NEW ECONOMICS FOUNDATION

CAPPING AMBITIONS

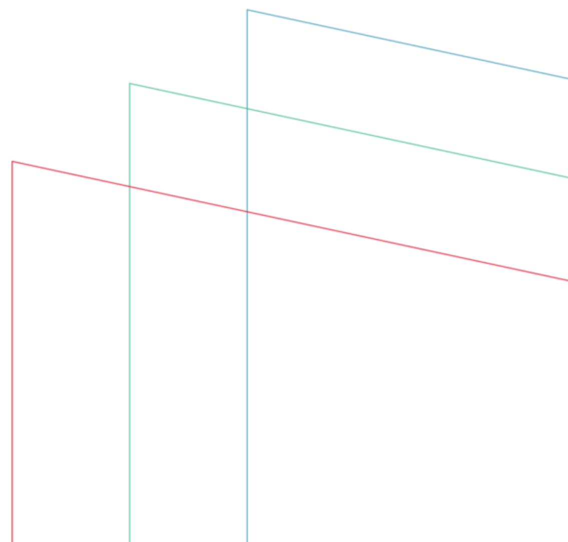
RECOGNISING THE ECONOMIC BENEFITS OF REDUCING CHILD POVERTY BY SCRAPPING THE TWO-CHILD LIMIT AND THE BENEFIT CAP

Written by: Sam Tims
Published: October 2024

New Economics Foundation
www.neweconomics.org
info@neweconomics.org
+44 (0)20 7820 6300

NEF is a charitable think tank. We are wholly independent of political parties and committed to being transparent about how we are funded.

Registered charity number 1055254
© 2024 The New Economics Foundation



CONTENTS

Executive summary **3**

The harmful current and future impacts of the caps **5**

A vital foundation for the child poverty strategy **10**

The wider economic benefits of reducing child poverty **13**

Better accounting for the economic benefits of social security 13

The child poverty strategy requires longer-term appraisals 17

Conclusion **20**

Appendix A: Modelling methodology **21**

Appendix B: Table of results **22**

Endnotes **23**

EXECUTIVE SUMMARY

The introduction of a cross-departmental taskforce dedicated to reducing child poverty is a positive signal of intent from the new government.[1] The drivers of poverty are wide-ranging, and a serious government response must be as well. That the strategy will explore all available levers is welcome, but this must not obscure the need to tackle the most direct drivers of child poverty. To ensure ambitions are not limited from the outset, the child poverty taskforce must acknowledge the ongoing harm that families are experiencing due to the inadequacy of the social security system the government has inherited.

For too long, social security and its associated costs have been viewed as something to be contained and cut. But if adequately funded and designed to provide genuine support, the income safety net can reduce poverty and prevent destitution, ease demand on other public services, and stimulate economic growth in areas where it has been most absent.

To realise the ambitions of the child poverty strategy, and to make a downpayment on its growth agenda, the new government should revoke the two-child limit and benefit cap. Ending these policies from April 2025 onwards will cost central government £2.5bn a year, rising to £3.5bn by 2029/30. The two-child limit constitutes the majority of these costs at £1.9bn and £2.6bn respectively. However, we argue that these costs will be significantly offset by short, medium and longer-term economic gains.

If these caps are retained, half of larger families (49.4%) are forecast to be living in relative poverty after housing costs by the end of this parliament. Removing the caps will reduce this by almost a sixth to 41.5%. Not only will scrapping these policies immediately lift 280,000 children out of poverty and reduce the depth of poverty for an additional 980,000, it will also boost economic activity. Based on the default fiscal multipliers employed by the Office for Budget Responsibility (OBR), gross domestic product (GDP) will increase by up to £1.5bn in the first year (depending on how the policy decision was funded), with the effects on GDP fading entirely after five years. If just the two-child limit was scrapped, the OBR would expect GDP to increase by £1.1bn in 2025/26.

We argue, however, that the OBR should revisit the size and longevity of their fiscal multipliers for these policies, accounting for the specific impact on families most likely to live in poverty. Furthermore, in areas where significant numbers of people will benefit from the ending of these caps, consumer and, in turn, business confidence will increase, enabling employers to make more long-term, productivity-enhancing decisions. Constituencies in Birmingham, Bradford, and Bolton will be among the largest beneficiaries of scrapping the two-child limit, each receiving a stimulus in the region of £10m a year.

To properly account for the effects of poverty reduction, a wider set of factors should be considered over a longer timeframe by the OBR. In reducing child poverty rates, pressures

on the NHS, schools, and social services will reduce, enabling the reallocation of resources to other areas of high demand. Not all these gains will materialise straightaway – the effects of poverty can be long lasting – but they are currently ignored entirely in OBR forecasts. We estimate that the reduction in child poverty in 2025/26 corresponds to lower demand for public services of £1.5bn a year over the medium-term. There are also real long-term gains to be realised. Reducing the poverty burden on children will lead to a healthier, better educated labour force in the future, increasing the productive capacity of the economy and unlocking higher earnings. For those children who in 2025/26 would not grow up in poverty, or in as deep poverty, we estimate their future net earnings to be £920m a year higher, with an additional £490m returned to government through taxation and reduced spending on social security.

While the gains would not yet be fully realised, we estimate that the total cost of child poverty would be £3.0bn a year (7.1%) lower in 2025/26 if both policies were removed from April 2025. By the final year of the parliament, the total reduction in the cost of poverty would be £4.0bn a year (8.7%), with the two-child limit alone contributing £3.2bn (7.0%). With the Chancellor already suggesting amendments to the OBR's forecasting, further considerations should be made to appropriately support the work of the child poverty taskforce.[2] Where policy decisions have a large impact on child poverty, the OBR should consider the wider benefits and adopt a longer timeframe for their modelling. To ensure impacts feed through into the labour force, and account for wider, less direct impacts of social security policy, a timeframe of 20 – 25 years should be considered.

Similarly, to ensure at least the medium-term benefits are accounted for in government decision making, the current five-year timeframe for the fiscal rules must be extended. By scrapping the two-child limit and benefit cap, the government would begin to reverse the sustained increases in poverty rates for larger families, boost spending in the most deprived parts of the country and help to reduce pressure on our struggling public services. Building on this with a wide-ranging agenda that accounts for the long-term social and economic benefits of improved childhoods would place the government on a trajectory to repeat the poverty reducing successes of the last Labour government.

