Benefit Spending and Reforms: The Coalition Government's Record

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Executive summary

Benefit spending under the coalition government

- The coalition government has implemented changes to the benefit system that mean spending in 2015–16 will be £16.7 billion lower than it would otherwise have been. Despite this, the forecast £220 billion of benefit spending in 2015–16 is virtually unchanged in real terms since 2010–11 (although it has fallen somewhat as a percentage of national income, from 12.4% to 11.6%). This reflects the fact that underlying economic and demographic factors are pushing up benefit spending.

- Growing pensioner numbers and higher entitlements among new pensioners have pushed up real-terms spending on the state pension by £12 billion between 2010–11 and 2015–16. This has been partially offset by falls in spending on other benefits for pensioners, leaving overall spending on benefits for pensioners £7 billion higher.

- In contrast, spending on benefits for working-age adults and for children has fallen by around £7 billion. This reflects declining amounts spent on tax credits, child benefit and jobseekers' allowance (JSA), which more than offset increases in spending on housing benefit and disability benefits (increases that have occurred despite cuts to these benefits). Falls in tax credit and child benefit expenditure reflect policy changes; lower spending on JSA instead mainly reflects lower unemployment.

Benefit policy changes implemented by the coalition government

- Underlying the net cut of £16.7 billion are gross takeaways of £24.7 billion, partially offset by gross giveaways of £8.1 billion – with the takeaways largely from benefits for working-age adults, and the giveaways largely to benefits for pensioners.

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- The biggest single spending cut has been the shift to uprating benefits in line with the Consumer Prices Index (CPI) – reducing spending by £4.3 billion in 2015–16. While one can debate whether the CPI is the *best possible* inflation measure to which benefits should be indexed, a move away from discredited measures known to overstate inflation does seem sensible.

- The 1% ceiling on benefit increases in place for April 2013, April 2014 and April 2015 (a cut of £1.7 billion), and freezes to child benefit and working tax credits (a cut of £3.0 billion), represent big cuts spread over a large number of people. Some cuts to housing benefit for private-sector tenants and, in principle, cuts to disability benefits (amounting to £1.7 billion) also represent coherent if controversial policies.

- Other changes to the indexing of benefits have been less well designed. For instance, if the 'triple lock' for the state pension is retained in the long term, then the state pension will grow faster than prices and earnings, costing many billions of pounds a year. It will already be costing £4.6 billion a year in 2015–16 compared with earnings indexation, and £1.1 billion relative to CPI indexation. It also stands in sharp contrast to the 1% ceiling on the indexation of working-age benefits, which was partly justified by noting that benefits indexed to inflation had been rising faster than earnings.

- Some reforms sit strangely with the rest of the benefit system. For instance, the localisation of council tax benefit undermines the drive towards simplicity and improved work incentives embodied by universal credit. Also, the new means test for child benefit has some undesirable features, including the fact that it is based on the income of the individual with the highest income in a couple, rather than on their combined income.

- Taken together, the reforms have changed the shape of the benefits system. Support for working-age families has been reduced for those with middle and higher incomes, and is now more targeted on those with the lowest incomes. However, increases in the generosity of the state pension, and the announcement of the introduction of a single-tier pension from 2016, represent a move *away* from means-tested support towards more universal benefits for pensioners.

- As well as changing the structure of benefits, the coalition government has also tightened the conditions that the recipients of a number of benefits have to meet, and has increased the number and severity of sanctions that can be levied if those conditions are not met. The aim is to encourage work – and in the case of lone parents, there is evidence that this has had some success.

- The Work Programme, where providers of welfare-to-work programmes are paid by results, has not yet delivered the forecast increases in employment entry and progression, although the National Audit Office reports performance is improving.

- Moving claimants of incapacity benefit and income support on grounds of disability on to employment and support allowance (ESA) has taken longer than expected. The assessment tests have also proved controversial (with many appeals from those initially found ineligible), and were reformed in March 2011, at which point the fraction of claims that were successful increased. Partly as a result, the shift to ESA is now expected to reduce spending by less than initially forecast.

Future challenges for the next government

- Two of the biggest changes to the benefit system planned by the coalition government have been so delayed that implementing them will largely fall to the next government: the roll-out of personal independence payment to existing claimants of disability living allowance, and the roll-out of universal credit.
- Universal credit – a plan to roll six out-of-work benefits into one single payment – has much to commend it: once fully rolled out it, it should make the benefit system more effective and coherent, and would increase the incentives many benefit claimants have to enter and to progress in work. However, the roll-out has been severely delayed by IT and management issues: the latest forecasts suggest it will still be incomplete in May 2020, 10 years after the reform was first announced.
- Another big challenge relates to the public finances. In order to keep to plans for total public spending set out in the 2014 Autumn Statement, cuts to social security spending totalling £21 billion by 2019–20 would be needed to prevent an acceleration in the rate of cuts to public service spending. This is around 23% of forecast spending on benefits for working-age people in 2015–16, implying substantial cuts for this group if pensioners were again largely protected.

1. Introduction

In 2010–11, the first year of the coalition government, spending on cash benefits, tax credits and the state pension was £220 billion (in 2015–16 prices): 27.6% of government spending, and 12.4% of national income. It is perhaps unsurprising, therefore, that the government looked to cut spending in this area as part of its efforts to reduce the large budget deficit it inherited. We estimate that the coalition government's changes to the benefit system will have reduced spending by nearly £17 billion in 2015–16, compared with what would have happened without those changes. However, despite these cuts, real benefit spending in 2015–16 is expected to be virtually the same as in 2010–11 (i.e. £220 billion). The fact that spending on benefits will not have fallen despite large discretionary cuts reflects the fact that a number of underlying factors are acting to push up spending – notably, the ageing of the population, weak earnings growth, a growing private rental sector in the housing market, and rising claims for disability benefits.

In this Briefing Note, we look at how benefit spending has changed under the coalition government, and assess the changes made to the benefit system. The picture that emerges is of a system more focused on pensioners, and with a greater reliance on means testing for working-age recipients. Some of the reforms made look like sensible ways to save money, and one – universal credit – represents a radical redesign of the system that could have significant advantages, if implementation issues can be overcome. However, some of the government's reforms have undesirable features and betray incoherent thinking on how benefits should be structured, and especially how they should be uprated over time. What this report *does not* do is provide a quantitative analysis of the distributional and work incentive effects of benefit reforms – that is the focus of a separate note.[2]

[2] J. Browne and W. Elming, 'The effect of the coalition's tax and benefit changes on household incomes and work incentives', Institute for Fiscal Studies (IFS), Briefing Note BN159, 2015 (http://www.ifs.org.uk/publications/7534).

The rest of this note proceeds as follows. In Section 2, we first describe how the amount spent on benefits has changed under the coalition government, distinguishing between the amount spent on pensioners and the amount spent on working-age adults and on children. We then provide estimates of the effect on benefit spending of discretionary changes implemented by the coalition government. Of course, changes to benefits not only have effects on spending, but also change the shape of the system for better or worse. Therefore, in Section 3, we provide a more detailed assessment of the various benefit policy changes that have been made, paying particular attention to whether policies are well designed, and to the possible or actual effects of changes on people's behaviour (both intended and unintended). In Section 4, we look to the challenges in benefits policy that this government will bequeath to its successor. We conclude in Section 5.

2. The big picture: benefit spending and reforms under the coalition government

This section provides an overview of how and why spending on social security benefits, state pensions and tax credits (henceforth 'benefit spending') has changed under the coalition government. We first outline what has happened to government spending in this area, before discussing the impact of reforms.

2.1 Benefit spending under the coalition government

Figure 2.1 shows total benefit spending in each year from 1997–98 to 2015–16. The dashed line shows spending as a share of national income, whilst the bars show real-terms spending in £ billion (adjusting for inflation using the Consumer Prices Index (CPI) – see Box 2.1 for an explanation of why we use a measure of household inflation).

Box 2.1. Adjusting for inflation when measuring benefit spending

In this Briefing Note, we adjust benefit spending figures for inflation as measured by the CPI. This is because we want to assess changes in the generosity of the system towards households, and the CPI is a measure of the change in the prices facing those households. When looking at the real-terms cost of benefit spending to the government, one might instead adjust for prices using the GDP deflator, because this is a measure of economy-wide inflation.[a]

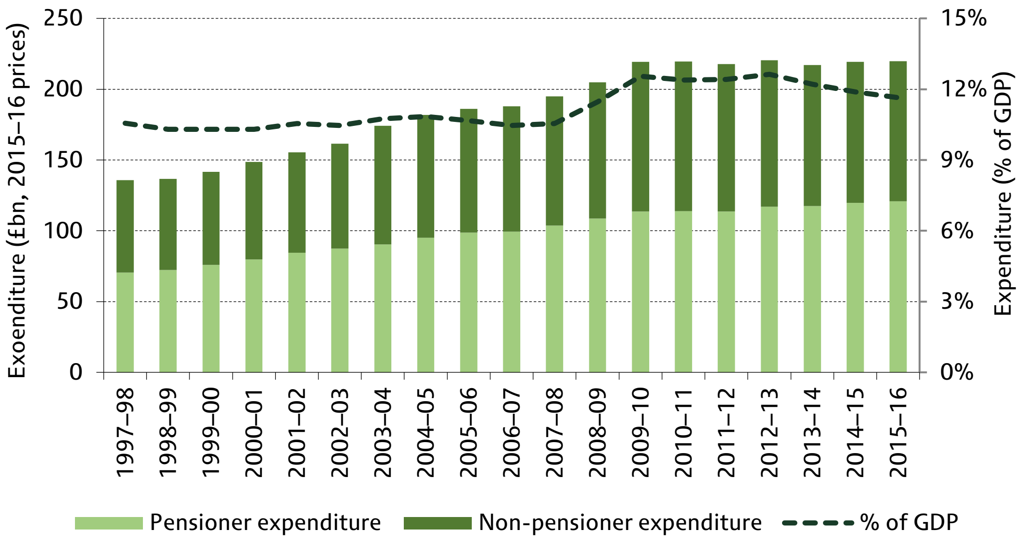
Between 1997–98 and 2010–11, the GDP deflator was higher than the CPI, on average. A higher rate of inflation corresponds to lower growth in real-terms spending; spending grew by an average of 3.8% a year relative to CPI inflation, but by an average of only 3.4% a year relative to the GDP deflator. However, CPI inflation has been higher than the GDP deflator in recent years. As a result, while CPI-adjusted benefit spending is expected to be unchanged between 2010–11 and 2015–16, spending adjusted by the GDP deflator is expected to have increased by £6 billion (0.5% per year).

[a] Note that the real-terms spending figures provided by the Department for Work and Pensions (DWP) are adjusted using the GDP deflator.

Between 1997–98 and 2007–08, benefit spending was broadly flat as a share of national income, at around 10.5%. Growth in the size of the economy was matched by real-terms increases in entitlements, particularly for low-income families with children and for pensioners (real-terms benefit spending grew by an average of 3.7% per year). Given that benefit spending tends to increase significantly as a share of national income in recessions, allowing it to rise in line with a growing economy was always likely to lead to a greater share of economic resources being spent on benefits in the long run. Indeed, the substantial fall in national income during the Great Recession, accompanied by large real-terms increases in benefit spending (averaging 6.1% across 2008–09 and 2009–10), led to a sharp increase in benefit spending as a share of national income, to around 12.5% in 2009–10. The coalition government therefore inherited a situation where benefit spending was taking up a historically high share of national income, and would not have declined rapidly in the absence of discretionary changes.

Spending was stable over the first half of the coalition government's time in office, but is forecast to decline to 11.6% of national income by 2015–16. As can be seen from Figure 2.1, this decline is the result of the return of economic growth rather than a real-terms fall in benefit spending. Given the scale of the cuts announced by the coalition government (discussed below), it is striking that in real terms, benefit spending in 2015–16 is expected to be the same as in 2010–11, at £220 billion.

Figure 2.1. Expenditure on social security benefits and tax credits: 1997–98 to 2015–16



Note: Figures exclude spending on council tax benefit. Pensioner expenditure is all spending directed at pensioners, including benefits that also go to those of working age.
Source: Authors' calculations using DWP, HM Revenue and Customs (HMRC), Office for Budget Responsibility (OBR) and Department for Social Development (DSDNI) data.

