

Institute for
Fiscal Studies

The impact of the UK Government's welfare reforms on labour supply in Wales

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Presentation to joint ministerial stakeholder event

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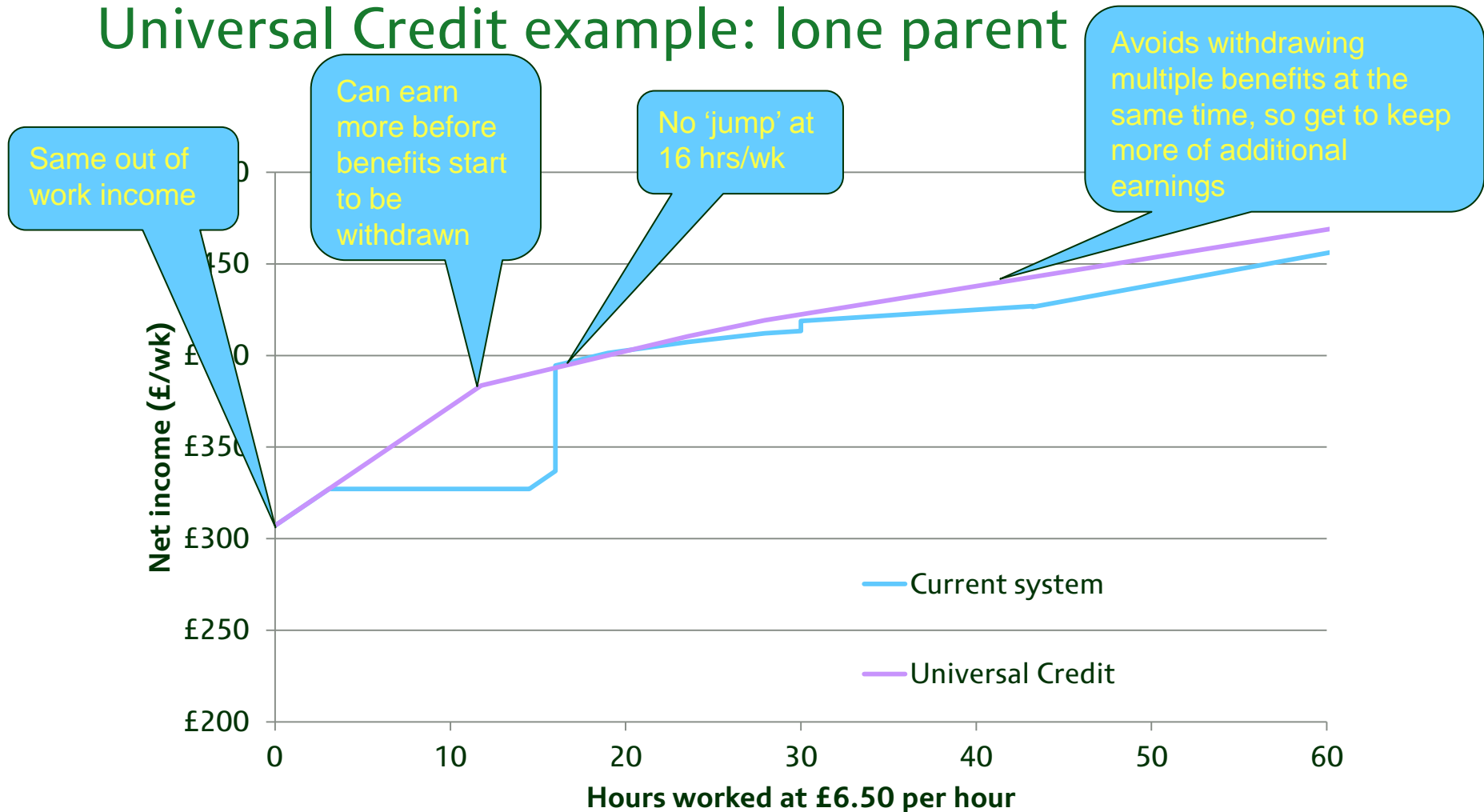
The scope of our report

- Benefit reforms only – not taxes
- Effects of reforms implemented from June 2010 to April 2014
 - And announced before the December 2012 Autumn Statement
- Separate out Universal Credit
 - Big, interesting, and different from other reforms
 - Gradual roll-out + transitional protection

