# CPAG briefing on the Child Trust Fund

**Introduction**

As an organisation campaigning to eradicate child poverty CPAG recognises the importance that the Child Trust Fund (CTF) holds within Government policy [1] and welcomes the progressive element within the endowments. We are always pleased with the allocation of additional funds to children (although they will not benefit from the scheme until they are 18). However, we do have reservations about a scheme which we fear will not improve the financial position of children living in poverty today.

Recent Government efforts have improved the financial situation for lower income families. However, there is a long way yet to go before day-to-day incomes are sufficient for a scheme like the CTF to work in the interests of the poorest families in society. Although the Government argues that 'savings provide both a financial buffer against rainy-day needs and a source of financial independence and opportunity…' [2] clearly a secure and adequate income is an essential prerequisite for the accumulation of savings. Sadly, for families whose income does not cover their current needs, safeguarding their child's financial future is a pipedream.

**Structure**

This briefing is broken into eight sections, each of which considers the CTF from a child poverty perspective.

1. Child poverty
    - the context

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[1] *Child Poverty Review,* (HM Treasury, 2004), para. 4.40

[2] HM Treasury, *Saving and Assets for All: The modernisation of Britain's tax and benefit system, number eight* (HM Treasury, 2001)

- o The targets

2. Income adequacy
3. Saving on a low income
4. Social mobility and inequality
5. Asset-based welfare
6. Social stigma and financial education
7. Trust fund growth

## 1. Child poverty

### 1.1 *The context*

> Our historic aim will be for ours to be the first generation to end child poverty, and it will take a generation. It is a 20-year mission but I believe it can be done. Tony Blair, 18 March 1999

1.1.1 The 1999 pledge to eradicate child poverty was a welcome – and long overdue recognition of the problems of child poverty which had grown sharply over previous decades. In 1979 the risk of of child in Great Britain being in income poverty stood at 14 per cent. By 1996/97 this had more than doubled to 34 per cent. By 2002/03 Government strategies had succeeded in reducing the risk to 28 per cent[3] - still double the 1979 figure – and made the historic commitment to reduce it further on route to eradication by 2020. The policy commmitment and political resolve around the pledge to eradicate child poverty has been very welcome, as has the positive progress made so far. However, further progress is can only be attained if the incomes of the poorest families and their children are increased. This requires significant improvement in the value of employment for families experiencing in-work poverty, and real increases in the value of financial support for children.[4]

1.1.2 The Government rightly recognises that financial security engenders educational, psychological and emotional benefits in the short-term and increases aspirations and opportunities in the longer term. It is clearly important to improve social mobility and raise educational expectations and achievement amongst children from disadvantaged backgrounds.

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[3] The definition used here is the percentage of children in households with incomes below 60 per cent of the national Figures from National Statistics, *Households Below Average Incomes*, 2004, p.219 Table H2

[4] Steps towards this are detailed in CPAG, *Ten steps to a society free of child poverty*, 2005

1.1.3 The Institute of Fiscal Studies (IFS) suggests that in 2001 the richest quintile had five times the income of the poorest, and suggests that inquality has *been at its highest levels since at least 1961*.[5] Recent research on social mobility in 2002/2003 indicates that there may be less equality of opportunity for children, and less movement between generations, now than for children in the 1950s. [6] The proportion of individuals who report no assets has risen, from 5% of the whole population in 1979 to 10% in 1996. The proportion of 20 to 24 year olds who report no assets is currently 20%.[7]

1.1.4 Despite welcome progress on child poverty, British society is marred by massive inequalities. The fact that income inequality is increasing and social mobility appears to be decreasing at a time when overall levels of child poverty are coming down is a source of considerable concern.

1.1.5 CPAG agrees that, in an increasingly affluent society it is wholly unacceptable that low income families and their children are excluded from the accummulation of capital and from the sense of financial security and social and educational aspiration that assets provide. We share the Government's belief that all members of a civilized society have the right to share in rising prosperity, and endorse the view that opportunities should be provided for the many, not just for the few. It is crucial that the UK – the fourth largest industrial country in the world - should become a more socially mobile society.

### 1.2 *Child poverty targets*

1.2.1 CPAG has significant concerns about the degree to which the Child Trust Fund (CTF) can assist in the eradication of child poverty when it offers no increase to the incomes of poor families whilst their children are actually growing up. We fear that the CTF may prove to be an unhelpful distraction from consideration of income adequacy.

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[5] Brewer, M, Goodman, A., Shaw, J. and Shephard, A. *Poverty and Inequality in Britain,* (Institute of Fiscal Studies), 2004, p. 16.

