Welfare changes this year: discussion of impacts and rationales

Robert Joyce, Senior Research Economist, IFS
Presentation to Association of Chartered Certified Accountants
10th September 2013
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.
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.
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.ifso.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

- **Council Tax Benefit**
- **Housing Benefit**
- **Working Tax Credit**
- **Income Support**
- **Child Tax Credit**
- **Child Benefit**
- **Net earnings less council tax**

**Net weekly income**

**Hours worked per week, at £6.50 per hour**
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

Net weekly income

Hours worked per week, at £6.50 per hour

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)

- 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)

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?

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

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\textsuperscript{th} (and previously the 50\textsuperscript{th}) 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