



Institute for Fiscal Studies



Benefit changes and distributional analysis

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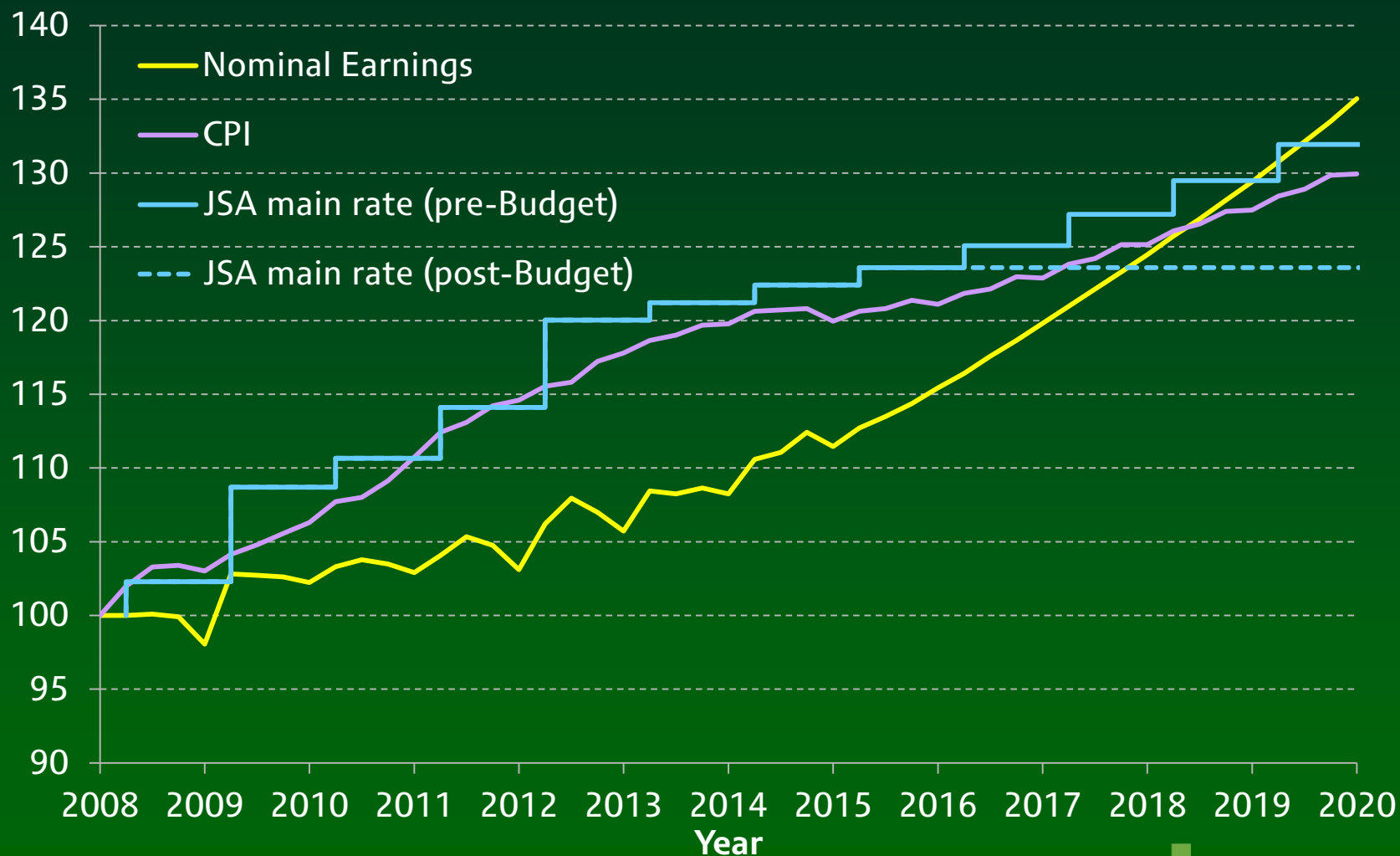
£12 billion of benefit cuts

- Changes announced yesterday reduce benefit spending by £12 billion in 2019-20
 - Two years later than promised in Conservative manifesto
- Where did Mr. Osborne find his £12 billion?
 - Further across-the-board freezes in benefit rates (£4bn in 2020-21)
 - Very large further cuts to tax credits (£6bn)
 - A takeaway from housing associations and LAs (£1.4bn)

4-year freeze to working-age benefits

- Most working-age benefits frozen in cash terms until April 2020
 - 4.8% real cut given OBR forecasts for CPI
 - Reduces spending by £4 billion in 2020-21
 - 13 million families lose £260 a year on average (7.4 million in work, losing £280 a year on average)
- Comes on top of 3 years of 1% nominal increases from April 2013
 - Total real cut of 8% between 2013 and 2020

Nominal earnings, prices and the main JSA rate (2008Q1=100)



