two or more children, regardless of family income level. The allowances were taxable for income tax purposes. At the same time, the tax code permitted a family to reduce its taxable income by deducting from gross income a flat-rate amount for each child in the family. The allowable deduction increased in three stages with the child's age. Generally speaking, the higher the family's income tax bracket, the more the deduction was worth.

The new program was phased in by gradually increasing the level of children's allowances while reducing the tax deductions for children each year. Under the tax system in the United Kingdom, the father usually claims all family deductions. With tax deductions for children being phased out, the effect of the reform was to reduce the weekly take-home pay of most fathers as their income taxes increased. Mothers, to whom children's allowances are payable, have received gradually larger cash benefits.[2]

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[1] Although officially called "family allowances" in the United Kingdom, the payments were based solely on the number of children. In other countries, family allowances include a variety of benefits paid to families under different circumstances. See Lynn M. Ellingson, "Recent Changes in French Family Allowance Policy," **Social Security Bulletin,** December 1979, pages 14–19.

[2] These benefits are paid under the social security program in the form of weekly vouchers redeemable at the post office.

The new children's allowances program thus aimed at achieving two goals: (1) To increase family support by also including the first child and increasing the cash benefit amount, and (2) to eliminate the inequity embodied in tax deductions for children by phasing out such deductions. Tax deductions were of greatest value to higher-income families and, in many instances, exceeded the children's allowance benefit by a considerable margin. On the other hand, the neediest families, those too poor to pay taxes, did not benefit from this program at all. By combining taxable cash payments and tax deductions into a single nontaxable and more substantial cash payment, the new program achieves a more equitable distribution among families of two forms of government support.

In carrying out this reform, the United Kingdom reflects a trend in family policy toward consolidating tax and benefit transfers to families. Other countries that in recent years have either eliminated or decreased the emphasis on tax deductions for children in favor of cash benefits are Australia, Canada, Denmark, the Federal Republic of Germany, Israel, and New Zealand.[3]

Background

Children's allowances were introduced in the United Kingdom in 1946. They are a direct outgrowth of, and in many respects complement, the social insurance program outlined in the famous Beveridge Report of 1942.

Beveridge, it may be recalled, argued for transferring payments for dependent children from social insurance to children's allowances, to be paid whether or not a family breadwinner was employed. In this way, Beveridge sought to ensure that workers with large families would not get more in benefits—that is, a basic benefit plus supplementary benefits for dependents—than they received in wages. Second, Beveridge argued that since the wage structure did not take family size into account, children's allowances were necessary to guarantee families a subsistence level of income, the same that social

[3] See Kenneth Messere and Jeffrey Owens, "The Treatment of Dependent Children Under Income Tax and Social Welfare Systems," **Social Security and Taxation,** International Social Security Association, 1979, and Leif Haanes-Olsen, "Israel's Program Revision for Families with Children," **Social Security Bulletin,** July 1978, pages 30–33.

insurance provided for the unemployed, disabled, and aged.

The government saw children's allowances as a way to dampen wage demands and therefore reduce inflation. Other arguments advanced in support of children's allowances at the time of their introduction were the need to alleviate child poverty and reverse the decline in the birth rate.[4] Children's allowances were seen then as a demographic tool.

Not all of Beveridge's proposals were finally adopted. Although he recommended that a weekly average benefit of £0.40 per child (the actual amount varied according to age) was the minimum necessary for subsistence, this amount was reduced to a flat rate of £0.25 when the children's allowances program was implemented in 1946.[5] When the new social insurance program came into effect in the following year, benefits included additional payments for dependent children. Beveridge's advice to exclude the first child in a family from children's allowances was followed, however.

Once in place, the children's allowances program remained virtually unchanged for 30 years. The demographic concern soon diminished in importance when the birth rate rose again in the 1950's. In any case, no empirical connection was ever established between children's allowances and fertility. In the optimistic atmosphere that prevailed after the establishment of the welfare state, it was thought that the provision of a basic level of benefits for all, plus children's allowances, would largely overcome child poverty. Children's allowances were raised slightly in 1952 and then again in 1956 for third and subsequent children only, but the real value of benefits declined steadily after each increase. Unlike other social security benefits, children's allowances were never indexed. As children's allowances were "neglected," their contribution to total family income became less and less significant. In terms of average earnings, the value of benefits for a family with three children decreased by half in 2 decades—from 8 percent in 1946 to 4 percent in 1967.[6] In light of this, children's allowances were increased in 1968, but this response was accompanied by a reduction in the income tax deduction. This procedure, known as "clawback,"[7] ensured that only those families too poor to pay income tax received the increase. Although, on balance, the majority of families was no better off, this was the first time that the tax and benefit issues were considered together.

A final increase, which took effect in April 1975 just before the reform program was enacted brought children's allowances to a level of £1.50 per week. Table 1 illustrates the fluctuations in the value of children's allowances (family allowances and child benefit) as a percentage of average earnings for families containing two, three, and four children.

