8. Options for cutting spending on social security[1]

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Summary

- Spending on benefits, tax credits and state pensions accounts for 30% of all government expenditure. As the government seeks further deficit reduction measures by 2017–18, it will presumably consider reductions in social security spending, and tax rises (see Chapter 9), alongside spending on public services (see Chapter 6).
- The period from 1997–98 to 2010–11 saw significant increases in the generosity of benefits for pensioners and for families with children, though those of working age without children fared less well. Welfare cuts being introduced during the current parliament have reduced entitlements for those of working age but pensioners have been largely protected. These cuts have only partly offset the increase in generosity for families with children seen between 1997–98 and 2010–11, but entitlements for those without children will, on average, be lower in real terms in 2015–16 than they were in 1997–98.
- An obvious way of making savings to the social security budget across the board would be to increase benefits by less than inflation in the next few years. The Autumn Statement contained proposals to increase most working-age benefits by 1% for the next three years. Further savings could be achieved by freezing these benefits, extending below-inflation uprating to more benefits or extending the period of below-inflation uprating to more than three years. To achieve large savings, state pensions would need to be affected.
- In a speech in the summer of 2012, the Prime Minister suggested some areas where he believed that the benefit system was too generous and gave claimants what he saw as perverse incentives, in particular around support for housing costs for young people and support for large families. Changes in these areas could potentially generate large savings, but it is unclear how far the government is prepared to go in reducing support. Introducing exemptions to cuts could further distort incentives; for example, if those aged under 25 were excluded from Housing Benefit unless they had children, those under 25 would have a stronger incentive to have a child.
- Savings could also be achieved by more radical changes to the benefit system – for example, by means-testing more disability and carer's benefits and by removing the last vestiges of the National Insurance system for those of working age. But these would be big changes in the nature of the support given by the benefit system. Careful consideration about who is deserving of support, and how much, should be given before making such changes.

[1] The Green Budget 2013 is funded by the Nuffield Foundation

8.1 Introduction

Spending on social security benefits and tax credits is expected to account for £212.1 billion in 2014–15, or more than 30% of total government spending. As the government considers further deficit reduction measures to be implemented by 2017–18,[2] it will presumably consider reductions in social security spending, and tax rises, as well as reductions in spending on public services. Indeed, prior to the Autumn Statement, both the Chancellor of the Exchequer and the Secretary of State for Work and Pensions stated an intention to reduce social security spending by £10 billion by 2016–17. The Autumn Statement contained £4.5 billion of additional cuts to social security spending in that year.

There are inevitable trade-offs associated with spending on social security. Clearly, spending will increase the incomes of those to whom it is targeted. But different elements of the system can also impact on people's incentives to work or to save, on their decisions over where to live and with whom, and even on choices about how many children to have (and when to have them). In the summer of 2012, the Prime Minister set out some of these trade-offs and expressed concern about what he saw as some perverse incentives within the system.

In this chapter, we examine ways in which further reductions could be made to the social security budget, taking account of some of these trade-offs.

Section 8.2 examines the current composition of the social security budget.[3] Section 8.3 considers the reasons behind the increase in spending seen over the period from 1997–98 to 2010–11 and shows the distributional impact of all tax and benefit reforms introduced since 1997–98. Section 8.4 considers possible future reforms that could be introduced to yield further savings from the social security budget, while Section 8.5 concludes.

8.2 Current spending on social security

Total expenditure on social security benefits and tax credits has fallen slightly from its record high of 13.8% of national income in 2009–10 to 13.5% of national income in 2012–13.[4] Slightly more than half of spending goes to pensioners, who make up around 20% of the total population. The composition of benefits that go to those above and below the State Pension Age is very different: the vast majority (around 80%) of benefits received by those of working age are means-tested in some way (this figure has recently increased as a result of the new 'high-income Child Benefit charge), whereas state pensions (which are not means-tested, and depend on individuals' National Insurance contribution record) account for nearly three-quarters of social security spending on pensioners.[5]

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[2] See Chapter 6.

[3] Throughout this chapter, 'social security' is used to mean all benefits, personal tax credits and state pensions.

[4] Source: Authors' calculations using DWP Benefit Expenditure Tables, (http://statistics.dwp.gov.uk/asd/asd4/index.php?page=long_term).

[5] Source: Authors' calculations using DWP Benefit Expenditure Tables, (http://statistics.dwp.gov.uk/asd/asd4/index.php?page=long_term).

Benefits for pensioners

Social security spending directed at those over the (female) State Pension Age[6] is expected to be around £111 billion in 2013–14. Table 8.1 details expenditure on each of the main benefits available to this population. As we would expect, the Basic State Pension is by far the largest component (57%) of social security spending on pensioners. A further 17% of the total will go on additional state pensions (the Graduated Retirement Pension, SERPS and S2P), bringing the total cost of all state pensions to around £82 billion.

Table 8.1. Pension-age welfare expenditure, 2013–14

	Expenditure (£ billion)
Basic State Pension	63.4
Additional state pensions	18.8
Attendance Allowance / Disability Living Allowance	10.5
Pension Credit	7.3
Housing Benefit	6.4
Winter Fuel Payments and TV licences	2.8
Other	1.9
Total	111.0

Note: Does not include spending on council tax support schemes that will be run by local authorities in England and the Scottish and Welsh Governments from April 2013.
Source: Authors' calculations using DWP Benefit Expenditure Tables (http://statistics.dwp.gov.uk/asd/asd4/index.php?page=long_term).

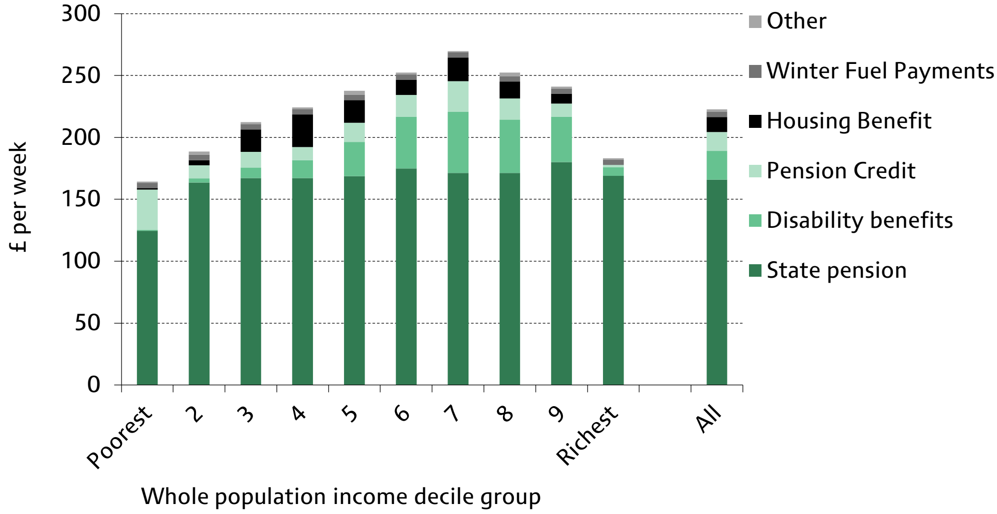
Perhaps more surprising is the composition of the remaining £30 billion. Pension Credit, the more generous means-tested benefit available to pensioners, accounts for less than £8 billion, and the much discussed universal benefits (Winter Fuel Payments and free TV licences for those aged 75 and over) cost around £2.8 billion, or less than 3% of the total social security spending on pensioners. The other main contributors to the total are disability benefits for pensioners, which now cost the exchequer more than £10 billion each year, and Housing Benefit, which will cost around £6.4 billion in 2013–14.

As Figure 8.1 shows, benefit entitlement among pensioner households varies relatively little according to where they are in the income distribution.[7] This is primarily the result of the fact that entitlement to the state pension is not means-tested. Spending on Pension Credit, the means-tested benefit for pensioners, is unsurprisingly concentrated towards the bottom of the income distribution. On the other hand, spending on disability benefits for pensioners is highest in the upper-middle of the income distribution. To give a sense of where pensioners are in the income distribution, Figure 8.2 shows what proportion of pensioners are in each decile. We can see that pensioner households are most highly concentrated in the lower-middle of the income distribution (income decile groups 2 to 5) and that relatively few pensioner households have very high incomes (in the top three income decile groups).

[6] The female State Pension Age is being increased from 60 to 66 between April 2010 and October 2020 and currently stands at around 61½.

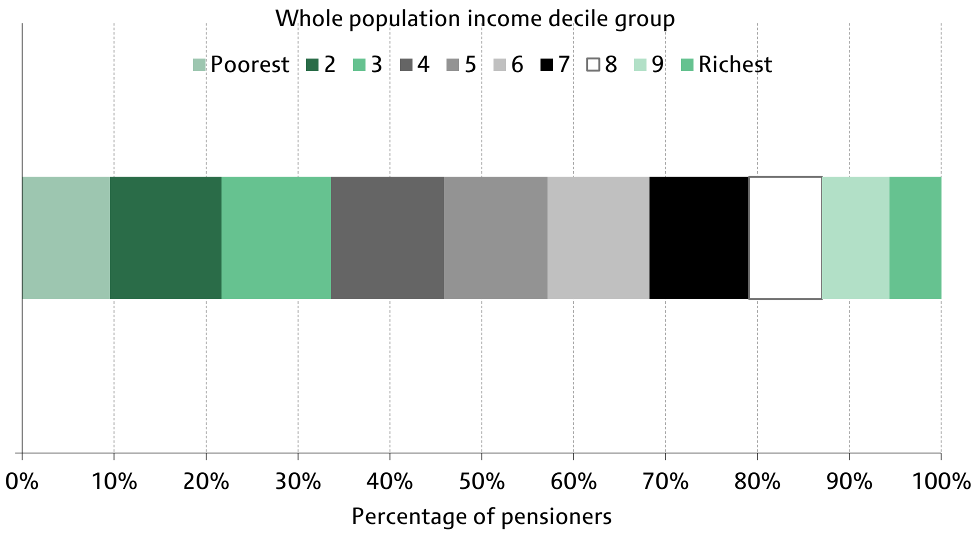
[7] Note that we are ranking households according to their income after taxes and benefits; thus one household may be in a higher income decile than another if it receives more in benefits even if it is identical in all other respects.

