



Institute for
Fiscal Studies

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

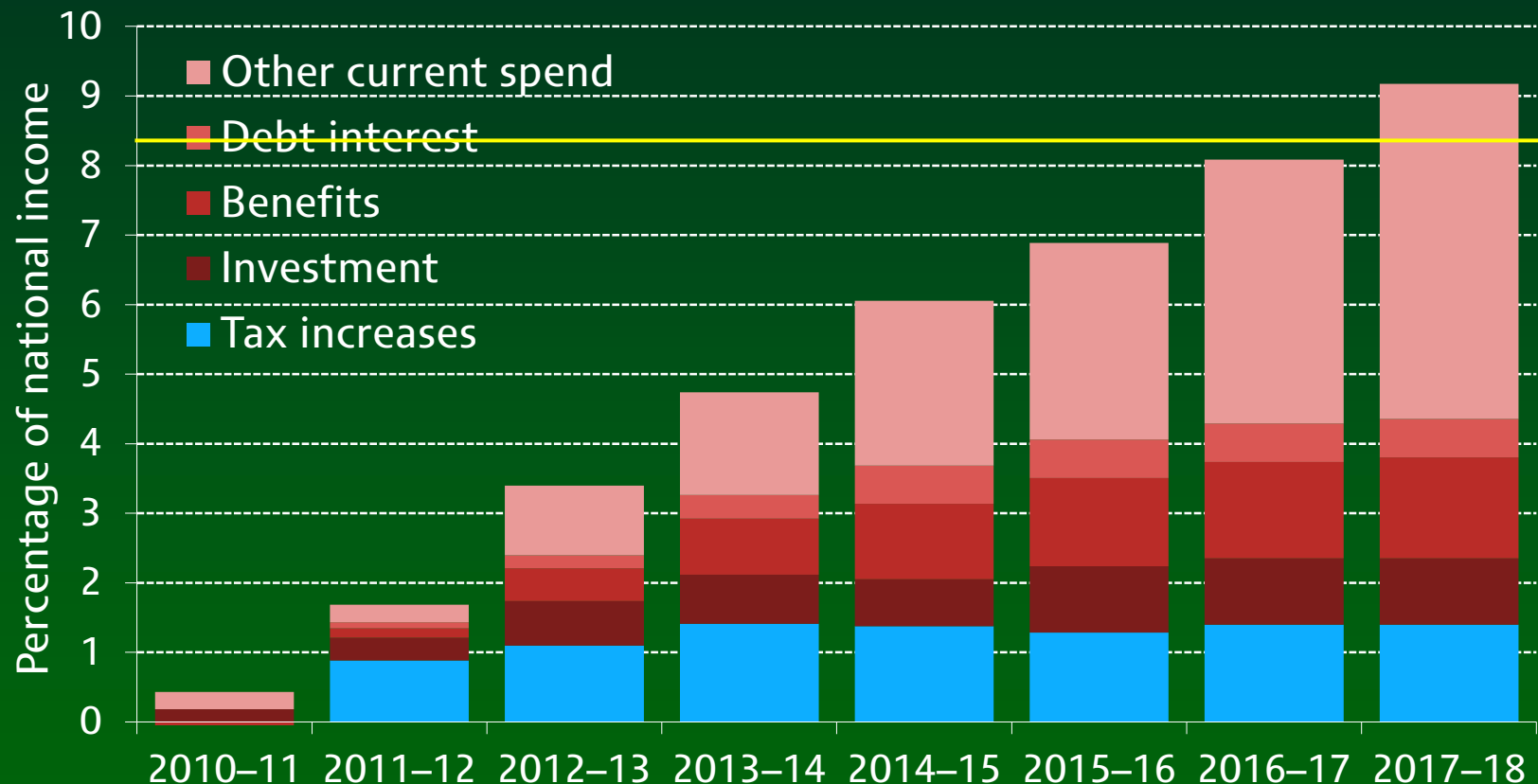
Carl Emmerson and Robert Joyce

Presentation to Low Pay Commission, London

20th December 2012

The cure (December 2012): 9.2% national income consolidation over 8 years (£144bn)

