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Austerity and tax and benefit changes affecting low-earning individuals

Carl Emmerson and Robert Joyce

Presentation at Low Pay Commission Information Retreat, London

5 October 2016

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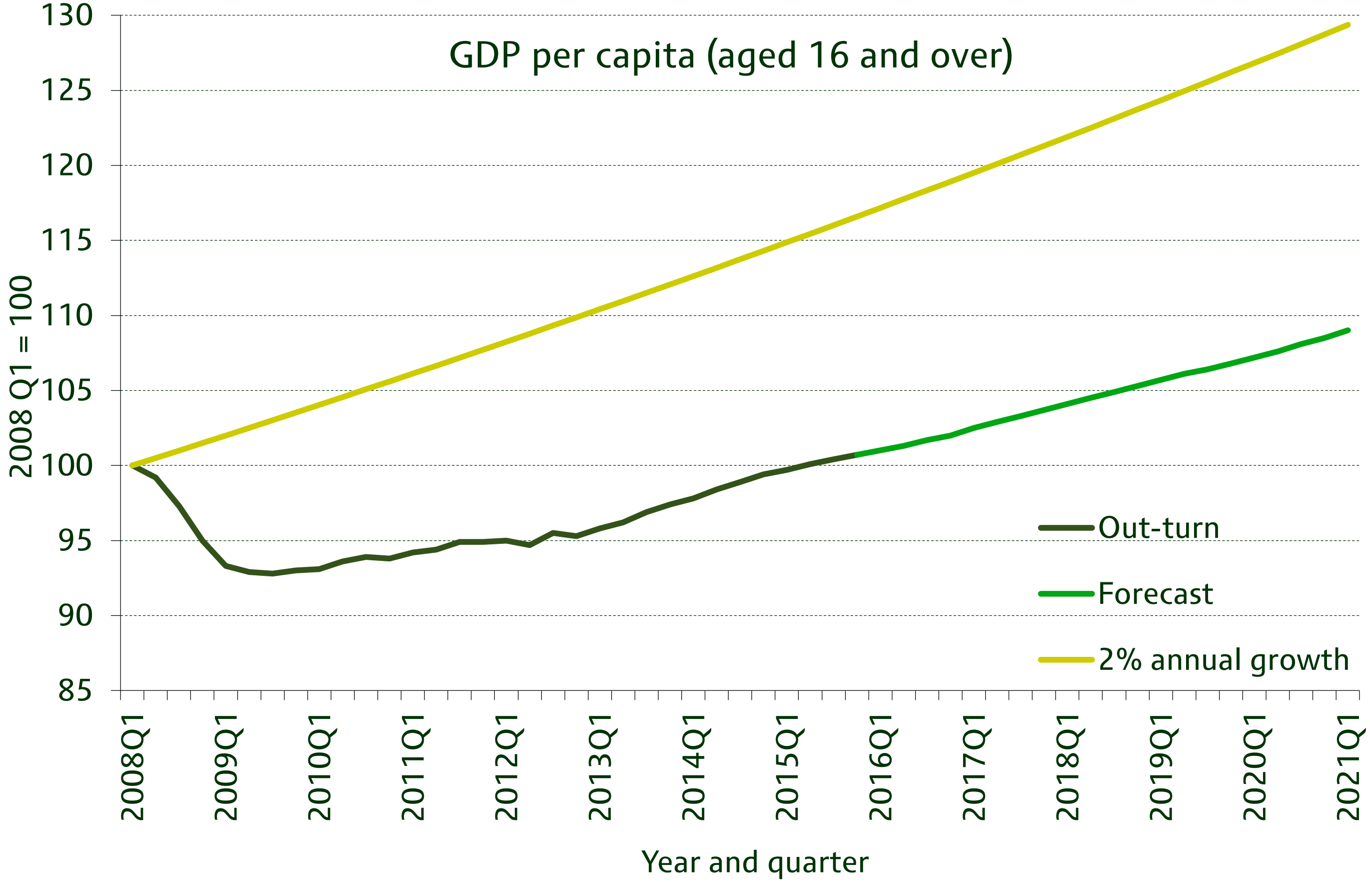
Pre-referendum forecast: GDP per capita only just back to pre-crisis levels



Source: Office for Budget Responsibility (2016).