THE HARMFUL CURRENT AND FUTURE IMPACTS OF THE CAPS

There has never been a consistent and meaningful connection between social security and living costs, with support mostly set at arbitrary rates and uprated by a measure of inflation.[1] The gap between the cost of living and support from social security grew in the 2010s, as the result of cuts and freezes. The erosion of the income safety net left households with little, if any, financial security on the eve of the pandemic – 31% of families could not afford a decent standard of living in December 2019.[3]

Among the most egregious of these cuts are the two-child limit and benefit cap. Not only do these policies create severe additional hardship for low-income households, but they misalign the needs of a family with their entitlement, and the effects are almost entirely targeted at children and parents. The two-child limit currently impacts 1.6m children while 87% of benefit capped families include children.[4, 5]

Table 1: London experiences the benefit cap more than any other region

Number of children impacted by the benefit cap in May 2024, and total gain if benefit cap removed in 2025/26 based on May 2024 caseload, by region

Region	Children impacted by the benefit cap	Quarterly increase	Gain to region if benefit cap removed
North East	8,900	3,000	£7,100,000
North West	32,900	12,300	£29,700,000
Yorkshire and The Humber	23,800	8,400	£20,700,000
East Midlands	18,600	7,400	£15,600,000
West Midlands	37,300	14,700	£34,000,000
East of England	32,400	10,800	£40,000,000
London	61,700	16,400	£134,200,000
South East	46,700	14,800	£63,900,000
South West	19,500	7,000	£20,300,000
Wales	11,400	3,900	£9,700,000
Scotland	11,400	3,900	£9,900,000
Great Britain	305,000	103,000	£385,000,000

Source: DWP, stat-xplore and OBR, economic and fiscal outlook March 2024

Introduced in 2013, the benefit cap places a limit on the support families can receive from means-tested benefits. A grace period exists to prevent a family newly receiving means-tested benefits from being hit by the cap. There are several other exemptions, including for families with net earnings above £793 a month, those with caring responsibilities, and

[1] Where not impacted by the spare room subsidy, support for social housing can meet need.

people with disabilities and health conditions that limit their ability to work. Yet there are 123,000 families to whom neither the grace period nor exemptions apply, reducing their average annual income by £3,100. The number of children impacted by the benefit cap has increased by 103,000 in the three months to May, due to uprating of 6.7% in April (Table 1).

London stands out when observing the current impact of the benefit cap. Almost one in three (31%) of families impacted by the cap live in London, with these households missing out on 35% of the total income lost to the benefit cap. However, only 20% of the children impacted by the cap live in London, where high housing costs require higher housing benefits leading to a higher likelihood of families with and without children being capped, despite the benefit cap in London being higher. Nationally, more than half (52%) of the 305,000 children impacted by the benefit cap live in larger families, and thus, depending on the age of their youngest sibling, are at risk of being hit by the two-child limit.

Indeed, there are at least 27,000 families impacted by both the benefit cap and the two-child limit.[6] As of April, the latter restricted support for 440,000 families with a third or subsequent child born after April 2017. For every child element of universal credit and child tax credits lost because of this policy, a family misses out on almost £3,500 a year. By the end of this parliament, we expect almost one in seven children (1.9m) to be impacted by the cap, 300,000 more than now (Figure 1).

Figure 1: One in seven children will be impacted by the two-child limit by 2029/30

Outturn and forecast number and percentage of children impacted by the two-child limit

Source: NEF analysis of DWP, two-child limit statistics and family resources survey using the IPPR tax-benefit model.

Note: Values are the midpoint of April that financial year and the following. The number of children impacted in April 2018, 2019, and 2020 are imputed using the average ratio of benefit units to children impacted in following years.

Constituencies in Birmingham, Bradford, and Bolton are among the most impacted by this cap. Approximately £10m will be denied to local economies in the most impacted constituencies this financial year (Table 2). Over £30m of potential income will be lost across the five Bradford constituencies this year alone. A full list of constituencies in England and Wales is available upon request.

Table 2: Constituencies in Birmingham, Bradford, and Bolton are the most impacted by the two-child limit

Number of children impacted by the two-child limit, and total income lost in the 10 most impacted constituencies in England and Wales in 2025/26 based on April 2024 caseload

Constituency	Children impacted by the two-child limit	Income lost
Birmingham Ladywood	10,100	£11,900,000
Bradford East	9,400	£10,600,000
Bradford West	8,600	£9,800,000
Bolton South and Walkden	8,300	£9,800,000
Birmingham Hodge Hill and Solihull North	7,900	£9,400,000
Leeds South	7,800	£9,000,000
Blackley and Middleton South	7,400	£8,600,000

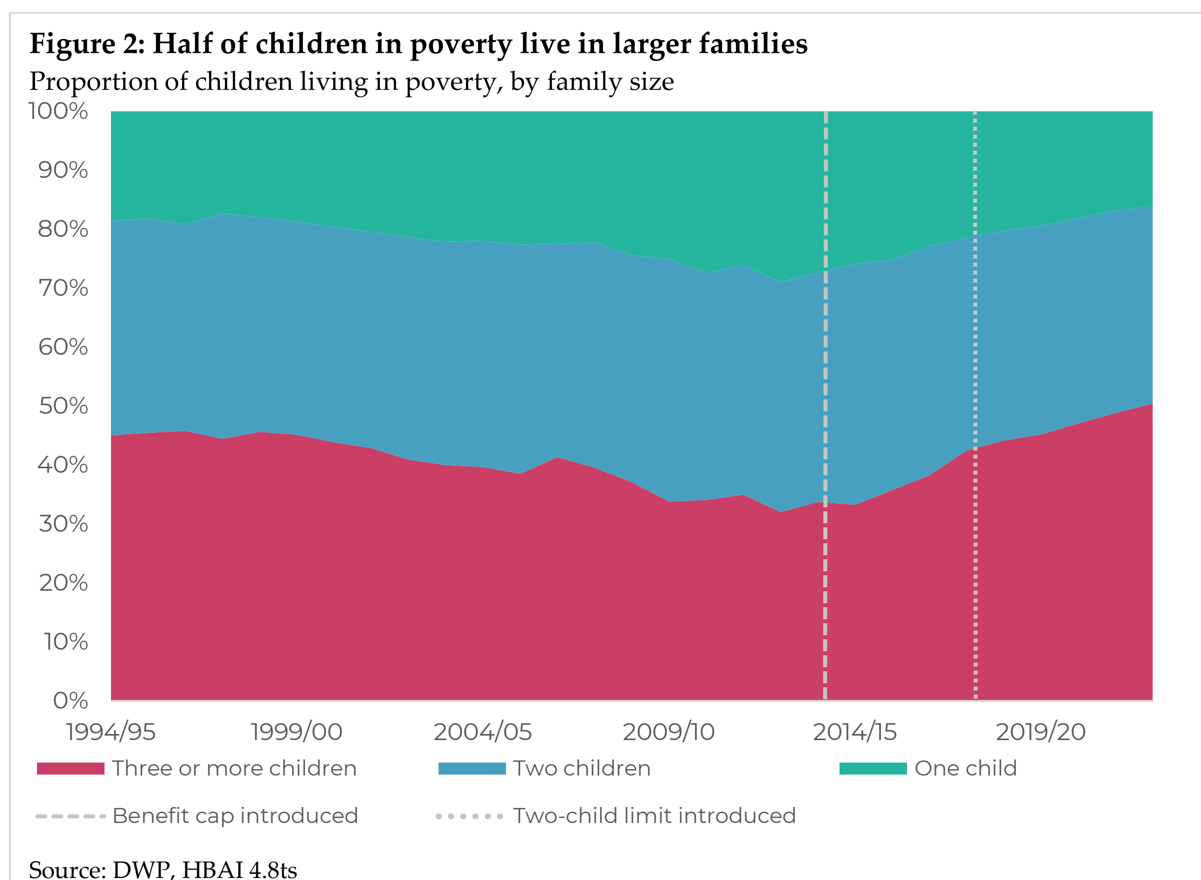
Walsall and Bloxwich	7,100	£8,200,000
Gorton and Denton	6,900	£8,200,000
Blackburn	7,200	£8,200,000

Source: NEF analysis of FOI 53647 and 92542

Note: Estimates for child tax credit is imputed using national totals and constituency level data for universal credit. We assume no interaction with the benefit cap in calculating lost income. Lost income calculated by number of child elements removed

Since 2015, child poverty has risen six times faster in the most deprived areas of the country compared to the least.[7] Among the areas with the fastest increases in child poverty are Bradford, Birmingham, Manchester, and Leicester. There are a number of reasons for this, including that in 63% of local authorities average wages have yet to recover to their 2008 peak.[8] But these caps are significant drivers – more children are impacted by the two-child limit in the areas that have experienced larger increases in child poverty. While poverty rates have remained broadly constant for smaller families, they have increased for families with three or more children, with half (50%) of children living in poverty now in larger families. This was just one third (32%) in 2012/13, just before the introduction of the benefit cap, and sat at 43% in the first year of the two-child limit (Figure 2).

