

# The distributional effects of the UK government's tax and welfare reforms in Wales: an update

IFS Briefing Note BN150

David Phillips

# The distributional effects of the UK government's tax and welfare reforms in Wales: an update

**David Phillips<sup>1</sup>**

*Institute for Fiscal Studies*

July 2014

ISBN: 978-1-909463-53-0

## Executive Summary

### Scope of the analysis

- This report is an updated analysis of the personal tax and benefit reforms implemented, or due to be implemented, by the UK's coalition government from when it was elected in May 2010 up to and including April 2015. This includes those measures that had been pre-announced by the previous Labour government which the new government chose to implement. Attention is restricted to personal tax and benefit reforms alone: it does not examine the impact of reforms to corporation tax and other taxes formally paid by businesses, nor the impact of changes to spending on public services. This is to ensure the analysis remains tractable and focused.
- Looking at reforms up to April 2015 includes almost all the major reforms currently in the pipeline. But Universal Credit (UC) will still be only partly in place. A combination of a long roll-out period and significant transitional provisions means that it will be a long time before UC is operating in a 'steady state'. Similarly, while new claimants in Wales have been required to claim Personal Independence Payments (PIPs) instead of Disability Living Allowance (DLA) since June 2013, existing working age claimants of DLA are being transferred slowly and most are not expected to be moved over until 2016 or 2017. For this reason, we analyse the reforms both including and excluding UC and PIPs.

---

<sup>1</sup> The author thanks Carl Emmerson at the IFS and Sara Ahmad, Bon Westcott, Mike Harmer and Julian Revell at the Welsh Government for helpful comments. They also gratefully acknowledge funding from the Welsh Government and from the Economic and Social Research Council (ESRC) through the Centre for the Microeconomic Analysis of Public Policy at IFS (grant reference ES/H021221/1).

### **Distributional effects of benefit reforms (excluding UC and PIPs)**

- The benefit changes (excluding UC and PIPs) reduce Welsh household incomes by £9 a week, on average, equivalent to £600 million a year across Wales as a whole. Within this figure are large takeaways from working-age households and a modest giveaway to pensioner households largely as a result of the “triple lock”.
- As a result, pensioners will have actually gained a little from the benefit reforms – around £2 a week (0.4% of net income) on average. On the other hand, working age households without children will have lost £6 a week (0.9% of net income) on average, and working age households with children will have lost £25 a week (3.6% of net income) on average. Households with children are hit harder than those without because they are more reliant on benefits, and because there are particularly large cuts to benefits that such households claim – such as child benefit and tax credits.
- Losses are largest towards the bottom of the income distribution – particularly just above and just below the poverty line. For instance, losses among the poorest fifth of the population average close to 7% of income among households with children, and 5% of income among working age households without children.
- The Welsh Government has also analysed the cost of the benefit reforms to Welsh households. Its work focuses on changes to working age benefits and therefore does not account for the giveaways to pensioners. Once this and other differences in coverage are accounted for, the Welsh Government's estimates and ours broadly match.

### **Distributional effects of benefit *and* tax reforms (excluding UC and PIPs)**

- The tax changes represent a small (£52 million) net giveaway to Welsh households, on average. This is because increases in income tax and NICs allowances more than offset increases in VAT and NICs rates. However, these gains are not evenly spread across the income distribution: they tend to be larger for middle income households, and smaller (or even negative) for lower income households. This re-enforces the pattern of bigger losses for poorer than middle income households that is found when looking at only changes to benefits.

- For instance, taking account of tax changes as well as benefit changes, makes relatively little difference to the losses among the poorest fifth of households. But losses for the middle fifth fall from 3.8% of net income to 2.6% of net income among those with children; and among those without children, a loss of 1.1% of net income becomes a gain of 1.0% of net income, after accounting for tax changes.
- Tax changes reduce the incomes of the richest 10% of Welsh households, because most such households do not gain from the higher income tax allowance (the higher rate threshold has been cut to offset this change), but are hit by increases in tax rates, and may be affected by reductions to pensions contributions relief.

#### **Distributional effects of benefit *and* tax reforms (*including* UC and PIPs)**

- Once UC and PIPs are rolled out, the package of reforms as a whole will reduce household incomes in Wales by an average of £10.75 a week, equivalent to £718 million a year across Wales as a whole.
- Fewer people are expected to qualify for PIPs than the existing DLA. This is one reason why working age households with someone claiming disability benefits will see a loss of nearly £34 a week, on average (6.5% of net income), compared to £10 a week (1.5% of net income) among other working age households. Another reason they lose more is that they are poorer, on average, and so are more likely to be hit by other benefit cuts too.
- UC is now expected to be a net takeaway from households in Wales rather than a net giveaway. This reflects cuts in the work allowances which mean UC will be less generous to working households than was initially expected.
- Losses from the tax and benefit reforms as a whole will be larger for non-working households, especially among those with children (non-working lone parents are set to lose £40 a week, or 11.6% of net income on average; non-working couples with children are set to lose £55 a week, or 12.8% of net income, on average). Single earner couples with children are also relatively hard hit, losing £32 a week or 5.4% of their net income, on average.
- In contrast, pensioners are set to see only modest falls in income of around £2 a week. And two earner couples without children are set to gain around £5 a week, on average, due to the higher income tax personal allowance.

- Thus different households are bearing very different burdens as part of the tax and benefit changes being enacted as part of the UK government's fiscal consolidation effort.

## 1. Introduction

Benefit spending per person in Wales was around 11% higher than the average for Great Britain as a whole in 2011–12.<sup>2</sup> In part, this reflects the fact that a higher fraction of Wales' population are pensioners – a group that relies heavily on state pensions and benefits, but which has been protected from recent cuts to benefit spending. But it also reflects higher entitlements to means-tested benefits and tax credits (due to lower-than-average incomes), and a much higher than average fraction of the population being in receipt of disability benefits. This greater reliance on benefits means there is a particular interest and need to understand the impact of recent benefit changes on the incomes of Welsh households.

This report updates the distributional analysis carried out in Section 3.1 of the IFS's report analysing the effects of the UK government's welfare reforms in Wales.<sup>3</sup> That work, carried out in 2012, included reforms implemented or planned between April 2010 and April 2014, which had been announced by the time of Budget 2012. It also isolated the impact of benefit changes (rather than looking at tax and benefit changes together). In this report we update and extend our earlier work to:

- Include reforms announced up to and including Budget 2014;
- Analyse the impact of the benefit changes on their own, but also analyse the impact of benefit and personal tax changes together;
- Examine the impact of the reforms that will have been implemented by one year later, in April 2015.

We analyse impacts separately excluding and including Universal Credit (UC) and Personal Independence Payments (PIPs), allowing us to assess the impact of these reforms on their own, and because UC and PIPs will in practice be only

---

<sup>2</sup> Table 2 of D. Phillips, *Government spending on benefits and state pensions in Scotland: current patterns and future issues*, Institute for Fiscal Studies, BN 139. Available at: <http://www.ifs.org.uk/publications/6818>.

<sup>3</sup> S. Adam and D. Phillips, *An ex-ante analysis of the effects of the UK government's welfare reforms on labour supply in Wales*, Institute for Fiscal Studies, 2013. Available at: <http://www.ifs.org.uk/comms/r75.pdf>.

rolled out to a small number of claimants by April 2015. In order to see the long term impacts of these reforms, in the results presented including these reforms, we model them as if they were fully in place by April 2015. An appendix provides further details on methodology, data and the reforms modelled.

## 2. The scope of our analysis

This report is an analysis of the personal tax and benefit reforms implemented, or due to be implemented, by the UK's coalition government from when it was elected in May 2010 up to and including April 2015. Three aspects of that focus should be made explicit.

First, we look at reforms implemented (or due to be implemented) after the UK's coalition government took office. That is not the same as reforms *announced* by the coalition: the present government has chosen to go ahead with certain changes announced by its Labour predecessor (such as limiting Local Housing Allowance to actual rent paid, and allowing the generosity of Winter Fuel Payments to fall when a temporary increase expired) and cancelled others (such as the introduction of a 'toddler tax credit'). The reforms that fall into this category are small relative to those announced by the coalition government itself.

Second, we examine reforms due to be implemented up to and including April 2015. Some of the reforms introduced by the present UK government affect the way that benefit and tax credit rates are increased year on year, and so have an increasing effect over time. The longer the time horizon chosen, the more these reforms dominate the picture. We therefore have to decide, in effect, how many years' worth of a new indexation policy to count within our analysis. Again, there is no good answer to this, and going up to the end of the present government's term of office seemed as natural a choice as any.

Looking at reforms up to April 2015 includes almost all the major reforms currently in the pipeline.<sup>4</sup> But UC will still be only partly in place. A combination of a long roll-out period and significant transitional provisions means that it will be a long time before Universal Credit is operating in a 'steady state'.<sup>5</sup> Similarly, while new claimants in Wales have been required to claim PIPs instead of

---

<sup>4</sup> One of the notable exceptions are the planned changes to support for childcare costs through the tax and benefit system, due to begin in Autumn 2015.

<sup>5</sup> The only area in Wales where Universal Credit has been rolled out so far is Shotton, in Flintshire. More generally for the country as a whole, it is expected that new claims for existing benefits will be stopped in 2016, and most existing claimants moved over to Universal Credit during 2016 and 2017.

Disability Living Allowance (DLA) since June 2013, existing working age claimants of DLA are being transferred to PIPs slowly and most are not expected to be moved over until 2016 or 2017 (although limited transfers began in October 2013). That is one reason why, we analyse the reforms both including and excluding Universal Credit and PIPs. The other reason is that Universal Credit is a major reform to the structure of the benefit system, and PIPs are of particular interest in Wales given the higher-than-average rate of disability and disability benefit receipt.

