HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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Summer Budget 2015: A summary (updated)

By Matthew Keep

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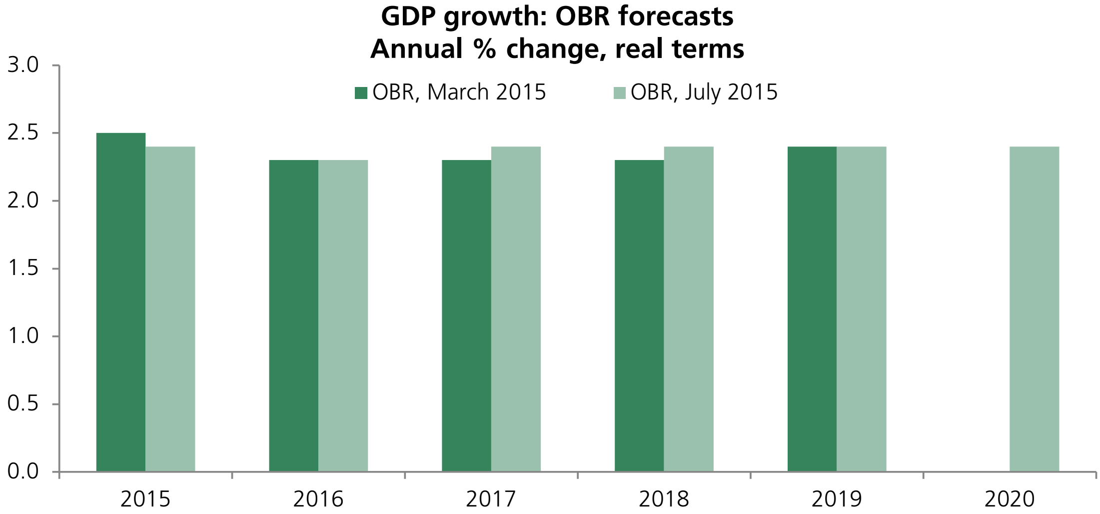

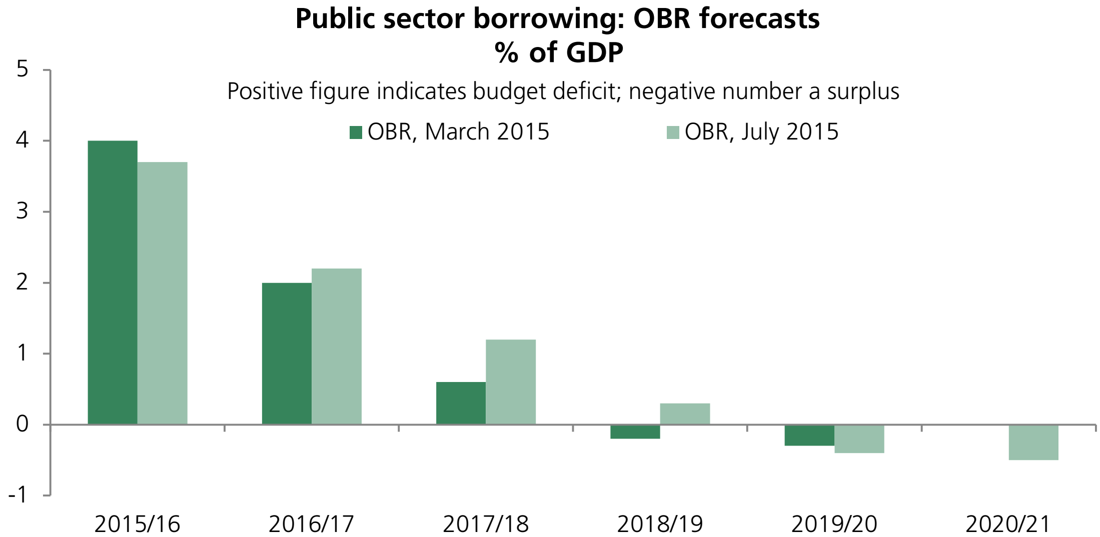

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1. Budget measures at a glance

The 2015 Summer Budget was presented by the Chancellor of the Exchequer to Parliament on 8 July 2015. At the same time the Office for Budget Responsibility published its updated forecasts in its Economic and Fiscal Outlook.

