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The Coalition's Record on Cash Transfers, Poverty and Inequality 2010-2015

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Summary

Presenting his 2010 spending review, George Osborne, the Chancellor, insisted that “those with the broadest shoulders should bear the greatest burden”. How did the Coalition’s benefit and direct tax policies affect the distribution of incomes, inequality and poverty?

- The Coalition’s immediate priorities affecting ‘cash transfers’ included increasing the income tax allowance towards £10,000 and a more generous system for increasing state pensions each year. Plans to amalgamate working-age benefits to create Universal Credit and introduce a ‘single-tier’ pension also emerged as flagship reforms.
- Benefits continued to increase with prices for the first two years, shielding many on low incomes from the effects of recession. As real incomes fell in the middle of the income distribution, inequality and relative poverty fell between 2009-10 and 2010-11 and were flat in the following two years to 2012-13 (the latest with available data). But poverty rose against a fixed real line.
- After 2012 many working-age benefits were cut in real terms, but spending on pensions continued to rise. In 2009-10, Labour’s last complete year, total spending on cash transfers was £182 billion, or 12.7 per cent of GDP. By 2014-15 projected spending had reached £188 billion (in 2009-10 prices), but had fallen as a proportion of GDP to 12.1 per cent.
- Modelling suggests changes to *direct* taxes, tax credits and benefits from May 2010 to 2014-15 were together fiscally neutral, rather than contributing to deficit reduction. They were also mainly regressive: tax credit and benefit cuts took more away from those in the bottom half of the income distribution than they gained through higher income tax allowances.
- Longer-term plans to continue linking working-age benefits to price inflation (or less) while pensions increase faster will further tilt policy in favour of pensioners. They will also extend the generally regressive effect of policy, except that Universal Credit may deliver more money to some poorer households, *if* it is claimed by some who do not claim all of the benefits it replaces.
- Child and working age poverty are projected to be higher in 2014-15 than in 2012-13, with further increases forecast to 2020-21. Deeper cuts to non-pensioner benefits and tax credits after the 2015 election would increase poverty, but the official target of eradicating child poverty by 2020, endorsed by the Coalition and Labour, already appears beyond reach.

1. Introduction

This paper is one of a series examining aspects of the social policy record of the Conservative/Liberal Democrat Coalition Government that came into office in May 2010, with a particular focus on poverty, inequality and the distribution of social and economic outcomes. The papers follow a similar but smaller set covering Labour's record from 1997-2010, published in 2013. This paper concentrates on cash transfers – social security benefits (including pensions) and tax credits. These cover areas sometimes described as 'welfare', but as that term can also be used more widely to cover the whole of the welfare state (including services such as the NHS and education) or much more narrowly to mean just benefits to out-of-work people of working age, it is avoided here.¹ Social security policy is the responsibility of the Department for Work and Pensions within Great Britain. Tax credits are administered across the United Kingdom, and social security policy and benefit structures in Northern Ireland generally follow similar principles to Great Britain, but the main focus here for aspects such as public spending is on Great Britain. The paper notes some differences in the implementation of recent reforms in Scotland and other devolved territories, but the effects of further devolution to Scotland of setting income tax rates and parts of social security following the independence referendum and report of the Smith Commission (2014) will come after the period which it covers.

The paper starts in Section 2 with an examination of the main features of the previous government's record on cash transfers, and hence the Coalition's inheritance. This is followed by discussion of the different parts of the Coalition's initial aims and goals as set out in the Coalition Agreement (and its origins in the respective party's election manifestos) in Section 3, and a summary of the policies eventually adopted (up to 2014) in Section 4. Section 5 looks at what this meant for public spending. Section 6 reviews available evidence on distributional outcomes, in most cases to 2012-13, half-way through the current Parliament, but before many of the changes in policy had taken effect. Sections 7 and 8 therefore present modelling evidence of the cumulative effects of tax and benefit reforms to 2014-15 and on the potential longer-term effects of existing and planned reforms. Section 9 concludes.

¹ See Office for Budget Responsibility (2014b), figure 1.1 and Hills (2015), chapter 9, for discussion of the relationship between these concepts and the relative scale of what is covered by them.

2. The Coalition's inheritance²

Despite the rhetoric of “broken Britain” made prominent in the run-up to the 2010 election by the Centre for Social Justice and its founder and soon-to-be Work and Pensions Secretary, Iain Duncan Smith, Labour's overall record on reducing poverty and inequality was a strong one by comparison with other recent governments. Its policy on cash transfers had prioritised reducing child and pensioner poverty, and by 2010-11 child poverty had fallen by a third since 1996-97 before allowing for housing costs (or a fifth after them) and pensioner poverty by 30 per cent (before housing costs) or a half (after them).³ Numbers below other relative income thresholds as well as the official poverty line of 60 per cent of median income, so this did not consist, as sometimes alleged, simply of leaving people in “poverty plus a pound”.⁴ On the other hand, working-age poverty increased. As a side-effect of these priorities, not only did poverty rates for different age groups converge in an unprecedented way, but the gaps between different age groups with median (middle) incomes were reduced by a third.⁵

Taken as a whole, Labour's tax and benefit policies redistributed modestly (if compared to the system it inherited adjusted in line with income growth) from the top half of the distribution to the lower half,⁶ although Labour avoided the language of ‘redistribution’. Overall, income inequality was broadly flat over its period in office as a whole (see Figure 8 below). In terms of inequality across the bulk of the population, the “90:10” ratio in 2009-10 was at much the same level as Labour inherited, but was lower in 2010-11 (marginally) than it had been for 25 years. The Gini coefficient measure – affected by rapidly growing incomes right at the top (about which Labour politicians had been at one point “intensely relaxed”) – was, however, higher in 2009-10 than Labour inherited, although it also dropped sharply in 2010-11 to where it had started in 1996-97, as those at the bottom were initially protected from the full effects of the recession.⁷

Because Labour only increased benefits and what became ‘tax credits’ selectively, overall spending on cash transfers was the same proportion of national income in 2007-08 as it had been in 1996-97. Within that the shares going to pensioners and to children (including tax credits dependent on having children) increased at the expense of other working age transfers. But with the combined effects of the economic crisis on increasing unemployment and associated benefits and in reducing real national income, total cash transfers were 2 per cent of GDP higher as a share of national income in 2009-10 (and 2010-11) than they had been in 1996-97. However transfers for working age people remained a lower percentage, despite the recession, than they had been in 1996-97.⁸

For the working age population, Labour's emphasis was on education, training, ‘making work pay’, and support into work. Conspicuously, Labour did not increase the real value of benefits for working age adults who were not in work, and their value fell further back relative to average incomes and to the poverty line. This continued the pattern seen since the early 1980s. For instance, the Office for Budget Responsibility shows that the average benefit payment made to unemployed people through Jobseeker's

² See Hills (2013) for a detailed analysis of Labour's policies towards cash transfers from 1997 to 2010 and their outcomes.

³ Hills (2013), table 4, and Figure 5 below; for more detail, see Carr, *et al.* (2014).

⁴ See calculations in Hills (2013), pp.29-30.

⁵ Hills (2013), figure 15, extended in Figure 6 below.

⁶ Adam and Browne (2010), figure 3.8; Sefton, Hills and Sutherland (2009), figure 2.5.

⁷ Measured inequality at the top was also affected by the movement of reported incomes from tax year to tax year by some of those affected by the new top income tax rate of 50 per cent that Labour brought in from April 2010.

⁸ See Table A1 and Figure 2 below.

Allowance and its predecessors had fallen from 24 per cent of GDP per adult in 1981-82 to 14 per cent in 1996-97 and fell further to 10.5 per cent by 2009-10.⁹

Labour's major reforms to the social security system took two forms, one destined to be followed by the Coalition and one which the Coalition has said it will replace. Through the Pensions Acts of 2007 and 2008, and with all-party support, it brought in reforms which improved the future value of state pension rights, including widening rights to a full pension, improving its value for lower earners, and returning to linking its value to earnings (from 2012), but with the State Pension Age due to rise from 65 after 2024. For non-state pensions, it brought in a system of automatic enrolment of employees into employer schemes or a new low-cost National Employment Savings Trust (NEST), but with the right to opt out.

For the working age population, Labour's major innovation was the introduction of tax credits, replacing and improving in-work benefits and means-tested benefits for children. These had a major effect in reducing child poverty at the same time as protecting work incentives. As part of a philosophy designed to reduce stigma, these were set up in a way that was analogous to the income tax system, with retrospective adjustments so that the amounts eventually paid out matched the incomes that people eventually reported to HMRC. The unpopularity of the claw-backs this involved for some – and the cost of rule changes designed to reduce the numbers affected – was one of the motivations for the ideas that eventually became the Coalition's Universal Credit proposals. Labour also introduced and left in place the new Child Poverty Act, which committed governments to reducing child poverty, including in relative terms to below 10 per cent by 2020.

Another part of its immediate legacy was that just before it left office, Labour made some revenue-raising changes to the direct tax system. Two which were already in place before the election in May 2010 were that the tax free income tax personal allowance was withdrawn (tapered away) from those with incomes above £100,000, and a new highest rate of 50 per cent was brought in for the slices of income above £150,000 per year. The former was left in place by the Coalition, but the top rate of tax was cut back to 45 per cent from 2013-14. Labour had also announced that National Insurance Contribution (NIC) rates would rise by 1 per cent for both employees and employers from April 2011. We discuss below the treatment of these changes in assessing the distributional effects of the Coalition's policies.

⁹ Office for Budget Responsibility (2014b), figure 8.1, and Table 3 below.

3. Coalition aims and goals

Table 1 shows key features of the immediate *Coalition Agreement* and the more detailed *Programme for government* after the election, and their relationship to the election manifestos of the two parties. It is notable that these embraced two key – and expensive – Liberal Democrat aims, a £10,000 income tax allowance (as a longer-term objective, with an immediate substantial increase) and the basic pension increasing with a ‘triple lock’ from 2011 (see below). The Liberal Democrats had made the promise to raise the annual tax-free income tax personal allowance to £10,000 the centre-piece of their Manifesto, putting the annual cost of this at £16.8 billion – a huge pledge at a time of fiscal crisis. It was to be paid for by restricting pension contribution tax reliefs to the basic rate of income tax, targeting tax credits on “those who need them most”, raising taxes on capital gains, a “mansions tax”, green taxation, and tax-avoidance measures.¹⁰ With only a minority of the tax-raising measures subsequently implemented in practice, finding other savings to balance the cost of the £10,000 personal allowance achieved in 2014-15 has been, as discussed below, at the core of Coalition policies towards benefits and tax credits.

Alongside this, the Liberal Democrats had also promised an immediate return to earnings-linking the basic pension from 2011 (rather than 2012 as promised by Labour), and for its value to be increased with the higher of prices, earnings or 2.5 per cent – what became known as the ‘triple lock’. This approach, more generous than had been planned by Labour or promised by the Conservatives, was adopted in the *Programme for Government*. At the same time other benefits for pensioners would be protected, as promised by the Conservatives in their Manifesto, for benefits going to all pensioners such as Winter Fuel Payments, free bus passes and free TV licences for older people. However, State Pension Age would rise more rapidly to 66 than previously planned (something proposed in both manifestos).

The increase in the income tax allowance was agreed instead of Conservative plans for employee National Insurance Contributions¹¹ and Inheritance Tax (raising the threshold to £1 million). While, the Coalition would “maintain the goal of ending child poverty in the UK by 2020”,¹² Child Trust Funds would be reduced (in fact, as proposed by the Liberal Democrats, they were abolished shortly after the agreement), and tax credits cut back for higher earners, and their administration reformed “to reduce fraud and overpayments”.

Otherwise there was comparatively little initially agreed on working-age benefits, apart from a statement that, “We will investigate how to simplify the benefit system in order to improve incentives to work”.¹³ This reflected the rather limited proposals the two parties had made in their manifestos. For instance, the Conservatives had proposed that long-term benefit recipients who failed to find work would have to “work for the dole”; and all existing Incapacity Benefit recipients would be reassessed to see whether they were, in fact, fit for work. Their aim was a “welfare system that is fair but firm”,¹⁴ but there was no promise of general reforms to the benefit system or statement about what would happen to the value of benefits, apart from those for pensioners. The Liberal Democrats had argued that, “Labour has

¹⁰ Liberal Democrats (2010), p.100. The measures listed would have raised £5.5 billion, £1.3 billion (by 2014-15), £1.9 billion, £1.7 billion, £3.3 billion and £4.0 billion respectively.

¹¹ The Conservative Manifesto had proposed that thresholds for employee and employer National Insurance Contributions (NICs) would be raised to offset Labour’s planned rise in contribution rates – “Labour’s jobs tax”.

¹² HM Government (2010), p.19.

¹³ HM Government (2010), p.23.

¹⁴ Conservative Party (2010), p. 16.

Table 1: From Manifestos to the Coalition's Programme for Government: Key Issues

	Conservative manifesto	Liberal Democrat manifesto	Coalition Agreement/ Programme for Government
Personal taxation	Increase in NICs threshold. Inheritance Tax threshold to £1 million. Freeze Council Tax for 2 years.	£10,000 income tax personal allowance by 2011-12	Substantial increase in personal allowance in 2011; longer-term objective of £10,000.
Pensions	Review date for SPA to rise to 66 Restore earnings limit for basic pension. Protect Winter Fuel Payment, free TV licences, etc.	Independent review of SPA. Immediate return to earnings indexation of basic pension with 'triple lock'. Reform WFPs. Pension tax relief only at basic rate	SPA to rise to 66 more quickly. State pension with 'triple guarantee' from 2011. Protect WFPs etc.
Tax Credits	Stop tax credits for incomes above £50,000. End the 'couple penalty'.	Fix tax credits for six months	Reduction in TCs for higher earners
Other transfers	Restrict Child Trust Funds to poorest third. Long-term recipients to 'work for dole'. Reassess all current claimants of Incapacity Benefit.	Abolish Child Trust Funds	Reduce spending on CTFs Reassess all current claimants of ICB.
Reform	Work to reduce high marginal tax rates on low earners	'Hugely complex and unfair system needs to be reformed'.	Will investigate how to simplify the benefit system.

created a hugely complex and unfair benefits system and it needs to be reformed",¹⁵ but the main specific reform they had proposed was just that tax credits would be fixed for six months at a time, ending the unpopular claw-back of over-payments.

However, after the Election, Iain Duncan Smith was appointed as Secretary of State for Work and Pensions. He brought with him the plans that had been worked on at the Centre for Social Justice, which he had established in 2004, for unifying means-tested benefits and tax credits in what was to become the Coalition's centre-piece Universal Credit reform.¹⁶

That longer-term reform will – if it fully materialises – come after a long series of specific cuts and reforms to working age benefits announced in the July 2010 Budget, October 2010 Spending Review and subsequent Budgets and Autumn Statements that were only vaguely foreshadowed by party manifestoes or the Coalition Agreement. It is the combination of these smaller reforms, alongside decisions on how benefits should be uprated from year to year, that have dominated what has actually happened to cash transfers and the direct distributional effects in the period up to 2014-15. Table 2 gives a timeline of these reforms, and they are described in more detail in the next section.

One notable rhetorical change from the previous government has been a change in the way the word 'fairness' is used in government statements of the rationale for reform. Under Labour, aims of 'creating a fairer society' had often been synonymous with reducing inequality, and their – often quiet – moves towards redistribution. Under the Coalition, 'fairness' has been used in a variety of ways.¹⁷ Sometimes this echoes Labour's use of the term, for instance, Chancellor George Osborne's statement with the 2010 Spending Review that "fairness also means that ... those with the broadest shoulders should bear the greatest burden" or Deputy Prime Minister Nick Clegg's invoking of fairness as being violated when children's life circumstances mean a "life sentence of disadvantage".¹⁸

But sometimes it has rather different connotations, for instance, for David Cameron at the 2010 Conservative Party conference, "Fairness means giving people what they deserve – and what they deserve depends on how they behave". The concept is often also used in terms of 'fairness' between those who are in and out of paid work, particularly the idea that it is unfair that the latter should be more favourably treated than the former – for instance, being supported by subsidies or Housing Benefit to live in places that would be too expensive for those who are in work, but not supported by benefits.¹⁹ Likewise, 'social justice' is now often used with an emphasis on changing individual behavioural factors, such as family breakdown or addiction, as opposed to broader notions of inequality.

The six overall objectives currently set out as 'Coalition priorities' for the Department of Work and Pensions (DWP)²⁰ summarise the priorities that flow from all of this:

- To encourage work and make work pay;
- Tackling the causes of poverty and making Social Justice a reality;
- Enabling disabled people to fulfil their potential;
- Providing a firm foundation, providing security for retirement and ensuring that saving for retirement pays;

¹⁵ Liberal Democrats (2010), p.17.

¹⁶ See Timmins (forthcoming) for more discussion of the idea's origins. See CSJ (2009) for the original proposals.

¹⁷ See Burchardt (2011) for more detailed discussion.

¹⁸ Quoted in Burchardt (2011).

¹⁹ Tunstall (2015).

²⁰ Prime Minister's Office (2014).

- Recognising the importance of family in providing the foundation of every child's life;
- Controlling costs: Improving services to the public by delivering value for money and reducing fraud and error.

The next section describes the policies that have been pursued in practice.

