

Tax Credits and Welfare for Working Families: A Case Study of Policy Transfer

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ABSTRACT

The United Kingdom has recently introduced the Working Families' Tax Credit (WFTC) as its main system of financial support for low-income working families. The reform has been motivated by the government's "common objectives of making work pay and tackling poverty". In this paper we look at the history of in-work support in the United Kingdom, and the current structure and administration of the WFTC in particular. We pose a number of questions of relevance to future policy formation: to what extent has UK welfare policy been informed by international experience in general, and by the United States' experience of EITC and TANF in particular? What are the mechanisms by which policy has been transferred between the US and UK? And has the transfer led to 'good' policy?

JEL CLASSIFICATIONS: C25; H31; J22

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1 Introduction

What are the links between globalisation and economic policy? For trade economists, since Taussig (1923) or even List (1841), this is essentially a question about whether, by introducing a particular policy innovation, it is possible to improve upon aggregate welfare attained under free trade. The optimal tariff is the classic case in point, where a large country can use a tariff to turn the terms of trade in its favour, though there are a whole series of second best arguments for intervention, which were systematically developed by Meade (1955) and Corden (1974). Although the imperfect competition and international trade literature resulted in some further refinement, the fundamental tenets of optimal intervention were left largely intact.

In the main, this literature was concerned with border measures. Increasingly, however, non-border measures of one form or another have come to dominate the policy agenda, not just in bilateral discussions (for example, the acceptability of genetically modified foodstuffs) but also in multilateral negotiations (for example, the role of new issues in the Uruguay Round agenda). This has shifted the focus of discussion on globalisation and economic policy away from optimal intervention in response to a given distortion and towards policy co-ordination and policy transfer. The former is the process whereby independent nation states co-ordinate intervention in order to minimise negative spillovers from uncoordinated action; the latter is the process whereby policies developed in one domain are adopted or adapted in another.

Policy transfer is the focus of this paper. With increasing globalisation of economic activity, there are increased opportunities to 'learn' from experience with intervention elsewhere. Although it continues to be the case that the public and social policy decision making process is fashioned largely by national priorities, it is nonetheless also the case that more than ever before national policy decisions are being informed by international experiences and policy structures. A number of factors have contributed to this. First, as a result of globalisation and technological development, policy ideas and initiatives are more easily communicated in the international arena.¹ Second, the surge in regionalism in the last decade or so of the twentieth century has stimulated more active dialogue on comparative policy. Third, many OECD governments claim to pursue programmes of

¹ See Stone (2000) for a discussion of the role of policy institutes and think tanks in the transfer of policy ideas.

'evidence based' policy. Fourth, international agencies like the World Bank and IMF actively facilitate or implement the transfer of policy.

The spectrum of policy domains across which policy transfer seems to be occurring is a broad one and it is not the purpose of this paper to survey it. Rather, we set out a simple organising framework for thinking about policy transfer and policy co-ordination and then focus on a specific policy domain.

We begin in Section 2 by setting out a framework to help us distinguish between policy co-ordination and policy transfer. The core of the paper then is a particular case study in policy transfer, namely the introduction of tax credits for welfare support in the United Kingdom. Thus in Section 3 we outline the development of in-work benefits in the UK and in Section 4 their development in the US. Section 5 then evaluates the nature and extent of welfare transfer in the UK and Section 6 concludes.

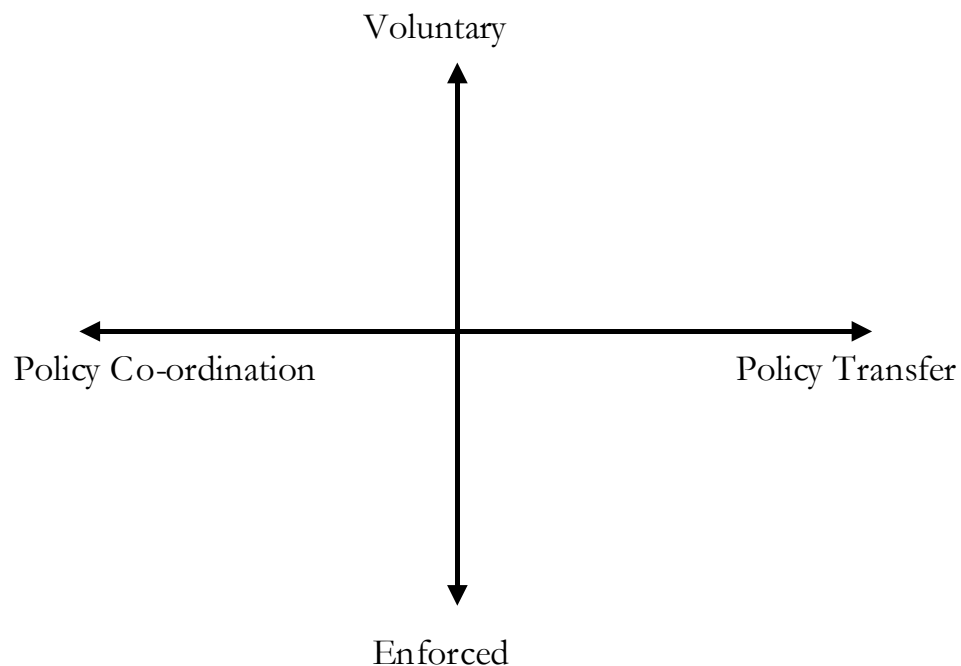
2 Globalisation, Policy Co-ordination and Policy Transfer

We begin by clarifying basic concepts. Globalisation we define as the internationalisation of economic activity, driven by increased armslength trade, increased cross-border investment and increasing migration. It is well known that globalisation increases interdependence between economies. With increased openness, shocks that originate in one economy are more likely to impact on another. This is also true of policy innovation: in a closed economy there is no scope for policy induced spillovers, in an open economy there is, and the more open the economies concerned, the greater the potential. Thus, with increasing openness comes pressures for *policy co-ordination* to minimise the spillovers from uncoordinated *policy competition*. In Figure 1, policy co-ordination is mapped in the north-east and south-east quadrants, depending upon whether it is voluntary or enforced. Table 1 gives examples of each in different policy domains.