This note provides an overview of the main Budget measures (see below), along with analysis of the forecasts, changes to the fiscal rules, changes to welfare, the National Living Wage, and public spending.

Measures at a glance

- A **National Living Wage (NLW)** introduced for workers aged 25 and above. A premium will be introduced above the National Minimum Wage leading to the NLW. From April 2016 the NLW will be set at £7.20: at this point the National Minimum Wage will be £6.70, so the premium will be £0.50. The Low Pay Commission will be asked to set out how the NLW will reach over £9, roughly 60% of median earnings, by 2020.

- Over £12 billion of **welfare savings** will be introduced by 2019/20, a summary of the largest savings are shown in the following section. Changes made to tax credits will see expenditure return to 2007/08 levels in real terms.

- Around £5 billion of savings made by tackling **aggressive tax avoidance and evasion** by 2019/20.

- Reductions in **public services spending** have been scaled back. Day-to-day spending on public services, grants and administration to be £83 billion higher over the Parliament than suggested by the Coalition Government's March 2015 plans.

- The government's fiscal rules are to be revised to include a **target for a budget surplus** by 2019/20 and for all subsequent years when in 'normal times'. The economy will be viewed as being in 'normal times' if real annual growth is above 1%.
- Tax-free **personal allowance** increased from £10,600 in 2015/16 to £11,000 in 2016/17 and £11,200 in 21017/18; **higher rate threshold** increased from £42,385 in 2015/16 to £43,000 in 2016/17 and £43,600 in 2017/18.

- A transferable **main residence allowance** of £175,000 for **Inheritance Tax** will be phased in by 2020/21. This will increase the effective Inheritance Tax threshold for married couples and civil partners to £1 million.

- **Pensions tax relief** for those with gross incomes over £150,000 will be restricted from 2016/17. The current annual allowance of £40,000 will be reduced to £10,000 once an individual's income reaches £210,000. There will be a wider **consultation** on reforming tax relief on pensions.

- **Corporation tax** reduced from the current level of 20% to 19% from 1 April 2017 and 18% from 1 April 2020.

- **The bank levy** will be reduced annually from the current level of 0.21% until reaching 0.1% in 2021. A **supplementary tax on banking sector profit** of 8% will be introduced from 1 January 2016.

- Dividend Tax Credit to be replaced with a new tax-free **Dividend Allowance** of £5,000 a year from April 2016. New tax rates for dividends income introduced.

- **Insurance premium tax** increased from 6% to 9.5% from 1 November 2015.

- A **new vehicle excise duty (VED) banding system** introduced for cars registered on or after 1 April 2017. From 2020/21 income from VED in England will contributed to the costs of the Strategic Road Network.

- **Non-domiciled** status will, from April 2017, be removed for anybody who has been resident in the UK for more than 15 of the previous 20 years.

- From April 2016 the **Employment Allowance**, which gives a National Insurance contributions free allowance to businesses, will be extended from £2,000 to £3,000.

- Following further discussions with businesses, a **levy on large UK employers** to fund 3 million **new apprenticeships** will be introduced.

- **Social housing rents** to be reduced by 1% a year for 4 years from 2016. Tenants with household incomes of £40,000 and above in London, and £30,000 in the rest of England, will be required to at least pay a near market rent to stay in their social rented accommodation.

- **Annual Investment Allowance**, a capital tax allowance, set at £200,000 from January 2016 – the January 2016 level was set to be £25,000.

- The **relief on finance costs that landlords of residential property** can get will be restricted to the basic rate of income tax. The restriction will be phased in over 4 years, starting from April 2017.

- From 2016/17 student maintenance grants will be replaced with **maintenance loans** for new students in England. The loans will be paid back once earnings exceed £21,000 a year. The loans will be worth up to £8,200 a year.

- The government has committed to meeting the NATO pledge to spend **2% of national income on defence** every year of this decade.

- The government has committed to **funding the NHS's** 'Five Year Forward View' which called for £8 billion by 2020/21.

- The government will provide funding for **public sector pay** increases of 1% for 4 years from 2016/17.

- The exemption for renewable source electricity from the **Climate Change Levy** will be removed from 1 August 2015.