Figure 8.1. Average weekly benefit entitlement among pensioner households in 2013–14



Notes: Income decile groups are derived by dividing all households into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale. Does not include spending on council tax support schemes that will be run by local authorities in England and the Scottish and Welsh Governments from April 2013.
Source: Authors' calculations using 2010–11 Family Resources Survey and TAXBEN, the IFS tax and benefit microsimulation model.

Figure 8.2. Proportion of pensioner households in each income decile group



Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

Benefits for those of working age

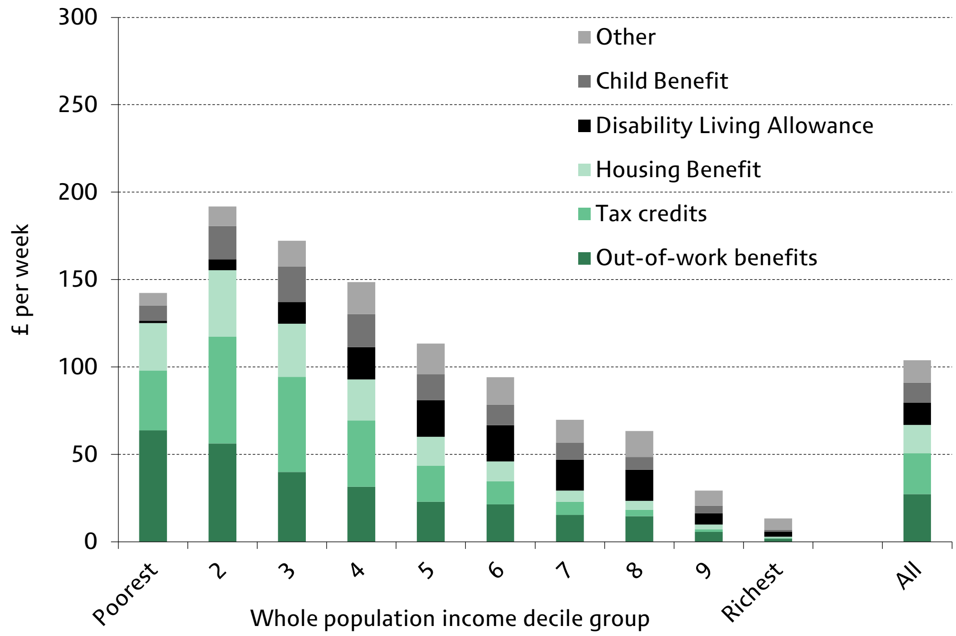
Total expenditure on benefits and tax credits directed at those of working age is forecast to be £91.2 billion in 2013–14. Table 8.2 lays out where that money will go. Perhaps most striking is the relatively small proportion of working-age welfare expenditure accounted for by benefits available only to those out of work. Together, Jobseeker's Allowance (JSA), Employment and Support Allowance (ESA), Incapacity Benefit (IB) and Income Support

Table 8.2. Working-age welfare expenditure, 2013–14

		Expenditure (£ billion)
Tax credits		28.8
Out-of-work benefits		19.5
of which:	Employment and Support Allowance	9.2
	Jobseeker's Allowance	5.7
	Income Support	3.0
	Incapacity Benefit	0.9
	Severe Disablement Allowance	0.7
Housing Benefit		17.1
Child Benefit		10.4
Disability Living Allowance / Personal Independence Payment		9.1
Statutory Maternity Pay		2.4
Carer's Allowance		2.0
Other		2.0
Total		91.2

Note: Does not include spending on council tax support schemes that will be run by local authorities in England and the Scottish and Welsh Governments from April 2013.
Source: Authors' calculations using DWP Benefit Expenditure Tables and OBR Economic and Fiscal Outlook.

Figure 8.3. Average weekly benefit entitlement among working-age households in 2013–14



Notes and source: As for Figure 8.1.

(IS) cost under £20 billion, or less than a fifth of total working-age expenditure, though workless families are also entitled to benefits that are also received by those in work, such as tax credits, Housing Benefit, Child Benefit and Disability Living Allowance. Because there are many more in-work than out-of-work families, of the £29 billion spent on tax credits in 2010–11, over £20 billion went to working families.[8]

The contrast between Figures 8.1 and 8.3 is striking. Unlike the pensioner population, benefit entitlement for working-age households is heavily concentrated in the bottom half of the distribution, reflecting the importance of means-testing in determining eligibility among the working-age population. It is noticeable that Disability Living Allowance is the one major benefit (since the introduction of the Child Benefit income tax charge) for which entitlement does not decline dramatically as one moves up the income distribution.[9]

8.3 How we got here: benefit and tax credit changes since 1997

This section examines how the levels and composition of benefit spending for pensioners and those of working age have changed since 1997–98 before isolating the impact of tax and benefit policy reforms on household incomes during this period.

Benefits for pensioners

Figure 8.4 shows how total spending on pensioners and each of the pensioner benefits has changed since 1997–98. It shows that between 1997–98 and 2010–11, social security spending directed at pensioners rose in real terms by around 60%, from £66 billion to £105 billion (in 2012–13 prices), with nearly two-thirds of this increase being driven by higher spending on state pensions.

This spending increased for several reasons. First, there was an increase in the number of pensioners: the number of people aged above State Pension Age rose from 10.4 million in 1997 to 11.9 million in 2010.[10] If spending per pensioner had remained constant across the period, total expenditure would have been £10 billion higher. In fact, expenditure increased by £39 billion in real terms; demographic change can therefore only explain around a quarter of the increase in expenditure. The amount each pensioner receives from the state has increased as well, by 39% in real terms between 1997–98 and 2010–11. This is faster than the real earnings growth of 20% that occurred during this period.[11] There are four broad reasons why this has happened. First, those who retired during this period had higher entitlements to state pensions as the State Earnings-Related Pension Scheme (SERPS) came to maturity:[12] expenditure on additional state pensions more than trebled over this period. Second, discretionary benefit changes introduced during this

[8] Source: HMRC, *Child and Working Tax Credit Statistics: Finalised Annual Awards 2010–11*, 2012 (http://www.hmrc.gov.uk/statistics/fin-main-stats/cwtc-awards.pdf).

[9] Note that we are including disability benefits in the income measure used when ranking households to put them into income decile groups but do not take account of the costs associated with having a disability.

[10] Source: ONS Population Estimates.

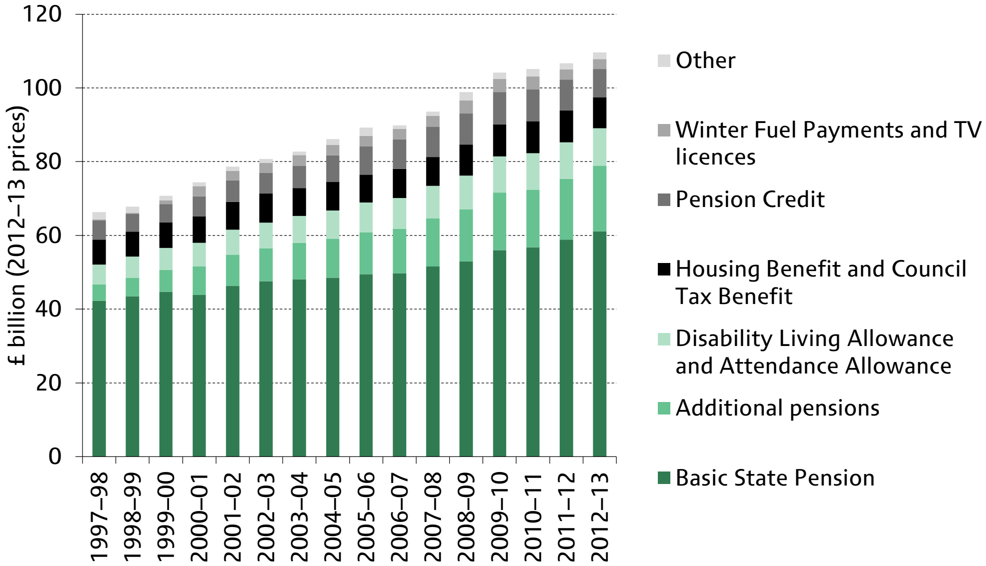
[11] Source: Authors' calculations using DWP Benefit Expenditure Tables and ONS Population Estimates.

[12] Accrual of rights under SERPS started in 1978 and individuals required 20 years of contributions to gain full entitlement. Thus, the first cohort of pensioners to benefit from full entitlement to SERPS retired in 1998.

period increased the generosity of means-tested support for pensioners (the Pension Credit was £150 for a single pensioner and £229 for a couple in current prices in 2010–11, compared with just £109 and £169 for a pensioner aged under 75 in 1997–98 under its predecessor, Income Support).[13] Spending per pensioner on means-tested support increased by 46%. Third, new universal payments for pensioners such as Winter Fuel Payments and free TV licences were introduced. Fourth, the number of people over pension age in receipt of disability benefits has increased (perhaps because of an increase in the number of very old people: the number of people aged 80 and over increased by a quarter between 1997 and 2010), which caused spending on disability benefits for pensioners to increase by 83% during this period despite no significant policy reforms in this area.