Characterising the reforms

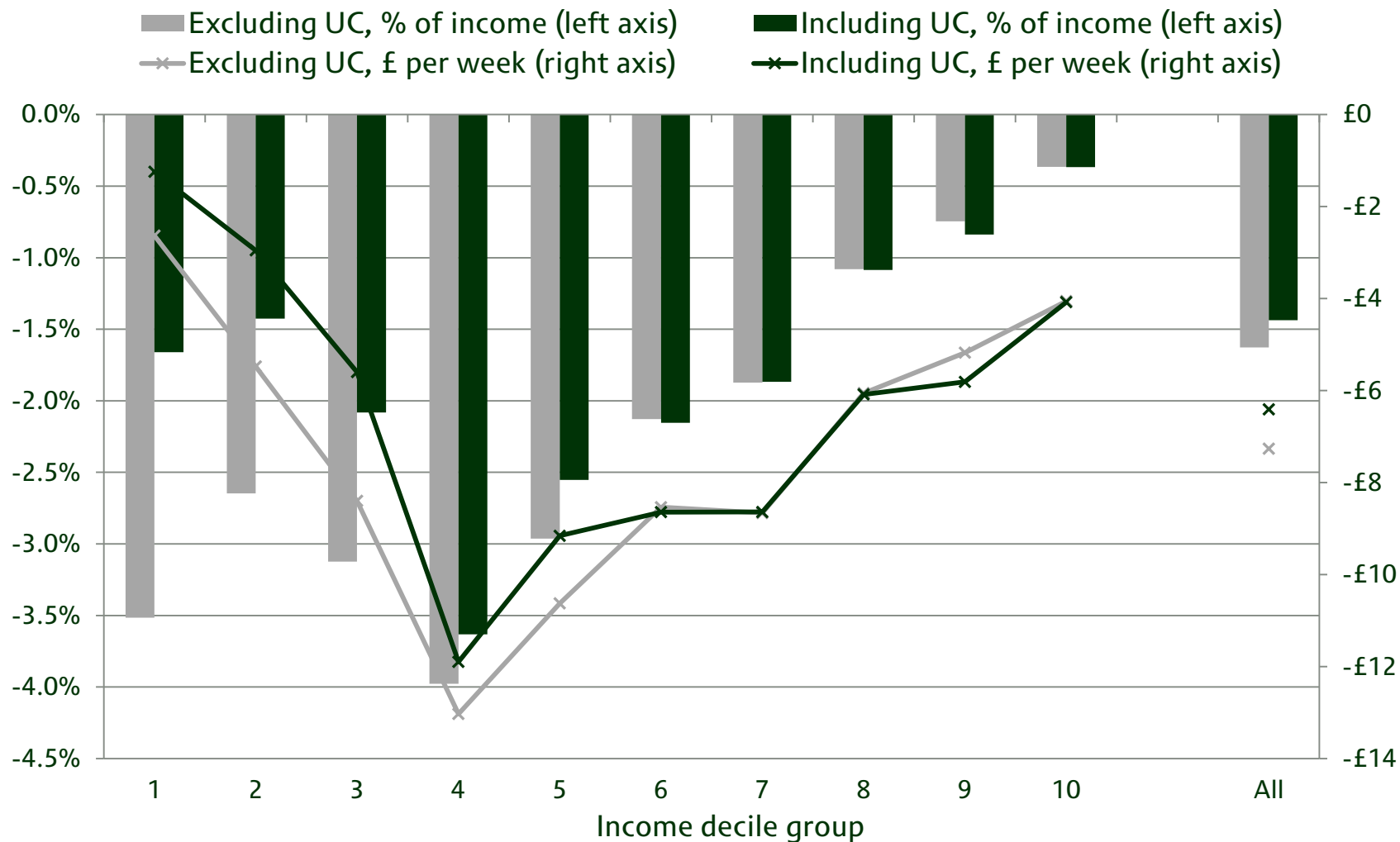
- Changes in the generosity of ‘safety-net’ benefits
 - cuts to Housing Benefit and Council Tax Benefit; benefit cap
 - increases in child element of Child Tax Credit
- Cuts to in-work support (Working Tax Credit)
- Means-testing more aggressively
 - increase in tax credit withdrawal rate; means-testing Child Benefit
- The switch to CPI uprating of benefits is the biggest cut
 - Affects both safety-net and in-work benefits