Table 1.—Value of children's allowances (family allowances/child benefit) as a percent of average earnings, selected years 1946–79[1]

Year	Family size (number of children)		
	Two	Three	Four
1946 [2]	4.0	8.0	12.0
1951	3.0	6.0	9.0
1952	4.5	9.0	13.4
1955	3.6	7.2	10.8
1956	3.4	7.6	10.9
1967	1.9	4.2	7.7
1968 [3]	3.9	8.3	12.6
1974	1.9	3.9	6.0
1975	2.5	5.0	7.6
1977	3.4	5.5	7.6
1978 [4]	7.2	10.8	14.4
1979	8.3	12.4	16.5

[1] Percentages based on average weekly earnings for adult men from the October survey of full-time manual workers, Department of Employment, United Kingdom, Standard Industrial Classification revised in 1948, 1958, 1968.

[2] Estimated.

[3] Benefit increase subject to clawback. For most families, therefore, percentages after tax were actually much lower for the period 1968–76.

[4] After November benefit increase.

Implementation of New Program

Although the Child Benefit Bill was enacted in 1975, implementation of the new program did not begin until April 1977. During the preceding summer the government tried to postpone introduction of the program because of public expenditure constraints and because the drop in take-home pay of most fathers resulting from the withdrawal of tax deductions might threaten the next stage of incomes policy, which involved wage restraint. The proposed delay drew much criticism and, as a result of public pressure, a compromise was reached under which the program would be gradually phased in over a period of 3 years (1977–80).[8]

The program began by paying £1.00 weekly for the first or only child (with an additional amount for single-parent families) while maintaining the old children's allowance rate for subsequent children. By including the first child, the new program increased the number of

[4] Leif Haanes-Olsen, "Children's Allowances: Their Size and Structure in Five Countries," **Social Security Bulletin,** May 1972, pages 17–28.

[5] In 1946, one British pound equaled $4.03 U.S. As of May 1980, it equaled $2.30 U.S.

[6] Tony Lynes, "Family Allowances in Great Britain," in Eveline Burns, editor, **Children's Allowances and the Economic Welfare of Children,** 1968.

[7] "Clawback" is the recovery of a transfer payment through the income tax mechanism. In this case, the children's allowance was paid to all, but was retrieved by taxation from the better-off families. More usually, selectivity is achieved through an income- or means-test rather than through the income tax.

[8] Hilary Land, "The Child Benefit Fiasco," **The Yearbook of Social Policy in Britain 1976,** London: Routledge & Kegan Paul, 1977.

eligible beneficiary families by 60 percent, from nearly 4.5 million to more than 7 million. During 1978, the weekly allowance was increased on two occasions: in April to £2.30, when the distinction between first and subsequent children was eliminated and again in November by an additional £0.70. In April 1979, benefits were increased to £4.00 weekly per child, but a second increase scheduled for November of that year was cancelled by the incoming Thatcher government.

The way in which the tax deductions for children were reduced during the transition period is presented in table 2. All annual changes were announced in April, which is the beginning of the tax year.

Of greatest importance to families, however, is the net effect of the reform on family income, which is determined in part by the rate of income tax paid. Most families in the United Kingdom pay tax at what is known as the "standard rate," (34 percent in 1977–78). The introduction of the new children's allowances program in 1977 therefore meant that most two-parent families with one child were better off by £0.30 per week. This figure represents the combined effect of the benefit for the first child and the decrease in the tax deduction. The April 1978 changes resulted in these same families having a net gain of £0.67 per week. Only those families with incomes below the tax threshold, the level at which income tax begins to be paid, received the full value of the benefit increases each year.

Total expenditures under the program for 1977–78 were £906 million, compared with £567 million paid out in children's allowances during the preceding year. In 1978–79, expenditures totaled £1,858 million. These figures, however, do not take into account the increase in government revenue obtained when the tax deductions for children were reduced. The net cost of the reform can be calculated as the difference between benefit expenditures and the increase in tax revenue. As an example, the April 1978 benefit increase had an estimated net cost of £310 million, achieved by subtracting a £320 million tax revenue gain from a total cost of £630 million.

Table 2.—Yearly income tax deductions for dependent children (child tax allowances), 1976–77 and 1977-80[1]

Tax year	Age of child: Under 11	11–16	Over 16 (full-time student)
	Before reform		
1976–77	£300	£335	£365
	After reform		
1977–78:			
First child	196	231	261
Additional child	170	205	235
1978–79	100	135	165
1979–80	0	0	0

[1] Excepted were certain children living abroad and full-time students over age 19, for whom deductions could still be claimed at the 1976–77 rate for each of the years indicated.

The current government has announced another weekly benefit increase for November 1980 of £0.75 per child. This change will bring the amount payable to more than 13 million children to £4.75.

