Research Note

Supporting Families with Children through Taxes and Benefits

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Abstract:

Families with children receive significant support from government. This is mainly to reduce the risk of child poverty and assist parents with childcare responsibilities to balance jobs and family life. There is a great variety of measures to support families and these have been used to differing extents across the EU. This policy brief focuses on the support given to families with children through tax-benefit systems.

All EU Member States provide some forms of support for children, typically in the shape of universal cash benefits, usually not taxed and increasing with the number of children in the household. Child-related tax concessions are generally complements to cash benefits and vice versa. Many measures are related to income, except in the Nordic countries, and some to the employment status of parents.

The support provided, estimated by using the EUROMOD micro-simulation model, varies between EU-15 countries (the new Member States are not so far covered by the model). In most countries, the support for children through child contingent payments (those dependent on the presence of children) is significant. But benefits paid for other reasons and which are not related to children as such ('non-child contingent') also effectively provide support and in some countries are even more important.

Child contingent support mostly consists of family benefits but also social assistance, including housing benefits. There is additional support through tax concessions in 9 countries but generally at a low level. Non-child contingent benefits vary considerably in terms of the form they take, being mostly old-age pension in Southern European countries and unemployment benefits and social assistance in others.

The way child-related support is channelled has an important effect on its distribution between households. Tax concessions tend to go more to better off families or provide flat-rate support to households with different income levels. In principle, shifting support from taxes to benefits, therefore, would have the effect of redistributing income to the poorest children, especially if the benefits are means-tested, without any additional budget cost. On the other hand, tax concessions tend to involve less distortion in terms of work incentives and have fewer problems of non take-up.

This Research Note has been produced for the European Commission Francesco Figari, Alari Paulus and Holly Sutherland of ISER, University of Essex from the Social Inclusion network of the European Observatory on the Social Situation and Demography. The views expressed are those of the authors and do not necessarily represent those of the European Commission.

European Commission
Directorate-General "Employment, Social Affairs and Equal Opportunities"
Unit E1 - Social and Demographic Analysis

Manuscript completed in April 2007

European Commission

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I. The issues

It is widely accepted that families with children should receive extra support from the public sector and this can be justified in a number of ways. These include the reduction of the risk of child poverty, ensuring equal opportunities for all children, and assisting parents with childcare responsibilities in order to increase the ability of parents to pursue working careers and so to facilitate at the same time the achievement of employment objectives.

In a cross-country perspective, the balance between these objectives is affected by different rates of unemployment and market inactivity among parents, lone parenthood and divorce, household composition and different degrees of inequality in wages. The importance of child-friendly policies, oriented towards the social inclusion of poor children and labour market participation of parents, has been stressed at the European level as a key part of the measures necessary to contribute to the achievement of the Lisbon objectives.

There is a great variety of measures to support families with children, the main division being between monetary instruments (i.e. cash benefits or tax concessions) and in-kind support (i.e. free or subsidised housing, childcare, schooling etc), the former being part of the tax-benefit system and the latter of public expenditure programmes. The overall level of public support given to families with children, taking account of all of these measures, differs substantially across countries.

This policy brief focuses on the support given to families with children through tax-benefit systems in the 15 EU (pre-2004 enlargement) countries. It starts with a brief overview, which is limited to the instruments explicitly labelled as being for children. This is followed by an analysis which includes all relevant benefits. These are divided into two broad categories: those that are contingent on the presence of children and those that are designed to support adults and which are not affected by the presence or otherwise of children but which may nevertheless assist households with children. It then goes on to consider the effect of different types of benefit on households with children with different levels of income.

II. The facts

Why support families with children?

Child-related instruments are integral to both the equity and efficiency of tax-benefit systems. First, they contribute to preserving horizontal equity by treating people not only according to their income but also to their different circumstances. Secondly, they aim to increase vertical equity by supporting families with higher expenditure and lower earnings as a consequence of the presence of children. It is a form of redistribution from childless families to those with children and in some cases to the poorest children (O'Donoghue and Sutherland, 1999).