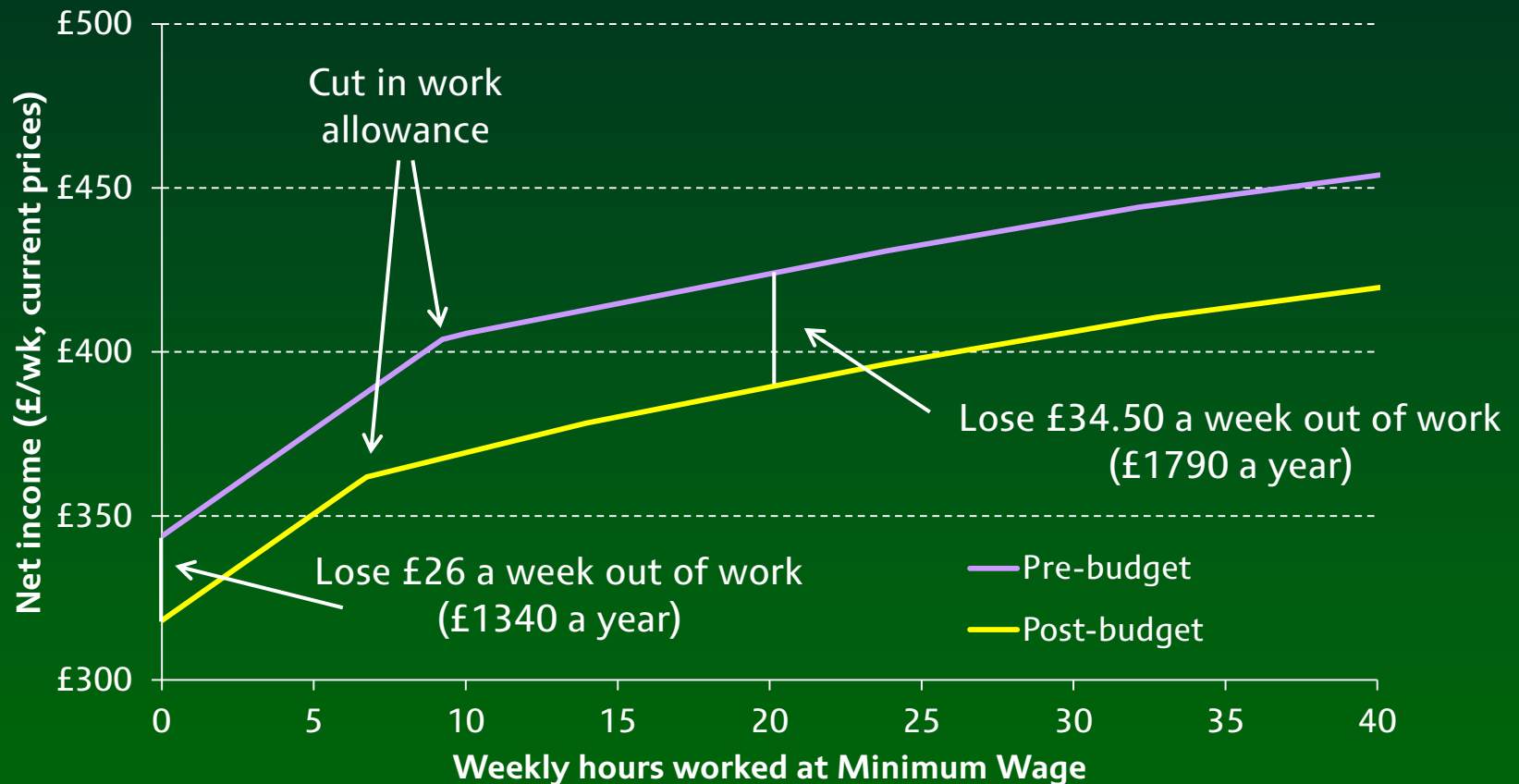
Cuts to tax credits/universal credit

1. Removing tax credit/UC entitlement for third and subsequent children from April 2017
 - Currently 872,000 families getting an average of £3,670 a year of support for third and subsequent children (548,000 in work)
 - Long run saving around £3 bn a year, saves £1.4bn in 2020-21 as only affects new claimants and new births
2. Abolition of the family element in child tax credit (and equivalent in UC) from April 2017 – extra money for first child
 - Long run saving around £2bn a year (4m families affected), saves £675m in 2020-21 as only applies to new claimants and new births
3. Cuts to work allowances
 - Biggest change announced yesterday (in revenue terms)

Cuts to work allowances

- Large reduction in how much families can earn before tax credits/universal credit (UC) start to be withdrawn
 - Tax credits start to be withdrawn once family earnings above £3,850 rather than £6,420
 - UC also withdrawn much earlier (straight away for non-disabled households without children)

Effect of Budget changes to taxes and benefits on lone parent's budget constraint in 2019–20



Assumes: 2 children aged under 5, median Local Housing Allowance rate

Cuts to work allowances

- Large reduction in how much families can earn before benefits start to be withdrawn (called 'work allowances' under UC)
 - Tax credits start to be withdrawn once family earnings above £3,850 rather than £6,420
 - UC also withdrawn much earlier (straight away for non-disabled households without children)
- Reduces spending by £3.4 billion in 2020-21
 - Just over 3m families lose an average of just over £1,000 per year
- Only affects working families
 - Protects the very poorest...
 - ...but weakens incentives for families to have someone in work

Reduction in the benefit cap

- Total annual amount of benefit out-of-work families can receive limited to £26,000 (£18,200 for single adults without kids)
 - Only 23,000 families currently capped
- Benefit cap cut to £23,000 (£15,410) inside London and £20,000 (£13,400) outside London from April 2016
 - Saving only £200m in 2020-21 after other changes
 - But maximum loss of £6,000 (£3,000 in London)
- Evidence that small proportion (c.5ppts) of those affected by current benefit cap responded by moving into work
 - Very few responded by moving to a cheaper property

