Briefing

Briefing for November 2017 Budget:

Incomes not keeping up with prices

Incomes are not keeping up with prices. The living standards of ordinary working families are being eroded. The summer 2015 Budget froze most benefits for working-age people for four years, from 2016/17 to 2019/20. This included benefits to top up low earnings and out-of-work benefits, and follows a period when rises were capped at 1%. The freeze has come at a time when the price of essentials is rising and average earnings stagnating.

Recommended actions

The November 2017 Budget must ensure the incomes of the least well off keep pace with the cost of essentials by removing the freeze and uprating income-related benefits with CPI from April 2018, and the local housing allowance with local rents.

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www.jrf.org.uk

JOSEPH ROWNTREE FOUNDATION

Key points

- Almost half a million additional people are likely to be in poverty by 2020/21 as a result of the four-year freeze on benefits that began in 2016/17. It is the biggest policy driver behind the expected rise in poverty.
- Higher than forecast inflation means the hit to low income families – and gain to the Treasury - will be an estimated £0.9bn more than the £4bn originally expected from this cut in 2020/21.
- JRF recommends removing the freeze on income-related benefits and uprating them with CPI inflation from 2018/19. This would result in 380,000 fewer people in poverty in 2020/21; some 9 in 10 would be in families with children and 17 in 20 would be working families. It would cost an estimated £2.8bn in 2020/21.
- Uprating just the child-related elements of Universal Credit from 2018/19 would cost around £1bn in 2020/21 and result in 100,000 fewer people in poverty that year.
- Uprating the Local Housing Allowance with local rents would help the 4.7million people living in the private rented sector who experience poverty after paying housing costs.
- Unfreezing benefits is a more effective way to help low-income families than increasing the personal tax allowance (PTA). The planned PTA rise should be delayed or cancelled - only £1 in every £6 spent on this policy goes to the bottom half of the income distribution.

The impact on family budgets

The four-year freeze will result in almost half a million (470,000) more people experiencing poverty in 2020/21 according to JRF analysis (see appendix for details). It is the biggest policy driver behind the expected rise in poverty between now and 2020/21 (IFS 2017).

In 2019/20, when the freeze is due to end, a low-income couple with two children in receipt of Universal Credit will be £16 per week - £832 over the year (in 2017 prices) - worse off than they would have been had benefits kept up with prices since 2010. The equivalent figure for a lone parent with two children is £13 per week (£676 over the year). Both figures are the same whether out-of-work or working full time for the National Living Wage (Hirsch, forthcoming).

"At the moment I'm just getting by, but I do worry about any extra expenses and how I'm going to pay for those because I've just got a limited income… I have laid awake at night thinking 'how am I going to pay for this?' better turn the heating right down, try and lower my heating costs…because there's not a lot else you can reduce. You can't shop around for your council tax, the only other things you can cut down on are food and fuel. What else do you do?"

Julie, Scarborough

As prices rise, the priority should be to protect the budgets of the lowest income families.

Circumstances have changed, policy needs to change

Much has changed since the freeze was announced in July 2015. The Brexit vote triggered a fall in the value of sterling, which has led to price rises. CPI inflation was 2.9% in August 2017 (ONS 2017) and is expected to remain around this level into 2018 (BoE 2017).

This is a sharper increase in prices than was forecast when the freeze was announced, leaving low-income families even further short than originally expected. JRF estimates this will result in an additional hit to low-income household budgets – and a gain to the Treasury - of almost £0.9bn in 2020/21. This is over and above the original Treasury estimate of a £4bn gain to the Exchequer in that year (HMT 2015).

The cost and impact of uprating income-related benefits with prices from 2018/19

The focus should be on making sure low-income family budgets at least keep pace with the cost of essentials, while reducing the benefit bill through higher employment and earnings, and lower housing costs. With more than half the people experiencing poverty already living in working households, and three in four people failing to escape low pay in a 10-year period, benefits to top up incomes will continue to play an essential role in supporting living standards.

As such, JRF recommends focusing on uprating targeted income-related benefits such as tax credits, Universal Credit, the Local Housing Allowance and Job Seekers Allowance, over more widespread benefits such as child benefit.

Uprating benefits (not including Child Benefit) with CPI inflation from 2018/19 is projected to result in 380,000 fewer people in poverty in 2020/21. Almost 9 in 10 would be in families with children and 17 out of every 20 would be in working families. It would cost an estimated £2.8bn in 2020/21.