The relationship between child poverty and overall poverty is not always clear even though both are measured in terms of household disposable income. In more prosperous countries (Denmark, Belgium, Sweden, Finland, France) as well as in Greece, child poverty rates, defined in relative terms as the proportion of children in households with equivalised income of less than 60% of the national median, are lower than that for the whole population (see **Table 1**). With the exception of Greece, in countries where general poverty rates are high (Portugal, Italy, Spain and Ireland), child poverty rates tend to be even higher than the overall rate (cf. Corak et al, 2005). This pattern of difference might be

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1 The views expressed in this document are those of the authors and do not necessarily represent those of the European Commission.

a consequence of effective anti child-poverty policies and/or the better economic situation of parents in the more prosperous countries where poverty rates are mostly lower.

Table 1: Child poverty rates compared with overall poverty rates in EU-15 (%), 2003

Poverty rate	**AT**	**BE**	***DK***	**FI**	***FR***	**DE**	**EL**	***IE***	***IT***	**LU**	**NL**	**PT**	**ES**	***SE***	**UK**
Children	11.6	8.0	6.1	11.3	9.3	15.5	17.5	26.9	26.0	14.9	13.9	27.9	25.4	8.2	19.6
Overall	11.1	10.6	9.8	12.2	10.4	13.0	19.7	22.0	20.6	9.3	11.9	20.9	19.1	8.7	16.2

Note: poverty line is defined as 60% of the median equivalised household disposable income, using modified OECD scales; countries in italic (DK, FR, IE, IT, SE) refer to 2001
Source: EUROMOD calculation (version C11). These figures may differ from those published by Eurostat but the relative levels across countries are similar.

Apart from equity concerns, support to families with children is important from an economic perspective based on efficiency arguments. Public transfers to children can be considered as a form of smoothing of inter-temporal difference in consumption patterns, making people better off at a time of greater need and supporting the process of intergenerational mobility. There is strong evidence that employment, educational, health and social outcomes for children growing up in poor families are more likely to be worse than those for better-off children (Ermisch et al, 2001). Public transfers could also encourage increased fertility and greater participation in the labour market of women, so contributing to economic growth. This is supported by the positive correlation between transfers and participation across the EU, with the Nordic countries in particular having high values of both.

How can families with children be supported?

The support of families with children takes place generally through both the tax and benefit systems, though the relative weight attached to the two and the specific forms of taxes and benefits used differ markedly across Europe.

Table 2 provides a snapshot of the main monetary tax-benefit instruments that are directed exclusively towards families with children. It does not include any other form of public support that involves supplementary child-related components (housing support and social assistance, in particular) or which is related to specific or temporary situations (such as disability, maternity and parental leave). Although being far from exhaustive, it gives an insight into the differences in the structure of child support across countries. It is important to note that the effect of fiscal instruments such as tax credits and tax exemptions depends on the tax unit of assessment – whether couples are taxed jointly or separately or have a choice between the two – which varies across countries.

The multiplicity of instruments which are used in most countries, on the one hand, confirms that tax concessions are generally complements of cash benefits and vice versa. On the other hand, a large number of different instruments does not necessarily imply a high level of public support since they tend to be targeted on specific groups of people.

It is noteworthy that there is an absence of universal benefits – i.e. those which are not dependent on income – in Southern Europe (Italy, Portugal and Spain). All other countries provide different forms of cash benefits, generally not taxed (with an exception of Greece) and increasing with the number of children in the household and, in some cases, their age. Austria is the only country providing support in the form of so-called ‘non-wastable’ tax credit which is not dependent on the final tax liability of households in terms of the amount received and which is, therefore, equivalent to cash benefits in its effect.

Table 2: Monetary tax-benefit instruments for families with children in EU-15, 2003

Country	Number of instruments	Non-income related instruments		Income related instruments		
		Benefit[a]	Tax credit[b]	Benefit[c]	Tax exemption[d]	Tax credit[e]
AT	5	yes	Yes	yes	No	no
BE	3	yes	no	no	Yes	no
DK	2	yes	no	no	No	no
FI	1	yes	no	no	No	no
FR	5	yes	no	yes	No	no
DE	2	yes	no	no	Yes	no
EL	6	yes	no	yes	No	yes
IE	4	yes	no	yes	Yes	no
IT	3	no	no	yes	No	yes
LU	6	yes	no	yes	Yes	yes
NL	2	yes	no	no	No	yes
PT	2	no	no	yes	no	yes
ES	6	no	no	yes	yes	yes
SE	1	yes	no	no	no	no
UK	2	yes	no	no	no	yes

a) Universal child benefits or family allowances targeted to specific situations (i.e. birth, beginning of school) or family characteristics (i.e. lone parent, employment status, total number of children). Generally not taxed, with the exception of some instruments in Austria and Greece.