Together, these increases in the amount of state support given to pensioners, and the increased levels of entitlement to private pensions among new retirees, meant that the income of the median pensioner increased by 29.4% between 1997–98 and 2009–10, compared with 26.0% for the median non-pensioner. By 2009–10, the median pensioner was richer than 40% of the population, whereas in 1997–98 they were only richer than 35% of the population.[14] Spending on pensioner benefits has continued to rise in the last two years despite an increase in the female State Pension Age (legislated in 1995). Overall, real benefit levels have not been cut, whilst demographic trends have continued.

Figure 8.4. Pensioner welfare expenditure since 1997–98



Notes: Pension Credit includes Minimum Income Guarantee between 1999–2000 and 2002–03 and Income Support for pensioners prior to 1999–2000. Numbers underlying figure are in the annex to this chapter.
Source: Authors' calculations using DWP Benefit Expenditure Tables.

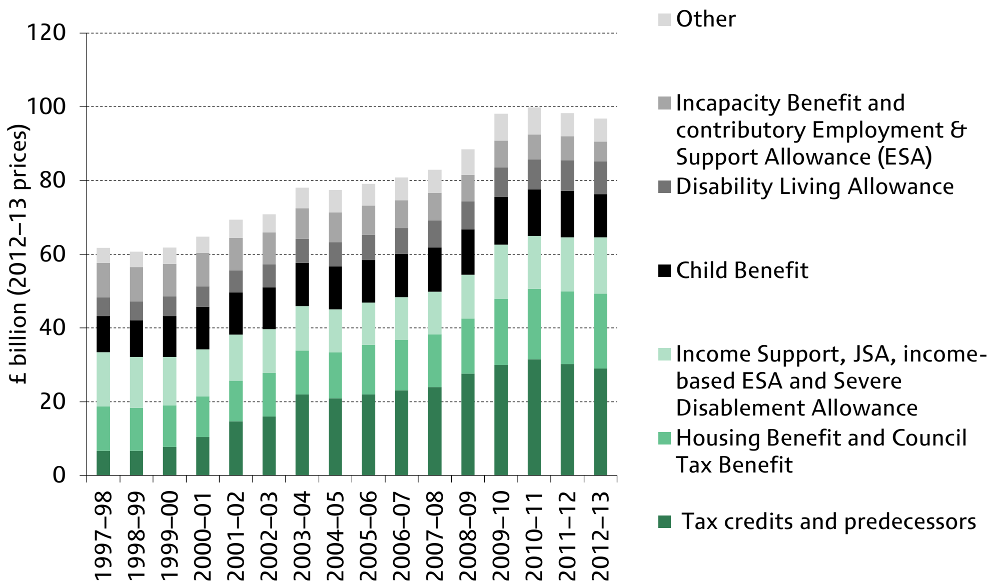
[13] Source: Authors' calculations using http://www.ifs.org.uk/ff/pencredit.xls and http://www.ifs.org.uk/ff/is.xls.

[14] For more details, see S. Adam, J. Browne and P. Johnson, *Pensioners and the Tax and Benefit System*, IFS Briefing Note 130, 2012 (http://www.ifs.org.uk/bns/bn130.pdf).

Benefits for those of working age

Figure 8.5 shows the same analysis for those of working age. Real-terms spending directed at the working-age population grew slightly faster than that directed at pensioners from 1997–98 to 2010–11, increasing by 62% (compared with 59% for pensioners), from £62 billion to £100 billion in real terms across the period. If spending per head had stayed constant across the period, expenditure would only have increased by £3 billion, since the population below State Pension Age grew by only 5% across the period.[15] Nearly two-thirds of this real-terms cash increase was driven by higher spending on tax credits, which were substantially more generous than the benefits they replaced. This encompassed increases in means-tested support for families with children in general, and particularly big increases in support for those in work. Spending on tax credits for those in paid work increased from under £3.3 billion in 1997–98 to more than £20 billion by 2010–11.[16] In contrast, spending on income-replacement benefits for those with disabilities (principally Incapacity Benefit, which was starting to be replaced by Employment and Support Allowance towards the end of this period) fell following reforms to Incapacity Benefit in the mid-1990s that tightened the disability test for entitlement to incapacity benefits and restricted the flow of claimants onto these benefits. Since 2010–11, spending on benefits for those of working age has fallen slightly as employment rates have increased and benefit cuts have been introduced.

Figure 8.5. Working-age social security and tax credit expenditure since 1997–98



Notes: Tax credits include Family Credit, Working Families' Tax Credit, Child Tax Credit, Working Tax Credit and child additions to out-of-work benefits before 2003–04. Numbers underlying graph are in the annex to this chapter.
Source: Authors' calculations using DWP Benefit Expenditure Tables and HMRC Accounts, and OBR *Economic and Fiscal Outlook*.

[15] Source: ONS Population Estimates.

[16] Source: DWP Benefit Expenditure Tables (http://statistics.dwp.gov.uk/asd/asd4/index.php?page=long_term) and HMRC, *Child and Working Tax Credit Statistics: Finalised Annual Awards 2010–11*, 2012 (http://www.hmrc.gov.uk/statistics/fin-main-stats/cwtc-awards.pdf).

Again, trends in spending are driven not just by changes in policy. For example, despite minimal policy changes, spending on Disability Living Allowance increased by 62% across the period 1997–98 to 2010–11, from £5.0 billion to £8.1 billion in real terms, as numbers in receipt grew from around 1.4 million to around 2.2 million. The dramatic increase in Housing Benefit expenditure on working-age households from £10.3 billion to £16.3 billion across the same period largely reflects rapidly-rising private sector rents and a declining social housing stock, rather than substantial changes in policy.[17]

Isolating the impact of policy reforms on household incomes

In assessing options for the future, it is also important to understand the effects of recent changes on the incomes of recipients.

We can give some indication of the scale of changes in benefit levels by looking at some examples. Table 8.3 shows, in real terms, how much would have been received in benefits in 1997–98, 2003–04, 2010–11 and 2015–16 for some example families.

But these examples can only provide a very partial picture. What we really need to do is look at how the combination of changes has affected groups of people. To do that, we use our model of the tax and benefit system to estimate the mechanical effects of tax and benefit changes across the income distribution. Note that this analysis does not allow for any impact of policy changes on households' behaviour or on pre-tax prices in the economy. Although this is a chapter on the benefit system, it is important in this context to see the effects of the tax and benefit system as a whole.

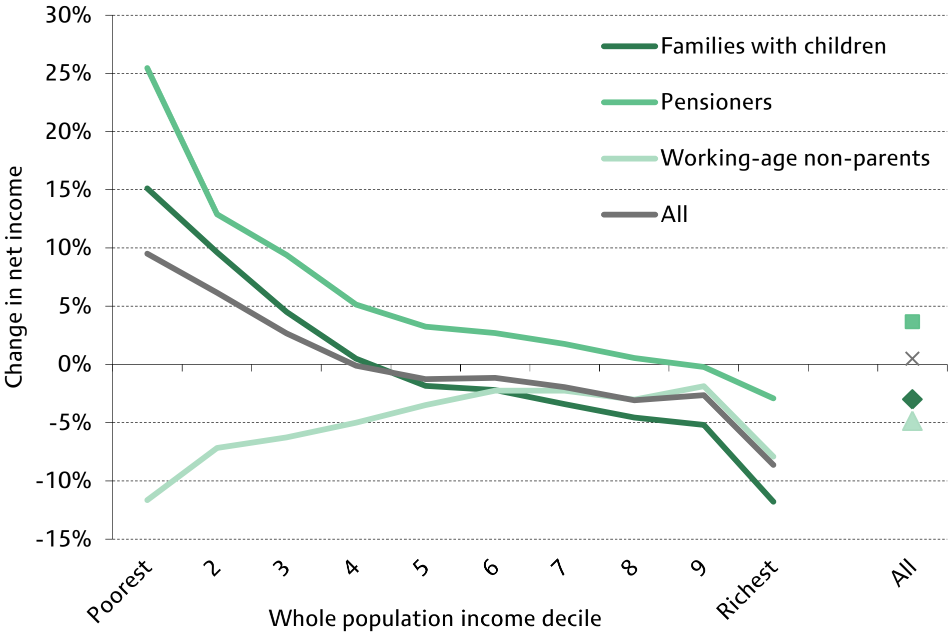
Table 8.3. Weekly benefit entitlement by household type

Family type	April 1997	April 2003	January 2010	April 2015
Unemployed lone parent with two children	£160.07	£206.33	£230.10	£207.30
Lone parent with two children, working 16 hours at minimum wage	£147.50	£199.85	£224.59	£207.30
Unemployed couple with two children	£194.52	£248.08	£280.06	£245.25
Couple with two children, one earns £25,000	£31.30	£75.24	£101.85	£75.01
Single unemployed person, no children	£73.25	£73.25	£73.25	£66.65
Single Incapacity Benefit / contributory ESA claimant, no children[a]	£104.60	£104.60	£104.60	£93.10
Pensioner with no private income or state pension entitlement	£103.46	£140.75	£142.46	£146.55

[a] Assumes Incapacity Benefit claimant began their claim aged over 45 and is in the work-related activity group in ESA.
Notes: Figures in 2012–13 prices. These figures do not include Housing Benefit or Council Tax Benefit.
Source: Authors' calculations using 2010–11 Family Resources Survey and TAXBEN, the IFS tax and benefit microsimulation model.

[17] Though, of course, in both of these cases, the decision not to make changes in the face of escalating costs represents a policy decision in itself.