Figure 2: Half of children in poverty live in larger families
Proportion of children living in poverty, by family size



Source: DWP, HBAI 4.8ts

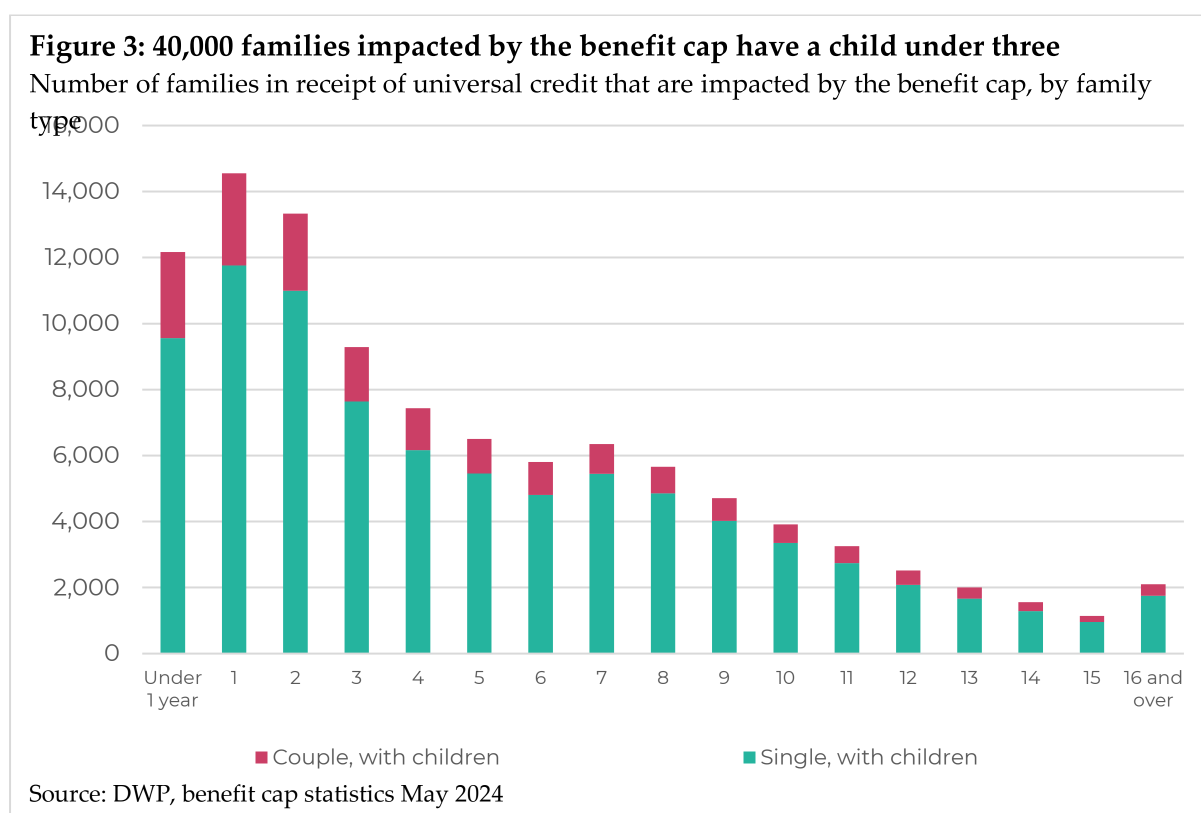
These harmful policies also highlight the marked shift in the expectations placed on single parents by the benefits system. Two decades ago, most lone parents would not have been required to seek work, and thus been exempt from the benefit cap were it in place then. Now

they make up 69.0% of all families impacted by the benefit cap. Not only have the employment expectations changed, but the benefit cap stands in contrast to headline conditionality rules.

Figure 3 shows that there are 32,000 lone parents in receipt of universal credit (UC) with a child under three that experience a reduction in support because of the benefit cap. To avoid the benefit cap, they would need to work at least 16 hours a week at the national living wage, and yet, because they have a young child, according to their claimant commitment they are not expected to work. Inconsistencies like this are far too common in our social security system. Removing the two-child limit and benefit cap will make the system easier to navigate and provide much needed support to families. This must be a priority for the new government as part of its planned child poverty strategy.

Figure 3: 40,000 families impacted by the benefit cap have a child under three

Number of families in receipt of universal credit that are impacted by the benefit cap, by family type



Source: DWP, benefit cap statistics May 2024

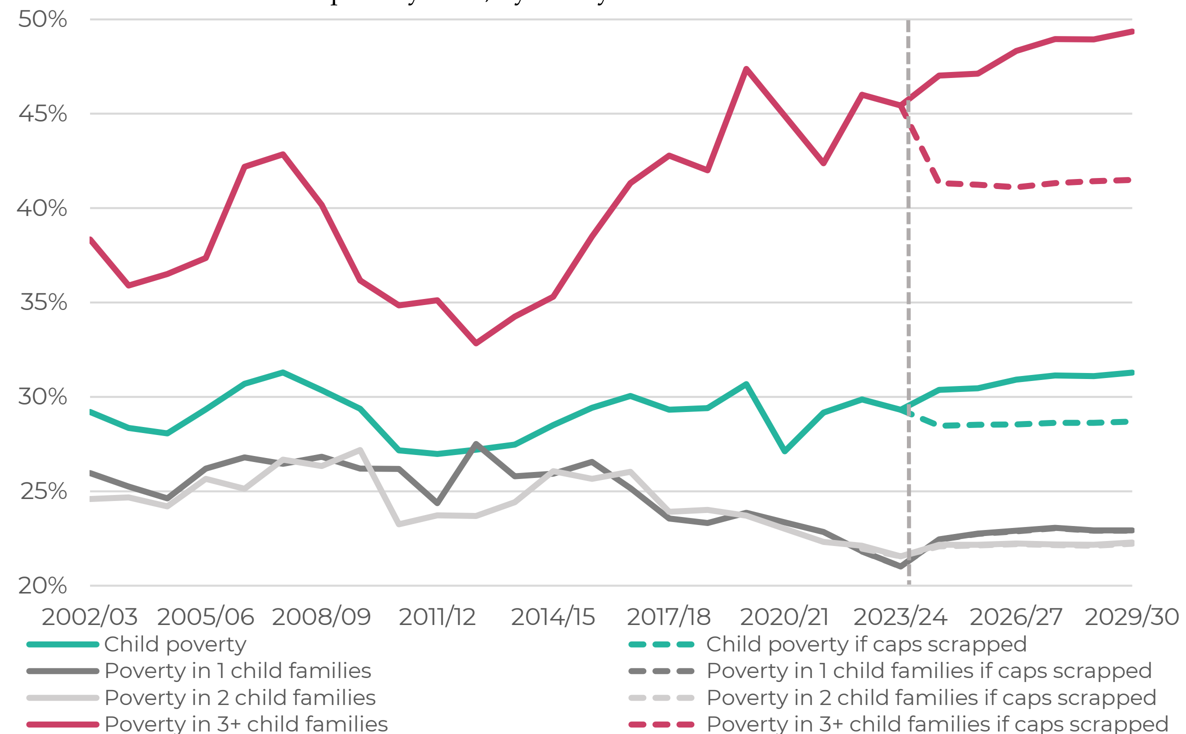
The number of families hit by the cap falls steadily as the age of the youngest child increases and work becomes more accessible for parents, with the high cost of childcare becoming less of a barrier. There are 57,000 families with a child under five impacted by the cap. Recent benefit cap data by gender is not easily available, but the vast majority of those impacted are single mothers.[9]