One reason why real-terms spending has not fallen under the coalition government is the continued growth in benefit spending directed at pensioners. In the decade from 1997–98, pensioner spending rose by 3.9% a year in real terms, slightly faster than non-pensioner spending (3.4%). As one would expect, this pattern was reversed during the recession; non-pensioner spending rose by 5.0% a year between 2007–08 and 2010–11, while pensioner spending rose by 3.1% a year. However, while spending on non-pensioners has fallen by 1.4% a year under the coalition government, spending on pensioners has increased by 1.2% a year. As a result, rising pensioner spending has cancelled out the fall in expenditure on those of working age. As discussed below, this divergence partly reflects the policy choices made by the coalition government; they have chosen to focus discretionary cuts on working-age benefit and tax credit recipients, while largely protecting pensioners.

Table 2.1 shows the spending on different benefits going to pensioners in 2010–11 and 2015–16. The headline is that a £12 billion increase in spending on the state pension more than explains the total increase in benefit spending directed at pensioners. In fact, spending on other benefits for pensioners has fallen in real terms – in particular, higher state pension entitlements have significantly reduced spending on (means-tested) pension credit and housing benefit.

It is important to note that the rise in real-terms spending on state pensions was the continuation of a long-run trend that is explained by two key factors. First, the number of pensioners has continued to increase as the population ages, despite increases in the female state pension age. Second, more recent cohorts of pensioners are more likely to qualify for earnings-related components of the state pension (and more women in those cohorts were able to meet the state pension qualification criteria). The continued

Table 2.1. Benefit expenditure on pensioners: 2010–11 and 2015–16

	Expenditure (£bn, 2015–16 prices)		% change
	2010–11	**2015–16**	
State pension	80.4	92.0	14.4%
of which:			
Basic state pension	*62.3*	*70.2*	*12.6%*
Additional state pensions	*18.0*	*21.8*	*20.8%*
Disability living allowance and attendance allowance	10.9	10.7	–1.9%
Pension credit	9.6	6.5	–31.6%
Housing benefit	6.9	6.8	–1.2%
Winter fuel payments and TV licences	3.8	2.8	–26.0%
Other	2.4	2.1	–10.3%
Total	**113.9**	**121.0**	**6.2%**
Number of pensioners (millions)	**12.2**	**12.5**	**2.8%**
Total per pensioner (£ per year)	**9,400**	**9,700**	**3.3%**

Note: Columns might not sum due to rounding.
Source: Authors' calculations using DWP, HMRC, OBR, DSDNI and ONS data.

increase in state pension spending has led to a significant change in the composition of benefit spending; the share of total benefit spending going to state pensions is expected to rise from 36.6% in 2010–11 to 41.8% in 2015–16, its highest level since 1983–84.[3]

In contrast with spending directed at pensioners, spending on benefits for non-pensioners has fallen under the coalition government. Table 2.2 shows how spending on the major benefits received by non-pensioners changed between 2010–11 and 2015–16.

The three areas that have seen the biggest falls in expenditure over that period are tax credits, child benefit and jobseekers' allowance (JSA) and income support (IS). In the first two of these cases, falls in real expenditure reflect the policy choices made by the coalition government – tax credit and child benefit entitlements have been cut

[3] Prior to 1983–84, despite pensioners making up a smaller share of the population, spending on the state pension constituted a larger fraction of overall benefit spending, because spending on benefits for working-age claimants (and especially means-tested benefits) was relatively lower.

significantly. (It is worth noting, however, that tax credit spending will still be higher than in any year before 2007–08.) In the case of JSA and IS, the fall in spending largely reflects substantial falls in unemployment.

However, spending on other benefits for non-pensioners has increased. In particular, housing benefit spending is expected to be £1.1 billion higher in 2015–16 than in 2010–11, and spending on disability benefits is expected to be £1.8 billion higher. In the case of housing benefit, underlying macroeconomic and demographic pressures more than cancelled out reductions in the generosity of support. The OBR identify three such pressures in their first *Welfare trends report*: the growth of the private rented sector, real growth in private rents and falls in real earnings.[4] In the case of disability benefits, the increase in spending is the continuation of a long-run trend; spending on disability living allowance (DLA) for non-pensioners increased by 67% between 1997–98 and 2010–11, driven largely by increasing numbers of claimants (rather than discretionary increases in DLA rates). The coalition government intended to arrest that upwards trend by replacing DLA with personal independent payments (PIP), but as discussed in Sections 3 and 4, this structural reform to the benefit system has been significantly delayed.

Table 2.2. Benefit and tax credit expenditure on non-pensioners: 2010–11 and 2015–16

	Expenditure (£bn, 2015–16 prices)		% change
	2010–11	**2015–16**	
Tax credits	33.2	29.9	-9.9%
Housing benefit	18.1	19.2	6.1%
Incapacity benefits	15.1	15.1	0.6%
Child benefit	13.7	11.7	–14.3%
Disability living allowance and personal independence payment	9.1	10.9	19.7%
Jobseekers' allowance and income support	8.5	5.2	–38.6%
Other	8.1	6.6	–17.8%
Total	**105.7**	**98.8**	**–6.5%**

Note: Incapacity benefits are incapacity benefit, employment and support allowance, income support on grounds of disability and severe disability allowance. The figure for child benefit is the gross amount paid out, *not* net of spending later recovered in tax through the high-income child benefit charge. Columns might not sum due to rounding.
Source: Authors' calculations using DWP, HMRC, OBR and DSDNI data.

2.2 The impact of policy changes on benefit spending

We now turn to consider discretionary changes to benefits, tax credits and state pensions. Table 2.3 shows the expected impact on government spending in 2015–16 of all the changes implemented by the coalition government. The figures shown are the expected effect of policies *relative to the system inherited* (not, for example, the overall expected change in real-terms spending on particular benefits).[5]

[4] OBR, *Welfare trends report – October 2014*, Office for Budget Responsibility, London, 2014 (http://budgetresponsibility.org.uk/welfare-trends-report-october-2014).

[5] They do not include the impact of policies where implementation began under Labour but continued under the coalition government, the most notable of which is the replacement of incapacity benefit with employment and support allowance.

The net impact of all the changes taken together is to reduce spending on benefits and tax credits in 2015–16 by around £16.7 billion compared with what would otherwise have been. Yet, as we showed earlier, total real-terms benefit spending is forecast to be almost unchanged during the coalition government's time in office. The implication is that in the absence of reforms, real-terms benefit spending would have increased by an average of 1.5% a year, from £220 billion in 2010–11 to £236 billion in 2015–16. This would have meant that the share of national income spent on benefits, tax credits and state pensions would have risen slightly across the parliament (from 12.4% to 12.5%), rather than falling by nearly a percentage point (to 11.6%).

Where have the £16.7 billion in savings come from?

One way in which the coalition government has reduced the generosity of the benefit system as a whole has been through changes to the annual indexation of benefits and tax credits. One such change is permanent – the move from using the Retail Prices Index (RPI) and Rossi measures to the CPI measure of inflation for most benefits. As long as CPI inflation is below RPI (and Rossi) inflation (as it usually is, and has been throughout the coalition government's time in office), this change will yield a larger total saving each year, relative to the system the government inherited.[6] The other wide-ranging change to indexation is temporary – nominal increases in most working-age benefits (excluding disability benefits) were limited to 1% for three years from April 2013. However, even a temporary change to indexation has a permanent effect on spending, as entitlements will be lower in every future year than they would otherwise have been. Together, these two changes reduced benefit spending in 2015–16 by £6 billion relative to the system the government inherited, and the savings from moving to CPI uprating will, if kept in place, continue to grow over time.

Beyond changes to indexation, there have been significant cuts to three large areas of benefit spending in particular: tax credits, housing benefit and child benefit. The generosity of the tax credit system was reduced in a number of different ways, saving a total of over £6.8 billion a year. This was partly offset by one significant increase in the generosity – the above-inflation increase in the child element of child tax credit in April 2011. The overall impact of changes to tax credits is therefore to reduce benefit spending by over £5 billion in 2015–16.

The next largest reduction in spending came from changes to child benefit. A high-profile policy change was the decision to withdraw child benefit from families containing an individual with a taxable income of over £50,000, saving nearly £1.9 billion in 2015–16. A similar amount was saved, perhaps drawing less attention, by freezing child benefit for three years from April 2010, and then limiting nominal increases to 1% in April 2014 and April 2015. Together, these changes are expected to reduce spending by almost £3.5 billion in 2015–16 and, under current policy, that figure will grow over time as more and more individuals have a taxable income over the fixed nominal threshold of £50,000.

The third major area where the coalition government chose to reduce the generosity of the benefit system was housing benefit. The majority of the cuts in this area were to the support available to private-sector tenants (despite the fact that the majority of housing benefit goes to social-sector tenants), with a number of changes in the way the maximum amount of rent covered by housing benefit – known as the local housing allowance (LHA)

[6] It is worth noting that this reform affected both pensioners and non-pensioners; for example, the indexation of earnings-related state pensions was affected.

Table 2.3. Estimated revenue effects in 2015–16 of benefit and tax credit changes implemented by the coalition government

	2015–16 estimated revenue effect (£ million)	
	Giveaway	**Takeaway**
Indexation reforms	0	6,000
of which:		
CPI-indexation of most benefits and tax credits[a]		*4,260*
1% nominal cap on increases in most working-age benefits and tax credits for three years from April 2013[b]		*1,740*
Pensioner benefits	5,265	1,450
of which:		
'Triple lock' the basic state pension[c]	*4,590*	
Pension credit changes[d]	*675*	*430*
Housing benefit	55	2,500
of which:		
Changes to local housing allowance	*15*	*1,820*
Cut housing benefit entitlement for under-occupying working-age social-sector tenants		*465*
Tax credits	1,650	6,835
of which:		
Changes to elements (including eligibility conditions), thresholds and tapers	*1,650*	*3,500*
Reduce eligible childcare costs from 80% to 70%		*405*
Changes to disregards		*1,295*
Administrative changes		*1,635*
Child benefit	0	3,480
of which:		
Withdrawal from families containing an individual with a taxable income over £50,000		*1,875*
Three-year freeze and two-year 1% indexation		*1,605*
Council tax benefit		475
Disability living allowance[e]		200
Employment and support allowance[f]		1,555
Jobseekers' allowance and income support	195	715
Introduction of household benefit cap		185
Other changes	915	1,335
Totals	**8,080**	**24,730**
Grand total	**16,650 takeaway**	

Note:

[a] Figure adjusted for inflation outturns. Includes changes to the indexation of additional state pensions but excludes the revenue effect of changes in the indexation of public-sector pensions.

[b] Figure adjusted for inflation outturns. Excludes 1% uprating of child benefit in 2014 and 2015 (costed separately).

[c] Figure adjusted for inflation and earnings outturns. Revenue effect is relative to the plans the coalition government inherited (moving from RPI to earnings for uprating the basic state pension from April 2012). Revenue effect relative to CPI uprating from April 2012 is a giveaway of £1.1 billion, and relative to continued RPI uprating is a takeaway of £0.7 billion.

[d] Giveaway and takeaway figures not available separately for some changes to pension credit.

[e] Effects of the replacement of DLA with PIP for working-age claimants updated using information in the OBR's *Economic and Fiscal Outlook,* March and December 2014.
[f] Figure does not include the estimated revenue effect of replacing incapacity benefit with employment and support allowance.
Source: Authors' calculations using HM Treasury Budgets, Autumn Statements and Spending Reviews, various years, OBR policy measures database (http://budgetresponsibility.org.uk/policy-measures-database/) and OBR, *Economic and Fiscal Outlook,* March and December 2014.

rate – is calculated. However, there was one change for social-sector tenants, with those deemed to be 'under-occupying' their property losing a percentage of their benefit entitlement (the so-called 'bedroom tax' or 'removal of the spare room subsidy'). Taken together, changes to housing benefit are expected to reduce spending by around £2.5 billion in 2015–16 relative to the system the coalition government inherited (although as noted above, real spending on housing benefit has continued to rise).