Policy co-ordination is generally a response to policy competition. The latter can take place with regard to border and non-border measures and any co-ordination introduced to deal with it can be voluntary or enforced. Tariff wars are the classic example of policy competition in the trade domain and the GATT's principle of non-discrimination combined with binding, the particular (rules based) device used to co-ordinate policy and minimise spillovers. The mechanisms are voluntary in the sense that Members opt in but

there are punishment mechanisms in place to deal with defection: including withdrawal of privileges and sanctioned retaliation.

Figure 1 Policy Co-ordination and Policy Transfer



Macroeconomic policy is another area where the literature on policy competition and policy co-ordination is well developed.² G7/G8 attempts to manage exchange rate fluctuations are an obvious case in point. More generally, fixed exchange rate regimes can be thought of as a device for exchange rate co-ordination. In the case of the Eurozone in Western Europe, this has been taken one step further: a single currency imposes a single co-ordinated monetary policy. In turn, this requires the Stability Pact to ensure fiscal co-ordination. Moreover, in the case of the latter, compliance is enforced by financial penalties (see Gros and Thygesen 1998 for details).

As noted earlier, the globalisation process has increased the visibility of non-border measures and brought pressures for greater co-ordination across a whole raft of policy domains. For the first time, the Uruguay Round brought many non-border issues into

the multilateral domain: regulatory arrangements in services provision; protection of intellectual property; trade related investment measures. These issues comprise part of the core for the so-called 'built-in agenda' of the Doha Round. But that Round is also likely to push discussions and attempts at co-ordination into completely new domains, including competition policy, welfare and labour market policies and environmental issues.

Table 1. *Examples of Policy Co-ordination and Policy Transfer.*

	POLICY CO-ORDINATION	
	Voluntary	Enforced
Trade Policy	Most Favoured Nation	Tariff Binding
Macroeconomic Policy	Exchange Rate Management	EU Stability Pact
Industrial Policy		US Special 301 Provisions
Environmental Policy	Kyoto Protocol	
	POLICY TRANSFER	
	Voluntary	Enforced
Trade Policy	Unilateral Liberalisation	SAL Liberalisation
Macroeconomic Policy	Central Bank Independence	Single Currency
Industrial Policy	Privatisation	SAL Privatisation
Welfare Policy	Tax Credits	

In contrast to policy co-ordination, policy transfer which is mapped in the north-west and south-west quadrants of Figure 1 is defined by Dolowitz and Marsh (2000) is a process where "... *knowledge about policies' administrative arrangements and ideas in one political setting is used in the development of policies' administrative arrangements, institutions and ideas in another setting.*" There are two important characteristics of policy transfer that should be noted. First, it is predicated on the belief that policy intervention will be welfare

² For a review of the literature, see Hughes Hallett (1989).

enhancing; second, it is evidence based. Thus, in contrast to the public choice view of policy formulation which views a given set of policies as the outcome of a process of interaction between competing interest groups, policy transfer is a process whereby governments adopt what they see as best practice, or better practice, by reference to experience with those policies elsewhere. With increased globalisation we have observed increased policy transfer, which is hardly surprising since, with increased openness, governments (or to be more accurate their advisers) have access to a wider information set and evidence on what works, or does not work, elsewhere in the global economy.

Like policy co-ordination, policy transfer can be voluntary or enforced and one can find examples of both across a range of policy domains. In trade policy for instance, unilateral liberalisation is a good example of policy transfer that can be voluntary. Krueger (1997) argues that most of the trade liberalisations that occurred in developing countries in the 1980s and 1990s were voluntary and evidence based, in the sense that developing countries that had pursued import substitution policies switched to outward oriented policies, having observed the success of countries that had developed with outward orientation. Arguably, however, many of these liberalisations were actually enforced policy transfer. In other words, they would not have occurred had the multilateral lending agencies in general and World Bank in particular not imposed liberalisation as a condition of a given lending programme. No doubt this was still seen as evidence based but it can more accurately be thought of as enforced rather than voluntary.

In the domain of macroeconomic policy, the increasing trend to central bank independence can be seen as a good example of policy transfer. An accumulation of evidence that linked the degree of independence of a central bank to an economy's (mean and variance) inflation performance was instrumental in the move to give independence among others to the Central Banks in the UK and Euroland. In the field of industrial policy, deconfinement of the public sector, or privatisation is another good example and again there are cases of both voluntary and enforced. With regard to the former, the influence of British experience on other programmes in continental Europe is a case in point; with regard to the latter, World Bank conditioned programmes are a good example. Another recent episode in the field of industrial policy is the auction of broadband spectrums, where British experience was followed in designing auctions elsewhere.

In summary, we view policy co-ordination as a mechanism for minimising spillovers from policy competition and policy transfer as a process of adopting or adapting policies from elsewhere that are deemed to be more efficacious than current practice. We now turn to a specific example of policy transfer, namely US-UK experience with in-work benefits.

3 The Development of In-Work Benefits in the United Kingdom

The history of the development of in-work benefits in the UK can be traced back to the Beveridge social security proposals of 1944. The original Beveridge report actually made very limited reference to the use of the benefit system to promote employment incentives. Indeed, Beveridge made almost no reference to in-work poverty: the focus was on poverty due to unemployment or old age:

“The Beveridge Report barely discusses the problem of poverty among working households. In this, it is very much a product of the particular time at which it was written[...]. For Beveridge it was axiomatic that anyone in employment had resources sufficient to support a wife and one child”,

Dilnot, Kay and Morris (1984, p.23).

In the early years, financial support for low-income families in the UK was delivered principally through the *Supplementary Benefit* system (the main ‘safety net’ benefit, known as National Assistance prior to 1966). The level of entitlement to Supplementary Benefit depended on family size and the age and number of children. It was withdrawn at a rate of 100 per cent beyond a small earnings disregard. This benefit, while playing an important distributional role, was not available to full-time workers. As a result, Supplementary Benefit did little to improve employment incentives.

In addition to Supplementary Benefit, a number of rent- and rate-rebate schemes were introduced to alleviate poverty among low income tenants and ratepayers. Initially many local councils administered their own schemes but these were replaced by national rent-rebate schemes in 1972 and 1974.