A VITAL FOUNDATION FOR THE CHILD POVERTY STRATEGY

The new government has rightly moved quickly to establish a cross-departmental taskforce to develop a child poverty strategy, with all policy levers that can reduce hardship on children within its purview. The need for a bold approach to tackling child poverty is clear. On current trends, headline child poverty is forecast to rise by 0.9 percentage points by the end of this parliament (Figure 4). This is driven almost entirely by rising poverty rates for families with three or more children. By 2029/30, we expect half (49.4%) of children from larger families to be living below the poverty line.

And yet, despite being the most effective levers the state can pull to rapidly ease poverty, the government has so far resisted calls to scrap the two-child limit, with the benefit cap receiving little, if any, attention. In failing to address either policy, they risk placing a ceiling on the ambitions of the child poverty strategy.

Figure 4: Scrapping the caps will reduce child poverty in larger families by a sixth
Outturn and forecast child poverty rates, by family size



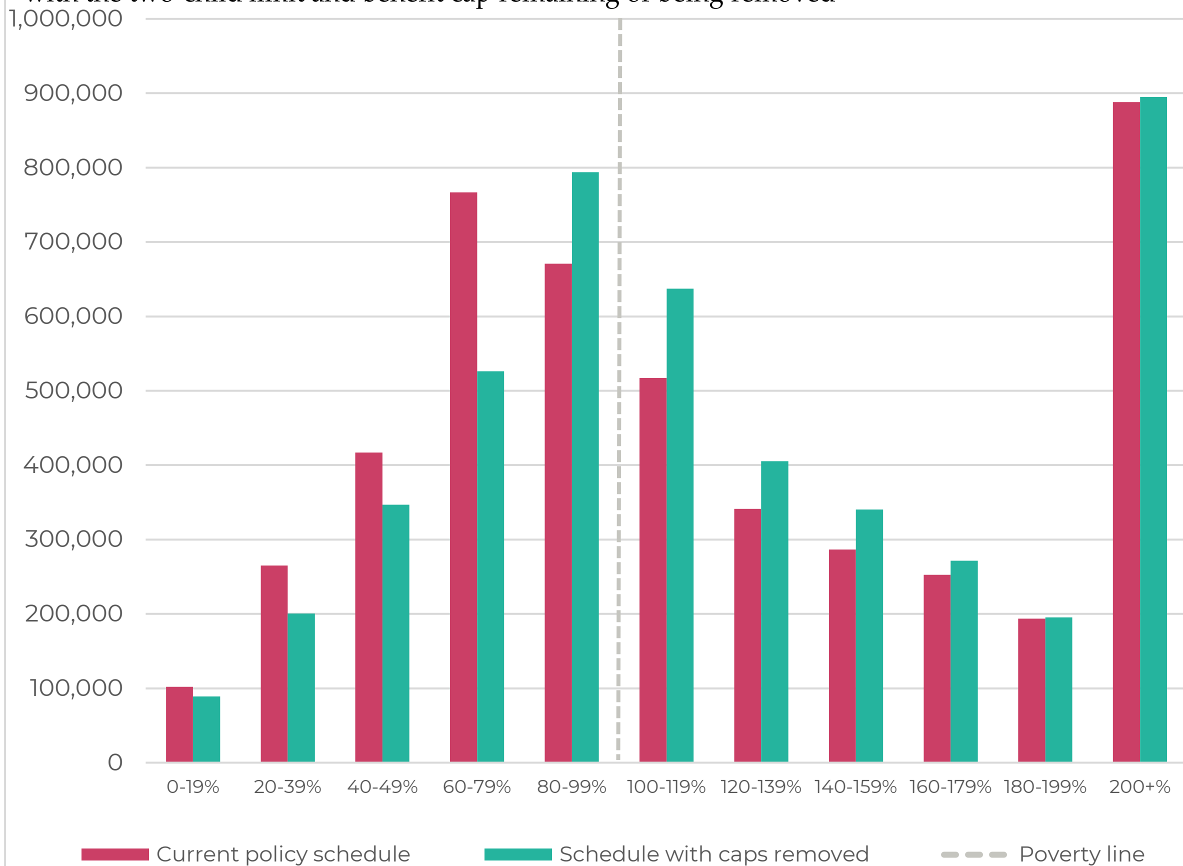
Source: DWP, HBAI 4.18ts and NEF analysis of family resources survey using the IPPR tax-benefit model.
Note: Poverty rate estimates produced by the IPPR tax-benefit model are calibrated to HBAI.

Revoking the two-child limit and benefit cap from April 2025 would cost central government £2.5bn in 2025/26 but would immediately reduce child poverty in larger families by 5.9 percentage points. By the end of the parliament, poverty rates for children in larger families will be a sixth (15.9% or 7.9 percentage points) lower than if both caps are

retained. In lowering the poverty rate for larger families, the new government would reverse the trends of recent years, returning their poverty rate to a level not seen since 2016/17. The two-child limit constitutes £1.9bn of this cost in 2025/26, with the benefit cap adding an additional £670m. Note this cost estimate for the benefit cap is sequenced after the two-child limit – the cost of scrapping the benefit cap by itself would be lower. Department for Work and Pensions (DWP) expenditure on improved support for larger families will rise to £3.5bn by the end of the parliament, primarily driven by the counterfactual of the ongoing rollout of the two-child limit which would impact more families over time. Full details can be found in tables B1 and B2 in the appendix.

As well as lifting 280,000 children out of poverty in 2025/26, scrapping both the two-child limit and the benefit cap will ease the poverty burden – the extent to which incomes fall short of the poverty line – for an additional 980,000 children. By 2029/30, the impacts rise to 370,000 and 1.2m children respectively. The easing poverty burden is shown by the rightward shift in Figure 5, but it also underlines the need for an effective strategy to follow what should be an obvious first step in reducing child poverty.

Figure 5: A wider child poverty strategy is required beyond scrapping the caps
Distribution of children according to household income relative to the poverty line in 2025/26, with the two-child limit and benefit cap remaining or being removed



Source: NEF analysis of family resources survey using the IPPR tax-benefit model.