Table 2: Timeline for Coalition reforms to cash transfers from 2011-12

2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
<p>Increase income tax personal allowance above inflation (with reduction in higher rate threshold)</p> <p>Basic State Pension indexed by highest of earnings, prices (CPI) and 2.5% (known as "triple lock")</p> <p>Increase pension Guarantee Credit by same cash amount as Basic State Pension</p>	<p>Increase some direct tax thresholds in line with CPI inflation instead of RPI</p>	<p>Personal allowance £10,000</p> <p>Personal allowance £10,600 and higher rate threshold raised</p>	<p>Personal allowance £10,000</p> <p>Personal allowance £10,600 and higher rate threshold raised</p>	<p>Personal allowance £10,600 and higher rate threshold raised</p>	<p>Personal allowance £10,600 and higher rate threshold raised</p>
<p>Uprate most benefits by CPI rather than RPI/Rossi</p>	<p>Increase most working-age benefits by 1% only instead of CPI for 3 years</p>	<p>Increase Child Benefit by 1% only</p>	<p>Increase Child Benefit by 1% only</p>	<p>Increase Child Benefit by 1% only</p>	<p>Freeze most working-age benefits for two years</p>
<p>Freeze Child Benefit in cash terms for 3 years</p> <p>Cash freeze in basic and 30 hours elements of WTC</p>	<p>Increase most working-age benefits by 1% only instead of CPI for 3 years</p>	<p>Increase Child Benefit by 1% only</p>	<p>Increase Child Benefit by 1% only</p>	<p>Increase Child Benefit by 1% only</p>	<p>Phase in Universal Credit to replace WTC, CTC, IS, income-related JSA, income-related ESA and HB by 2017/18</p>
<p>Increase in main VAT rate from 17.5% to 20% and main NIC rates increased by 1%</p> <p>Council tax freeze for 2 years (3 in Scotland)</p> <p>Increase withdrawal rate of tax credits from 39% to 41%</p> <p>Baby element of CTC abolished</p> <p>Child Trust Funds abolished</p> <p>Set LHA maximum rent to 30th percentile instead of 50th percentile of local rent (and linked to CPI, not rents) and rate cut for single adults, 25-34.</p>	<p>Cash freeze in couple and lone parent element of WTC</p> <p>Taper Child Benefit away from families with anyone with taxable income in excess of £50,000; extinguished for those with £60,000 or more.</p>	<p>Reduce top tax rate from 50% to 45%</p> <p>Replace Council Tax Benefit with local support (and cut support for working-age claimants)</p> <p>Introduce benefit cap (maximum payment of working age benefits, except for disabled and WTC recipients)</p> <p>Replace DLA with PIP, reassessing all Incapacity Benefit claimants, reducing the numbers entitled</p> <p>Cut Housing Benefit for people under-occupying social housing ('Bedroom Tax'); Increase LHA rates by CPI, not actual rents</p>	<p>Introduce transferable personal allowance for married couples without a higher rate taxpayer</p> <p>Introduction of tax-free childcare for 2-earner families paying formal childcare costs</p>	<p>Introduce transferable personal allowance for married couples without a higher rate taxpayer</p> <p>Introduction of tax-free childcare for 2-earner families paying formal childcare costs</p>	<p>Change childcare support within Universal Credit from 70% to 85% of eligible costs</p> <p>Single-tier state pension for new pensioners from 2016/17</p>

GPI – Consumer Prices Index; CTB – Council Tax Benefit; CTC – Child Tax Credit; DLA – Disability Living Allowance; ESA – Employment and Support Allowance; HB – Housing Benefit; IS – Income Support; JSA – Jobseeker's Allowance; LHA – Local Housing Allowance; NIC – National Insurance Contribution; PC – Pension Credit; PIP – Personal Independence Payment; UC – Universal Credit; VAT – Value Added Tax; WTC – Working Tax Credit.

4. Coalition policies

Looking at the period of government as a whole from May 2010 to Autumn 2014, policies towards cash transfers and income distribution can be grouped into five:²¹

- Personal tax changes, including the commitment to increasing the income tax personal allowance to £10,000;
- Decisions on how social security benefits should be adjusted from year to year, differing markedly between pensions and other benefits;
- Cuts and reforms to specific benefits;
- Continuing but adding to Labour's pension reform programme; and
- Merging six working age benefits into Universal Credit.

Personal tax changes

For most income taxpayers – although with no effect on those with the lowest incomes – the most important change has been the increase in the income tax allowance from a cash amount of £6,475 in 2010-11 in stages to reach £10,000 by 2014-15 (and £10,600 from April 2015). This was much faster than either price inflation or income growth. It took the allowance back, for instance, to the same value in relation to earnings that it had been back in 1973, when the modern structure of income tax was introduced. Compared to a price-linked allowance, this was worth about £550 per year for most income taxpayers.²² The point above which higher rate tax (40 per cent) becomes payable on extra income was, however, cut back to remove the benefit of this increase from higher rate taxpayers. Older taxpayers already benefited from an 'age allowance' (£9,490 in 2010-11) and did not benefit from the increased personal allowance. Indeed, rather than waiting for the main personal allowance to catch up, in the 2012 Budget Chancellor George Osborne announced that the age allowance would be abolished, a move immediately labelled as a 'granny tax' (although a comparatively small change compared to the other ways in which pensioners were being protected). Parallel changes were made to the thresholds for paying National Insurance Contributions, offsetting for some the effects of the previously announced increase in contribution rates in 2011-12. As discussed below, the biggest beneficiaries of all this in relation to their incomes are those in the middle of the income distribution and just above it.

A further reform to start from 2015-16 is that single-earner basic rate married taxpayers will be able to transfer 10 per cent (just over £1,000) of an unused personal allowance to their spouse.

The greatest controversy has surrounded income tax on those with the very highest incomes. The Coalition left in place the withdrawal of the personal allowance for those with incomes above £100,000, brought in some tighter limits on higher-rate pension contribution tax relief (although much less ambitiously than had been proposed by the Liberal Democrats) and introduced changes that tapered away the value of Child Benefit from families in which an individual has annual taxable income of over £50,000. But from 2013-14, the 50 per cent marginal rate on incomes above £150,000 inherited from Labour was reduced back to 45 per cent. It is controversial – but unclear – how much this cost. Very few people have incomes high enough to be affected either way, and those who do often have the ability to realise parts of their income in one tax year rather than another (for instance, through changes

²¹ For a more comprehensive list, see De Agostini, Hills and Sutherland (2014), Appendix 1, and the detailed listing in the 'welfare benefits change chart' available at <http://www.nawra.org.uk/index.php/resources/newresources/>.

²² The personal allowance would have reached £7,265 per year by 2014-15, if it had been increased in line with the Consumer Prices Index (CPI). Because the allowance has been withdrawn from those with incomes above £100,000 since April 2010, the increase does not benefit those with the very highest incomes.

to the payment date of bonuses or the draw-down of dividends from companies they control).²³ When the new rate was first announced, some brought forward income to 2009-10 to avoid it. When its reduction was announced, some delayed income to 2013-14 to reduce the liability to 45 per cent. Such manoeuvres both cut what was actually raised in the years when the 50 per cent rate was in place, and distorted the top of the distribution of reported incomes in those years.

Uprating of benefits

Before the 2010 election, most benefits and state pensions were adjusted each year in line with price inflation, as measured by the Retail Prices Index (or by a variant of it which excluded housing inflation for many means-tested benefits).²⁴ As discussed in Section 6, a critical initial 'non-decision' of the Coalition (and its Labour predecessor) was to leave this in place (up to 2012-13). This meant that many benefits were protected in real terms up to then, even though real earnings had been falling in the wake of the financial and economic crisis. This contrasted with the cuts in benefits in cash terms by some other European governments worst hit by the more recent economic crisis. The effect was that minimum incomes rose in relation to average incomes and earnings. This reduced inequality between the bottom and middle of the income distribution and tended to reduce *relative* poverty. The effect of the system was to shield some of the poorest initially from the effects of the 2008 crisis.

What has happened since presents a marked contrast between pensions and other benefits, for some groups reversing the effects of this original protection (and more than reversing it in the long run), but for pensioners maintaining it. First, the basic pension (and the future amalgamated 'single tier' pension described below) is now 'triple-locked'. This means that its value rises each year by the highest of price inflation (now measured by the Consumer Prices Index, CPI), earnings growth or 2.5 per cent. If the economy and earnings returned to steady growth, in the long run this would mean the pension growing in line with earnings. But if there are fluctuations in real earnings, the long run 'ratchet' effect would mean that pensions will grow slightly *faster* than earnings.

For most working age benefits, the largest change, however, has been the switch to using the CPI to adjust benefits from year to year, rather than the RPI (or an index related to it). In recent years, the CPI measure has grown more slowly than the RPI, and there are two reasons why over the long term one would expect this to continue. One is a technical difference in how the two are calculated, where it can be argued that the RPI's methods overstate the level of price increases experienced by consumers. The other is the exclusion of housing costs – on the argument that for low-income households, protection is given by Housing Benefit (although see below for restrictions that now apply to this). Neither necessarily measures the inflation actually experienced by benefit recipients, however – in recent years, for instance, as fuel and food prices (important in low-income budgets) have risen faster than general prices.²⁵ This switch was one of the largest austerity measures reducing the social security

²³ 'Additional' (ie top) rate taxpayers are estimated by HMRC to be 343,000, or just over 1 per cent of all 30 million income taxpayers (HMRC, 2014a, table 2.1). They estimated that between £16-18 billion of income was moved to be realised in the year 2009-10 to 'forestall' the new 50p top rate, around 2 per cent of the income of the top 1 per cent (*ibid.*, pp.14-15).

²⁴ See De Agostini, Hills and Sutherland (2014), Appendix 3, for details of 'default' indexation arrangements up to 2011 and since then. Some elements – such as capital limits for means-tested benefit receipt are rarely adjusted at all.

²⁵ See the final sub-section of Section 7 for further discussion.

budget – originally expected to save more than £6 billion per year by 2014-15, and increasing amounts in future years.²⁶

Accelerating the effects of the switch to CPI was a further decision that for three years from 2012-13 most working age benefits would only be increased by only 1 per cent, reducing their real value, however inflation is measured.²⁷ Child Benefit was frozen in cash terms for three years from 2011-12, and then increased by 1 per cent in 2014-15, and so cut significantly in real terms. The 'family element' of Child Tax Credit was also frozen, although the per child element was increased. All of these measures can be seen as being designed to reduce benefits in real terms, reflecting the real fall in earnings in the recession. But most of them (apart from those relating to children) had not been increased when real wages grew in the years before the crisis. In contrast to pensioners, who get 'the better of prices and earnings' the medium-term effect of this is more akin to working age people getting 'the lower of prices and earnings'.

For the longer term, if it is sustained, a crucial decision will be the announcement in the 2013 Autumn Statement that that will be a 'welfare cap' on the total of cash transfer spending, excluding state pensions and Jobseeker's Allowance (and associated Housing Benefit). This will set a cash limit on what is currently just over half of cash transfers, with the future amount involved rising only with currently projected inflation (or less in the first year), rising from £119.5 billion in 2015-16 to £126.7 billion in 2018-19. This compares with forecast spending on the items covered of £117.8 billion in 2014-15.²⁸ This has three implications. First, it institutionalises the idea that non-pension benefits should by default be linked to price inflation, and so fall in relation to other incomes, if they rise in real terms. Second, if inflation actually turns out to be faster, the available value of total spending will be reduced in real terms, and with it the living standards of those receiving benefits, unless something else means that demands on the benefit and tax credit system fall – for instance, if low pay rose faster than other incomes (reducing the cost of tax credits), or rents rose less rapidly than other prices (reducing the cost of Housing Benefit). But third, in the other direction, if demands on the system grew – if, for instance, the number of people entitled to disability benefits rose or rents rose faster than other prices – the resources available for everything else would have to be cut. Rather than such risks being carried across the whole population, they will now effectively be carried only by those receiving benefits and tax credits.

Specific benefit and tax credit reforms

More visible than those changes has been a series of reforms to different parts of the benefit system. These include:

- A **cap** of £26,000 per year in the total amount of benefits that working age people and their families can receive (excluding those on certain disability benefits or working enough hours to qualify for Working Tax Credit). The argument for this is that total benefits should not exceed average household earnings. It has the most effect on large families living in London, paying

²⁶ When it was announced, the Treasury projected that the measure would yield savings of £5.8 billion by 2014-15 (although part of the saving comes from public service pensions) (HM Treasury, 2010, table 2.1).

²⁷ The 2014 Autumn Statement announced a further freeze in most working age benefits and tax credits in cash terms for two years after April 2015, in order to create further savings. With CPI inflation forecast by the Office for Budget Responsibility (2014a) to be 2 per cent each year, this would imply a further 4 per cent cut in the real value of the benefits.

²⁸ OBR (2014b), table 2.

high rents that would otherwise be eligible for Housing Benefit, and entitled to most support for their children.

- Tighter specific limits on **Housing Benefit**, with the limits for eligible private sector rents first reduced to cover only the lowest 30 per cent of local rents and then increased only with CPI inflation (which has been well below actual rent increases).
- Working age (but not pensioner) social tenants who have more bedrooms than deemed necessary have had their eligible rent for Housing Benefit cut by 14 per cent or 25 per cent (if deemed to have two rooms too many) – a move described as the '**bedroom tax**' by its opponents, and as 'abolition of the spare room subsidy' by the government.²⁹
- Council Tax was frozen or only increased by small amounts by most councils (who faced strong penalties from central government if they did not), and so fell in real terms. But responsibility for what was **Council Tax Benefit**, which previously gave rebates of the whole tax to those with the lowest incomes, was passed to local authorities, but with a 10 per cent cut in the resources to deliver council tax support.³⁰ Those over pension age continue to be entitled to support as under the old system, so working age people have seen their support cut, unless councils could find other revenue sources to protect them. The impact is greatest in areas that have the largest proportion of older residents to protect. Most have not continued the exemption for those with the lowest incomes, with the result that even those at or below Income Support level now have to pay part of their Council Tax, commonly with a minimum contribution of 20 per cent.³¹ For those already on the minimum incomes given by Income Support or Jobseeker's Allowance, this can imply a major cut in what is left for other items, and is cited as one of the factors where 'welfare reform' is increasing hardship (see below). The reform was announced by the Department for Communities and Local Government as part of the 2010 Spending Review. The creation, in effect, of several hundred different local means-tested benefit schemes contrasts strikingly with the parallel efforts of the Government to unify and simplify other means-testing through Universal Credit (see below).
- As well as the effects of indexation changes described above, **tax credits** have been made less generous in various ways. These include: abolition of the 'baby element' of Child Tax Credit (CTC); withdrawal of the part of CTC that could previously be paid to those with incomes up to £50,000 or more³²; a faster rate of tax credit withdrawal as earnings rise (from 39 to 41 per cent); an increase in the weekly working hours requirement for couples; and reduction in eligible childcare costs from 80 to 70 per cent. Income now has to drop by £2,500 from an original assessment before tax credits are adjusted upwards, rather than adjusted for any fall in income. At the same time, the tolerance for increases in income before tax credits are reduced has been cut back to £5,000.
- A series of reforms to **disability benefits** have made conditions for their receipt tighter, and their administration tougher. These include the reassessment of all previous recipients of Incapacity Benefit, as they have been transferred to Employment and Support Allowance (ESA), if a "Work

²⁹ In Scotland, the Scottish Government covers the cost of what would otherwise be due under the 'bedroom tax' if people apply, and it does not apply to existing tenants in Northern Ireland.

³⁰ See Adam and Browne (2012), National Audit Office (2013a), Bushe, Kenway and Aldridge (2013) for detailed discussion and analysis of the reform.

³¹ Adam and Browne (2013) suggest that the average effect of the change is equivalent to a minimum contribution of 10.4 per cent.

³² This existed as a replacement for the short-lived Children's Tax Credit, itself a replacement for the old Married Couples Allowance in income tax, in turn a replacement for the Married Man's Allowance.

Capability Assessment" finds that they meet tightened conditions (or to Jobseeker's Allowance, at a lower rate, if they do not). People with a strong national insurance record are now entitled to only one year of "contributory" ESA before being subject to family means-testing. At the same time Disability Living Allowance is being replaced by "Personal Independence Payments", with a 20 per cent cut in the budget and a greater focus on the most severely disabled people.

- The **Social Fund**, which previously gave crisis loans and grants in emergencies to benefit recipients through a national scheme, has been mainly abolished and responsibility for devising local schemes passed to local councils in April 2013 (along with some partial funding for two years).
- The **administration** of many out-of-work benefits in terms of conditions for entitlement through attending interviews, making job applications and undertaking training has been made stricter and the penalties greater, with a very large increase in the number of people 'sanctioned' by having their benefits stopped (see Section 7).
- **Child Trust Funds**, introduced by Labour, were abolished, and the planned national roll-out of 'Savings Gateway' incentives for those with low incomes was cancelled.

Pension reforms

With the exception of the abolition of the income tax age allowance, the treatment of pensioners in terms of cash transfers has contrasted greatly with that of families with children and others of working age. As described above, since 2011 the basic state pension has been increased each year in line with the 'triple lock' and so has risen both in real terms and in relation to earnings. Shortly before the 2010 election David Cameron promised that additional benefits such as the Winter Fuel Payment (WFP) and free TV licences for those over 75 would be protected, and this has been done, for the life of the current Parliament, at least (although with WFP paid at a lower rate from 2011-12).

The Coalition has followed through with other elements of the pension reforms set in train by its predecessor, including – after an initial review - the introduction of 'automatic enrolment' (but with the right to opt out) of employees into employer pension schemes or the new low-cost National Employment Savings Trust (NEST). The phasing in of this started with the largest employers, and with lower minimum contribution rates from employer and employee than will be in place eventually.