Third, is the fact that our attention is restricted to personal tax and benefit reforms alone: we do not examine the impact of reforms to corporation tax and other taxes formally paid by businesses, nor do we examine the impact of changes to spending on public services. To some extent these distinctions are arbitrary. Although business taxes do not fall directly on individuals and households, ultimately all taxes – including business taxes – are borne by real people in the form of lower real income than they would otherwise have (through lower wages, lower dividend payments, or higher prices). Similarly, benefits and public services are often close substitutes to the point of being barely distinguishable: state-provided or state-subsidised childcare acts to reduce the amount childcare costs parents, boosting their disposable income in much the same way as a tax credit that covers most of the cost of childcare does. But, in practise, modelling the distributional effects of business taxes and public services is difficult, and is beyond the scope of this report. Indeed, data limitations mean that we cannot model all personal tax and benefit reforms – although we can model the majority of them, and virtually all of the major ones. The appendix provides further details on the reforms included in our analysis.

### **3. The distributional effects of the benefit reforms (excluding Universal Credit and PIPs)**

We first analyse the distributional effects of the benefit reforms on their own, excluding Universal Credit and PIPs. When doing this we hold the tax system fixed as it was in May 2010, adjusting for inflation using the uprating rules that the coalition government inherited.

The set of benefit reforms we model reduce total benefit and tax credit entitlements in Wales by about £600 million. This corresponds to £9 per household per week on average, roughly 1.6% of their net income.<sup>6</sup> Box 1

---

<sup>6</sup> Among those households who do lose from benefit changes, the loss is obviously substantially greater.

compares this estimate to those produced by other organisations and discusses why figures differ.

#### Box 1. Comparing our estimates to those produced by other researchers

This analysis is the only one which quantifies the distributional impact of benefit reforms in Wales – that is how the impact differs across different types of households. However there are other studies which attempt to quantify the average impact on Welsh households and the aggregate implications for Wales.

Researchers at Sheffield Hallam University have estimated a total cost to Wales of £1,070 million, which is £470 million greater than our estimate.<sup>a</sup> However, they include some measures that we do not, and exclude others that we do include. For instance, they include the replacement of Incapacity Benefit with Employment and Support Allowance (which we do not, as this began under the last Labour government), the replacement of Disability Living Allowance with Personal Independence Payments (which we do model, but in a later section, as it will largely not take effect until after 2015), and changes to rules about in-year income changes in tax credits (which we cannot model due to data limitations). Adjusting for these differences would reduce the Sheffield Hallam figure to around £760 million, which differs from our own by just £160 million. Their figures do not include the impact of the ‘triple lock’ for pensions which has increased state pension and pension credit entitlements, but nor do they include the impact of the switch from RPI to CPI uprating. But overall, once such differences in coverage are accounted for, the two estimates look more similar than headline figures suggest, despite using very different methods.

The Welsh Government has also produced an analysis which estimates a figure of £930 million, which falls to £800 million when excluding the impact of the shift to PIPs (which we analyse later).<sup>b</sup> However, again, the impact of the ‘triple lock’ for pensions is not accounted for in this analysis because the focus was on working-age benefit recipients. Our estimates suggest that this may have boosted spending on the state pension and pension credit by between £150 and £200 million. Accounting for this, our estimates look similar to those produced by the Welsh Government, again despite the very different methods used in each set of analysis.

<sup>a</sup> C. Beatty and S. Fothergill (2013), Hitting the poorest places harder: the local and regional impact of welfare reform, Centre for Regional Economic and Social Research, Sheffield Hallam University.

<sup>b</sup> Welsh Government (2014), Analysing the impact of the UK Government’s welfare reforms in Wales – Stage 3, Part 2: Impact in local authority areas.

The figure is roughly £10 million larger than our previous estimate of £590 million that was included in our original report. Several offsetting factors underlie this small increase.

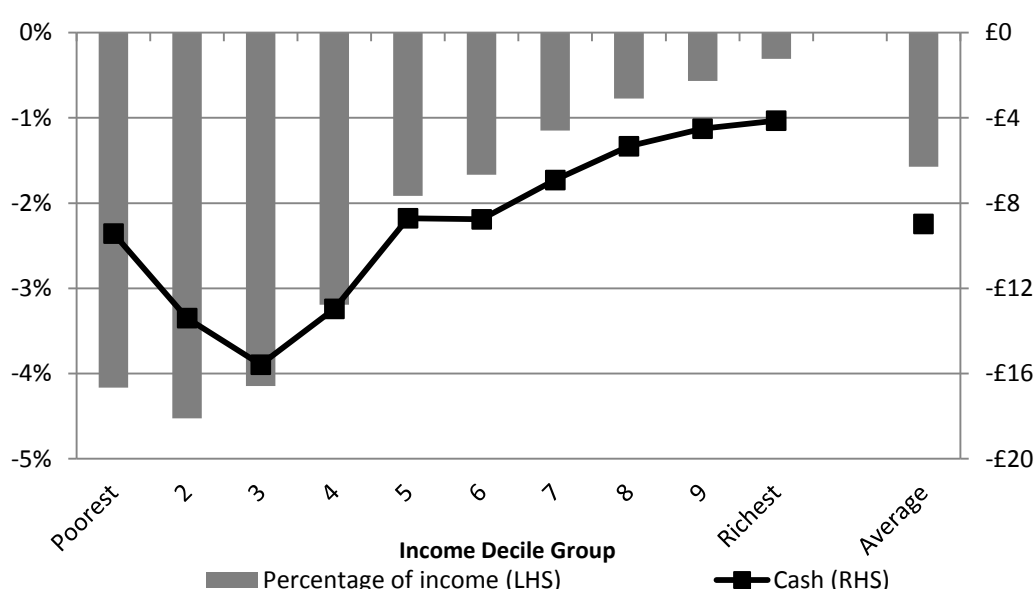
The first is a larger take-away from the below-inflation 1%-per-year increases in most working age benefits in April 2013, April 2014 and April 2015. In addition, by including one extra year (from April 2014 to April 2015) in our analysis, we include an additional year of effects from reforms that compound, such as changes in benefit uprating rules. However, three further changes offset much of these additional cuts. First, is the fact that the “triple lock” for the state pension and matching increases to pension credit are now estimated to be a bigger giveaway to pensioner households than we initially thought. This reflects the fact



that earnings growth has remained weaker and inflation higher than was expected in 2012 (the triple lock ensures that pensions go up in line with whatever measure is higher, or by a minimum of 2.5%). Second is a change in the way we model the time-limiting of contributory employment and support allowance as a result of updated data becoming available. This is now expected to cost Welsh households only around half what we initially expected. Third, is the fact we no longer model a cut in council tax benefit given the Welsh Government's decision to fund the shortfall from its own resources.

Figure 1 shows how the average losses described above translate into losses across the income distribution.<sup>7</sup> The coalition's welfare reforms (excluding Universal Credit and PIPs) take money predominantly from the bottom half of the income distribution.

Figure 1. Losses across the income distribution in Wales from the benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices



Notes: Income decile groups are derived by dividing all households in Wales into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale.

Source: Author's calculations using TAXBEN run on updated data from the 2009–10 to 2011–12 Family Resources Survey.

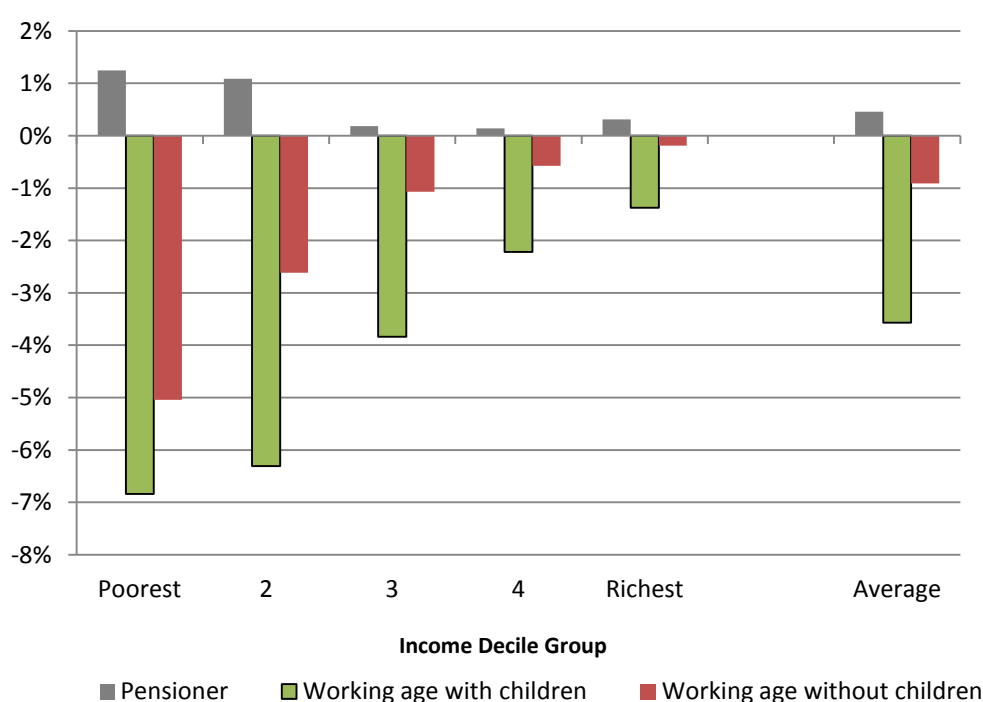
Since the bulk of the reforms represent cuts to means-tested benefits, it is hardly surprising that those higher up the income distribution (who are entitled to less benefits, if any) lose less than the bottom half, although better-off households do lose out from some cuts such as the freeze in Child Benefit, the withdrawal of Child Benefit from incomes of £50,000 upwards and the withdrawal of the family

<sup>7</sup> Appendix B shows the income levels different types of households need to reach to be in different decile groups of the income distribution.

element of Child Tax Credit at a lower income than before. But losses are not largest in cash or percentage terms at the very bottom of the distribution. This is because the cuts to in-work benefits (the recipients of which tend to be towards the bottom of the distribution, but not at the very bottom) such as the Working Tax Credit have been larger than the cuts to out-of-work benefits.

