



Institute for
Fiscal Studies

Do the UK government's welfare reforms make work pay?

Stuart Adam and James Browne

One Great George Street, London, 11 September 2013

The scope of our report

- Effects of reforms implemented from May 2010 to May 2015
 - Not reforms *announced* in that period
- On those below 2010 state pension age
- Separate out the effects of:
 - Changes in population characteristics (esp falling real earnings)
 - Tax reforms
 - Benefit reforms
 - Universal Credit

Two kinds of financial work incentives

- Incentive to be in paid work at all
 - Replacement rate (RR): out-of-work income / in-work income
 - Participation tax rate (PTR): proportion of total earnings taken in tax and withdrawn benefits
- Incentive for those in work to increase their earnings
 - Effective marginal tax rate (EMTR): proportion of an extra £1 of earnings taken in tax and withdrawn benefits
- ❖ In all cases, higher numbers = weaker incentives

What would have happened without reforms?

- As of 2010, most rates & thresholds updated with RPI inflation
- Earnings growing significantly less quickly between 2010 and 2015
 - Forecast to fall 5.6% relative to relevant RPI figure
- This tends to weaken work incentives
 - Net earnings fall relative to out-of-work benefits
- Quantify this by comparing incentives:
 - 2010 population, 2010 tax & benefit system
 - 2015 population, 2015 tax & benefit system in the absence of reforms
- To do this, must simulate a synthetic 2015 population
 - Start with 2010 data
 - Increase earnings with industry-specific earnings growth, etc

What would have happened without reforms?

- Results:
 - Mean RR rises from 55.3% to 57.0%
 - Mean PTR rises from 51.3% to 52.4%
 - Mean EMTR rises from 52.9% to 53.5%
- Significant, though not enormous, weakening of work incentives

Characterising the tax reforms

Raise net £11bn in 2015-16

1. Changes in rates

- Increases in NICs and VAT; reductions in fuel duties
- *Generally weaken work incentives*

2. Changes in thresholds

- Big increase in income tax allowance; small increase in NICs thresholds
- Reduction in higher-rate threshold
- *Generally strengthen incentives for low earners, weaken for high earners*

Characterising the benefit reforms

Save net £22bn in 2015-16

1. Changes in the generosity of ‘safety-net’ benefits
 - cuts to housing benefit and council tax support; benefit cap
 - increases in child element of child tax credit
 - *cuts strengthen work incentives; increases weaken them*
2. Cuts to in-work support (working tax credit)
 - *weaken incentive to have someone in paid work*
 - *but strengthen incentives to earn more if working, and to have a second earner*
3. Means-testing more aggressively
 - increase in tax credit withdrawal rate; means-testing child benefit
 - *complicated and mixed effect on work incentives*
- Change to uprating of benefits is the biggest cut
 - CPI instead of RPI or Rossi – effects get bigger each year
 - Uprating limited to 1% in 2013, 2014 and 2015
 - Affects both safety-net and in-work benefits

