

# Welfare budget and benefit cuts

The Government is seeking £12 billion per year of further cuts to annual social security spending by 2017-18. This will involve difficult decisions: cuts only affecting better-off benefit claimants tend to weaken incentives to work, while cuts protecting work incentives tend to hit the poorest and increase poverty.

Despite nearly £17 billion of already implemented cuts to the social security budget, the level of spending is expected to be roughly the same in 2015-16 as it was in 2010-11 in real terms. This is because of several economic and demographic factors – including an ageing society, a growing private rented sector increasing the housing benefit caseload, and lower-than-expected earnings growth – which have increased expenditure.

The IFS Green Budget 2015, published by the Institute for Fiscal Studies (IFS), has analysed the issues facing the Government in reducing spending on social security. Further analysis has been carried out by Robert Joyce in the IFS paper *Benefit cuts: where might they come from?*.

The biggest unprotected spending items are tax credits and housing benefit, followed by disability and incapacity benefits, and child benefit (which the Prime Minister has since suggested will not be cut further, beyond the nominal freeze already planned until April 2018). Some combination of these benefits is virtually certain to be cut if the £12 billion in cuts is to be delivered.

## Initial findings

- **Across-the-board cuts:** Freezing most working-age benefits for two years, as currently planned, is set to save about £1 billion per year; extending to a five year freeze would reduce annual spending by a further £4.5 billion.
- **More aggressive means-testing:** Reducing the work allowances in universal credit (the amounts that can be earned before universal credit starts to be withdrawn) by 10 per cent would reduce spending by £700 million annually. Alternatively, increasing the 'taper rate' (the rate at which universal credit is withdrawn as net earnings rise) from 65 per cent to 70 per cent could reduce spending by £1.3 billion a year. However, more aggressive means-testing tends to weaken the incentive for many individuals to enter paid work or increase their earnings.
- **Housing benefit:** Reducing housing benefit for social tenants from 100 per cent to 90 per cent of their rents would cut spending by around £1.6 billion a year. Making all private sector tenants also pay at least 10 per cent of their rent would be an additional cut of £0.9 billion. Alternatively, subjecting all social sector claimants to the same local housing allowance (LHA) rules as most private sector claimants would reduce spending by around £700 million a year. In the private sector, a further reduction in LHA rates to the 20th percentile of local rents would reduce spending by roughly £400 million a year.

## Initial findings – continued

- **Child benefit:** The high-income child benefit charge is not a well-designed policy, and it is set to affect more and more families over time due to fiscal drag. It would be possible to carry out this expansion of means-testing in a less arbitrary way whilst integrating the different strands of income-related support for children. Abolishing child benefit now and increasing the child elements of universal credit to compensate low-income families would reduce benefit entitlements by around £4.8 billion a year.
- **Disability benefits:** Introducing tax on disability living allowance and personal independence payment would raise about £915 million a year; doing the same for attendance allowance would reduce spending by £550 million in 2015-16. This would protect the lowest-income recipients from cuts; but there are good reasons why these benefits are currently universal and non-taxable, as they are there to compensate for the costs of disability which apply regardless of income.

## BRIEF DESCRIPTION OF THE PROJECT

The IFS Green Budget is published every year in the run-up to the Chancellor's Budget statement, analysing key areas likely to be under scrutiny in the Budget debate and examining alternative policy options.  
Web: [www.ifs.org.uk/tools\\_and\\_resources/green\\_budget](http://www.ifs.org.uk/tools_and_resources/green_budget)

## FOR MORE INFORMATION

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The IFS was established in 1969 and is today Britain's leading independent microeconomic research institute. It is core-funded by the ESRC.

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The views expressed in this evidence briefing are those of the authors and not necessarily those of the ESRC.

## Policy relevance and implications

- Spending on social security will always involve trade-offs. Central to this is the trade-off between targeting support on particular groups (such as the poor, or those with children) and avoiding perverse incentives around choices such as how much paid work to do, or where to live and with whom. Policymakers should bear these trade-offs in mind, have a clear vision for what they want the social security system to achieve, and ensure that the overall system fits together coherently.
- Substantial cuts to working-age benefit and tax credit spending will tend to affect mostly relatively low-income households – because about 80 per cent of that spending is means-tested – and to disproportionately affect families with children, who are entitled to more benefits. Most working-age benefit recipients are in work.
- Any cuts package should be designed considering its combined effects. For example, low-income renting families could be affected by cuts to housing benefit and tax credits simultaneously.
- Governments should avoid setting future benefit rates in nominal terms (rather than in real terms, or relative to a meaningful economic variable such as earnings). It exposes both the exchequer and (typically poor) households to unnecessary inflation risk. Most recently, this has hurt the exchequer: the unexpected fall in inflation has meant that the policy of uprating most working-age benefits by one per cent implies much smaller real cuts than originally envisaged.