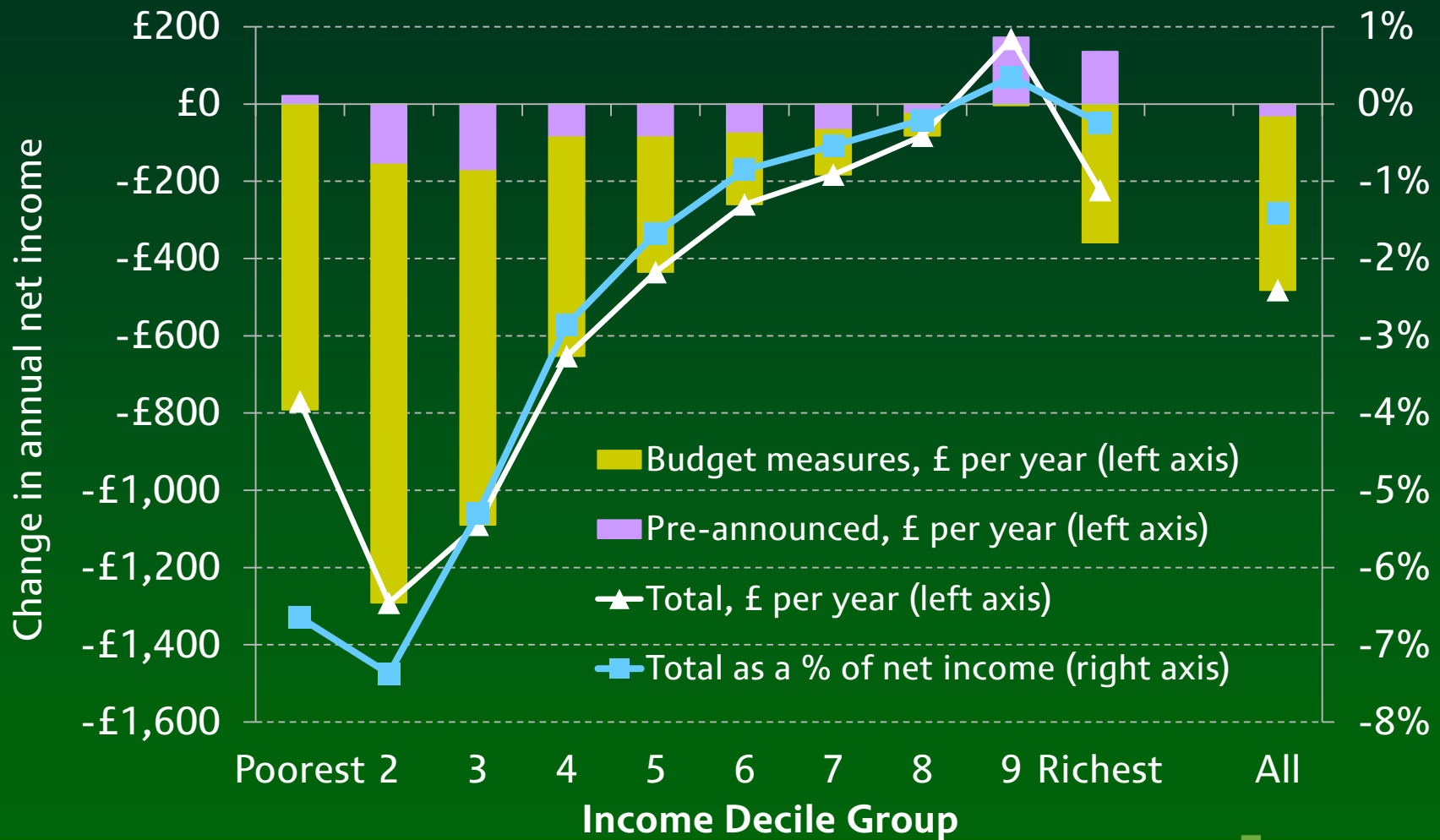
Other benefit changes

- Abolishing work-related activity group premium in ESA for new claimants: £640m in 2020-21
 - Currently 488,000 claimants receiving £29 a week premium (20% of all ESA claimants)
 - Weakens incentive to get into the WRA group (rather than JSA), strengthens incentive to get into the support group
- Changing support for mortgage interest from benefit to loan: £250m in 2020-21
 - Significant strengthening of the work incentives of home-owners
- Entitlement to housing benefit removed for most childless 18-21 year olds who are out of work: £40m in 2020-21

Distributional impact of tax and benefit changes

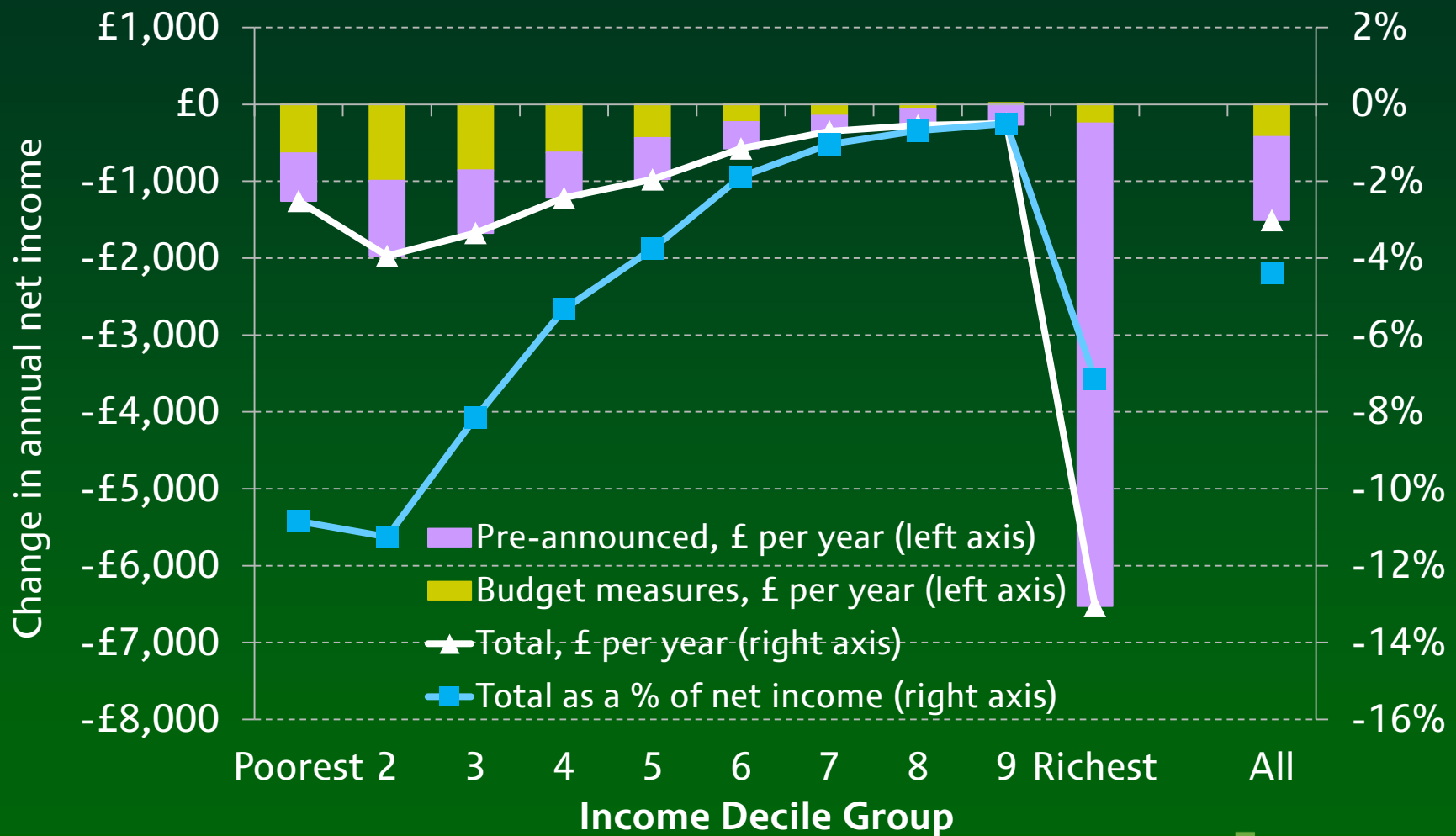
- Look at all changes between April 2015 and April 2019, and between January 2010 and April 2019
 - Pre-announcements and Budget measures
 - Universal credit fully in place by April 2019 (with no transitional protection)
- Where measures only affect new claimants, we model as being fully in place
- Include everything I've talked about so far (except ending of HB entitlement for 18-21 year olds out of work)

Impact of tax and benefit reforms between April 2015 and April 2019 (including universal credit)



Assumes full take-up of means-tested benefits and tax credits.