Another part of the reform package was an increase in State Pension Age (SPA) as longevity increased. Labour's legislation had set out an increase from 65 for men and women to 66 between 2024 and 2026, with increases of a further year in the two following decades. In an early move, partly justified by faster longevity growth projections, but also announced as part of the Government's austerity measures, this was brought forward to being completed by 2020. As this coincided with the long-planned increase in women's SPA from 60 to 65 between 2010 and 2020, this meant an especially fast change for some women born in the years around 1954, who will now receive their pension up to ten years after those born four years earlier. The announcement gave only a few years for people to adjust their retirement plans. For the longer term, the Government has announced that the increase to 67 will also be brought forward, and that there will be a more automatic link between SPA and forecasts of future longevity, designed to keep the proportion of adult life spent above SPA constant. There would, however, be at least ten years' notice of any change (in contrast to the accelerated increase to 66) and independent involvement in the review process.³³

³³ DWP (2013), section 6.

The state pension system inherited by Labour in 1997 had two elements – the flat rate basic pension and the State Earnings Related Pension. As part of its early reforms, Labour renamed the second element as the State Second Pension and increased its value for lower earners by giving a minimum for those who qualified. Its later reforms had set in train a process under which its flat rate element would steadily become more important, and the earnings-related part less important, eventually disappearing.

The Coalition – led by Liberal Democrat Minister, Steve Webb – has greatly accelerated this process, with reforms that mean that those retiring from 2016 will be entitled to an amalgamated flat rate 'single tier' pension, with no relation to previous earnings or the amount of NICs paid. In many ways, this brings the state pension system back full circle to the contributory flat rate pension introduced after the 1942 report by fellow Liberal, William Beveridge. Entitlement will still depend, however, on the number of years that contributions are paid or credited for, rather than it being a full 'citizen's pension', without such conditions (as had been advocated in the Liberal Democrat Manifesto). As entitlements of existing pensioners will be unaffected by the reform, it will be decades before the parts that are related to their earnings in the period after Barbara Castle's reforms of 1978 that established SERPS finally disappear.

This simplification will be welcomed by many, not least by many women with interrupted earnings careers and self-employed people who will now have entitlement to a full 'single tier' pension when they reach pension age after 2016 – with a forecast value of 'no less than' £148.40 per week, rather than just the basic pension, currently worth £113.10 per week. However, the reform is being introduced at zero net cost to the government, so beside these gainers, there are losers – those with middle earnings who would have built up bigger entitlements under the previous two-tier system. The overall effects of this are discussed in Section 8 below.

Separately from these reforms, the 2014 Budget contained a surprise announcement that from April 2015, those saving in the tax-favoured form of building up pension rights would no longer have to convert the pension pot they build up into a flow of retirement income by the age of 75. Hitherto, it had been assumed that the quid pro quo for the tax advantages of pension saving³⁴ was that people tied up most of their savings in a form that ensured that they would have a steady flow of income (an annuity) through retirement (thereby reducing their potential need for state support in some form if they miscalculated in some way). Both Liberal Democrat and Conservative manifestos had said that they would scrap the annuity requirement, provided people had enough income to keep clear of means-testing, but the Coalition's *Programme for government* said only that they would "explore the potential to give people greater flexibility in accessing part of their personal pension fund early".³⁵ The complete deregulation now announced is far more radical than this. Part of the rationale for it is that under the 'single tier' pension, future retirees will be carried clear of means-testing.

Universal Credit

Over the period of the current Parliament, to 2015, the effects of Coalition policies on cash transfers are dominated by its decisions on indexation of benefits, tax credits and tax allowances,

³⁴ See Hills and Glennerster (2013), section 8.2 for a description and discussion.

³⁵ HM Government (2010), p.26.

alongside the specific reforms and cuts described above. But in the long run, it has seen the creation of Universal Credit as being its major legacy in reforming the system for working age people.³⁶

This reform is ambitious – to bring together six means-tested benefits and tax credits that are currently run separately, so that by 2017, 7.5 million households will be receiving it. It amalgamates support for people in work and out of work, abandoning Gordon Brown's philosophy that keeping in-work tax credits separate from other benefits would reduce stigma and increase take-up. By having a single 'taper' or withdrawal rate – originally 'illustrated' at between 55 and 70 per cent, but later set at 65 per cent – it is intended to get rid of overlaps in means-tests and taxation that can leave some people facing effective marginal tax rates of 90 per cent or more.³⁷ There will no longer be a rule on minimum numbers of hours to qualify for the in-work support system so that, for instance, there will be a clearer gain from people moving from being out of work entirely into work of, say, ten hours per week. But accompanying this there will be new 'conditionality' on those working part time to increase their hours until their weekly earnings reach a minimum.³⁸ To match what Ministers see as the "real world" of work, payments will be monthly, not weekly or fortnightly, and will – for most cases – include a cash payment to cover or contribute to rent, rather than payments going direct to landlords, as Housing Benefit often does now. Unlike tax credits, where payments depend on an initial assessment of what income has been, and then later adjustment after the end of the year to get the total payment right when their actual income is known, Universal Credit entitlement will be calculated in "real time", based on actual income reported by employers to HMRC for the previous month, combined together with DWP's knowledge of their circumstances (and those of any partner).

Whether these ambitions can be delivered remains to be seen.³⁹ An immediate issue is the speed with which Universal Credit can actually be rolled out. Building up from its start in April 2013, only 18,000 people were receiving it in October 2014.⁴⁰ DWP's original plan in 2011 was that by then the caseload would be more than 2 million.⁴¹ The intention was that the caseload would reach more than 7 million by 2017-18; the independent Office for Budget Responsibility now projects that it will only reach 3 million by then (and fewer than 1 million in 2016-17).⁴² The cases involved in the initial phase have been those expected to be the simplest, rather than those involving complicated changes in circumstances from month to month. But one witness told the House of Commons Public Accounts Committee that there are expected to be 1.6 million changes in circumstances every month for the system to cope with when it is fully rolled out.⁴³ Doubts have been raised about how the new system will affect money management within couples, used to separate payments going to each partner, and whether some recipients, most of whom budget over far shorter periods than a month, will run into problems before the next monthly payment is due, or whether more may run into arrears as the equivalent of Housing Benefit is paid as cash. From previous research for some couples, there is a risk that this system could result in

³⁶ DWP (2010a, b).

³⁷ There will still, however, be overlaps with direct taxation and means-tested Council Tax support, so the maximum combined rate of withdrawal could still be more than 80 per cent.

³⁸ And this will apply to the whole benefit, whereas at present conditions may apply to only some of the separate elements that are being combined.

³⁹ See Hills (2015), chapter 4 for an overview of the issues, and Brewer, Browne and Jin (2011, 2012), Tarr and Finn (2012), Brewer and De Agostini (2014), Pennycook and Whittaker (2012), and Public Accounts Committee (2013) for more detailed analysis and commentary on particular aspects.

⁴⁰ DWP (2014a).

⁴¹ NAO (2013b), figure 12.

⁴² OBR (2014c), chart D, p.156.

⁴³ PAC (2013).

mothers being left with the problem of surviving with their children on reduced amounts, where partners are irresponsible or do not share resources. It is unclear whether the safeguards that will allow separate payments in some cases will be effective in preventing this.

Under the agreement reached following the Independence Referendum in September 2014, the implementation of Universal Credit in Scotland may in future differ from that in the rest of the country, including in its treatment of housing costs and the way in which it is paid (see Section 8).

Much therefore remains unclear, but in Section 8 below, we look at the distributional effects that the current design of Universal Credit could imply if fully in place by 2019-20, alongside the effects of benefit and tax indexation conventions as they currently stand.

Looking at policy as a whole, many more changes have been made than had been outlined in the Coalition Agreement or election manifestos. Alongside the increase in the income tax personal allowance and the triple lock for state pension indexation, there have been more ambitious pension reforms and the plans to introduce Universal Credit, which were only outlined in general terms. But the long list of specific benefit reforms and cuts were only foreshadowed by the general aims of 'making work pay' and cutting the cost of 'welfare' as part of overall austerity.

5. Spending on social security and tax credits

What has happened to public spending on social security and tax credits since the Coalition has come to office is a result of the collision on the one hand of the policies described above, many of which were designed to restrain spending growth, and on the other the pressures on the system from factors such as unemployment, rising rents and an ageing population. Table A1 in the appendix presents a long-term times series for spending (using current government definitions) divided between that going to pensioners, that going to families because they have children, and other working age benefits and tax credits.⁴⁴

In Labour's last complete year, 2009-10, total spending on cash transfers was £182 billion, or 12.7 per cent of GDP. The following year, as the Coalition took office, with benefit and tax credit rules as inherited in April 2010, spending rose to £184 billion (at 2009-10 prices), but fell to 12.5 per cent of GDP. By 2014-15 projected spending had reached £188 billion, falling further to 12.1 per cent of GDP. Figures 1 and 2 show how this spending broke down between that aimed at the three age groups in real terms and as a share of national income. For comparison with the Coalition period, they show the position in the year before Labour took office (1996-97), the year before the economic crisis (2006-07), and then each year since 2009-10. Figure 1(b) shows the cumulative changes in real terms between 1996-97 and each financial year from 1997-98 onwards.

For working-age benefits unrelated to having children, spending in Labour's first ten years fell from £41.4 to £40 billion in 2006-07, before jumping by 20 per cent with the recession to reach £48 billion in 2009-10. Under the Coalition it peaked at £50 billion in 2012-13, falling back to £48 billion in 2014-15. This implied a fall in such spending over the Labour period as a whole from 3.9 per cent of GDP in 1996-97 to 3.4 per cent in 2009-10, and a further fall over the Coalition period to 3.1 per cent of GDP by 2014-15. In contrast to public perceptions,⁴⁵ under both governments such transfers fell in relation to both total public spending and national income.

By contrast, spending related to children rose rapidly under Labour but has fallen under the Coalition. With the new and more generous tax credit system, child-related transfers more than doubled in real terms under Labour to reach nearly £40 billion in 2009-10, but were reduced to £36 billion by 2014-15 (at 2009-10 prices). This implied a rise from 1.5 to 2.8 per cent of GDP over the Labour years, but a fall to 2.3 per cent of GDP by 2014-15.

A third pattern is shown by spending on pensioners, rising under both governments. In real terms, pensioner benefits rose from £58 billion in 1996-97 to £94 billion in 2009-10 and £103 billion in 2014-15. In the Labour period the growth in pensioner benefits accounted for more than half of the growth in all transfers in real terms. In the Coalition period, pensioner benefits continued to grow, but other benefits and tax credits fell back. As a share of national income, transfers to pensioners rose from

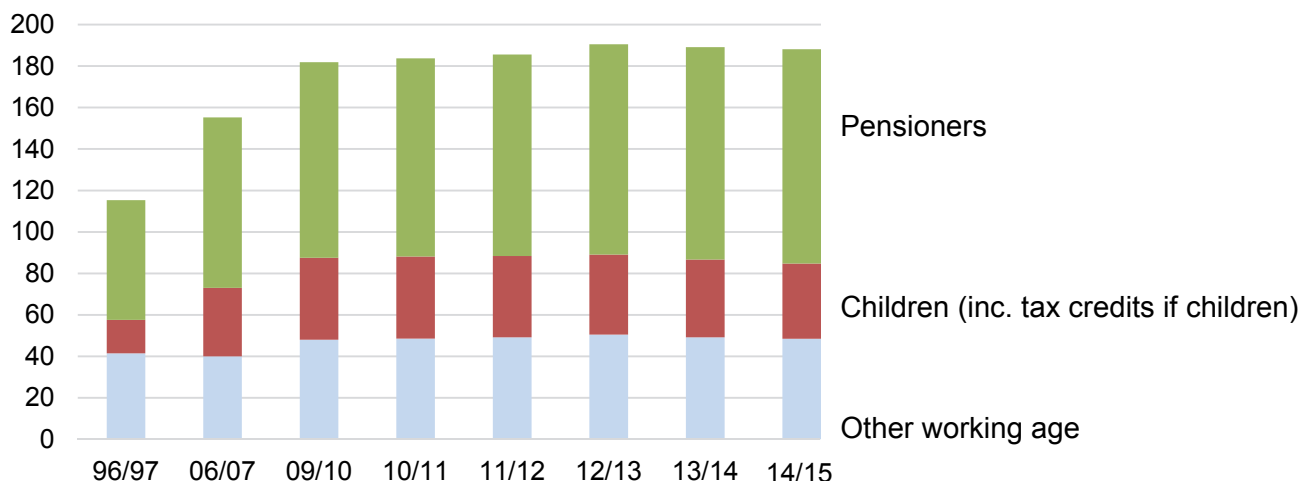
⁴⁴ This uses DWP's calculations of past spending using current definitions (for instance excluding payments in the past made through Income Support for residential care, or more recently for Council Tax Benefit). In the breakdown presented here, payments related to children include Child Benefit and all tax credits going to families with children (the equivalent of what were Family Credit and Income Support child additions). They exclude Working Tax Credit for those without children and maternity benefits. The figures are for Great Britain (as social security in Northern Ireland is separately administered), with tax credits spending adjusted by DWP from UK figures.

⁴⁵ See Hills (2015), chapter 9, for further discussion.

5.4 per cent of GDP in 1996-97 to 6.6 per cent in 2009-10, and were at the same figure in 2014-15 (but down from a peak in 2012-13).

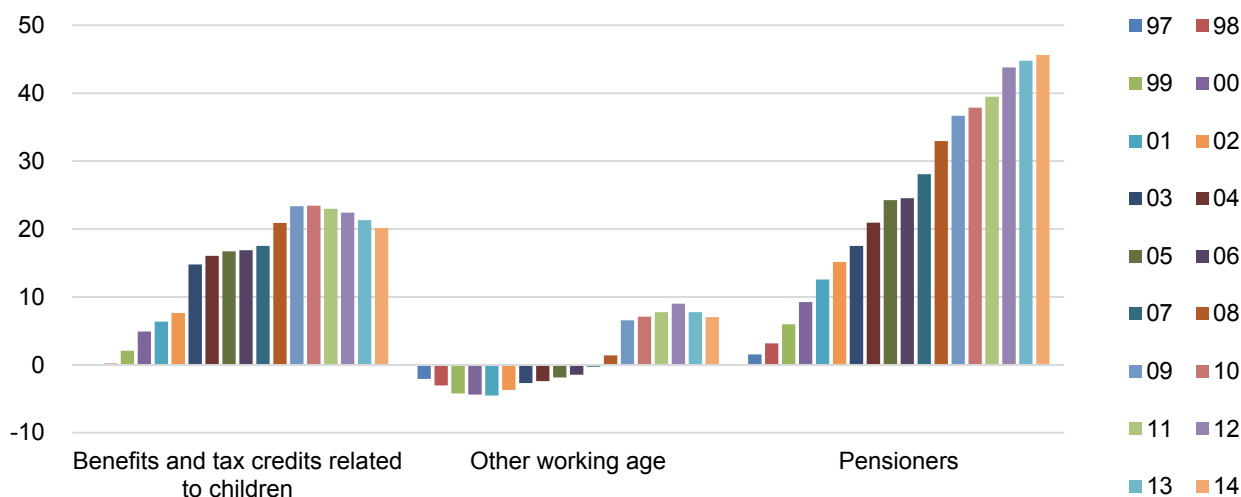
In summary, looked at in relation to national income, the Coalition continued Labour's pattern of increased spending on pensioners, but partly reversed Labour's increased spending on children. Working age benefits unrelated to having children fell under both governments, despite the effects of the economic crisis.

Figure 1(a): Social security and tax credits, 1996-97 to 2014-15 (selected years; £ billion, 2009-10 prices; Great Britain)



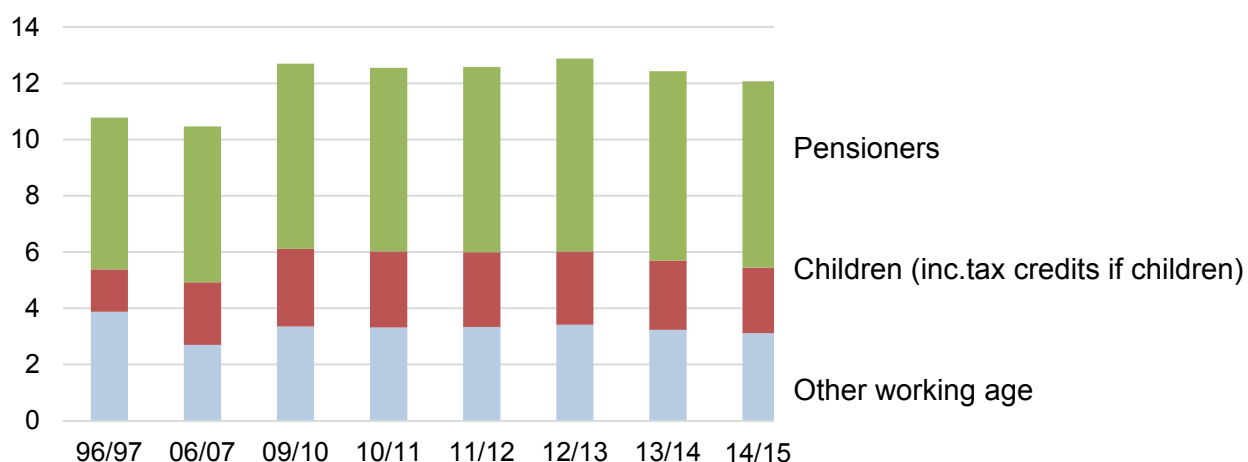
Source: Table A1.

Figure 1(b): Real change in spending on social security and tax credits since 1996-97 (Great Britain)



Source: Table A1. Figures show change from 1996-97 in financial years from 1997-98 onwards (£ billion, 2009-10 prices).