Universal Credit example: lone parent

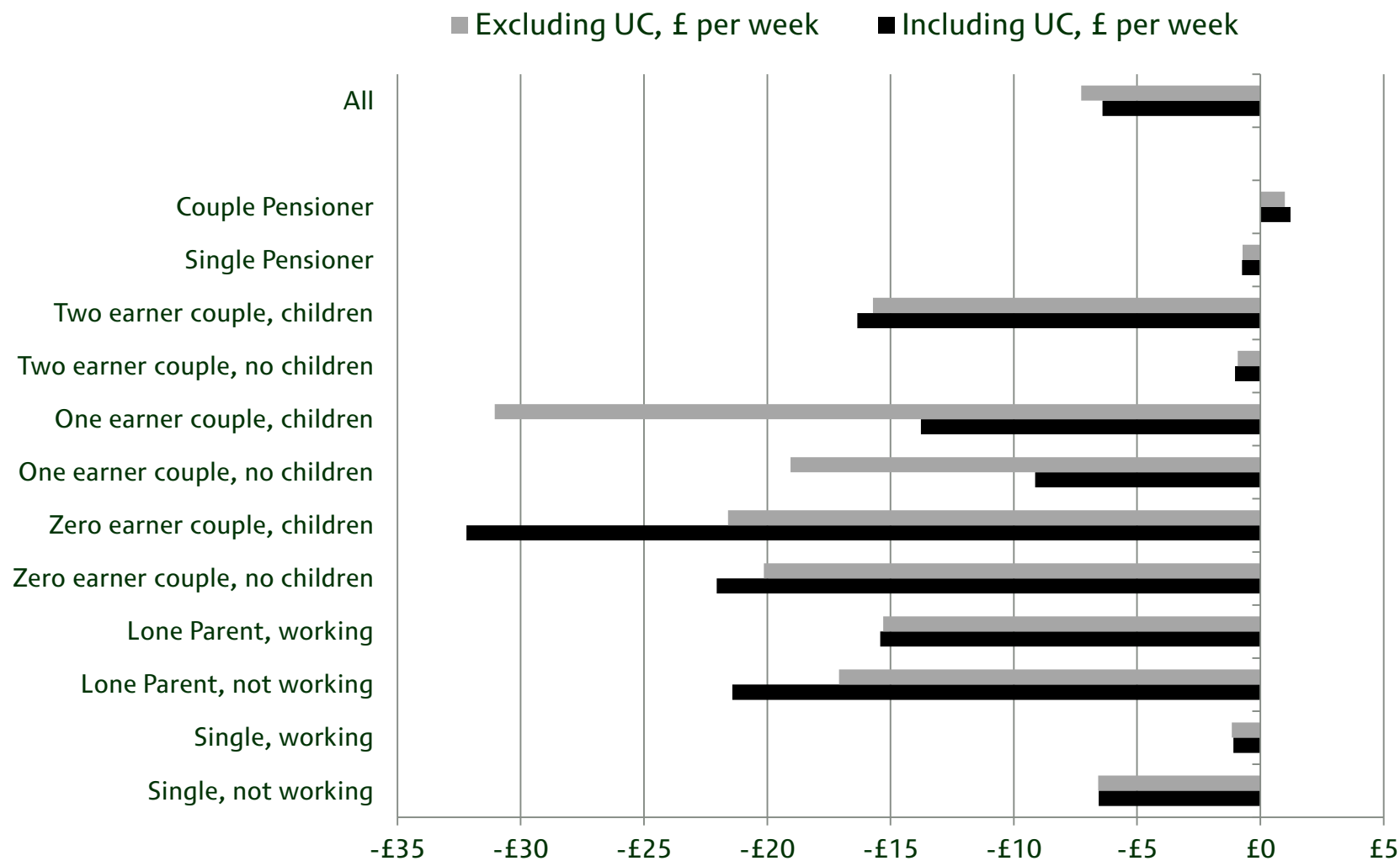


Assumes: wage £6.50/hr, 2 children, no other income, £80/wk rent. Ignores council tax and rebates

Distributional impact of the reforms



Distributional impact of the reforms



Labour supply and labour demand

- Reforms we model (excl. UC) save £590m in Wales in 2014-15
 - Universal Credit as modelled would cost £70m in Wales
- This (or any) fiscal tightening reduces aggregate demand
 - People spend less → firms produce less → fewer jobs → less spending...
 - Across the UK, OBR estimates a welfare cut equal to 1% of GDP would reduce GDP by 0.6% in the short term.
 - Negative impact may be higher in the context of a weak economy
 - A short-run issue, but an important one at the moment
- That is not the focus of our report
- We look at labour supply
 - Changes to work incentives affect how much people choose to work
 - The fundamental issue in the long run