Beyond these three large areas of benefit spending, there were other cuts in generosity, including the time-limiting of contributory employment and support allowance (ESA), the 10% cut in funding that accompanied the localisation of council benefit, and the introduction of a household benefit cap. The revenue effect of the last of these changes in particular is small. One reform that could have important consequences for government spending in the long run is the replacement of DLA with PIP. This is expected to cut spending by over £2 billion a year when fully implemented, but delays to the roll-out plan mean the impact in 2015–16 is expected to be small (around £200 million).

Overall, it is clear that the cuts to benefits and tax credits made by the coalition government have mostly affected working-age recipients, rather than pensioners. Sometimes this protection has been implicit – the decision to make significant cuts to tax credits and child benefit is a decision to reduce the generosity of the system for families with children (and some low-income working families without children), rather than pensioner families. Sometimes the protection has been explicit – pensioners were not affected by the housing benefit cut for under-occupying social tenants, and they will not be moved from DLA to PIP, nor have they been affected by council tax benefit cuts.

In addition to this protection, Table 3.1 shows that the coalition government's reforms have increased the generosity of benefits for pensioners, at least compared with inherited plans. This has come through the introduction of the 'triple lock', whereby the basic state pension is uprated by the greatest of earnings, CPI inflation and 2.5%. It is estimated that the 'triple lock' in 2015–16 will have increased spending on the state pension by £4.6 billion relative to uprating the basic state pension in line with earnings from April 2012 (the plan the coalition government inherited). This reflects the weak earnings growth seen, and perhaps it is unlikely any government would have moved to pure earnings indexation when earnings were so weak. The 'cost' of the triple lock is £1.1 billion relative to uprating the basic state pension in line with CPI (the rule the government now uses for almost all other benefits and tax credits) and spending is actually estimated to be £0.7 billion *lower* than if the basic state pension had continued to be uprated in line with RPI.[7]

Of course, reforms to the benefits system have not just had an impact on the government's fiscal position and the incomes of recipients. The decisions taken about where and how to cut (and indeed where to increase the generosity of support) have also changed the shape of the system. The next section addresses the question of whether the specific policy changes represent a change for the better.

[7] Source: Authors' calculation using HMT budgets and OBR economic and fiscal outlook, various years. RPI inflation has generally exceeded the higher of CPI inflation, earnings and 2.5%.

3. Policy changes: a detailed assessment

In this section, we look in more detail at the various reforms made by the coalition government – discussing their merits, and examining their effects on benefit claimants. As most of the changes to benefits aimed at reducing expenditure, we ask whether the precise changes made seem like a sensible way of cutting costs – or whether alternative policies may have been better. And we assess whether the changes make sense as part of a coherent and well-designed social security system.

In doing this, we group policy changes into seven subsections:

- changes to the way benefits are indexed from year to year (Section 3.1);
- changes to the amount of housing benefit that can be claimed (Section 3.2);
- changes to tax credits and child benefit (Section 3.3);
- the introduction of an overall 'benefits cap' (Section 3.4);
- the localisation of support for council tax (Section 3.5);
- changes to disability benefits (Section 3.6);
- changes to conditions for receiving benefits and the sanctions that can be applied when conditions are not met (Section 3.7).

3.1 Changes to indexation

Choosing the default way in which benefits are changed from year to year (a process known as uprating or *indexation*) is one of the key decisions that need to be taken when designing a system of cash support. Benefits could be indexed to a measure of inflation so that they maintain their real-terms value. Since the early 1980s, this has been the default form of indexation for most benefits in the UK. However, as earnings and national income tend to grow in real terms over time, this approach will normally lead to benefits falling relative to earnings, and benefit spending falling as a share of national income. To avoid this, benefits could be indexed to the change in earnings, or the change in national income per person.[8] Of course, as has happened since the recent recession, earnings can sometimes fall in real terms. This means that indexation to earnings could result in a real-terms fall in the value of benefits in some years, even if the long-run effect is to increase their real-terms value.

The coalition government inherited a system in which most non-means-tested benefits were indexed to RPI inflation, and most means-tested benefits were indexed to the Rossi measure of inflation (effectively a measure of RPI that excludes mortgage interest, rent and council tax).[9] As part of broader changes to indexation (including to most taxes and to public service pensions), it has changed the measure of inflation used to index most benefits to CPI inflation. However, a number of temporary and ad hoc deviations from standard indexation have proven to be less sensible – including freezing and capping some benefits, as well as the 'triple lock' on state pensions.

[8] The OBR's assumption in its long-term projections of the public finances is that benefits will increase in line with earnings in the longer term, even though default indexation is largely inflation based.

[9] There were exceptions. The guarantee element of the pension credit was, and remains, indexed to average earnings, by default, and a number of elements of the system were, and remain, frozen in nominal terms by default (such as the income level at which working tax credit begins to be withdrawn).

The switch to CPI indexation

The CPI tends to give a lower estimate of inflation than both the RPI and Rossi. This change in indexation rules is now forecast to save the government £4.3 billion in 2015–16 given outturns and forecasts for the various inflation measures (note that in Budget 2011, it was forecast to save around £7.8 billion, as the gaps between CPI and RPI and Rossi inflation were then forecast to have been much greater than they have turned out to be). Such savings were likely an important motive for the change, given the need for spending cuts, but the government also claimed that the CPI provided a better measure of benefit recipients' 'inflation experience'.

In comparing these indices, there are two key considerations.

- First, the formulas used to calculate RPI and Rossi, versus the CPI. The formula used to calculate RPI and Rossi suffers from a number of technical flaws, which mean it overstates inflation.[10] These flaws have led the Office for National Statistics to remove the 'National Statistic' status from the RPI. The CPI measure of inflation does not suffer from these problems and, in this respect, is a superior measure.
- Second, the CPI also differs from the other indices in terms of the goods and services it includes. Compared to the RPI, the CPI *excludes* mortgage interest and council tax costs, and compared with Rossi (which also excludes these items) the CPI *includes* rents.[11]

Rossi's exclusion of rents meant its coverage was more appropriate than that of CPI given benefits policy prior to 2013, because the vast majority of claimants of formerly Rossi-indexed benefits were insulated from rent costs due to their receipt of housing benefit. Changes to how housing benefit for private-sector tenants is indexed in 2013 (see later) mean this is unlikely to be the case in the long term though: more private-sector housing benefit claimants will be exposed to changes in rents as time goes by, and the CPI might then better reflect their 'inflation experience'.

What about the comparison between RPI and CPI? Surely excluding mortgage interest costs – a major expense for many recipients of benefits formerly linked to RPI, like child benefit and tax credits – is a retrograde step? In answering this, it is important to note that when interest rates go up, they not only push up mortgage interest costs, they also increase the amount people earn from their savings. Across the economy as a whole, these two factors should roughly balance, meaning rising interest rates redistribute income from net borrowers to net savers, but do not increase the overall average cost of living. This would suggest that if a single inflation measure were to be used for all types of benefits, then one that excluded mortgage interest costs – e.g. CPI – may be more appropriate.

But, of course, borrowing and saving do not necessarily balance for particular individuals or population groups: working-age benefit recipients often have net financial debt, and pensioners often have net savings. A measure of inflation that accounted for mortgage interest costs might better reflect changes in the living costs of some groups, such as

[10] For further details, see P. Levell, 'A winning formula? Elementary indices in the Retail Prices Index', Institute for Fiscal Studies (IFS), Working Paper W12/22, 2012 (http://www.ifs.org.uk/publications/6456).

[11] Also, RPI is based on weights for different goods that exclude the spending of the richest people, and pensioners who obtain at least two-thirds of their income from the state; CPI does not exclude these groups.

working-age people; and one that excluded it might better reflect that of other groups, such as pensioners. Using different measures of inflation to index benefits for different population groups would have its own problems though.[12]

To summarise, although CPI is not a perfect measure of the 'cost of living', the shift to CPI indexation seems broadly sensible: RPI and Rossi systematically overstate inflation; and somewhat counter-intuitively the coverage of CPI might be preferable as well.

Below-inflation increases in benefits and tax credits

Freezes in child benefit and a number of elements of the working tax credit, and the capping of many working-age benefit increases at 1% in April 2013, April 2014 and April 2015, are more obviously measures designed to reduce benefit spending. They represent a simple and sizeable reduction in expenditure that is broad-based (among working-age recipients) rather than focused on particular groups of claimants.

The background to this reform is that since the late 2000s recession, earnings have increased considerably less quickly than prices. As a result most benefits, indexed to prices by default, were rising faster than earnings – see Figure 3.1. The government pointed to this pattern of benefits but not wages keeping pace with prices, when making the case for capping increases in many benefits at 1%, thereby reducing their real-terms value.[13]

Does this mean that the government thinks that inflation indexation is not always the appropriate default rule? If so, a couple of important points are worth bearing in mind. First, more generally, earnings tend to grow faster than prices, a policy of straightforward earnings indexation would imply substantially *higher* benefit rates in the long run than currently planned, and would therefore increase benefit spending. Second, a policy of indexing to the lesser of inflation and earnings growth each year is unlikely to be desirable. This would imply that benefits would rise by less than both prices and earnings. While one can always reasonably debate the appropriate *level* of entitlements, it is not clear why any government should want benefits to be falling indefinitely over time, both in real terms and relative to earnings. Or, for that matter, why the rate of decline should depend on the volatility in, and correlation between, year-on-year changes in prices and earnings, as is the case under such a 'minimum' rule.

If the aim of the policy was to reduce the real-terms value of benefit rates, then capping increases at a fixed nominal 1% would not be the best solution either. The size of the real-terms cut depends on the level of inflation – higher inflation means a bigger real-terms cut, and vice versa. The effect of such a policy on real-terms expenditure is therefore also uncertain, as it depends on future inflation. In fact, as a result of lower-than-forecast inflation, our estimates suggest that the three years of 1% nominal increases will save £1.8 billion in 2015–16, compared with an initial Treasury estimate of £2.3 billion (and an estimate of £2.8 billion made in Budget 2013).[14] If the government had chosen instead

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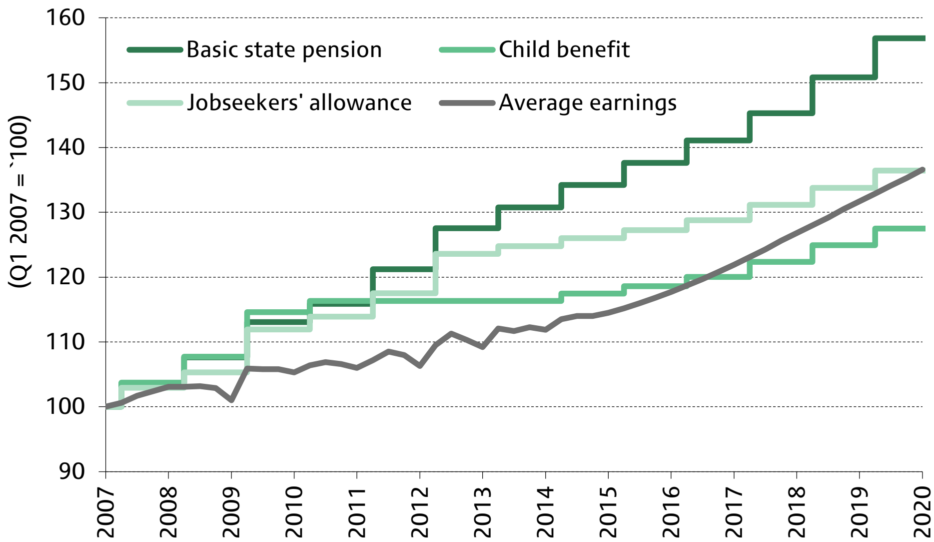
[12] There may be a stronger case for using different inflation measures for different benefits, as was formerly the case. For instance, it might be more appropriate to index tax credits using a measure of inflation that does account for mortgage interest – because the tax credits means test means that entitlements are reduced when interest income increases.