b) Non-wastable tax credit paid as cash transfer.

c) Means-tested child benefits or family allowances, which tend to decrease when the income of beneficiary increases. Generally not taxed, with the exception of some instruments in Ireland.

d) Tax allowances depending on the presence of children (Belgium, Germany and Spain) or being a lone parent (Ireland, Luxemburg and Spain).

e) Non-wastable tax credit paid as cash transfer in the UK and wastable tax credits paid as tax rebate in Greece, Italy, Luxemburg, the Netherlands, Portugal and Spain (working mother, related to the SICs paid).

Note: countries in italic refer to 2001. Source: EUROMOD Country Reports (2001, 2003); Kesti (2003)

Income-related instruments can be means-tested (i.e. withdrawn with the income or assets of the beneficiary), offset against taxes to be paid or deductible from the income tax base. There are five different modes of support across the EU:

- Austria, France, Greece and Ireland have means-tested instruments whose amount, for an entitled beneficiary, does not vary with income: either the instrument is received in full or it is not received at all.
- Ireland, Italy, Luxemburg, Portugal, Spain and the UK give support through generally non taxed benefits or non-wastable tax credit (UK) whose amount decreases when the income of the beneficiary increases.
- Belgium, Germany, Ireland, Luxemburg and Spain have tax deductions related to the presence of children with greater value for taxpayers subject to higher tax rates.
- Greece, Italy, Luxemburg, the Netherlands and Portugal present wastable tax credits that affect only taxpayer families with a positive amount of tax to be paid.
- Denmark, Finland and Sweden do not have any income related instruments.

Lone parents are entitled to receive extra support through supplements of non-income related benefits in Finland and Germany, and through specific instruments in Austria and Denmark. Moreover, in most of the countries they receive additional income related support. Some instruments in Austria, Belgium, Greece, Ireland, Italy and the UK are related to the employment status of the parents, supporting a direct relationship between public support of children and participation of parents in the job market. Austria, Spain and the UK have recently reformed their systems, focusing respectively on universal benefits, tax concessions and means-tested benefits respectively, to give further support to families (Levy et al, 2007).

EU countries also differ substantially in the public provision of in-kind benefits (childcare and education, in particular) and in the tax treatment of expenditure (i.e. tax exemption or tax credit) related to children with relevant effects on the labour market participation of women (Del Boca and Wetzels, 2007).

The current level of support to families with children

In general, the financial support that a child receives in each country depends on the overall level of public transfers, the economic circumstances and demographic characteristics of the family, and, in some cases, the age of the child. The situation in EU-15 Member States in terms of the public support to children in the form of cash payments is described below.

The estimates of support are derived by using EUROMOD, a multi-country tax-benefit micro-simulation model, currently covering all the EU-15 countries (Sutherland 2001, 2007). The estimates relate to 2003 for most countries, except for Denmark, France, Ireland, Italy and Sweden, where they are for 2001. Micro-simulation methods enable to take into account the important interaction between the different measures, while the multi-country dimension enables results to be compared across countries on a meaningful basis.

In order to obtain an estimate of the overall amount received in the form of public transfers by families with children, both the direct ('child contingent') and indirect ('non-child contingent') support is calculated. The average amount of cash support per child received which is contingent on the presence of a child in the family (i.e. child contingent) includes both universal and income-related elements of the system, tax concessions as well as direct public expenditure, labelled as being for children (as set out in **Table 2**), as well as complements and supplements payable as part of, for example, housing and assistance benefits by virtue of the presence of children[2]. Non-child contingent amounts of indirect support received by a child consist of all other benefits, including public pensions, received by households[3].

The two measures are not quite consistent as the child contingent amounts are assumed to be entirely incident on children: ie the total amount received by the household in this form is divided among the children. The other benefits are assumed to be shared by all household members and are divided equally among them. This different treatment is adopted on the assumption that, unlike general benefits, those intended for children are in fact spent specifically on children.

In addition, the child contingent estimates include tax concessions whereas the non-child contingent amounts incorporate cash payments alone. Moreover, taxation of benefits received is not taken into account. In some countries, therefore, significant proportions of benefit paid are clawed back in income tax, while in others these amounts are negligible. Bearing these points in mind the following analysis shows how cash support for children varies in its size and composition across countries.