Figure 2 shows that the losses differ substantially for households of different types, both on average, and when one conditions on income. For instance, the average loss to working age households with children is just over 3% of income, compared to less than 1% for working age households without children, and a gain equivalent to 0.5% of income, on average, for pensioner households (the impact in cash terms are illustrated in Appendix Figure A2). Pensioners have done relatively well because their benefits have, on average, been increased.

Figure 2. Losses by household type and across the income distribution in Wales from the benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices



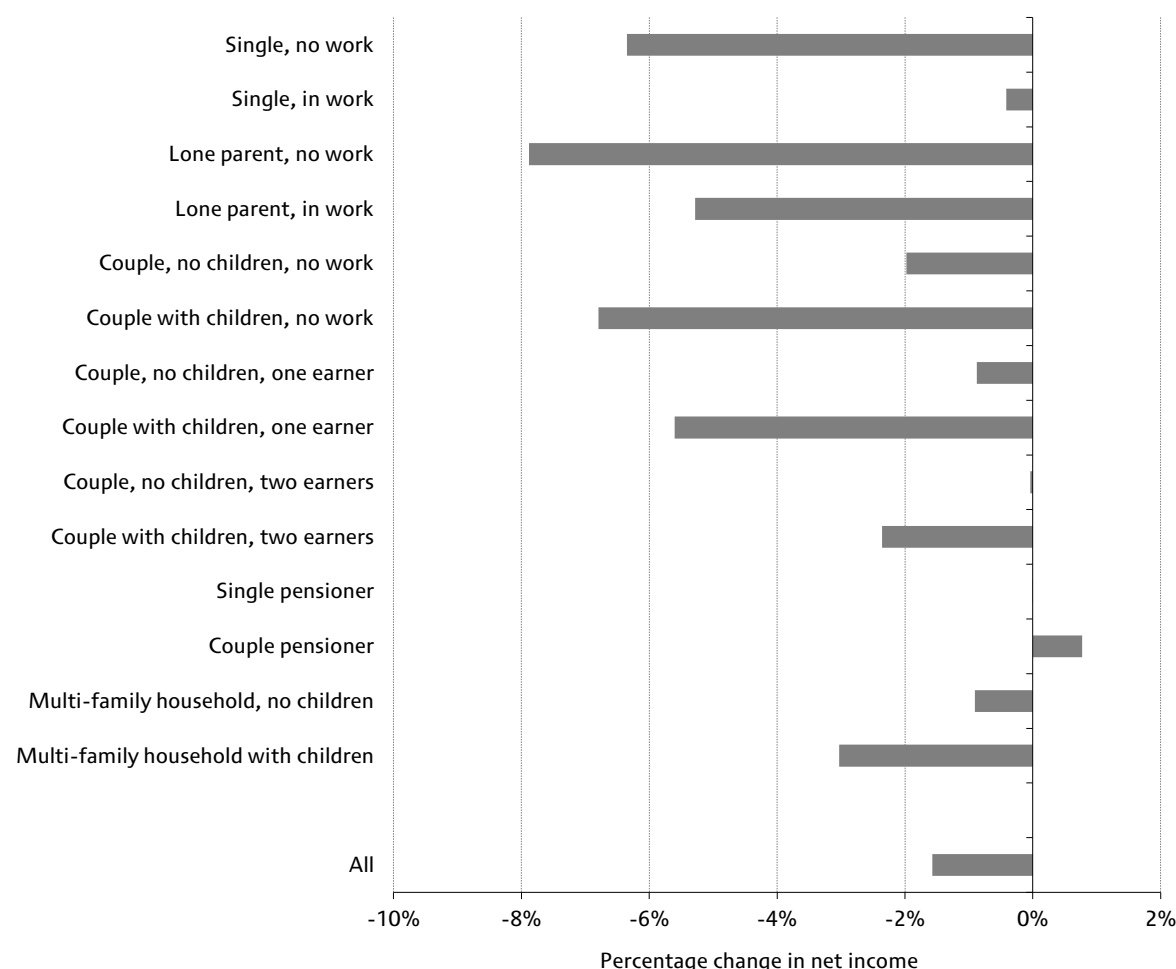
Notes: Income quintile groups are derived by dividing all households in Wales into 5 equal-sized groups according to income adjusted for household size using the McClements equivalence scale.

Source: As for Figure 1.

Losses exceed 5% of net income, on average, for households with children in the bottom two-fifths of the income distribution, and for working age households without children in the bottom one-fifth of the income distribution. This is much bigger than further up the distribution. In contrast, gains are largest for poorer

pensioner households – more than 1% of income for those in the poorest two-fifths of households.

Figure 3. Losses by detailed household type in Wales from the benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices



Source: As for Figure 1.

Figure 3 shows a breakdown of these losses by more detailed household type (again Appendix Figure A3 shows cash-terms figures).<sup>8</sup> This shows that the biggest losses measured as a percentage of income are for lone parents and couples with children with one or no earners, and for single adults without children who do not work. This reflects the fact that such households are more reliant on benefits, and/or are particularly reliant on those benefits which have been cut the most such as tax credits, housing benefit and disability benefits. On the other hand, losses are much smaller for single adults without children who work, working couples without children, and pensioners (particularly pensioner couples, who gain an amount close to 1% of net income, on average).

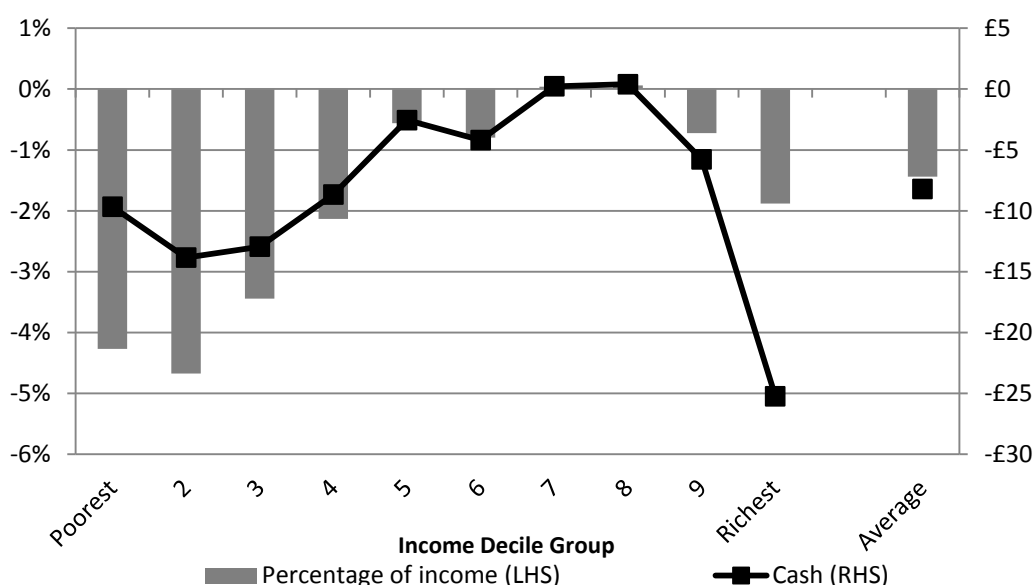
<sup>8</sup> Appendix B shows the number of households in each group in Wales and their average net income.

## 4. The distributional effects of the tax and benefit reforms (excluding Universal Credit and PIPs)

In this section we add in the effect of the personal tax changes implemented (or due to be implemented) between May 2010 and April 2015. This includes increases in the main rate of VAT and the rates of NICs, but also cuts to the top rate of income tax, to fuel duties, and large increases in the income tax personal allowance. The overall effect of all these tax measures is a giveaway to Welsh households. This reduces the size of the loss to the average Welsh household from benefit and personal tax changes taken together to £8.20 per week (1.4% of net income), or £548 million per year in total across Wales.

Figure 4 shows the effects across the income distribution. Tax changes have acted to reduce slightly losses towards the bottom of the distribution. But they have had a bigger impact towards the middle of the distribution. For instance, a loss of 1.9% of income to decile group 5 from the benefit changes alone, becomes a loss of just 0.6% when tax changes are also taken into account. And a loss of 1.2% for decile group 8, becomes a gain equivalent to 0.1% of net income (£0.39 per week). These gains in the middle of the income distribution reflect the substantial benefit many such households have had from the higher personal allowance, and to a lesser extent, real-terms cuts in fuel duties.

Figure 4. Losses across the income distribution in Wales from the tax and benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices



Notes: As for Figure 1.

Source: As for Figure 1.

Despite a cut in the top rate of income tax from 50 to 45%, tax changes actually act to increase the hit to the richest tenth of Welsh households from 0.3% (benefit changes alone) to 1.9% (including tax changes too). This is because other changes such as the freeze in the higher rate threshold and reductions to pensions contributions relief more than outweigh the changes affecting the very few Welsh households with people on incomes of more than £150,000 a year.