The detrimental impacts of these policies are clear, and the wider literature shows that neither policy is achieving its behavioural objectives, with birth rates unaffected by the two-child limit.[10] In weakening family finances, the state is more often than not pushing parents – many of whom have existing and significant barriers to paid work – further from the labour market. This shouldn't come as a surprise, the rationales for these policies were, and still are, ill-conceived. We need a strong income safety net that adequately accounts for our needs. Doing so not only reduces the scarring effects of poverty on individuals, but also improves the health of local economies in poorer parts of the country.

THE WIDER ECONOMIC BENEFITS OF REDUCING CHILD POVERTY

Overturning economic malaise and creating shared prosperity requires both public and private investment to be directed towards areas with severe levels of hardship and struggling local economies. To measure the impact of such public spending on the economy over the short- to medium-term, the OBR first uses fiscal multipliers. Further considerations are then made where the effects of a policy are deemed to be longer lasting.

However, the OBR's current approach risks underestimating the strength of welfare multiplier effects while ignoring the wider benefits of policies that tackle child poverty. Indeed, in this section we find significant benefits from reducing child poverty that will exist beyond a five-year timeframe. Even if the OBR were to recognise these medium- and long-term gains, the fiscal framework would not, with poverty alleviation undervalued as a result. To ensure at least some of these benefits are accounted for in government decision making, the current five-year timeframe for the fiscal rules must be extended. In better recognising the benefits for people, places, and the economy as a whole, the government will be giving the child poverty strategy the best possible chance to succeed.

BETTER ACCOUNTING FOR THE ECONOMIC BENEFITS OF SOCIAL SECURITY

Fiscal multipliers estimate the extent to which changes in government spending generate secondary effects in the wider economy through shifts in aggregate demand. For every £1bn spent by the government on social security, the OBR would score an increase in GDP of up to £600m in the first year of the policy (the impact multiplier) due to higher spending by those benefitting from the policy change. In the case of revoking the two-child limit and the benefit cap from April 2025, the OBR would expect GDP to be £1.5bn higher in 2025/26. The value of the multiplier has a significant impact on government decision making. For example, the underestimation of the size and longevity of multiplier effects incorrectly predicted that debt-to-GDP would fall and there would be no long-term economic fallout from austerity measures.[11, 12]

The overall effect depends in part on the source of the funding. The maximum gain could be achieved through additional borrowing. If the policies were instead paid through general tax rises, the OBR estimates that GDP would increase by £270m. However, if the policy could be funded while reducing government spending in an area with a low multiplier this might result in an increase closer to the max, like reducing the gains to high-income households from ISAs. That the OBR use a multiplier for social security that is greater than the multiplier for tax is likely due to assumed differences in the marginal propensity to

consume (MPC) of people targeted by a policy. The MPC – the amount of new income spent rather than saved – is highest for low-income households because they are more likely to spend rather than save any additional income. The same multiplier estimates are assumed for positive and negative changes in spending, despite evidence suggesting the MPC for low-income families experiencing a reduction in income are larger than when income changes are positive.[13]

Table 3: Social security spending is a strong choice of investment for the new government

Default fiscal multipliers used by the OBR

Category of multiplier	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Public investment	1	0.83	0.43	0.23	0.07	0
Public services	0.45	0.42	0.29	0.13	0.04	0
Social security	0.6	0.57	0.43	0.23	0.07	0
Tax	0.33	0.3	0.23	0.14	0.05	0

Source: OBR, dynamic scoring of policy measures in OBR forecasts [accessed 12th September 2024]

The impacts upon GDP are assumed to fade to zero by the fifth year of the policy – the end of the forecast period. The OBR expects that changes in monetary policy and wages compensate for the increase to aggregate demand, returning output to its estimated potential by the fifth year. The potential of the economy, and therefore the gap between actual and potential output, is unobservable but is often theorised to be determined by supply-side factors such as population growth and the participation rate.

Despite the importance of this measure, there is no consensus over the size of the output gap nor how quickly it may close.[14] If the output gap is estimated incorrectly, to the extent that resources are being permanently underutilised, then the secondary effects of a change in demand could also be long-lasting, if not permanent. Some also argue that the concept of potential output lacks validity, the key argument here being that rooting forecasts in historical trends has significant and negative implications on economic policy.[15]

The IMF has previously argued that multipliers should be increased by up to 60% when the output gap approaches its largest historical negative value – when the economy is at the lowest point in the economic cycle.[16] Utilising this approach could increase the year zero social security multiplier in Table 3 to as far as 0.96 in certain economic conditions. A decrease of up to 40% was recommended for when the economy is overheating. Despite the economic turbulence of the 2008 crash, a decade of austerity, the pandemic and now the cost of living crisis, the OBR's social security multiplier has remained at its starting point of 0.6 since 2010.[17] This is in part driven by the range of views on the appropriate magnitude of multipliers.[18]

That the variation in the output gap has little, if any, effect on the size of the OBR fiscal multiplier is a potential limit on the applicability of a default multiplier for all types of social security policy. Intuitively, awarding the same set of fiscal multipliers to all increases and

decreases in social security spending contrasts with the range of recipients for universal, contributory, and means-tested benefits. It is incredibly unlikely that the MPC of every pensioner benefitting from the triple lock on the state pension, or of higher-earning parents losing eligibility to child benefit, is the same as those impacted by the two-child limit or the benefit cap. In keeping with the eligibility criteria of means-tested benefits, these are low- and middle-income families. These families will spend more of any additional income they receive than their higher-income counterparts.

The current ability for OBR to tailor their multipliers to specific policies is limited. Pragmatically, the OBR lacks capacity to make bespoke multiplier estimates for every policy and is therefore limited to existing evidence which tends to generalise over large areas of policy. But where the broad categorisation of policies limits forecasting, where policy breaks new ground, or where the underlying economic conditions make past events less relevant as predictors of future outcomes, it is important to consider alternative approaches. In forthcoming work, NEF will propose an alternative framework for estimating multipliers that will better account for the specifics of a policy while improving the clarity the OBR provides on its projections. In particular, investment into our threadbare income safety net will be treated more positively under this framework.

Indeed, models have found large social security multiplier effects within a UK context, with positive and negative impact multiplier of 1.5 and 1.8 respectively.[19] These are far above the OBR's value. As the fifth least equal country within the OECD, it is also likely that the effects of social security spending would be magnified.[20] Meta-analysis of international evidence also suggests that the OBR is underestimating its fiscal multiplier for social security policies. [21] This comparative study also found that such spending would likely produce more positive and persistent multiplier effects than other forms of government policy, effects that are sustained beyond the OBR's five year forecast period