[13] For example, in the Chancellor's 2012 Autumn Statement speech (http://www.hm-treasury.gov.uk/as2012_statement.htm), he said 'we have to acknowledge that over the last five years those on out-of-work benefits have seen their incomes rise twice as fast as those in work. With pay restraint in businesses and government, average earnings have risen by around 10% since 2007. Out-of-work benefits have gone up by around 20%.'

[14] These figures exclude the two-year 1% nominal upratings of child benefit and LHA rates.

to increase benefits by inflation minus a certain amount (e.g. 1 percentage point), it could have chosen the desired real-terms reduction, and guaranteed a more certain amount of savings.

Figure 3.1. Benefit rates and average earnings (cash terms index, 2007 = 100)



Source: Earnings and inflation forecasts from OBR (http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/). Past benefit levels from DWP, various years.

The 'triple lock'

Since April 2012, the basic state pension been increased by the *maximum* of earnings growth, CPI inflation, or 2.5% (hence the so-called 'triple lock'). Because earnings have not kept pace with inflation, this is substantially more generous than the plans inherited from the last government, which were to move to earnings indexation from April 2012. This additional generosity will cost an estimated £4.6 billion in 2015–16 (much more than the £0.5 billion it was forecast to cost when first announced in June 2010).[15] However, compared with the previous system of indexation to RPI inflation, because CPI (or 2.5%) has generally been below RPI inflation, the 'triple lock' has been less generous, actually saving £0.7 billion.

The rationale for this policy has not been clearly stated, but it might reflect a desire to protect pensioners from real-terms cuts in their pension when real-terms earnings fall (which is what would otherwise occur under pure earnings indexation). However, just as policy-makers should be cautious of using 'minimum' rules, they should also be cautious of using 'maximum' rules such as the 'triple lock'. These mean that if wages sometimes increase less quickly than prices, then the state pension increases by *more* than both earnings and prices in the long term. This feature of the 'triple lock' can be seen clearly in Figure 3.1.

Maintenance of the 'triple lock' could therefore have important implications for the burden that state pensions place on the public finances over the coming decades. In its

[15] The lower initial costing reflected forecasts that earnings would quickly begin to outpace inflation – which turned out not to be the case.

2013 and 2014 Fiscal Sustainability Reports,[16] the OBR forecast that if earnings and inflation in future behave as they have done since 1993 (when the focus of monetary policy in the UK first moved to inflation targeting), the state pension will increase by an average of 0.3% per year more than earnings if the 'triple lock' is retained. By 2062–63, the cumulative effect of that 0.3% a year will be to increase state pension spending by around 0.8% of national income (around £15 billion a year in 2015–16 terms) compared with a policy of earnings indexation. This is in the context of a projected increase in the cost of the state pension from 5.5% of national income in 2018–19 to 7.9% of national income in 2063–64, implying that around one-third of the increase in costs of the state pension projected over the next 50 years are due to the 'triple lock'.

If the government did want to raise the level of the state pension relative to earnings for the long term, the 'triple lock' is not a sensible way of achieving this (simple discretionary increases in generosity would be better). This is because, under the 'triple lock', the value of the state pension in the long term depends not only on long-term inflation and increases in average wages, but also on the *volatility* of wage growth and inflation (and the correlation between them).[17] There is no rationale for the state pension to increase more in the long term just because of greater year-to-year volatility in earnings growth or inflation.

If, instead, the government wants to protect pensioners from real-terms reductions in the state pension when earnings fall, by increasing the pension by more than earnings in such circumstances, but *does not* want to increase the value of the state pension relative to earnings in the *long term*, a mechanism to 'claw back' above-earnings increases would need to be developed. One option would be to set a target for the level of the state pension relative to average earnings, and to cap increases in the state pension (e.g. at inflation) if the state pension was above that level.

3.2 Changes to housing benefit

Housing benefit is forecast to cost £26.0 billion in 2015–16, with roughly 60% of this going to social housing tenants, and 40% to private-sector tenants.[18] As already mentioned, spending has actually increased since 2010–11, despite significant discretionary cuts to housing benefit These cuts were of two main kinds. The first was to reduce the maximum amount of housing benefit that could be claimed, for almost all claimants in the private sector, and for a particular group of social-sector claimants. The second was a change in the way the maximum amount of housing benefit private-sector tenants can claim is indexed.[19]

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[16] See http://cdn.budgetresponsibility.independent.gov.uk/2013-FSR_OBR_web.pdf and http://budgetresponsibility.org.uk/pubs/41298-OBR-accessible.pdf.

[17] Pages 43 and 44 of D. Phillips, 'Government spending on benefits and state pensions in Scotland: current patterns and future issues', Institute for Fiscal Studies (IFS), Briefing Note 139, 2013 (http://www.ifs.org.uk/publications/6818), provide an illustrative example that demonstrates this issue clearly.

[18] Source: Authors' calculations using DWP, DSDNI, HMRC and OBR data.

[19] There have been a number of other changes, such as changes to the amount deducted from housing benefit if someone has a lodger, a grown-up child or another 'non-dependent' living with them, and allowing payments for additional bedrooms for carers. We do not discuss these changes. We discuss changes to the indexation of housing benefit here, rather than in the previous subsection, because some knowledge of how housing benefit works is required to understand the reform to indexation made – and the problems with it.

Changes to housing benefit for private-sector tenants (LHA)

For the vast majority of private-sector tenants, the maximum amount of rent covered by housing benefit is determined by a housing allowance (LHA) rate, which depends on the area in which they live and the number of bedrooms to which they are deemed to be entitled (which depends on family size and structure). From April 2011, these LHA rates were reduced in a number of ways:[20]

- LHA rates were moved from the 50th percentile (median) of local rents for a given number of bedrooms to the 30th percentile;
- claimants can no longer keep any of the difference between their rent and their LHA rate when their rent is below their LHA rate (they had previously been able to keep up to £15 per week);
- national caps were introduced on LHA rates;
- the five-bedroom LHA rates were abolished;
- most single individuals aged between 25 and 34 inclusive, and without children, are now entitled only to the shared accommodation rate, rather than the one-bedroom rate.[21]

Taken together, these changes are expected to save the government £1.3 billion in 2015–16. In 2010, 55% of tenants were renting a property that cost more than the maximum LHA they were entitled to, and therefore had to contribute to their rent; following the reforms, this increased to 62% (and 68% among new claims for LHA).[22]

The first and second of the reforms affect a large number of private-sector housing benefit claimants and make up the bulk of savings (£0.9 billion), whereas the other three affect smaller subgroups of that population. However, losses to the individual claimants affected by these latter reforms can be substantial. The DWP impact statement suggested the average loss to those living in properties of five bedrooms or more (and therefore, potentially subject to the abolition of the five-plus bedroom rate) was £74 a week.[23] And, in central London, for instance, the maximum amount that could be claimed by someone needing a four-bedroom property fell from £1,000 a week in June 2010, to £400 a week once the cap took effect.[24]

Moving LHA rates from the 50th to the 30th percentile of local rents is a coherent way to reduce the generosity of private-sector housing benefit. The implied judgement is that LHA rates should be high enough to cover the full rent of the cheapest 30% of appropriately sized properties in an area, rather than half of them. The removal of the right for claimants to keep up to £15 of the difference between their rent and the LHA

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[20] New claimants were affected immediately, but existing claimants received some transitional protection, and so were mostly affected between January and December 2012.

[21] This change took effect from January 2012.

[22] M. Brewer, C. Emmerson, A. Hood and R.Joyce, *Econometric analysis of the impact of Local Housing Allowance reforms on existing claimants*, Institute for Fiscal Studies (IFS) External Publication, Department for Work and Pensions Research Report No 871, 2014 (http://www.ifs.org.uk/publications/7277).

[23] DWP, 'Housing Benefit: changes to Local Housing Allowance', DWP Impact Assessment, 2010 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214327/lha-impact-nov10.pdf).

[24] Information available at https://www.whatdotheyknow.com/request/broad_rental_market_areas_brma_a. The equivalent cap is now £412.89 per week.

rate, however, may be counterproductive as it removes any immediate incentive for private-sector housing benefit claimants to negotiate a rent below their LHA rate.

The government might have hoped that a significant part of the impact of these cuts would be felt by private landlords, rather than their tenants. Economic theory (and previous evidence) suggests that a significant amount of the housing subsidies provided by governments feed through into higher rents, and so cuts to housing benefit should reduce rents, mitigating the effect on tenants. However, an independent evaluation conducted for the DWP found that, at least in the short run, 90% of the impact of cuts appeared to be felt by tenants, and only 10% by their landlords.[25] In the long run, the incidence may be different. The evaluation also found evidence that some of those subject to the national caps on LHA rates had moved out of the affected areas (largely in central and inner London) as a result of the caps.

From April 2013, further changes to LHA were made. In particular, the link between LHA rates and current local rents was generally broken, with LHA rates instead being indexed from then on using CPI inflation (which has historically been lower than the growth in rents). The exception is that they will be set at the 30th percentile of local rents if that is lower than the implied CPI-uprated LHA rate. Assuming that rents continue to grow in real terms, this condition will become increasingly irrelevant over time. Together with a temporary capping of increases in LHA rates at 1% in April 2014 and April 2015, forecasts suggest the changes in indexation will save around £0.5 billion in 2015–16. In future years, these savings will grow indefinitely as long as private-sector rents continue to grow in real terms.

The immediate consequence of the change is that LHA rates relative to local rents will tend to decline, and decline more in areas that experience faster rent growth after 2012–13. Where local rents grow in real terms, those LHA claimants whose rent levels are already at least as high as their LHA rates will be affected by the reforms immediately; other claimants will be affected in time, as their rents overtake their LHA rates and are no longer fully covered by housing benefit.

The details of this policy will lead to some odd effects. Although the policy will break the link between levels of rent subsidy and levels of local rents, it does not represent a move towards greater geographical uniformity of LHA rates: they will instead be linked to *historic* levels of local rents. There seems to be no justification for geographical relativities in rent subsidies in 2050, for instance, depending upon geographical differences in rent levels in 2012. Indeed, if the ranking of areas by rent level changes after 2012, then there can be (and already are)[26] areas that have *higher* rent levels than other areas and yet have *lower* LHA rates. This is not at all sensible. Moreover, the decision to set LHA rates each year at the minimum of the 30th percentile of local rents and the previous year's LHA rate uprated in line with CPI means that volatility in local rents in the short run could affect the level of LHA rates in an area permanently (and

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[25] M. Brewer, C. Emmerson, A. Hood and R.Joyce, *Econometric analysis of the impact of Local Housing Allowance reforms on existing claimants*, Institute for Fiscal Studies (IFS) External Publication, Department for Work and Pensions Research Report No 871, 2014 (http://www.ifs.org.uk/publications/7277).

[26] For instance, in 2014–15, the two-bedroom LHA was set at £109.57 per week in the Lincolnshire Fens, 5p per week *lower* than the £109.62 per week in Shropshire. In contrast, the 30th percentile of rents in the Lincolnshire Fens was almost £5 a week *higher* than in Shropshire. See http://webarchive.nationalarchives.gov.uk/20140711154517/http://www.voa.gov.uk/corporate/_downloads/xls/2014_LHA_RATES.xls.

measured rents at a local level can indeed be volatile from year to year). This is another undesirable feature of the policy.

Alternative policies could better achieve the aims that seem to underlie the policy. If the desire was to reduce LHA rates relative to rents (as would be the case if rents grow faster than CPI inflation), one could instead reduce the percentile of the rent distribution at which LHA rates are set. If the aim was for greater geographical uniformity, then LHA areas could be expanded (potentially to cover the whole of Great Britain). As it stands, the former link between housing benefit and contemporaneous local rents has been broken for private sector tenants – without a clear and well-thought idea of what to replace this with. A fundamental reassessment of how support for housing costs is structured is overdue.

Changes to housing benefit for social-sector tenants

From April 2013, working-age[27] housing benefit claimants in social housing who are deemed to be under-occupying their homes have had their maximum housing benefit awards reduced. This is estimated to have affected about 660,000 families in 2013–14, which is about one-third of working-age housing benefit claimants in the social rented sector. Four-fifths of affected families who have one more bedroom than they are deemed to need have had awards cut by 14%; the other one-fifth of those affected, who have at least two more bedrooms than they are deemed to need, have had awards cut by 25%. Taking these two groups together, losses average £14 a week, or around £700 a year.