Figure 5. Losses by household type and across the income distribution in Wales from the tax and benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices

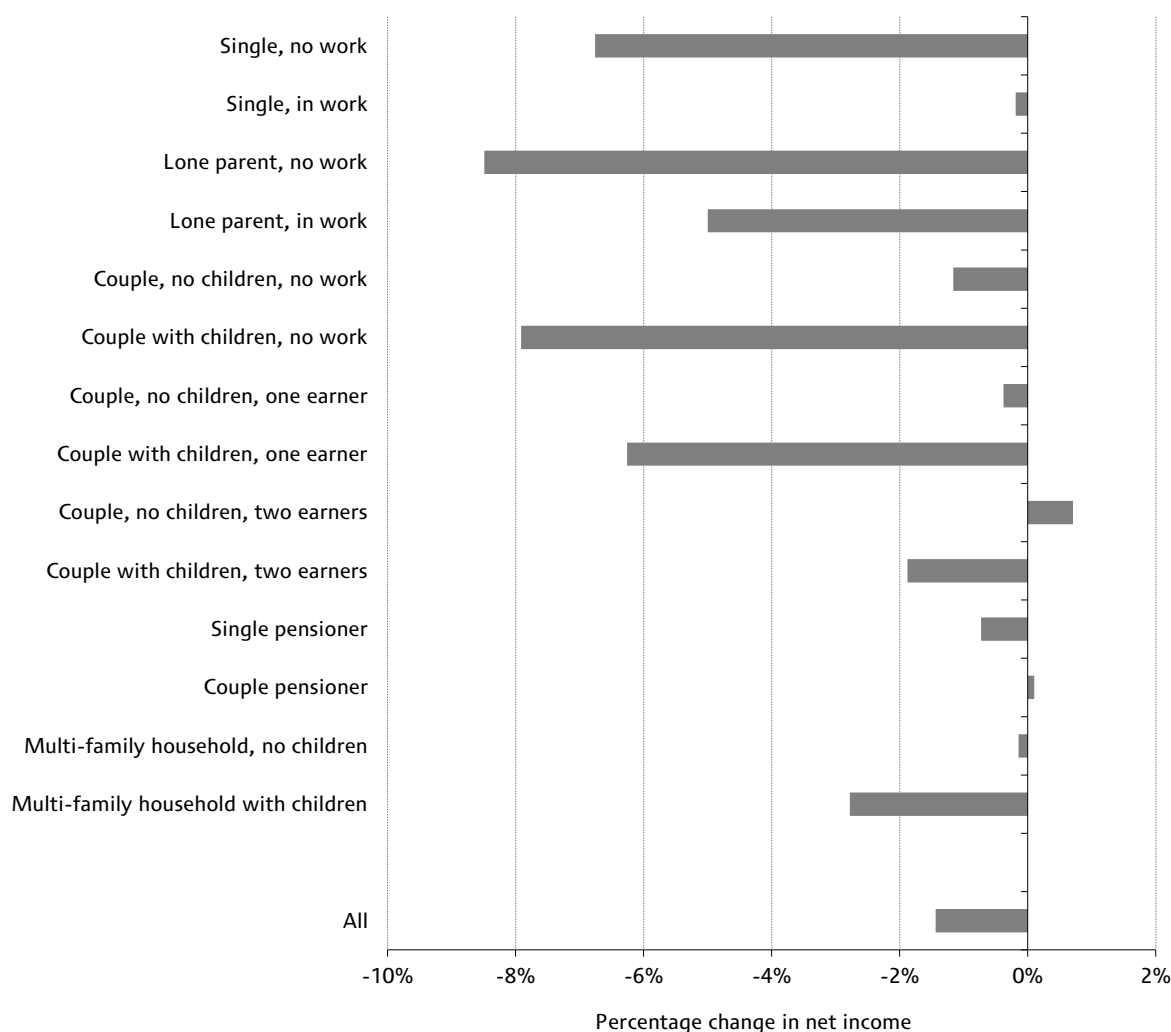


Notes: Income quintile groups are derived by dividing all households in Wales into 5 equal-sized groups according to income adjusted for household size using the McClements equivalence scale.

Source: As for Figure 1.

Figure 5 shows how the effects of reforms differ by broad household type when tax changes are also accounted for. This shows that adding in the effect of tax changes actually has little effect on households of any type at the bottom of the income distribution, on average. Further up the distribution, the effects are much more dramatic. For instance, working age households without children in the third and fourth quintile groups gain the equivalent of ~1% of net income once tax changes are accounted for – largely due to the higher personal allowance, which many households benefit from more than once (if they have more than one income tax payers). Conversely, upper and middle income pensioners actually lose slightly from the full package of benefit *and* tax reforms. That is because they lose from changes such as the increase in the main rate of VAT, but most do not gain from the higher personal allowance (indeed, the pensioners' tax allowance that many would have received was frozen).

Figure 6. Losses by detailed household type in Wales from the tax and benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices



Source: As for Figure 1.

Figure 6 shows a breakdown of losses by more detailed household type. Comparing this with Figure 3 shows that tax changes have acted to:

- Increase losses for non-working households with children, as such households are unlikely to gain from the higher personal allowance but lose from the by higher main rate of VAT;
- Reduce losses for most types of working households, and particularly two earner couples as such households often gain twice over from the higher personal allowance;
- Also increase losses for single earner couples with children. But much of this effect is driven by the effect of changes affecting the richest 10% of households (many of whom are in this group).

## 5. The distributional effects of tax and benefit reforms (including Universal Credit and PIPs)

As discussed earlier, two major policy changes will only be partially rolled out by April 2015 and so were excluded from the above analysis. But, it is worthwhile examining the effects these reforms (UC and PIPs) will have when fully in place. We do this here by modelling them *as if* they were fully in place in April 2015.

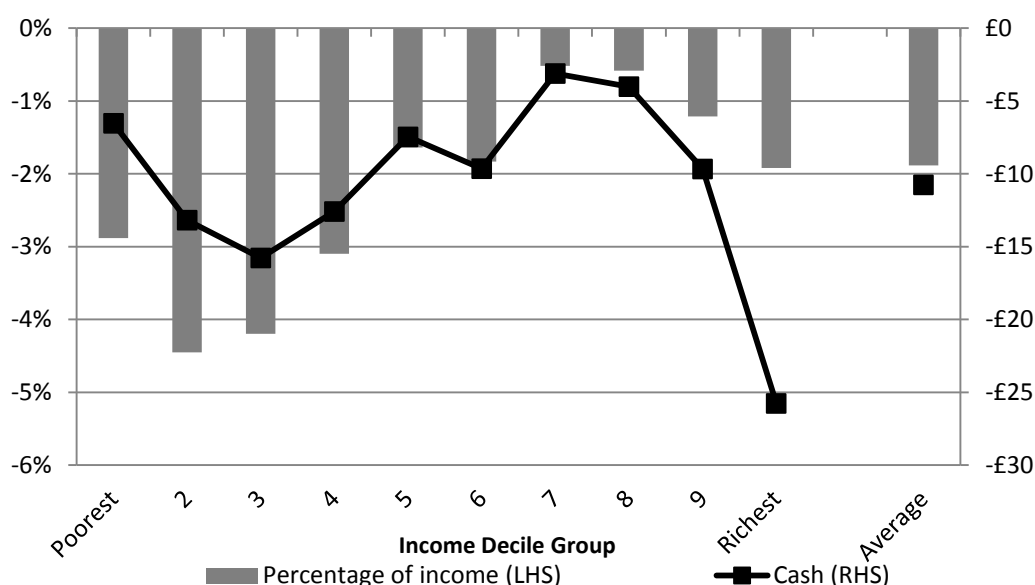
UC now appears to be a small takeaway from Welsh households, on average, but the more stringent PIPs regime is expected to be a much larger takeaway. Together, they reduce average household incomes by £2.55 per week, or around £170 million in total across Wales.<sup>9</sup> Together with the other tax and benefit changes, that takes the total takeaway to £10.75 per household per week, on average. In aggregate this is a loss of £718 million to Welsh households.

Figure 7 shows that these reforms actually go some way to ameliorating the impact of the tax and benefit changes on the poorest households – for instance the loss for the poorest tenth of households in Wales falls from around £9.70 (4.3% of income) to around £6.50 (2.9%) per week. That is because UC is set to increase the amount many benefit recipients who work a few hours a week will receive (because support is less aggressively tapered away if one has some earnings). It is further up the income distribution that the policies result in a takeaway from households. For instance, for the 5<sup>th</sup> and 6<sup>th</sup> decile groups (in the middle of the income distribution), average losses increase from 0.6% to 1.6%, and from 0.8% to 1.8%. This reflects the fact that under UC, the 16/24 and 30 hours rules that provide a boost in income will no longer exist. And more importantly, it is towards the middle of the income distribution that many existing working age DLA claimants can be found – the group that will (potentially) lose out from the shift to PIPs.

---

<sup>9</sup> Given that we have modelled these changes together, we cannot easily back-out costings of the individual reforms. This is because of interactions between different parts of the benefit system. The two reforms together reduce the benefit entitlements of households where no one is disabled by around £40 million. This must be attributable to UC. This can likely be considered a lower bound on the losses to households from UC. We previously estimated that UC was a giveaway to households in Wales. The fact that it is now a net takeaway reflects cuts to the UC work allowances which mean it is now less generous to in-work households than we previously thought. It also means it is likely that UC will do less to improve work incentives, on average, than we previously thought.