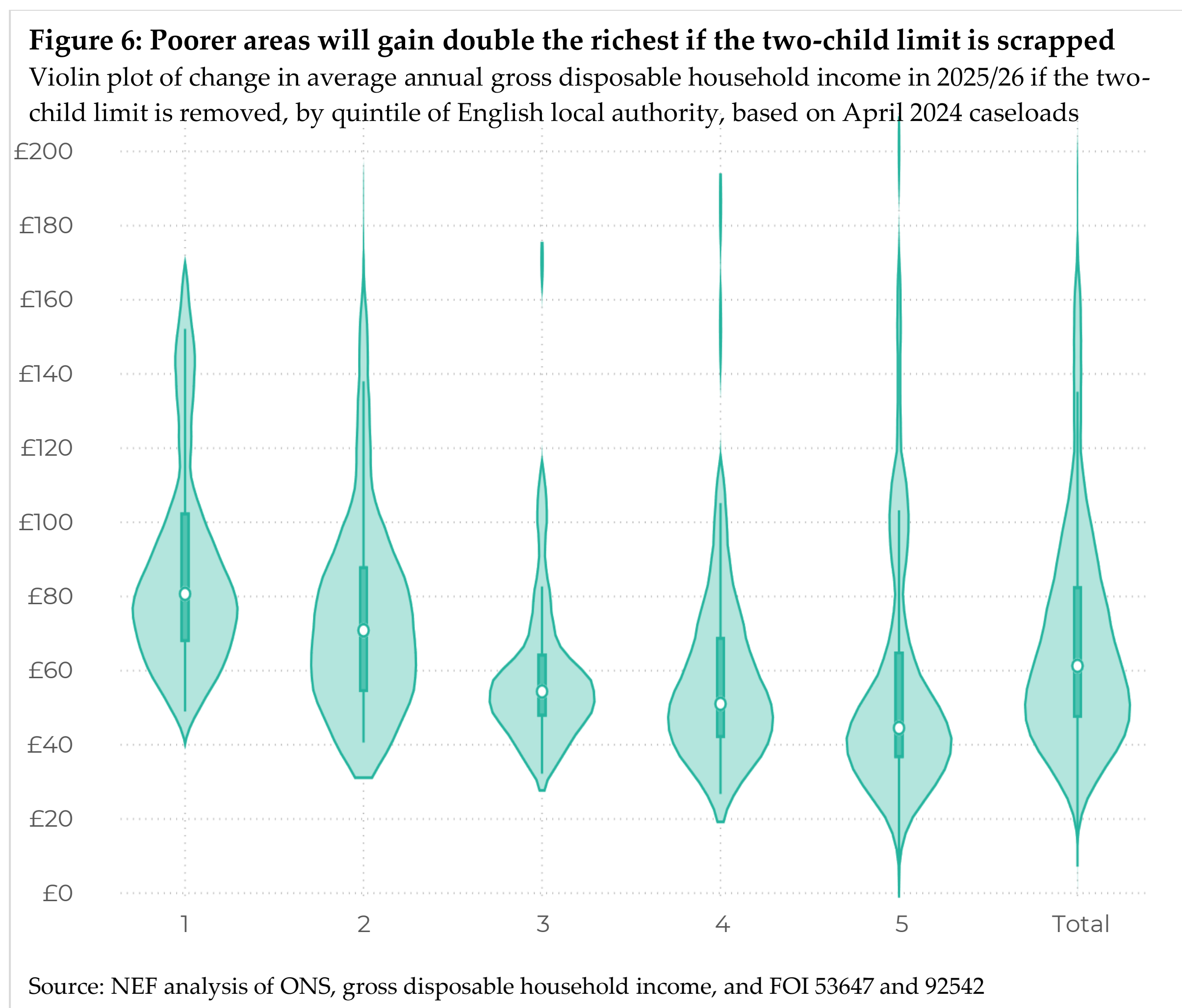
Beyond the short-term impacts on GDP expressed through multipliers, the OBR considers whether a policy is expected to interact with the supply side of the economy, and thus be longer lasting under their framework. For social security spending, this typically is considered by the interaction with the labour market.[22] As discussed above, neither the two-child limit nor the benefit cap have improved work outcomes. Instead, research has highlighted the counterproductive interactions parents have had with the labour market as a direct result of these caps. If deemed large enough, and if believing the evidence to be sufficient, the OBR may factor such impacts into their estimate for the potential of the economy.

It is unclear whether other sustained effects that result from permanent reductions in child poverty and the redistribution of demand are accounted for. In scrapping the caps, meagre consumer confidence among low-income families will improve, signalling to businesses that demand is set to grow in areas with higher levels of hardship. Confident firms make more

long-term, productivity-enhancing decisions, like investing in the skills of their employees and upgrading equipment.[23]

Every part of the country will benefit if the two-child limit is scrapped. But Figure 6 underlines the extent to which removing the limit will lift consumer and business confidence in areas currently lacking in demand. In the poorest quintile of English local authorities, the annual income of the median household – that is of all households, not just those impacted by the two-child limit – will increase by £80 in 2025/26, double that in the richest 20% of local authorities (£40). Scrapping the two-child limit is therefore an efficient way to increase demand in poorer areas of the country, with local economic growth the result.

Figure 6: Poorer areas will gain double the richest if the two-child limit is scrapped
Violin plot of change in average annual gross disposable household income in 2025/26 if the two-child limit is removed, by quintile of English local authority, based on April 2024 caseloads



Source: NEF analysis of ONS, gross disposable household income, and FOI 53647 and 92542

Richer but deeply unequal areas of the country will also benefit from scrapping the two-child limit. Some of the largest increases in average household income would occur in London. Of the 10 local authorities that would experience the largest average increase, three are among the richest quintile – Hackney (£200), Newham (£160), and Tower Hamlets (£150). Outside of the capital, we find a strong negative correlation (-0.67) between median

household gain from scrapping the two-child limit and average gross disposable household income.[2]

THE CHILD POVERTY STRATEGY REQUIRES LONGER-TERM APPRAISALS

For any policy that significantly impacts child poverty, the length of the forecast period is also important in determining the wider impacts. Within the OBR's framework, this has particular relevance where policies can alter the size and skill of the future workforce, not just consumer and firm confidence.

As of 2023, child poverty is estimated to cost us at least £39.4bn in higher current spending on public services and lower future earnings for children growing up in poverty now.[24] In areas with greater levels of child poverty, local and national government spend more on schools and the NHS as well as other public services including social services. While necessary to ease the disadvantage created by poverty and hardship, this downstream spending cannot fully negate the wide-ranging impacts of child poverty – the long-term impacts of hardship must be dealt with at the source.[25] The higher pressure on public services accounts for £20.5bn (52%) of the total cost of child poverty.

Reducing child poverty will therefore ease pressures on public services, enabling resources to be reallocated. While large, these gains will not necessarily occur immediately – the impacts of poverty are long lasting. Once realised, the resulting improvement in children's mental and physical health will ease pressures on the NHS, allowing staff time to be used treating other patients, with the greatest benefit in the north.[26] The secondary effects of reduced demand, for example in health improvements for the wider public, are important gains, but are not considered within our estimates below.

Likewise, reducing child poverty can cumulatively improve attainment throughout a child's time in education, reducing the additional resource spent in closing education gaps.[27] It is worth noting that not all of the effects of poverty are costed within this estimate, for example, the impact on labour market participation for parents discussed earlier. To account for the impact on future earnings of a child better fulfilling their potential, policy impacts also need to be considered over a longer period, enough time for someone to establish themselves in the labour market. A forecast period of 20 to 25 years is therefore necessary.