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



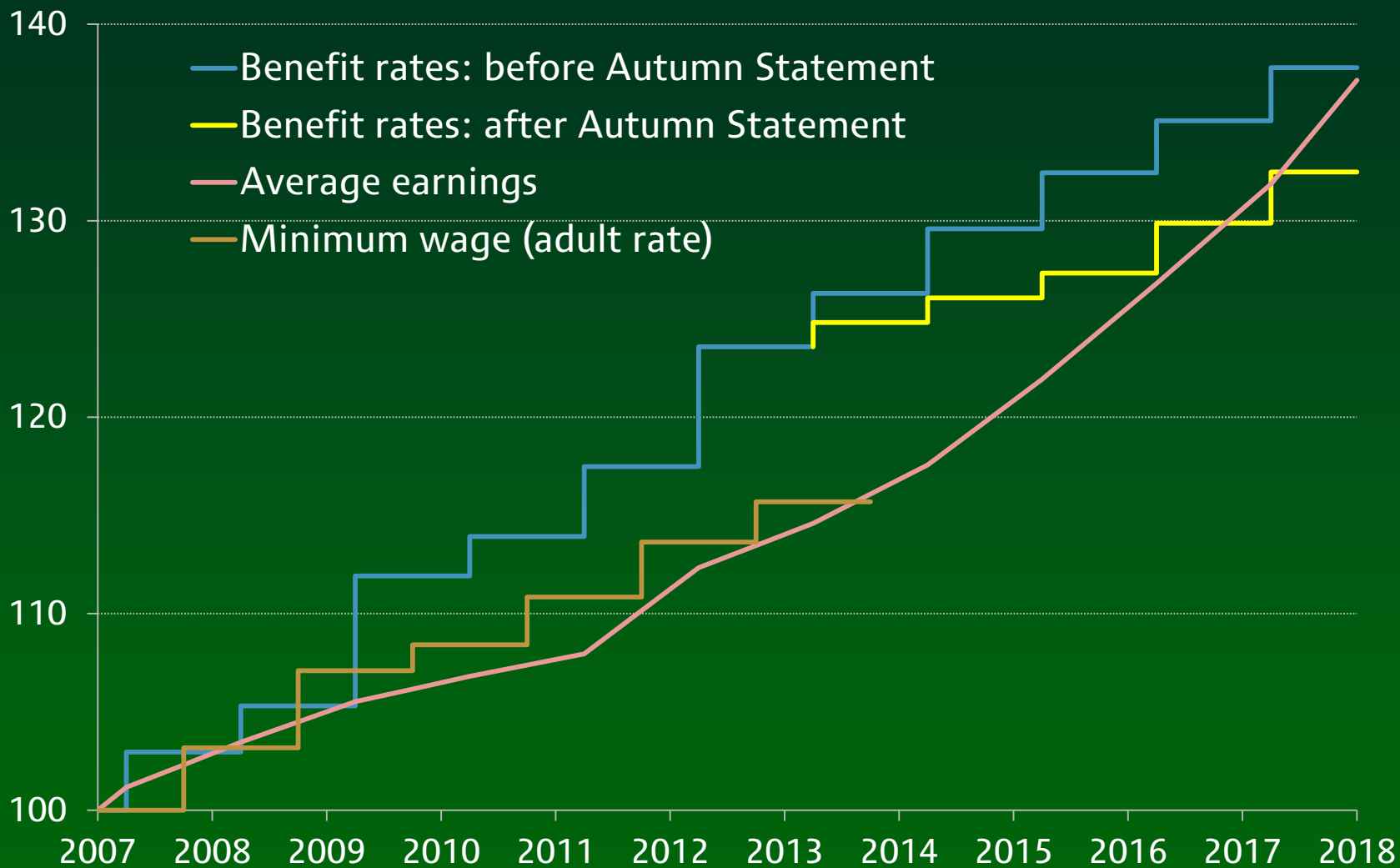
Tax cuts coming up (in April 2013)

- Personal income tax allowance up £1,115 in real terms – annual gain of up to £223 for some low-earners.
- More real cuts to fuel duty and Council Tax (latter may not benefit those on CT Benefit). Minor effects on work incentives.

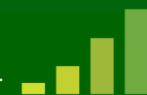
Welfare cuts coming up (1)

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

Earnings and out-of-work benefits (Jan 2007=100)



Sources: Past earnings from ONS series DTWM, ROYK, MGRZ, MGRQ, past benefits from DWP, forecasts of inflation and earnings growth from OBR.



Welfare cuts coming up (1)

- Most existing benefits and tax credits to be increased by 1% in April 2013, 2014 and 2015 (not for pensioners and more severely disabled)
 - 4% real-terms cut overall
 - Affects in-work and out-of-work benefits
- Frozen in cash terms in April 2013: basic element and 30-hour premium in Working Tax Credit; Child Benefit
- These reforms will have mixed impacts on work incentives

Welfare cuts coming up (2)