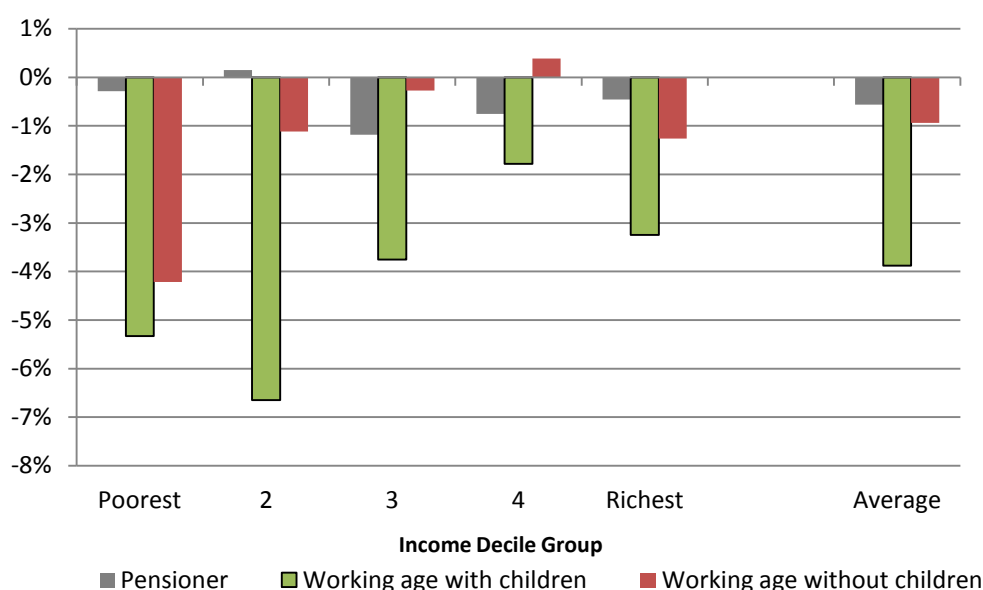
Figure 7. Losses across the income distribution in Wales from the tax and benefit reforms (including Universal Credit and PIPs), 2014–15 prices



Notes: As for Figure 1.

Source: As for Figure 1.

Figure 8. Losses by household type and across the income distribution in Wales from the tax and benefit reforms (including Universal Credit and PIPs), 2014–15 prices



Notes: Income quintile groups are derived by dividing all households in Wales into 5 equal-sized groups according to income adjusted for household size using the McClements equivalence scale.

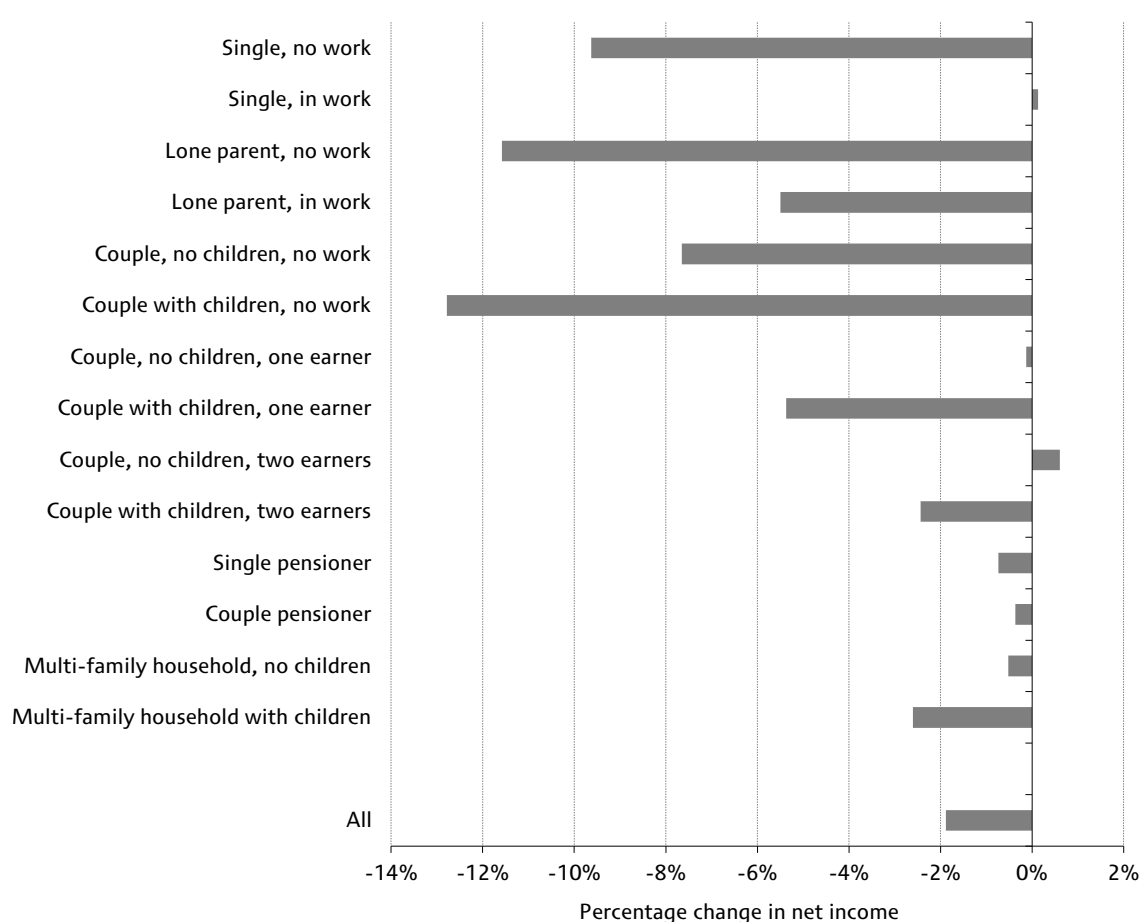
Source: As for Figure 1.

Figure 8 shows how different broad types of households fare. Poorer working age households benefit from UC, but middle income working age households are hit hard by UC and PIPs. Perhaps more surprisingly, there are also effects on low and



middle income pensioner households. The move from DLA to PIPs do not affect this group (although future generations of pensioners will lose from this reform) and UC is a working age benefit – so why this big effect? It is explained by the fact that families containing someone aged above and someone aged below the state pension age see reduced entitlements under UC: they will only be entitled to working age rates rather than the higher pension credit rates. And UC treats the non-labour income of these households much more harshly than the existing benefits and tax credits system.

Figure 9. Losses by detailed household type in Wales from the tax and benefit reforms (including Universal Credit and PIPs), 2014–15 prices



Source: As for Figure 1.

Figure 9 shows a breakdown of losses by more detailed household type. Comparing this with Figure 6 shows that UC and PIPs will, taken together, act to:

- Reduce the income of non-working households. This is because UC treats unearned income (such as spousal maintenance, or savings income) more harshly than existing taxes and benefits, so those non-working families

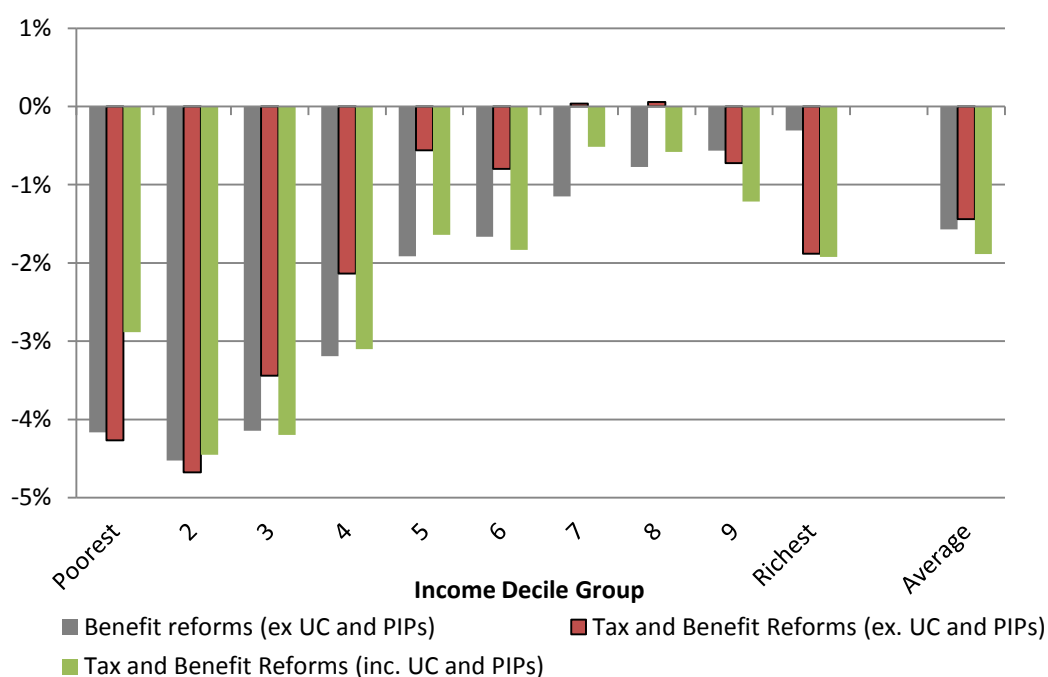
with such sources of income can suffer large losses under the new system. In addition, many disabled households also contain no workers;

- Increase the income of one-earner households (except working lone parents). This is because UC is tapered away more slowly with earnings than existing benefits and tax credits (the abolition of the 16/30 hours rules and less generous treatment of spousal maintenance more than offset this for lone parents);
- Reduce the income of pensioner couples, on average. But, the effects are concentrated on the relatively small numbers of pensioner households where one person is aged over and the other aged under the state pension age, and they currently claim means-tested benefits. Such households are set to lose a lot under UC.

## 6. Conclusions

This report has analysed the distributional effects of the UK government's personal tax and benefit changes in Wales.

Figure 10. Summary of gains and losses across the income distribution, 2014–15 prices



Notes: As for Figure 1.

Source: As for Figure 1.