Figure 8.6. Distributional impact of tax and benefit changes introduced between 1997–98 and 2015–16



Notes: Income decile groups are derived by dividing all households into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the second poorest, and so on up to decile group 10, which contains the richest tenth. Ignores most 'business taxes' (notably corporation tax, business rates and employer National Insurance contributions) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Does not include changes to additional state pensions and localisation of support for council tax in April 2013.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2010–11 Family Resources Survey and 2010 Living Costs and Food Survey.

Figure 8.6 shows the impact of reforms from 1997–98 to 2015–16 by comparing household incomes under an unreformed 1997–98 tax and benefit system (where unreformed means tax thresholds and benefit rates are increased each year in line with the baseline the Treasury uses in Budgets and Autumn Statements, which generally means increasing cash amounts in line with various measures of inflation) and a system with all reforms announced to be in place by 2015–16 (with, again, reforms measured relative to the baseline used in Budgets and Autumn Statements).

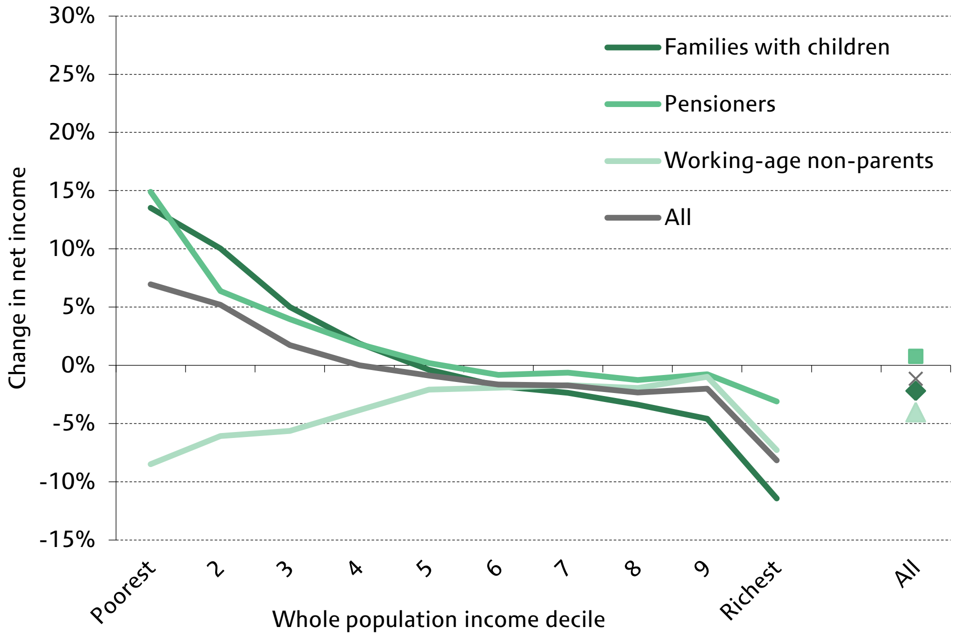
The figure shows that, on average, low-income households have gained overall from tax and benefit changes introduced between 1997–98 and 2015–16 – the 'giveaways' during the period from 1997–98 to 2010–11 more than offset the 'takeaways' that have been implemented since 2010.[18] However, these averages hide significant differences between different types of household. Whereas for low-income families with children and pensioners, the real-terms increases in benefits between 1997–98 and 2010–11 more than offset the impact of cuts being introduced in the period 2010–11 to 2015–16, benefits for working-age people without children were not increased significantly between 1997–98 and 2010–11 and are being reduced by the measures introduced since 2010. Working-age people in the top half of the income distribution did not benefit

[18] Figure 7.7 shows the impact of just those measures introduced since the start of the fiscal consolidation in January 2010. A comparison of the two therefore reveals the impact of reforms introduced between April 1997 and January 2010.

significantly from tax and benefit changes introduced between 1997–98 and 2010–11, and have lost out from tax rises introduced since then.

The impact of measures introduced since the start of the fiscal consolidation in January 2010 is isolated in Figure 7.4. That graph shows that at the lower end of the income scale pensioners have lost the least as a result of these changes, while at higher levels of income it is working-age households without children who have lost the least. This is because the income tax personal allowance for working-age people has been increased significantly, whereas pensioners' tax allowances will be frozen in nominal terms from April 2013. Better-off families with children have lost out from more aggressive means-testing of tax credits and the withdrawal of Child Benefit from families where (at least) one adult has an income above £50,000.[19]

Figure 8.7. Distributional impact of tax and benefit changes introduced between 1997–98 and 2015–16 relative to earnings indexation



Notes and source: As for Figure 8.6.

Another baseline against which we can compare tax and benefit reforms is one where cash amounts are increased in line with growth in average earnings over time. In normal times, increasing benefits in line with prices sees the incomes of those dependent on benefits falling behind the incomes of the rest of the population. It is for this reason that, in its long-run fiscal forecasts, the Office for Budget Responsibility (OBR) assumes that benefits will rise in line with earnings. Furthermore, as this baseline involves significant 'fiscal drag' over time (as more taxpayers fall into higher tax brackets because tax thresholds do not keep pace with growth in earnings), it also involves tax revenues increasing as a share of national income. As we can see in Figure 8.7, relative to a baseline of earnings indexation, the impact of reforms is much more even across the income distribution. Benefit increases for low-income families with children and pensioners, although large in real terms, were less significant relative to average earnings growth over the whole period. At the upper end of the income distribution, the losses from tax

[19] See Chapter 7 for more details of tax and benefit changes being introduced in 2013–14.

and benefit reforms appear larger relative to this baseline. This is because tax thresholds have not kept pace with real earnings growth, meaning that reforms relative to this baseline represent a larger net tax rise.

Summary

Social security spending has increased substantially since 1997–98 for both pensioners and those of working age, both in real terms and as a share of national income. Higher spending on pensioners was driven by a combination of policy changes that increased the generosity of means-tested support for poorer pensioners, increases in the number of people above the State Pension Age and higher levels of entitlement to additional state pensions among more recent retirees. The increase in spending for those of working age was largely driven by policy reforms, particularly the significant increase in the level of support given to in-work families with children. In contrast to the increased generosity of child-contingent benefits between 1997–98 and 2010–11, benefits for those without children will be lower in real terms in 2015–16 than they were in 1997–98.

Measures introduced by the current government have reduced the incomes of low-income working-age people by more than those of low-income pensioners, who have been largely protected from welfare cuts.

8.4 Options for future savings

One part of the context, then, for thinking about where future savings might come from is an understanding of where the money goes, how and why spending levels have changed, and who has gained and who has lost from recent changes.

We will now look at some specific parts of the social security system and consider possible ways of saving money. But in doing so we will also be bearing in mind the trade-offs that are at the heart of the system, particularly in the context of some of the issues raised by the Prime Minister in the summer.

Uprating policy

The way in which benefits are uprated at the start of each financial year has already been changed significantly by the current government (see Box 8.1). An obvious way of making additional savings to the social security budget through across-the-board cuts is to increase benefits less quickly. Most benefit rates for those of working age are being increased by 1% in April 2013 rather than the 2.2% by which they would have increased under normal indexation rules.

The current proposal is for the 1% cap to apply in 2013, 2014 and 2015. If the policy were extended for two additional years to cover the whole period of fiscal consolidation, the government would save an additional £1.2 billion in 2017–18. Alternatively, if the benefits currently subject to the 1% cap were instead frozen in nominal terms for three years, it would save another £1.5 billion by 2015–16. Freezing those benefits that are currently excluded from the 1% cap, but not the Basic State Pension and Pension Credit,

Box 8.1. Uprating policy under the current government

Before 2011, most benefit and tax credit rates increased in line with RPI (retail price index) or Rossi inflation[a] each year. The current government made two significant changes to this in 2010. First, the Basic State Pension will now be increased by the highest of CPI (consumer price index) inflation, earnings growth and 2.5% each year (the so-called 'triple lock').[b] This is a more generous treatment than had been proposed by the previous government, which had intended that the Basic State Pension should increase in line with earnings growth from 2012–13. Second, most other benefits are now increased in line with CPI inflation, which tends to give smaller increases in most years. The only significant benefits not affected by these changes were Pension Credit, which continues to increase in line with earnings growth each year by default, and Winter Fuel Payments, which are frozen in nominal terms. In terms of uprating, then, benefits for pensioners have been protected from cuts, or even been made more generous, whereas those for working-age people have been made less generous.

In the Autumn Statement, the government justified the decision to increase benefits by less than CPI inflation for the next three years by pointing out that, as a result of earnings falling in real terms since the beginning of the financial crisis in 2007, benefits have increased more quickly than earnings since the beginning of 2007. Current policies will (on the OBR's projections) bring the ratio of benefits to earnings back to its 2007 level some time in 2016, rather than in 2018 as would have happened under the previous policy.[c] The Prime Minister suggested in a speech in June 2012 that benefits should be linked to the lower of inflation and earnings growth. Such a change in default uprating procedures would avoid the need for policy changes such as those announced in the Autumn Statement. But if this were a hard-and-fast rule for benefit uprating in the long run, it would imply that benefits did not keep pace with either inflation or earnings growth – it is unclear why any government would want benefits to be falling indefinitely over time, even if it thought that the level of benefits should be lower. Such a policy would also bring the difference in indexation procedures for pensioner benefits and for benefits for people of working age into even more stark contrast: whereas pensioners would see their state pension increase in line with the higher of price inflation and earnings growth each year (and a minimum nominal increase of 2.5%), those claiming working-age benefits would see increases of the lower of these two indices.