Two kinds of financial work incentives

- Incentive to be in paid work at all
 - Measured by the participation tax rate (PTR) – the proportion of total earnings taken in tax and withdrawn benefits
- Incentive for those in work to increase their earnings
 - Measured by the effective marginal tax rate (EMTR) – the proportion of an extra £1 of earnings taken in tax and withdrawn benefits

Characterising the reforms

- Changes in the generosity of ‘safety-net’ benefits
 - cuts to Housing Benefit and Council Tax Benefit; benefit cap
 - increases in child element of Child Tax Credit
 - *cuts strengthen work incentives; increases weaken them*
- 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*
- Means-testing more aggressively
 - increase in tax credit withdrawal rate; means-testing Child Benefit
 - *complicated and mixed effect on work incentives*
- The switch to CPI uprating of benefits is the biggest cut
 - Affects both safety-net and in-work benefits

Effects on average work incentives

	April 2010	Percentage point change from:		
		Reforms exc. UC	UC	Reforms inc. UC
PTR	32.7%	-0.4	-0.4	-0.8
EMTR	36.9%	-1.1	-0.4	-1.5

- Changes are small on average
- But this conceals big changes at the individual level
 - e.g. 23% see their PTR change by more than 10 percentage points
- UC particularly effective at mitigating the very weakest incentives
 - e.g. no. facing PTR above 75% falls from 46,000 to 10,000
 - Nobody will face an EMTR above 81%

Average PTR by group

	April 2010	Reforms exc. UC	UC	Reforms inc. UC	Number (thousands)
Single, no children	37.2%	-1.0	-0.8	-1.8	452
Lone parent	32.0%	2.2	-2.0	0.1	104
Partner not working, no children	38.8%	0.1	-3.9	-3.9	205
Partner not working, children	49.6%	9.5	-16.0	-6.4	123
Partner working, no children	22.4%	-2.1	1.1	-1.0	460
Partner working, children	33.0%	-1.5	5.2	3.6	413
All	32.7%	-0.4	-0.4	-0.8	1,757

- Average reductions bigger for those aged 55+ and those in social rented accommodation
- At low earnings (<£12,000), falls from UC offset rises from tax credit reforms

Average EMTR by group

	April 2010	Reforms exc. UC	UC	Reforms inc. UC	Number (thousands)
Single, no children	33.6%	-1.4	-0.3	-1.7	258
Lone parent	63.0%	-1.5	-10.8	-12.3	56
Partner not working, no children	39.8%	0.1	2.9	3.0	89
Partner not working, children	59.3%	-2.2	2.8	0.6	64
Partner working, no children	30.5%	-1.0	-0.1	-1.2	383
Partner working, children	37.5%	-1.0	-0.4	-1.5	350
All	36.9%	-1.1	-0.4	-1.5	1,198

- Average reductions bigger for those in rented accommodation
- Average reductions biggest at earnings of £10,000 to £15,000

Impact on financial work incentives: summary

- Small average effects conceal big effects for different groups
- Reforms strengthen incentives to be in work, on average
- Biggest effects are on the 1st earner in couples with children
 - Strengthened by Universal Credit; weakened by other reforms
- Tend to be opposite effects on those with working partners
 - Much more numerous
- Reforms also strengthen incentives for those in work to earn more
 - Mainly because cuts reduce the number subject to means testing
- Universal Credit reduces the very highest PTRs and EMTRs

Modelling the impact of changing financial work incentives on labour supply in Wales

We take two approaches:

1. Estimate models of labour supply for lone mothers and couples (with and without children) using UK and Welsh data
 - Not single people without children
 - Also exclude people aged 21 or under, aged 60 or over, disabled, or self-employed, and their partners
2. Examine the literature to get plausible estimates of responsiveness and apply them to calculated PTRs and EMTRs
 - Look at ‘low’, ‘central’ and ‘high’ responsiveness scenarios to see how sensitive results are
 - Can include everyone using this method
 - But the literature also tends to exclude the groups we exclude in our models, so results for these groups more tentative

Central estimates of labour supply impacts (I)

For the sample of lone mothers and couples for whom we can use both modelling approaches:

- The impact on employment seems to be small
 - Pre-reform employment for sample is 615,000
 - Up 2,000 (method 1) or 200 (method 2) following reforms excl. UC
 - Up 300 (method 1) or 200 (method 2) following reforms inc. UC
- Some differences across demographic groups. With UC in place:
 - Employment rises a bit among lone mothers and couples without children
 - But falls a bit among couples with children (especially among women)