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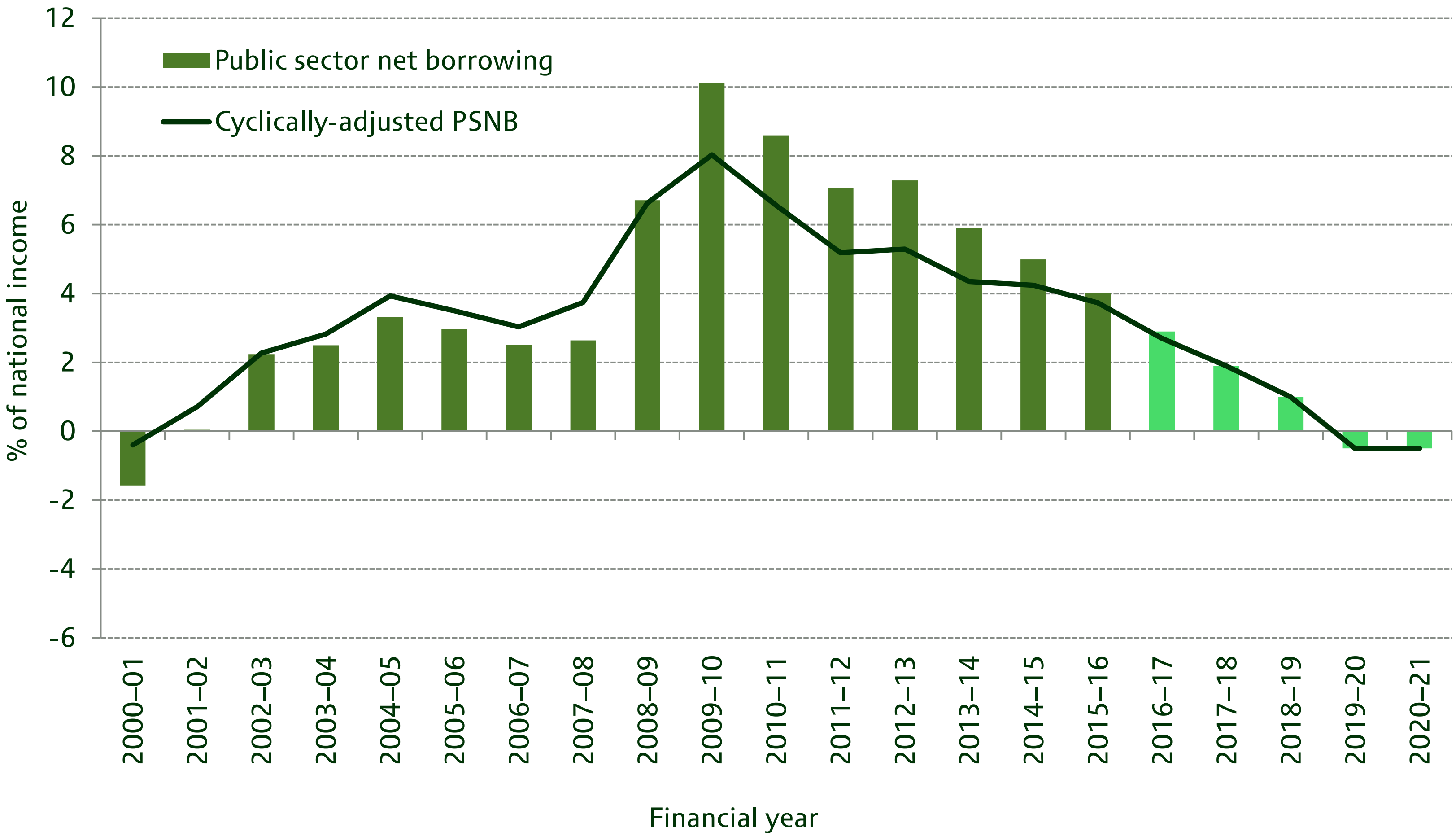