Together, these changes to indexation policy (both the switch to CPI indexation and the 1% uprating in 2013, 2014 and 2015) will yield around £7 billion[d] in savings by 2014–15, with larger savings in future years.

[a] The Rossi inflation measure is similar to the RPI measure but excludes housing costs. The rationale behind using this index for out-of-work benefits was that those entitled to these benefits have their housing costs paid for through Housing Benefit and so are unaffected by changes in housing costs.
[b] For example, the Basic State Pension is due to increase by 2.5% in April 2013 because both annual CPI inflation in September 2012 (at 2.2%) and earnings growth in the relevant period (at 1.6%) were less than 2.5%.
[c] For more details, see A. Hood, R. Joyce and P. Johnson, 'The effects of the Welfare Benefits Up-rating Bill', IFS Observation, 2013 (http://www.ifs.org.uk/publications/6539).
[d] Source: Table 2.1 of various Budgets and Autumn Statements.

would save another £1.9 billion by 2015–16.[20] Also freezing the Basic State Pension and Pension Credit would yield further savings of £4.5 billion. Alternatively, if the Basic State Pension and Pension Credit were increased by 1% in each of the next three years, this would save £2.8 billion a year by 2015–16.[21]

Pensioner benefits

The government has committed to maintaining spending on the main benefits for pensioners at current levels. And, in England, local authorities will not be allowed to reduce the amount of support given to low-income pensioners for their council tax once they are given responsibility for designing council tax support schemes from this April. Given that we saw in Section 8.2 that more than half of the total social security budget goes to pensioners, expenditure on benefits for those of working age would have to be cut by more than 2% in order to save 1% on the overall budget while protecting pensioners entirely.

Were the government to find substantial spending reductions from pensioners, it would likely need to change either the levels or eligibility criteria for state pensions, since they account for nearly three-quarters of social security spending on pensioners. This is hard to achieve in the short run. Options might include reducing the levels of the Basic State Pension (perhaps by picking the triple lock) or increasing the State Pension Age more quickly than currently planned.

Given that there are already plans to accelerate increases in the State Pension Age over the next two decades, further increases might significantly disrupt the plans of those approaching pension age. It seems unlikely that pension age could be raised further in the next five years.

Making the indexation arrangements for state pensions less generous would reverse the government's own policy, and would leave pensioners unexpectedly worse off. It might also increase the actual and perceived risks associated with governments backtracking on what should be long-term commitments on pension policy. Even so, working-age benefit recipients are already suffering below-inflation benefit rises. As we have seen, applying the same policy to pensioners – by uprating state pensions and Pension Credit by 1% over the next three years – would save £2.8 billion a year by 2015–16.

A potential reform that is frequently discussed is means-testing the universal benefits received by pensioners – namely, Winter Fuel Payments and free TV licences. As we saw in Section 8.2, these benefits make up only a small proportion of the income that pensioners receive from the state: the total cost of Winter Fuel Payments is projected to be £2.1 billion in 2012–13, and free TV licences are expected to cost £600 million, out of total payments of £110 billion.[22] As these benefits are relatively small, designing a specific means test would likely be highly inefficient. They might most easily be restricted to only those claiming Pension Credit. There is some uncertainty over exactly how much this would save, not least because around a third of those entitled to Pension Credit do not

[20] These are predominantly benefits received by those with disabilities, in particular Attendance Allowance, Carer's Allowance, Disability Living Allowance, Incapacity Benefit, disability premiums in means-tested benefits and the support group component of Employment and Support Allowance.

[21] All costings in this paragraph were made using TAXBEN run on the 2010–11 Family Resources Survey.

[22] The total cost of concessionary bus travel in England was just under £1 billion in 2011–12, though not all of this was for free bus passes for pensioners. Source: Table BUS0502 of Department for Transport statistics, https://www.gov.uk/government/statistical-data-sets/bus05-subsidies-and-concessions.

take it up.[23] Our modelling suggests that with full take-up of means-tested benefits, such a policy would reduce the cost of Winter Fuel Payments by around £1.2 billion and the cost of free TV licences by around £300 million. Taking account of low levels of take-up might increase the savings by £500 million (to around £2.0 billion). So some low-income pensioners who did not claim the means-tested benefits to which they are entitled would lose out from such a change.

This suggested saving of £1.5–£2 billion is not trivial. But in the context of total spending on pensioner benefits, it is still relatively small beer. The debate about these benefits seems to have become more totemic than a serious analysis of whether there is scope for reducing benefit payments to the elderly population.

Working-age benefits: Universal Credit

The benefit system as it affects those of working age will shortly undergo one of its most radical structural changes since the 1940s, as six of the seven main means-tested benefits (or eight, now that Child Benefit is withdrawn from those with annual incomes above £50,000) for those of working age are replaced with a single payment, Universal Credit. The roll-out of Universal Credit will begin in a small number of pilot areas in April, before new claims of JSA cease everywhere in October 2013 and new claims for other means-tested benefits and tax credits stop in 2014. From October 2014, existing claimants of means-tested benefits and tax credits will see their claims shifted across to Universal Credit.[24] We therefore consider reforms to Universal Credit rather than changes to the existing set of means-tested benefits and tax credits. In seeking to reduce the cost of Universal Credit, the government faces two broad options: reduce the generosity of the elements that make up a family's maximum award, or means-test Universal Credit more aggressively.

Housing component of Universal Credit

As we saw in Section 8.3, spending on Housing Benefit (HB) has risen rapidly in recent years. The housing component of Universal Credit will replace Housing Benefit and, like it, will be set equal to the minimum of a family's Local Housing Allowance (LHA) amount and their rent for those in the private rented sector or actual rent (subject to certain restrictions) for those in the social rented sector. LHA amounts vary according to the number of bedrooms a family is deemed to need and the 'Broad Rental Market Area' (BRMA) in which they live.[25] For example, a lone parent with two children aged 10 or over of opposite sexes (and so entitled to a bedroom each) can claim up to £340 per week in central London, compared with less than £127 per week in central Manchester.

The swiftly-rising bill for HB has raised a number of concerns. The Prime Minister has suggested that there should be restrictions both on who is entitled to claim and on the maximum levels of rents. In both cases, he suggested that the benefit system currently

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[23] Latest DWP estimates suggest that around 35% of those who are entitled to Pension Credit do not take up their entitlements. See Department for Work and Pensions, *Income-Related Benefits: Estimates of Take-Up in 2009–10*, 2012 (http://statistics.dwp.gov.uk/asd/income_analysis/feb2012/tkup_full_report_0910.pdf).

[24] See Chapter 7 for more information on Universal Credit.

[25] A BRMA is an area 'within which a person could reasonably be expected to live having regard to facilities and services for the purposes of health, education, recreation, personal banking and shopping, taking account of the distance of travel, by public and private transport, to and from those facilities and services'. It must contain a variety of residential property types held on a variety of tenures. See Valuation Office Agency, 'Guidance to Rent Officers determining Broad Rental Market Areas', May 2012 (http://www.voa.gov.uk/corporate/_downloads/pdf/GuidanceToRentOfficersDeterminingBRMAsApril2012.pdf). There are currently 192 BRMAs in Great Britain.

allows people who are not in paid work to occupy accommodation that they would not be able to afford were they to work, in particular with reference to people aged under 25 and those living in more expensive areas.[26]

In raising these issues, Mr Cameron was setting out one side of a real trade-off. If we do pay more where housing costs are higher, some people who are out of work will be subsidised to live in expensive areas. And the benefit system will make it easier for young people to leave the parental home. On the other hand, if the costs are not paid, it would become impossible for large numbers of people to live in some areas, people might be forced to move soon after losing a job, and young people with difficult home lives may be forced into homelessness.

In August 2012, around 380,000 people aged under 25 were receiving Housing Benefit, claiming the equivalent of £1.8 billion a year.[27] If eligibility to HB were completely removed from this group, a significant amount could therefore be saved. However, it is unlikely that such a blanket restriction on eligibility for HB would be introduced: as the Prime Minister acknowledged in his speech, 'a lot of these young people will genuinely need a roof over their head. Like those leaving foster care, or those with a terrible, destructive home life, and we must always be there for them.' The question of how far it is desirable to go in this direction is an inherently subjective one, but some statistics on the composition of the caseload give some idea of the difficulties one would face: for example, 45% of HB claimants aged under 25 are lone parents, and they account for nearly half of the expenditure. Restricting receipt to under-25s with children immediately creates a rather perverse incentive (the empirical importance of which we do not know) to have a child.

Reforms already introduced have restricted the ability of LHA claimants to live in the most expensive areas. New national caps on LHA rates mean that the amount claimed cannot exceed a certain level even if the rules that determine these amounts would imply a higher level (generally, LHA amounts are set at the 30th percentile of rents for properties of a given size in each BRMA, though this will change in April 2013 – see Chapter 7. The national caps currently only affect a few areas in Inner London. An obvious way to generate further savings would be to reduce these caps. However, since rents are so much higher in Inner London than anywhere else in Great Britain, relatively few additional areas would be affected by lowering the cap by, say, 10%. And since the introduction of the national caps in the first place will only save £70 million in 2013–14, the reductions in the national caps would have to be severe for significant savings to be made.

Another alternative that could be considered is to set regional caps on LHA amounts so that Housing Benefit claimants are not able to live in the most expensive areas in each region. Or, the BRMA could be made larger and/or the LHA rates set at a level lower than the 30th percentile of rents in each area.

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[26] In his speech on 25 June 2012 at Bluewater, Kent, the Prime Minister asked, 'up to what age should we expect people to be living at home?' and 'those who work in expensive postcodes who aren't on benefits typically have to move further out and commute in to work … should those on benefits be financially helped to live exactly where they want to?' (http://www.number10.gov.uk/news/welfare-speech/).