Many of the key findings are summarised in Figure 10:

- The benefit changes hit poorer households harder than middle income and higher income households, although the biggest losses are for those just above and just below the poverty line as opposed to the “very poor”.
- Tax changes have ameliorated the impact of benefit cuts for households in the middle of the income distribution. This is because, on average, changes to income tax have more than offset the increase in the main rate of VAT. But this is not the case at the bottom and top of the income distributions
- The full roll out of UC and PIPs after 2015 will, together, help the poorest households. But it will hit those households who are expected to lose entitlement to disability benefits, most of whom are currently in the middle of the income distribution.

Table 1 shows that the losses are highest for working age non-working households. Taken together, such households will lose close to 10% of their income as a result of tax and benefit reforms once UC and PIPs are fully in place, on average. The Table also shows that tax changes and the introduction of UC will partially but not fully offset the impact of the benefit cuts on working households in the bottom half of the income distribution. Losses from the benefit cuts of £18.50 per week (4.2% of income), on average, are reduced to £10.13 per week (2.3% of net income) once tax changes and the introduction of UC and PIPs are taken into account.

**Table 1. Losses by work status of household, 2014–15 prices, % and £s per week**

	Benefit changes (ex UC and PIPs)	Tax and benefit changes (ex UC and PIPs)	Tax and benefit changes (inc UC and PIPs)
Pensioner	+0.5% (+£1.87)	-0.2% (-£0.98)	-0.5% (-£2.13)
Non-working (exc. pensioner)	-5.1% (-£17.76)	-5.9% (-£20.42)	-9.7% (-£33.79)
Working, poorest half of population	-4.2% (-£18.50)	-2.6% (-£11.43)	-2.3% (-£10.13)
Working, richest half of population	-0.9% (-£7.92)	-0.7% (-£6.70)	-0.9% (-£8.45)

Source: As for Figure 1.

Table 2 below shows that working-age disabled households lose substantially more, on average, than working-age non-disabled households. This reflects the fact that working age disability benefits face particular cuts – such as time-limiting contributory employment and support allowance, and the replacement of DLA with PIPs. And in addition, because households containing disabled

people have lower pre-tax-and-benefit incomes, on average, they are also more likely to be losing from other benefit cuts, and are less likely to have gained from increases in the income tax personal allowance.

**Table 2. Losses by household disability status, 2014–15 prices, % and £s per week**

	Benefit changes (ex UC and PIPs)	Tax and benefit changes (ex UC and PIPs)	Tax and benefit changes (inc UC and PIPs)
Working-age non-disabled	-1.8% (-£11.87)	-1.4% (-£8.86)	-1.5% (-£9.55)
Working-age disabled	-4.0% (-£20.55)	-3.9% (-£19.94)	-6.5% (-£33.54)
Pensioner (all)	+0.5% (+£1.87)	-0.2% (-£0.98)	-0.5% (-£2.13)

Notes: A disabled household is defined as one where someone would have been entitled to disability benefits under the April 2010 benefits system. Pensioner households are included for comparison purposes and include both disabled and non-disabled pensioners.

Source: As for Figure 1.

Overall, reforms are expected to reduce household incomes in Wales by around £10.75 per week in 2015, which is equivalent to £720 million a year across the country. But, this is not spread equally. Some households will be hit much harder – particularly working age disabled households, non-working households, and those with children – while other households may have in fact gained – such as two earners where both gain from the increases in the income tax personal allowance. For instance, losses average £55 a week for a non-working couple with children, while two earner couples without children gain by £5 a week on average. And, of course, these averages hide significant variation within these groups, with some households hit significantly harder (and some gaining more). Thus different households are bearing very different burdens as part of the UK government’s fiscal consolidation effort.

## **Appendix 1: methods, data and modelled reforms**

This report makes heavy use of the IFS’s tax and benefit micro-simulation model, TAXBEN, which can be used to calculate how actual and alternative tax and benefit systems would affect the incomes of a representative sample of the population of Wales. For this report we run TAXBEN on data from the Family Resources Survey (for direct taxes and benefits) and Living Costs and Food Survey (for indirect taxes), increasing the sample size by pooling 3 years of data (from 2009–10 to 2011–12, with financial variables all uprated to simulate the 2014–15 population). We also adjust figures to account for the under-recording

of the number of people with incomes above £100,000 per year, the size of the incomes, and the effect of tax changes on such high income individuals.

TAXBEN models entitlements to benefits and tax liabilities rather than actual benefit receipts and tax payments. In reality, some households who are entitled to benefits do not claim them, and some households do not pay all the taxes they owe. If this were the only factor our analysis would overstate initial benefit spending and tax revenues, and hence, overstate the impact of the reforms. But the survey data we use seems to under-record benefit entitlements, and incomes and tax liabilities. This means figures produced by TAXBEN match overall tax receipts and benefits closely, and estimates of the impact of reforms should also closely match their true effects.

### ***Benefit changes modelled***

The following changes to the benefit system are included in our modelling (those in bold are ‘giveaways’ to households, while the rest are ‘takeaways’):

- Expiry of temporary increase in Winter Fuel Payments so rate falls back from £250 to £200 (from £400 to £300 for those aged 80 or over)
- **Reduce hours of work required for WTC from 30 to 16 for those aged 60 or over or with a partner aged 60 or over**
- Change Local Housing Allowance so that cannot claim more than the amount of rent actually paid (previously, could keep up to £15 per week if rent paid was less than the LHA rate)
- Switch to uprating most benefits by CPI (instead of RPI or Rossi), and limit increases to at most 1% in 2013, 2014 and 2015
- **‘Triple lock’ for basic State Pension (highest of CPI, average earnings or 2.5%) from April 2012, after increase in line with RPI in April 2011 (higher than triple lock would have been that year)**
- **Increase Pension Credit Guarantee Credit by same cash amount as State Pension**
- Cash freeze in the Pension Credit Savings Credit for 4 years from April 2011, with a reduction in April 2012
- Cash freeze in the basic and 30-hour elements of WTC for 3 years from April 2011, and in the couple and lone parent element in April 2012
- Increase the hours requirements for WTC from 16 to 24 for couples with children
- Reduce the proportion of eligible childcare costs covered by tax credits from 80% to 70%

- Withdraw the family element of Child Tax Credit immediately after withdrawing other elements of tax credits (previously withdrawn only once income exceeded £50,000)
- **Increase the child element of Child Tax Credit by £180 above inflation**
- Remove the baby element of Child Tax Credit
- Freeze Child Benefit in cash terms for 3 years
- Taper Child Benefit away from families containing someone earning more than £50,000
- Restrict Sure Start Maternity Grant to the first birth
- Set Local Housing Allowance rates at 30<sup>th</sup> instead of 50<sup>th</sup> percentile of local rents
- Increase Housing Benefit deductions for resident non-dependants in April 2011 and uprate them with CPI thereafter
- Cap total rent claimable for a given family composition under Local Housing Allowance (irrespective of local rents) and abolish rates above the 4-bedroom rate
- Increase Local Housing Allowance rates in line with CPI rather than actual rents
- Cut Local Housing Allowance (to the 'shared room rate') for single adults aged 25–34 without children
- Cut Housing Benefit for people under-occupying socially rented properties
- Time-limit contributory Employment and Support Allowance to 1 year except for the most severely disabled
- Introduce a benefit cap, £500 per week in 2013–14 (£350 for single adults), for working-age adults, excluding recipients of WTC or Disability Living Allowance and the most severely disabled recipients of Employment and Support Allowance
- Replace Disability Living Allowance with Personal Independence Payment, reassessing claimants' health condition in the process
- Introduce Universal Credit to replace 6 existing means-tested benefits and tax credits

We do not model the following changes:

- Abolition of the 50+ return-to-work element of WTC
- Changes to the treatment of changes in circumstances within-year for tax credits

- Introduce the Work Programme to replace previous welfare-to-work schemes (the Flexible New Deal in Wales)
- Extend Lone Parent Obligations, requiring lone parents with children aged 5 to 9 to claim Jobseeker's Allowance rather than Income Support
- Changes to benefit sanctions regimes
- The increase in the state pension age for women (which was announced in 1995)

### ***Tax changes modelled***

The following changes to the tax system are included in our modelling (those in bold are 'giveaways' to households, while the rest are 'takeaways'):

- The increase in VAT from 17.5% to 20.0% and Insurance Premium Tax from 5% to 6%
- Changes in excise duty rates including escalators for tobacco and alcohol **(and subsequent cuts to beer duty), and real-terms reductions in fuel duties**
- Increases in all rates of NICs and **increases in the employee, self-employed and employer NICs thresholds**
- **Above-indexation increases in the income tax personal allowance to £10,500 in April 2015**
- **Introduction of a £1,050 transferable income tax allowance for married couples where neither partner is a higher rate taxpayer in April 2015**
- Freezing of the over 65s income tax allowance and abolition for new pensioners
- Real-term reductions in the income tax higher rate threshold
- **Reduction in the additional rate of income tax from 50% to 45%**
- Restrictions to pensions contributions tax relief

We are unable to model other tax changes such as changes to business taxation, capital gains taxes, inheritance tax, or changes to anti-avoidance rules etc.

## Appendix 2: Further information on income decile groups and household types

Table A1. Net income range for households of different types, by decile group of overall Welsh income distribution (£s per week)

Decile group	Single, no children	Couple, no children	Single, 2 children (10 and 14)	Couple, 2 children (10 and 14)	Average income
1 (Poorest)	0 – 159	0 - 261	0 - 290	0 - 392	226
2	159 – 191	261 – 313	290 – 347	392 – 469	296
3	191 – 220	313 – 360	347 – 400	469 – 540	376
4	220 – 246	360 – 404	400 – 448	540 – 605	406
5	246 – 284	404 – 465	448 – 516	605 – 698	454
6	284 – 320	465 – 524	516 – 582	698 – 786	526
7	320 – 367	524 – 601	582 – 667	786 – 901	601
8	367 – 429	601 – 704	667 – 781	901 – 1,055	689
9	429 - 533	704 – 874	781 – 971	1,055 – 1,312	796
10 (Richest)	533 +	874 +	971 +	1,312 +	1,340

Notes: The range of incomes in quintile group 1 is the same as decile groups 1 and 2 combined. The range of incomes in quintile group 2 is the same as decile groups 3 and 4 combined. Etc. Incomes are baseline (pre-reform) incomes.