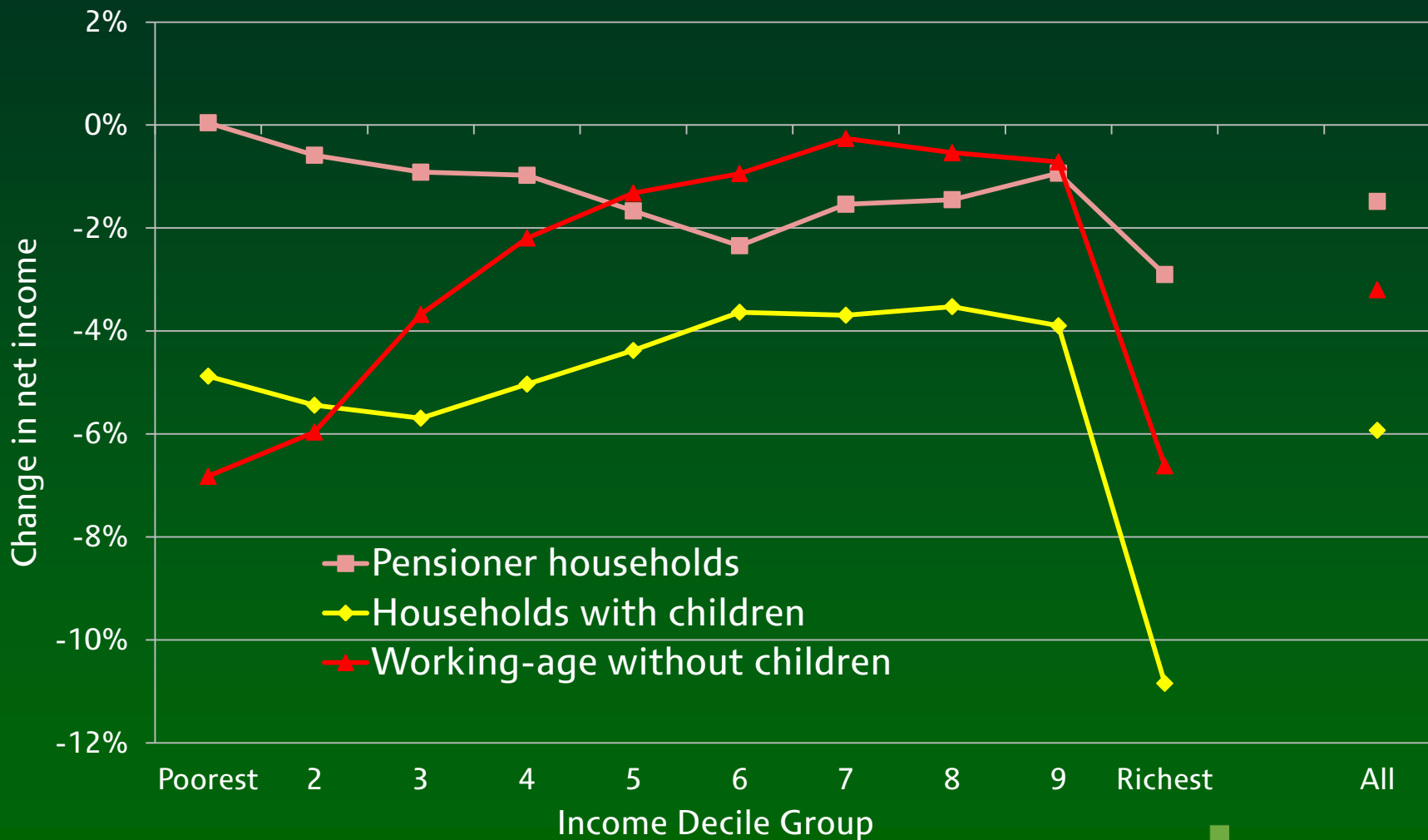
- Housing Benefit cuts (tend to strengthen work incentives)
 - Entitlements for private renters will start rising with national prices (not local rents) – those in areas with real rent growth will lose
 - Cuts to HB entitlement for the 660,000 ‘under-occupying’ working-age social tenant families (14% cuts for some, 25% for others)
- Council Tax Benefit localised; new grants to Local Authorities and Scot/Wales govts will cover only 90% of existing CTB budget
 - Pensioners in England HAVE to be protected; required savings equal to 19% of working-age CTB budget
 - LAs can design their own CTB schemes; and can choose to protect CTB claimants by finding cuts from elsewhere in their budgets
 - Uncertainty about what they’ll do and effects on incomes and work incentives

Universal Credit (UC)

- Will integrate 6 of 7 existing means-tested payments into one
- New claimants of out-of-work benefits get UC from October 2013
- New claimants of tax credits and existing claimants migrate to UC from April 2014 over a period of 4 years
- Incomes of out-of-work people largely unaffected by transition
 - But their work incentives will change
- Will tend to strengthen incentives to work and earn more for:
 - Jobs with low earnings and hours worked (<16, <24, <30 depending on family type)
 - Those currently receiving multiple means-tested benefits and tax credits

