



Institute for  
Fiscal Studies

# Welfare changes this year: discussion of impacts and rationales

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# Outline

## 1. Context

- Overall fiscal tightening: size and composition
- Tax and benefit elements
  - Main components
  - Distributional impact
- More general pressures on household incomes

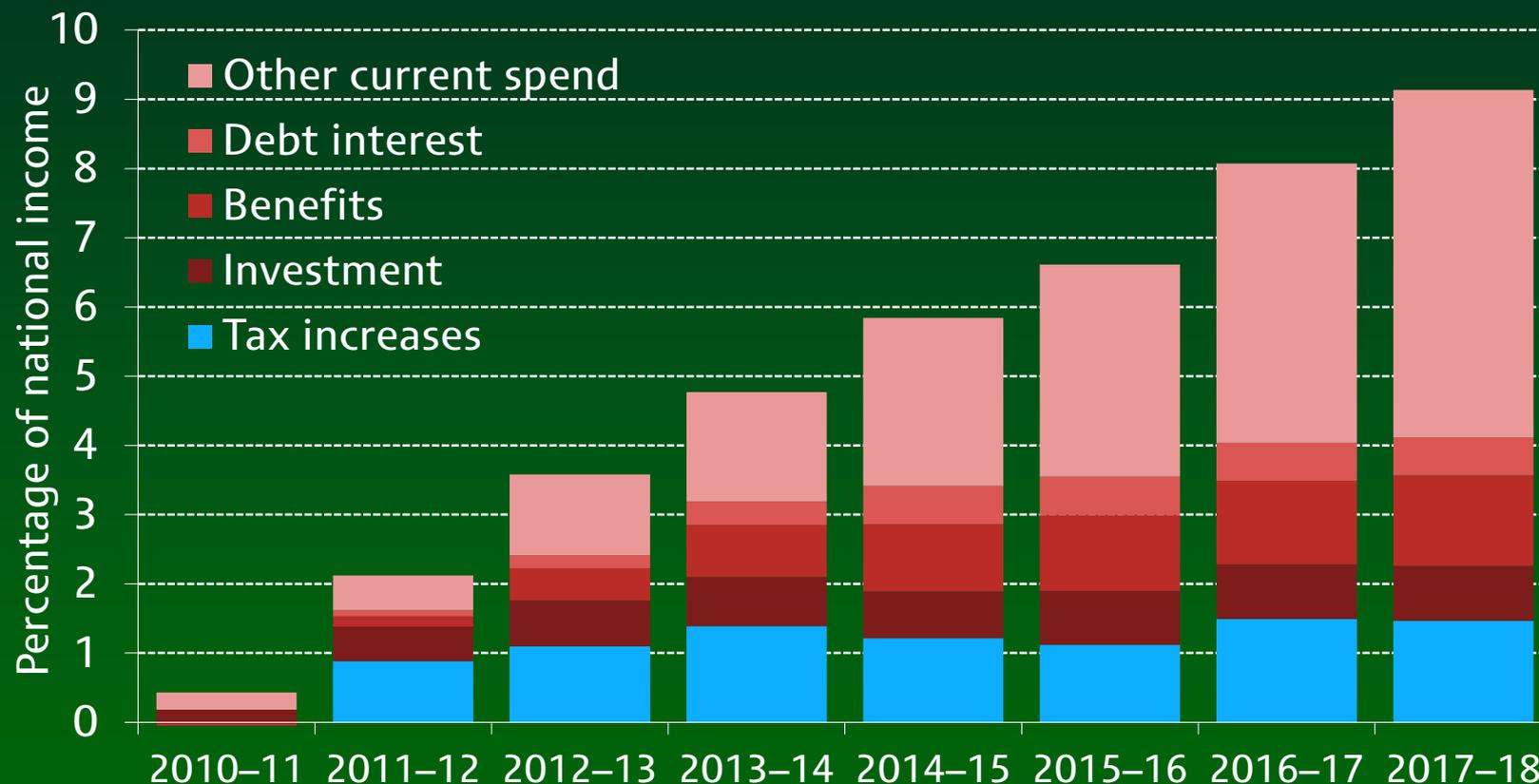
## 2. Welfare reforms happening this year