The stated rationales for the policy include encouraging more efficient use of the social housing stock and treating private renters (whose housing benefit was already linked to family size) and social renters more similarly. These seem laudable goals. But this policy, dubbed the 'bedroom tax' by its critics, has perhaps been one of the most controversial benefit changes made by the coalition government (and the Labour Party, SNP, UKIP, Green Party and the Liberal Democrats have all pledged to reverse, at least partially, this change). This is despite it being relatively small (£465 million per year in 2015–16) in the context of the overall cuts.[28] One reason may be the type of people affected. Many would have previously been paying no rent and would have to contribute for the first time. Almost seven-in-ten (68%) of affected people say they, or someone in their household, has a disability or long-term illness. And 45% claim to have lived in their property for 10 or more years; long-standing tenants, who have formally life-long tenancies, may particularly resent the pressure to move.

A second reason may be the *effects* on tenants. Although there has been no comprehensive quantitative evaluation of the effects of the policy, a survey of the effects on tenants has been undertaken.[29] In the first six months of the policy, 4.5% of affected tenants moved to a smaller socially rented property. However, there is a shortage of smaller properties available; DWP figures suggest there is a need for 600,000 one-

[27] 'Working age' for these purposes is defined as between the ages of 16 and the female State Pension Age. This is gradually rising from its current level of 61 to 66 by 2020. Therefore, all else equal, the number of claimants affected by this measure will rise slightly over time.

[28] The costing for the policy change is from Table 2.2 of HM Treasury, *Budget 2013*, March (http://www.hm-treasury.gov.uk/budget2013.htm). Subsequent figures are from DWP's Impact Assessment, June 2012 (http://www.dwp.gov.uk/docs/social-sector-housing-under-occupation-wr2011-ia.pdf) or *Evaluation of Removal of the Spare Room Subsidy*, Research Report No 882, DWP, 2014 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/329948/rr882-evaluation-of-removal-of-the-spare-room-subsidy.pdf).

[29] See *Evaluation of the Removal of the Spare Room Subsidy*, Research Report No 882, DWP, 2014 (link in previous footnote).

bedroom properties, but only 360,000 exist, for instance. If unable to find an appropriately sized socially rented property, some have moved to a private rental property and started claiming LHA (this could end up as more or less expensive for the taxpayer than the original housing benefit claim); 1.4% of claimants had done so six months after the introduction of the policy.

Affected tenants also have somewhat strengthened work incentives (there is less housing benefit to lose if they enter work or increase their earnings) and there may therefore be employment responses on their part: 14% of affected individuals report they looked for a job as a result (and some workers report seeking additional hours or a pay rise). If they cannot increase their income or move house, they may reduce expenditure on other goods and services, or may borrow (21%) or receive financial help (9%) from friends and family. They may also struggle to pay their rent: evidence suggests that around half of those affected were in rent arrears six months after the introduction of the policy. Increases in the amount of government finance to support discretionary housing payments were partly aimed at alleviating these problems, and 22% of affected families report applying for such a payment.

Social landlords may also respond to the policy by allocating families to properties using different criteria;[30] increasing efforts to identify overcrowding and under-occupying tenants and encouraging them to exchange homes; and building more small properties to address the aforementioned shortage.

It is worth noting that the greater the extent to which the policy encourages more efficient usage of social housing, the less it will reduce expenditure on housing benefit. If under-occupying and overcrowded households effectively swap homes in response, then both groups of households will be able to cover all their rent through housing benefit claims, just as they could before the policy was implemented. In contrast if housing decisions are unaffected by this policy, then it would not improve (or reduce) the appropriateness of the allocation of the social housing stock, but it would reduce housing benefit spending.

3.3 Changes to tax credits and child benefit

Changes to tax credit rates, thresholds and tapers

As shown in Table 2.3, changes to tax credit rates, thresholds and tapers are forecast to reduce spending on tax credits by around £1.9 billion per year in 2015–16, relative to the system the coalition government inherited.[31] Major changes include:

- freezes to the main, lone parent and couple elements of the working tax credit;
- increases in the hours-of-work requirements for couples with children to receive working tax credit;
- an increase in the rate at which tax credits are tapered away as income rises from 39p for every £1 of extra income to 41p;
- reductions in the incomes at which tapering away of tax credits begins, most notably for the 'family element' of the child tax credit;[32]

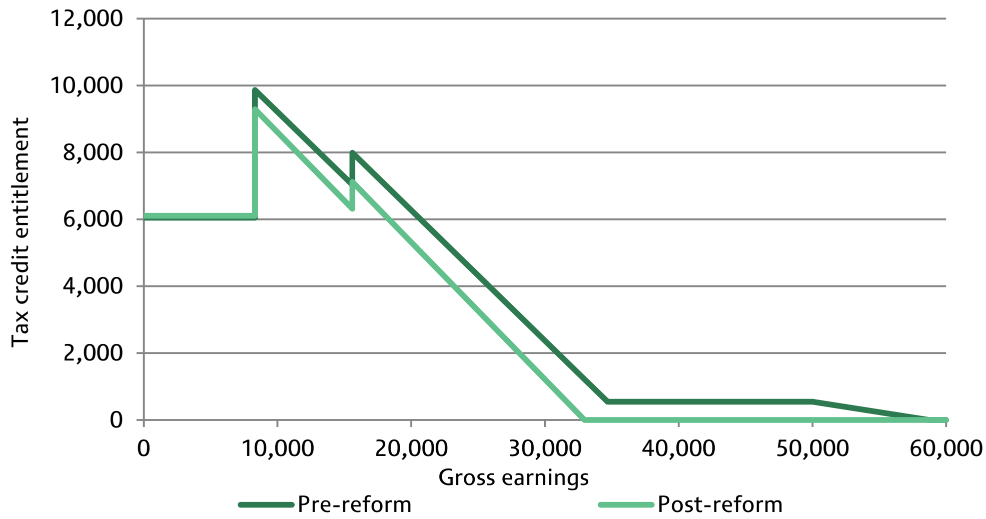
[30] For example, if young couples without children are currently given properties with more than one bedroom in expectation that they will shortly have children, this may be less likely in future.

[31] This figure is the sum of takeaways and giveaways on tax credit elements, tapers and thresholds, and childcare support as reported in Table 2.3.

- reductions in the proportion of childcare costs that can be claimed for, from 80% to 70%;
- removal of a number of elements of tax credits (such as 'baby' element paid to families with a child aged under 1);
- and increases in the child element of the child tax credit (the only significant giveaway).

The result of these changes is that the poorest (e.g. non-working) families with children generally receive a little more support from tax credits than they otherwise would have, but that families with higher income receive less (especially if they claim support for childcare costs). In this way, the changes mean that support has become more targeted at

Figure 3.2. An example lone parent's tax credit entitlement under the pre-reform (2010) and post-reform (2015) benefits systems



Source: Authors' calculations. Lone parent is assumed to earn £10 per hour and work 52 weeks per year, and have no other sources of income, except child support (which is not subject to means testing).

those with the lowest incomes, but at the expense of a weakening of work incentives.[33] This is illustrated in Figure 3.2, which shows the amount tax credits an example lone parent with two children would receive at different levels of earnings under the reform and uprated (pre-reform) tax credit system.[34]

Changes to tax credit administration

Perhaps surprisingly, at £2.9 billion, changes to the administration of tax credits – such as how underpayments and overpayments, debts, and error and fraud are dealt with – are

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[32] This now begins as soon as the 'child' elements have been fully tapered away, rather than at a family income of £50,000 a year.

[33] Or, more correctly, this is a weakening of incentives to have at least one adult in work. For couples, the incentive for a second adult to enter work may actually increase because smaller tax credits mean that there is less to be tapered away when the second adult enters work.

[34] Note that such a lone parent family could also be affected by changes to other benefits – such as housing benefit, council tax benefit, JSA – which are not shown in the figure (many of these reforms are difficult to show in such a graph). In many instances, reforms to other benefits take the reform of reductions in maximum entitlements. These hit those with the lowest incomes (who are entitled to the maximum), but also mean that entitlements are fully tapered away at a lower level of income than previously. Thus, some families who were previously entitled to a small amount of these other benefits might find they no longer are. Thus, changes to maximum entitlements, while hitting the lowest income families, also tend to mean the remaining support is more concentrated on those with the lowest incomes.

due to contribute more to estimated spending cuts than are the policy changes described above.

After its introduction by Labour in 2003, the tax credit system very soon ran into problems of overpayments (and to a lesser extent, underpayments) because people did not promptly inform HMRC when their circumstances changed. In particular, many families whose income increased during the year and who therefore should have been receiving fewer tax credits than they actually were, faced paying back sometimes sizeable amounts of 'overpayments'. This led to significant criticism of the system. As a result, the Labour government increased the amount by which income could change once a claim for tax credits for a given year had begun *without affecting tax credit entitlement* from £5,000 to £25,000. This led to a significant reduction in the number of 'overpayments', but at the cost of paying large amounts of tax credits to people whose income had increased substantially, and who might therefore be deemed to be less in need of those tax credits.

The coalition government has reduced this within-year 'income increase disregard' back to £5,000. It also introduced for the first time, an 'income decrease disregard' of £2,500, so that tax credit awards are not increased within-year unless a family's income falls by more than £2,500. When cuts to spending are required, an obvious place to look are those whose incomes have increased, and who may therefore no longer have such need for the money (it is less clear whether those who see their income fall are such a logical target). But there are drawbacks. First, these disregards provide incentives for families to limit income increases to less than £5,000 (to avoid recalculation of tax credit entitlements), and to increase income falls to more than £2,500 (so that entitlements *are* recalculated). This issue clearly existed for £25,000 disregard but affected fewer people. Second, overpayments unsurprisingly have become a bigger issue again as the 'income increase disregard' has been reduced. HMRC statistics show that the fraction of awards where overpayments were made increased from 20% to 27% between 2010–11 and 2012–13, the latest year for which data are available.[35]

In part to address these concerns, the 2014 Autumn Statement confirmed that where changes in circumstances are known by HMRC – using the new 'real-time information' available to it from employers, for instance – changes to tax credit payments would be made immediately (rather than, for instance, trying to reclaim overpayments later). This might prevent families from spending overpaid tax credits that they subsequently have to pay back, and might reduce costs to government (collecting debt is more difficult than reducing payments up front).

Means testing child benefit

Child benefit was frozen in cash terms in April 2011, April 2012 and April 2013. In April 2014 and April 2015, it was, and will be, increased by 1% in cash terms. In addition to these real-terms reductions in child benefit rates, the coalition government has also introduced a means test for the first time. Since January 2013, child benefit has been tapered away for families containing an individual with a taxable income exceeding £50,000 a year, with families containing an individual with a taxable income of £60,000 a year or more receiving no child benefit. This was estimated to affect around 1.2 million

[35] Data from HMRC statistics, available at https://www.gov.uk/government/collections/personal-tax-credits-statistics. Note overpayments can also occur for reasons other than income changes – such as changes in parents partnership status, and children leaving home or full time education.

families[36] and to save the government around £1.5 billion in its first year, rising to £1.9 billion in 2015–16.

In the context of a large fiscal consolidation, one can understand why the government looked at universal benefits going to those on higher incomes as one candidate for cuts. However, various features of the design of this particular policy look problematic.

First, the means test is based on the income of the person with the highest income, which contrasts with the more usual family-income means test used in the benefits system. It leads to the situation in which a family where the highest-income individual has an income of £60,000 receives no child benefit, but a family where both parents have an income of £50,000 (and hence a total income of £100,000) receives full child benefit. This may be seen as unfair. Other alternatives were (and are) available: child benefit could have been integrated with the child tax credit and have been subject to a family-level means test.

