Press Release

High September inflation increases welfare spending, but benefit recipients lose from new indexation rules

Today the Office for National Statistics published the annual rates of inflation to September. These numbers are particularly important: September inflation figures are used to determine increases in personal tax and benefit parameters and public sector pensions at the beginning of the next financial year.

- The fact that inflation rates are above those previously expected by the Office for Budget Responsibility will add roughly £1.8 billion to welfare spending next year.
- But the fact that benefits will be increased by inflation measured by the Consumer Prices Index rather than that measured by the Retail Prices Index or the Rossi index, as happened until last year, means that many benefit recipients will be worse off than they would otherwise have been. Over time this change will prove to be the biggest change to welfare system so far implemented by the government.

From April 2011 onwards, most benefit and tax credit parameters and public sector pensions will be increased annually in line with the Consumer Prices Index (CPI), whereas they had previously risen in line with either the Retail Prices Index (RPI) or the Rossi index. From April 2012 onwards, personal tax thresholds will also be indexed to the CPI, rather than the RPI as previously. The table below shows annual inflation as measured by the CPI, RPI and Rossi index in September 2010 and September 2011.

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<th>RPI inflation</th>
<th>Rossi inflation</th>
<th>CPI inflation</th>
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<tbody>
<tr>
<td>September 2010</td>
<td>4.6%</td>
<td>4.8%</td>
<td>3.1%</td>
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<tr>
<td>September 2011</td>
<td>5.6%</td>
<td>6.8%</td>
<td>5.2%</td>
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Key points include:

- Benefits that were formerly indexed to the RPI and the Rossi will be about 1.8% and 3.1% lower respectively in 2012–13 as a result of the indexation change which took effect from April 2011 (in the absence of other policy changes in relation to those benefits). For example, the rate of Jobseeker’s Allowance, which was formerly indexed to the Rossi, will be £71.00 per week rather than £73.25 per week for a single person.

- Much of the revenue raised from the reform is the result of savings in benefits and tax credits which are received proportionately more by those on low incomes. Unsurprisingly therefore, the indexation switch hits those on lower incomes harder as a proportion of income, on average.
In the first two years since the indexation switch, the differences between CPI inflation and RPI and Rossi inflation have been relatively large by recent historical standards. This increases the immediate impact of the indexation switch.

Nevertheless, the impacts so far have been relatively small. The tenth of the population with the lowest incomes, who lose the most in 2012–13 as a proportion of income, lose less than one percent of their net income, on average. But the impacts will compound indefinitely over time.

Robert Joyce, a Research Economist at IFS, said “Given the importance of indexation policy in determining the future shape of the tax and benefit system, it would be helpful for the Government to set out its thinking on such policy systematically. Why should the Basic State Pension rise at a different rate to public sector pensions? Why should the employer’s National Insurance threshold rise at a different rate to the employee’s National Insurance threshold? These questions are not about how generous the tax and benefit system should be to particular groups. Rather, they relate to how the generosity of the system to particular groups should change over time”.

ENDS

Notes to Editors:

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2. You can download a full Briefing Note ‘The impact in 2012-13 of the change to indexation policy’ from the IFS website: http://www.ifs.org.uk/publications/5713