[27] £1.8 billion is 52 times weekly expenditure on Housing Benefit in August 2012 for those under 25. See tables 9a and 9b of DWP Housing Benefit and Council Tax Benefit Statistics, August 2012, http://statistics.dwp.gov.uk/asd/index.php?page=hbctb.

Child element of Universal Credit

As we saw in Section 8.3, the generosity of means-tested support for those with children increased significantly between 1997–98 and 2010–11. The child element of the Child Tax Credit was the main tool that was used to do this between 2003–04 and 2010–11: it increased from £1,939 to £2,486 in current prices during this period.[28] The child element of Universal Credit will provide the same support in broadly the same manner.

If the government wished to reverse this increase in generosity, it could reduce the child element of Universal Credit back to its 2003–04 real-terms level. This would save nearly £4 billion a year, a demonstration of how much additional resource was put into means-tested support for families with children over the last decade. Around 3.7 million families with children would lose out, and the average loss among these families would be around £20 per week.[29]

Of course, one of the reasons for increasing tax credits for low-income families with children was the desire of the previous government to try to meet its challenging targets for reducing income-based child poverty measures. New targets are now, in principle, legally binding on the government through the Child Poverty Act 2010. Reducing benefits for low-income families with children would increase income-based measures of child poverty and therefore would make achieving the targets set out in that Act harder to achieve. On the other hand, as IFS researchers have previously argued, there is in any case absolutely no chance that these supposedly legally-binding targets will be met.[30]

Another change that has been suggested to child-contingent benefits is to restrict the number of children that claimants receive benefit for, at least in some cases. In his June 2012 speech, the Prime Minister expressed concern about the way in which the structure of the benefit system means that 'for most in work when they have a child their income will change very little but for many on out-of work benefits, their income will change substantially.... Quite simply, we have been encouraging working-age people to have children and not work, when we should be enabling working-age people to work and have children'. These incentives do exist, though it is not clear to what extent people respond to them. Previous IFS research has shown that the introduction of the Working Families' Tax Credit, which gave additional support to in-work families with children but not those without, led to an increase in the number of births shortly afterwards. But it is not clear whether this was the result of people having more children than they otherwise would have or having them sooner.[31]

An across-the-board restriction on the number of children that families can claim Child Benefit and Child Tax Credit for would yield significant savings. Estimates using our model of the tax and benefit system, TAXBEN, suggest that expenditure on Child Benefit would be reduced by around £700 million and on Child Tax Credit by £2.4 billion if both benefits were restricted to two children.[32] But the government has signalled that any

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[28] The child element of the Child Tax Credit is the maximum amount a family can claim for each additional child that they have.

[29] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

[30] See M. Brewer, J. Browne and R. Joyce, *Child and Working-Age Poverty from 2010 to 2020*, IFS Commentary 121, 2011 (http://www.ifs.org.uk/comms/comm121.pdf).

[31] See M. Brewer, A. Radcliffe and S. Smith, 'Does welfare reform affect fertility? Evidence from the UK', IFS, Working Paper WP08/09, 2008 (http://www.ifs.org.uk/wps/wp0809.pdf).

[32] These figures are calculated using TAXBEN run on the 2010–11 Family Resources Survey, which significantly under-records the number of large families in the UK when compared with administrative data on receipt of Child Benefit and Child Tax Credit. The savings from this policy would likely be larger than them in practice.

policy changes in this area would be restricted to families where neither parent is in paid work so that this group would face the same costs of having additional children as others. If only out-of-work families were affected, the savings would fall to £1.4 billion for Child Tax Credit and £200 million for Child Benefit. There are also important questions about whether cuts should be imposed on those who already had more than two children at the time the policy was introduced or on those with three or more children who became unemployed. Savings would be very heavily reduced if protection were given to particular groups (for example, widows or those with disabilities) or if restrictions were only imposed on those who were out of work who had additional children, since only around 35,000 non-working families who already have at least two children have an additional child each year.[33]

Means-testing more aggressively

The basic structure of Universal Credit is that a family's maximum entitlement is calculated (based on the family structure, housing costs and disability status), a certain amount of earned income is disregarded for the purposes of the means test (with the size of the disregard depending on family type, housing tenure and disability status) and then each pound of earned income above the disregard reduces the Universal Credit award by 65p. Thus, there are two ways in which the means test could be made more aggressive, either by reducing the income level at which Universal Credit starts to be withdrawn (i.e. reducing the disregards) or by increasing the rate at which it is withdrawn as income rises (i.e. increasing the taper rate). Reducing all disregard amounts by 10% would save nearly £0.7 billion.[34] Increasing the rate at which Universal Credit is withdrawn as income rises from 65p for each additional pound of income to 70p would save around £1.3 billion a year.[35]

These reforms would not affect the Universal Credit entitlements of those with the lowest incomes. However, by protecting those not in work while reducing support for families with someone in paid work, both reforms would tend to weaken the incentive for those in families where no one is in paid work to start working. Furthermore, increasing the taper rate would weaken the incentive for those on the taper to increase their earnings slightly: taxpayers on the Universal Credit taper would lose 79.6p of each additional pound earned through a combination of higher taxes and lower Universal Credit entitlement, compared with 76.2p when the taper is 65%. Given that one of the aims of Universal Credit was to strengthen work incentives, it seems unlikely that the government would introduce large changes such as these.

Working-age benefits outside of Universal Credit

There are a number of working-age benefits that fall outside of Universal Credit, including Child Benefit, Disability Living Allowance, Attendance Allowance and Carer's Allowance.

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[33] Source: Authors' calculations using the 2010–11 Family Resources Survey.

[34] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

[35] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

Child Benefit

Child Benefit, even after reforms just introduced which will remove it from families where someone has a taxable income over £60,000 a year, will go to 7.1 million families, in respect of 11.7 million children, at a cost of £10.4 billion in 2013–14.[36]

Significant savings are already planned from Child Benefit, not just by withdrawing it in its entirety from families containing a high-income individual, but also by freezing it for three years from 2011–12 and raising it only by 1% a year in 2014 and 2015. Together, these changes are expected to save around £3 billion in 2015–16.[37] Beyond further below-inflation increases, two straightforward cuts in coverage that would save some money might include limiting payment to the first two children only, saving around £715 million and affecting 850,000 families, or reducing the age of eligibility from 19 (for those in full-time education) to 16, saving around £720 million from around 825,000 families.[38]

Further reforms of this nature, particularly on top of the recent withdrawal from families containing an individual with an income greater than £50,000, would further undermine Child Benefit's role as a universal recognition of the additional costs of children. Were the government to want to pursue such a policy to its logical end point, it could both save money, and get round some of the oddities inherent in the current method for withdrawing Child Benefit from those on higher incomes, by simply abolishing it and increasing the appropriate components of Universal Credit such that those entitled to Universal Credit saw their Universal Credit amounts increased by the amount of Child Benefit they currently receive.

We calculate that this would save around £4.5 billion a year in the long run. Given that take-up of Child Benefit is close to 100% but take-up of Universal Credit is likely to be at least a little lower than this, the true savings would probably be somewhat higher. The losers from this policy would be those who currently receive Child Benefit but who will not be entitled to – or would not claim – Universal Credit. To give an idea of who these families are, entitlement to Universal Credit will expire at a gross salary of around £27,000 for a single-earner family with one child in owner-occupied accommodation, £33,000 if they have two children and £39,000 if they have three children. Child Benefit entitlement currently expires when the gross taxable income of the highest-income individual is £60,000. Around 4.3 million families would lose out from this policy, with the average loss around £20 per week or £1,040 per year among these families.[39]

An alternative policy would be to integrate Child Benefit with Universal Credit but withdraw it from a higher threshold, say the equivalent of a gross income level of £50,000 so that lone parents and single-earner couples would be broadly unaffected but some two-earner couples with a joint income above this level would lose out. (This would be a system similar to how the family element of Child Tax Credit was withdrawn from a higher-income threshold before April 2012.) This system would save £3.0 billion a year.[40] Figure 8.8 shows the total amount of support given for a single-earner couple with two

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[36] Source: Authors' calculations based on HMRC Child Benefit Statistics, August 2011 (http://www.hmrc.gov.uk/statistics/child-geog-stats/chb-geog-aug11.pdf), OBR Economic and Fiscal Outlook, December 2012 and using TAXBEN run on the 2010–11 Family Resources Survey.

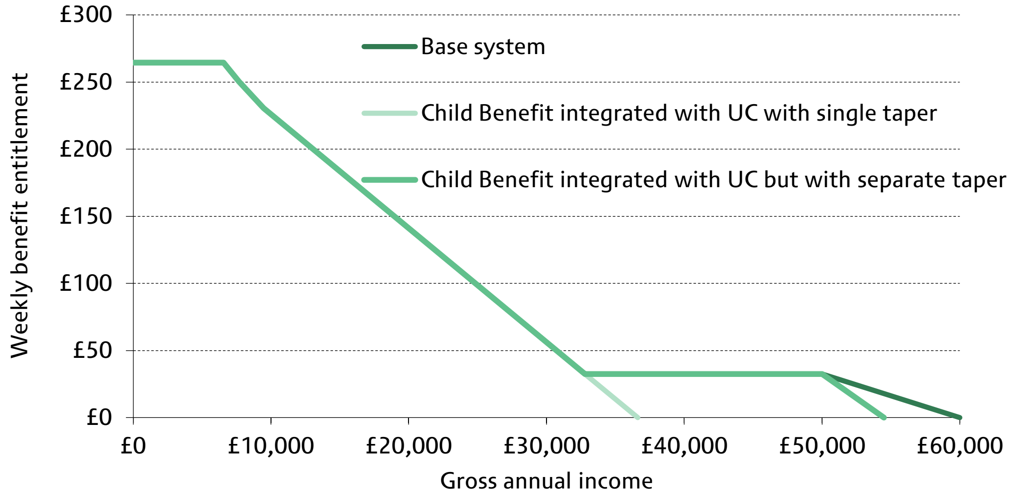
[37] Source: Table 2.1 of various Budgets and Autumn Statements.