3.1 Family Income Supplement (1971)

The Family Income Supplement (FIS) was the first benefit in the UK aimed explicitly at low-income families with children with at least one parent in work. Introduced in 1971 by the Conservative government under Edward Heath, FIS was initially intended as a temporary mechanism for alleviating in-work poverty. Two-parent families were eligible for FIS if one of them worked 30 hours a week or more: lone parents needed only to work 24 hours a week. FIS paid was 50 per cent of the difference between a ‘prescribed amount’ (which varied according to the number of children in the family) and the family’s *gross* income.³

3.2 Family Credit (1988)

The transformation of FIS into Family Credit was one of a range of benefit reforms designed to eliminate some of the more complex features of the UK transfer system. The principal aims were; first, to target low-income households with children; and second, to improve work incentives, not least by eliminating effective marginal tax rates of over 100 per cent. Family Credit (FC) differed from FIS in several ways.

- FC was withdrawn at a rate of 70 per cent as *net* income increased, compared with 50 per cent of *gross* income under FIS.
- FC was available to more households than FIS. This was partly because it was more generous and partly because the minimum weekly hours of work required to claim was 24, compared with 30 under FIS (for couples).⁴
- The calculation of FC entitlement was based on income over a six-week period. Once established, the level of FC payment was fixed for 6 months.

³ This had an unfortunate effect: an increase in gross income could actually *reduce* net income. Both FIS and Housing Benefit were simultaneously withdrawn as gross income increased. When combined with the increase in income tax and National Insurance liabilities, the effective marginal tax rate could exceed 100 per cent.

⁴ Official figures calculated that around 341,000 families in 1991 were in receipt of FC compared with 220,000 FIS recipients in April 1987. Source: UK DSS *Social Security Statistics*, 1988 and 1991.

3.3 Reforms to Family Credit (1992-1999)

The UK Government introduced a further series of reforms throughout the 1990's.⁵ In 1992 the minimum hours of work limit for receipt of Family Credit was reduced from 24 to 16 hours per week for families with children. This made the benefit available to many low-paid, part-time workers previously excluded from financial support.⁶ In 1995, the government added a further £10 per week payment for families with at least one adult working 30 hours or more, in order to make full-time work relatively more attractive to low-income families. A childcare earnings disregard was added for low-income families purchasing formal (registered) childcare. This allowed expenditure of up to £60 per week on childcare to be disregarded from the Family Credit means test.

3.4 The Working Families' Tax Credit (1999)

The Working Families' Tax Credit (WFTC) replaced FC in 1999. Its structure is similar to FC, but it is substantially more generous. The government expects a near doubling of the number of recipients compared with FC: around 1,500,000. The main differences between WFTC and the latest FC (at April 1999) are:

- i. Increases in the adult credit: from £49.80 under FC to £53.15 under WFTC
- ii. increases in the child credit: from £15.15 for a child under 11 to £25.60 under WFTC;
- iii. an increase in the threshold before the payment is withdrawn: from £80.65 to £91.45 per week;
- iv. a reduction in the withdrawal rate from 70 per cent to 55 per cent;
- v. a new childcare credit of 70 per cent of actual childcare costs, up to a maximum of £150 per week, to replace the childcare disregard;

A stylised comparison of WFTC and FC is shown in Figure 2. The figure shows the value of the two credits at various hours of work. It is interesting to note that the largest

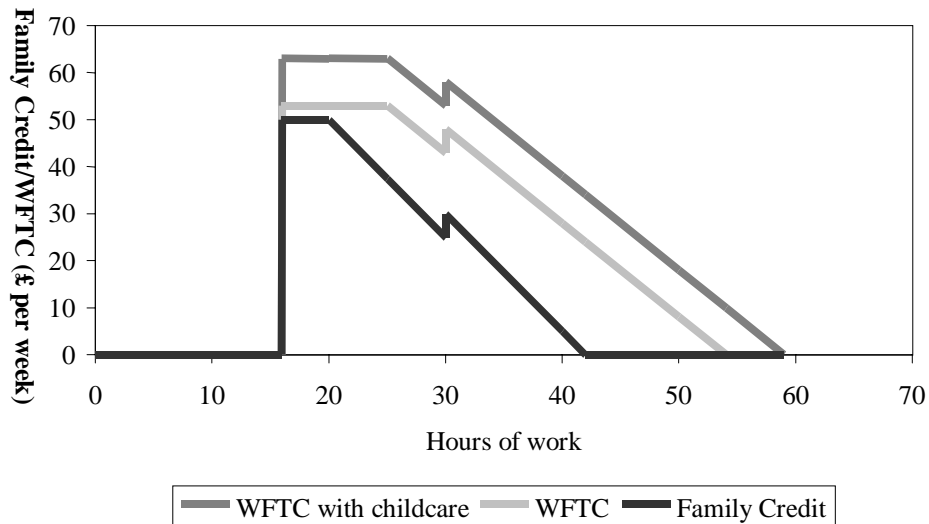
⁵ These are covered in more detail in Duncan (2000).

⁶ Dilnot and Duncan (1992) discuss this particular reform in detail.

cash gains from WFTC go to people who are currently just at the end of the taper under FC. For them, the introduction of WFTC will create an entitlement to in-work support whereas before they were ineligible for FC.

The childcare credit under WFTC increases entitlement by 70 per cent of childcare costs up to £100 per week for people with one child (£150 per week for people with two or more children). The effect of the childcare credit is also illustrated, as the highest line in Figure 2. In comparison with the childcare disregard in Family Credit, the WFTC childcare credit *increases* the total financial support available to mothers who work and pay for childcare. Indeed, the potential generosity of the childcare credit is one of the more interesting features of the new WFTC; at its maximum, it will be worth up to £105 per week. With such generous support available, the WFTC childcare credit is likely to have a considerable (expansive) impact on the childcare market in the UK. There have been some early simulations of the possible work incentive consequences of the WFTC including the childcare credit,⁷ but as yet there has been little, if any, work on the likely impact of the childcare credit on the extent of use of formal childcare services.