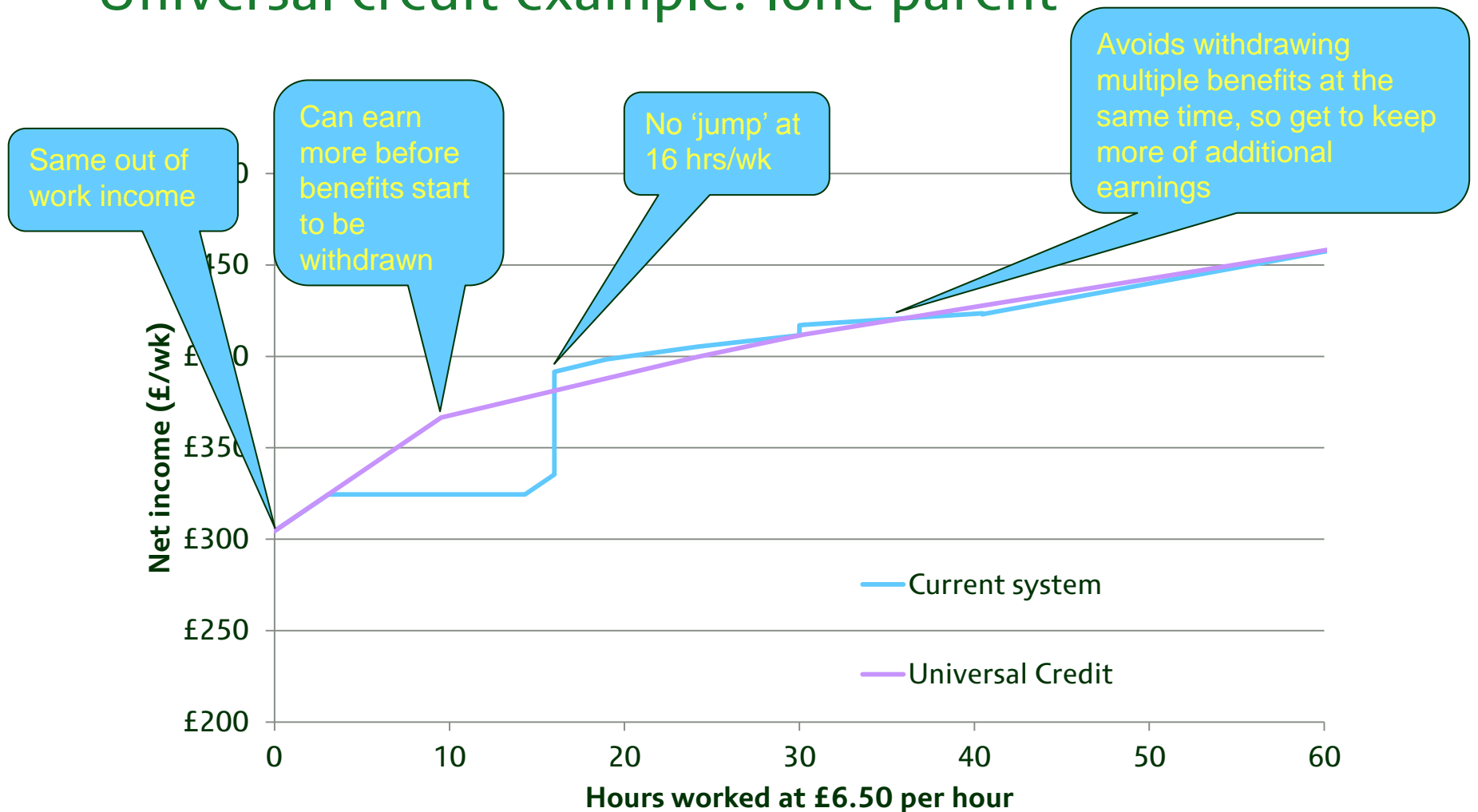
Benefit reforms affecting non-financial incentives

- Work Programme replaced previous welfare-to-work schemes
 - Further shift towards payment by results
 - Should give providers better incentives and flexibility to innovate
 - Initial evidence not encouraging
- Lone parents with youngest child aged 5-9 moved from IS to JSA
 - Additional work search requirements (available and seeking work)
 - Recent study found that equivalent policy where child aged 10+ increased affected lone parents' employment by 8-10ppts after a year
- Tougher medical reassessments for disability benefits
 - Move from IB to ESA finding one third fit for work (moved onto JSA)
 - Another 40% put into ESA Work Related Activity Group, with work-focused interviews, 'condition management', etc.
 - Move from DLA to PIP expected to disqualify 20% of claimants
 - All likely to promote employment but hard to quantify

Universal credit

- Radical reform of the benefits system
- Being phased in between April 2013 and December 2017
- One benefit to replace 6 existing means-tested working-age benefits
 - IS, income-based JSA, income-based ESA, CTC, WTC, HB
 - Council tax benefit localised instead
- Roughly revenue-neutral overall