Figure 2: Social security benefits and tax credits as % GDP, 1996-97 to 2014-15 (selected years; Great Britain)



Source: Table A1.

A very detailed picture of spending on the different components of cash transfers over the last thirty years is given by the recent Office for Budget Responsibility *Welfare Trends Report* (also covering total social security and tax credit spending), looking not just at trends in spending on different items, but also at what has driven them. Table 3 summarises some of this picture for four selected years, 1996-97, 2006-07 (just before the crisis), 2009-10 and 2014-15. It divides the reasons for changes in spending on each category in relation to GDP into two components – the number of recipients as a proportion of the adult population, and the average payment received calculated by OBR as a percentage of GDP per adult.⁴⁶ The first two lines of the table show what have happened to pensioner benefits, and the other lines to non-pensioner benefits and tax credits.

Concentrating on the Coalition period, the overall fall in spending by nearly one per cent of GDP on OBR's definitions can be seen to be the product of:

- A rise in the value of state pensions per recipient (relative to GDP per adult), offset partly by a reduced extent and value of Pension Credit payments;
- Reduced extent and value of Incapacity Benefit (now becoming ESA), but offset by increased DLA/PIP payments per recipients (over this period);
- A significant fall in the proportion of adults receiving tax credits, but with the average payment for those remaining rising (as the small entitlements for those with higher incomes were cut out);
- Fewer children and Child Benefit becoming less generous;

⁴⁶ These categories are not exhaustive, but account for around 90 per cent of all spending in 2014-15. Classification changes connected to the introduction of tax credits after 1996-97, and overlaps in the way past benefits are allocated by OBR between current categories mean that the figures for 1996-97 may not be fully comparable with those for later years. Differences between the coverage of transfers by OBR and the use of later data mean that the total shown here, 12.5 per cent of GDP in 2014-15, is greater than the figure derived from DWP projections shown in Figure 2 (12.1 per cent), and the fall from 2009-10 to 2014-15 is 0.9 per cent of GDP, rather than the 0.4 per cent shown in Figure 2.

Table 3: Caseloads, average awards and costs as % of GDP, main benefits, 1996-97 to 2014-15

	Recipients as % adult population			Average award as % of GDP per adult			Cost as % of GDP					
	96-97	06-07	09-10	14-15	96-97	06-07	09-10	14-15	96-97	06-07	09-10	14-15
State pensions (GB)	23.2	24.2	25.1	25.2	17.1	16.2	18.5	19.9	4.0	3.9	4.7	5.0
Pension Credit (GB)	3.9	5.7	5.5	4.4	12.1	9.0	10.4	8.9	0.5	0.5	0.6	0.4
Incapacity Benefit (GB)	6.2	5.6	5.4	4.8	24.0	15.6	17.2	16.3	1.5	0.9	0.9	0.8
DLA/PIP (GB)	4.0	5.8	6.3	6.3	13.8	11.4	12.8	13.5	0.6	0.7	0.8	0.9
Tax Credits (UK)	5.0	12.3	12.6	8.8	11.8	12.3	15.8	19.5	0.6 ¹	1.5	2.0	1.7
Child Benefit (UK)	28.8	27.4	27.5	25.6	3.1	2.7	3.0	2.7	0.9	0.7	0.8	0.7
Income Support (GB)	12.1	4.4	3.9	1.5	14.7	14.6	15.0	10.8	1.8 ¹	0.6	0.6	0.2
Unemployment Benefit (GB)	4.4	1.9	3.1	2.2	14.4	9.3	10.5	9.7	0.6	0.2	0.3	0.2
Housing Benefit (GB)	20.5	16.1	17.8	18.8	6.9	6.7	7.8	7.6	1.4	1.1	1.4	1.4
All cash transfers (UK)	-	-	-	-	-	-	-	-	11.8	11.1	13.4	12.5

Sources: OBR (2014b), chart 1, and figures 5.1, 5.2, 6.1, 6.2, 7.2, 7.3, 7.5, 8.1 and 9.1

Note 1. Definitional differences from later years and overlaps in how past benefits are classified between current categories mean these items cannot be totalled. Note that what had been the Married Couples Allowance in income tax (the cost of which is not included here) was replaced by part of tax credits from 2001-02

- Further reduction in the extent and value of remaining Income Support payments (partly as it is converted into other benefits and tax credits);
- A reduced number of recipients of unemployment benefits (JSA) and a further fall in its relative value.
- A standstill in the total cost of Housing Benefit, as the increase in the numbers receiving it was offset by a fall in the value of awards.⁴⁷

The largest contributors to the overall fall were the reductions in tax credits and Income Support, with the largest increase coming from state pensions. The first of these contrasted with the Labour period, when both the extent and value of tax credits increased,⁴⁸ while the increase in pensions continued the pattern under Labour. Income Support has fallen as recipients have transferred to other benefits, and this has continued. For instance, the Labour government progressively reduced the age limit for a youngest child for lone parents to be eligible to claim Income Support rather than Jobseeker's Allowance (with the conditions for seeking work that requires). This had been 16 up until 2008, but had been reduced to 7 by October 2010, and was further reduced to 5 from November 2012. The Labour period as a whole also saw reductions in the extent and relative value of unemployment benefits and of incapacity benefits.

It is notable that 'contributory' benefits for working age people, which depend on people's past record of paying National Insurance Contributions, continued to decline under the Coalition, making up only 5 per cent of the total social security bill in 2014-15, compared to 7.3 per cent in 2009-10 and 10 per cent in 1996-97 (and 15 per cent in 1979-80).⁴⁹ Despite the frequent rhetoric from both sides of the political spectrum that benefits should reflect "something for something", in practice this principle affects working-age benefits less and less.

Comparative international figures are not yet available for 2014, but Table 4 shows how public spending on cash transfers compares between thirty OCED countries for which OECD has published data for both the calendar years of 2009 and 2013 (with a comparison for 1995, where available). The UK was in the lower half of spenders at all three dates amongst this group of countries. In 2009 it had been 19th out of the thirty countries for cash transfer spending as a share of GDP (and 20th for the 28 countries for which data are available for 1995). In 2013 it was 18th equal, with Estonia having dropped below it. As many of the countries had increased their spending by more than the UK (0.4 per cent of GDP) as had cut it or reduced it by less. Notably over this period, the divergence between countries increased, with the highest seven spenders in 2009 all increasing the GDP share of cash transfer spending by more than the UK, and four of the lowest six cutting their spending. Overall, the UK remains a relatively low spender compared with other industrialised countries, and that remained true under both the Labour and Coalition governments.

⁴⁷ This came despite eligible social sector rents rising considerably faster than GDP per adult over the period, while eligible private rents (affected by tightened rent caps) grew more slowly (OBR, 2014b, chart 3.16).

⁴⁸ A part of this was accounted for by classification changes, but also by the elimination of the Married Couple's Allowance in income tax (not allowed for in these figures), which was replaced by part of Child Tax Credit (which included a 'family element' going to all parents, unless they had very high incomes; this is now withdrawn at a lower threshold).

⁴⁹ Figures based on DWP (2014), table 2A. Percentages in earlier years reflect the definitions of social security at the time, rather than being reclassified on current lines.

Table 4: Public spending in cash transfers as % of GDP in OECD countries

	1995	2009	2013	Change 2009 to 2013
Austria	19.1	19.2	19.7	0.5
France	17.1	18.9	19.5	0.6
Italy	14.1	18.9	19.3	0.4
Belgium	17.3	18.1	19.2	1.1
Finland	20.2	17.0	18.4	1.4
Portugal	11.0	16.9	18.3	1.4
Spain	14.9	16.0	17.6	1.6
Hungary	..	15.7	15.5	-0.2
Germany	15.4	15.7	14.7	-1.0
Greece	11.6	15.7	15.5	-0.2
Poland	17.5	15.2	14.5	-0.7
Slovenia	0.0	14.5	15.5	1.0
Luxembourg	14.6	14.4	14.7	0.3
Denmark	16.4	14.0	14.6	0.6
Ireland	10.8	13.8	14.2	0.4
Estonia	..	13.7	11.9	-1.8
Sweden	16.6	13.7	13.5	-0.2
Czech Republic	10.4	12.7	13.1	0.4
United Kingdom	10.7	11.8	12.2	0.4
Norway	12.9	11.6	12.2	0.6
Netherlands	15.0	11.4	11.9	0.5
Slovak Republic	11.8	11.3	11.8	0.5
New Zealand	11.6	10.6	9.8	-0.8
Canada	11.0	10.0	9.1	-0.9
United States	8.3	9.6	9.7	0.1
Israel	9.4	9.4	9.3	-0.1
Australia	9.0	8.0	8.6	0.6
Iceland	6.3	7.7	7.3	-0.4

Source: OECD Social Expenditure Database, cash benefits as % of GDP, extracted 12 August 2014. Cash benefits in the UK include tax credits.

6. Outcomes: poverty and inequality by 2012-13

Because of lags in data availability, we currently only have statistics for the combined results of the recession and policy developments up to the period half way through the Coalition's term of government, the financial year 2012-13. It should be noted that this preceded many of the specific benefit and tax credit cuts and changes listed in Section 4, several of which started to take effect from April 2013, and before the three years when many working age benefits were increased by only 1 per cent, below the rate of inflation. In the following section we therefore look at the distributional effects of policy as announced up to 2014-15 (and beyond) using modelling results.

Over the period to 2012-13, the dominant feature affecting the bottom of the income distribution by comparison with the middle (median) was that many pensions, benefits and tax credit rates were still increased in line with inflation (as measured by the RPI), at a time when real wages had fallen in the wake of the crisis, and with them net household incomes. Table 4 gives one indication of the effects of this. It presents Income Support levels for nine different family types as a percentage of the official poverty line (as given by 60 per cent of median incomes after housing costs) in 1997-98 and from 2008-09 to 2012-13.

The notable feature over the Labour period had been the sharp differences in treatment between family types. The minimum income for pensioner couples (today given through Pension Credit) had risen from 83 per cent of the poverty line to 96 per cent by 2010-11, and from 93 to 110 per cent for single pensioners. There were increases too for working age couples with children and single parents, although to levels still short of the official poverty line. But for single people and couples without children, Income Support fell further below this poverty line, to less than half of it for single people aged under 25.

Over the first two years of the Coalition, Income Support rates grew in relation to the poverty line for all of the family groups shown, reflecting the fall in real median net incomes, while these benefit levels were generally price inflation protected. For pensioner couples, minimum incomes had reached the poverty line, and for single pensioners they had reached 113 per cent of it.

The table also compares benefit rates for some of these family types with the income levels given by the Joseph Rowntree Foundation's 'Minimum Income Standards' (MIS) approach. This uses structured consultations with members of the public on what items constitute and their costs to calculate minimum incomes for different kinds of family.⁵⁰ In 2010, apart from pensioners, MIS levels were higher than the official poverty line, so benefits were a smaller percentage of each standard. While there had been little change between 2008 and 2010 in the relationship between benefits and the MIS, for the family types for which figures are available, by 2014 benefits had fallen further behind them. This in part reflects the way in which the MIS allows for changes in the specific prices of items chosen as necessities, and so have been affected by things like the faster increase in fuel prices than other prices. On this basis, by 2014, the minimum incomes set by the state (if not affected by things like shortfalls between Housing Benefit and actual rents) had fallen further behind those set by the public.

⁵⁰ Davis, Hirsch and Padley (2014).

Table 5: Income Support levels in relation to poverty thresholds 1997-98 to 2012-13 and Minimum Income Standard 2008 to 2014, by family type

	% of poverty line ¹ :				% of MIS ² :		
	1997-98	2008-09	2010-11	2012-13	2008	2010	2014
Single, 18-24, no children	52	40	42	43	-	-	-
Single 25+, no children	65	51	52	55	42	41	39
Couple working age, no children	60	46	48	50	42	40	-
Couple, 1 child aged 3	67	66	69	72	62	61	-
Couple, 2 children aged 4,6	67	75	78	83	62	62	57
Couple, 3 children aged 3,8, 11	71	82	85	90	61	62	-
Single parent, 1 child aged 3	81	81	84	88	67	65	57
Pensioner couple (aged 60-74)	83	94	96	100	106	102	95
Single pensioner (aged 60-74)	93	108	110	113	109	103	-

Source: Sefton, Hills and Sutherland (2009), table 2.4, extended and updated.

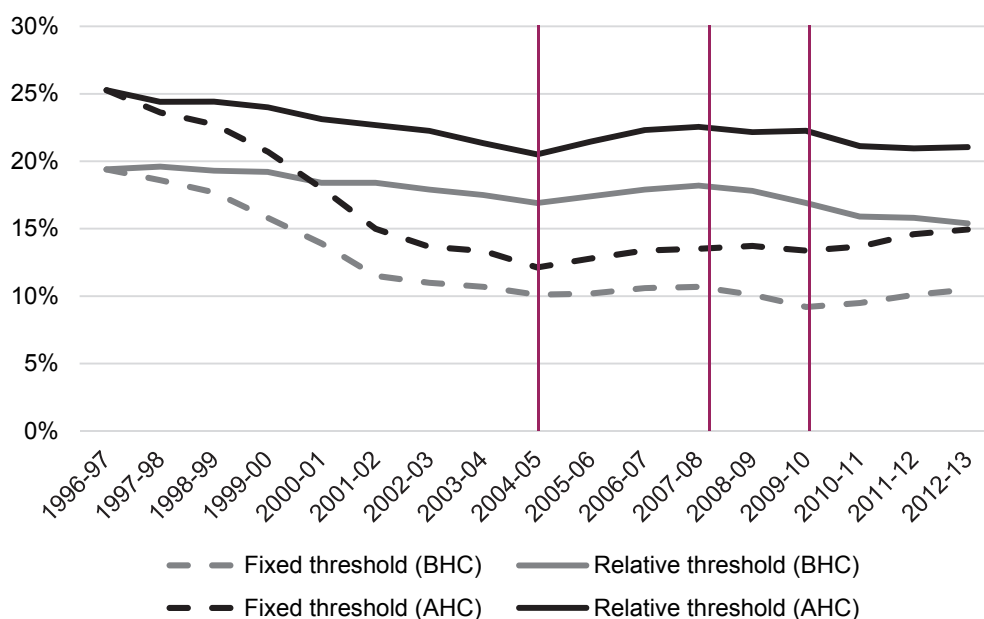
Notes: 1. The poverty threshold used is 60% of median equivalised household incomes (After Housing Costs) in that year from DWP (2014) and earlier equivalents.

2. 2008 MIS figures are from Table 8 of Bradshaw et al (2008) and show Income Support/ Pension Credit levels in April 2008 as a percentage of the Minimum Income Standard (MIS) for each family type (excluding rent, council tax and childcare costs). See Bradshaw et al (2008) for further details. 2010 MIS figures from http://minimumincomestandard.org/budget_summaries_2008_2012.htm. 2014 MIS figures from Davis, Hirsch and Padley (2014), table 2.

These movements in benefits (and in incomes in low-paid work) compared to the relative poverty line are part of the reason for the overall trends shown in Figure 3, drawn from the DWP's *Households Below Average Income* (HBAI) statistics. Measured before allowing for housing costs these show *relative poverty* falling between 2009-10 and 2012-13, but poverty against a *fixed* real line (based on median incomes in 1996-97) rising.⁵¹ Measured after housing costs, relative poverty also fell between 2009-10 and 2010-11, but was then flat until 2012-13, in contrast to the picture before housing costs, while poverty against a fixed line has risen more sharply than before housing costs.

⁵¹ The percentage below a higher fixed line based on 2010-11 median incomes (BHC) also rose over those three years (from 15 to 17 per cent) (Carr, et al., 2014, chart 2 and table 3a).

Figure 3: Proportion of population with income below 60 per cent of 1996-97 median income in real terms and below 60 per cent of contemporary median income, 1996-97 to 2012-13



Source: DWP/IFS Households Below Average Income analysis (from IFS *Poverty and Inequality* spreadsheet, 2014); figures for UK.

For some commentators, the difference between trends against fixed and relative thresholds implies that indicators of this kind are inherently flawed, showing as they do that relative poverty was falling even though the real incomes of many of those at the bottom were falling, albeit not as fast as those of others. It is indeed cold comfort to people with low incomes that things are deteriorating less rapidly in percentage terms than they are for those with higher incomes. But it is precisely because the data are available on both criteria that we can judge ‘success’ or ‘failure’ in a more sophisticated way than would be possible from a single indicator, which would have shortcomings in particular situations, whichever one is chosen. In earlier discussion of different approaches to measuring trends in numbers in poverty, the author suggested that:⁵²

- If we are not making progress against a line fixed in real terms (such as the US poverty line), we are doing badly;
- If we are making progress against an Irish-style poverty measure (combining relative low income and material deprivation), we are doing fine; and
- If we are making progress against absolute, Irish-style and European-style relative measures, we are doing well.