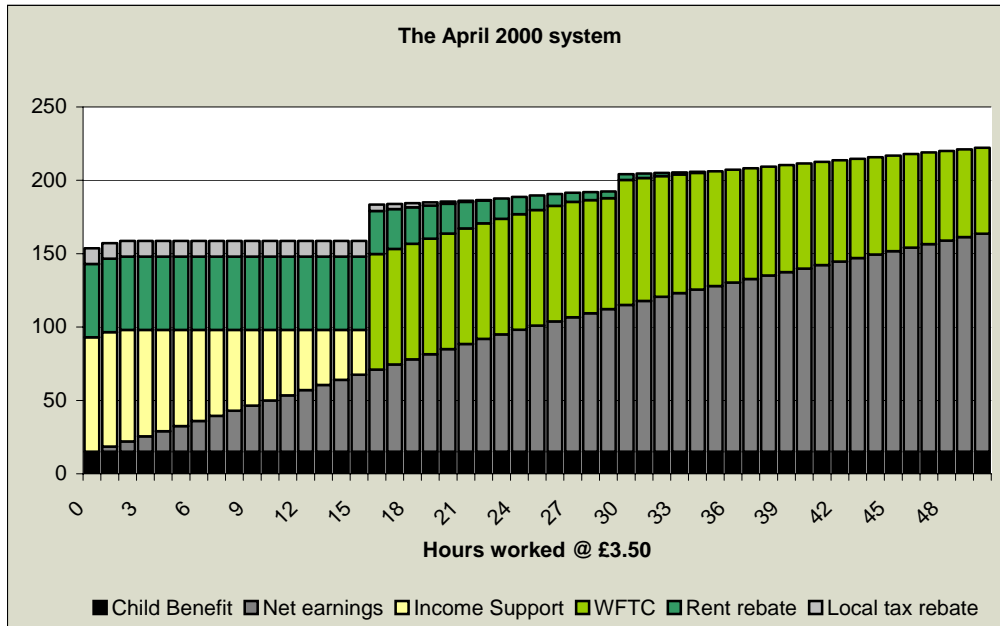
Figure 2: *Family Credit and WFTC*



⁷ Blundell, Duncan, McCrae and Meghir (2000)

As noted previously, households who are eligible for FC and WFTC are often also entitled to Housing Benefit and Council Tax Benefit. These last benefits interact with the in-work credits, meaning that disposable income increase by less than the value of the FC/WFTC payment. Figure 3 indicates the degree to which the increased generosity of WFTC is negated by interactions with other benefits.

Figure 3. UK budget constraint by income source, single parent, 2000



4 The Development of In-Work Benefits in the United States

Low-income families in the United States receive support from three main programmes: Food Stamps, Temporary Assistance for Needy Families (TANF) and the Earned Income Tax Credit (EITC). TANF — which supports low-income families in and out of work — replaced the old Aid to Families with Dependent Children (AFDC) programme in 1996. States now receive a block grant from the Federal government and have considerable freedom to set the eligibility, generosity, work requirements and other TANF rules. The resulting variability makes it difficult to characterise the system facing a typical low-income family across the United States.⁸ Nonetheless, most states provide a maximum credit to low-income families, subject to resource limits, time limits and work or job-search requirements. The credit is then tapered away as income rises, perhaps after an initial disregard. In addition, there are a number of means-tested programs providing subsidised healthcare, housing and childcare.

4.1 *The Earned Income Tax Credit (EITC)*

The EITC began in 1975 as a modest program aimed at offsetting the social security payroll tax for low-income families with children. But it has now become an important plank in the federal Government's anti-poverty strategy, following major expansions in the tax acts of 1986, 1990 and 1993 (taking effect in 1987, 1991 and 1994-6 respectively). The EITC now costs almost as much as Food Stamps and TANF combined.⁹

EITC is a refundable tax credit.¹⁰ Families apply for it when they file their annual tax returns. Eligibility depends upon having some earned income in a year and on the number of qualifying children (children can be up to age 23 if in full-time education). The amount of credit depends on earnings, other sources of income (from investment *etc.*) and the number of qualifying children. A much smaller EITC is available for people without children. Married couples are assessed jointly. There are three regions in the credit schedule. In the phase-in region, the credit is equal to a percentage of income until

⁸ Committee on Ways and Means (1998) describes the rules that the federal government imposes on states. Gallagher et al (1998) provides a comprehensive description of the TANF rules in all states as of October 1997. The Welfare Rules database at the Urban Institute is an online database of the key parameters in states' TANF programmes.

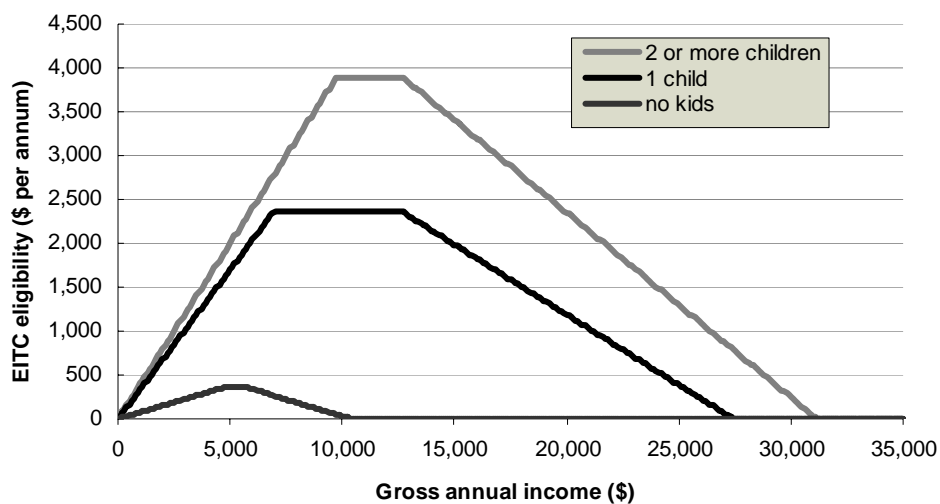
⁹ In 1999, EITC spending was \$31.9bn, compared to \$16.7bn on TANF and \$19.0bn on Food Stamps (cited in Hotz and Scholz, 2001).