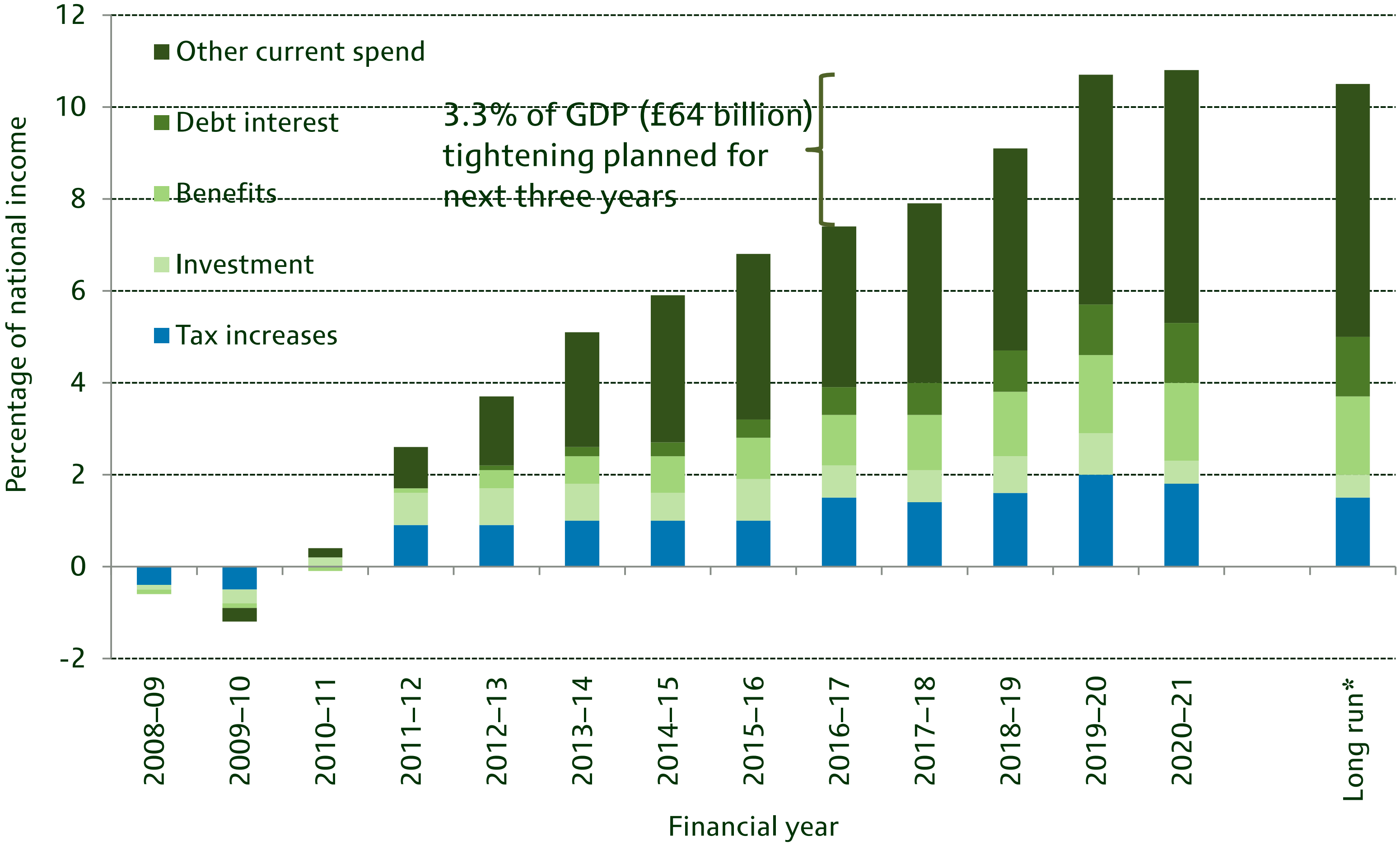
Pre-referendum forecast: deficit reduced from peak, but some way off being eliminated



