The fiscal squeeze and tax and welfare changes affecting low-earning individuals

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Presentation to Low Pay Commission, London
20th December 2012
The cure (December 2012): 9.2% national income consolidation over 8 years (£144bn)

Dec 2012: 8.2% national income (£129bn) hole in public finances

Sources: HM Treasury; OBR; Author’s calculations.
Tax cuts coming up (in April 2013)

• Personal income tax allowance up £1,115 in real terms – annual gain of up to £223 for some low-earners.

• More real cuts to fuel duty and Council Tax (latter may not benefit those on CT Benefit). Minor effects on work incentives.
Welfare cuts coming up (1)

- Most existing benefits and tax credits to be increased by 1% in April 2013, 2014 and 2015 (not for pensioners and more severely disabled)
  - 4% real-terms cut overall
  - Affects in-work and out-of-work benefits
Earnings and out-of-work benefits (Jan 2007=100)

Benefit rates: before Autumn Statement
Benefit rates: after Autumn Statement
Average earnings
Minimum wage (adult rate)

Sources: Past earnings from ONS series DTWM, ROYK, MGRZ, MGRQ, past benefits from DWP, forecasts of inflation and earnings growth from OBR.
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Welfare cuts coming up (1)

• Most existing benefits and tax credits to be increased by 1% in April 2013, 2014 and 2015 (not for pensioners and more severely disabled)
  – 4% real-terms cut overall
  – Affects in-work and out-of-work benefits

• Frozen in cash terms in April 2013: basic element and 30-hour premium in Working Tax Credit; Child Benefit

• These reforms will have mixed impacts on work incentives
Welfare cuts coming up (2)

• Housing Benefit cuts (tend to strengthen work incentives)
  • Entitlements for private renters will start rising with national prices (not local rents) – those in areas with real rent growth will lose
  • Cuts to HB entitlement for the 660,000 ‘under-occupying’ working-age social tenant families (14% cuts for some, 25% for others)

• Council Tax Benefit localised; new grants to Local Authorities and Scot/Wales govts will cover only 90% of existing CTB budget
  • Pensioners in England HAVE to be protected; required savings equal to 19% of working-age CTB budget
  • LAs can design their own CTB schemes; and can choose to protect CTB claimants by finding cuts from elsewhere in their budgets
  • Uncertainty about what they’ll do and effects on incomes and work incentives
Universal Credit (UC)

- Will integrate 6 of 7 existing means-tested payments into one

- New claimants of out-of-work benefits get UC from October 2013
- New claimants of tax credits and existing claimants migrate to UC from April 2014 over a period of 4 years

- Incomes of out-of-work people largely unaffected by transition
  - But their work incentives will change

- Will tend to strengthen incentives to work and earn more for:
  - Jobs with low earnings and hours worked (<16, <24, <30 depending on family type)
  - Those currently receiving multiple means-tested benefits and tax credits
Distributional impact of tax and benefit reforms
January 2010 - April 2015 inclusive, as if Universal Credit fully in place

Notes: Excludes reform to Council Tax Benefit. Fuel duty modelled at average 2015-16 level.
## Distributional Impact of Tax and Benefit Reforms

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

### Change in Net Income

<table>
<thead>
<tr>
<th>Household Type</th>
<th>Change in Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, no work</td>
<td>-12%</td>
</tr>
<tr>
<td>Single, in-work</td>
<td>-8%</td>
</tr>
<tr>
<td>Lone parent, no work</td>
<td>-8%</td>
</tr>
<tr>
<td>Lone parent, in-work</td>
<td>-4%</td>
</tr>
<tr>
<td>Couple no children, no work</td>
<td>-2%</td>
</tr>
<tr>
<td>Couple with children, no work</td>
<td>-2%</td>
</tr>
<tr>
<td>Couple no children, 1 earner</td>
<td>-2%</td>
</tr>
<tr>
<td>Couple with children, 1 earner</td>
<td>0%</td>
</tr>
<tr>
<td>Couple no children, 2 earners</td>
<td>2%</td>
</tr>
<tr>
<td>Couple with children, 2 earners</td>
<td>4%</td>
</tr>
<tr>
<td>Single pensioner</td>
<td>6%</td>
</tr>
<tr>
<td>Couple pensioner</td>
<td>8%</td>
</tr>
<tr>
<td>Multi-family household, no children</td>
<td>10%</td>
</tr>
<tr>
<td>Multi-family household with children</td>
<td>12%</td>
</tr>
</tbody>
</table>

### Notes:
- Excludes reform to Council Tax Benefit.
- Fuel duty modelled at average 2015-16 level.
Summary

• We are 1/3 of way through expected large fiscal consolidation

• Rise in personal allowance will benefit some low-earners by £223 p.a.

• Earnings growing less quickly than prices, so out-of-work benefits have been rising faster

• Lots of in-work and out-of-work welfare cuts imminent, on top of those already implemented and planned for later in parliament
  – Overall impact of these on work incentives for low earners is mixed

• Universal Credit is a major structural change and will affect incomes and work incentives (but its impact will be less immediate)