Universal credit example: lone parent

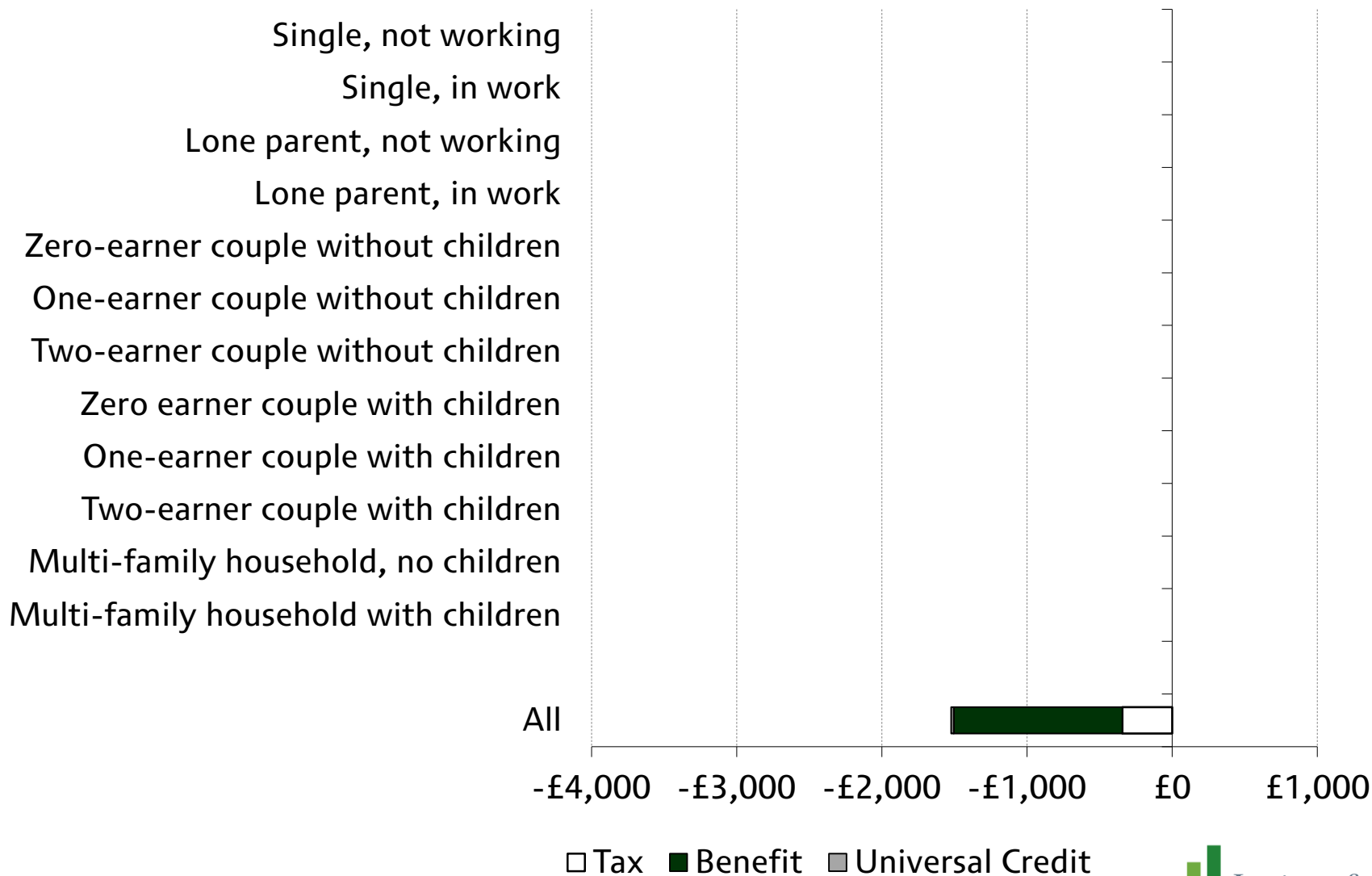


Assumes: wage £6.50/hr, 2 children, no other income, £80/wk rent. Ignores council tax and rebates