[6] See for example Machin, S. and Gregg, P. 'A lesson in education: University expansion and falling income mobility', in *New Economy,* Institute for Public Policy Research, 2003 pp 194-198

[7] Kelly, G., Gamble, A., and Pacton W. 'Stakeholding and individual Ownership Accounts' in Dowding, K., De Wispeleaere, J and White, S. (eds) *The Ethics of Stakeholding* (Palgrave, 2003)

1.2.2 CPAG would like to emphasise that, although the CTF is being presented as part of the Government's strategy to eradicate child poverty [8] - it will not benefit children – it is for people aged 18.

1.2.3 Although CTF will benefit some lower income families, we are concerned that families who are at greatest risk of living in severe and persistent poverty are the least likely to be able to contribute to the CTF, so their children will derive little or no financial benefits when they turn 18. The very children who would benefit most from having savings and assets are likely to derive least financial advantage from the scheme.

1.2.4 Given ongoing problems with the administration of tax credits, and the much publicised inadequacies of the Social Fund ,[9] we believe that it would be more appropriate and more effective to divert additional funds and administrative time and energies to improving elements of provision that are designed to support low income families rather than on a scheme which many commentators believe will disproportionately benefit higher income families.[10] (See also para 2.5 below.)

**2. Asset-based welfare – an equitable system?**

2.1 The IFS have argued that:

> a sound rationale for asset-based welfare [including the CTF] must show that there is more value in providing financial assistance to families in the form of assets than there is in spending the same amount on transfer payments, such as the integrated child credit and the employment tax credit, or on improving public services or cutting taxes. [11]

We do not feel that such an argument has – as yet – been won.

2.2 The Government views the asset-based welfare as an additional, 'complementary, strand of welfare policy'. [12] We hope that the CTF will complement and not replace income-based support for children.

2.3 The research base on the efficacy of asset welfare is poor compared to other forms of spending. It is clearly important that the Government monitors aggregate saving

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[8] *Child Poverty Review,* (HM Treasury, 2004) para 4.40

[9] See for example Howard, M, *Lump Sums Roles for the Social Fund in Ending Child Poverty,* (Child Poverty Action Group, Family Welfare Association and One Parent Families, 2003); see also a recent National Audit Office analysis, NAO, *Helping those in financial hardship: the running of the Social Fund*, HC 179 Session 2004-2005, January 2005.

[10] See Haurant, 'Child trust funds 'will benefit better off' in *The Guardian,* 15 December, 2003 'Child trust funds …may in fact be of most use to well-off parents, MPs concluded today.'

[11] IFS, *op cit.*

[12] *Savings and Assets for All* (HM Treasury, 2001)

rates and fund growth amongst poor and socially excluded families, and the impact this has on their current income levels.

2.4 Although the Government will provide separate endowments of £250 at birth and age seven with £500 for children from poorer households, the bulk of fund size, and growth is expected to come from maximum contribution levels and profitable investment schemes.

2.5 The Institute of Fiscal Studies emphasises that 'Tax relief on Child Trust Funds is likely to benefit children from richer families to a greater degree since they are likely to be able to save more into their children's funds.' [13]

2.6 This view is echoed by the Share Centre, a member of the London Stock Exchange, who indicate on their website, 'to really make the most of your CTF, you should take maximum advantage of the opportunity to add up to £1,200 a year'. Such an investment will be not be possible for the vast majority of low income families, whose children's fund will therefore do significantly worse than middle to high income families' funds.

2.7 We are concerned that a scheme that was specifically designed to enhance aspirations and engender a greater sense of financial security amongst poorer families may in fact disproportionately benefit better off families. According to calculations undertaken by The Share Centre, which has information about the CTF on its website, a child who receives £250 and has a family who can invest the maximum monthly contribution of £100 a month or £1,200 a year over the full 18 years will have a baseline fund of £21,850 (excluding the 7 year Government 'top up'). At 7% return per annum, the value of this fund at age 18 would be £41,860 (before inflation). [14]

2.8 On the other hand the Inland Revenue calculates that if a family simply invests the £250 initial sum and it grows by 7 per cent over the 18 years, it would be worth £456, after taking into account an inflation rate of 2.5%. If the original endowment is £500 it would be worth £911.[15] Clearly poorer children who fall just below the threshold for an additional endowment, and whose parents cannot make additional contributions, will receive least aged 18.

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[13] Quoted in *Child Trust Funds Bill* Bill 1 of 2003-04 (Library Research paper 03/90, 12 December 2003, House of Commons Library) p18

[14] These figures can be viewed at www.share.com/ctf/about.html

[15] These figures are taken from *Detailed proposals for the Child Trust Fund* (HM Treasury, 2003)

2.9 These enormous potential financial disparities would compound financial, social and educational inequalities and exacerbate problems with 'transmitted' disadvantage and low social mobility when children reach 18. (See section 7 below) They negate the concept of 'progressive universalism'.