2. OBR forecasts for the economy

The OBR published its Economic and Fiscal Outlook, July 2015 on the same day as the Budget. It contains independent official forecasts for the economy up to 2020 and the public finances up to 2020/21.

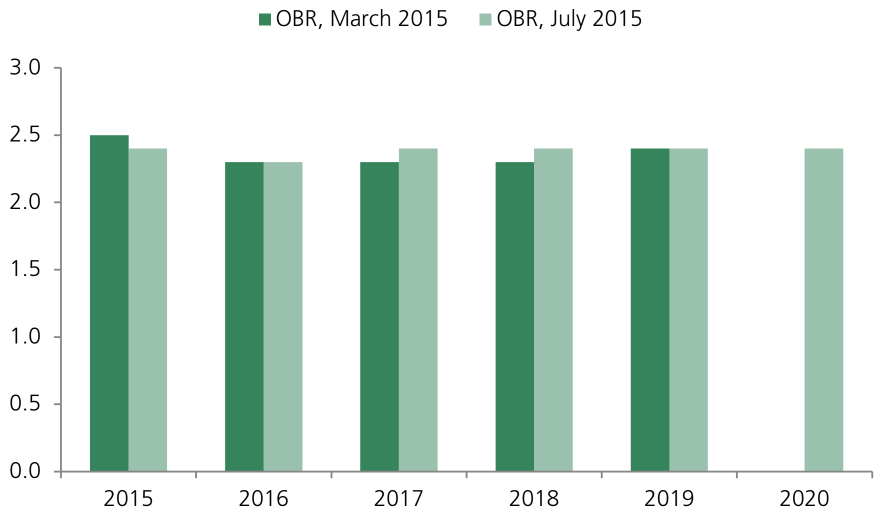
2.1 GDP growth

The OBR forecasts that the UK economy will grow by 2.4% in 2015, down slightly from the OBR forecast at the time of the March Budget of 2.5% growth in 2015. For the rest of the forecast period, the July forecasts are similar to those from March – growth of 2.3% and 2.4% a year.

OBR forecasts of GDP growth (%)

	2015	2016	2017	2018	2019	2020
OBR, March 2015	2.5	2.3	2.3	2.3	2.4	na
OBR, July 2015	2.4	2.3	2.4	2.4	2.4	2.4

GDP growth: OBR forecasts
Annual % change, real terms

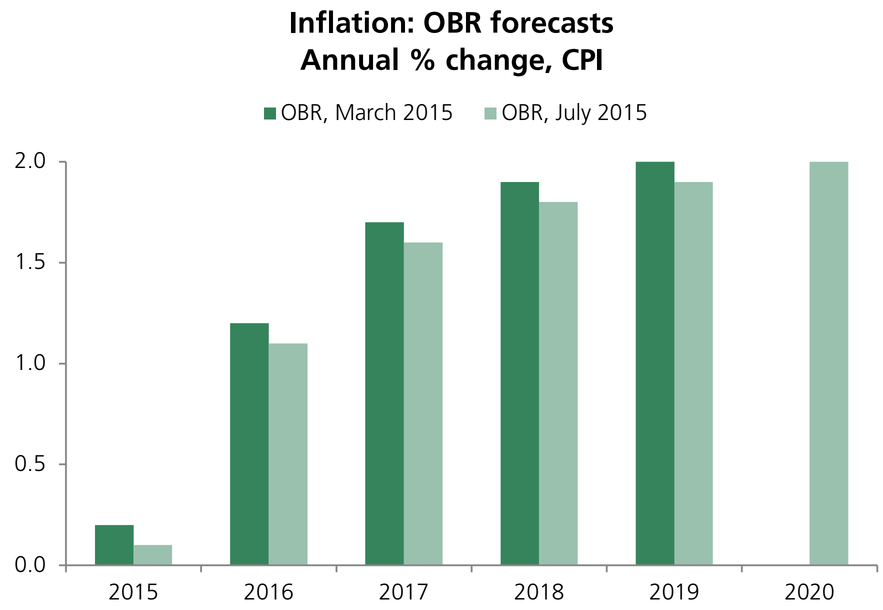


2.2 Inflation

Inflation has fallen sharply since mid-2014, due in part to the fall in the price of oil. The OBR forecasts published at the time of the Summer Budget are for slightly slower increases in inflation compared to the forecasts published in March. Inflation is now expected to return to the Bank of England's target of 2.0% by 2020.