- Universal Credit
- Council Tax support
- Housing Benefit for private renters
- Housing Benefit for social renters
- Overall family benefits cap

## 3. Conclusions

# Size and shape of fiscal consolidation

As of March 2013: 8.6% national income (£133bn) hole in public finances, offset by 9.1% national income (£141bn) consolidation over 8 years



Notes: Figures include realised underspends by government departments and latest estimate of Exchequer savings from changing to CPI indexation (based on IFS calculations).

Sources: HM Treasury, Office for Budget Responsibility, IFS calculations.

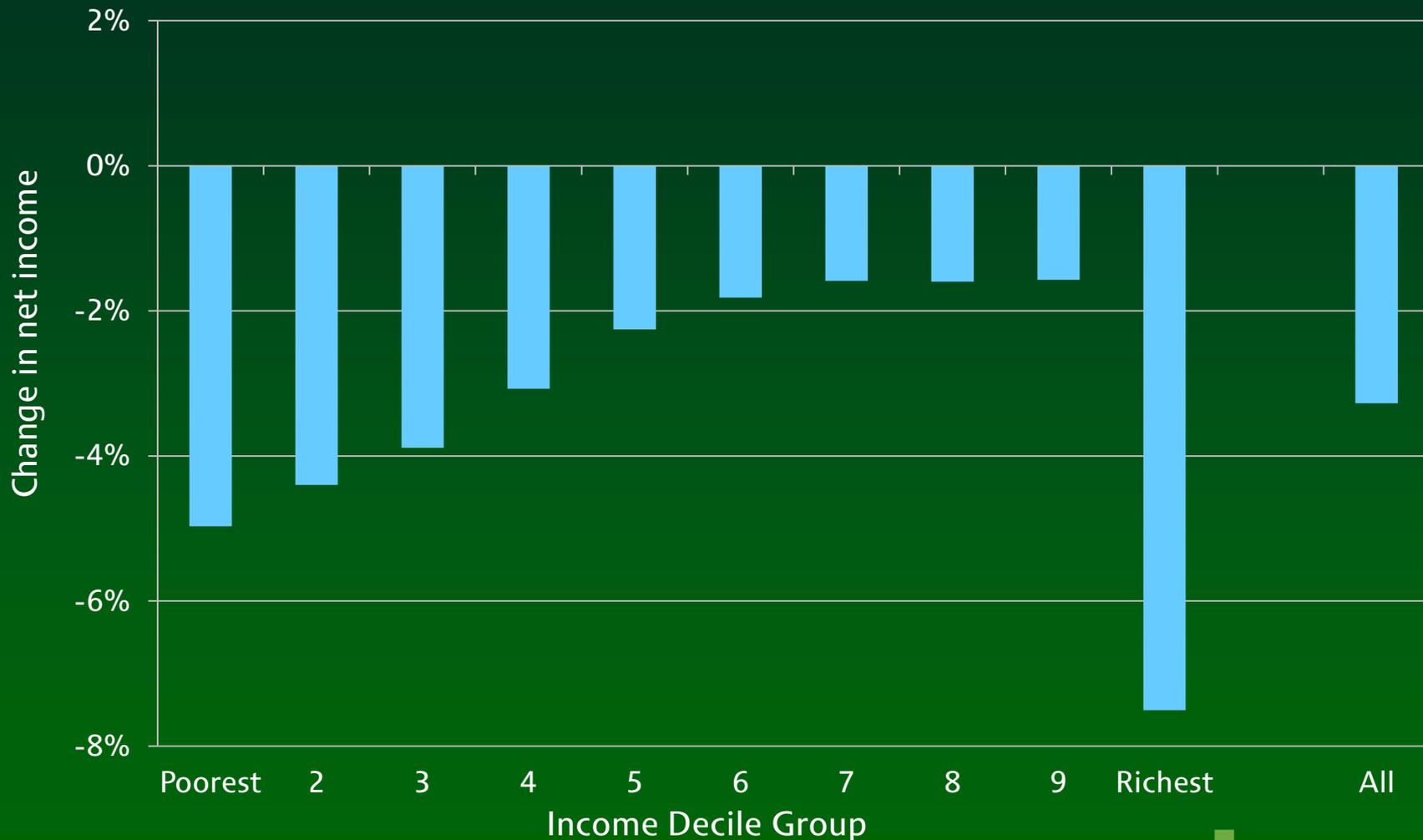


# Some of the major tax/benefit revenue raisers

- Tax rises