Impact of tax and benefit reforms between Jan 2010 and April 2019 (including universal credit)



Assumes full take-up of means-tested benefits and tax credits.

English social rents: cut in cash terms by 1% p/y for 4 years

- 12% cut relative to previous policy (rents rising by CPI + 1ppt p/y)
- 1.2 million families not on housing benefit (HB) gain by average of about £700 p/y (current prices)
 - Majority (about 2.7 million) of social tenant families in England do not directly gain as they are on HB; but work incentives strengthened
- Clearly increases total subsidy to social tenants - yet net gain of £1.4bn scored to exchequer, due primarily to lower HB spending
 - OBR point out that policy would weaken public finances if housing associations (who lose rental income) were counted as public sector
- Impacts on social landlords:
 - Total rental income reduced by at least about £2 ½ bn in today's prices
 - Govt hopes this can be absorbed through “efficiency savings” – but clearly could reduce maintenance / construction

Market rents for higher-income social tenants

- From 2017-18, social tenants with household incomes above £30k (£40k in London) to pay “market or near market” rent
 - Likely to affect about 10% of social tenants
 - Expected yield for exchequer of £240m in 2020-21 (all from local authorities; housing associations allowed to reinvest the income)
- Potentially large disincentives for tenants to increase income
- Continues theme of making direct rent subsidies more like housing benefit, with same pros and cons:
 - more targeted on those with lowest current resources
 - weakens work incentives for those receiving subsidy

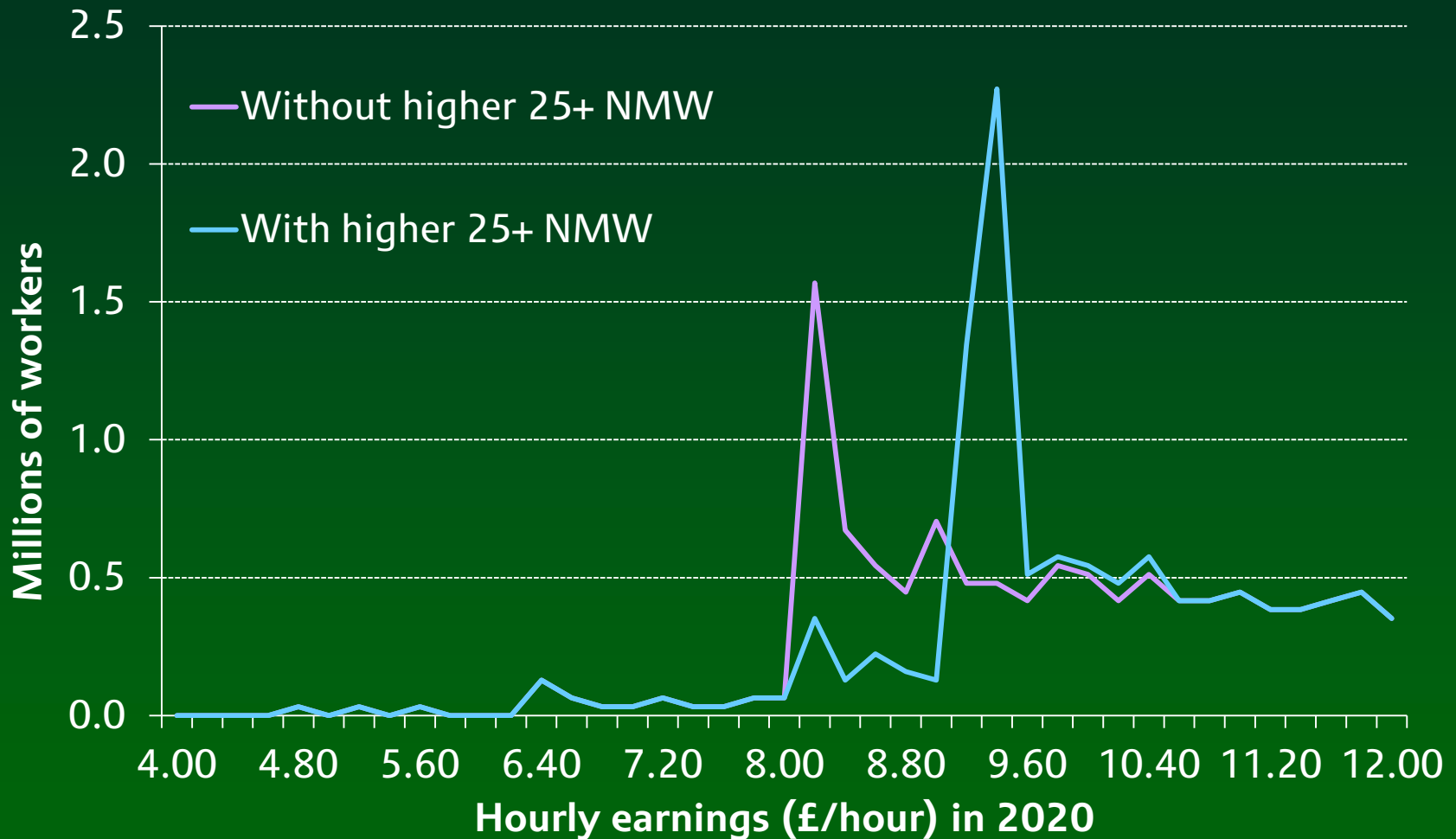
Increasing the minimum wage for adults aged 25+

- Chancellor announced the introduction of a higher minimum wage for adults aged 25 and over, the “National Living Wage”
- £7.20 p/h in April 2016: 50p higher than NMW
- Set to increase such that it reaches 60% of median hourly earnings by April 2020
 - OBR assumes this will be £9.35 in April 2020
 - 13% (£1.10) higher than if the NMW rose in line with average hourly wages

The effect of a higher 25+ NMW

- OBR assumes 2.7 million people who earn below £9.35 per hour in 2020 would see hourly pay increase
 - Small spillover effects on slightly higher earners

“Illustrative” earnings distributions in 2020 with and without higher 25+ NMW



Source: Chart B.1 Office for Budget Responsibility (2015)
Economic and Fiscal Outlook: July 2015