¹⁰ Hotz and Scholz (2001) is a recent and comprehensive review of the operation and impact of the EITC.

the credit equals the maximum amount. There is then a flat region across which the maximum credit is received. In the phase-out region, the credit is tapered away to zero.

In 2000, for example, a family with two or more children received a maximum credit of \$3,888 in EITC, phased in at a rate of 40 per cent. The maximum credit was reached at \$9,720, and was held until incomes passed \$12,690. Beyond this maximum, a taper of 21.06 per cent was applied to the level of EITC. At these rates, the EITC was withdrawn completely when income reached \$31,152.

Figure 4. The Earned Income Tax Credit in 2000

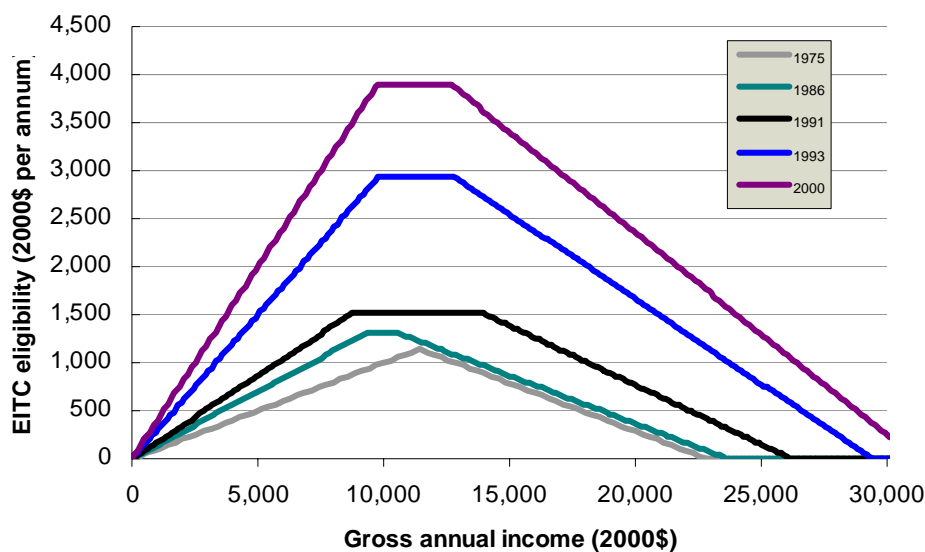


4.2 The Development of the Earned Income Tax Credit in the United States

It is instructive to see how the Earned Income Tax Credit has evolved over time in the US. In 1975, the first EITC system had a single rate structure for all families with children that did not differentiate rates according to the number of children in the household. Not until the 1990 reform did the rate for adults with two or more children exceed that for families with a single child, although the differentiation at that time was relatively modest. In 1993 and again in 1996, the rate for households with two children was systematically increased relative to single child households. In addition, a smaller EITC was made available to childless households.

Figure 5 compares the (uprated) values of EITC systems from 1975 to 2000 (for families with two children). It is clear that the generosity of financial support under EITC has increased considerably over the period since its inception in 1975 to the most recent structure in 2000. Table 2 lists the main events in the history of in-work benefit reform in the United States and the United Kingdom.

Figure 5. The development of the Earned Income Tax Credit from 1975 to 2000



4.3 A comparison of the design features of WFTC and EITC

The UK system of support for low-income working households is unusual in that it includes an explicit hours-of-work condition as well as an earnings-related ‘means-test’ when assessing the level of entitlement.¹¹ Most in-work transfers base entitlement on earnings alone, as is the case for the Earned Income Tax Credit (EITC) system in the United States.¹²

Table 2. A history of tax credit reforms in US and UK.

US	<i>Year</i>	UK
	1971	Family Income Supplement (FIS) introduced as a means-tested in-work benefit.
Earned Income Tax Credit introduced for low-income working families with children (max credit: \$400)	1975	
Tax Reform Act 86: EITC generosity increased	1986/7	
	1988	FIS replaced by Family Credit (FC) (increased generosity, lower overall METR). Hours condition on eligibility (24 hours per week).
Omnibus Reconciliation Act 1990: EITC generosity increased. Separate rates for 2+ children. EITC excluded from means test in other welfare programs.	1990/1	
	1992	Hours condition for eligibility to FC cut to 16.
Omnibus Reconciliation Act 1993: EITC generosity increased for families with 2+ children. EITC extended to include workers without children.	1993	

¹¹ The Canadian Self-Sufficiency project (SSP) is perhaps the only comparable transfer programme which includes an explicit hours condition among the rules of entitlement See Card, Michalopoulos and Robins (2000) for a detailed analysis of the Canadian SSP pilot.

¹² The EITC includes three regions; a ‘phase-in’ region for which entitlement increases as earnings increases, a plateau where maximum entitlement is maintained, and a ‘phase-out’ region where the credit is withdrawn until exhausted. So, EITC entitlement depends on hours of work, but does not include a specific hours-related condition.

Clinton's Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA). EITC generosity increased. AFDC replaced by TANF.	1995	Additional credit of £10 for those working 30 hours per week. Childcare expenditure disregards introduced.
	1996	The Taxation of Benefits under Pilot Schemes (Earnings Top-Up) Order of 13 th September 1996 made provision for a pilot study examining the effect of a FC-type system for families with no children.
	1997	Labour Government elected in UK. Chancellor announces intention to introduce new tax credit
	1998	SSSC visits US to examine EITC implementation issues. UK Chancellor pre-announces WFTC reform.
	1999	WFTC replaces FC (increased generosity, reduced taper, support for childcare costs)
	2000	Increased generosity. WFTC paid through the tax code.
	2002	WFTC and IS child payments to be re-configured into the Working Tax Credit (WTC, available to all working families, including those without children) and Integrated Child Credit (ICC, available to all families with children) from 2003.