  - Rise in main VAT rate in Jan 2011 (~£12 billion per year)
  - Rise in employee National Insurance contribution rates
  - Reductions to higher rate income tax threshold
  - Several tax rises affecting very highest-income individuals
- Benefit cuts
  - Changes to indexation (RPI/Rossi to CPI; 1% uprating for 3 years)
  - Cuts to Housing Benefit for both private and social renters
  - Multi-year cash freezes for Working Tax Credit and Child Benefit

# Combined impact of tax and benefit reforms

January 2010 - April 2015 inclusive, as if Universal Credit fully in place



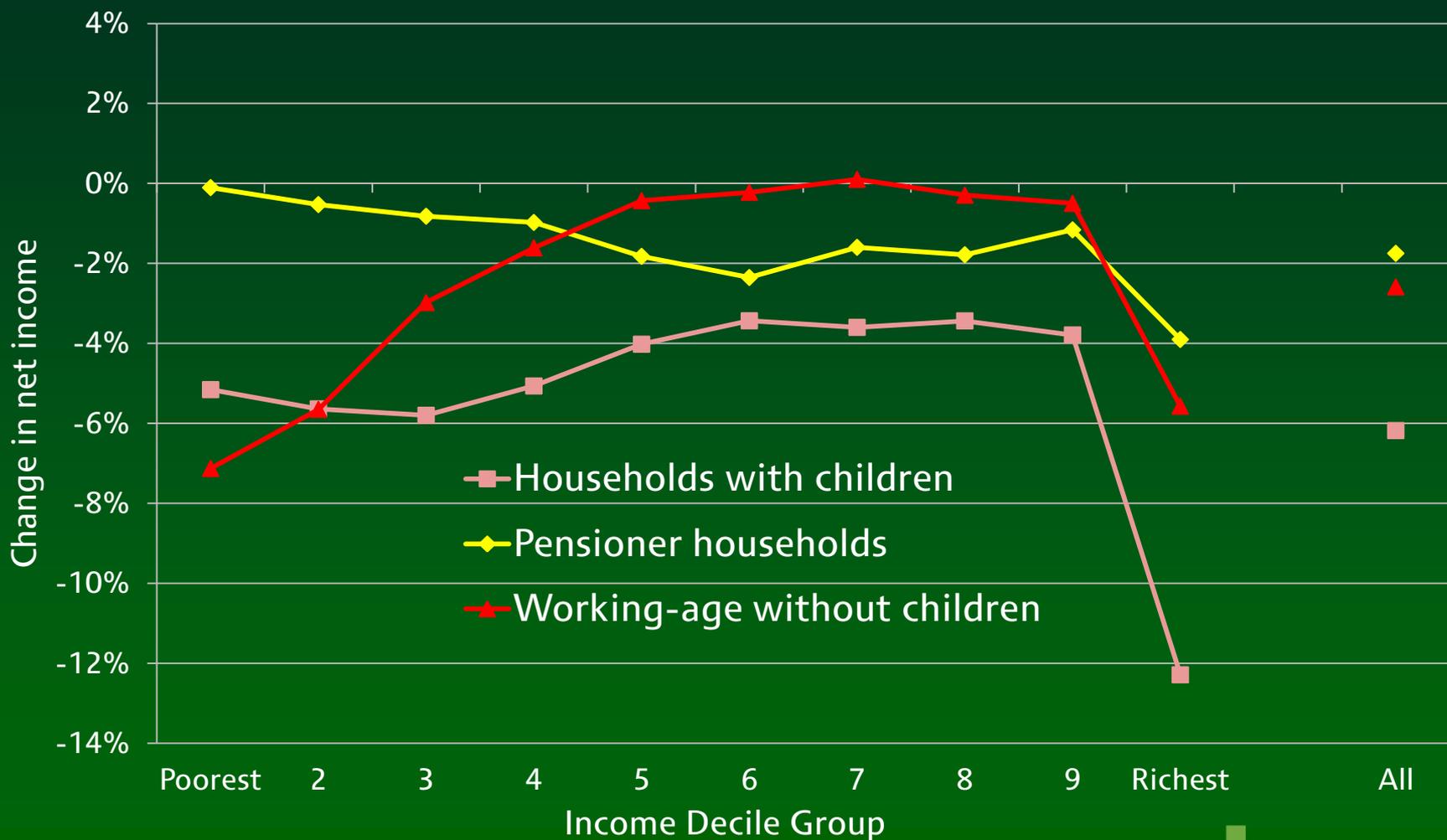
Fuel duties modelled at average 2015-16 level.