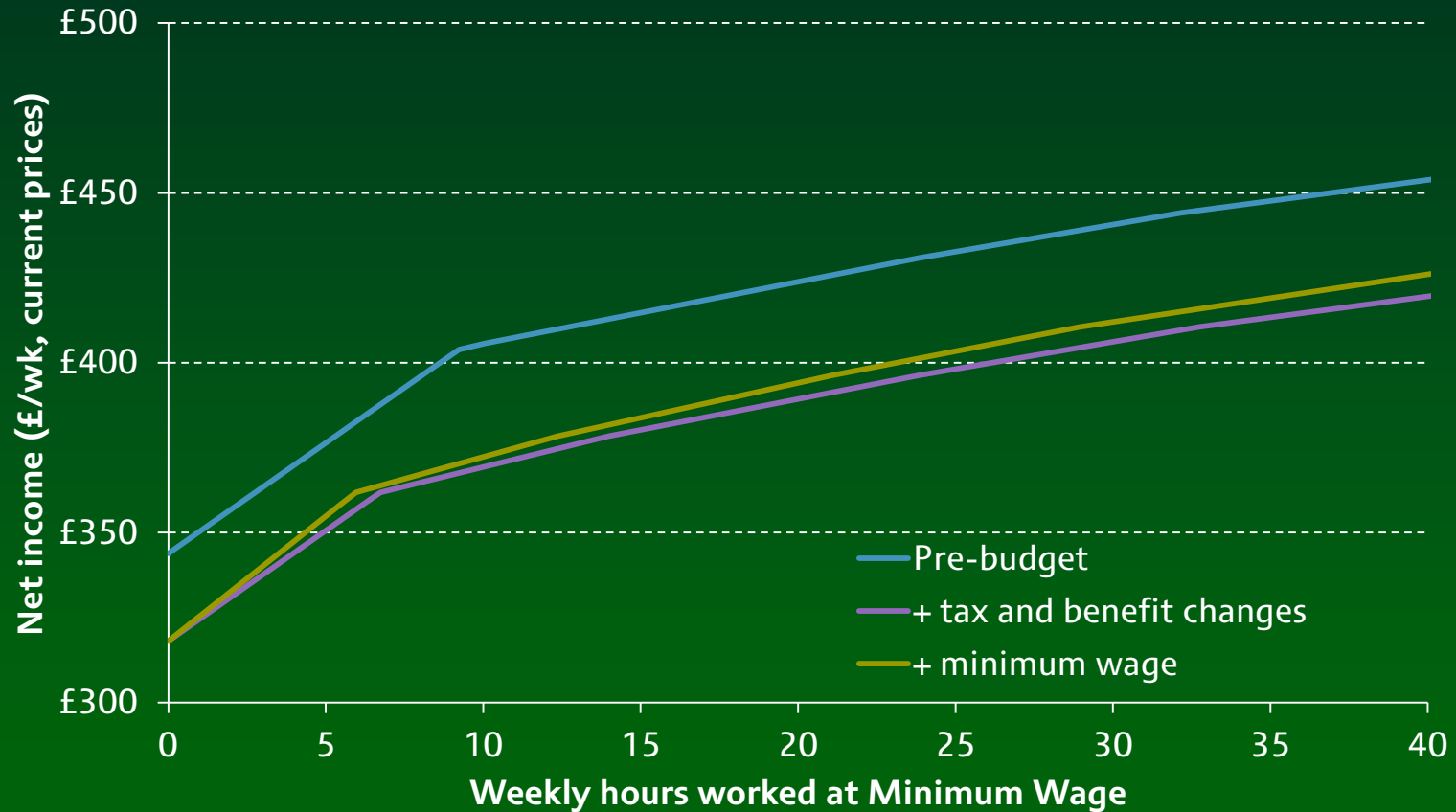
The effect of a higher 25+ NMW

- OBR assumes 2.7 million people who earn below £9.35 per hour in 2020 would see hourly pay increase
 - Small spillover effects on slightly higher earners
- Relatively likely to be part-time, relatively likely to be female
 - Half have a working partner
- Could see reduced hours/employment as well as higher wages
 - OBR's central assumption is fall in employment of 60,000 (2% of those directly affected), but subject to significant uncertainty
 - Reduces GDP by 0.1% in 2020

Tax credits and the minimum wage

- OBR estimates £4 billion direct impact on gross earnings
 - Some lost in income tax, NICs and withdrawn benefits
- Much smaller than the takeaway from tax and benefit changes

Effect of Budget changes to taxes, benefits and the minimum wage on lone parent's budget constraint in 2019–20