In partitioning some of the economic and social costs of child poverty, we can identify the potential medium- and long-term gains to society from scrapping the two-child limit and benefit cap. These gains are not simply the result of lifting incomes above the poverty line

---

[2] $r_s(282) = -0.67, p < 0.001$

but will occur wherever the poverty burden is eased. In Figure 5, we saw that alongside making a significant improvement in the poverty rate for larger families, scrapping the two-child limit and benefit cap would also reduce the poverty burden for another 980,000 children in 2025/26. To account for all these children living in poverty that would benefit, we extend the cost of child poverty analysis beyond a binary marker using the following:

$$C_i = C \cdot \frac{G_{S_i} - G_{F_i}}{G_{S_i}} \cdot \frac{f(G_{S_i})K_i}{\sum_i G_{S_i}K_i}$$

Where C_i is the reduction in the cost of child poverty applicable to family i, C is the total cost of child poverty, while G_{S_i} and G_{F_i} are the starting and finishing gap to the poverty line. Fraction $a = \frac{G_{S_i} - G_{F_i}}{G_{S_i}}$ measures how much of the poverty gap has closed as a result of scrapping the caps, K_i is the number of children in the family, and $b = \frac{f(G_{S_i})K_i}{\sum_i G_{S_i}K_i}$ is the proportion of the total starting poverty gap that is applicable to a family. Note that fraction a is capped at one for families lifted out of poverty. Fraction b is greatest for those living in deeper poverty, awarding a larger share of the cost of child poverty to those in the most hardship – that is to say lifting a child from deep poverty to poverty is likely to have a greater impact than lifting them from just below to just above the poverty line. Further, the function f must satisfy that $\sum_i f(G_{S_i})K_i = \sum_i G_{S_i}K_i$. For this analysis we assume that f is linear, but the relationship between depth and cost of poverty warrants further research.

In lifting the two-child limit from April 2025, we estimate the cost of child poverty to fall by £2.2bn (5.3%) a year. Demand for public services would reduce by £1.1bn a year over the medium-term and we would expect the future net earnings of children less impacted by poverty to be £690m a year higher, with a further £370m returned to government. Because of the continued rollout of the two-child limit, the reduction in poverty would be greater by 2029/20. This would lower the cost of child poverty by £3.2bn (7.0%) a year, of which £1.7bn is over the medium-term, with £1.0bn and £540m in higher annual net earnings and tax receipts respectively over the long-term.

If both policies were removed from April 2025, we estimate that the cost of child poverty would reduce by £3.0bn (7.1%) a year. Over the medium-term, £1.5bn could be reused for public services and £920mbn of potential net future earnings could be realised, with an additional £490m returned to government through higher taxes and lower social security spending. By the end of the parliament, the total reduction in the cost of poverty would be £4.0bn (8.7%) lower. Potential demand for public services would be £2.1bn lower, with increased future net earnings of £1.2bn and direct savings to the exchequer £670m higher.

In 2025/26, we estimate 26.3% of all children living in poverty would benefit from the two-child limit and benefit cap being scrapped, 8.8% of all children. By the end of the parliament this rises to 31.3% and 10.7% respectively. More children will benefit from these gains next

year in Wales (13.8%), the north-east (13.3%), and north-west (13.2%), than in other areas (Table 4). The largest cost changes would occur in the north-west (£530m), followed by London (£430m) and the south-east (£340m).

Table 4: The cost of child poverty will be 7.1% lower if the caps are scrapped in 2025/26

Reduction in the cost of child poverty if the two-child limit and benefit cap are scrapped, percentage of children benefitting and percentage of children in poverty gaining in 2025/26

Area	Reduction in cost of child poverty	Children gaining	Children in poverty gaining
North East	£140,000,000	13.3%	34.4%
North West	£530,000,000	13.2%	30.5%
Yorkshire and the Humber	£330,000,000	11.8%	33.0%
East Midlands	£200,000,000	7.5%	24.5%
West Midlands	£250,000,000	9.7%	22.2%
Eastern	£180,000,000	5.0%	19.9%
London	£430,000,000	9.5%	26.8%
South East	£340,000,000	6.6%	25.3%
South West	£170,000,000	5.9%	20.6%
Wales	£220,000,000	13.8%	40.1%
Scotland	£60,000,000	3.9%	13.3%
Northern Ireland	£90,000,000	7.6%	28.6%
Total	£2,950,000,000	8.8%	26.3%

Source: NEF analysis of family resources survey using the IPPR tax-benefit model and CPAG, the cost of child poverty in 2023.

CONCLUSION

To signal the serious intent of the government, the publication of the child poverty strategy in the spring will inevitably require a recommendation to end the two-child limit, with the detrimental contribution of the benefit cap on incomes and wellbeing at least significantly addressed. But with an additional 109 children pulled into poverty by the two-child limit every day since the election and the impact of the benefit cap increasing with large and sustained rent hikes, the government should not wait until the spring to make this decision.[28, 29]

The government should confidently make the case that ending these policies is not only the right thing to do morally, but also economically. It will bring immediate benefits to local economies in disadvantaged areas of the country, relieve pressure on public services over time, and improve the long-term life-chances and earnings potential of the children affected.

Adjusting fiscal rules, economic assumptions, and forecasting to better account for these types of effects should also contribute to a wider shift in thinking about the need for a social security system that ensures everyone's basic needs are met. To align support with living costs, the government should move towards NEF's proposal for a living income, starting with an urgent implementation of an essentials guarantee and the reversal of austerity measures.[30, 31]

APPENDIX A: MODELLING METHODOLOGY

Much of our analysis uses the institute for public policy research (IPPR) tax and benefit model (TBM). This microsimulation engine allows us to analyse the distributional impact of tax and benefit changes on family's representative of the UK population. To estimates the costs of scrapping the two-child limit and benefit cap we make the following adjustments:

- We assume the full rollout of UC in every year of modelling.
- The take-up rate of UC is calibrated to official statistics on the two-child limit for April 2024. As our estimates are for the entirety of the financial year, rather than just the start, we assume that slightly more than 1.6m are impacted by the two-child limit. To approximately match our modelling, we set the overall UC take-up rate to 50%. This produces a take-up rate of 66% among larger families, with slightly over 1.6m children impacted by the cap.
- The IPPR TBM relies on small a sample sizes for the modelling of the benefit cap, which impacts far fewer families than the two-child limit. This produces higher than expected cost and poverty estimates. To account for this, we calibrate our estimates down by approximately 25% to match total reduction in income due to the cap the latest available data.