Distributional impact of tax and benefit reforms

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

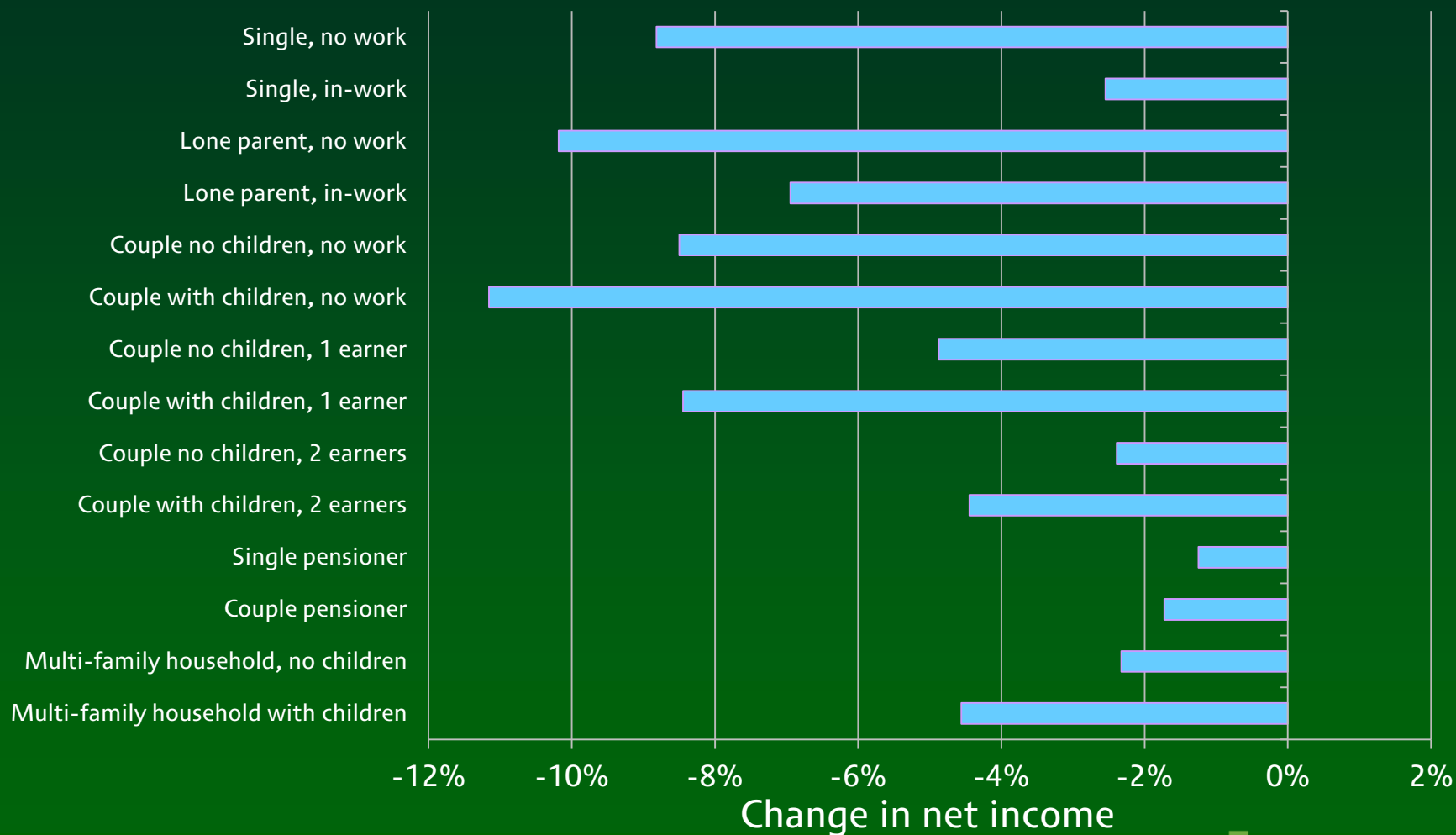


Notes: Excludes reform to Council Tax Benefit. Fuel duty modelled at average 2015-16 level.

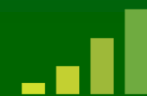


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Summary

- We are 1/3 of way through expected large fiscal consolidation
- Rise in personal allowance will benefit some low-earners by £223 p.a.
- Earnings growing less quickly than prices, so out-of-work benefits have been rising faster
- Lots of in-work and out-of-work welfare cuts imminent, on top of those already implemented and planned for later in parliament
 - Overall impact of these on work incentives for low earners is mixed
- Universal Credit is a major structural change and will affect incomes and work incentives (but its impact will be less immediate)