[38] Source: Authors' calculations using HMRC Child Benefit Statistics, August 2011.

[39] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

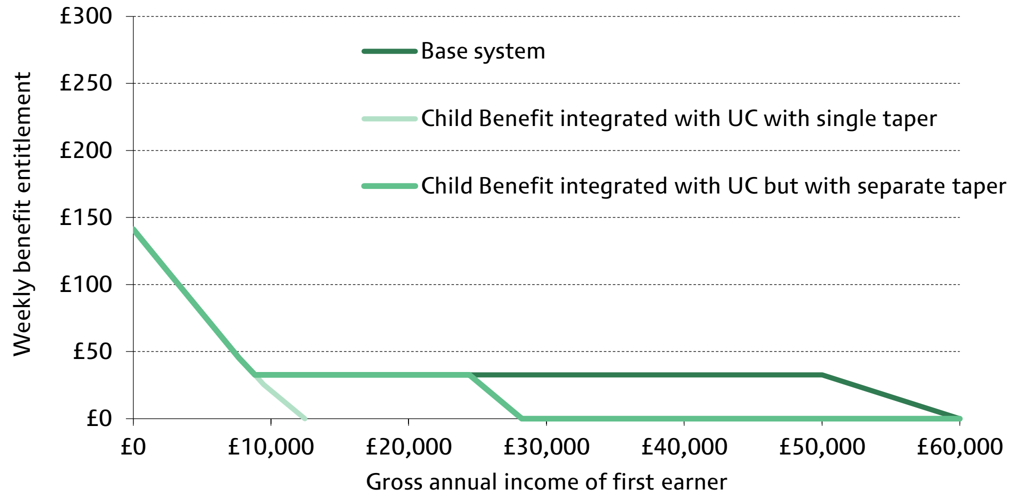
[40] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

Figure 8.8. Total benefit entitlement for single-earner couple with two children under April 2015 Universal Credit system, and two reforms considered in this section



Notes: Family lives in owner-occupied accommodation. Ignores support for council tax.
Source: Authors' calculations using TAXBEN.

Figure 8.9. Total benefit entitlement for two-earner couple with two children under April 2015 Universal Credit system, and two reforms considered in this section



Notes: Family lives in owner-occupied accommodation. Ignores support for council tax. Assumes gross annual earnings of £20,000 for second earner.
Source: Authors' calculations using TAXBEN.

children in owner-occupied accommodation by income level under all three systems. Figure 8.9 shows the total amount of support given to a two-earner couple by the earnings of the first earner in the case where the second earner earns £20,000 per year before tax.

Disability and carers' benefits

In 2012–13, it is projected that spending on Disability Living Allowance (DLA) will be £13.4 billion, with £5.5 billion spent on Attendance Allowance (AA) and £1.9 billion on Carer's Allowance (CA). Expenditure on DLA and AA has increased dramatically since

1997–98, as we saw in Section 8.3: in real terms, spending on DLA increased by over 80% and spending on AA by 56% between 1997–98 and 2010–11.[41]

DLA and AA exist to compensate those with disabilities for the additional costs that they face in terms of additional care and mobility costs, irrespective of how much other income they have or whether they are in work. Thus, these benefits are claimed by households at all income levels: as we saw in Section 8.2, the largest concentration of claimants of DLA and AA is in the upper-middle of the income distribution. CA exists to support those who provide care to someone on one of these benefits, and covers both pensioners and those of working age. These are all benefits that are worth the same amount to all recipients as they are neither means-tested nor taxable.

There are good reasons to keep things this way: these benefits compensate disabled people for the additional costs that they face and provide support for those who provide care for disabled people that might otherwise have to be paid for out of the public purse. Even so, a government looking for savings might consider taxing these benefits or replacing them with means-tested benefits so that support only went to those without other means of support (such as earned or unearned income or a spouse in paid work). The government would have to think carefully about the aims of disability and carers' benefits before making any such changes.

Making DLA taxable would save about £620 million a year; doing the same for AA would save £350 million.[42] Savings could also be made by scrapping these benefits and introducing new disability premiums in Universal Credit and Pension Credit. While it is hard to be precise about how much could be saved through such a policy, we estimate that around one-third of DLA and AA claimants will not be entitled to either Universal Credit or Pension Credit. While this does not imply that a full third of the cost of the benefits would necessarily be saved, it does suggest that a radical policy such as this could garner significant savings. Scrapping CA and allowing claimants to claim Universal Credit instead would save between £100 million and £200 million a year; the savings are relatively small as most claimants of CA would be entitled to claim another means-tested benefit to offset the loss.[43]

Another way of reducing expenditure on these benefits would be to make the disability test more stringent. The government has already done this for DLA, as it will be replaced with Personal Independence Payment for those of working age from this April, and it is expected that 20% of claimants will lose their entitlement as a result (see Chapter 7 for more details). If the new system were extended to those aged over State Pension Age, assuming the same proportion of claimants would lose eligibility under the new regime, a further £900 million a year could be saved in the short run.[44] Given that the disability tests for AA and the care component of DLA are similar at the moment, equivalent reforms could be introduced to AA; if this resulted in the same proportion of claimants losing their entitlement to support, around £1.1 billion could be saved.[45]

[41] All figures in this paragraph are for expenditure on both those above and those below State Pension Age.

[42] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

[43] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

[44] Source: Authors' calculations using DWP Benefit Expenditure Tables. Note that in the long run, all claimants will have been subject to the new regime (DLA claimants can continue to claim over the age of 65, but new claimants have to claim AA rather than DLA if they are aged 65 or over).

[45] Source: Authors' calculations using DWP Benefit Expenditure Tables.

Contributory benefits

Over time, the UK has moved away from a system of contributory benefits and means-testing has become a lot more important. For those of working age, the only remaining contributory benefits are contributory JSA and ESA which, together with Incapacity Benefit (which is closed to new claimants, with existing claimants being transferred to ESA), are projected to cost £6 billion in 2012–13.

We have gone so far down the road away from a contributory system that the government might want to scrap these remnants and save around £500 million by doing so.[46] This is a lot less than the £6 billion cost of the benefits, since most recipients would be entitled to means-tested Universal Credit in their absence.

But this raises a pretty fundamental question about the development of the social security system. Such a change would reduce the amount of social insurance against the risk of unemployment or disability offered to those with a partner in paid work or other unearned income, and would mean that those in couples would potentially receive no *individual* income in their own right if they became unemployed or disabled.[47] A proper social insurance system (where benefits received when out of work are linked to previous earnings in work) may be desirable if individuals see that the additional social insurance contributions they make when they increase their earnings give them higher entitlements to benefits in the future and so do not face the same disincentive effect from such contributions that they would from an income tax.[48] However, we are a long way from such a system in the UK: paying additional National Insurance contributions (NICs) has a minimal impact on entitlements to benefits, meaning that, at the margin, NICs act almost entirely as a tax.[49] Indeed, Disney (2004) shows that the 'tax component' of National Insurance contributions is among the highest in OECD countries.[50]

Abolishing the remaining contributory benefits would also appear to be inconsistent with some of the ideas expressed by Mr Cameron last summer:

> Today we treat the man who's never worked in the same way as the guy who's worked twenty years in the local car plant, lost his job and now needs the safety net. So here we could ask whether your reward for paying in is that you won't have to face all the tough conditions that we're imposing on those who haven't paid anything into the system at all.

There is still space for a substantial debate about the role of some form of contributory principle.

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[46] Source: Authors' calculations using TAXBEN run on the 2010–11 Family Resources Survey.

[47] For more on this, see F. Bennett and H. Sutherland, 'The importance of independent income: understanding the role of non-means-tested earnings replacement benefits', Institute for Social and Economic Research (ISER), Working Paper 2011–09, 2011 (https://www.iser.essex.ac.uk/files/iser_working_papers/2011-09.pdf).

[48] An extreme version of such a system, where an individual's social security contributions are paid into and benefits paid out of a personal account, which is then used to purchase an annuity at retirement, is analysed by Bovenberg et al. (2008). They conclude that such a system could lead to significant efficiency gains in cases where the social security system primarily redistributes within periods in an individual's lifetime rather than between individuals. See A.L. Bovenberg, M.I. Hanson and P.B. Sorensen, 'Individual savings accounts for social insurance: rationale and alternative designs', *International Tax and Public Finance*, 2008, 15, 67–86.

[49] The only benefit to paying additional NICs is for those with incomes between the low earnings threshold (currently £14,700 per year) and the upper accruals point (currently £40,040 per year), who in some cases will see their S2P entitlement increase as a result of increasing their earnings and paying more in National Insurance contributions.

[50] R. Disney, 'Are contributions to public pension programmes a tax on employment?', *Economic Policy*, 2004, 19, 267–311.

Other benefits

There remain some benefits in the system that now appear outmoded, dating from an era when few married women were in paid work and industrial injuries were the most common reason for men being unable to work. Examples of these might include bereavement benefits and widows' pensions (expected to cost £598 million in 2012–13) and industrial industries benefits (£905 million). Of course, if these benefits were abolished, claimants would become entitled to other benefits that are more widely claimed. The data available to us are such that we cannot reliably give an estimate for how much would be saved if all of these benefits were abolished, but abolishing widows' pensions would save only £200 million as most people who receive them would be entitled to higher levels of means-tested benefits if these pensions were removed.