In most countries, children are supported to a significant extent through child contingent benefits though also by non-contingent ones (see Figure 1). The average amount of child-contingent tax concessions and benefits per child is 14.4% of per capita disposable income while non-child contingent benefits (gross of taxes) amounts to 5.9%. (If child contingent benefits were assumed to be shared by all household members instead of children – see above – then this gap would be smaller, but would not disappear. If the taxation of benefits were accounted for then the gap would be wider since, typically, it is earnings replacement benefits such as pensions that are taxed, rather than child-targeted benefits.)

In a number of cases, notably the four Southern EU countries, non-child contingent benefits are comparable (Portugal and Italy) or even exceed child-contingent cash payments (Greece and Spain), which are less than anywhere else in the EU. It is also the case, however, in Denmark and Sweden, the latter partly because of generous maternity benefits, considered as non-child contingent in the present analysis. Apart from these two countries, the level of non-child contingent benefits per child is in a rather narrow range of 3-6% of per capita income. Child contingent benefits on the other hand, vary much more widely from 5% in Spain to 23% in Luxembourg.

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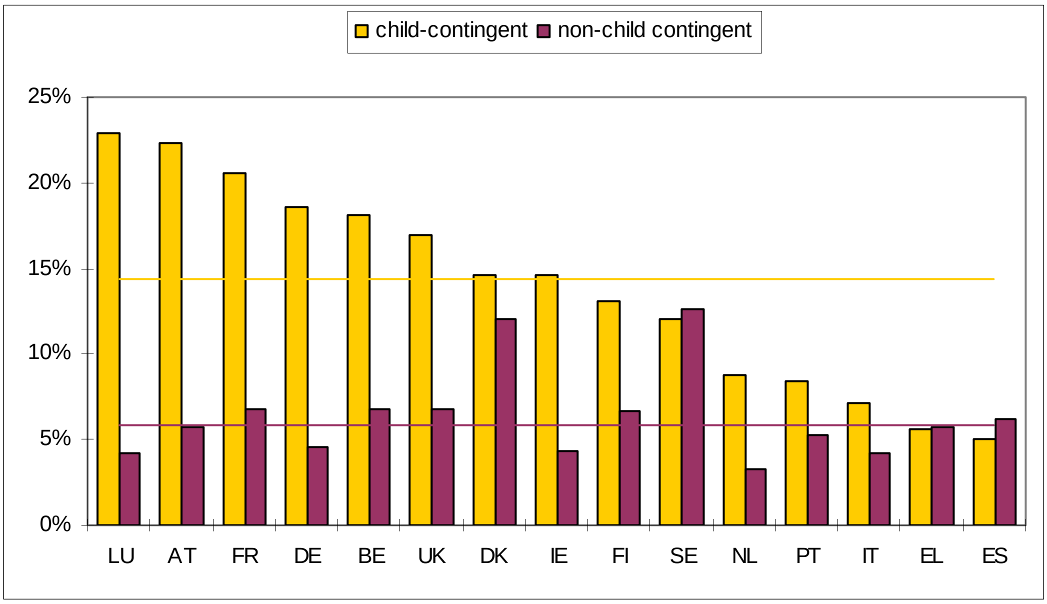
2 A child is defined here as a person under the age of 18. The age limit for child related tax-benefit instruments varies substantially both across countries and within a country – for most of the instruments it is between 16 and 18 while it is extended when a child is still in full time education.

3 Both measures are then normalised by per capita disposable income in each country.

Figure 1: Child contingent and non-child contingent cash payments per child as a percentage of per capita disposable income