2.10 Better-off families will also benefit from favourable tax arrangements. Although dividends are taxed at source with the CTF, there is no capital gains tax and no further income tax to pay. According to calculations issued by the Share Centre (see para 2.7 above) the combination of parental contributions of £100 a month and 7% growth (resulting in a CTF worth £41,860) could generate a tax-free growth of over £30,000.

2.11 There is a risk that families will end up with *less* money than originally invested. All investments carry a financial risk which better-off families can cope with, but may prove devastating for low income families who do not have any financial security nets.

2.12 Unsurprisingly, lower income families are unlikely to avail themselves of potentially profitable but risky schemes. A survey undertaken by the Association of British Insurers (ABI) reveals that 42% of parents are most likely to invest their child's CTF in a deposit account as opposed to alternatives that may be more appropriate for long-term investments such as stakeholder account (20%) or accounts that invest in the stock market (9%). [16]

2.13 ABI are also concerned that the CTF will constitute a disincentive to save for parents who also have a child born before the September 2002 cut-off date for the CTF who are concerned about sibling inequity.

2.14 The availability of schemes is an ongoing source of concern. Fidelity Investments, the UK's biggest retail fund manager, withdrew from the CTF scheme, just weeks before the Inland Revenue was due to send information and vouchers to families. Analysts said that fund managers were likely to find the CTF market unprofitable because the grants were too small to justify the administrative costs associated with investing them. However, a commentator observes "If there is a limited choice of providers, people investing their CTF money will not have access to the best fund

[16] The survey was commissioned by the ABI and carried out by YouGov in January 2005, among a sample size of 338 parents in the UK.

managers." [17] There are other problems with the management of funds. For example, more profitable schemes may not be available in disadvantaged areas.

2.15 Low-income families are already excluded from many financial services because of a lack of assets or credit score, or products not being advertised in poorer areas. It is possible that even if more profitable schemes are available, poorer families may be excluded from participating.

2.16 Although asset-based welfare policy should be explicitly redistributive - the state should not only ensure that inputs are pro-poor, but that outcomes are as well – the CTF does not appear to fulfil this remit.

**3. Income adequacy**

3.1 There is, of course, a direct link between inadequate income and a low accumulation of financial assets.

3.2 However, far from engaging with benefit adequacy, the Government has avoided any suggestion that the CTF is an effective means of redistributing wealth. Indeed, in a speech to the IPPR on 7 June 2000, David Blunkett suggested that it might be more beneficial to invest in asset-based welfare than invest equivalent amounts on increases to income support or child tax credit, because assets have an 'independent effect on individuals' life chances and attitudes, above and beyond such factors as their social class background of educational achievement.' [18] This argument does not engage with the fact that people living in low income households cannot, and should not be expected or made, to save out of incomes that are already too low to live on.

3.3 Income adequacy is an essential pre-requisite for the accummulation of assets, but there is little in the new scheme to help low income families save for the future. Indeed, for families on very low incomes, attempts to save will further sap inadequate incomes and may draw families into debt.

3.4 The Government recognises that the poorest and most disadvantaged children need financial security during their childhood. These children will be adversely affected if their parents attempt to contribute to their CTF out of incomes that are already inadequate to meet current needs. In fact, families who are at greatest risk of living in severe and persistent poverty – and would benefit most from having

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[17] Gibson, Alison. 'Fidelity pulls out of Child Trust Fund', *Financial Times,* 16 December 2004.
[18] Emmerson, C., Wakfield, M. *The Saving Gateway and the Child Trust Fund: Is Asset-based welfare 'well fair'?* (Institute for Fiscal Studies, Commentary 85, 2001) p10.

savings and assets - are the least able to contribute to the CTF and so their children will derive least benefit from the scheme.

3.5 High levels of inequality and low levels of social mobility are the direct result of inadequate income levels – which could be compounded by the CTF.

**4. Saving on a low income**

4.1 The Government emphasises 'behavioural benefit of saving' arguing that 'there is some evidence to suggest that the *process* of saving has a positive impact on individual's self-reliance, and attitude towards personal development.' [19] It believes that 'the very act of saving encourages greater reliance, forward-planning and an increased willingness to make personal investments.' [20] Families living in poverty often feel inadequate, powerless and helpless because they are unable to save. Failing to save for their child's future may engender additional feelings of inadequacy, powerlessness and guilt amongst parents who cannot contribute to the CTF.