The DWP does not calculate a measure for the whole population that combines relative low income and material deprivation (but see below for children). But from Figure 3, four contrasting periods can be seen (when measuring incomes before housing costs). From 1996-97 to 2004-05, poverty was falling both in relative terms and against a fixed real line. The same was true from 2007-08 to 2009-10. Both periods could be seen as successful in reducing the extent of poverty. But from 2004-05 to 2007-08 and again from 2009-10 to 2012-13, poverty rose against the fixed line, suggesting that policy was

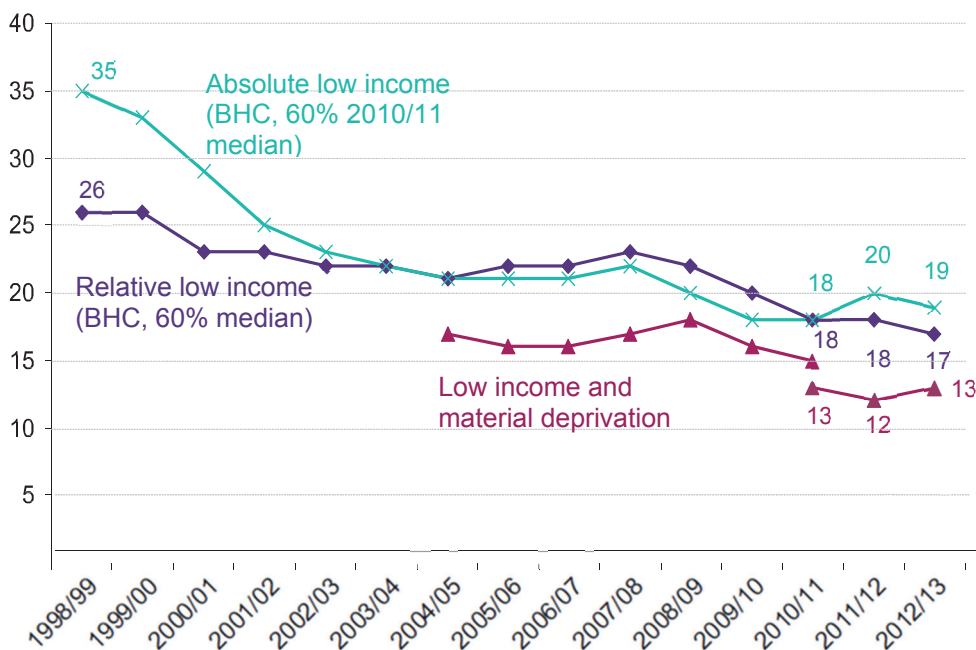
⁵² Hills (2004), p.47.

failing, with people on low incomes becoming poorer, whatever was happening to the (contrasting) movements in relative poverty.

When measured after housing costs, the period from 1996-97 to 2004-05 was also one when poverty fell against both relative and fixed real lines. But since 2004-05 after housing costs poverty has risen in most years against the fixed line, while in relative terms it first rose and then fell until 2010-11. Only the period up to 2004-05 could be counted as success in both terms, therefore.

For children specifically, the HBAI statistics, used to monitor progress against the targets embodied in the last government’s Child Poverty Act, allow progress to be tested against all three of the US, Irish and European-style measures, at least since 2004-05. The picture shown in Figure 4, reproduced from the DWP analysis (for incomes *before* allowing for housing costs), suggests that there have been two periods of clear progress against child poverty, from the start of this series in 1998-99 to 2004-05, and again between 2008-09 and 2009-10. The two years between 2004-05 and 2006-07 could be seen as partly successful, with falling numbers against the combined relative low income and material deprivation measure. By contrast, there have been two periods of failure, with child poverty rising against an absolute line, between 2006-07 and 2007-08 and again between 2010-11 and 2011-12. The changes between 2011-12 and 2012-13 for children are more ambiguous, with numbers falling against both relative and fixed real lines, but rising against the combined measure incorporating material deprivation.

Figure 4: Children with incomes below relative and fixed real poverty lines, and with both low relative income and material deprivation, 1998-99 to 2012-13



Source: Carr, et al. (2014), chart 3.

It would be helpful to be able to compare trends of this kind in the UK with those in other countries. But the lags in comparable data are longer, and so cover little of the Coalition’s period in office. A recent UNICEF ‘report card’ on child poverty looks at changes in child poverty against fixed (‘anchored’) real poverty lines in 41 countries over the recession. But in the main data source used, the

figure used for 2012 relate to income over the preceding year in most countries, that is, in 2011.⁵³ Over that period, child poverty against a fixed line fell in 18 of the countries, but rose in 23 of them, including by 1.6 percentage points in the UK, but by more than 10 percentage points in 5 (including by 20 points in Iceland).⁵⁴ The increase between 2008 and 2012 in 'severe material deprivation' reported for children in the UK was from 5 to 12 per cent, the seventh largest out of 33 countries compared, and taking the UK to the tenth highest level amongst them.⁵⁵ It will be some time, however, before we will be able to compare trends between countries over the whole period since 2010.

Poverty rates for different groups

The discussion above suggests that both before and since the 2010 election, particular age groups have been affected differently by policy towards cash transfers, as well as by wider economic changes. One result of this can be seen in Figure 5, which shows in the top panel relative poverty rates for children, pensioners, and working age people without children against a fixed real line (based on 1996-97 median incomes). The bottom panel shows changes against a relative line. In both cases there has been a remarkable convergence. In 1996-97 the child poverty rate was 27 per cent (before housing costs), but that for working age people without children was 12 per cent. By 2009-10, the relative child poverty rate was down to 20 per cent, but that for working age people without children had risen to nearly 15 per cent. In the latest figures this gap is even smaller, between 14 per cent for working age people without children and 17 per cent for children. Compared to the fixed real line, the gap in poverty rates had almost been eliminated by 2009-10. All three experienced a similar rise in poverty against the fixed line from 2009-10 to 2012-13, so this convergence was maintained.

After allowing for housing costs, the fall in relative poverty for children since 1996-97 has been somewhat smaller, and from a higher base, so it remains above the national average. By contrast, the fall for pensioners has been faster than before allowing for housing costs, so that by 2012-13 after housing costs poverty for pensioners was 13 per cent, now well below the figure for the whole population of 21 per cent.⁵⁶ Looking forward, policies since 2012-13 and planned for the years after 2014-15 suggest that pensioners may continue to be better protected against poverty than others, as discussed in the next two sections.

⁵³ Although for the UK, '2012' incomes are those measured in 2012. Deprivation indicators are for 2012 in all cases.

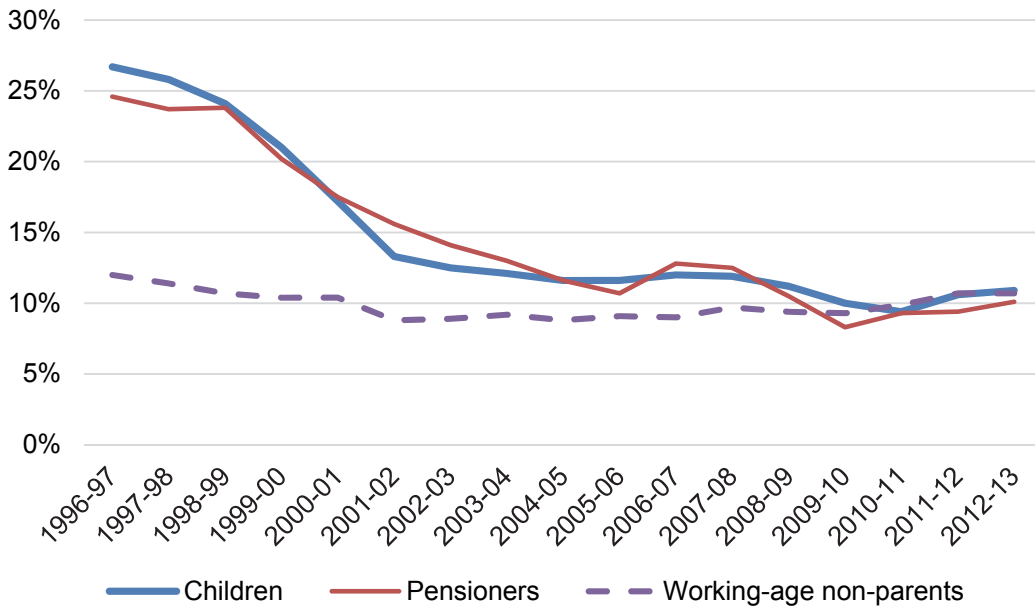
⁵⁴ UNICEF Office of Research (2014), league table 1.

⁵⁵ UNICEF Office of Research (2014), figure 5. Severe material deprivation indicates that children are living in households that lack four or more of nine key indicators of living standards (such as being able to keep the home adequately warm, or owning a car, television or washing machine).

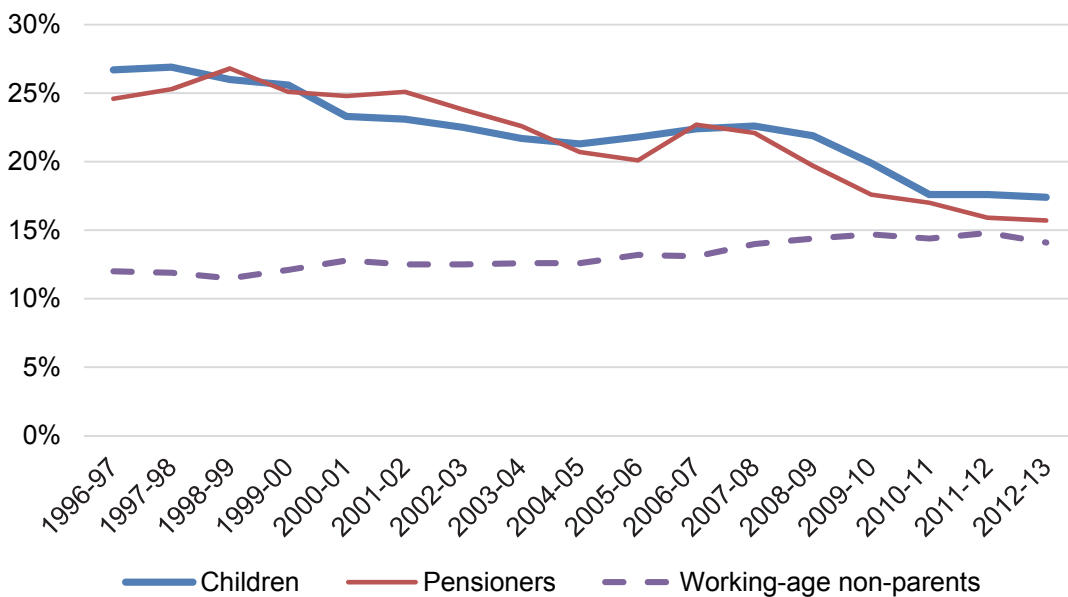
⁵⁶ Belfield, et al. (2014), figure 4.6b and Carr, et al. (2014), table 6a.

Figure 5: Proportion of population with incomes below 60% of 1996-97 median income in real terms and below 60% of contemporary income (BHC) by population group

(a) Percentage below fixed threshold



(b) Percentage below relative threshold

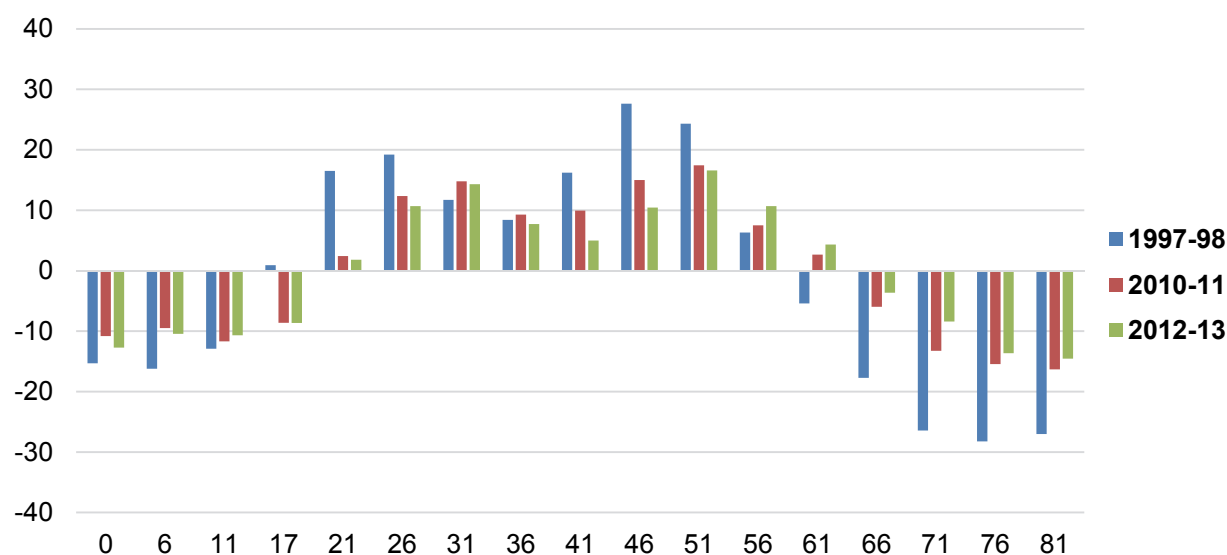


Source: DWP/IFS Households Below Average Income analysis (from IFS *Poverty and Inequality* spreadsheet, 2014); GB figures until 2001-02, UK from 2002-03.

Income differences by age

One of the notable effects of the Labour government's policies between 1997 and 2010 is that the concentration on transfers for children and pensioners helped considerably to reduce variations not just in poverty rates, but also in median incomes over the life cycle.⁵⁷ Figure 6 shows the extent to which this occurred, and whether the process had continued by 2012-13.⁵⁸ It shows for each age group the percentage difference between the median equivalent income for that age group and the overall median in the three years 1997-98, 2010-11 and 2012-13.

Figure 6: Difference in median net income (before housing costs) for each age group from overall median, 1997-98, 2010-11 and 2012-13



Source: Derived from DWP analysis of Family Resources Survey (GB 1997-98; UK 2010-11 and 2012-13). Incomes are adjusted for household size and are before housing costs.

Variations in incomes over the life cycle, even for those with middle incomes, was much more pronounced in 1997 than in 2010. Children aged 0-10 had incomes (based on the households they lived in) more than 15 per cent below the overall median, and older people in the age groups above 70 had incomes more than 25 per cent below it. Those aged 46-50 by contrast had median income more than 25 per cent above the overall median. As the second columns in the figure show, these differences had narrowed (by about a third overall) by 2010-11.

The picture in 2012-13 shows that for most age groups the differences from the overall median had narrowed further, especially for those in their 40s and 60s. However, differences had now *widened* for children aged under 10 and people aged 56-65. Although these two years are early in the Coalition's period in office, these trends are consistent with the overall balance of policy described above, with Labour's policies favouring pensioners being continued, but those favouring children being reversed (for instance, as tax credits for middle-income families with children were reduced). The net overall effect is very striking for those early in retirement. Back in 1997-98 median incomes for those aged 66-70 were

⁵⁷ Hills (2013), table 11 and figures 14 and 15.

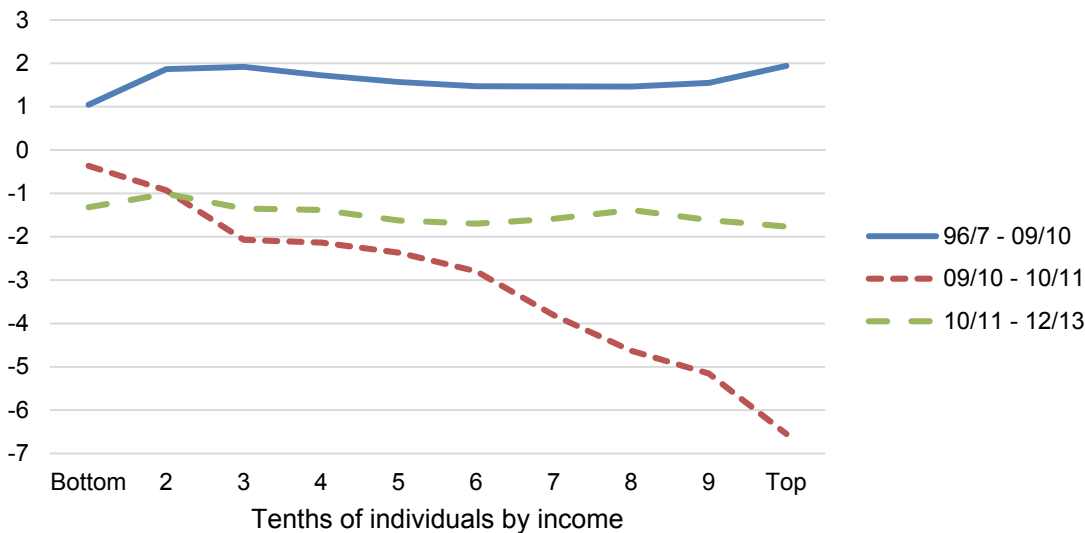
⁵⁸ This is taken from DWP analysis of the HBAI dataset showing the distribution of net equivalent incomes by age and other characteristics. A more detailed analysis of how income inequalities changed between and within different age groups between 1997-98 and 2012-13 will be published as a paper in the Social Policy in a Cold Climate programme later in 2015.

18 per cent below the overall median; by 2012-13 they only fell short by 4 per cent. For those aged 71-75 the shortfall fell from 26 to 8 per cent. But the position of children has stopped improving and the shortfall for children aged 0-5 is now almost as great as for those aged over 76. After housing costs the difference in the fortunes of children and older people is even more pronounced. Those aged 66-70 had median incomes above those for the whole population by 2012-13, and those aged 71-75 median incomes matching the national figure. By contrast, the poorest age groups after housing costs are now all of the age groups of children together with those aged 17-20.

Overall income inequality

The DWP and Institute for Fiscal Studies (IFS) analysis of the HBAI dataset can also be used to examine overall trends in income inequality in the three years up to 2012-13, and how they compared with those under the preceding government. A first comparison is in Figure 7. This shows (at an annual rate), changes in the real incomes of those at the mid-point of each tenth of the income distribution,⁵⁹ first between 1996-97 and 2009-10, between then and 2010-11 (straddling the change of government), and then between 2010-11 and 2012-13. Over the Labour period to 2009-10, incomes grew at an annual rate of between 1 and 2 per cent in all the income groups. Between the second tenth and the ninth tenth, this was faster for those nearer the bottom of the distribution than those nearer the top. But it was lowest for the bottom tenth (at the fifth percentile) and as high for the top tenth (95th percentile) as for any of the other groups. As shown below, this means that inequality trends which compare those near the top and bottom of the distribution (such as the ‘90:10 ratio’) differ from those affected by the very top and bottom (such as the Gini coefficient).