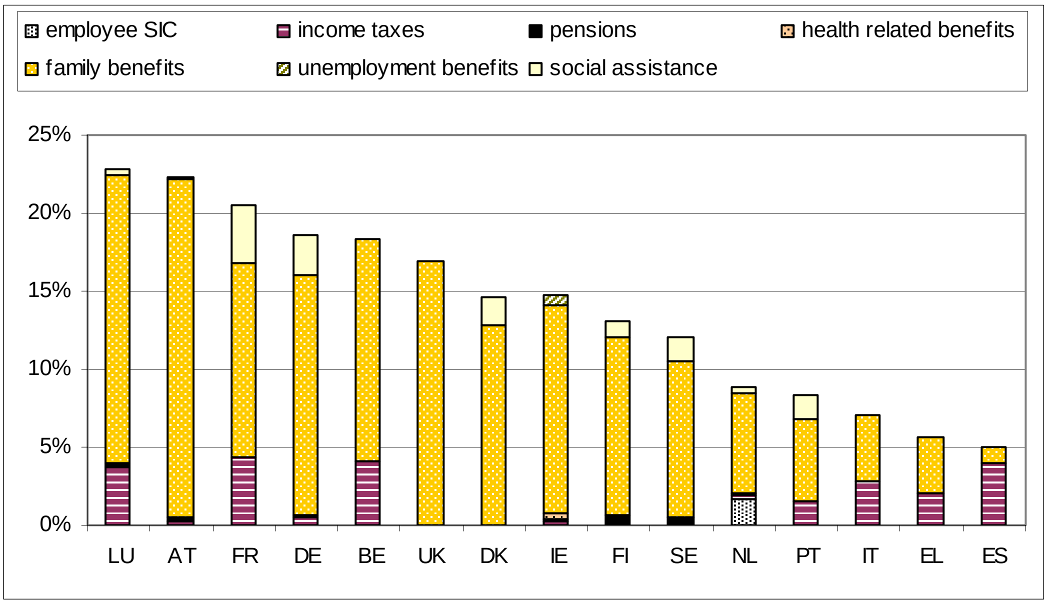


Note: sorted by the level of child contingent benefits, horizontal lines denote the average for each group
Source: EUROMOD calculation (version C11)

It is instructive to break down benefits and tax concessions further into five sub-groups: pensions (i.e. old age and survivor benefits), health related benefits (i.e. disability, sickness and care), family benefits (including among other things support for child care and disabled children), unemployment benefits (including pre-retirement pensions and benefits) and social assistance (including housing benefits). (These categories are broadly in line with the OECD benefit classification with only some minor exceptions.)

Child contingent benefits (see **Figure 2**) consist, unsurprisingly, mostly of family benefits. Social assistance is of secondary importance, contributing more to income in France, Germany and the Nordic countries, while the other types of benefit contribute only marginally. There is additional support through tax concessions in 9 countries, though at a relatively low level, apart from Spain where it exceeds the income from benefits. The main contribution on the tax side comes mostly in the form of income tax allowances, except in the Netherlands where most of the effect comes through lower social insurance contributions.

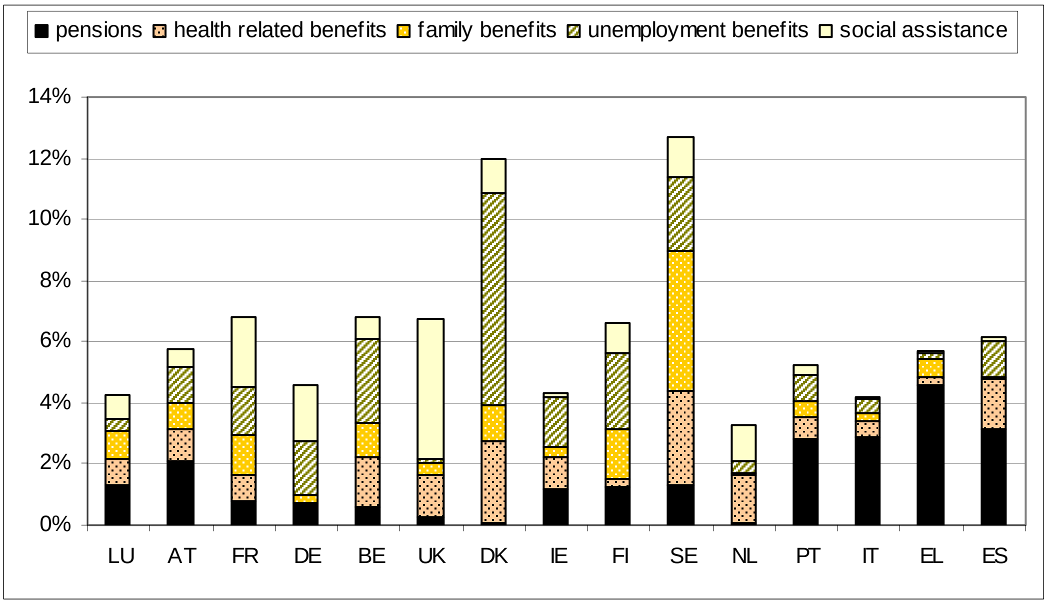
Figure 2: Child contingent cash payments per child as a percentage of per capita disposable income by benefit and tax categories