Central estimates of labour supply impacts (II)

- Among couples with children, reforms change number of earners
 - Very much in line with different changes in incentives

% of couples with children that have:	Pre-reform	Reforms (excl. UC)	Reforms (inc. UC)
0 earners	3.0	3.1	2.5
1 earner	27.0	26.1	28.9
2 earners	70.0	70.8	68.6

- Another notable change is an increase in the number of lone mothers working less than 16 hours a week under UC
 - But still only a small number (4.9% up from 4.0% of lone mothers)

Central estimates of labour supply impacts (III)

Including whole working-age population in Wales (method 2 only):

- Still a very modest impact on employment
 - *unchanged* following the reforms excluding UC
 - ❖ Small increases in employment among singles without children and those in couples whose partner works...
 - ❖ ...offset by small falls among lone parents and people with non-working partners
 - *Up 5,000 (0.3 ppts)* following full set of reforms (including UC)
 - ❖ Increases among single adults, lone parents and those with non-working partners...
 - ❖ ...only partly offset by falls among those with working partners
- Pattern is in line with changes in incentives
- Expected patterns by 0-earner, 1-earner and 2-earner couples too

Central estimates of labour supply impacts (IV)

- Impact on total hours worked is slightly greater, reflecting lower EMTRs which encourage existing workers to work more
 - Up 0.4% following reforms excluding UC
 - Up 1.0% following reforms including UC
 - Latter is around 15 minutes per person per week.
- Gross earnings are predicted to increase, again modestly:
 - Up £58 million (0.2%) following reforms excluding UC
 - Up £149 million (0.5%) following reforms including UC
 - Big percentage increase (5.1%) for lone parents following UC

Results are somewhat sensitive to assumed degree of responsiveness...

- ‘Low’ scenario: people roughly *half* as responsive as central case
- ‘High’ scenario: people roughly *twice* as responsive as central case

	Change in number employed	Change in employment rate (ppts)	% change in aggregate hours worked (employees only)	Change in aggregate gross earnings (£m)
<i>Excluding UC:</i>				
Low	-100	0.0	+0.1	+16
Central	0	0.0	+0.4	+58
High	+300	0.0	+1.0	+145
<i>Including UC:</i>				
Low	+1,900	+0.1	+0.2	+37
Central	+5,000	+0.3	+1.0	+149
High	+13,200	+0.7	+2.7	+411

- All scenarios show a fairly modest impact of the reforms on labour supply, especially prior to introduction of UC

...but there are also major changes to ‘non-financial’ work incentives...

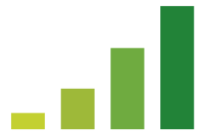
- The Work Programme
 - Although less of a change in Wales than some other parts of UK
- Lone parents with children over 5 and many former Incapacity Benefit recipients will be compelled to seek work (on JSA)
- Universal Credit has several, potentially big, changes:
 - Better admin and smoother transitions may ease moves into work
 - Simpler, more transparent incentives (but lose salience of WTC?)
 - Work-search requirements may extend to many more, esp. in couples
 - e.g. JSA conditions apply up to 16 hours or £76 (£121 for couples)
 - UC may extend to 35 x min wage = £213 (£426 for couples)
- Expect these to increase employment and earnings, but magnitude of effect isn’t clear

... and weak labour demand may act to reduce the employment effects of the reforms in short-term

- Perhaps not everyone wanting work can get jobs, or increases in the numbers of people seeking work allow employers to cut wages
 - Evidence that weak labour demand (high unemployment) means *actual* employment/hours increases less than *desired* labour supply
- Also potential for negative spill-over effects on others
 - Lower wages and/or lower employment for other workers
 - Expect these to be concentrated among people with similar skills not seeing same improvement in work incentives
- But these labour demand constraints should be a short-term issue and resolve as economy improves

Conclusions

- The effects of the reforms on financial work incentives are clear:
 - Slightly stronger incentives to be in work, on average
 - Big difference between first and second earners in couples
 - Fewer people facing benefit withdrawal, especially very highest EMTRs
- Changes in financial work incentives predicted to have fairly modest impact on labour supply in Wales
 - Again, notable differences by first and second earners
- But the size of the labour supply effect is still uncertain
 - Results are somewhat sensitive to how responsive you assume people are
 - Changes in non-financial incentives could be important
 - Weak labour demand could limit effects in the short term



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