Figure 7: Annualised rate of change in income by decile group, % (BHC)



Note: Derived from IFS poverty and inequality spreadsheet (using figures for Great Britain). Lines show change at mid-point of each decile group (ie 5th percentile, etc). Incomes are equalised and are before housing costs.

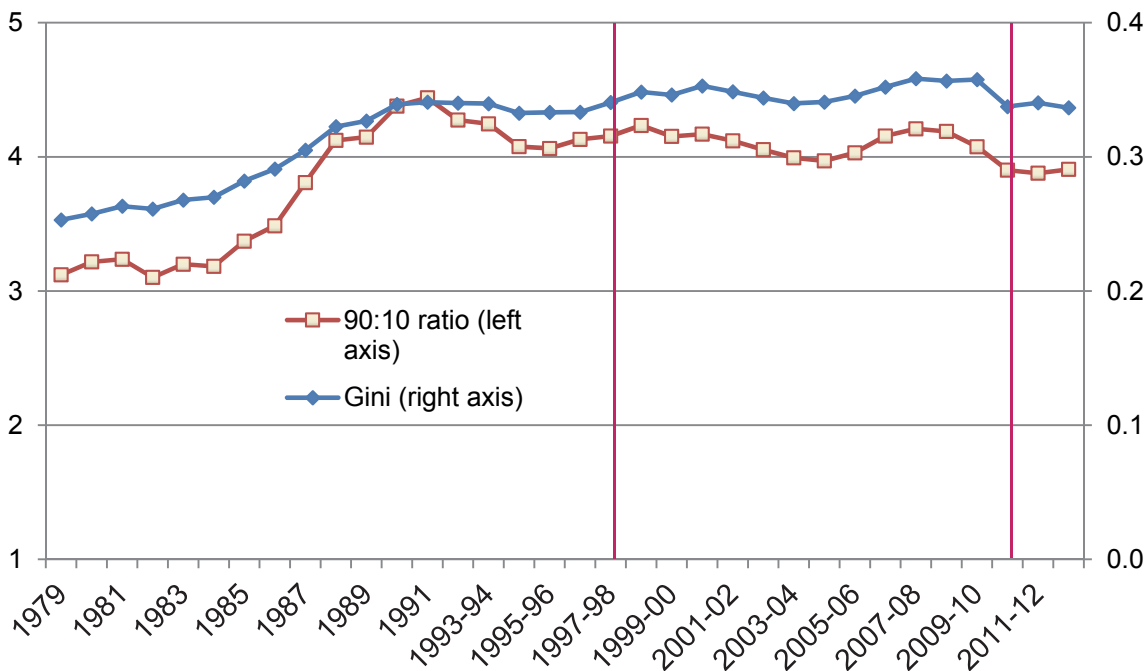
In the year from 2009-10 to 2010-11, incomes fell throughout the distribution, but by much more the top, where they fell by more than 6 per cent in a single year, than at the bottom (where the price-protection of many benefits, up to 2011 at least, had the greatest protective effect). In the two years

⁵⁹ That is at the 5th, 15th, 25th percentiles, etc.

from then until 2012-13, real incomes fell by between 1 and 2 per cent at an annual rate for all groups, with the slowest fall for the second poorest group, and the largest for those in the middle and the top.⁶⁰

These results show, amongst other things, the sensitivity of any conclusion on inequality trends to which year is seen as the final ‘Labour year’ and so the base for the Coalition’s period, that is whether it is taken as 2009-10 (Labour’s last full year in government) or 2010-11 (with the rules of taxes and benefits almost entirely set by Labour and taking effect from April 2010, before the election). This can also be seen in Figure 8, showing inequality trends back to 1979 (based on analysis by the Institute for Fiscal Studies). Inequality, whether measured by the Gini coefficient or the 90:10 ratio, fell sharply between 2009-10 and 2010-11 (as higher incomes fell fastest), and was then relatively flat over the following two years. So, as would be expected from Figure 7, if 2009-10 is taken as the base year, inequality fell at the start of the Coalition government but if 2010-11 is taken as the base year, it was flat. Either way, income inequality in 2012-13 was as low as it had been since before Labour came to office – the difference in interpretation would be over whether this is seen as part of the Coalition’s inheritance from Labour, or whether the Coalition is given the ‘credit’ in terms of falling inequality as it came into office.⁶¹

Figure 8: Income inequality, 1979 to 2012-13 (before housing costs, GB)



Source: IFS Inequality and Poverty spreadsheet, 2014.

⁶⁰ The picture after allowing for housing costs is similar, but with somewhat larger gains in income between 1996-97 and 2009-10, and bigger losses between 2010-11 and 2012-13. In the year from 2009-10 to 2010-11, the losses for most income groups were similar to those before housing costs, but the bottom group recorded a small gain rather than a small loss.

⁶¹ If income is measured after housing costs, the overall pattern is similar, with the Gini coefficient peaking between 2007-08 and 2009-10, but then dropping sharply in 2010-11, to a level again matching that when Labour came into office, and then remaining flat for the next two years.

7. Modelled effects of Coalition policy changes to 2014-15⁶²

Given the lags in availability of data and statistics, to understand the position reached further on in the life of the government, it is helpful to look at analysis that models the effects of the changes that have been made to tax and transfer policy on representative samples of the population. Such analysis also allows a focus on the effects of these *policy* changes, abstracted from other changes in the economic environment. The discussion below looks at results from three modelling tax-benefit exercises: using the EUROMOD model based at Essex University, carried out for the Social Policy in a Cold Climate programme; by the Institute for Fiscal Studies; and by the Treasury. In all three cases, the results do not allow for any behavioural change induced by the policies, for instance if working patterns are changed as benefits become more or less generous, or if those with the very highest incomes arrange their affairs to move their reported incomes between tax years in response to pre-announced changes in the highest income tax rates.

As is discussed in the parallel paper presenting the EUROMOD results⁶³, where they are discussed in more detail, there are choices over several key assumptions that have to be made in such analysis. Figure 9 reproduces our central results based on the following:

- Comparing the *direct* tax (income tax and NIC), tax credit and benefit systems as were in place at the time of the election in *May* 2010 with those applying in 2014-15. They do not include changes in indirect taxes, such as the increase in VAT.
- Comparing the actual 2014-15 system with a base system adjusted in line with price (CPI) inflation (the upper panel of Figure 12) or by changes in average earnings (the lower panel). By contrast with what normally happens in times of growth, the second of these, with an earnings-adjusted base, shows the 2014-15 system as more generous: the comparison is with a system where real benefit levels would have been *cut* in line with average earnings, for instance.
- Allowing for the way in which not all of those who are entitled to benefits and tax credits actually claim them.
- However, the analysis does not allow for the way in which those with the very highest incomes are under-represented in the survey used (as, for instance, is done by the IFS).

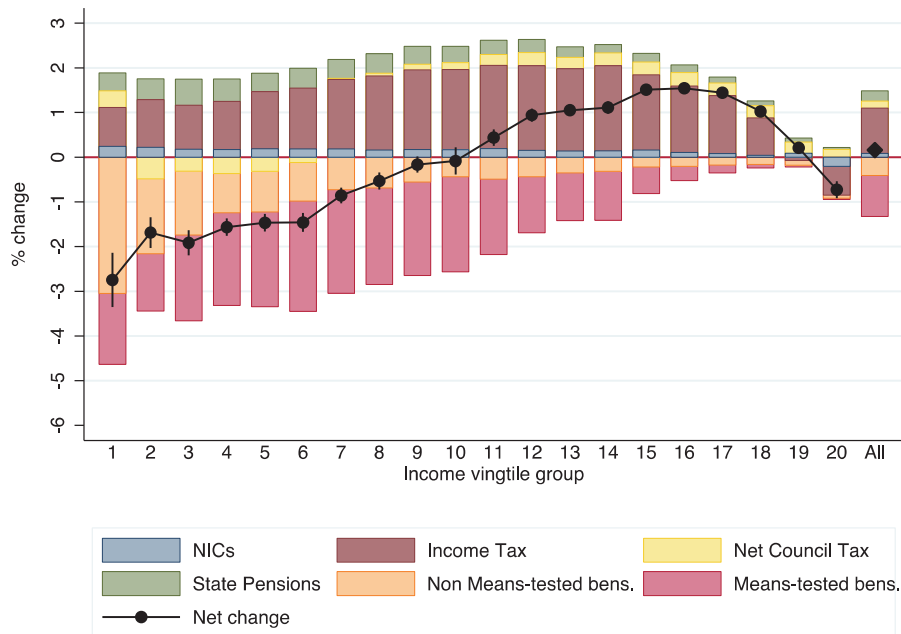
The results show average gains or losses from six broad parts of the direct tax and benefit systems, and (as the solid line) the net effect of all of them together, combining the various negative and positive effects. Negative effects (downward pointing parts of the bars) are due to increases in tax and contribution liabilities, or to reductions in benefit and pension entitlements (for those receiving them), and positive effects to tax and contribution cuts or benefit increases. This is shown for each twentieth ('vingtile') of individuals. The population is divided this finely because of the importance of the differences in results between groups right at the top and the bottom of the distribution. Confidence intervals around the net effects are shown on the figures, indicating that the broad shape of the effect is reliable.

⁶² This section and the next are based on more detailed analysis presented in De Agostini, Hills and Sutherland (2014).

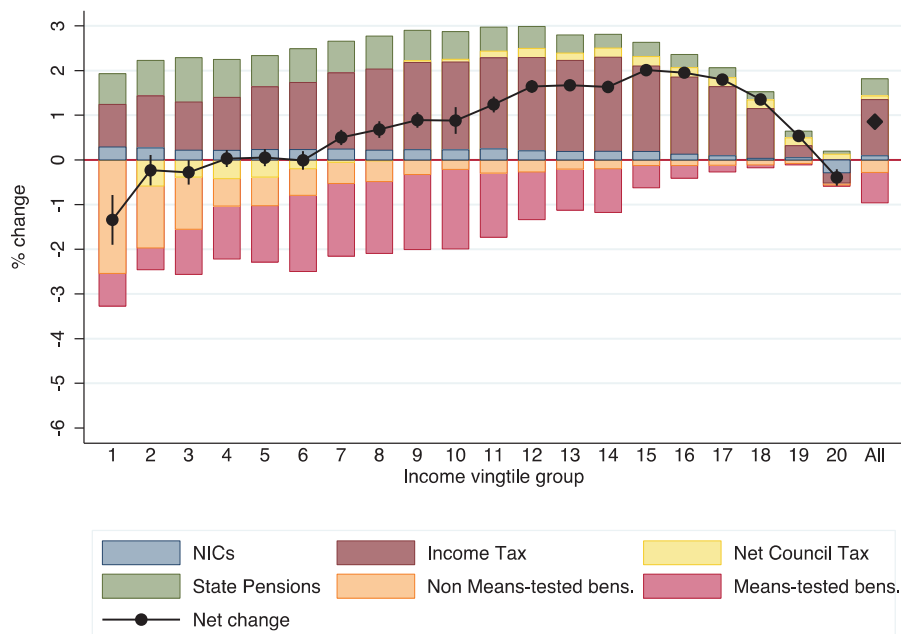
⁶³ De Agostini, Hills and Sutherland (2014).

Figure 9: Percentage change in household disposable income by income vingtile group due to policy changes 2010 to 2014-15

(a) Compared with May 2010 policies uprated to 2014/15 using CPI



(b) Compared with May 2010 policies uprated to 2014/15 using average earnings



Notes: 2010 policies are as in May. Observations are ranked into vingtile groups using household disposable income in 2010 equivalised using the modified OECD equivalence scale. The net change is shown with a 95% confidence interval, calculated using bootstrap.

Source: De Agostini, Hills and Sutherland (2014) based on analysis using EUROMOD G1.5.

Looking first at the results compared to price-indexation in the top panel, a first observation is that *overall* the changes were neutral. Means-tested benefits and tax credits were cut, compared to a price-indexed system, but people paid less net Council Tax (as cuts of what was Council Tax Benefit were more than offset by Council Tax itself falling in value in real terms), and some gained from reduced Income Tax liabilities (with the increased personal allowance) and from state pensions rising faster than CPI-inflation. Remarkably, given that this was a time of austerity, the net effect of the reforms emerges as neutral to the public finances. As discussed above, the savings from benefits and tax credits becoming less generous in real terms were offset by the high cost of the increase in the income tax personal allowance.

However, this fiscally neutral combination had a substantial distributional effect. Overall, the poorest twentieth lost nearly 3 per cent of their incomes (before allowing for indirect taxes) and the next five-twentieths approaching 2 per cent. But, with the exception of the top twentieth, the income groups in the top half of the distribution were net gainers on average. From the bottom to four-fifths of the way up, the changes were clearly regressive, hitting those lower down hardest as a share of their incomes. This is because benefit reductions were greater for the bottom half than their gains from lower Income Tax. But rising through the top fifth of the distribution the gains from higher income tax allowances were increasingly offset by other changes, so that those in the penultimate twentieth broke even, and the top twentieth made a small loss on average – although it should be added that within this, those in the top one per cent represented in this survey emerge as narrow *gainers* as a result in the cut of the top marginal rate from 50 to 45 per cent, comparing the 2014/15 system with that in place in May 2010.⁶⁴ On this basis, the reforms had the effect of making an income transfer from the poorer half of households (and some of the richest) to most of the richer half, with no net effect on the public finances.

Looking at the population divided in other ways, some groups were clear losers on average – including lone parent families, large families, children, and middle-aged people (at the age when many are parents).⁶⁵ Others were gainers, including two-earner couples, and those in their 50s and early 60s. Londoners were, on average, less favourably affected than people in other regions (as a result of more of them having very high and having very low incomes, and also because changes and limits on Housing Benefit and other benefits had more effects in the capital).

The bottom panel shows the results if the comparison is made with the May 2010 system uprated in line with the growth of average earnings. This would be consistent with preserving a system that had the same *relative* generosity as at the start, and would thus be neutral towards inequality. Against this comparator, households as a whole *gained*, by an average of 0.9 per cent of disposable income. In other ways, the pattern is similar to that in the top panel, but with greater differences for those in the bottom half. On this basis the changes are also shown as regressive until the very top, with larger net gains for the top half of the distribution.

Figure 9 shows that using either comparator, reductions in the value of both means-tested and non means-tested benefits were the main net contributing factor to income losses. The regressive overall effect was largely the result of households nearer the bottom losing the most from reduced means-tested and non-means-tested benefits, while those in the top half gained most from lower income

⁶⁴ See De Agositini, Hills and Sutherland (2014), figure A4.2, bearing in mind that confidence intervals are very wide for percentile intervals.

⁶⁵ De Agositini, Hills and Sutherland (2014), section 5.

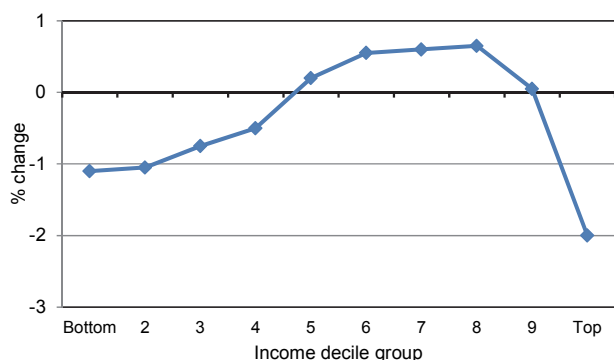
tax, with the exception of those in the very top twentieth, who were paying more in income tax and National Insurance Contributions than they would have done.

Figure 10 shows the results of similar modelling exercises (for comparability using those presenting changes up to 2014/15) by HM Treasury and the Institute for Fiscal Studies. These differ in various ways from the comparison given in Figure 9:

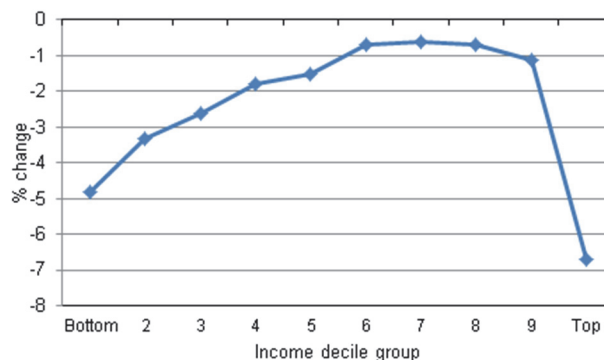
- Both compare the 2014-15 system with a 2010 base uprated for *price* inflation, as in Figure 9 (a).
- They both allow for *indirect* tax changes, such as in VAT, as well as in direct taxes. This increases the scale of losses across the income distribution, but particularly (as a share of income) for those with lower incomes.
- The IFS results use as the base system that in place in *January* 2010, that is before the changes to income tax affecting those with the highest incomes applying from April 2010, which Labour had announced in March 2009. This has a large effect at the top of the income distribution, as the figures for the top income group in these analyses include *losses* comparing the 45 pence top rate in 2014-15, with the 40 pence top rate in January 2010. By contrast, the figures in Figure 9 allow for the *gains* (in both cases for a very small group right at the top) from the 45 pence rate being lower than the 50 pence top rate in place from April 2010.
- The Treasury analysis starts from changes made since the June 2010 Budget but includes no effects from changes in the highest rate of tax (either way). It takes into account a range of other tax changes including restrictions to tax reliefs for pensions (although the full range of what is included is not itemised in the related documentation).
- The Treasury analysis also allows for partial benefit take-up in some way, but the IFS analysis assumes full take-up of entitlements (which increases losses calculated for the bottom income groups).
- The Treasury analysis is based on the position of *households* (regardless of their size), while our and the IFS analysis shows the position counting *individuals* separately (based on household income).