Assumes full take-up of means-tested benefits and tax credits.



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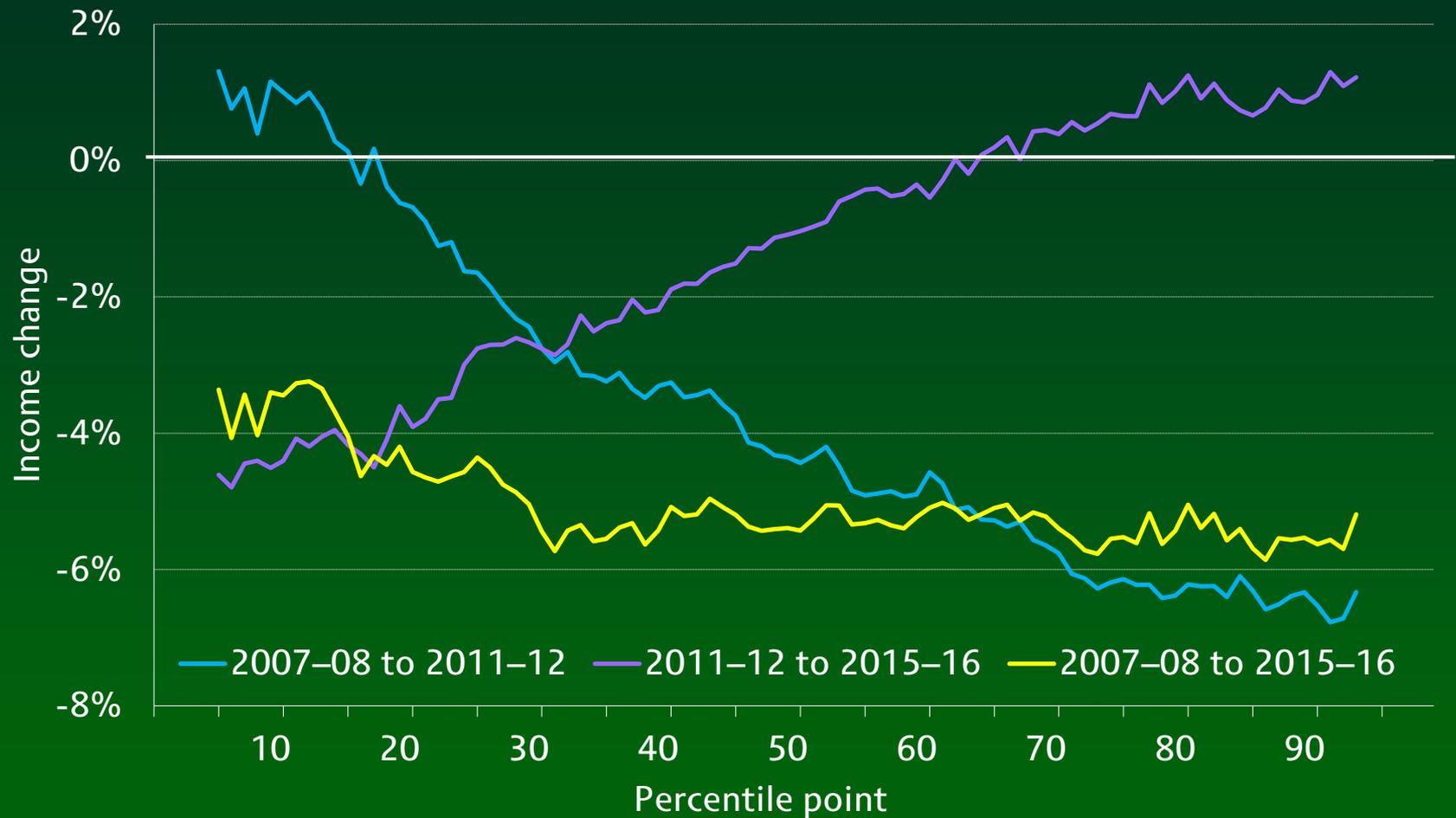
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Assumes full take-up of means-tested benefits and tax credits.