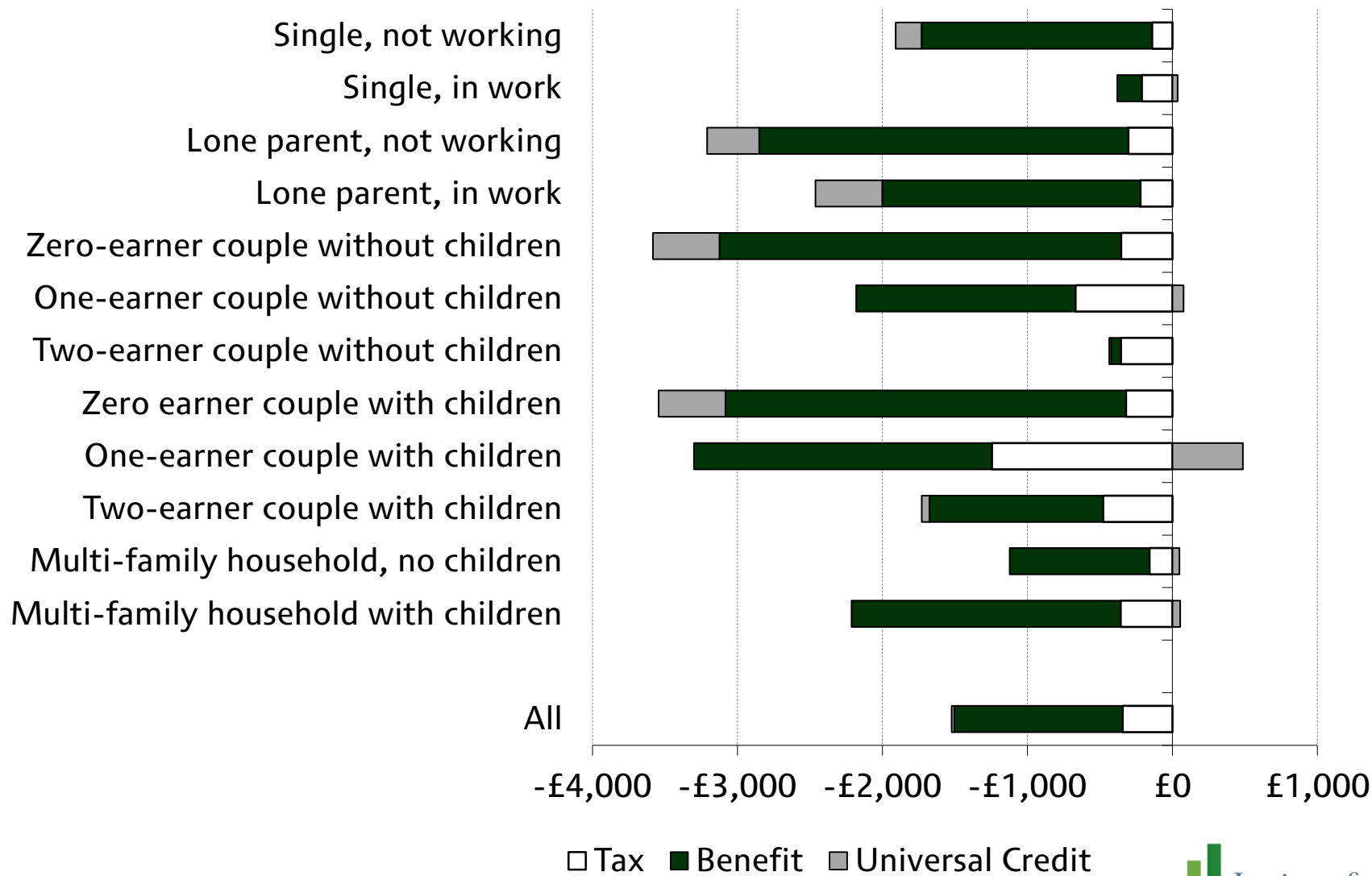
Universal credit: non-financial aspects

- Better admin and smoother transitions may ease moves into work
 - If can operate successfully with Real Time Information
 - Simpler support with more transparent incentives may help
 - Though lose the salience of a working tax credit
 - And quicker response of support to earnings may be prominent
 - Conditionality may extend to many more people, esp. in couples
 - JSA conditions now apply up to 16 hours or £76 (£121 for couples)
 - UC may extend to 35 x min wage = £213 (£416 for couples)
- Little empirical evidence on likely impact of these

Distributional impact of the reforms



Distributional impact of the reforms



Effects on average work incentives

	2010	2015, no reforms	Percentage point change from:		
			Tax reforms	Benefit reforms	UC
RR	55.3%	57.0%	-0.4	-2.3	-0.7
PTR	51.3%	52.4%	-0.7	-1.2	-0.7
EMTR	52.9%	53.5%	+1.0	-0.9	-0.1

Averages conceal huge individual-level variation

- For example, benefit reforms (including UC):
 - reduce PTRs by >5ppts for 7.5m people and by >20ppts for 1.6m
 - increase PTRs by >5ppts for 3.5m people and by >20ppts for 1.1m
 - reduce EMTRs by >20ppts for 2.0m people
 - increase EMTRs by >20ppts for 1.0m people
- Lots of reforms have big effects on small numbers of people
- UC gets rid of many of the very weakest work incentives:
 - reduces number of people with PTRs >75% by half (1.5m)
 - reduces number of people with EMTRs >85% by more than 90% (0.5m)