Note that the bereavement benefits have already been made less generous for new claimants but existing claimants were protected at the time changes were made. Thus, changes that affected existing claimants would save more in the short run than in the long run.

8.5 Conclusions

Social security and tax credit spending is expected to be £212.1 billion in 2014–15, more than 30% of total government spending. As well as supporting those with the greatest needs, handing out such sums of money inevitably affects people's behaviour in the labour market, their household structure and where they choose to live. This is the age-old trade-off between achieving redistribution and providing strong incentives that governments have to balance when designing the tax and benefit system.

Of the total social security budget, slightly more than half is spent on pensioners. Spending has risen substantially over the last 15 years, both because of demographic changes and because of discretionary increases in generosity to pensioners and low-income families with children. Those of working age without children have not fared so well. Support for working-age people is being cut back between 2010 and 2015, though pensioners have been largely protected from the austerity package so far: the indexation procedures for the Basic State Pension and Pension Credit have been made more generous or left unchanged while those for working-age benefits have been made less generous, and the universal pensioner benefits have been left untouched while Child Benefit has been withdrawn from families containing a high-income individual. There may be good reasons for doing this, but choosing to protect pensioner benefits means that proportionally larger cuts have to be made to those for working-age people to achieve a certain level of savings.

Given the government's intention to further tighten fiscal policy by 2017–18, it will presumably consider reductions in social security spending and tax rises alongside spending on public services. Choosing how to cut spending on social security will inevitably depend on subjective decisions on how much support different groups should receive, and on the distributional impact of other government policies such as monetary policy and cuts to public services.

Table 8.4 summarises the estimated potential savings from the changes we have considered. This provides important context for any discussion of future reductions to the welfare budget; the relatively small sum saved from means-testing universal pensioner benefits, for example, belies their role in the policy debate.

Table 8.4. Options for further savings

	Savings in 2015–16[a] (£ billion a year)
Uprating policy	
Freeze all benefits for three years from April 2013	7.9
Freeze all benefits except the State Pension and Pension Credit for three years from April 2013	3.4
Extend 1% uprating to the State Pension and Pension Credit for three years from April 2013	2.8
Extend 1% uprating for those benefits currently affected to 2017–18	1.2[b]
Pensioner benefits	
Extend disability reassessment to those aged 65 and over	2.0
Means-test Winter Fuel Payments and TV licences	1.5–2.0
Make Attendance Allowance taxable	0.35
Working-age benefits	
Integrate Child Benefit within Universal Credit	4.5
Reduce child element of Universal Credit to 2003–04 levels	3.8
End additional entitlements at the second child	> 3.1
Integrate Child Benefit within Universal Credit but have separate taper from £50,000	3.0
Abolish Housing Benefit for under-25s	1.8
End additional entitlements at the second child for workless families	> 1.6
Increase Universal Credit taper to 70%	1.3
Abolish Child Benefit for over-16s	0.7
Reduce Universal Credit disregards by 10%	0.7
Make Disability Living Allowance taxable	0.6
Abolish remaining contributory benefits	0.5
Abolish widows' benefits	0.2
Abolish Carer's Allowance	0.1–0.2

[a] Unless otherwise stated.
[b] Estimated saving in 2017–18.
Source: Authors' calculations using TAXBEN and administrative data.

When deciding what policy changes to introduce, though, the government should think about how the social security system ought to be reformed rather than simply examining feasible ways of reducing expenditure. A number of the reforms we have considered in this chapter would fundamentally change the nature of the support given through the benefit system. Many of these would involve moving even further in the direction of means-testing – for example, Disability Living Allowance and Attendance Allowance could be taxed or means-tested and the remaining vestiges of the contributory benefits system abolished. Such reforms would mean that support for the additional costs caused by disabilities and social insurance against unemployment and work-limiting disabilities would be withdrawn from those with other means of support such as unearned income or a working partner. It is important to think about the structure of the system one wants in the long term and the judgements to be made over the various trade-offs that are an inevitable part of any social security system. At the highest level, one needs to be clear to what extent there is a role for a social insurance system, how important means-testing should be and what role one sees for universal benefits. One then needs to consider particular trade-offs between benefit levels and structures and effects on poverty and income levels on the one hand, and incentives to work, save, have children, get married and choose particular sorts of housing on the other. The government has identified areas where it believes that the system is overly generous and allows those on benefits to make choices about where to live and how many children to have that those in paid work would find it costly to make. If reducing support in these areas would act to mitigate perverse incentives without introducing new ones, the case for those reductions would be stronger than that for others. But this is not necessarily true in the case of all of the examples the government has brought up: for example, many of those aged under 25 claiming Housing Benefit are lone parents or members of other vulnerable groups where it might not be reasonable to expect that they could live with their parents. Allowing only these groups to claim Housing Benefit might create an incentive for those aged under 25 to have a child – a demonstration of the trade-offs that exist in making these decisions.

So far, the government's strategy for welfare reform has appeared muddled at times. For example, it announced an intention to integrate all means-tested benefits for those of working age into a single payment but it kept support for council tax separate and introduced a new means test for Child Benefit. Integrating Child Benefit within Universal Credit would more comprehensively end its role as a universal recognition of the costs of children. But it could also deliver substantial savings. With regard to uprating policy, the government allowed a large nominal increase in benefit rates in April 2012 that ran well ahead of earnings growth before announcing real cuts in benefit rates in the following three years to restore the pre-crisis ratio of benefits to earnings levels more quickly. We do not know how the government thinks benefits ought to be uprated over time; we should do.

Most importantly, before thinking further about how to reduce expenditure, the government should set out a clear strategy for the design of the benefit system and how benefit rates should be related to other economic variables.

Annex. Social security spending, 1997–98 to 2012–13

Table 8.A1. Pensioner benefits

	Expenditure in £ billion (2012–13 prices)						
	Basic State Pension	**Additional pensions**	**DLA & AA**	**HB & CTB**	**Pension Credit**	**Winter Fuel Payments & TV licences**	**Other**
1997–98	42.3	4.4	5.4	6.8	5.2	0.3	2.0
1998–99	43.5	5.0	5.7	6.8	4.9	0.3	1.6
1999–00	44.7	5.9	6.0	6.9	5.0	1.0	1.2
2000–01	43.8	7.8	6.4	7.2	5.4	2.7	1.1
2001–02	46.3	8.5	6.8	7.6	5.8	2.7	1.1
2002–03	47.6	9.0	6.9	7.9	5.6	2.7	1.0
2003–04	48.1	9.9	7.3	7.5	6.0	2.9	1.0
2004–05	48.5	10.6	7.6	7.7	7.2	2.9	1.5
2005–06	49.5	11.4	8.0	7.6	7.6	2.9	2.3
2006–07	49.8	12.1	8.3	7.9	7.9	2.9	1.0
2007–08	51.6	13.1	8.8	7.8	8.3	2.9	1.2
2008–09	53.0	14.1	9.2	8.4	8.4	3.5	2.3
2009–10	56.0	15.6	9.8	8.6	8.8	3.5	1.8
2010–11	56.8	15.6	9.9	8.6	8.7	3.5	2.1
2011–12	58.9	16.5	9.9	8.7	8.3	2.8	1.7
2012–13	61.1	17.8	10.1	8.5	7.6	2.7	1.8

Note: Pension Credit includes Minimum Income Guarantee between 1999–2000 and 2002–03 and Income Support for pensioners prior to 1999–2000.
Source: Authors' calculations using DWP Benefit Expenditure Tables.

Table 8.A2. Working-age benefits and tax credits

	Expenditure in £ billion (2012–13 prices)						
	Tax credits & predecessors	**HB & CTB**	**IS, JSA, income-based ESA & SDA**	**Child Benefit**	**Disability Living Allowance**	**IB & contributory ESA**	**Other**
1997–98	6.7	12.1	14.6	9.9	5.0	9.4	4.1
1998–99	6.7	11.6	13.8	9.9	5.2	9.3	4.2
1999–00	7.7	11.3	13.1	11.1	5.3	8.9	4.4
2000–01	10.4	11.1	12.7	11.5	5.6	9.0	4.5
2001–02	14.7	11.1	12.5	11.5	5.9	8.8	4.9
2002–03	16.0	11.8	11.9	11.4	6.2	8.6	5.0
2003–04	22.0	11.9	12.1	11.7	6.5	8.4	5.5
2004–05	20.9	12.5	11.6	11.6	6.6	8.1	6.0
2005–06	22.0	13.4	11.5	11.6	6.9	7.9	5.9
2006–07	23.1	13.7	11.5	11.7	7.0	7.6	6.2
2007–08	23.9	14.4	11.5	12.0	7.3	7.5	6.3
2008–09	27.6	15.0	11.9	12.3	7.6	7.2	6.9
2009–10	29.9	18.0	14.7	12.9	8.1	7.2	7.3
2010–11	31.5	19.0	14.3	12.7	8.1	6.8	7.4
2011–12	30.2	19.7	14.7	12.6	8.4	6.5	6.2
2012–13	29.0	20.3	15.4	11.7	8.9	5.4	6.2

Note: Tax credits include Family Credit, Working Families' Tax Credit, Child Tax Credit, Working Tax Credit and child additions to out-of-work benefits before 2003–04.
Source: Authors' calculations using DWP Benefit Expenditure Tables and HMRC Accounts, and OBR *Economic and Fiscal Outlook*.