In addition, the way in which it is withdrawn (1% of total maximum child benefit for the family is withdrawn for every £100 by which taxable income exceeds £50,000) means that people with more children face higher marginal income tax rates than those with fewer children. For instance, someone with one child facing withdrawal of child benefit currently faces a marginal income tax rate of 51% (the higher rate of 40% plus 11% as child benefit is withdrawn), whilst someone with three children faces a marginal income tax rate of around 64% (40% plus 24%). Over time, as indexation increases the amount of child benefit that is to be withdrawn, these tax rates increase: after 10 years of 2% inflation, the marginal income tax rate facing someone with three children would increase to 69% (40% plus 29%). Indeed, with many children (nine or more, currently) and/or in the long term as child benefit increases, the marginal income tax rates facing people with children can exceed 100%, meaning that cutting back their income would leave them better off. These are not desirable features of any means test.

These issues result from the fact that a fixed 1% of child benefit is withdrawn for every £100 of income above £50,000, irrespective of how much child benefit there is to be withdrawn. A better solution may be to reduce child benefit by a fixed cash amount (e.g. £15) for every £100 of income above £50,000. This would mean that all families subject to withdrawal face the same additional marginal tax rate (e.g. 15%) and so the same overall marginal income tax rate (e.g. 55%); as a result, child benefit would be fully tapered away at higher levels of income for those with more children, and as the rate of child benefit increases.

Another issue is that the £50,000 threshold above which child benefit starts to be withdrawn is fixed in cash terms, which means that, over time, more and more families will find their entitlement to child benefit reduced or removed completely, as inflation and income growth take their income above £50,000. Indexing this threshold rather than freezing it would therefore represent an improvement, albeit one that would increase benefit spending.

3.4 The 'household' benefits cap

In April 2013, an overall benefits cap was introduced for working-age families (despite the name, the cap applies at the family, not the household, level).[37] In the main, it applies

[36] See HMRC's tax information and impact note: www.hmrc.gov.uk/budget2012/tiin-0620.pdf.

to non-working, non-disabled families – families containing a working (or recently working) individual or a disabled individual are mostly exempt.[38] The cap has been set at £350 per week for childless single people and at £500 per week for other families (with these caps fixed in cash terms by default). The level of these caps means that they essentially only affect families with large numbers of children and/or high housing costs, who are consequently receiving a lot of child-contingent support and/or housing benefit. This is reflected by the fact that 80% of families affected so far have contained at least three children and 46% have been living in Greater London (where rents are high).[39]

In aggregate, the number of households affected is relatively small, but those affected, on average, lose substantial amounts. In its initial impact assessment, the government estimated 56,000 families in Great Britain would lose an average of £93 each per week, reducing spending by around £275 million a year.[40] The forecast spending cut had fallen to about £185 million a year by Budget 2013, seemingly as the result of a fall in the number of families expected to be subject to the cap (if it were entirely due to this, the aggregate and per-family savings imply that around 38,000 families would be affected). Published statistics suggest that, in fact, around 27,000 families were being capped once the policy was fully rolled out in late 2013, with their benefit income reduced by a total of about £100 million a year (or £70 each per week, on average).[41]

Note that this is not necessarily the same as the total reduction in spending – as this will also be affected by people moving house or entering work to avoid the benefits cap. A recent impact evaluation suggests that claimants were 4.7 percentage points more likely to move into work (as measured by claiming working tax credit) as a result of the cap, with those losing the most being most likely to enter work. However, there is only evidence of moving house among the very small group who lost more than £200 a week.[42]

3.5 The localisation of support for council tax

The coalition government inherited a system where low-income families were able to claim council tax benefit (CTB), which paid up to 100% of their council tax liability. CTB was abolished from April 2013, and support for low-income families in paying their council tax was localised, with English local authorities, and the devolved Scottish and Welsh governments, able to design their own schemes. At the same time, funding was initially cut by 10%; the money provided was based on 90% of what the UK government estimates would otherwise have been spent on CTB in that nation or English local authority in 2013–14 (this funding is now wrapped up into general revenue support

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[37] The cap was applied in April 2013 to only four local authorities: Bromley, Croydon, Enfield and Haringey. The cap was rolled out across the rest of Great Britain by 12th August 2013. See W. Wilson, *The Household Benefit Cap*, SN/SP/6294, House of Commons Library, 2014 (www.parliament.uk/briefing-papers/sn06294.pdf).

[38] There are exemptions for war widows and widowers, families in receipt of DLA, the PIP, the support component of ESA, an industrial injuries benefit or working tax credit, and those on universal credit whose family earnings exceed £430 per month. The cap also does not apply for 39 weeks after the end of an employment spell if that spell lasted for at least one year.

[39] See source cited in footnote 37.

[40] Source: DWP, 'Impact assessment for the benefit cap', July 2012 (http://www.dwp.gov.uk/docs/benefit-cap-wr2011-ia.pdf).

[41] See DWP's benefit cap statistics, available at https://www.gov.uk/government/statistics/benefit-cap-number-of-households-capped-to-august-2014.

[42] DWP, 'Benefit cap: analysis of outcomes of capped claimants', 2014 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385970/benefit-cap-analysis-of-_outcomes-of-capped-claimants.pdf).

grants to English local authorities, and block grants to the devolved governments, which have since been cut further).[43] Entitlements for pensioners in England are set by the UK government and must be maintained at their existing level. This implies an estimated 19% initial reduction in funding for the English working-age population.[44]

There is no obligation for local authorities in England, or the devolved governments, to spend the amount of the new grant on council tax support for working-age individuals: they may, for example, choose to maintain support at its existing level or even to increase it and find the necessary savings elsewhere in their budgets, or they may cut entitlements by more and use the surplus for other purposes.

The Scottish, Welsh and Northern Irish governments chose to maintain support at the same level as under CTB, but most English local authorities did implement cuts to support. Previous work by IFS researchers[45] found that around 80% of local authorities in England reduced entitlements for working-age families in the first year of operation of the scheme, with 70% introducing 'minimum payments' so that even those on the lowest incomes had to pay some of their council tax. Another common change was a reduction in the level of savings people could hold and still receive support. Only three councils increased the taper rate at which support is withdrawn as income increases. The same research shows that the introduction of minimum payments led to a significant increase in requests for advice about council tax from the Citizens Advice Bureau. Council tax arrears also increased by more than one-fifth in 2013–14, which some suggest may be linked to the CTB reforms.[46]

The stated aims of localisation were to allow support to reflect local priorities, and to strengthen the incentives of the devolved governments and English local authorities to promote employment and growth in the local economy. But it could also change other incentives. It could reduce incentives to increase council tax rates, reduce incentives to facilitate low-value housing development, increase incentives to discourage low-income families from living in the area, reduce incentives to encourage take-up of support and strengthen incentives to reduce overpayments. The overall pattern of change in incentives is complex, empirically unknown and not unambiguously positive.

It is difficult to think of good economic reasons why localisation was chosen over the government's original plan to integrate CTB into universal credit (with, if the government had wished, a centralised cut to reduce spending by £0.5 billion). Keeping these separate creates difficult issues regarding how they will interact and it reintroduces the possibility of people being subject to overlapping means tests, and hence having extremely weak work incentives. By localising support for council tax, the central government has passed these difficult issues on to the devolved governments and local authorities, which have no experience in designing welfare systems; and the resulting variation in council tax rebate schemes that is clearly developing will reduce transparency and increase complexity and

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[43] Northern Ireland is affected in much the same way as Scotland and Wales: it is now provided with a grant based on 90% of the amount forecast to be spent on 'rates rebates' (domestic rates remain the system of local taxation in Northern Ireland).

[44] S. Adam and J. Browne, 'Reforming Council Tax Benefit', Institute for Fiscal Studies (IFS), Commentary C123, 2012 (http://www.ifs.org.uk/publications/6183).

[45] S. Adam, J. Browne, W. Jeffs and R. Joyce, *Council Tax support schemes in England: what did Local Authorities choose, and with what effects?*, Institute for Fiscal Studies (IFS), Report R90, 2014 (http://www.ifs.org.uk/publications/7057).

[46] See, for instance, K. Wiggins, 'Exclusive: Council tax arrears up 20% in wake of localisation of benefits', 2014 (http://www.lgcplus.com/briefings/corporate-core/finance/exclusive-council-tax-arrears-up-20-in-wake-of-localisation-of-benefits/5072759.article).

bureaucracy. Sadly, this is all at odds with the basic and commendable principle of simplification underlying universal credit (see Section 4).

3.6 Changes to disability benefits

The coalition government has made a number of changes to the two biggest disability benefits (ESA and DLA), aimed at least in part at reducing the number of claimants of disability benefits.

Changes to ESA

In October 2008, the last Labour government introduced ESA as a replacement for incapacity benefit (IB) and IS on the grounds of disability. It has both contributory (i.e. based on paying sufficient National Insurance contributions) and means-tested elements. The aim of the reform was to tighten eligibility criteria, and to introduce new conditions and support for claimants who were deemed able to take part in activities in preparation for a return to work, thus increasing employment prospects. However, when the coalition government came to power, roll-out to existing claimants had not yet started (it had been repeatedly delayed by Labour): it started the process of assessing the eligibility of existing IB and IS claimants for ESA in October 2010.

This would seem to be sensible if it were felt that some people who did not really need support were receiving IB and IS on the grounds of disability, and/or that not enough effort was made to prepare those claimants who may be able to work in future for that prospect. It could also provide a useful contribution to spending cuts. However, there have been a number of problems. First, although the roll-out was initially scheduled to be completed by March 2014, a few claimants are yet to be reassessed and remain on IB and IS. Second, of those reassessed, fewer people have been found to be ineligible than expected (20%), and more than expected have been found to be unable to take part in activities in preparation for returning to work (40%), and are therefore entitled to higher levels of support.[47] Moving claimants from IB and IS on to ESA has therefore reduced expenditure by less than expected when the coalition government confirmed they would go ahead with this policy in 2010.[48]

In part, these issues may reflect difficulties in carrying out the 'work capabilities tests' used to assess claimants' eligibility for ESA. These tests have proven controversial. For instance, to date, 40% of new claimants found fit for work have appealed, with almost 40% of those appeals having been successful (although, note that this means more than 84% of those found fit either do not appeal, or lose their appeal).[49] As a result of criticism, a series of major changes to the work capabilities test were made from March 2011 onwards. These changes may have contributed to significant increases in the fraction of claims that are successful, and of claimants deemed unable to start preparing for work,

[47] See DWP, *ESA: outcomes of Work Capability Assessments September 2014*, DWP, London, 2014 (https://www.gov.uk/government/statistics/esa-outcomes-of-work-capability-assessments-september-2014). The 'support group' are those deemed too disabled to engage in work-related activity, and the 'work-related activity group' are those deemed too disabled to commence work immediately, but who are able to start preparing for a return to work.

[48] See OBR, *Welfare trends report – October 2014*, Office for Budget Responsibility, London, 2014 (http://budgetresponsibility.org.uk/welfare-trends-report-october-2014/). This cites these factors as *two* factors contributing to increases in forecast spending on 'incapacity benefits', but unfortunately does not provide figures on how much they have contributed.

[49] Same source as footnote 47. DWP publish statistics on appeals for new claimants only, and not those formerly claiming IB or IS who have undergone reassessment for ESA.

since 2011. Difficulties with the tests have also led to the early termination of the contract with ATOS, who were previously contracted to provide the tests until August 2015.[50]

The government has made a number of other changes to ESA. First, since April 2012, those entitled to the contributory element of ESA can only receive it for up to one year unless they are deemed too disabled to start preparations for work. This means that after one year, for those deemed able to make some preparation for work, ESA is available only if their family income is low enough. This is expected to reduce expenditure by around £1.4 billion in 2015–16, and represents a further erosion of what little of the contributory principle remains in the working-age benefits system. Second, 'ESA in youth', which allowed those aged under 20 (or up to 25 in special circumstances) to claim contributory ESA even if they did not meet the contributions conditions, was abolished in April 2012.