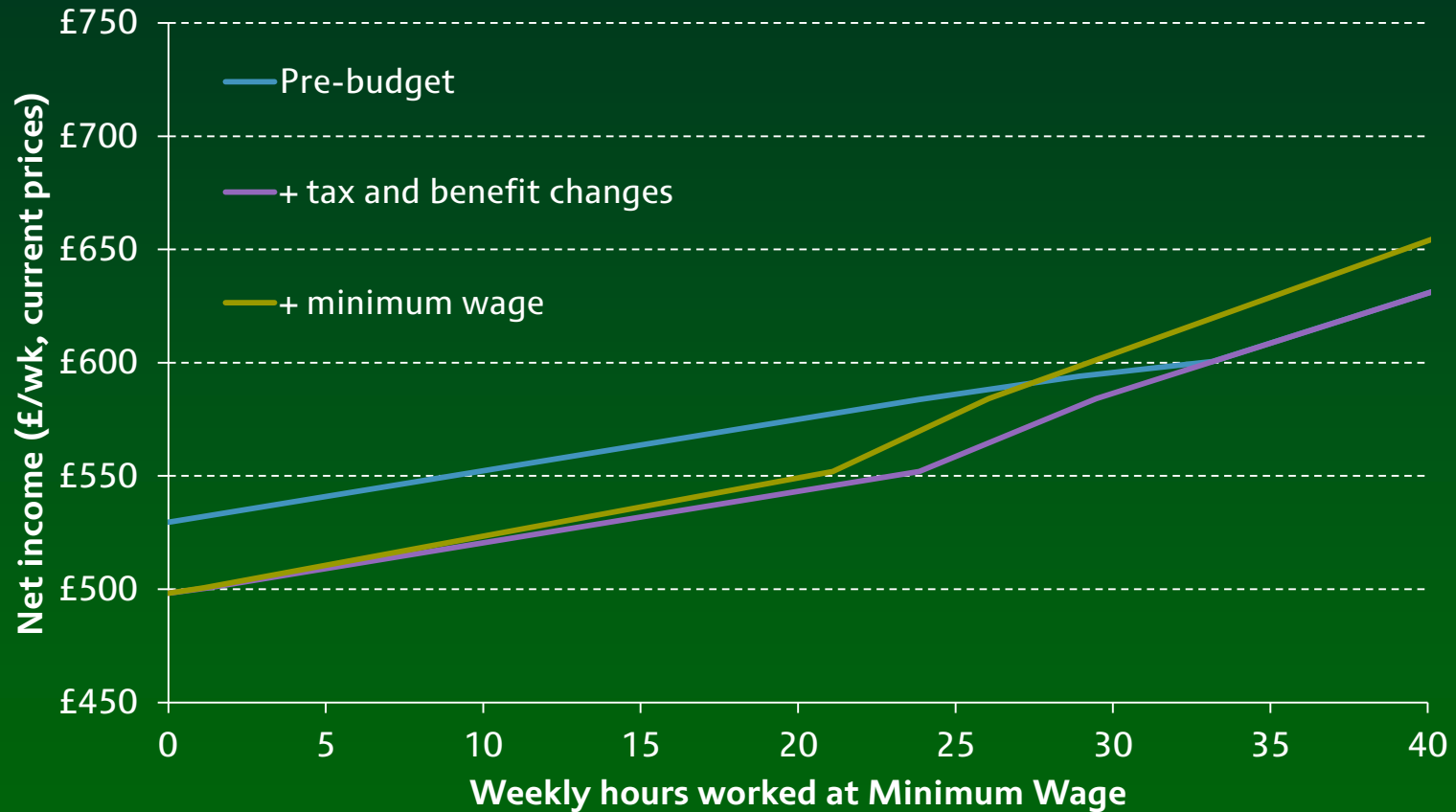


Assumes: 2 children aged under 5, median Local Housing Allowance rate, 'National Living Wage' 13% above NMW.

Tax credits and the minimum wage

- OBR estimates £4 billion direct impact on gross earnings
 - Some lost in income tax, NICs and withdrawn benefits
- Much smaller than the takeaway from tax and benefit changes
- Crucially, tax credits and minimum wages targeted differently...
 - Tax credits support those with low annual family incomes
 - Minimum wages support those with low hourly wages, many of whom have higher family incomes

Effect of Budget changes to taxes, benefits and the minimum wage on budget constraint of a second earner in a couple in 2019–20



Assumes: 2 children aged under 5, median Local Housing Allowance rate, 'National Living Wage' 13% above NMW, partner earns £25,000 a year.

Tax credits and the minimum wage

- OBR estimates £4 billion direct impact on gross earnings
 - Some lost in income tax, NICs and withdrawn benefits
- Much smaller than the takeaway from tax and benefit changes
- Crucially, tax credits and minimum wages targeted differently...
 - Tax credits support those with low annual family incomes
 - Minimum wages support those with low hourly wages, many of whom have higher family incomes
- ... and so are not substitutes

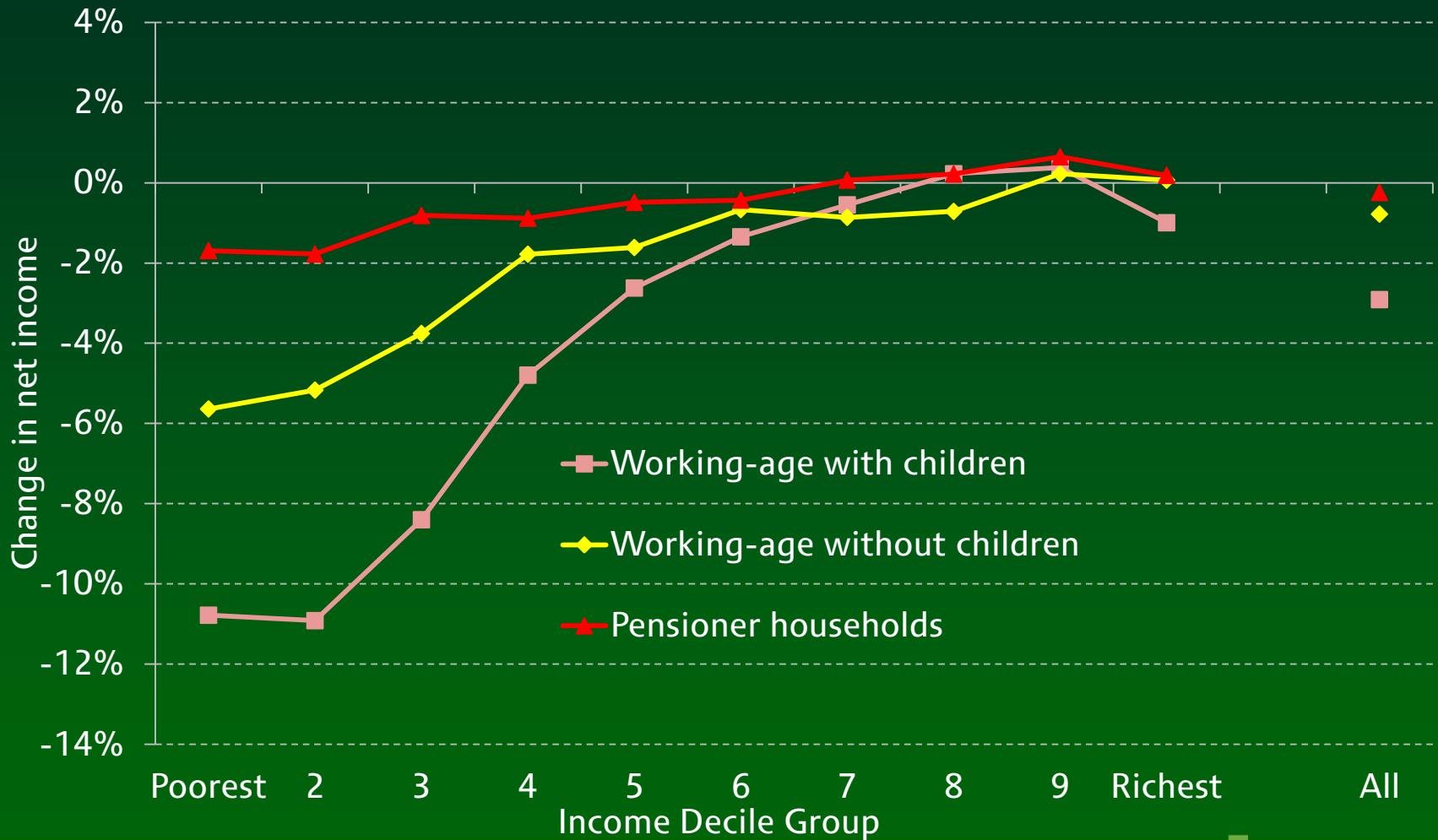
Conclusions

- Where did Mr. Osborne find his £12 billion?
 - Further across-the-board freezes in benefit rates (£4bn in 2020-21)
 - Very large further cuts to tax credits (£6bn)
 - A takeaway from housing associations and LAs (£1.4bn)
- Chose to focus tax credit cuts on working families
 - Many of whom will not be compensated by higher NMW
- Limiting support to two children significant step in weakening relationship between need and entitlement in the benefit system
 - Theme emerging with caps on support for children, housing costs, and total benefit income