4.2 There are not just serious differentials in potential financial outcomes from the CTF, but the process of saving places an disproportionate burden upon parents from different income levels.

4.3 A lone parent on income support who has one child receives nearly £114.00 a week, or £11,400 a year. (This includes child tax credit and child benefit). If this parent put the full annual amount (£1,200) into her child's CTF, it would constitute just over 10% of her annual income. For richer families, saving £1,200 a year is a significantly lower proportion of income and so it is easier to achieve. Ironically, richer children are more likely than poorer children to have relatives – such as grandparents – who are in a position to contribute to their CTF without incurring major financial hardships.

4.4 Attempting to save for the future when there are not sufficient funds for the present will draw low-income families into debt and could suck families into lending schemes which exacerbate problems by charging high interest rates.[21]

4.5 The poorest children may actually be damaged if their parents attempt to save out of inadequate incomes, leaving even less to spend on them throughout their

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[19] *Saving and Assets for all,* p10

[20] *Saving and Assets for all,* p1

[21] *The Guardian* recently reported on a new credit card aimed at millions of low income families will be charging interest of up to 70 per cent. (Reported by Patrick Collinson in *The Guardian,* February 12 2005*)*

childhood. This will not only blight childhoods, but may actively damage long-term opportunities and aspirations – the exact opposite of the CTF's underlying ethos.

4.6 Saving for the CTF may sap financial 'safety nets' for current and ongoing family needs, which could have a negative impact on children's health and levels of social inclusion in the short term and upon educational outcomes in the long term. Saving out of inadequate incomes could have a detrimental impact upon the health and welfare of all family members – particularly mothers who already go without to safeguard their child's welfare. Trying to save on a low income could also increase stress levels and reduce an individual's ability - and confidence - to access paid employment.

**5. Inequality and social mobility**

5.1 The Government argues that the CTF will help to promote 'inter-generational mobility – extending to the children of lower-income families the opportunities that might be taken for granted up the income ladder' [22] We fear that, for some families the CTF may retain – or actually exacerbate - financial inequality.

5.2 The main beneficiaries of the CTF will almost certainly be better-off families, for whom the accummulation of assets – be they stocks and shares or housing – is already more common. Such families need little incentive to save, nor are they short of the finances necessary to do so. There will also be disparities amongst low-income families, some of whom may have relatives who can contribute, others who will not.

5.3 The Government 'wants more young people to reach age 18 with a financial asset that will provide them with financial opportunities and security – for example, by helping them pay for lifelong learning, or by providing them with money in a savings account they can call on when starting a family, buying a house, or in times of special needs.' [23] However, we are concerned that the poorest and most disadvantaged children – who would derive particular advantages from having access to savings and assets when they are 18, but whose parents cannot contribute to the CTF - will find themselves significantly worse off relative to their peer group when they receive their CTF's aged 18. Furthermore, we are concerned that the

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[22] *Savings and Assets for All* p1.
[23] *Savings and Assets for all*, p1.

CTF may be targeted when a child reaches 18 (for example for educational costs, such as university top up fees, or rental deposits).

5.4 Given the marked disparities between higher income and lower income beneficiaries of the CTF, it seems unlikely it is the most effective way of redressing inequality or increasing social mobility.

**6. Social stigma and financial education**

6.1 The Government argues that 'the CTF could also be used to link into broader social concerns such as civic responsibility, community service or educational achievement.' [24] It believes the CTF will be particularly effective in boosting aspirations amongst poorer children who are severely disadvantaged by social financial exclusion.

6.2 However, if poorer children are aware that their CTF is doing significantly worse than their richer school friends, it may have a negative impact on their self-esteem, aspirations and educational attainment levels and lower expectations of themselves generally. Access to their CTF when they are 18 will not redress educational disadvantages, stigma or social exclusion experienced during childhood.

6.3 We are concerned that the financial differentials discussed above, related to disparities in income and ability to save, may be compounded along disability/ethnicity grounds. Far from benefiting poorer children, it could lead to them being further stigmatised in schools - particularly if teachers discuss CTF's as part of 'financial education' and children compare how their CTF is doing in both the classroom and playground.

6.4 Families already incur significant additional educational costs.[25] Poorer children are already excluded from some forms of educational provision (such as school trips) because their parents are unable to make a financial contribution. The CTF might exacerbate a sense of educational exclusion.

6.5 Poorer children may be the source of moral approbrium when, aged 18, their CTF provides them with little or nothing in the way of financial security.

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[24] *Savings and Assets for all,* p19

[25] See, for example, Brunwin, T., Clements, S., Deakin, G., and Mortimer, E. *The cost of schooling* (Research Report 588, DfES, 2005)