The replacement of DLA with PIP

DLA is the single biggest benefit paid on grounds of disability, and is designed to provide financial support to those whose disability means that they need significant care and supervision and/or have difficulties with walking. It has also been one of the most rapidly growing benefits: real-terms spending on DLA in Great Britain almost doubled from £7.2 million in 1997–98 to its peak of £14.1 billion in 2013–14, driven by a two-thirds increase in the number of claimants (from 2.0 to 3.3 million). In an effort to arrest this rise, starting in April 2013, PIPs began to replace DLA for adults aged under 65. This is a major reform: in 2013–14, there were 1.9 million such claimants of DLA, accounting for real-terms expenditure of £7.7 billion (with an average award of £79 a week).[51]

PIPs differ from DLA in a number of ways. First, the disability test involves an assessment of an individual's ability to 'participate fully in society', rather than the severity of their disability per se. This means that, unlike for DLA, there are no medical conditions that lead to an automatic entitlement to PIP. It is also awarded for a fixed term of between one and 10 years, with claimants automatically reassessed at the end of their term, as well as during that term if there are indications that circumstances have changed (DLA involves no such automatic reassessment).

The requirements for receiving PIP are intended to be more stringent than for DLA (and there is no lower rate as there is in DLA), which mean that the reform is forecast to reduce benefit caseload, and to result in lower expenditure. The roll-out of PIPs has been much delayed, however, reducing savings in the short term, and early evidence suggests that the tighter eligibility criteria might not save as much as initially hoped. These delays and problems mean ensuring the roll-out is a success will therefore be a task largely for the next government; Section 4 contains further discussion of this challenge.

3.7 Changes to benefits conditionality and sanctions

The coalition government has also strengthened the conditions claimants are expected to meet in order to receive a number of other benefits; increased the sanctions that can be applied if they are judged not to have met those conditions; and made changes to programmes designed to help those on out-of-work benefits move into paid work .

[50] S. Kennedy, *Incapacity Benefit Reassessments*, SN/SP/6855, House of Commons Library, 2014 (www.parliament.uk/briefing-papers/SN06855.pdf).

[51] See DWP, 'Benefit expenditure and caseload tables 2014', 2014 (https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2014).

The Work Programme and changes to conditionality

Claimants of JSA have to meet certain work-search requirements in order to receive benefits. The coalition government has strengthened these conditions, particularly for longer-term claimants, and has extended a policy introduced by the Labour government, moving lone parents of younger children from IS – where there are no work-search requirements – to JSA.

It has also changed the system for supporting longer-term unemployed people back in to work. From 2011, the Work Programme replaced existing programmes, with the aim of increasing the likelihood that longer-term unemployed people move into, and stay in, work. Taking part in the Work Programme is compulsory after nine months of claiming JSA for those aged 18–24, and after 12 months for those aged 25 or over, although some claimants deemed 'seriously disadvantaged' (including some of those who have recently been receiving IB or ESA) may have to take part after three months. Those refusing to take part, or failing to engage with the programme, face benefit sanctions (see below).

The Work Programme is delivered by a mix of private, voluntary and public-sector organisations, which are given significant autonomy in what type of support they deliver, what activities participants are required to undertake, and how they manage their caseload, subject to satisfying what they promised in their bids, and a complaints procedure. The payments from the government to these organisations depend on how successful they are in getting people into sustained work ('payment by results').

The evaluation of the Work Programme suggests that these payment systems are not operating particularly well, however: in particular, providers find it difficult to support the most difficult cases without up-front payment, and although they eventually get paid more for helping harder-to-help groups into work, they still face incentives to prioritise the easiest cases *within* payment groups. As a result of these difficulties, DWP are reviewing the structure of payments for future contracts.[52] Evidence on the effects of the programme on employment is more limited, because no official evaluation of this has taken place. The latest National Audit Office (NAO) report concludes that what evidence that does exist suggests that the programme has not led to increases in entry into employment and job retention relative to pre-existing programmes.[53] However, it does say there are 'signs that performance is [...] improving' and that the programme has resulted in people moving off benefits sooner.

Changes have also been made to the conditions jobseekers have to meet in order to receive JSA. Claimants now have to sign a 'claimant commitment', agreed between them and their Job Centre Plus advisor, which sets out the work-search and preparation activities that must be completed. Claimants can also volunteer for training or short-term unpaid work placements whilst still claiming JSA (these activities may be compulsory for those in the Work Programme). On the one hand, partaking in these activities may make people less able to take up paid work during the period of training or unpaid work. On the other hand, it may also improve employability and motivation, aiding the return to employment. Unfortunately, as with the Work Programme, there has been no evaluation of the impact of these changes.

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[52] DWP, *Work programme evaluation: operation of the commission model, finance and programme delivery,* Research Report No 893, DWP, London, 2014 (https://www.gov.uk/government/publications/work-programme-evaluation-operation-of-the-commissioning-model-finance-and-programme-delivery).

[53] National Audit Office, *The Work Programme,* July 2014 (http://www.nao.org.uk/report/the-work-programme/).

Evidence is available for another major change though. The coalition government has subjected more lone parents to the requirements of JSA by moving them off IS. This reform, known as Lone Parent Obligations (LPO), began under Labour in November 2008. Before that date, lone parents whose youngest child was aged up to 16 were able to claim IS and therefore faced relatively limited work-search requirements. The age condition was reduced to 12 from November 2008, to 10 from October 2009, to 7 from October 2010 (a plan the coalition government inherited from Labour), and to 5 from May 2012. The official evaluation of the policy examines the impact of the first *three* of these changes, and finds that employment among those affected increased by around 8–10 percentage points after 12 months.[54] Although this means most *did not* enter sustained work within 12 months, it is a remarkably large impact nonetheless.[55] No official evaluation of the final reduction in the LPO age to 5 has taken place, but employment data from the Labour Force Survey *do not* show a similar increase in the employment rate for those affected by this last stage of the reform.[56]

Changes to sanctions

Claimants who do not meet their obligations for JSA and ESA face sanctions – effectively, the loss of these benefits for a given period of time. Sanctions regimes for both benefits have been revised by the coalition government. In the case of JSA (for which the number of sanctions has been greatest), payments can be withdrawn in full for a period of between four weeks and three years, depending on the severity of the failure to comply with conditionality requirements (such as failing to attend a training scheme or a job adviser interview) and the number of previous 'failures'.[57] This is tougher for most groups than the previous regime, especially for those being sanctioned for their second or subsequent failure.

The number of sanctions has also increased substantially. For instance, during the first six months of 2014, 380,000 sanctions were applied to JSA recipients, compared with 285,000 during the first six months of 2010. This is despite the number of JSA claimants falling from an average of 1,540,000 in the first half of 2010 to 1,126,000 during the first half of 2014. In part, this reflects an increase in the actual use of sanctions from 58% to 73% of cases where they could potentially be used.

[54] DWP, *Lone parent obligations: an impact assessment*, Research Report No 845, DWP, London, 2013 (https://www.gov.uk/government/publications/lone-parent-obligations-an-impact-assessment-rr845).

[55] For comparison, the Working Families Tax Credit, which led to significant increases to in-work cash support for many lone parents is estimated to have increased employment by around 5 percentage points, overall. See, M. Brewer, A. Duncan, A. Shephard and M. Jose Suarez, *Did Working Families' Tax Credit work? The final evaluation of the impact of in-work support on parents' labour supply and take-up behaviour in the UK,* HMRC, London, 2005 (https://www.gov.uk/government/publications/did-working-families-tax-credit-work).

[56] R. Blundell, C. Crawford and W. Jin, 'What can wages and employment tell us about the UK's productivity puzzle?', Institute for Fiscal Studies (IFS), Working Paper W13/12, 2013 (http://www.ifs.org.uk/publications/6749). See Figure 16, which also suggests that the impact of the earlier changes was largest for lone parents whose youngest child was aged 7– 9, with smaller changes observed in employment rates for parents of 10–15 year olds.

[57] Failures range from low-level ones, such as failing to attend an adviser interview, to more serious ones, such as failing to be available for work or refusing to accept an appropriate job offer. Over half (56%) of adverse decisions since October 2012 are for low-level failures – see Table 1.5 of DWP's *Jobseeker's Allowance and Employment and Support Allowance sanctions: decisions made to June 2014*, https://www.gov.uk/government/statistics/jobseekers-allowance-and-employment-and-support-allowance-sanctions-decisions-made-to-june-2014 (this is also the source for values in the next paragraph). For more details on the new JSA (and ESA) sanctions regime, see *Jobseeker's Allowance: overview of revised sanctions regime* (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/238839/jsa-overview-of-revised-sanctions-regime.pdf).

It is unclear whether the greater use and greater severity of sanctions has led to increased job-search effort and/or greater moves into work by those facing the risk of sanction; again, there has been no formal evaluation.

4. Future challenges in benefits policy

The previous section described the significant changes to the benefit system undertaken by the current government. But some of the biggest structural reforms planned for this parliament have been significantly delayed. As a result, the next government will inherit a number of challenges: moving the stock of DLA recipients to the new PIP; completing the roll-out of universal credit (if the next government chooses to do so); and possibly implementing further cuts to benefit spending.

4.1 Moving the stock of DLA recipients to PIP

The latest published policy costing (in Budget 2013) shows that the transition from DLA to PIP will reduce spending by about £2.9 billion in 2017–18 as a result of tighter eligibility criteria, with annual spending £1.1 billion lower by 2015–16. However, as a result of delays to the reassessment of existing DLA claimants, and because more people have been found to be eligible for PIP than had been expected at the time of Budget 2013, OBR forecasts suggest savings of only around £0.2 billion in 2015–16 and reduced long-run savings from the policy.[58]

Roll-out of PIP has been delayed at least in part because both DWP and the assessment providers have taken far longer to assess new claims than expected. This has resulted in backlogs and delays for claimants, with DWP 'often unable to tell new claimants how long they are likely to wait, potentially creating distress and financial difficulties'. [59] In order to deal with these issues, the transfer of existing DLA recipients to PIP (which was due to begin in October 2013) was put on hold for most people.[60] Full roll-out of PIP to all existing claimants is not expected to commence until October 2015, and is expected to take at least three years. It will therefore be up to the next government to try to ensure that the large-scale roll-out of reassessments does not run into the same types of problems.

Significant delays and backlogs remain – of the 76,300 claims for reassessment made between October 2013 and October 2014, only 29,900 had completed reassessment by October 2014.[61] However, backlogs are now starting to fall – for instance, between August and October 2014, 128,900 claims were made for PIP (both new claims and reassessments), while 175,400 reassessments were completed. This may mean a corner has been turned. But expanding reassessment will mean that many more people will need to be assessed, and may involve more challenging cases than the relatively small group currently facing reassessment. Experience from the IB/ESA transfer also shows that

[58] Authors' calculations using Budget 2013 costings and information provided in the March and December 2014 OBR *Economic and Fiscal Outlook* documents, available at http://budgetresponsibility.org.uk/.

[59] National Audit Office, *Personal Independence Payment: early progress*, available at http://www.nao.org.uk/report/personal-independence-payments-pip-2/.

[60] Reassessments have begun for DLA recipients turning 16, those at the end of a fixed-term award, those where information has been received about a change of circumstances, and those volunteering.

[61] PIP statistics available at https://www.gov.uk/government/collections/personal-independence-payment-statistics/.

reassessment decisions can be controversial and are sometimes successfully challenged. Thus, there remains the risk that the expected reductions in spending (even given recent downward revisions to these expectations) may not materialise.

4.2 Rolling out universal credit nationally and to the stock of existing benefit claimants

The single biggest change to the benefit system planned by the coalition government is the replacement of a range of means-tested benefits and tax credits with universal credit (UC). Roll-out has been much delayed and only a few thousand claimants in a few areas of the country are currently using the new system. It will be up to the government formed following the May 2015 election to decide whether to continue with the programme, and if so, to roll out the benefit more widely to new claimants, and then eventually to existing benefit claimants.

What is universal credit?

UC is set to replace IS, income-based JSA, income-based ESA, housing benefit, working tax credit and child tax credit. Maximum out-of-work entitlements to benefits are the same as under the current system for most claimants,[62] but there are increases to the amounts that one can earn before entitlement starts being reduced for many people.[63] The rate at which entitlements are tapered away above these 'work allowances' is also being reduced for many people: existing out-of-work benefits are withdrawn pound for pound as after-tax earnings rise, whereas universal credit recipients lose only 65p of entitlement for every £1 increase in after-tax earnings. Taken together, these changes increase the incentive for many families to have someone in paid work, because they lose less of their benefits when they do so than under the present system. In particular, the most striking effect of UC on financial work incentives is to strengthen them significantly for those facing the weakest incentives under the existing system.[64] In addition, UC regulations allow for the extension of work-search requirements to many more individuals in work,[65] although it is not planned to make use of such powers in the short-to-medium term.[66]

The other key aim of UC is to simplify the benefits system, increasing take-up and reducing error and fraud. Whereas under the current system many claimants have to submit claims for a number of different benefits to different agencies (local councils for

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[62] Although, those with unearned income or high levels of savings may lose under the universal credit system, since such income is treated less generously than under the current system (particularly compared with tax credits).