OBR forecasts of CPI inflation (% change on previous year)

	2015	2016	2017	2018	2019	2020
OBR, March 2015	0.2	1.2	1.7	1.9	2.0	na
OBR, July 2015	0.1	1.1	1.6	1.8	1.9	2.0



2.3 Employment and unemployment

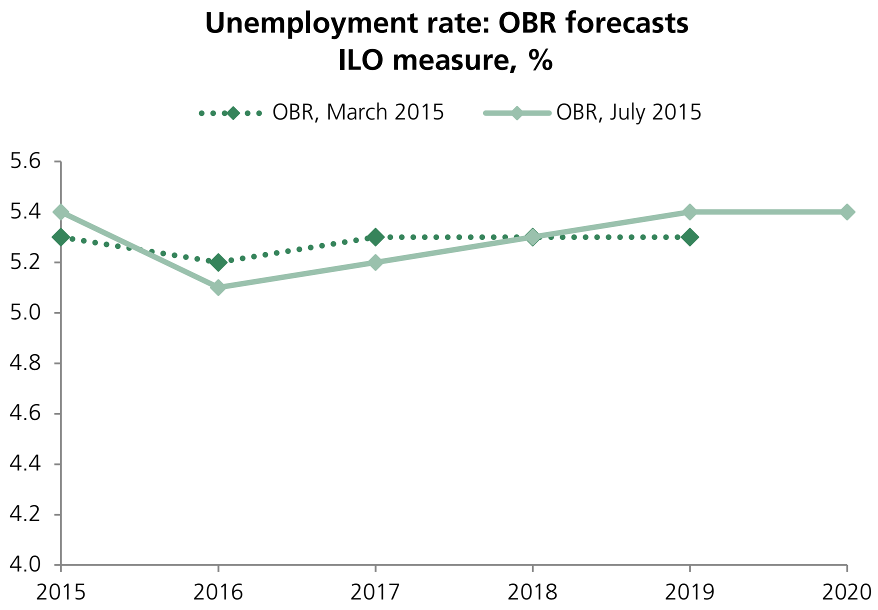
OBR forecasts for the unemployment rate are broadly similar to those made at the time of the March Budget. A slightly lower unemployment rate is forecast for 2016 and 2017, and a slightly higher rate is forecast for 2019.

The number of people in employment is forecast to rise to 32.1 million by 2020, along a very similar trajectory to that forecast by the OBR at the time of the March Budget.

The number of people claiming unemployment benefits (the claimant count) is forecast to fall to 730,000 in 2016 before rising to 790,000 by 2020.

OBR forecasts: employment and unemployment

	2015	2016	2017	2018	2019	2020
Employment, millions						
OBR, March 2015	31.1	31.4	31.5	31.7	31.9	na
OBR, July 2015	31.2	31.5	31.6	31.7	31.9	32.1
ILO unemployment rate, %						
OBR, March 2015	5.3	5.2	5.3	5.3	5.3	na
OBR, July 2015	5.4	5.1	5.2	5.3	5.4	5.4
Claimant count, millions						
OBR, March 2015	0.77	0.74	0.76	0.77	0.77	na
OBR, July 2015	0.78	0.73	0.75	0.77	0.78	0.79