Source: Office for Budget Responsibility (2016).

Pre-referendum plan: considerable fiscal tightening planned for next three years



Source: Institute for Fiscal Studies.

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Ex-ante analysis of possible impact of Brexit on the UK economy and public finances

- Elimination of the UK's net financial contribution to the EU would strengthen the public finances by about £8 billion (≈150m per week)

- But relatively small change to GDP would dominate this
  – loss of 0.6% GDP wipes out £8 billion gain to public finances from ending budget contributions

- Unfortunately nearly all forecasters suggest bigger GDP losses than that
  – Bank of England's August inflation report downgraded forecast GDP in 2019 by 2½%

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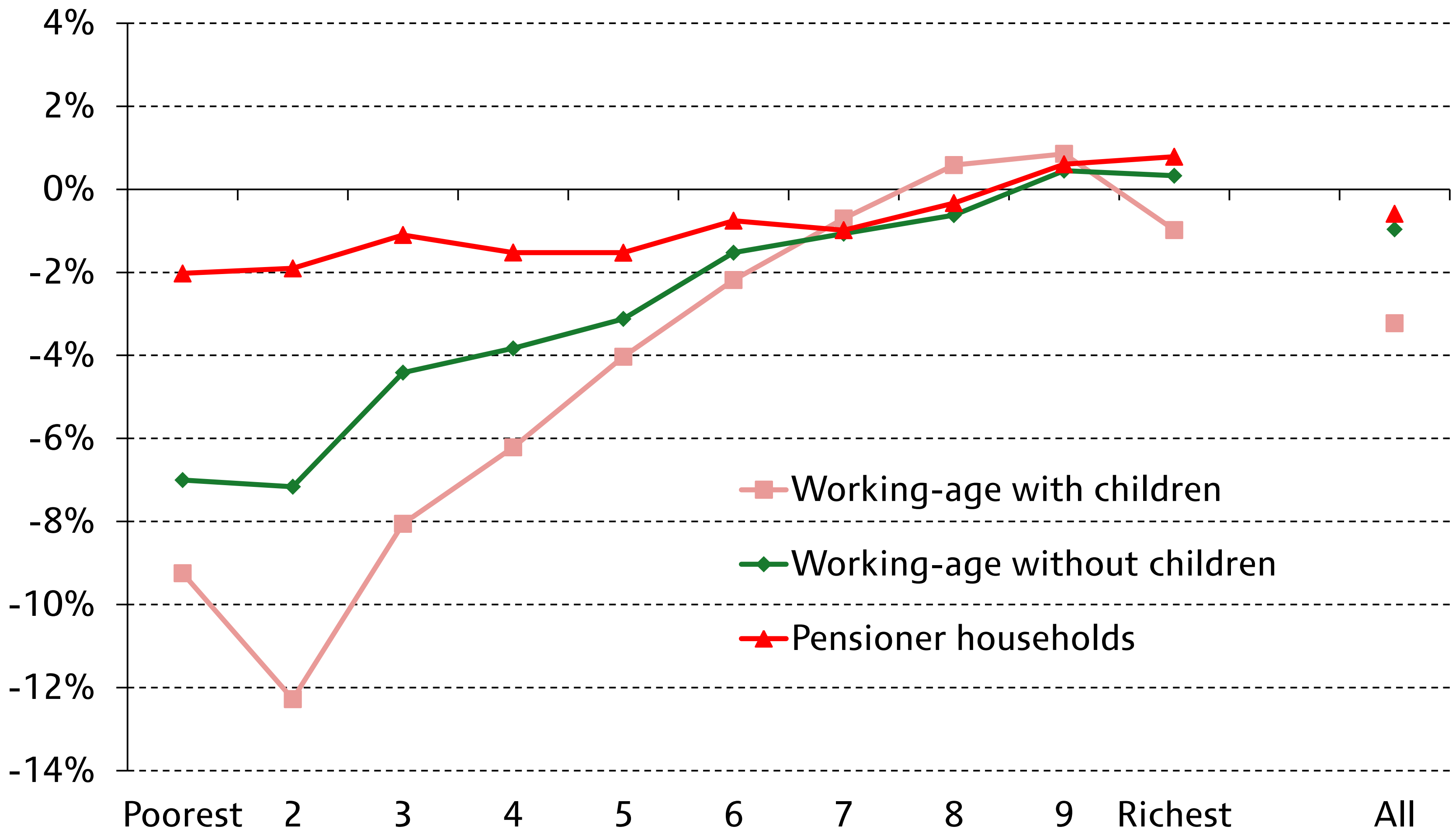
So where now for fiscal policy?