Average RR by group

	2010	2015, no reform	Percentage point change from			Number (million)
			Tax	Benefits	UC	
Single, no children	38.7%	41.5%				10.5
Lone parent	70.6%	72.3%				2.0
Partner not working, no children	58.6%	59.8%				3.1
Partner not working, children	70.0%	71.8%				2.8
Partner working, no children	55.0%	56.0%				9.4
Partner working, children	65.6%	67.3%				8.7
All	55.3%	57.0%				36.6

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Average RR by group

	2010	2015, no reform	Percentage point change from			Number (million)
			Tax	Benefits	UC	
Single, no children	38.7%	41.5%	-0.9			10.5
Lone parent	70.6%	72.3%	-0.6			2.0
Partner not working, no children	58.6%	59.8%	-0.1			3.1
Partner not working, children	70.0%	71.8%	-0.5			2.8
Partner working, no children	55.0%	56.0%	-0.0			9.4
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Lone parent	70.6%	72.3%	-0.6	-1.7		2.0
Partner not working, no children	58.6%	59.8%	-0.1	-4.3		3.1
Partner not working, children	70.0%	71.8%	-0.5	-0.1		2.8
Partner working, no children	55.0%	56.0%	-0.0	-1.3		9.4
Partner working, children	65.6%	67.3%	-0.3	-2.0		8.7
All	55.3%	57.0%	-0.4	-2.3	-0.7	36.6