# Tax/benefit changes just one part of pressure on incomes

## Income changes, actual and projected, 2007-08 to 2015-16



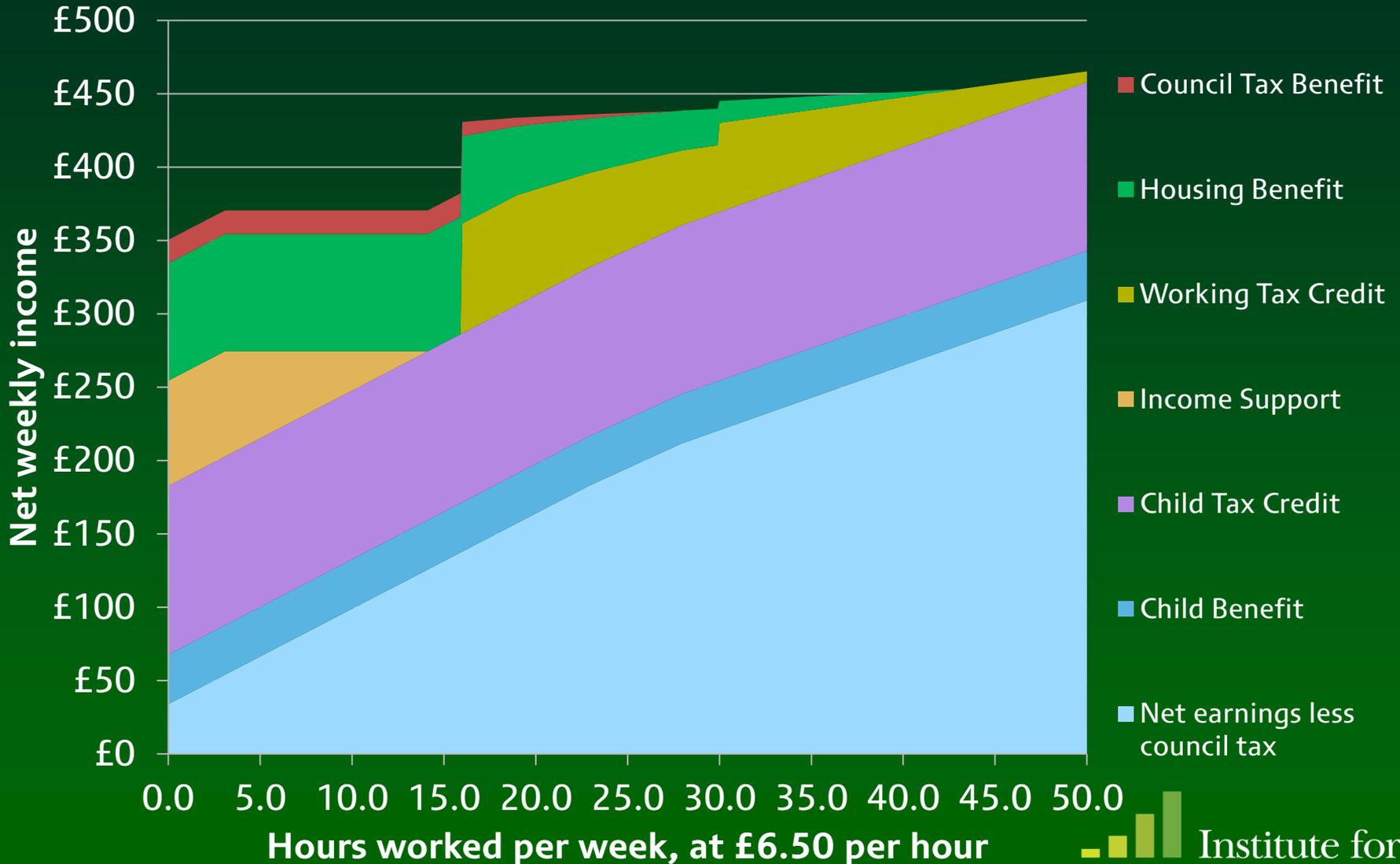
Note: Figure taken from Brewer et. al. (2013), <http://www.ifs.org.uk/publications/6725>.

# The changes are not just about fiscal tightening

- System is undergoing a restructuring
- Govt is *spending* substantial sums on priority tax cuts
  - £24 billion by 2016-17 on increasing personal allowance, and cutting fuel duties and main rate of corporation tax
- Many benefit cuts do more than just reduce entitlements
  - Change structure and principles behind support offered
- Universal Credit represents perhaps the most important structural change to benefits system since 1940s