Table A2. Number of households and average income, by household type (£s per week)

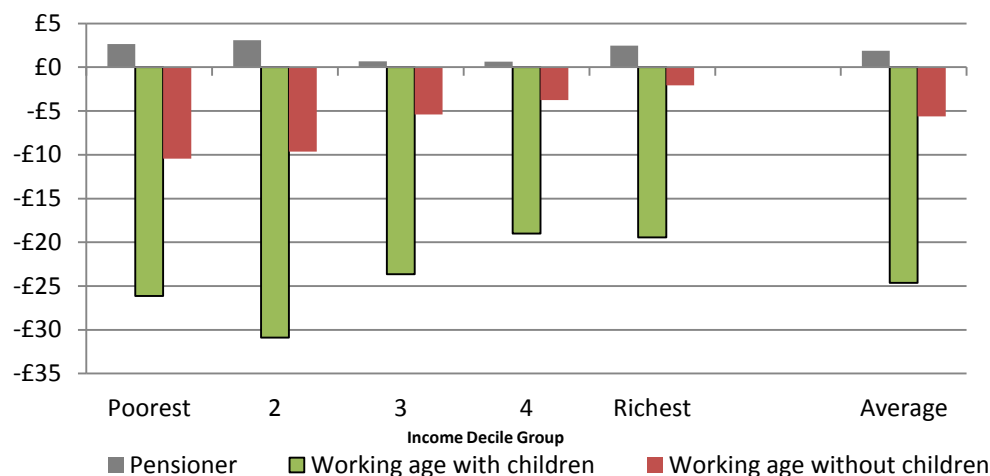
Decile group	Number of Households in Wales	Average income
Single, no work	71,790	231
Single, in work	99,921	443
Lone parent, no work	41,003	341
Lone parent, in work	35,891	478
Couple, no children, no work	32,146	430
Couple with children, no work	18,127	432
Couple, no children, one earner	60,192	584
Couple with children, one earner	64,766	605
Couple, no children, two earners	105,819	801
Couple with children, two earners	140,380	830
Single pensioner	209,099	301
Couple pensioner	167,677	542
Multi-family household, no children	166,947	796
Multi-family household with children	68,695	810



## Appendix 3: additional cash terms figures

Figures are numbered to match the corresponding figure in the main body of the report (hence Figure A2 is the cash-terms equivalent of Figure 2, etc).

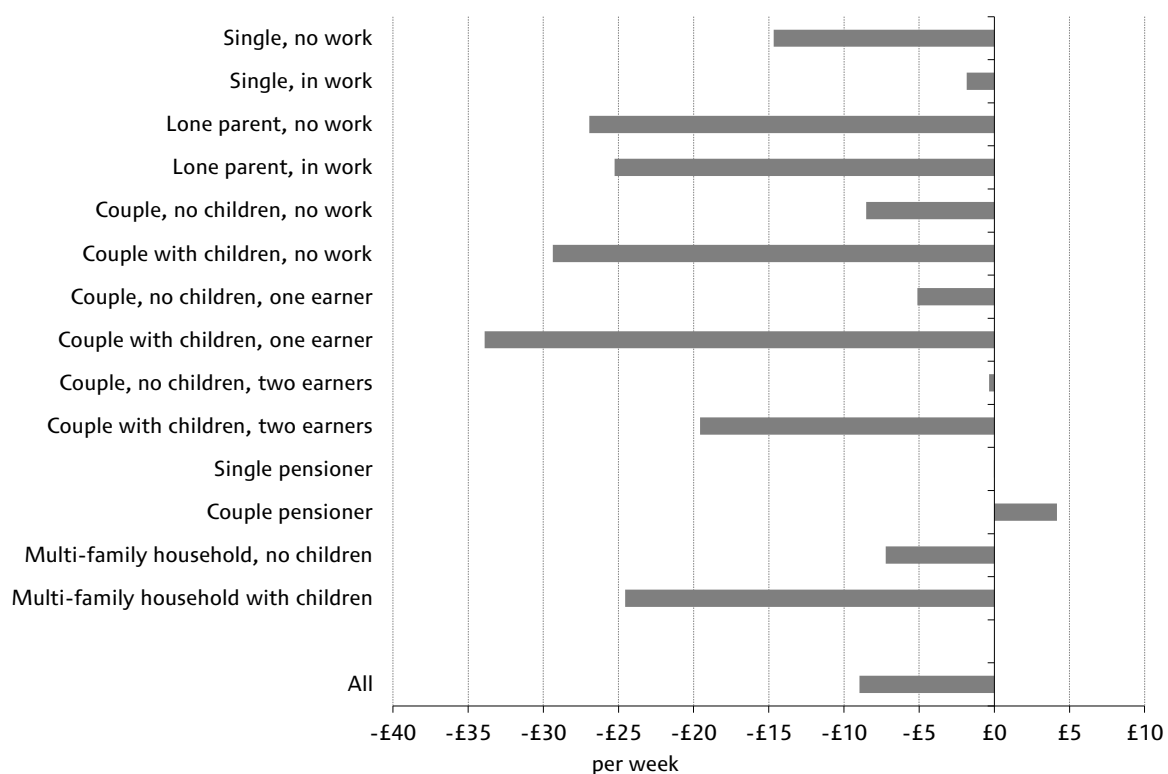
Figure A2. Losses by household type and across the income distribution in Wales from the benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices (£s p. week)



Notes: As for Figure 2.

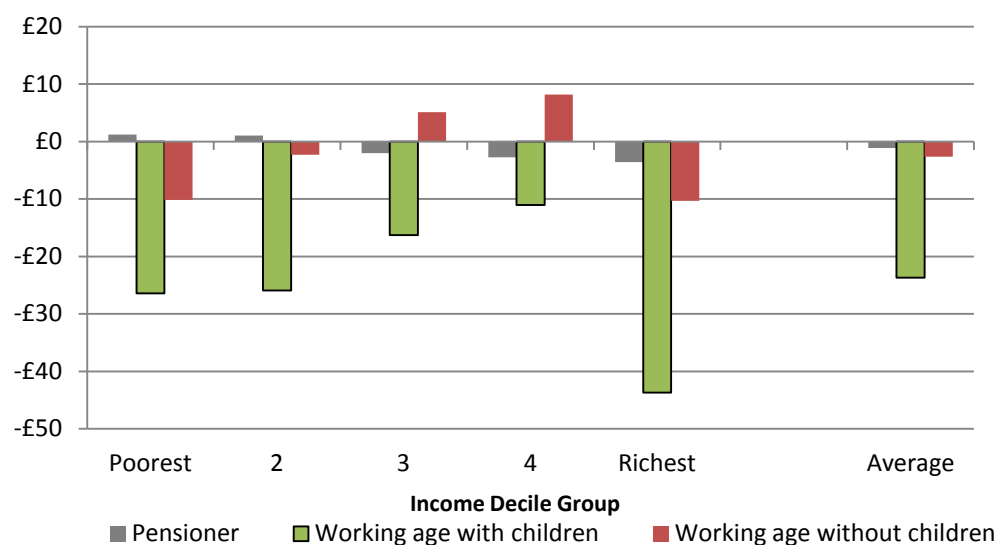
Source: As for Figure 1.

Figure A3. Losses by detailed household type in Wales from the benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices (£s p. week)



Source: As for Figure 1.

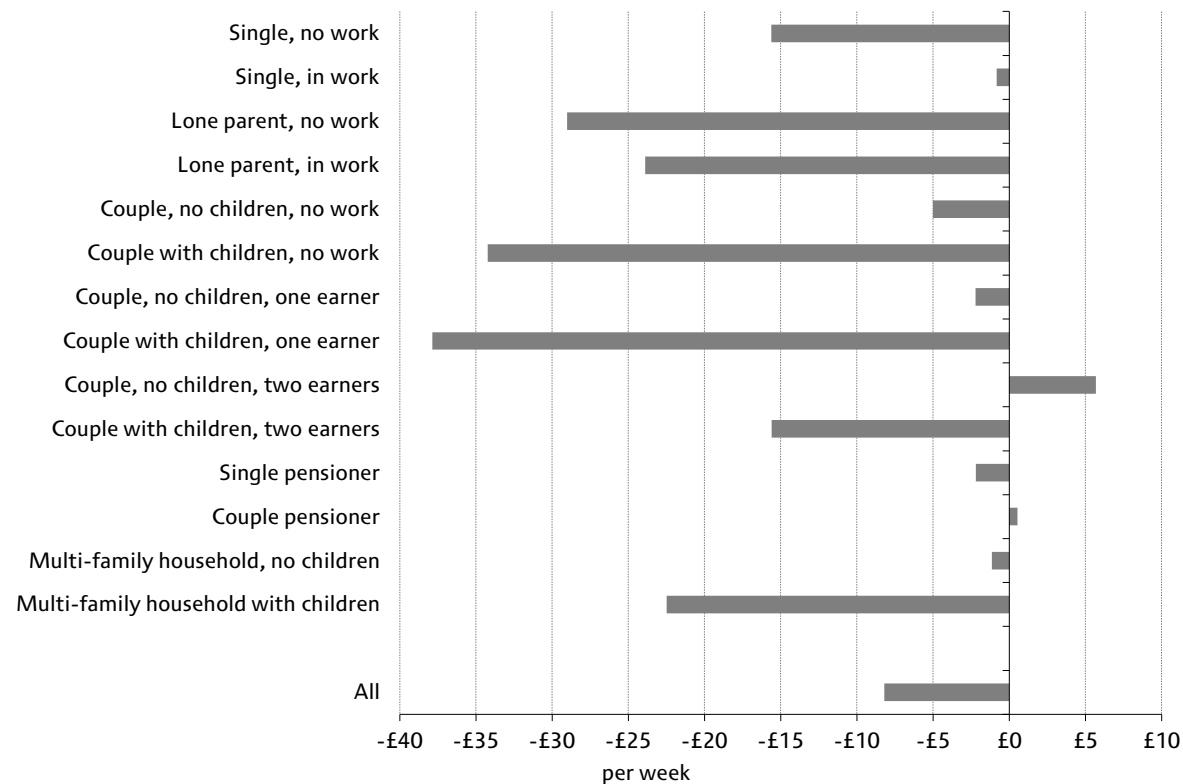
Figure A5. Losses by household type and across the income distribution in Wales from the tax and benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices (£s p. week)



Notes: As for Figure 2.