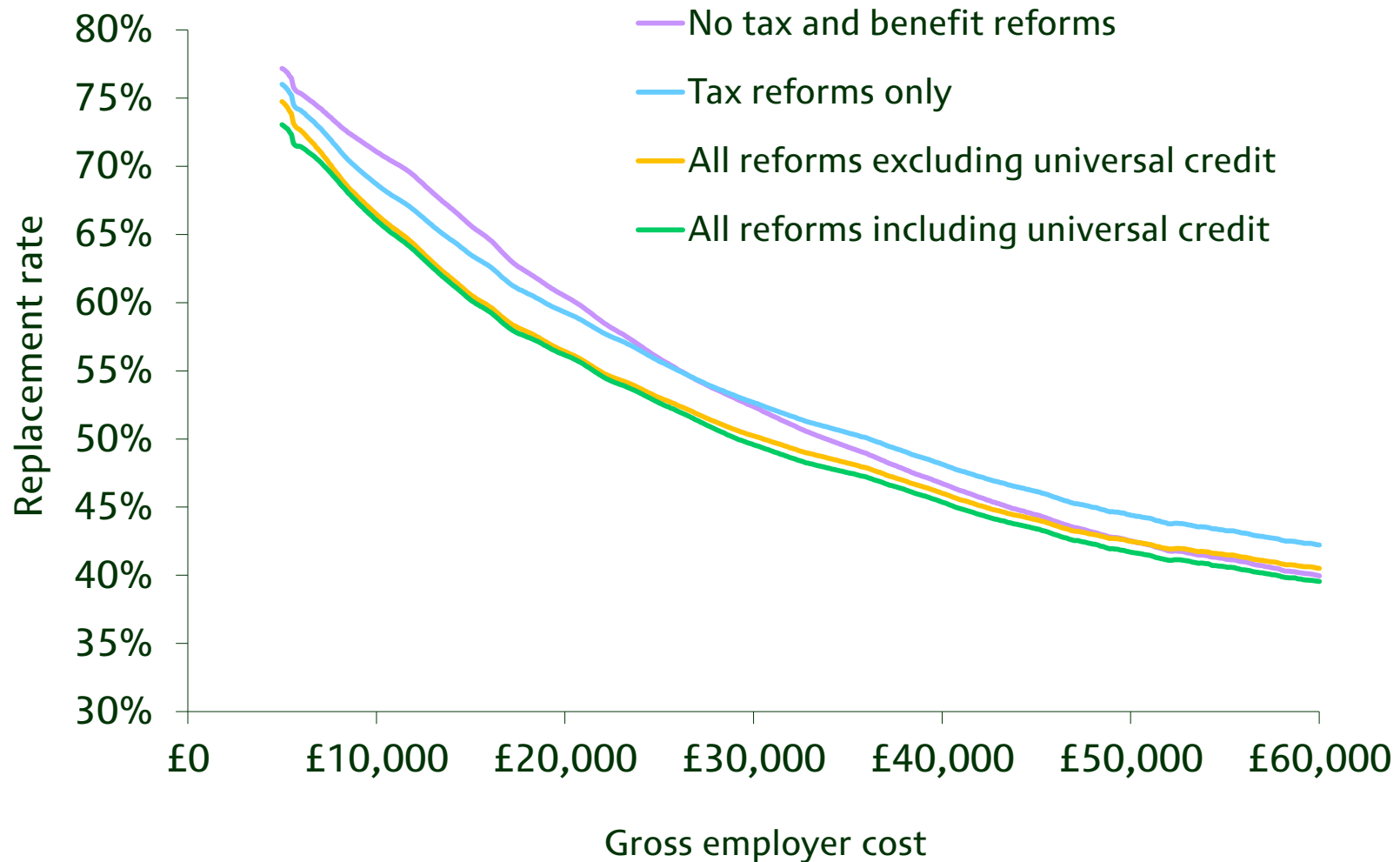
Average RR by group

	2010	2015, no reform	Percentage point change from			Number (million)
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Single, no children	38.7%	41.5%	-0.9	-3.5	-0.9	10.5
Lone parent	70.6%	72.3%	-0.6	-1.7	+0.3	2.0
Partner not working, no children	58.6%	59.8%	-0.1	-4.3	-3.2	3.1
Partner not working, children	70.0%	71.8%	-0.5	-0.1	-5.7	2.8
Partner working, no children	55.0%	56.0%	-0.0	-1.3	+0.1	9.4
Partner working, children	65.6%	67.3%	-0.3	-2.0	+0.9	8.7
All	55.3%	57.0%	-0.4	-2.3	-0.7	36.6