Evaluation

Both political parties have supported the new children's allowances program. The reform is seen as the most efficient tool for alleviating family poverty and concentrating family support on those who need it most. The program extends the tax advantages available to families with children to all families, even if they pay no income tax, and extends the benefits of children's allowances to every child in a family. It is also praised for its role in maintaining incentives to work. The reason for this is that the nontaxable benefits are paid in full to working families but are subtracted from the benefits paid to those on public assistance. A further advantage of the new children's allowances program is that it reduces dependence on means-tested benefits, thereby pulling more families out of the so-called "poverty trap." This term refers to the situation faced by poor families when an increase in earned income actually leaves them worse off because they lose eligibility for means-tested benefits and have to pay tax on the additional earnings.

Criticism of the new program has focused on the adequacy of the benefit payment. It is pointed out that benefits are below what is considered the subsistence level for meeting a child's needs, as indicated by the level of dependents' supplements for other social security benefits such as retirement, survivors', and invalidity pensions. To illustrate, a pensioner receives a supplement of £7.10 for each dependent child (in addition to children's allowances) while dependents' supplements for public assistance average £7.13 per week (varied according to age), compared with £4.00 for children's allowances. [9]

A second weakness of the children's allowance program is the lack of an automatic adjustment mechanism, a feature carried over from the former program. There is thus no guarantee that family support will maintain its value in face of inflation. Two possible increases in the benefit amount have been skipped over, creating an 18-month interval between the time the benefit was last raised in April 1979 and the next scheduled increase in November 1980. Moreover, the pending increase is expected to be approximately £0.45 less than the amount needed to keep pace with the cost

[9] These rates reflect the November 1979 benefit adjustment.

of living—about 7 percentage points below the projected annual inflation rate.

Two methods of indexing children's allowances have been suggested.

1. The allowances could be tied to other social security benefits, which are adjusted annually in November. Although the adjustment has been keyed to either prices or wages, whichever is higher, the new social security bill, which has just been passed and will determine the November 1980 uprating, changes the indexing formula to follow prices only.
2. Benefits could be indexed in line with the personal tax allowances—that is, tax deductions for single persons and married men, which are increased annually in April in line with the retail price index.

The success of the reform depends on the extent to which the value of family support is maintained over time. With the structure of the program now fully in place, it remains to be seen whether or not the government will demonstrate its commitment to the substance of the reform as well.

Conclusion

Originally children's allowances programs, not only in the United Kingdom but also in other countries, were designed as an income supplement for families with children, particularly lower-income families, and secondarily for such reasons as encouraging population growth. A parallel development was the creation of a number of means-tested programs aimed at helping the needy, including needy families. Better-off families also had the advantage of tax deductions for their children.

This multiplicity of programs led to discussions on how to combine various supplementing and competing benefits. In the early 1970's, for example, one proposal in the United Kingdom was that a negative income tax replace virtually all of the benefits. It included a "child credit," which in large part guided the reform of children's allowances.

The integration of income tax and family benefits represents a step in the direction of rationalizing the various government programs. Several other countries have also taken this approach, setting a trend for future developments in family policy.

Research Grants Studies

Sections 702 and 1110 of the Social Security Act authorize extramural research projects in the broad areas of social security. The Social Security Administration provides funding through grants to nonprofit organizations and through contracts with both nonprofit and profitmaking organizations. From time to time, as projects are completed, the **Bulletin** publishes summaries of research findings. A summary of a completed project (Grant No. 90612) is presented below.

Retirement Patterns for Self-Employed Workers

This research project concentrates on the 1969 and 1971 waves of the Social Security Administration's Retirement History Study (RHS). Data from the RHS are used to analyze the retirement patterns of self-employed workers and to contrast those patterns with the patterns among wage and salary workers. The research was conducted by Joseph F. Quinn, Boston College, Department of Economics.

Two motives underlie this research. First, the self-employed sector is an important, though declining segment of the labor force and therefore deserves study. This sector is particularly important among older workers, since the proportion of workers who are self-employed increases steadily with age. In previous research, the self-employed are either excluded from the analysis or are included in the much larger number of wage and salary workers. In the former case, nothing is learned about the retirement decisions of the self-employed. In the latter, any unique relationships are swamped by the rest of the sample. In this research, the retirement patterns of the self-employed are concentrated on specifically and the focus is on how they differ from the rest of the population.

The second reason for studying the self-employed is that they work in an institutional environment substantially different from that of wage and salary workers. The self-employed generally are not affected by compulsory retirement and are much less likely to be covered by pension plans. In addition, they are less constrained by institutional rules concerning vacation time and length of the work week and should be better able to vary the amount and kind of labor supplied.

The lack of compulsory retirement provisions and the relative flexibility with respect to hours suggest that the self-employed may more easily be able to withdraw gradually from the labor force than their wage and salary counterparts. Given the psychological and financial trauma that often accompanies sudden and complete retirement, the option to withdraw slowly may be an important advantage of self-employed status. These advantages may induce career self-employed individuals to remain in the labor force longer than those in wage and salary jobs. They also may induce some of the wage and salary workers to shift to the self-employed sector in later years.

The sample for this research, drawn from the RHS, consists of 836 white married men aged 58–63 in 1969.