APPENDIX B: TABLE OF RESULTS

Table B1: Summary of results if the two-child limit is removed

Finding	Year	
	2024/25	2029/30
Cost to central government	£1.74bn	£2.62bn
Children benefitting	1,630,000	1,940,000
That live in poverty	1,100,000	1,430,000
That will be lifted from poverty	220,000	320,000
Reduction in cost of child poverty	£2.05bn	£3.24bn
Lower demand for public services	£1.07bn	£1.69bn
Increased future net earnings	£0.64bn	£1.01bn
Higher future tax and lower social security	£0.34bn	£0.54bn
Percentage reduction in cost of child poverty	5.0%	7.0%

Table B2: Summary of results if the two-child limit and benefit cap are scrapped

Finding	Year	
	2024/25	2029/30
Cost to central government	£2.33bn	£3.52bn
Children benefitting	1,730,000	2,060,000
That live in poverty	1,190,000	1,540,000
That will be lifted from poverty	270,000	370,000
Reduction in cost of child poverty	£2.8bn	£3.99bn
Lower demand for public services	£1.46bn	£2.08bn
Increased future net earnings	£0.87bn	£1.25bn
Higher future tax and lower social security	£0.47bn	£0.67bn
Percentage reduction in cost of child poverty	6.9%	8.7%

ENDNOTES

[1] Prime Minister's Office. (2024). *Ministerial taskforce launched to kickstart work on child poverty strategy*. https://www.gov.uk/government/news/ministerial-taskforce-launched-to-kickstart-work-on-child-poverty-strategy
[2] Partington, P. (2024). *Reeves pushes for OBR to upgrade growth forecasts amid planning reforms*. Guardian. https://www.theguardian.com/business/2024/sep/26/rachel-reeves-obr-growth-forecasts-planning-budget
[3] Tims, S., & Stirling, A. (2022). *The national living income: Guaranteeing a decent minimum income for all*. New Economics Foundation. https://neweconomics.org/2022/12/the-national-living-income
[4] Department for Work and Pensions., & HM Revenues and Customs. (2024). *Universal Credit and Child Tax Credit claimants: statistics related to the policy to provide support for a maximum of 2 children, April 2024.* https://www.gov.uk/government/statistics/universal-credit-and-child-tax-credit-claimants-statistics-related-to-the-policy-to-provide-support-for-a-maximum-of-2-children-april-2024
[5] Department for Work and Pensions. (2024). *Benefit cap: number of households capped to May 2024.* https://www.gov.uk/government/statistics/benefit-cap-number-of-households-capped-to-may-2024/benefit-cap-number-of-households-capped-to-may-2024
[6] Jayanetti, C. (2024). *Scrapping two-child benefit limit 'would still leave 100,000 young Britons in poverty'*. Guardian. https://www.theguardian.com/society/article/2024/sep/01/scrapping-two-child-limit-young-britons-poverty
[7] Tims, S., & Straňák, B. (2024). *Child poverty rises six times faster in most deprived areas compared to the richest*. New Economics Foundation. https://neweconomics.org/2024/03/child-poverty-rises-six-times-faster-in-most-deprived-areas-compared-to-the-richest
[8] Trades Union Congress. (2024). *Pay packets worth less than 2008 in nearly two-thirds of UK local authorities – TUC analysis reveals*. https://www.tuc.org.uk/news/pay-packets-worth-less-2008-nearly-two-thirds-uk-local-authorities-tuc-analysis-reveals
[9] Women's Budget Group. (2020). *Written evidence CVG0004*. Women and Equalities Committee https://committees.parliament.uk/writtenevidence/7274/pdf/
[10] Patrick, R. et al. (2023). *Needs and Entitlements: Welfare reform and larger families, Benefit Changes and Larger Families*. Benefit Changes and Larger Families. https://largerfamilies.study/publications/needs-and-entitlements/
[11] Blanchard, O., & Leigh, D. (2013). *Growth Forecast Errors and Fiscal Multipliers*. International Monetary Fund. https://www.imf.org/external/pubs/ft/wp/2013/wp1301.pdf
[12] Fatás, A., & Summers, L. (2016). *The Permanent Effects of Fiscal Consolidations.* National Bureau of Economic Research. https://www.nber.org/papers/w22374
[13] Bunn, P. et al. (2017). *The consumption response to positive and negative income changes*. Bank of England. https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2017/the-consumption-response-to-positive-and-negative-income-changes.pdf
[14] Stirling, A. (2019). *Time for Demand*. New Economics Foundation. https://neweconomics.org/uploads/files/NEF_Time_For_Demand_2019.pdf
[15] Tooze, A. (2019). *Output gap nonsense*. Social Europe. https://www.socialeurope.eu/output-gap-nonsense
[16] Batini, N., Eyraud, L., & Weber, A. (2014). *A Simple Method to Compute Fiscal Multipliers*. International Monetary Fund. https://www.imf.org/en/Publications/WP/Issues/2016/12/31/A-Simple-Method-to-Compute-Fiscal-Multipliers-41627
[17] Office for Budget Responsibility. (2015). *Economic and Fiscal Outlook*. https://obr.uk/docs/dlm_uploads/July-2015-EFO-234224.pdf

[18] Office for Budget Responsibility. (2012). *Some recent analysis of multipliers*. https://obr.uk/box/some-recent-analysis-of-multipliersa/
[19] Mosley, M. (2021). *Welfare as fiscal policy? Why benefits should be raised, not lowered, during recessions*. London School of Economics. https://blogs.lse.ac.uk/covid19/2021/07/20/welfare-as-fiscal-policy-why-benefits-should-be-raised-not-lowered-during-recessions/
[20] Organisation for Economic Co-Operations and Development. (n.d). *Income Inequality*. https://www.oecd.org/en/data/indicators/income-inequality.html?oecdcontrol-730a127c5d-var6=INC_DISP_GINI [accessed 2024, August 29]
[21] Cardosa, D. et al. (2023). *The multiplier effects of government expenditures on social protection: A multi-country study*. Research Center on Macroeconomics of Inequalities. https://madeusp.com.br/wp-content/uploads/2023/08/wp18_vf_site_att.pdf
[22] Johal, S. (2023). *A review of welfare policy costings*. Office for Budget Responsibility. https://obr.uk/docs/dlm_uploads/Working-paper-20-A-review-of-welfare-policy-costings-1.pdf
[23] Stirling, A. (2019). *Time for Demand*. New Economics Foundation. https://neweconomics.org/uploads/files/NEF_Time_For_Demand_2019.pdf
[24] Hirsch, D. (2023). *The cost of child poverty in 2023*. Child Poverty Action Group. https://cpag.org.uk/sites/default/files/2023-08/The%20cost%20of%20child%20poverty%20in%202023.pdf
[25] Hirsch, D. (2008). *Estimating the costs of child poverty*. Joseph Rowntree Foundation. https://www.donaldhirsch.com/costofpoverty08.pdf
[26] Mccabe, R. et al. (2024). *Implications of child poverty reduction targets for public health and health inequalities in England: a modelling study between 2024 and 2033*. Journal of Epidemiology and Community Health. https://jech.bmj.com/content/jech/78/10/632.full.pdf
[27] Hirsch, D. (2007). *Chicken and egg: child poverty and educational inequalities*. Child Poverty Action Group. https://www.donaldhirsch.com/chickenegg.pdf
[28] Child Poverty Action Group. (2024). *10,000 children dragged into poverty by two-child limit since Labour took office*. https://cpag.org.uk/news/10000-children-dragged-poverty-two-child-limit-labour-took-office
[29] Office for National Statistics. (2024). *Private rent and house prices, UK: September 2024*. https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/privaterentandhousepricesuk/september2024
[30] Tims, S., & Stirling, A. (2022). *The national living income: Guaranteeing a decent minimum income for all*. New Economics Foundation. https://neweconomics.org/2022/12/the-national-living-income
[31] Joseph Rowntree Foundation., & Trussell Trust. (2024). *Guarantee our Essentials: reforming Universal Credit to ensure we can all afford the essentials in hard times*. https://www.jrf.org.uk/social-security/guarantee-our-essentials-reforming-universal-credit-to-ensure-we-can-all-afford-the