ADDITIONAL DISTRIBUTIONAL ANALYSIS

Impact of tax and benefit reforms

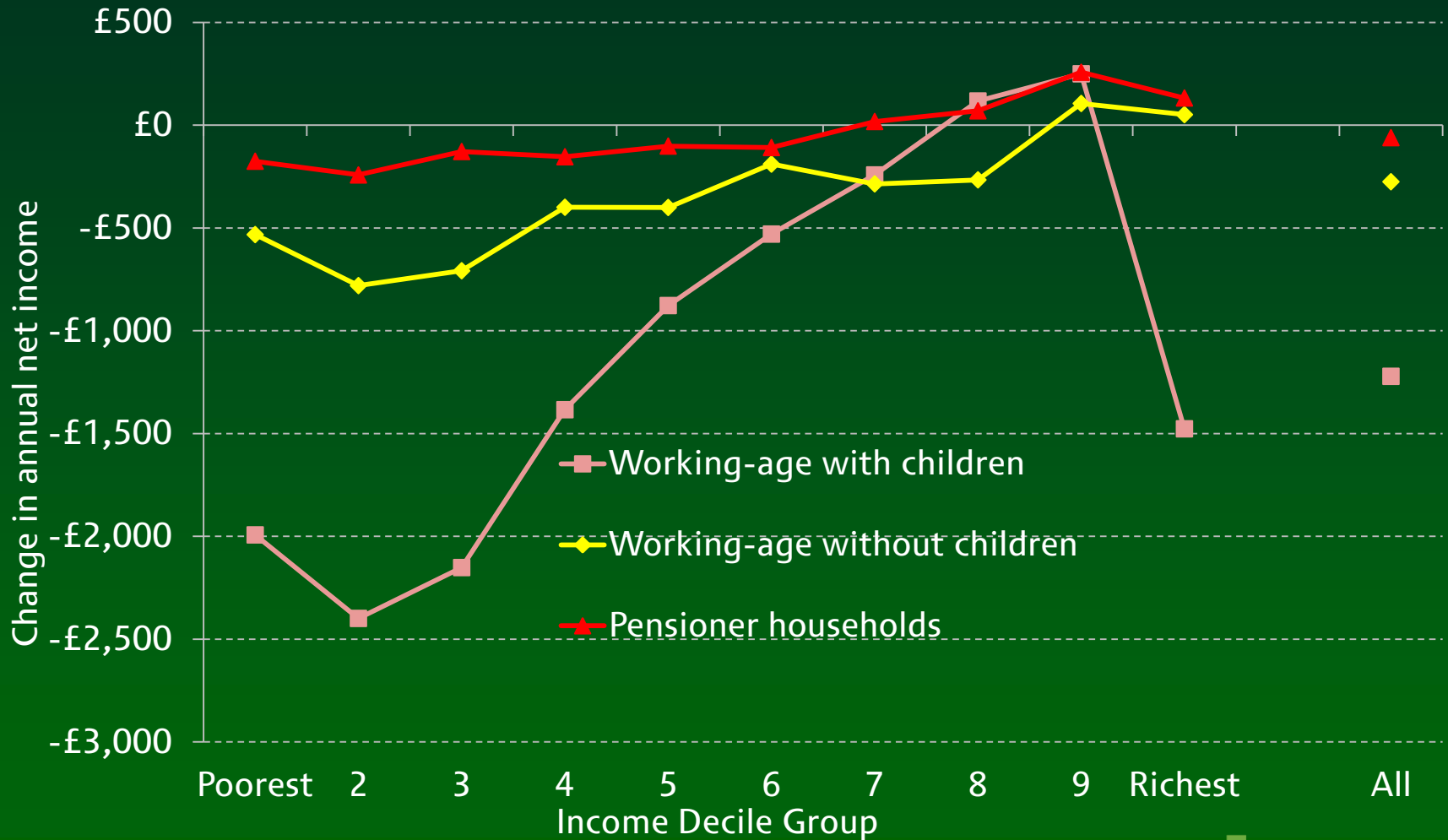
April 2015 – April 2019 (including universal credit)



Assumes full take-up of means-tested benefits and tax credits.