[63] It is worth noting, however, that although more generous than under the current system, the generosity of these 'work allowances' has already been cut several times, even before the full roll-out of universal credit has even commenced.

[64] For more details, see S. Adam and J. Browne, 'Do the UK Government's welfare reforms make work pay?', Institute for Fiscal Studies (IFS), Working Paper W13/26, 2013 (http://www.ifs.org.uk/wps/wp1326.pdf). It is important to note that the impact of universal credit on work incentives is not always positive. A significant number of households that currently benefit from working tax credit will face a somewhat weaker incentive to have someone in work, because entitlements to universal credit can be lower than entitlements under the current system of benefits and tax credits. Furthermore, households will tend to face a weaker incentive to have a second worker in work. This is partly due to a higher withdrawal rate for universal credit than is the case currently for tax credits alone. However, it also reflects the fact that those households that are entitled to more support under universal credit when one person works than currently will have *more support to lose* if a second worker enters work.

[65] For example, for couples with joint weekly earnings up to 70 times the hourly minimum wage (£455 a week, currently), compared to those with joint weekly earnings up to £125 a week under the current system.

[66] See the Explanatory Memorandum to the Universal Credit Regulations 2013, http://www.legislation.gov.uk/ukdsi/2013/9780111531938/pdfs/ukdsiem_9780111531938_en.pdf.

housing benefit, the DWP for IS, and HMRC for tax credits), UC will require a single claim for a single benefit.[67] This should be simpler for claimants (increasing take-up and possibly reducing error) and easier to administer and check (reducing error and fraud).[68] By integrating the systems of out-of-work benefits and in-work tax credits, it might also encourage more people to enter paid work by smoothing the transition.

Most families will receive UC on a monthly basis, with entitlements based on circumstances during the previous month and calculated using 'real-time' information from employers. This should result in far fewer underpayments and overpayments than the current system and may reduce the amount of fraud and error. The flip side is that using information from the previous month (rather than self-reported information) may mean payments do not respond to changes in circumstances as quickly as they can now. Concerns have also been raised about the ability of UC recipients to budget on a monthly, as opposed to weekly, basis and to manage payment of rent to landlords.[69]

Delays to the roll-out

UC therefore has much to commend it: once fully rolled out, it should make the welfare system more effective and coherent, and will increase the incentives many benefit claimants have to enter and progress in work. Unfortunately, the way in which it is being rolled out precludes a formal evaluation of its effects on employment or fraud and error, though. This represents a missed opportunity. But of perhaps more immediate concern to the next government is that, to date, progress on rolling out UC has been much slower than initially planned.

The initial plans were for the roll-out of UC to begin in some pilot areas in the North West of England in April 2013, with the rest of the country following from October 2013. Existing claimants were to be moved on to universal credit from April 2014 onwards, with the transition completed by December 2017. In practice, UC has only been rolled out (as of December 2014) to new claimants in the North West of England, and a few small areas in the rest of Great Britain, and then only for a subset of claimants.[70] As of the end of October 2014, just 17,850 claimants were being paid UC, with around 900 new claimants starting to receive the benefit every week that month (as a comparison, around 27,000 new claimants start receiving housing benefit every week, on average).[71]

Roll-out has been delayed due to a plethora of operational problems, the most prominent of which have been difficulties with both existing and planned IT systems and a lack of stability of senior management (it is reported that there have been 11 changes in the head of the programme since 2010). In late 2013 and early 2014, both the House of Commons Work and Pensions Committee and the Public Accounts Committee issued reports critical of DWP's handling of the operation and roll-out of UC.[72] The NAO was also

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[67] Claimants will need to make a separate claim to their local authority for Council Tax Benefit (see Section 3).

[68] The incorporation of 'real-time' information from employers may also help to reduce fraud and error.

[69] See, for instance, A. Tarr and D. Finn, *Implementing Universal Credit: Will the reforms improve the service for users?*, Joseph Rowntree Foundation, 2012 (http://www.jrf.org.uk/publications/implementing-universal-credit).

[70] Source: https://www.gov.uk/jobcentres-where-you-can-claim-universal-credit (accessed 09/12/2014). Universal credit is only available to those with children in a few jobcentre areas, for instance.

[71] Source: https://www.gov.uk/government/statistics/universal-credit-29-apr-2013-to-6-nov-2014, and https://www.gov.uk/government/statistics/experimental-housing-benefit-and-council-tax-benefit-flows-data-november-2008-to-present.

[72] See Work and Pensions Committee, *Universal Credit implementation: monitoring DWP's performance in 2012–13*, http://www.publications.parliament.uk/pa/cm201314/cmselect/cmworpen/1209/120902.htm, and

critical of DWP's early performance, but highlighted that with 'realistic plans and strong discipline' universal credit could ultimately achieve 'considerable benefits'.[73] The most recent report from the NAO, published in November 2014, concludes that DWP has 'reset universal credit on a sounder basis but at significant cost, by extending the time for implementation and choosing a more expensive approach'.[74]

Roll-out will now continue on a phased geographic basis. UC will be available nationwide to new claimants who would formerly have claimed *only* JSA by March 2016, with nationwide roll-out to other new claimants due to be completed by December 2017. Managed migration of existing JSA, IS and housing benefit claims is set to begin in January 2018 (by which time the migration of *all* existing claims was originally planned to be complete) and to be completed by January 2020. The managed migration of those claiming only ESA and/or tax credits is then set to occur 'at some point' beyond April 2020 (i.e. not during the expected term of the *next* government, but during the *one after that*).[75]

The OBR has expressed doubts about even this timescale and its public finance forecasts assume a further six months' delay to published plans for most parts of the programme. The NAO also highlights that while progress in rolling out universal credit has recently improved, DWP's plans remain 'highly ambitious', with risks relating to IT systems, staff training, and senior management and leadership of the programme. It also highlights that the new roll-out plans mean that significantly more administrative resources will be required than initially anticipated, with a significant amount of 'manual checking' required before new automated systems come online. The next government (and perhaps even the following one) clearly faces a major challenge in rolling out UC, even to the new much-delayed timetable.

4.3 Finding further reductions in benefit expenditure

As discussed earlier, the coalition government has made cuts to benefit spending that are estimated to total £16.7 billion in 2015–16 as part of its efforts to reduce the UK's structural budget deficit. Although substantial (equivalent to around 7% of overall benefit spending, and 15% of spending on working-age claimants), this is less than was initially expected; changes to indexation have saved less than originally anticipated (and the 'triple lock' for the state pension has cost more), and reforms to disability benefits have taken longer to be rolled out and have led to fewer people being denied benefits than initially forecast. Clearly, it is not always easy to fully deliver planned reductions in benefit expenditure.

The next government will face a choice of whether it wants to look to benefit spending for further savings as it attempts to tackle a budget deficit that is forecast to still be over £75 billion a year in 2015–16. IFS researchers have calculated that if the plans for total public spending set out in the 2014 Autumn Statement are to be kept to, then cuts to social

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Public Accounts Committee, *Universal Credit: early progress*, http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/619/61902.htm.

[73] See DWP, *Universal Credit: Early Progress*, National Audit Office, London, 2013 (http://www.nao.org.uk/report/universal-credit-early-progress-2/).

[74] See DWP, *Universal Credit: Progress Update*, National Audit Office, London, 2014 (http://www.nao.org.uk/report/universal-credit-progress-update-2/).

[75] Timetable listed in the OBR's *Economic and Fiscal Outlook*, December 2014, available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/.

security spending totalling £21 billion by 2019–20 would need to be implemented, unless the rate of cuts to public service spending were to accelerate. Benefit cuts of £21 billion would be similar to the scale of cuts the coalition government planned to deliver over this parliament, but over one-quarter larger than the latest data suggest will actually be delivered by 2015–16.

£21 billion represents around 10% of forecast total benefit spending in 2015–16. However, it is 23% of forecast spending on benefits for working-age people – implying very substantial cuts for this group if pensioners were again largely excluded from the cuts. The next government will therefore face tough choices about how to deliver further cuts to benefits, if it wants such cuts to make a substantial contribution to further fiscal consolidation. This tricky issue will be analysed in more detail in a chapter in this year's IFS Green Budget, which will be published on 4 February 2015.[76]

5. Conclusions

This Briefing Note has examined the trends in benefit spending under the coalition government and the policy changes implemented during this period.

In total, we estimate that discretionary policy changes implemented by the coalition government will reduce benefit spending by nearly £17 billion a year in 2015–16, compared with what otherwise would have happened. However, underlying factors have been pushing up benefit spending, including the ageing of the population, weak earnings growth, changes in the housing market, and continued growth in the numbers of working-age people claiming disability benefits. This means that benefit spending in 2015–16 is forecast to be effectively unchanged in real terms (at £220 billion) from 2010–11.

However, the pattern of benefit spending will have changed. Spending on the state pension will have risen significantly, pushing up overall spending on benefits for pensioners by around £7 billion in real terms. In contrast, spending on benefits for working-age adults and children will have fallen by around £7 billion. Demographic change and policy decisions have therefore led the system to become more focused on pensioners.

Reforms mean there is now a greater reliance on means testing for working-age recipients – with the formerly universal child benefit now not available to those families where someone has a taxable income of more than £60,000 a year, and tax credits withdrawn from many families on middle incomes. But this does not mean poorer families have escaped from benefit cuts. They have been harder hit by many of the other cuts – such as freezes and below-inflation increases in benefit rates, and cuts to housing and council tax benefits. And because they have little in the way of other income, cuts in their benefits have a larger proportional effect on the overall incomes of poorer households than middle and higher income ones.[77]

For pensioners, the story is different: increases in the relative generosity of the state pension and plans for a 'single-tier pension' from April 2016 represent a move towards

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[76] The IFS Green Budget will be available to download here: http://www.ifs.org.uk/tools_and_resources/green_budget.

[77] See for instance, Figure 3.8 of J. Browne and W. Elming, 'The effect of the coalition's tax and benefit changes on household incomes and work incentives', Institute for Fiscal Studies (IFS), Briefing Note BN159, 2015 (http://www.ifs.org.uk/publications/7534).

greater universality and *away* from means-testing. The 'single tier pension' will also remove much of the link between National Insurance contributions and the amount of state pension one will receive; and changes to ESA also represent a further erosion of what little remains of the contributory principle for working age claimants as well.

But the main object of the reforms was to reduce expenditure. Some of the reforms made look like sensible ways to save money. For instance, uprating benefits in line with CPI rather than RPI or Rossi by default is the biggest single cut (£4.1 billion) and represents a move away from inflation measures that systematically overestimate true inflation. Reductions in the maximum amount of housing benefit that private-sector tenants can claim, and changes to disability benefits also, in principle, represent coherent if controversial policies.

But a few changes have undesirable features and betray incoherent thinking on how benefits should be structured and, especially, how they should be indexed over time. For instance, the 'triple lock' for the state pension means that the state pension is likely to go up more quickly than both prices *and* earnings, potentially costing many billions a year if retained in the long term. Similarly, the rationale given for capping increases in working-age benefits is a little like an informal rule for such benefits to go up by the *minimum* of earnings or prices, which would lead to their value *falling* relative to both earnings and prices over time. The next government would do well to think more clearly about how benefits should be indexed over time.

This government will also bequeath a number of other tricky problems to the next government. This includes the roll-out of universal credit – a policy that has much to commend it, but which has been plagued by problems and is now years behind the original schedule. Of course, the still-large budget deficit means that there could be pressure to find further cuts in benefits – a prospect that may become harder, especially if pensioners continue to be protected from the cuts.