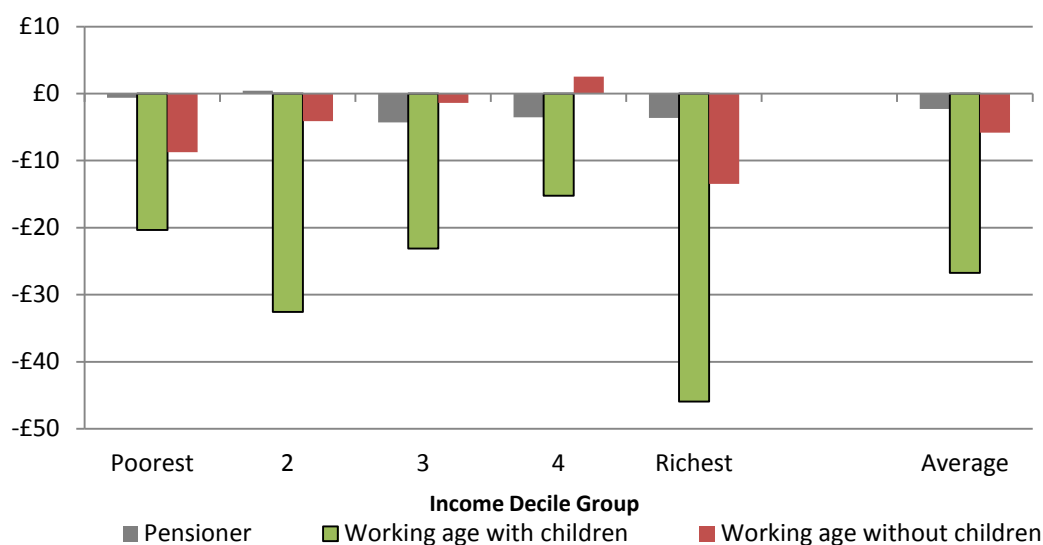
Source: As for Figure 1.

Figure A6. Losses by detailed household type in Wales from the tax and benefit reforms (excluding Universal Credit and PIPs), 2014–15 prices (£s p. week)



Source: As for Figure 1.

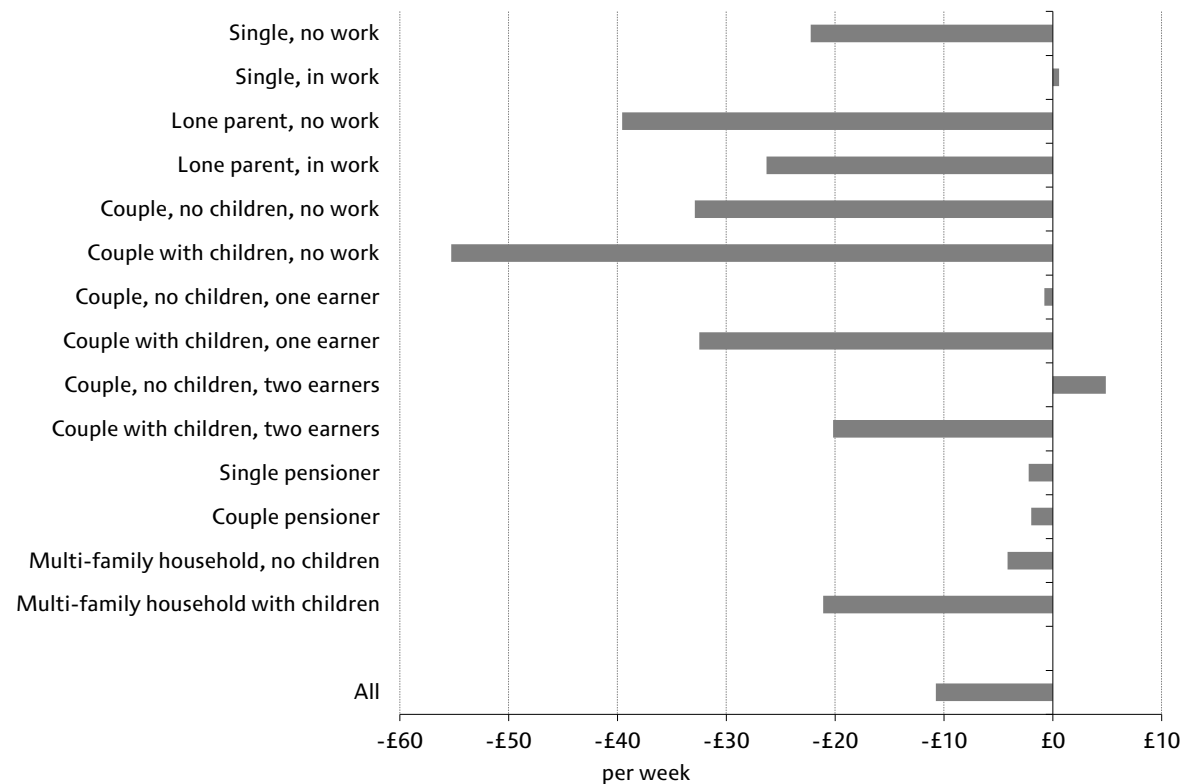
Figure A8. Losses by household type and across the income distribution in Wales from the tax and benefit reforms (including Universal Credit and PIPs), 2014–15 prices (£s p. week)



Notes: As for Figure 2.

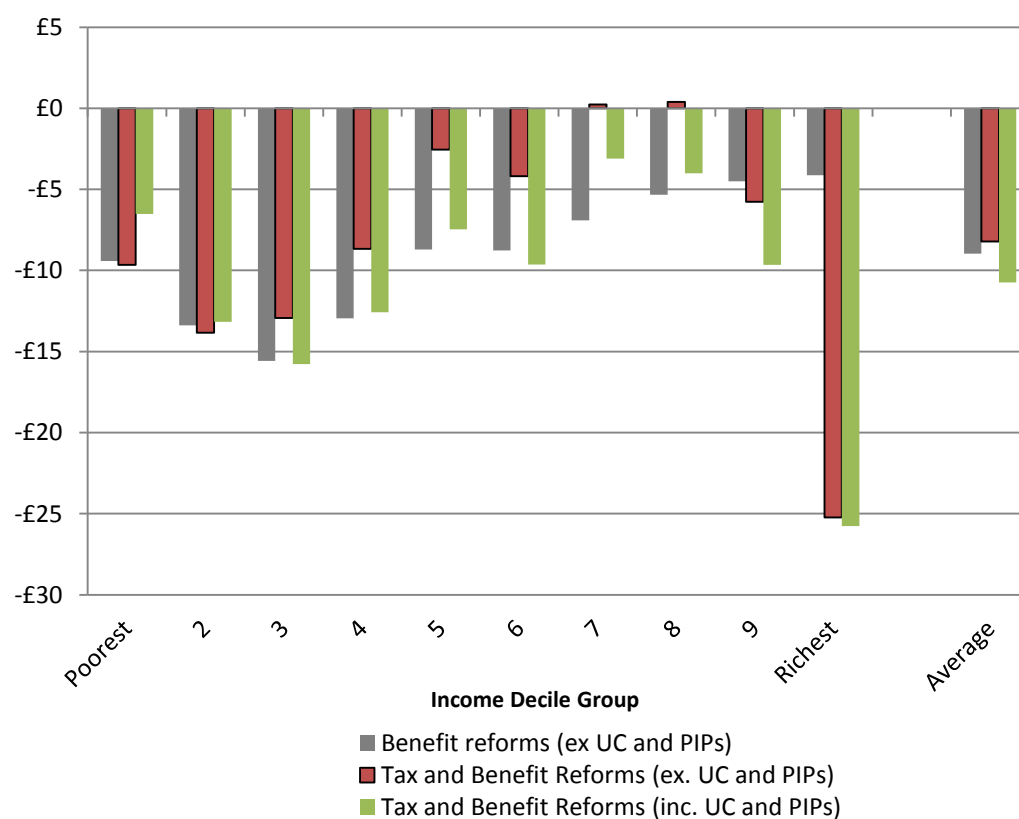
Source: As for Figure 1.

Figure A9. Losses by detailed household type in Wales from the tax and benefit reforms (including Universal Credit and PIPs), 2014–15 prices (£s p. week)



Source: As for Figure 1.

Figure A10. Summary of gains and losses across the income distribution, 2014–15 prices (£s per week)



Notes: As for Figure 1.

Source: As for Figure 1.