# WELFARE CHANGES THIS YEAR

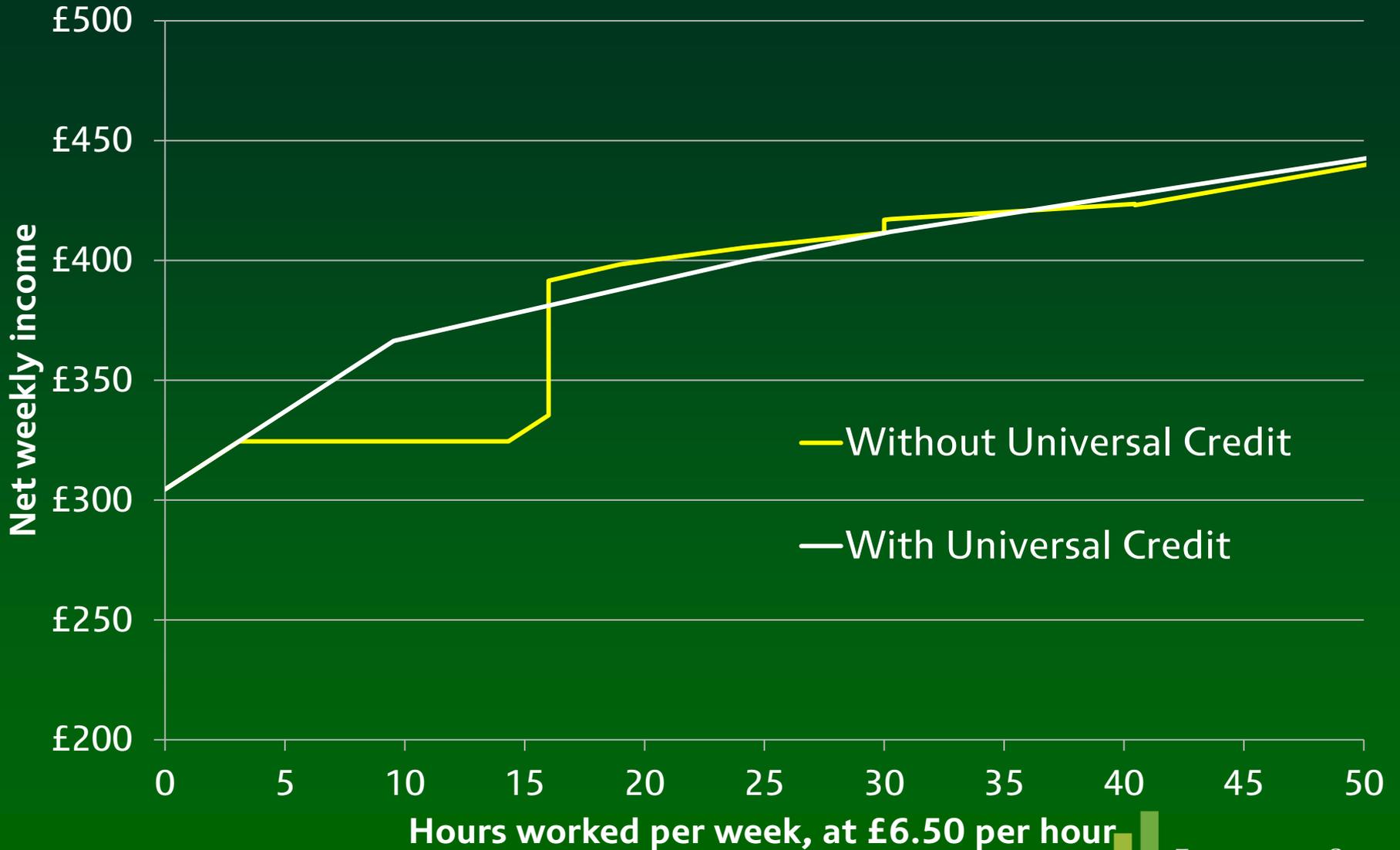
# Current system: an example lone parent with 2 children



# Universal Credit (<http://www.ifs.org.uk/publications/6147>)

- Integrates 6 of 7 existing means-tested payments into one
- For most people with no private income/capital, entitlements same as under current system
  - e.g. extras for children and rent mirror Child Tax Credit, Housing Benefit
- Key difference is how means-testing will operate
  - E.G. Currently, if you find work, you might lose some tax credits, some Housing Benefit and your Jobseeker's Allowance
  - These means tests are all separate with different rules
  - Under UC you get one payment; as your earnings rise it is withdrawn according to one set of rules

# The same example lone parent – impact of Universal Credit



Note: ignores council tax and associated rebates.



## Universal Credit (2)

- Mechanical impacts on financial work incentives are mixed (strengthened for some; weakened for others)
- But clear gains to be had from:
  - More ‘rational’ system: structure of support will depend on design of one means test, not arbitrary overlaps between different ones
  - Greater clarity/certainty for claimants about their incentives
  - Smoothing transition from out-of-work to in-work benefit receipt
- A major, welcome simplification
  - Why would you want a jumble of overlapping means tests rather than a single integrated one?
  - Clearly with operational challenges, at least in short run

