Benefit changes and distributional analysis

Andrew Hood
£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)

Year

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• Large reduction in how much families can earn before tax credits/universal credit (UC) start to be withdrawn
  – Tax credits start to be withdrawn once family earnings above £3,850 rather than £6,420
  – UC also withdrawn much earlier (straight away for non-disabled households without children)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

Cut in work allowance

Lose £26 a week out of work (£1340 a year)

Lose £34.50 a week out of work (£1790 a year)
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• Large reduction in how much families can earn before benefits start to be withdrawn (called ‘work allowances’ under UC)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)

Change in annual net income

Income Decile Group

- Poorest 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9 Richest
- All

Budget measures, £ per year (left axis)
Pre-announced, £ per year (left axis)
Total, £ per year (left axis)
Total as a % of net income (right axis)

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)

Change in annual net income

- £1,000
- £0
- £-1,000
- £-2,000
- £-3,000
- £-4,000
- £-5,000
- £-6,000
- £-7,000
- £-8,000

Poorest 2 3 4 5 6 7 8 9 Richest All

Income Decile Group

Pre-announced, £ per year (left axis)
Budget measures, £ per year (left axis)
Total, £ per year (right axis)
Total as a % of net income (right axis)

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

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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)

Change in net income
Income Decile Group
Poorest 2 3 4 5 6 7 8 9 Richest All

Assumes full take-up of means-tested benefits and tax credits.
Impact of tax and benefit reforms
April 2015 – April 2019 (including universal credit)

Change in annual net income

- £3,000
- £2,500
- £2,000
- £1,500
- £1,000
- £500
- £0
- £500
- £1,000
- £1,500
- £2,000
- £2,500
- £3,000

Income Decile Group
Poorest 2 3 4 5 6 7 8 9 Richest All

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

Assumes full take-up of means-tested benefits and tax credits.
Impact of tax and benefit reforms
April 2015 – April 2019 (including universal credit)

Single, no work
Single, in work
Lone parent, no work
Lone parent, in work
Couple, no children, no work
Couple with children, no work
Couple, no children, one earner
Couple with children, one earner
Couple, no children, two earners
Couple with children, two earners
Single pensioner
Couple pensioner
Multi-family household, no children
Multi-family household with children

Assumes full take-up of means-tested benefits and tax credits.
Impact of tax and benefit reforms
April 2015 – April 2019 (including universal credit)

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