Impact of tax and benefit reforms

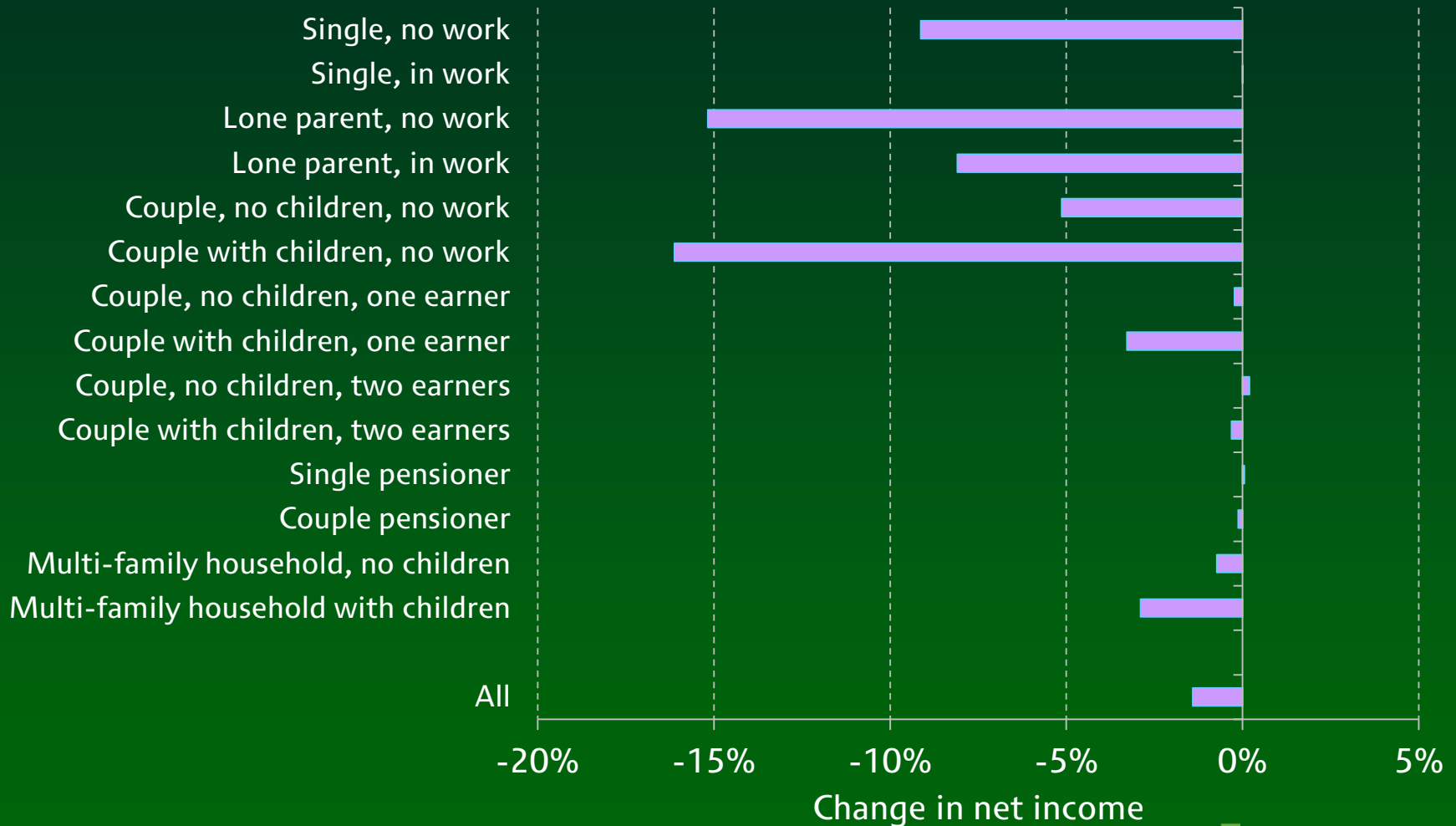
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Impact of tax and benefit reforms

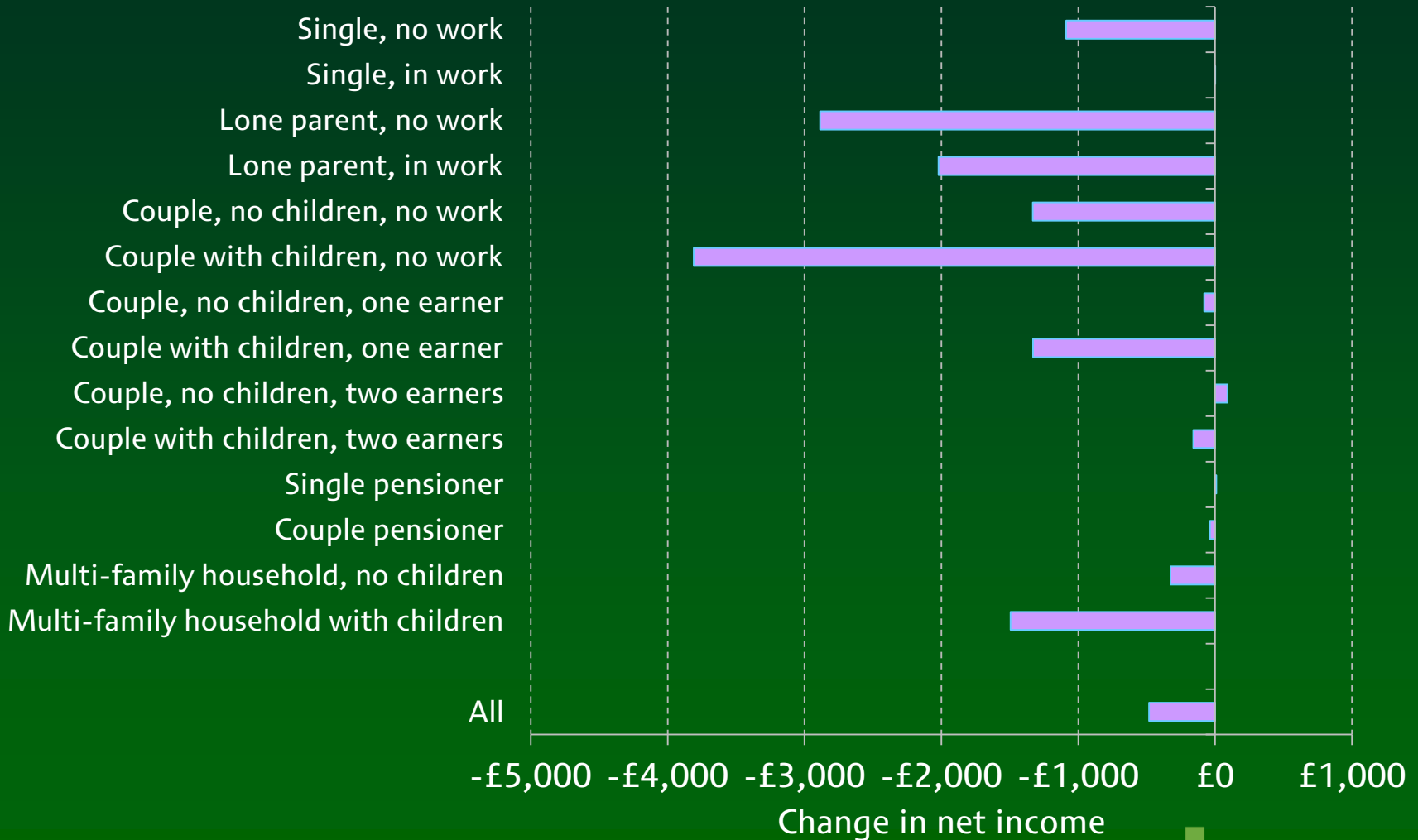
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Impact of tax and benefit reforms

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