# Support for council tax ([www.ifs.org.uk/publications/6183](http://www.ifs.org.uk/publications/6183))

- Council Tax Benefit was essentially a means-tested council tax rebate
- It was a national benefit – whilst maximum entitlements depended on council tax liability, rules of means test were set centrally
- 5.9 million families received it – more than any other means-tested benefit or tax credit
- Three decisions have been made.
  1. To (effectively) cut central government funding for it by 10%
  2. To keep council tax support separate from UC
  3. To localise it

## Support for council tax ([www.ifs.org.uk/publications/6183](http://www.ifs.org.uk/publications/6183))

1. To (effectively) cut central government funding for it by 10%
  - Usual tradeoffs apply: very difficult to save full 10% without either hitting the poorest households or significantly weakening work incentives
2. To keep council tax support separate from UC
  - Creates tricky issues re how CTS and UC will interact
  - Re-introduces potential for overlapping means tests and extremely weak work incentives that UC would otherwise have eliminated
3. To localise it
  - Passes these problems on to local authorities (who have little to no experience designing benefit systems)
  - Allowing each LA to have different CTS system undermines the principle of simplicity behind UC

# Housing Benefit: cuts for ‘under-occupying’ social sector tenants (if working-age)

- Who is affected?

Family type	Number	% of working-age social tenants on HB	Average weekly loss
<b>All in Great Britain</b>	<b>660,000</b>	<b>31%</b>	<b>£14</b>
Under 60, couples with children	70,000	20%	£15
Under 60, lone parents	150,000	21%	£13
Under 60, couples without children	80,000	68%	£16
Under 60, single	320,000	38%	£14
60+ but under Pension Credit age	50,000	53%	£15

Source: DWP Impact Assessment



# Housing Benefit: cuts for 'under-occupying' social sector tenants (if working-age)

- Potential rationales:
  1. Better use of social housing stock
  2. Equity between private and social sector tenants
  3. Saving money (note tradeoff with 1); strengthening work incentives
- Actual effects highly uncertain. Many possible responses, including:
  - Social landlords using different allocation rules
  - Tenants moving
  - Composition of new builds changes, e.g. more 1-bed properties
- Should be monitored closely
- Alternatives? Put direct cost on social landlords?

# Housing Benefit for private renters: index to national prices (not local rents)

- Background on Housing Benefit for private renters:
  - There are limits on rent amounts that can be covered
  - These vary by area (and family type)
  - They are called Local Housing Allowance (LHA) rates
  - LHA rates were based on 30<sup>th</sup> (and previously the 50<sup>th</sup>) percentile of private rents in area
- The (latest) reform: index LHA rates to CPI, not local rents

# Consequences of breaking link with rents

- In short run, similar effects to any broad-based cut to Housing Benefit
- But in long run this way of making cuts will have very odd effects
- 1. If real rent growth, % of rent costs covered by HB would become negligible
  - Strange, as HB exists explicitly to help with rent costs
- 2. ***Geographic variation*** in HB entitlements to be increasingly arbitrary
  - Relativities between LHA rates across the country will for ever be fixed at their 2012 levels
  - Relevant local rent measure should clearly be current, not historic
  - Unwelcome parallels with council tax system?

# Overall (working-age) family benefits cap

- Applies to most out-of-work working-age families
  - But only ~40,000 will have benefits reduced
  - Weekly cap to be £350 for childless single people; £500 for others
  - Those who do lose will tend to lose a lot (avg £93 per week)
- 2 ways you could be affected:
  - You have high rent (and hence high Housing Benefit)
  - You have lots of children
- Why layer cap on top of system designed to allow higher payments?
  - Perceived problem better targeted by directly changing rules for housing- and child-related support

# Conclusions

- Many important reforms taking place
- Aggregate cuts to welfare should be seen in context of fiscal consolidation – social security is 30% of government spending
  - Trade-offs between work incentives and redistribution when making these cuts
- Various changes are also structural in nature – not just reducing benefit rates
- Verdict on these changes is mixed