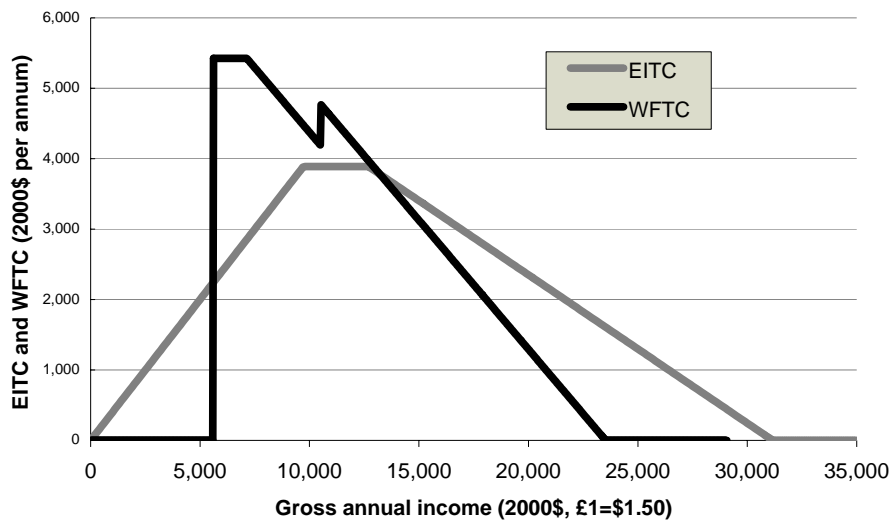
Sources: Brewer (2000); Dolowitz (2000); Eissa and Liebman (1996).

The desirability of an explicit hours condition is of course the subject of some debate. On the positive side, it can be argued that the hours-related eligibility condition in the WFTC improves the targeting of the benefit towards working households, and may therefore be more effective in promoting employment incentives. There may also be a higher *deadweight* cost to the EITC, since the tapers are relatively low compared with WFTC and extend higher up the earnings distribution. On the negative side, higher withdrawal rates are typically needed to pay for the greater generosity of hours-conditioned transfers. This might lead to labour market 'inertia': people have an incentive to work at or near the hours threshold, but little or no incentive to work much beyond. In contrast, EITC recipients can adjust their labour-market behaviour with a potentially smaller loss of entitlement. Indeed, they might ultimately find it less burdensome to float off receipt entirely as they acquire skills and labour market experience.¹³

¹³ Holtzblatt and Liebman (1998) present a useful comparison of the structure, administration and incentive implication of EITC and WFTC. Whitehouse (1996) presents a more international viewpoint.

Despite these differences, the EITC and WFTC systems of supplementing low-paid employment share some strong similarities in design, generosity and integration with other elements of their respective tax and transfer systems. Figure 6 shows how the two systems compare in terms of generosity and structure, by plotting the EITC for a single parent with one child in July 2000 alongside the corresponding WFTC schedule (the latter expressed in \$US). And Figures 7 and 8 show how the two tax credit systems integrate with other elements of their respective tax and transfer systems. One can clearly see that both systems are targeted on similar regions of the budget constraint in the two countries, and are likely to provide similar work incentives to low-wage and non-working households.

Figure 6. A comparison of EITC and WFTC systems (2000 prices)



5 The Nature and Extent of Policy Transfer

The aim of any system of in-work benefits is to shift the balance between incomes in and out of work. Tax and transfer systems were, in the past, often designed solely with distributional objectives in mind. Now, in-work benefits, once rare, have become widespread. Countries as diverse as Belgium, Canada, Finland, Italy, New Zealand, the United Kingdom and the United States have now adopted a policy of subsidising low-paid workers' wages as a way of improving work incentives. Many other countries are actively considering whether to adopt tax credits as part of larger scale welfare reform.¹⁴

¹⁴ Australia and France among others

Figure 7. UK budget constraint by income source, assuming hourly wage of £3.60

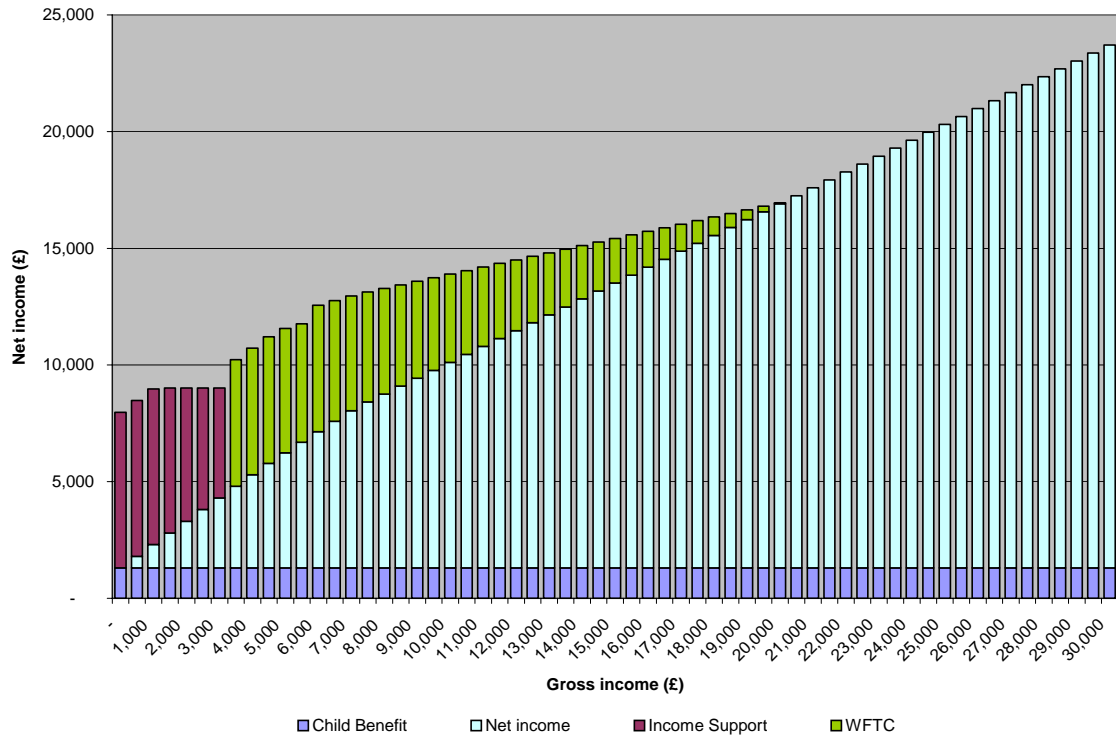
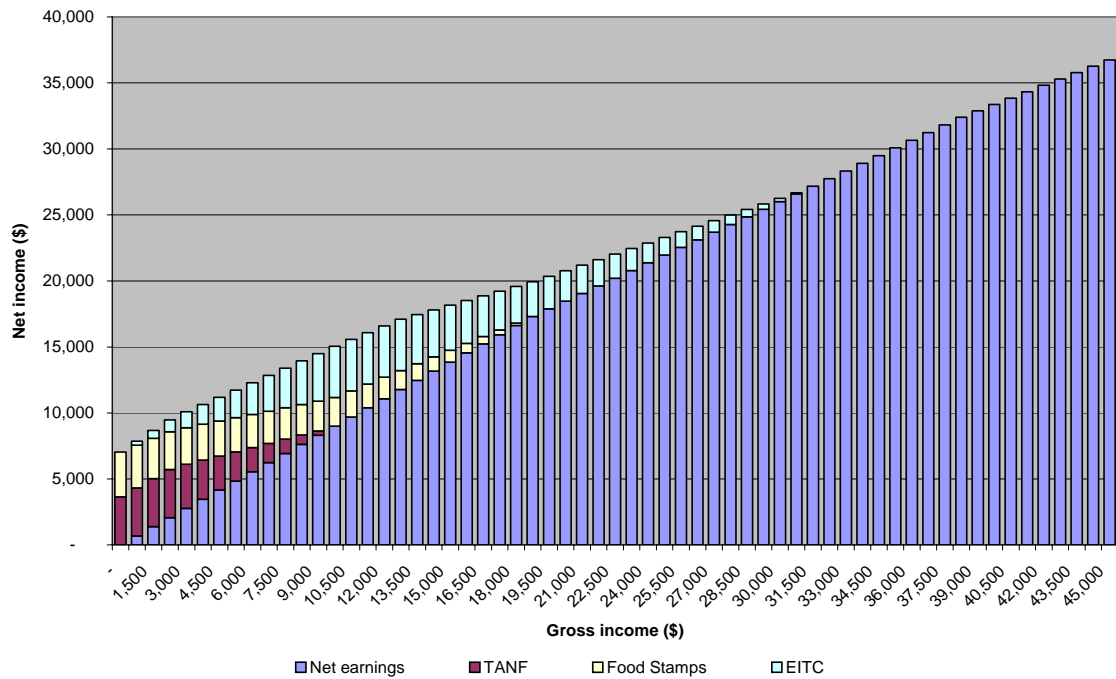