- Sensibly the government is no longer committed to delivering an overall budget surplus in 2019–20
  - despite this target being legislated just a year ago
- But that need not mean the “end of austerity”
- Mr Hammond might in fact decide to extend austerity
  - at its current pace that might get us to surplus a year or two later
- Or he might decide on something else entirely
  - good economic reasons for allowing borrowing to finance investment spending, which is an approach long-favoured by the Labour Party
  - reverting to Mr Osborne’s initial, flexible, rule of targeting the deficit five years out
- Uncertainty over economic developments is pervasive

Impact of tax and benefit reforms

May 2015 – April 2019 (including universal credit)



Assumes full take-up of means-tested benefits and tax credits and all changes fully in place

Personal allowance rising to £11,500 in 2017–18

- Given current inflation that looks like a real rise of about £400…
  - …in which case basic rate taxpayers would pay £80 per year less tax

- Minimum wage workers on housing benefit or council tax support (or universal credit) will lose much – typically most – of that gain

- At current NLW, would mean have to average 31 hours per week throughout year to pay income tax (but about 22 to pay ee NICs!)

- Would need to rise further 9% over following 3 years to reach manifesto commitment of £12,500 by 2020
  – So further discretionary rises likely

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Benefit changes between now and April 2017

- Freeze on most working-age benefits continues in April
  - Real impact currently looks small (CPI inflation 0.6%, but may grow)

- Benefit cap being cut from £26k imminently (“autumn 2016”)…
  - …to £23k in London and £20 elsewhere
  - Still small in aggregate: 88k households expected to be capped (compared to 24k now)
  - But impacts on those affected are large: average loss of > £3,000 per year
  - Significantly strengthens work incentives: WTC claimants are exempt
  - But only small proportion (about 5ppts) of those affected by current benefit cap responded by moving into work

- Housing benefit removed from most out-of-work childless 18-21 year-olds
  - Very big impact on very small group
  - Will strengthen their work incentives considerably

