Benefit and tax credit changes
Andrew Hood
The big picture

• Government still planning £12bn cut to annual benefit spending by end of the parliament
  – But less than half delivered by 2017-18
  – £4bn from freeze to 2020, £4-5bn additional cuts to universal credit, £1½bn cuts to housing benefit spending (plus other smaller changes)

• Benefit spending excluding state pensions in 2020-21 forecast to be at its lowest as a share of national income for 30 years

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Benefit/tax credit spending excluding state pensions, as % of national income

Note: Years are financial years. Data points from 2015-16 are projections, marked with dotted lines. Author’s calculations using November 2015 EFO and July 2015 DWP benefit expenditure tables.
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The tax credit U-turn

- July 2015 Budget announced £4.4bn cut to tax credits for low-income working families in April 2016
  - Cut in income threshold from £6,420 to £3,850
  - Increase in taper rate from 41% to 48%

- Those two cuts were cancelled yesterday
  - Cost: £3.4bn in 2016-17 (not £4.4bn)
  - Lower cost is combination of avoidable mistakes in official July costing and forecast changes

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Housing benefit cut for social tenants

• Local caps on HB in private sector extended to new social tenancies
  – Applies from April 2018, on tenancies signed from April 2016
  – Cuts HB by £225m in 2020-21

• Cut will get bigger. If applied to all social tenants now:
  – HB would be cut by £1.1 bn (from base of around £25bn)
  – 800,000 households would lose average of £1,300 per year

• Long-run effects would be larger still if social rents grow faster than HB caps (which are CPI-indexed)

• The caps are increasingly arbitrary and in need of reform
  – They depend on 2012-13 level of 30th percentile of private sector rents (for properties of relevant size in local area)
Short-run impact of tax and benefit changes
Changes in April 2016 only

Note: Assumes full take-up of means-tested benefits and tax credits.
Long-run impact of tax and benefit changes
All changes introduced May 2015-April 2019 fully in place

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Benefit system still much less generous in long run

1. Lots of other benefit cuts announced in July that are going ahead (and more announced yesterday)
   - e.g. freeze until 2020, 2-child limit in tax credits & universal credit

2. Reversal of tax credit cuts makes no difference in long run
   - Tax credits being replaced by universal credit

• Work incentives strengthened on average in long run
  - Cuts to out-of-work benefits as well as in-work benefits
  - Those with working partners have less benefit income to lose by moving into work
Universal credit still less generous than pre-election plans

• UC replacing tax credits (along with 4 other means-tested benefits)
  – Under previous plan, UC roughly as generous as system it replaces
  – Though significant gains and losses for different families

• UC unaffected by yesterday’s tax credit U-turn
  – Cut to work allowances announced in July still going ahead
  – Will affect similar group to abandoned tax credit cuts
Example of work allowance cut announced in July
Couple with 2 children, owner-occupiers

Annual universal credit entitlement

£0 £2,000 £4,000 £6,000 £8,000 £10,000 £12,000 £14,000

£0 £5,000 £10,000 £15,000 £20,000 £25,000 £30,000

Annual income net of income tax and employee NICs

Before work allowance cut
After work allowance cut

Loss of £1,080
Universal credit vs. the system it is replacing

• UC now represents additional cut on top of other changes
  – Cuts benefit entitlements by £3.7bn a year in the long run
  – Existing claimants protected in cash terms when moved onto UC

• 4.5m working families affected by introduction of UC
  – 2.6m lose an average of £1,600 a year
  – 1.9m gain an average of £1,400 a year
  – Total cut of £1.5bn a year

• 1.8m non-working families affected by introduction of UC
  – 1.2m lose an average of £2,500 a year
  – 0.6m gain an average of £1,000 a year
  – Total cut of £2.2bn a year
Universal credit vs. the system it is replacing

• UC now represents additional cut on top of other changes
  – Cuts benefit entitlements by £2.7bn a year in the long run
  – Existing claimants protected in cash terms when moved onto UC

• 3.9m working households affected by introduction of UC
  – 2.1m lose an average of £1,600 a year
  – 1.8m gain an average of £1,500 a year
  – Total cut of £0.7bn a year

• 1.5m non-working households affected by introduction of UC
  – 1.1m lose an average of £2,300 a year
  – 0.5m gain an average of £1,000 a year
  – Total cut of £2.0bn a year

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Timing of universal credit roll-out uncertain...

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Source: Chart 4.8 in OBR Economic and Fiscal Outlook, November 2015.
Summary

• Big decision yesterday was to scrap two planned cuts to tax credits

• But in fact, tax credit U-turn has no long run effect
  – Tax credits being replaced by universal credit
  – UC unaffected by yesterday’s announcement

• Government still planning deep cuts to working-age benefits
  – Including for low-income working families
  – Though overall package will strengthen work incentives on average
ADDITIONAL DISTRIBUTIONAL ANALYSIS
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Long-run impact of tax and benefit changes
All changes introduced April 2015-April 2019 fully in place

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Change in annual net income

Income Decile Group

Pre-Autumn Statement
Post-Autumn Statement
Average gain from National Living Wage

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Change in annual net income

Income Decile Group

Working-age with children
Working-age without children
Pensioner households

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