Figure 8. US budget constraint by income source (Florida TANF structure)



Source: Brewer (2000).

5.1 *Patterns of welfare reform in the US and UK*

As is apparent from Table 2, there are comparable or parallel patterns of welfare reform in the United States and the United Kingdom, extending over a period stretching as far back as the early 1970's, and certainly pre-dating the most recent development of tax credits in the UK.

The 1970's saw the introduction of the first in-work benefit in the United Kingdom (the Family Income Supplement, or FIS) and, four years later, the first earnings-conditional tax credit in the United States (the EITC). In the late 1980's, we saw an increase in generosity of the EITC and, at broadly the same time, a restructuring of the Family Income Supplement into Family Credit (FC). The 1988 FC system combined an increase in generosity with the introduction of an explicit hours condition for entitlement, something that the EITC didn't possess. Nevertheless, the hours condition in Family Credit can be viewed as an extreme version of a 'phase-in' region of the sort that exists under EITC. In that sense, the 1988 Family Credit reform shared the spirit of the incumbent EITC system at that time (that is, to promote employment incentives by making entitlement and generosity contingent on employment).

The US government increased the generosity of the EITC during the early 1990's, through the Omnibus Reconciliation Acts of 1990 and 1993, and Clinton's Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996. The only structural development of EITC during that period (in 1993) was the creation of a small entitlement to EITC among low-wage working families without children. At this time, entitlement to Family Credit was restricted to working families with children. That is not to say that similar developments were not considered in the United Kingdom. In 1995, the then Conservative UK government released a Green Paper (Department for Social Security, 1995) that proposed the introduction of the *Earnings Top-Up* (ETU). This was an in-work benefit very much in the mould of the Family Credit, but designed specifically for people (singles and couples) without dependent children. And in the following year, the *Taxation of Benefits under Pilot Schemes (Earnings Top-Up) Order* made provision for a pilot study of the effects of the ETU on employment incentives. Although the scheme was never introduced¹⁵, this initiative nevertheless illustrates a continued pattern of close association between reforms to the US EITC scheme and proposals for reform to in-

¹⁵ The election of a Labour government in 1997 prevented the ETU from passing into national legislation.

work benefits in the UK. So is the association of policy ideas between the US and UK merely coincidental? There is firm evidence to the contrary. This can be seen most recently in the UK's move from Family Credit to the new Working Families' Tax Credit (WFTC).

5.2 The introduction of WFTC in the United Kingdom

In preparation for the introduction of the Working Families' Tax Credit (WFTC) in 1999, the UK Government initiated a wide-ranging consultation exercise which gathered evidence from a range of sources on the effectiveness of work-related support in promoting employment incentives and supporting families on low incomes. It is certainly true that the WFTC reform in the UK was informed to a large degree by the US experience of the Earned Income Tax Credit¹⁶. The issue was initially raised by the current UK Chancellor of the Exchequer, Gordon Brown, in his first Budget speech in July 1997:

"...I have therefore also asked Martin Taylor to consider at an early stage the advantages of introducing a new in-work tax credit for low-paid workers. It would draw upon the successful experience of the American earned income tax credit, which helps reduce in-work poverty, and now helps 19 million lower-paid workers in America. [...] Conclusions that emerge from this tax benefit review will inform the judgments in my next Budget..."

Rt Hon Gordon Brown MP (Chancellor), Budget Speech, 2nd July 1997.

Shortly after its election, the UK government commissioned the Social Security Select Committee (SSSC) to visit the United States to learn about the structures, implementation and practical experience of American welfare systems. Following their visit, Martin Taylor released two reports on the possibility of a tax credit system for the United Kingdom (HM Treasury 1998a, 1998b) to coincide with the Budget of March 1998. And during that budget, the UK Chancellor confirmed that an employment-contingent tax credit, the Working Families' Tax Credit, was to be introduced in the following year.