Figure 10: Percentage change in household disposable income due to policy changes, 2010 to 2014/15; estimates from other analyses

(a) HM Treasury: Autumn Statement (2013)



(b) IFS analysis: post Budget 2014



Sources: HM Treasury (2013), chart 2D; Phillips (2014).

The differences between the results are discussed in De Agostini, Hills and Sutherland (2014, section 6). All three analyses agree that the changes were regressive between the bottom tenth of the distribution and the seventh or eighth tenths. The scale of the losses at the bottom are greatest in the IFS analysis (including all indirect tax changes and assuming full benefit take-up) and least in the Treasury analysis.⁶⁶ The big difference is whether the top tenth has lost a greater share of income than the bottom tenth. One important issue illustrated by Figure 9 is that the experience of the 'next to top' twentieth has been more favourable than that of the very top twentieth, which is masked by looking at the top tenth together (and because those right at the top account for such a large share of the income of even the top tenth, this has a large effect on the average for them). In the IFS analysis, with the highest incomes adjusted to align with data for top incomes from tax records more accurately, this effect is larger.

But a major issue is over whether the income tax changes announced in *Labour's* March 2009 Budget, which took effect from the start of April 2010, are counted as part of the system inherited in May 2010 or not. Our analysis takes the system actually in place at the time of the election as being the most appropriate base. If the 2014-15 system was compared with the system in place in *January* 2010, as in the IFS analysis, then our analysis would also suggest that the top twentieth lost as much from direct tax and benefit changes as the bottom twentieth.⁶⁷ The result depends, therefore, on whether the Coalition is given 'credit' for deciding not to reverse Labour's changes that were already in effect when they took office. If it is, the overall regressivity of the reforms is reversed right at the top. However, there are many other features of the inherited system (not least its very existence) which were not changed either, so the kind of comparison in Figure 9 appears the more natural one to make. On that basis, while the top twentieth lost slightly, their proportionate loss remained smaller than for all of the income groups in the bottom half of the population.

Other indicators of material deprivation and hardship

Such modelling results give some indication of changes that will have occurred by 2014-15 so far as income changes are concerned, but they will not capture the whole picture. This is for several reasons. First, they do not capture the effects of differential inflation for different groups. In this period prices have risen faster for those with low incomes than for others - between the second quarters of 2010 and 2014, the all-items CPI rose by 11 per cent, but food by 18 per cent and fuel by 34 per cent, for instance. Looking at household spending patterns by income, Adams and Levell (2014, figure 9) suggest that between 2007-08 and 2013-14 annual inflation was just under 4 per cent for the poorest households, compared to 3.4 per cent at the median, and less than 3 per cent for the richest households. Analysis by the Office for National Statistics (2014, table 5.1) also shows that in the two years up to 2013, prices rose by 6.9 per cent for the poorest tenth of households, compared to a rise of 5.5 per cent in the CPI. Davis, Hirsch and Padley (2014) suggest that the specific items in baskets of goods needed to achieve a 'minimum income standard' rose by 27-28 per cent between 2008 and 2014, compared to an increase of 19 per cent in the CPI. All of this suggests that living standards for those on low incomes will have fallen faster than would be suggested when adjusting by the national inflation rate.⁶⁸

⁶⁶ This may partly be explained by the use of different micro-data from that used in Figure 9.

⁶⁷ De Agostini, Hills and Sutherland (2014), figure 6.2.

⁶⁸ However, by the end of 2014, inflation was falling for food and fuel, which will partly reverse some of these effects.

As one indication of the effects of specific inflation affecting those with low incomes disproportionately, the Department for Energy and Climate Change (2014, chart 6.1) estimates that the national 'fuel poverty gap' in England will have increased from £1.0 billion in 2012 to £1.1 billion in 2014. That is, the extra amount that 'fuel poor' households would have to spend to keep adequately warm increased by a tenth (in cash terms) over those two years.

A second issue is that some people have been affected much more strongly by benefit changes than others, in particular factors such as the 'benefit cap' of £26,000, tighter limits on eligible private sector Housing Benefit claims, the 'bedroom tax' for some social tenants, cuts in council tax support, and particular disability benefit changes. Some of this is captured in the variation of experience around the averages presented above. For instance, while the average loss for the poorest tenth shown in Figure 9(a) was 3 per cent, a quarter of those in that group lost more than 5 per cent of their income (but a tenth gained more than 5 per cent).⁶⁹

But other factors are not captured by the modelling, notably changes in administration of benefits. In the year up to March 2014, the number of JSA recipients were 'sanctioned' for breaching conditions and having benefits suspended for one to three months (or longer) was 800,000, compared with between 200,000 and 300,000 per year in the decade up to 2008. A further 440,000 were referred for sanctioning, but did not have an 'adverse decision'. More than half (500,000) of the sanction decisions were reversed on appeal or cancelled because people stopped their JSA claim (for reasons that are not known), but only after people had spent time without benefit.⁷⁰

Official statistics on households reporting material hardship to large-scale surveys are only available to 2012-13. These showed a rise, for instance in the number of children affected by material hardship from 22.3 per cent in 2010-11 to 24.1 per cent in 2012-13.⁷¹ However, there is growing qualitative evidence of the hardships faced by particular groups most affected by more recent benefit reforms and changes in administration.⁷² It can also be seen in the rapidly increasing use of voluntary food banks, with for instance more than 900,000 people receiving three-day food parcels from the Trussell Trust charity in 2013-14, up from 350,000 in 2012-13 and 60,000 in 2010-11.⁷³ In the evidence reviewed for the all-party parliamentary report on hunger in the UK, Forsey (2014, p.52) finds that nearly half (48 per cent) of those referred to the food banks had been referred because of problems or delays with benefit claims.

⁶⁹ De Agostini, Hills and Sutherland (2014), figure 4.2.

⁷⁰ MacInnes, et al. (2014), pp.94-95 (figures are for Great Britain). See Oakley (2014) for more discussion.

⁷¹ Belfield, et al. (2014), table 4.3.

⁷² O'Hara (2014); Power, et al (2014a, b).

⁷³ See www.trusselltrust.org.uk/stats.

8. Longer-term effects of policy change

As discussed in Section 4, some of the Coalition's most important policy changes will have long-term effects (if they are sustained), rather than having their main effects by 2014-15. This section examines four of them:

- The new basis for uprating pensions, benefits and tax credits from year to year (CPI-indexation for most, but the triple lock for state pensions, but some working age benefits only to be uprated by 1 per cent in 2015-16 and then frozen for two years from 2016-17).
- Pre-announced changes such as the introduction of partial transferable personal income tax allowances for some married couples and changes in tax treatment of savings and childcare.⁷⁴
- Full introduction of Universal Credit.
- Introduction of the new single tier state pension for those reaching state pension age from 2016 and other pension reforms.

The first part of this section looks at the distributional effects of the first three by 2019-20, compared with the Coalition's starting position in May 2010. The second part looks at the implications of these three changes for future poverty rates. The third looks at evidence on the effects of the introduction of the single tier pension.

For the future, two major changes in the structure of the welfare state in general and of cash transfers in particular were foreshadowed in November 2014. First, the Smith Commission (2014), backed by an all-party agreement, set out the main features of further devolution to Scotland. This will involve control by the Scottish Parliament over rates of income tax in Scotland and over the housing elements of Universal Credit (the equivalent of current Housing Benefit, including whether or not to impose the 'bedroom tax'). It will also control certain benefits for carers and disabled people, and various others including Winter Fuel Payments. State pensions will remain at UK level. The main elements of Universal Credit will continue to be set by DWP, but the Scottish Parliament will be able to vary features such as the frequency of payment and how it is paid. The Scottish Parliament will also be able to create new benefits or top-up existing ones (bearing the cost itself). Second, the Prime Minister announced his intention that if re-elected after the next election, transfers to recent immigrants to the UK, in and out of work will be restricted. Other parties have also suggested ways in which entitlements will be reduced or removed. The effects of both of these developments – and of the 'Stormont House agreement' reached in Northern Ireland in December 2014, which will lead to flexibility in the way 'welfare reforms' are implemented there – lie outside the scope of this paper, but in the long-term may have very large effects on the operation of cash transfers across different parts of the United Kingdom and the boundaries of who is eligible for them.

⁷⁴ See De Agostini, Hills and Sutherland (2014), pp.12-13 and Appendix 1.

*Distributional effects of planned changes by 2019-20*⁷⁵

Many other things will, of course, happen over the next five years, and current plans may not come to fruition or be carried through, but Figure 11 shows the effects of comparing the direct tax and benefit system implied by current plans for 2019-20 with the Coalition's inherited system, if it had been left unreformed but updated in line with *earnings* growth from 2010. It is the equivalent of Figure 9(b), on the basis that over the long-run, this is the most appropriate basis for judging effects on inequality. The results are shown for each tenth of the population, rather than by twentieth, as in Figure 9.⁷⁶

First, the overall position is – in these earnings-linked terms – slightly less favourable for households than under the 2014/15 system, with an average loss of 0.6 per cent of income compared to the 2010 system. In other words, by 2019-20 current policies would more than reverse the overall net gain of 1 per cent of average household income by 2014-15 (compared to earnings-linking the base system) shown in Figure 9(b). Households would pay slightly more income tax under the 2019-20 system than in May 2010, with the reductions that we found from 2010 to 2014-15 offset by the effects of fiscal drag in the later period. The overall losses in the value of benefits would be increased beyond those up to the 2014-15 period, despite the introduction of Universal Credit.

The changes through to 2019-20 maintain the same regressive pattern for the bulk of the population between the second and the eighth decile groups as was seen up to 2014-15. Indeed, the regressivity is strengthened, with the second poorest group losing 3.4 per cent of its income overall, compared to 0.1 per cent up to 2014/15, and the eighth group still gaining by more than 1 per cent of its income. The figure also shows that the changes are progressive right at the top, though, with the top tenth losing 1 per cent of its income, mainly as a result of higher income tax (as a result of fiscal drag), rather than breaking even as up to 2014-15.⁷⁷

However, right at the bottom, the picture is very different, with a net gain of nearly 3 per cent for the bottom tenth by 2019-20 (compared to a loss of more than 0.5 per cent by 2014-15). The difference is entirely due to the effects of introducing Universal Credit (UC), which in this modelling is simulated to lead to very large gains as a percentage of income to some households who do not receive all of the benefits that it replaces. These very large changes are chiefly due to the way the modelling deals with non-take-up of benefits. It assumes that a household which currently takes up *any* of the benefits that UC replaces would then take up UC. This can result in large percentage gains for those only taking up some of their entitlements under the old system (e.g. Housing Benefit but not Income Support), who as a result have very low incomes. Although this is a modelling assumption, it reflects one of the main arguments put forward for UC consolidating various payments and claims processes into one.⁷⁸ It is possible, however, that this could go the other way if, for instance, UC is seen as more stigmatised than

⁷⁵ This subsection is based on De Agostini, Hills and Sutherland (2014), section 7 (updated to take account of measures announced in the 2014 Autumn Statement, including a small increase in income tax and NIC thresholds and two additional years of freezing of working age benefit rates, as well as updating inflation and earnings growth assumptions in line with December OBR projections).

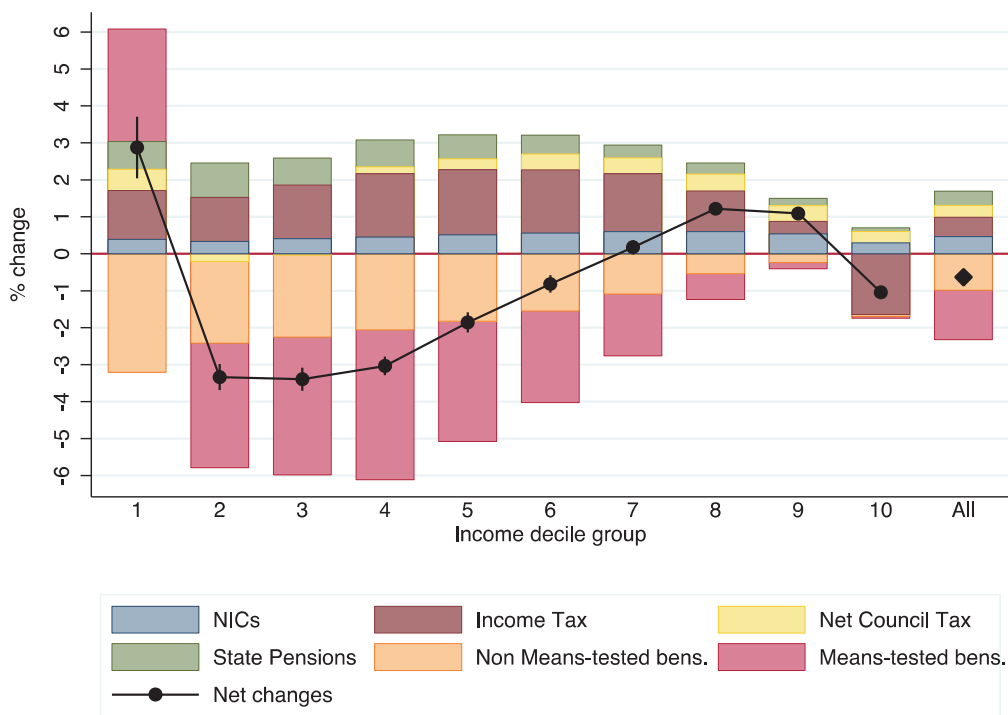
⁷⁶ This is because some of the gains due to Universal Credit for some of those with the lowest incomes can be very large in percentage terms and would dominate the picture by twentieth, meaning that we could not show the detail of what was happening to other groups.

⁷⁷ The top twentieth (not broken down in this figure) loses 1.6 per cent compared to 0.5 per cent up to 2014-15.

⁷⁸ In their modelling of the transition the Treasury make a similar assumption but also add the more optimistic assumption that a proportion of people not taking up *any* of their entitlements under the old system would claim and receive UC under the new system (HM Treasury, 2013).

the benefits previously claimed or the increased conditionality or changes in ways it is paid puts off potentially entitled claimants. When – if – UC is fully introduced, its effects will depend critically on such behavioural differences, which makes its overall effects very hard to forecast.⁷⁹

Figure 11: Percentage change in household disposable income by income decile group due to policy changes 2010 to 2019/20 (2010 policies uprated to 2019/20 using average earnings)



Notes: 2010 policies are as in May. Observations are ranked into decile groups using household income in 2010 equivalised using the modified OECD equivalence scale. The net change is shown with a 95% confidence interval, calculated using bootstrap.

Source: Updated version of Figure 7.1 in de Agostini, et al. (2014); authors’ calculations using EUROMOD G1.5.

Projections for future trends in poverty rates

The distributional effects shown in Figure 11 suggest that planned benefit and tax reforms by 2019 would imply higher poverty and inequality than in 2010, despite the possible gains from Universal Credit for some who currently do not claim all their entitlements.⁸⁰ However, many other factors will affect poverty and in equality as well. Table 6 brings together recent trends in poverty rates measured both in relative terms and against a fixed real line with projections made by researchers at the Institute for Fiscal Studies for the period until 2020-21 in their analysis. These take account of economic trends

⁷⁹ Nor does analysis of this kind allow for behavioural change, such as changed hours of work following the end of the hours rules – whether increases from zero to small numbers, or decreases from the current minimum requirements for claiming tax credits.

⁸⁰ Other things being equal, the changes shown in Figure 11 would imply an increase of 1.8 percentage points in the relative poverty rate (and a similar change against a fixed line based on 2010 incomes, as there would be little difference between real median incomes in 2010 and 2019 in these projections) and of 0.7 percentage points in the Gini coefficient.

such as earnings growth and inflation, as for instance forecast by the Office for Budget Responsibility. The projections for pensioners are based on detailed modelling of demographic and other trends leading to changes in the composition of the older population.

Table 6: IFS projections of poverty rates to 2020-21 (Before Housing Costs)

	Relative poverty rates (60% contemporary median)			Poverty rate against fixed real line (60% 2010 median income updated with RPI)		
	Children	Working-age non-parents	Pensioners	Children	Working-age non-parents	Pensioners
Actual						
2009-10	19.9	14.7	17.6	18.0	13.7	15.8
2010-11	17.6	14.4	17.0	17.6	14.4	17.0
2011-12	17.6	14.8	15.9	19.8	16.0	17.5
2012-13	17.4	14.1	15.7	19.5	14.9	17.3
Projected						
2012-13	17.4	14.1	-	19.5	14.9	20
2014-15	20.3	15.3	-	23.2	16.7	23
2017-18	20.4	15.1	-	23.2	16.6	22
2020-21	20.9	15.8	-	24.5	17.3	24
Change 12-13 to 20-21¹	+3.5	+1.7	Na	+5.0	+2.4	+4

Note: 1. Change calculated from unrounded projections.

Sources: Actual figures from IFS Inequality and Poverty spreadsheet (2014). Projections for children and working age non-parents from Browne, Hood and Joyce (2014), p.4. Projections for pensioners (over 65s) from Emmerson, Heald and Hood (2014), figure 5.4 (using poverty line updated with RPI).