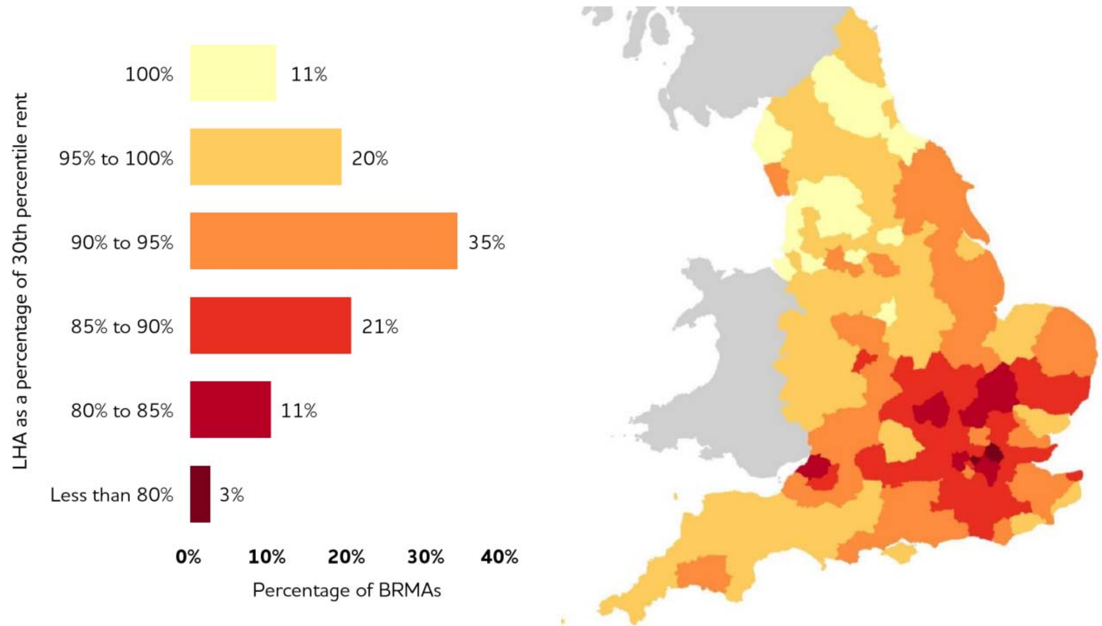
Among the benefits that are currently frozen, there are two particular priorities for action:

1) Child-related benefits: given the substantial rise in child poverty expected over the next few years (IFS 2017) there is a good argument for prioritising families with children. Growing up in poverty damages children's prospects, resulting in lower earnings and higher benefit claims later in life. Child poverty costs the Exchequer an estimated £6.4bn per year in lost tax revenue and additional benefit spending (Bramley et al 2016). Focusing just on uprating benefits targeted at low-income children (not including Child Benefit) from 2018/19 would cost around £1bn in 2020/21. It would result in 100,000 fewer people in poverty in that year.

2) Local Housing Allowance: the private rented sector (PRS) is fast becoming the tenure that houses people in poverty. Today 4.7million people living in the PRS experience poverty after paying for housing and the number of people in poverty in the PRS doubled in the decade 2004/05 to 2014/15 (Tinson et al 2016). Local Housing Allowance (LHA) helps those on low incomes to pay their rent, however it wasn't rising with local rents even before it was frozen. Figure 1 shows which places have the largest gap between LHA rates and what they would be had they moved in line with the local 30th percentile rent (the limit of what LHA will cover) for two bedroom properties. In areas such as Milton Keynes, LHA only covers 86% of the rent, creating a shortfall of £117 per month; in central London it covers 55%, with a shortfall of over £1,000 per month.

   LHA should be reset to ensure it does cover the bottom 30% of local rents and should be uprated in line with local rents. This is a more appropriate measure than CPI given the wide variation in rents across the UK.

Figure 1: difference between 2017 LHA and 30th percentile rent, two bedroom property



Note: maps for one, three and four bedroom properties also available. Source:

http://pdf.euro.savills.co.uk/uk/residential---other/policy-response-impact-of-the-lha-increase.pdf

Uprating benefits is a more effective way to help low-income families than increasing the personal tax allowance

The Government is committed to raising the personal tax allowance (PTA) to £12,500 by 2020, and the Higher Rate threshold to £50,000. The Office for Budget Responsibility (OBR) estimates this will cost £1.3 billion in 2020/21 (OBR 2017). This policy will not help people on the lowest incomes.

Only £1 in £6 spent on raising the PTA will go to households in the bottom half of the income distribution, and JRF analysis finds it has a negligible impact on poverty.

Directing this money to raising benefits in line with inflation would have a far greater impact on low-income households. **We recommend delaying or cancelling the increase in the PTA and targeting the money at low-income families.**

References:

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Appendix: methodological note

The analysis of the cost and impact of benefit uprating scenarios was carried out using the IPPR Tax Benefit Model, which is based on the Family Resources Survey.

The base scenario is tax and benefit policy as announced at the 2017 Spring Budget. Assumptions about earning growth and inflation are as projected by the OBR at the time of the 2017 spring budget. In this scenario tax thresholds are assumed to go up with CPI inflation, and most working age benefits are frozen until 2019/20.

The model was used to estimate the impact on relative income poverty (measured as 60% of the median income, equivalised for household size, after housing costs) and the cost of different policy scenarios. The poverty line was recalculated when a scenario had an impact on median income. The analysis assumes Universal Credit (UC) has fully replaced the benefits and tax credits system and does not incorporate transitional protections that will be available to some people when they migrate onto UC. It does not make assumptions about behaviour change. Where it refers to families the analysis is of benefit units. The analysis was carried out by Guoda Cibaite.

The priority scenario was selected on the basis of value for money, measured by the cost per person exiting poverty.

Uprating scenarios tested:

- Uprating all frozen benefits in line with CPI inflation from 2018/19.
- Uprating all frozen benefits excluding child benefit in line with CPI inflation from 2018/19.
- Uprating UC work allowances only in line with CPI inflation from 2018/19.
- Uprating all frozen child related benefits in line with CPI inflation from 2018/19.
- Uprating UC child related elements in line with CPI inflation from 2018/19.
- Uprating all frozen benefits by 1% from 2018/19.
- Uprating all frozen benefits excluding child benefit by 1% from 2018/19.

About the Joseph Rowntree Foundation

The Joseph Rowntree Foundation is an independent organisation working to inspire social change through research, policy and practice.

JRF is working with governments, businesses, communities, charities and individuals to solve UK poverty. All research published by JRF, including publications in the references, is available to download from www.jrf.org.uk

If you would like to arrange a meeting with one of our experts to discuss the points raised please contact:

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