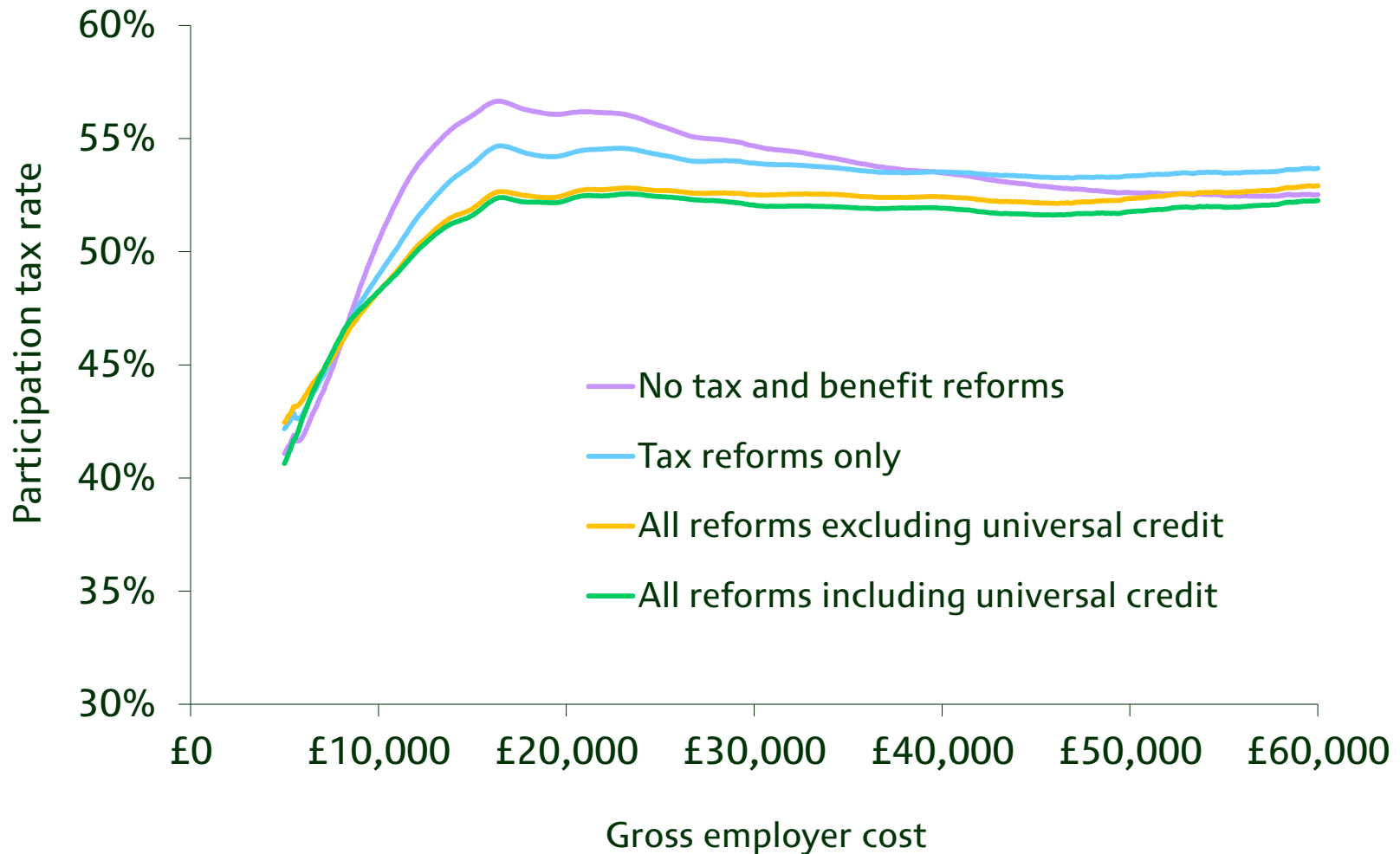
Average PTR by group

	2010	2015, no reform	Percentage point change from			Number (million)
			Tax	Benefits	UC	
Single, no children	53.8%	55.6%	-0.8	-2.0	-1.5	10.5
Lone parent	53.6%	51.7%	-0.4	+1.3	+3.6	2.0
Partner not working, no children	60.4%	60.9%	-0.1	-2.1	-3.4	3.1
Partner not working, children	70.8%	71.3%	-0.5	+4.8	-10.7	2.8
Partner working, no children	42.4%	43.1%	-0.6	-1.5	+0.1	9.4
Partner working, children	48.4%	49.5%	-0.8	-1.8	+2.5	8.7
All	51.3%	52.4%	-0.7	-1.2	-0.7	36.6

Average RR by earnings (or potential earnings)



Average PTR by earnings (or potential earnings)



Average EMTR of workers, by group

	2010	2015, no reform	Percentage point change from			Number (million)
			Tax	Benefits	UC	
Single, no children	50.5%	51.4%				6.5
Lone parent	74.2%	73.3%				1.1
Partner not working, no children	55.3%	55.8%				1.7
Partner not working, children	67.4%	67.0%				1.9
Partner working, no children	48.5%	49.0%				8.1
Partner working, children	52.4%	53.6%				6.9
All	52.9%	53.5%	+1.0	-0.9	-0.1	26.1

Average EMTR of workers, by group

	2010	2015, no reform	Percentage point change from			Number (million)
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Single, no children	50.5%	51.4%	+1.0			6.5
Lone parent	74.2%	73.3%	-0.4			1.1
Partner not working, no children	55.3%	55.8%	+1.0			1.7
Partner not working, children	67.4%	67.0%	+0.7			1.9
Partner working, no children	48.5%	49.0%	+1.5			8.1
Partner working, children	52.4%	53.6%	+0.8			6.9
All	52.9%	53.5%	+1.0	-0.9	-0.1	26.1