¹⁶ See Eissa and Liebman (1996)

5.3 Lesson-drawing and the partial transfer of welfare policy

In the parliamentary debates which followed the 1998 Budget proposal, we see very clear evidence of lesson-drawing and partial policy transfer. In response to a parliamentary question in 1998 put by Mr Jim Cousins (MP for Newcastle Central), Mr David Davis MP flagged up the close relationship between the WFTC and the US system of Earned Income Tax Credit:

“Working Families’ Tax Credit is based on the American EITC. [...]. In America, the EITC is known for its administrative complexity, its weakness as an incentive provider and its proneness to fraud--it is the most fraud-prone benefit in the United States. Those three weaknesses are intertwined: complexity of the policy leads to administrative weakness, which leads to policy failure and to fraud. In this country, fraud takes between 6 per cent. and 16 per cent. of any welfare budget other than pensions, which amounts to between £4 billion and £5 billion of taxpayers’ money lost each year. It would be a tragedy if, on top of its other problems, that problem were to afflict the WFTC as well.”

Mr David Davis (MP for Haltemprice and Howden), 23rd March 1998.

What is interesting here is not merely the fact that lesson-drawing from US experience is integrated into the formulation of UK welfare policy, but that lesson-drawing flags up limitations in the wholesale transfer of a particular welfare policy from one domain to another. In this example, the complexities of administration and the prevalence of fraud in EITC claims are highlighted as potential dangers that ought to be accounted for in the design of the UK tax credit system. In a later parliamentary debate (in this case following the introduction of the WFTC), the same Member of Parliament again drew attention to the lessons drawn from the US experience of EITC, and the partial and adaptive nature of the transfer of US welfare policy to the UK:

“In addition, we have the experience of the earned income tax credit in the United States, on which the Working Families’ Tax Credit is based. An article in Fiscal Studies based its criticism on a study by the Internal Revenue Service--the American Inland Revenue--that was released in early 1997. It found that taxpayers claimed \$4.4bn more in EITC funds than they were eligible to receive...”

Mr David Davis (MP for Haltemprice and Howden), 16th February 2000

So we see here how lessons have been drawn from US experience of fraudulent claims in

the initial implementation of the EITC, and flagged as a cautionary tale in the design of the British WFTC system. The same Member of Parliament went on to describe how the WFTC was adapted to counter the potential problem:

“...The counter-argument is that the United Kingdom proposals were developed to be aligned with the pre-existing in-work benefit system rather than the tax credit system in the United States. For example, eligibility for the EITC was originally checked retrospectively, in line with the policy on tax measures. The IRS now verifies eligibility before payment. Such a process is built into the UK proposals because they are based on existing structures for in-work benefits.”

Mr David Davis (MP for Haltemprice and Howden), 16th February 2000

This last statement demonstrates how lesson-drawing in the administration of the EITC in the United States directly led to an adaptation of the structure of WFTC in order to offset potentially fraudulent claims. The statement also serves to introduce the idea that a number of agents or actors may play a role in the process of policy transfer.¹⁷ So, is the process of adaptive policy transfer policy likely to lead to good policy? Perhaps the most convincing testimony that this is the case comes from a prominent US academic and policy commentator, who said in 1998 that:

“The Working Families Tax Credit combines the best features of the UK's Family Credit and the US's Earned Income Tax Credit. [...] The most impressive feature of this plan is that it achieves the advantages of paying benefits through the tax system without losing the many desirable features of Family Credit, and without sacrificing the simplicity of the UK tax system [...] Initial indications are that the Labour government has taken a good programme and made it better”.

Prof Jeffrey Liebman (Harvard), *Financial Times*, 17th March 1998.

¹⁷ The reference to an article in *Fiscal Studies* in the statement refers to Brewer (2000), an economist at the Institute for Fiscal Studies, an independent research organisation with a brief to comment on issues of public policy concern.

5.4 'Reverse' welfare policy transfer

We have already described how adaptive policy transfer can improve on an existing policy structure. However, one can see evidence of the process of policy transfer evolving beyond a simple one-way process, into a more general environment of mutual learning and lesson-drawing. The point is most elegantly put by Walker and Wiseman (2001); they visualise the communication of welfare policy ideas between the UK and the US in terms of a '*transatlantic policy transfer loop*'. We have seen evidence in the 1980's and 1990's of UK welfare policy taking a lead from US experience, with adaptation to counter some of the less desirable features of the EITC system. However, the effects of introducing the WFTC in the United Kingdom are in turn being monitored closely by other countries, including the United States. Welfare reforms and pilot studies around the world form the subject of a plethora of evaluation studies, each looking in detail at the impact of reform on behaviour, on distribution and on cost. With such a surfeit of information, it is relatively easy for governments to learn of new policy, and draw lessons from their implementation, as an input in their own welfare reform agenda.

6 Conclusions

We began by distinguishing between policy co-ordination and policy transfer and linked both to the globalisation process. With increased globalisation, potential spillovers from policy competition increase, as do the potential benefits of policy co-ordination. But increased globalisation also brings with it opportunities to learn from the experience of others, either in adapting existing policies or developing new policies. Thus, other things being equal, we would expect that the incidence of policy transfer increases with globalisation.

There is evidence of increased policy transfer occurring, both on a voluntary and enforced basis. Although we provide examples of both in a range of policy domains, we do not attempt to survey this. Rather we focus on a particular policy episode, the development of in-work benefits in the United Kingdom. In examining the UK experience we find that policy transfer has occurred on a voluntary basis but it has been partial rather than complete. In other words, the UK has not simply taken the EITC 'off the shelf' but has adapted it, partly to acknowledge the different institutional setting in the UK but also to avoid some of its less desirable characteristics. In other words, the fundamental principles have been adopted but its implementation adapted.

Time will tell whether this particular episode has resulted in policy transfer which is in some sense 'successful'. The early signs are, however, very promising, with evidence pointing to improved employment incentives and the administration and delivery of the system is working well. In fact, the implementation of the WFTC has been sufficiently successful that there is evidence of 'reverse policy transfer' beginning to take place. In other words, reforms to the EITC, based upon experience with the WFTC.

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