

The Spending Review and children

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In 2009–10 public sector borrowing reached 11.1% of national income. To reduce this deficit, the coalition Government has announced plans to cut public spending by £80 billion a year by 2014-15, £18 billion of which will be found from cuts in welfare spending. What do these plans mean for children and child poverty? In this talk, I will focus on the changes to tax credits and welfare benefits. But of course families with children will be affected by other tax changes, such as the rise in VAT, the changes to NI and the rise in the tax allowance, and changes to other public services, as Helen and Helen will make clear.

The largest single saving from the welfare budget came from the decision to link benefits and tax credits with the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) or Rossi index. Because the CPI usually gives a lower measure of inflation than either the RPI or the Rossi index, this is effectively an across-the-board cut to all benefits received by working-age adults (the pension credit guarantee and the Basic State Pension have been spared, since these will be increased in line with earnings rather than prices); the change is estimated to save the Government £5.8 billion a year by 2014–15, a figure that will rise thereafter as the savings compound.

The other benefits that will be hit with significant cuts are child benefit, the child and working tax credits, housing benefit – particularly housing benefit paid to those renting in the private sector, known as Local Housing Allowance – Disability Living Allowance (DLA) and Employment and Support Allowance (ESA). Most of these are benefits that have seen expenditure rise in real terms over the past 10 or 15 years. But there is no simple reason for these increases: spending on housing benefit did rise considerably during the recent recession, as one would expect, but both the numbers of claimants and average awards had been rising for a number of years before the financial crisis hit. The increased spending on DLA largely reflects higher numbers of recipients (as real entitlements have hardly changed). Spending on tax credits has risen, by contrast, largely through policy decisions taken by the past government to increase entitlements for families with children in real terms.

Of those cuts specifically directed at families with children, £3.5 billion will be saved in child benefit by freezing it for three years, and then means-testing it

by removing it from families containing a higher-rate income tax payer. Regardless of the merits of taking child benefit away from better-off families, we have argued that the mechanism chosen by the Government is unfair and inefficient, as it will mean that families just below the higher-rate threshold for income tax will be considerably worse off from a small rise in income. The Government argues that using the income tax system to means-test child benefit is less costly than devising a brand-new means-test. But there is already a system of means-testing support for families with children – the child tax credit - and the Government could have straightforwardly reduced spending on child benefit by combining it with the child tax credit in some way. Furthermore, the Spending Review documents revealed that the Government expects to lose £280 million a year from parents manipulating their taxable income to avoid crossing the higher-rate threshold, which is hardly the sign of a cheap or efficient means-test.¹ We hope the Treasury considers the merits of a gradual withdrawal of child benefit from higher-rate thresholds, rather than this all or nothing cliff-edge, before it comes to legislate in a future Finance Bill.

The reforms to tax credits mainly involve a faster withdrawal as earnings rise, withdrawing the family element of the child tax credit immediately after the child element is exhausted, and reducing the generosity of the childcare element of the working tax credit. Overall, from April 2012, a two child family will not receive any tax credits if their income exceeds £31,000. Significant sums will also be saved by altering the way in which tax credits respond to changes in circumstances (essentially, allowing parents less time to back-date claims, having tax credits respond more quickly to rises in income, and more slowly to falls in income). However, the Government has announced above-inflation increases in the child element of the child tax credit in 2011 and 2012, at a total cost of £2.4bn. The combined impact of all these changes on tax credit entitlement is, then, complicated, depending on how many children are in the family, whether it qualifies for the working tax credit, how many hours worked and family income. But note that the rise in the child element of the child tax credit can dominate the other changes for some families, at least through to 2012/3.

I won't say any more about the changes to DLA and ESA as they are not explicitly focused on families with children, but I do want to mention the decision to cap benefits for workless, non-disabled, non-widowed families at £500 per week. This will primarily affect large families – for example, any workless family with 7 or more children will be affected – and those receiving

¹ See Spending Review policy costings document, http://cdn.hm-treasury.gov.uk/sr2010_policycostings.pdf.

large amounts of Housing Benefit or Council Tax Benefit. This is an arbitrary way to make policy: if the Government believes that certain families are receiving too much in benefits, it would be far better to address the underlying structure of the benefit system; if the Government thought such families faced too little incentive to work, it ought to alter the conditionality which applies to benefit recipients.

Are there any overarching themes running through these benefit cuts, other than the desire to curb spending? First, pensioners have been mostly spared: the pension credit and basic state pension are hardly affected by the move to index benefits with the CPI, the new medical assessment for DLA will not apply to Attendance Allowance (the equivalent benefit for pensioners), and universal benefits for pensioners will continue in their non-means-tested form. Secondly, although all working-age benefits have been cut back to some extent, the working-age benefit system as a whole will be more focused on the poorest as a result of these reforms.

Inevitably, though, the poor will lose more as a percentage of income than the rich from such a large reduction in the overall welfare bill. And, as our distributional analysis of all tax and benefit changes to be introduced between now and 2014–15 shows, the net tax rises announced by the Government are not sufficient to offset this pattern for the bottom 90% of the population.

The Government initially claimed that its June 2010 Budget was progressive, in that the richer families lost a greater fraction of their income than poorer families, but this was based on an analysis of tax and benefit changes which omitted some of the largest welfare cuts because the Treasury did not feel it could model precisely which households would be affected. We showed that, after making reasonable assumptions about who will lose from changes to DLA and tax credits, and using information published by the Department for Work and Pensions about the impact of LHA changes, the June 2010 Budget was regressive amongst the bottom 90% of the income distribution. As the welfare cuts in the Spending Review clearly led to losses amongst poorer households which were greater than those amongst richer households (as a proportion of their income), the overall set of this Government's changes to taxes and benefits is clearly regressive amongst the bottom 90% of the income distribution.

The Government has similarly claimed that its tax and benefit changes will have no measurable impact on child poverty in 2012/13. We will shortly be publishing our assessment of poverty between 2010 and 2012. But we have

already noted that the Treasury's supporting analysis again omits many of the welfare cuts due in 2012–13, and that there are more cuts to welfare benefits between 2012-13 and 2014-15. So it would be very surprising if the direct impact of the Government's tax and benefit changes to date on child poverty was neutral by the end of the Parliament. The Government has said, though, that it is unfair to judge it on policies due by 2014-15 given that it has not made a final decisions on the level of welfare benefits and tax allowances in that year. In particular, we now know that the Government intends to introduce a Universal Credit, replacing all means-tested benefits and tax credits for those of working age, from 2013. In principle, a unified system of means-testing will save the government money, reduce losses to fraud and error, and be simpler and more transparent for claimants. The Government also want to strengthen the incentive to work facing benefit recipients, particularly for so-called mini-jobs. A definitive assessment of its impact on children, though, will have to wait until the Welfare Reform Bill is published early next year.

To find out more, visit <http://www.ifs.org.uk/projects/346>.