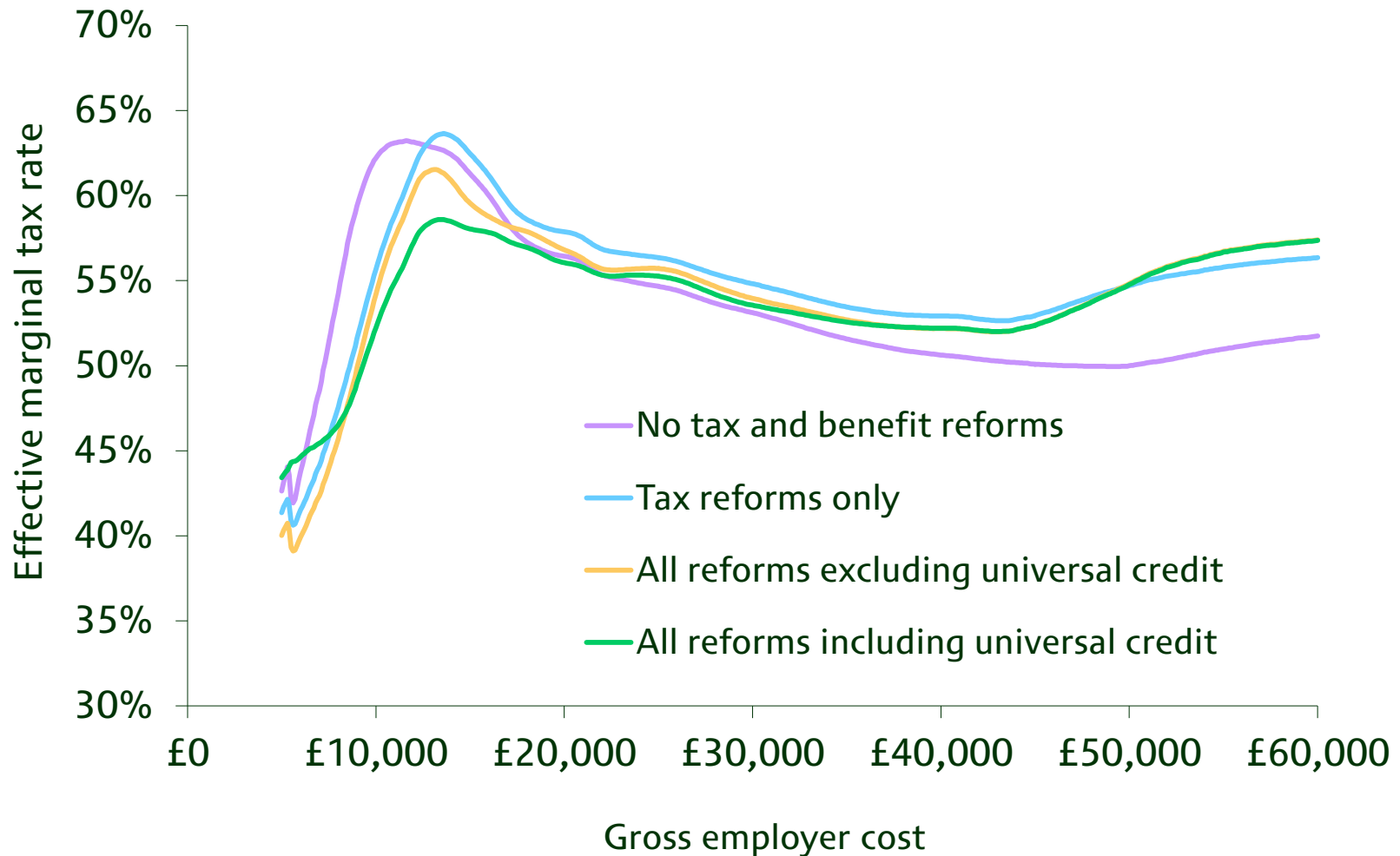
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Single, no children	50.5%	51.4%	+1.0	-1.4		6.5
Lone parent	74.2%	73.3%	-0.4	-1.0		1.1
Partner not working, no children	55.3%	55.8%	+1.0	-0.7		1.7
Partner not working, children	67.4%	67.0%	+0.7	-1.0		1.9
Partner working, no children	48.5%	49.0%	+1.5	-0.5		8.1
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Lone parent	74.2%	73.3%	-0.4	-1.0	-5.2	1.1
Partner not working, no children	55.3%	55.8%	+1.0	-0.7	-0.4	1.7
Partner not working, children	67.4%	67.0%	+0.7	-1.0	+1.2	1.9
Partner working, no children	48.5%	49.0%	+1.5	-0.5	-0.3	8.1
Partner working, children	52.4%	53.6%	+0.8	-1.0	+0.0	6.9
All	52.9%	53.5%	+1.0	-0.9	-0.1	26.1

Average EMTR of workers, by earnings



Conclusions

- Reforms strengthen incentives to be in work, on average
 - More than offsetting effects of falling real earnings
 - Strengthened less for those with children than those without
- Benefit cuts primarily responsible for that strengthening
 - But not dramatic given scale of cuts, partly because of nature of tax credit reforms
- UC strengthens incentive for couples to have someone in work
 - But weakens incentive to have a second earner
- Little net effect on incentives for those in work to earn more
 - Benefit cuts reduce the number subject to means testing
 - Tax rises increase EMTRs, except among lowest earners
- Small average effects conceal big effects at individual level
- UC removes many of the weakest work incentives
- But NB financial work incentives are not the whole story!