Note: countries are sorted by the level of child contingent benefits
Source: EUROMOD calculation (version C11)

Non-child contingent benefits (**Figure 3**), on the other hand, show much greater variety of composition. Southern European countries rely to a large extent on pensions, while Belgium, Germany and the Nordic countries (especially Denmark) provide significant support in the form of unemployment benefits. The latter is practically non-existent in the UK, which relies most on social assistance transfers. Social assistance is also important in France and Germany, but insignificant in Southern European countries. Health-related benefits contribute about one half of non-child contingent benefits in the Netherlands and are also notable in Sweden and Denmark. Family benefits which are included under this head and are particularly significant in Sweden relate mainly to study grants which are available for older children.

Figure 3: Non-child contingent benefits per child as a percentage of per capita disposable income by benefit categories



Note: countries are sorted by the level of child contingent benefits
Source: EUROMOD calculation (version C11)

There are also significant variations within countries between households with different levels of income, especially in Denmark, Ireland and the UK (see **Figure 4**). In most countries, support is targeted in particular at children in low income households, in a few, support is relatively even spread across the income distribution and only in Greece and Spain, there is more support provided to the higher income households. France, Luxembourg and Spain are examples where the pro-poor effect from means-tested benefits is balanced by highly pro-rich tax concessions. In general, in countries where child-contingent support is inversely related to income, the same is true of non-child contingent support. Countries in which only one of these types of support is targeted in this way include France, Italy and Portugal (only child contingent support) and Belgium (only non-child contingent support). Overall, the total combined support for children varies from 7% of per capita disposable income in Greece for those in the bottom decile to 47% in Denmark for those in the second from bottom decile.

Children are also not evenly spread across the income distribution. In most cases, there are more children in lower deciles, except in the Nordic countries and Belgium, where children are concentrated in the middle deciles, and Greece, with a slightly larger share of children in the upper deciles (**Figure 4**). However, as deciles are based on disposable income, i.e. after receipt of benefits and deduction of taxes and contributions, the distribution of children is also affected by the distribution of child support.

III. Policy conclusions

At any given level of child-contingent support, the way in which this is channelled in particular countries has an important effect on the distribution of the support for households across deciles. Tax instruments are of assistance to better off families or, at most, provide a flat-rate amount of support across the distribution. In principle, therefore, shifting from tax to benefit instruments would enable a country to redistribute income to the poorest children without any additional budget cost.

There is also strong evidence (from the UK) that mothers are more likely to spend income on children needs rather than fathers (Lundberg et al, 1997). To the extent that child-contingent cash benefits are granted to mothers, they are, therefore, more likely to be spent for the well-being of children than tax concessions which simply reduce the tax of income earner.