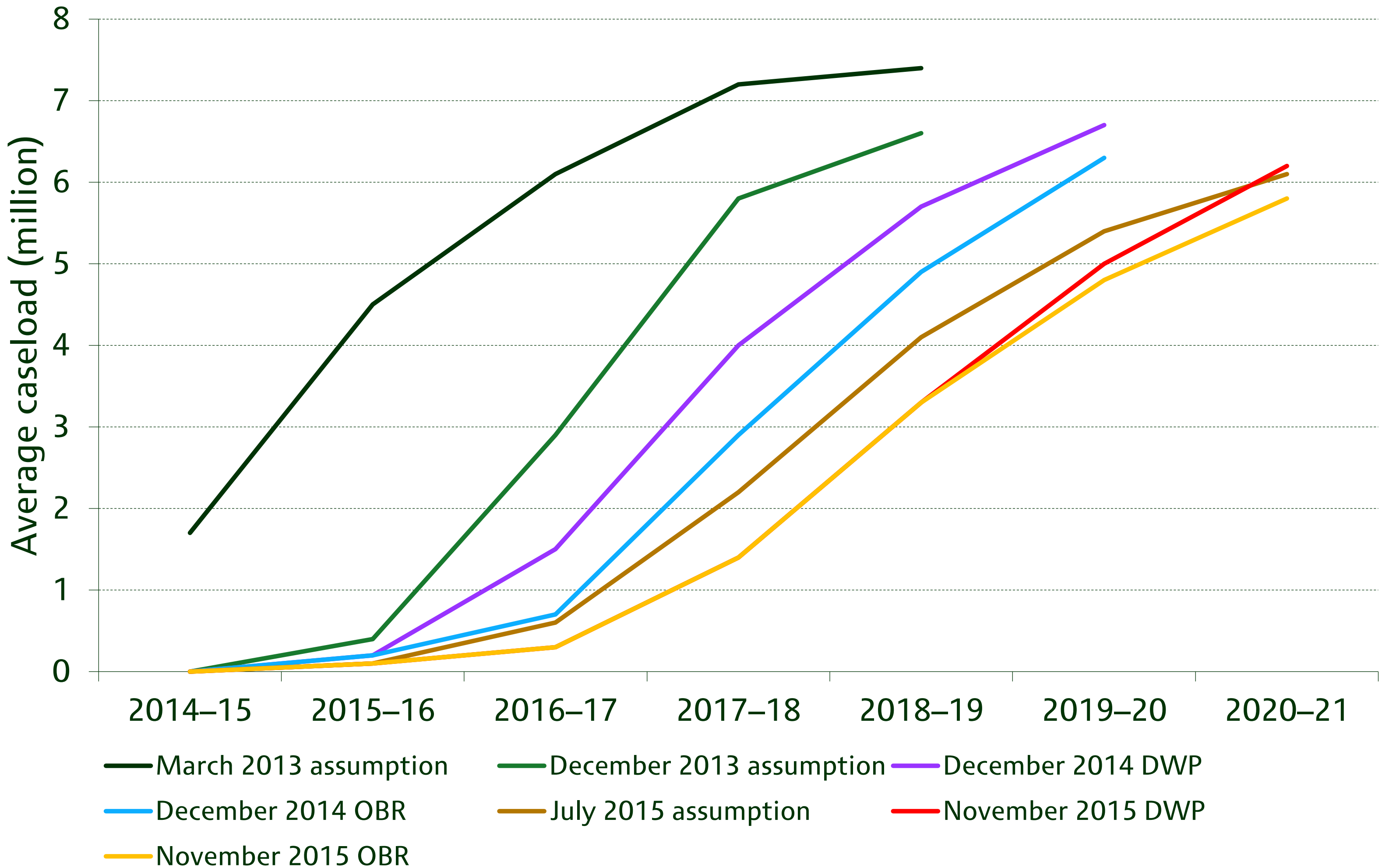
Changes being phased in from April

- Extra tax credits for third and subsequent children abolished for new claimants and new births
  - Currently around 900k families get average of £3,670 per year of support for 3rd and subsequent children; about 550k are in work
  - Though impact gradual – only about half of long run impact by 2020
- Family element of child tax credit removed for new claimants
  - £545 p/y less for all new CTC claims
  - About 4m families affected in long run
- CTC is means-tested so both cuts tend to strengthen work incentives for low-earning parents
- Employment and Support Allowance
  - New claimants in WRAG group (those assessed as less ill) to get same rate as JSA claimants – cut of £30 per week
  - Currently about 500k such people (20% of ESA claimants)
  - Weakens incentive to get into WRAG group (rather than JSA); strengthens incentive to get into support group

Changes and delays to Universal Credit

- Further delays to rollout announced at end of last year…

Changing assumptions about UC roll-out



Notes and sources: see Figure 10.5 of Green Budget document

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Changes and delays to Universal Credit

- Further delays to rollout announced at end of last year…
- …and more over summer
  - Rollout now not due to be complete until March 2022

- Plan for what UC will look like when in place has also changed
  - Now clearly a net takeaway compared to legacy system
  - Mainly due to cuts to 'work allowances'
  - Impacts on work incentives very mixed, though does get rid of weakest incentives
  - Lots more analysis of new UC plans in Green Budget 2016: www.ifs.org.uk/uploads/gb/gb2016/gb2016ch10.pdf

Conclusions

- Pre-referendum plan was for further spending cuts in order to eliminate the budget deficit by the end of this parliament
- Decision to leave the EU will lead to forecast growth and tax receipts being downgraded
  - rather than add to planned austerity Chancellor has said he will break the commitment to eliminate the deficit by 2019–20
  - will austerity be extended into the next parliament or will the government instead live with borrowing on an ongoing basis?
- Benefit cuts in this parliament will reduce incomes of working age households in the bottom half of the income distribution
  - but will also strengthen work incentives
- Full roll-out of Universal Credit further delayed
  - once in place will also reduce incomes of working age families; impacts on work incentives very mixed, though does get rid of weakest incentives

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