All projections of this kind are subject to wide uncertainty. It should be noted, for instance, from the table that the projections for pensioners below a fixed line for 2012-13, using a base of information available up to 2011-12 were already too pessimistic when compared with the actual figures for 2012-13 that have since been published. That said, the implications are that other things being equal, given what we know about future policy and likely future economic trends, poverty will rise further against both relative and fixed real lines and for all the groups shown.⁸¹ The projections suggest that most of the increase will already have occurred by 2014/15. This is particularly significant in relation to the 2010 Child Poverty Act, which says that government should reduce relative child poverty to below 10 per cent. With a level of 17.4 per cent in 2012-13, and the suggestion that there would be a further 3.5 percentage point rise by 2020-21, the end result would be child poverty at more than twice the target laid down in the Act. In the face of such trends, the official body monitoring progress under the Act reached the “reluctant conclusion” in 2014 that while child poverty in 2012-13 was at historically low levels, “there is no way that the government can meet the statutory target to eradicate child poverty by 2020”.⁸²

⁸¹ However, if the fixed real line was increased in line with inflation as measured by the CPI, rather than the RPI, the proportion of those over 65 below it would fall below 16 per cent by 2020-21, rather than rise to 24 per cent (Emmerson, Heald and Hood, 2014, figure 5.4).

⁸² Press release accompanying Social Mobility and Child Poverty Commission (2014).

Longer-term pension reforms

As described in Section 4, the Coalition took office in the middle of a series of pension reforms being carried out with all-party support. The first of these was the introduction of automatic enrolment of employees into workplace pensions (or the new National Employment Savings Trust), but with the right to opt out. After commissioning an initial review,⁸³ this policy was continued, albeit at a somewhat slower pace than initially planned. Early indications are that the policy is being successful in increasing membership of non-state pension schemes. With the scheme now extended to all those working for organisations with 250 or more employees, the opt-out rate has been only 9-10 per cent. When fully introduced, the Pensions Policy Institute projects that its results could mean between 13 and 15 million employees being members of workplace pension schemes by 2030, compared to only 6.5 million in its absence. The assets in private sector 'Defined Contribution' (DC) schemes, where eventual pensions depend on investment returns, could rise from £310 billion now to between £450 and £505 billion (in earnings-linked terms) by 2030.⁸⁴

So far, this policy therefore looks as if it will have positive effects on the resources available for retirement in the long-term. There are, however, three caveats. First, its introduction was in the context of a precipitous decline in the value of pension rights that people in work have been accruing, after most employers abandoned their previous more generous 'Defined Benefit' (DB) pension schemes. The change will moderate the rate of decline in non-state pension rights, rather than reversing it. Second, the system is building up at present to a minimum combined contribution rate of 8 per cent of the earnings that are covered. That was already recognised by the Pensions Commission, which recommended the scheme, as being about half the rate required to build up a retirement income that would reach the aspirations of people on median earnings for a minimum income in retirement.⁸⁵ Since then, long-term rates of return have fallen, increasing the size of potential shortfalls, if contributions do not exceed the minimum. But third, as discussed below, it has become highly uncertain what proportion of people's pension pots will translate into retirement income, following the Coalition's tax reforms announced in March 2014.

The Coalition has also accelerated the pace of the reforms to state pensions it inherited. This includes applying the 'triple lock' uprating of state pensions (the medium-term effects of which are discussed above), accelerating increases in State Pension Age (SPA), and introducing 'single tier' state pensions for those reaching it from April 2016. The effects of these reforms have been examined in detail by the Pensions Policy Institute.⁸⁶ One immediate point to note is that they are designed to be at zero net cost compared to previous plans (in fact they are likely to save spending in the long term). By implication, any gainers from the reform have to be matched by losers. Who will gain is more obvious than who will lose. The gainers (amongst those retiring from April 2016) include:

- Self-employed people;
- Many women who had interrupted careers in paid work, who would not have accrued large rights to the current State Second Pension (S2P); and

⁸³ Johnson, Yeandle and Boulding (2010).

⁸⁴ Pensions Policy Institute (2014a).

⁸⁵ Pensions Commission (2005).

⁸⁶ See the series of papers in Pensions Policy Institute (2014b). Note that not everyone retiring from 2016 will receive the full single-tier pension; many will not. This is because some have been 'contracted out' of the state system and so it is assumed that they will receive at least as much from their private pension as the shortfall, while others will not have been contributing for or credited for enough years (35) to get the full amount.

- Some of those who have been 'contracted out' of S2P, paying lower NICs in return for their employer promising a high enough pension, who will now build up greater state pension rights (but at the cost of paying higher NICs).

The losers are more obscure. In the medium term they include those who *would have* built up more substantial rights to the S2P in the years from 2016 until their state pension age than the amount they will accrue towards the single-tier pension (over and above the current basic pension). These tend to be those with higher earnings and more continuous periods in employment, and so are likely to be better off than many of the gainers. However, the effect of this is that the second aim of the pension system – to allow people to replace what they see as an adequate proportion of pre-retirement income – will become harder to achieve for this group, particularly as they may only have been affected by Automatic Enrolment for a few years. They also include those who might have received the top-up from the 'Savings Credit' system introduced by the last government. In the longer term, for people reaching SPA in later years a much larger group will receive less than they would have done, including those with modest earnings, as the single-tier pension is less generous than the amounts they would have accrued. Overall, DWP estimated that the single-tier system (with the triple lock in place) would cost about the same amount as the current system until around 2030, but after that becomes cheaper (or rather the increase in cost less rapid), reaching 8.1 per cent of GDP in 2060, rather than 8.5 per cent.⁸⁷

Later analysis by PPI finds a smaller saving, and indeed a net cost of the reform in the short term, but without allowing for offsetting savings in other pensioner benefits (such as Housing Benefit or council tax support). However, those calculations do not allow for the effects of the further reforms to state pension age announced by the Coalition, aimed at stabilising length of time above the SPA at a third of adult life (from age 20). That would mean, for instance, a likely rise in the SPA to 68 by the mid-2030s and 69 by the late 2040s. This would reduce spending by 0.3-0.4 per cent of GDP from the mid-2030s onwards.⁸⁸

On balance, the reforms appear progressive between those with higher and lower previous earnings for those retiring in the years immediately after 2016, but in the longer run they mean lower state pension rights for younger cohorts than they would have accrued under the current system – and from a later age (but only if they continue to gain in life expectancy compared to earlier generations).

There is another, so far less-noticed, aspect to the reforms. Hitherto many earners have been 'contracted out' of the second pension system, themselves and their employers paying lower NICs in return. From 2016 this will end, and NIC rates will rise for this group and their employers. The Government estimates that this will improve the Treasury's cash flow by £5 billion per year in 2016 (falling to under £4 billion by 2030), of which it has committed £1 billion to partial implementation of the Dilnot Commission's recommendations for funding long-term care and £750 million to childcare reforms.⁸⁹ This will come from what are mainly public sector workers and their employers. For workers, the increase – of 1.4 per cent in their NIC rate – may be seen as being in return for a greater flat-rate entitlement after retirement. For employers, the increase – of 3.4 per cent – will be an increase in labour costs. It is not yet clear what effect this will have on, for instance, the budgets of schools and hospitals as their NICs increase, and whether this will be compensated in any way by the Treasury. If there is no

⁸⁷ PPI (2014b), paper 3, chart 4.

⁸⁸ PPI (2014b), paper 5, chart 6.

⁸⁹ PPI (2014b), papers 4 and 5.

compensation there would have to be equivalent cuts in services after April 2016, which seem so far to have attracted little discussion.

Finally, it is very unclear what the effects of the deregulation of the use of pension funds for those retiring from April 2015 will be. Some may as intended find investment solutions that are better value than annuities have been, but others may fall victim to aggressively sold ostensibly high-return investment schemes which come unstuck. A further 'mis-selling' problem is possible. If significant funds are invested in 'buy to let' properties or passed on to help children get on the housing ladder, that could have unintended consequences for the housing market, driving up house prices further (and possibly contributing to sharper booms and busts in them). Early indications are that most people, to start with at least, would use the majority of their pension pot for a pension or savings of some other kind – but others may spend their most of their pensions savings early. Pensions Minister Steve Webb has argued that with the new single-tier pension taking more people clear of means testing, people drawing down their fund early was less of a concern that it would have been, and that he would be relaxed, even if they blew it on a Lamborghini sports car.⁹⁰ That may be extreme, but with widespread lack of knowledge of things that are in any case highly uncertain, such as life expectancy and future rates of return, there is a significant danger that some may make short-term decisions they later come to regret – and which they see government as being in part responsible for. As great a danger is that some may hoard their savings out of undue caution or a desire to pass them on as an inheritance.⁹¹

At all events, what retirement incomes will be is less certain than it was, with many people at least taking on more risk. More fundamentally, in the long run the question may arise as to why pension saving, if no longer constrained in its use, attracts such a high degree of tax advantage, and indeed whether private sector 'pensions' will continue to exist in the way that we have known.

⁹⁰ Talking to the BBC, 21 March 2014 [<http://www.bbc.co.uk/news/uk-politics-26649162>]

⁹¹ In January 2015, Mr Webb floated the idea that an equivalent option to realise capital by selling future annuity rights could in future be extended to existing pensioners. If this happened a much larger group could be affected by the potential positive and negative effects of the deregulation already announced.

9. Conclusions

Despite the dominance of rhetoric about bearing down on 'welfare', policy towards social security and tax credits has been more varied than a picture of simple cuts starting when the Coalition took office. In the first phase nearly all of the inherited system was maintained intact, including increasing benefits to maintain their real value against general price inflation. Given that real earnings were falling over the period, this is one of the main explanations why income inequality and relative poverty both fell at the start of the Coalition's period in office, which is what is covered by currently available statistics up to 2012-13. However, poverty rates measured against a fixed real line have been rising since 2009-10, especially after housing costs are allowed for.

The second phase, however, had effects that built up through this period, some because they were cumulative, such as changes in indexation of benefits and tax credits or the increase in the personal allowance for income tax, or because they took effect later, with (as laid out in Table 2) several measures coming into effect from April 2013 or later (such as changes in council tax support, the introduction of the 'bedroom tax' for social tenants, or some of the disability benefit reforms).

Modelling of the effects of all the changes between May 2010, when the Coalition came into office, and 2014-15 suggests that on balance the direct tax and benefit reforms were fiscally neutral, rather than contributing to deficit reduction, compared to the inherited system if it had been adjusted for price inflation (measured by the CPI). The specific reforms and cuts did reduce spending on benefits and tax credits, and direct taxes did rise through higher National Insurance Contributions, and changes such as withdrawing Child Benefit from families containing a higher earner. But the benefit to the public finances from these was entirely offset by the very large cost of increasing the annual income tax personal allowance to £10,000. The net effect was regressive below the top fifth or so of the income distribution. Above that, gains were smaller as a share of income, and included losses on average for those in the top twentieth (but much less as a share of their incomes than for those at the bottom). Some analysis has suggested that the proportionate cost of 'austerity' in this area has been as great for those with the highest incomes as for those at the bottom. However, this follows, for instance, if the analysis measures the effects of the changing systems starting from *January* 2010, and so includes some of the income tax changes affecting the highest earners introduced by the last government from April that year, and already in effect before the last election.

At the same time, rising food and fuel prices have affected those with low incomes most. Alongside the specific benefit changes since 2013, this implies that living standards will have fallen – and hardship risen – faster at the bottom than suggested by the figures adjusted for general inflation.

In the longer term, as well as specific cuts for particular groups, three factors may dominate judgements about the Coalition:

- the effects of Universal Credit (if it is eventually fully rolled out as planned);
- the way in which benefits will be uprated in line with the CPI at most (possibly much less, if the 'welfare cap' on aggregate spending bites) and cut in real terms in some years, but with the state pension increased with the 'triple lock'; and
- the pension reforms planned for those reaching (an increasing) State Pension Age from 2016, alongside radical deregulation of what people can do with their pension pot once it has been accumulated.

Modelling suggests that the first two of these will in combination be revenue-raising (compared to a distributionally neutral path with values indexed in line with other incomes) and that they would further increase the regressive effects of policy across most of the income range, and with it inequality. However, if the introduction of Universal Credit meant that some of those currently failing to claim some of the benefits it is replacing claimed their full entitlement, there could be some significant gainers amongst those with very low incomes. Conversely, if the effect of the reform is to spread stigma to more parts of the benefit system, the reverse could occur, and the regressive effects of reforms would be exacerbated. Even if Universal Credit works as intended, relative poverty would rise under current policies.

Even more uncertainty surrounds the long-run effects of the Coalition's pension reforms. In the medium term there will be some clear gainers from the 'single-tier' pension reforms for those reaching state pension age from April 2016. These will be balanced by losses to groups who may generally be somewhat more affluent. At the same time the Treasury will gain from higher employer and employee NICs from ending 'contracting out', with large potential extra costs for public sector employers, such as schools and hospitals. How that will play out is unclear. There is even less clarity about the effects of deregulation of the use of pension pots. At one end, it could mean that people are able to use and invest their retirement resources in the ways that best meet their needs. At the other, it could open the door to substantial 'mis-selling', while the whole meaning and purpose of 'pension saving', and the substantial tax privileges it attracts, are thrown into doubt.

A further side-effect of the pension reforms will be an increase in national insurance contribution rates for many public sector employees and their employers. It is not yet clear what effect this will have on, for instance, the budgets of schools and hospitals as their NICs increase, and whether this will be compensated in any way by the Treasury. If there is no compensation there would have to be equivalent cuts in services after April 2016.

While the policies of the 1997-2010 Labour governments were marked by its much more favourable treatment of both families with children and pensioners than of other people of working age, since May 2010 it has been pensioners that have been generally protected, while the costs of reform and austerity have fallen on families with children and others of working age on lower incomes. Whether this balance is politically sustainable – particularly as it comes alongside a sharp deterioration in the market incomes of those currently in their 20s – is yet to be seen.

Finally, the boundaries of entitlements to cash transfers are now planned to be redrawn after the next election. First, the Scottish Parliament will have new powers to change the structure of income tax and over the housing costs part of Universal Credit and some other benefits that will no longer be set by Westminster. This could mean that for the first time since 1948 there would no longer be a common safety net for citizens across the UK. Second, entitlements of recent migrants to cash benefits and tax credits are likely to be restricted or removed for some period after arrival. Both would have implications for the shape of the 'safety net' function of cash transfers, and of the gaps in its coverage.

Appendix 1

Table A1: Benefit and tax credit spending, 1996-97 to 2014-15 (Great Britain)

	£ billion, 2009-10 prices				% TME				% GDP			
	Total	Child- ren	Other WA	Pens- ioners	Total	Child- ren	Other WA	Pens- ioners	Total	Child- ren	Other WA	Pens- ioners
96/97	115.3	16.2	41.4	57.7	27.4	3.8	9.9	13.7	10.8	1.5	3.9	5.4
97/98	114.8	16.3	39.4	59.2	27.2	3.8	9.3	14.0	10.3	1.5	3.5	5.3
98/99	115.6	16.4	38.4	60.8	27.1	3.8	9.0	14.3	10.0	1.4	3.3	5.3
99/00	119.1	18.3	37.2	63.6	27.5	4.2	8.6	14.7	9.9	1.5	3.1	5.3
00/01	125.1	21.1	37.1	66.9	29.1	4.9	8.6	15.6	10.0	1.7	3.0	5.4
01/02	129.7	22.5	36.9	70.3	27.2	4.7	7.7	14.7	10.3	1.8	2.9	5.6
02/03	134.4	23.8	37.8	72.8	26.7	4.7	7.5	14.5	10.3	1.8	2.9	5.6
03/04	144.9	31.0	38.8	75.2	27.1	5.8	7.3	14.1	10.7	2.3	2.9	5.5
04/05	149.9	32.2	39.0	78.6	26.7	5.7	6.9	14.0	10.7	2.3	2.8	5.6
05/06	154.4	32.9	39.6	81.9	26.3	5.6	6.7	14.0	10.7	2.3	2.7	5.7
06/07	155.3	33.0	40.0	82.2	25.9	5.5	6.7	13.7	10.5	2.2	2.7	5.5
07/08	160.6	33.7	41.2	85.8	25.9	5.4	6.6	13.8	10.5	2.2	2.7	5.6
08/09	170.5	37.1	42.8	90.6	26.1	5.7	6.6	13.9	11.5	2.5	2.9	6.1
09/10	181.9	39.5	48.0	94.4	27.0	5.9	7.1	14.0	12.7	2.8	3.4	6.6
10/11	183.7	39.6	48.6	95.6	27.1	5.8	7.2	14.1	12.5	2.7	3.3	6.5
11/12	185.5	39.2	49.2	97.2	28.0	5.9	7.4	14.7	12.6	2.7	3.3	6.6
12/13	190.5	38.6	50.5	101.5	30.0	6.1	8.0	16.0	12.9	2.6	3.4	6.9
13/14	189.1	37.5	49.2	102.5	28.6	5.7	7.4	15.5	12.4	2.5	3.2	6.7
14/15	188.1	36.3	48.5	103.3	28.4	5.5	7.3	15.6	12.1	2.3	3.1	6.6

Source: Derived from DWP (2014b). TME is Total Managed Expenditure.

Notes: Spending on non-pensioner benefits is divided between items aimed at children – mainly Child Benefit, Child Tax Credit and Working Tax Credit for families with children (and their earlier equivalents, such as Family Credit and WFTC) – and other transfers for the working age population (which includes items such as the adult parts of Income Support or Jobseeker's Allowance, including for parents, as well as maternity benefits, Housing Benefit for working age families, and Working Tax Credit for non-parents). Working Tax Credit divided between parents and non-parents using data from HMRC (2014b) (with 2012-13 proportions applied to later years).

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