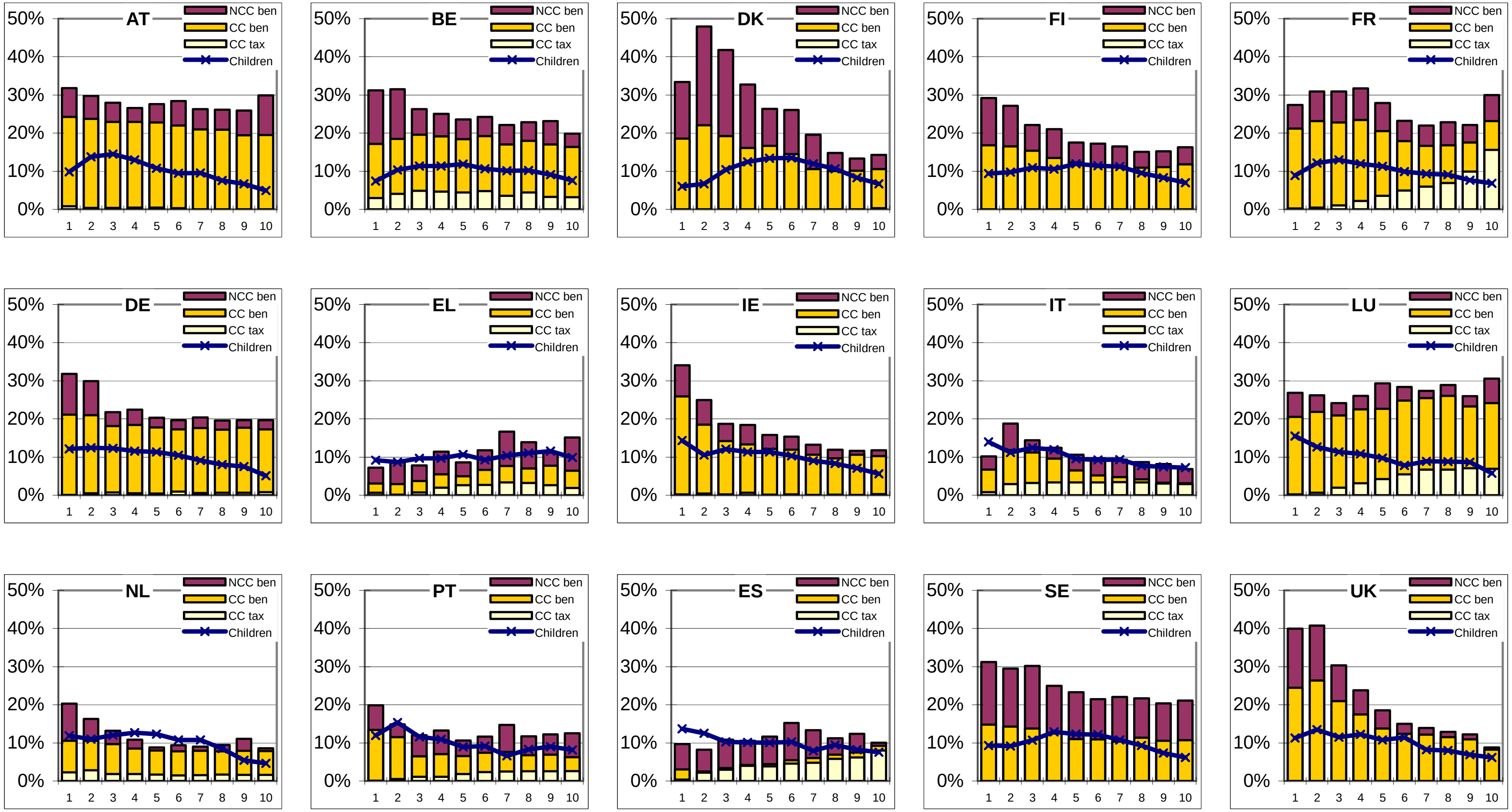
However, the choice between the tax system rather than the benefit system as a channel to give support to families with children should also take account of the strong likelihood that take-up will be higher for instruments which work through the tax system than benefits which are means-tested, given the reluctance of people to claim the latter as well as the difficulty involved (HM Treasury, 1998). Evidence suggests that in some countries the support through the tax system (i.e. tax credits rather than welfare benefits) is becoming more common (Bradshaw and Finch, 2002).

Countries with more generous systems (i.e. Austria, Luxemburg, France and Denmark) provide most of their support through non-income related benefits. On the one hand, it confirms the validity of universal benefits as an appropriate tool to support children and to fight child poverty in particular, given their efficient provision generally on a weekly or monthly basis, as well as the absence of social stigma and their high take-up. On the other hand, means-tested instruments are an efficient way of targeting support on the most needy, despite having higher costs in terms of non take-up and adverse impact on employment incentives for the second earner in a couple (Whiteford and Adema, 2007).

Public support is generally greater for younger (0-5 years) than older (6-17 years) children but with some exceptions (SSO Report, 2006). The age incidence of public support and the timing of interventions over childhood seem to have an effect on the future life chances of children (Ermish et al, 2001).

An important deficiency of the results presented above is the fact that no allowance has been made for the taxation of benefits received, which accordingly means that the level of support is overstated in some countries where such taxes are significant. What matters is the true net effect of the tax and benefit system as a whole and this is the subject for further work.

Figure 4: Child contingent (CC) and non-child contingent (NCC) cash payments per child as a percentage of per capita disposable income by income deciles and the share of children in each decile



Source: EUROMOD calculation (version C11)

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