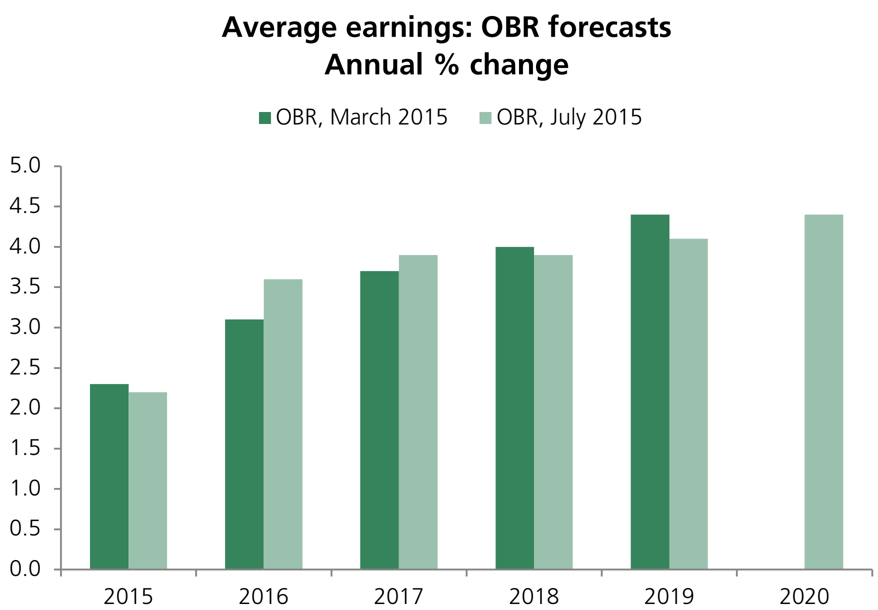
2.4 Average earnings

The OBR forecasts that annual growth in average wages will increase from 2.2% in 2015 to 4.4% in 2020 (in cash terms).

The OBR's forecasts published alongside the Summer Budget are for higher annual growth in wages in 2016 and 2017 compared to the forecasts published alongside the March Budget, with lower growth in 2018 and 2019.[1]

OBR forecasts of average earnings (% change on previous year)

	2015	2016	2017	2018	2019	2020
OBR, March 2015	2.3	3.1	3.7	4.0	4.4	na
OBR, July 2015	2.2	3.6	3.9	3.9	4.1	4.4



[1] The OBR's measure of average earnings (using national accounts data) is different to other, more commonly-used, measures of earnings such as Average Weekly Earnings and the Annual Survey of Hours and Earnings.

3. OBR forecasts for the public finances

OBR forecasts: public finances

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Net borrowing, £ billion						
OBR, March 2015	75	39	13	-5	-7	na
OBR, July 2015	70	43	24	6	-10	-12
Net borrowing, % of GDP						
OBR, March 2015	4.0	2.0	0.6	-0.2	-0.3	na
OBR, July 2015	3.7	2.2	1.2	0.3	-0.4	-0.5
Net debt, £ trillion						
OBR, March 2015	1.53	1.58	1.61	1.62	1.63	na
OBR, July 2015	1.53	1.58	1.60	1.62	1.62	1.63
Net debt, % of GDP						
OBR, March 2015	80.2	79.8	77.8	74.8	71.6	na
OBR, July 2015	80.3	79.1	77.2	74.7	71.5	68.5

3.1 Public sector borrowing

The OBR forecasts that public sector net borrowing will total £70 billion in 2015/16, £5 billion less than they forecast at the time of the March Budget.

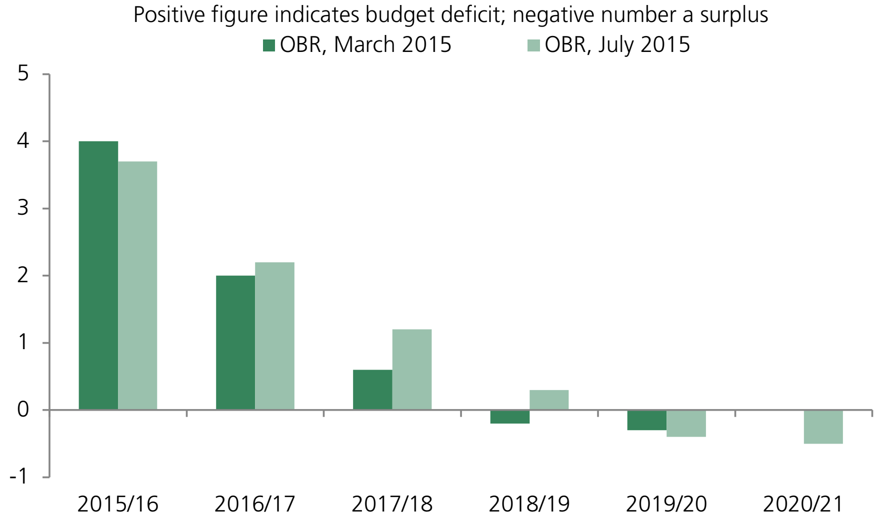
For the years 2016/17 to 2018/19, the July OBR forecasts are for higher borrowing compared to the March forecasts. The OBR state that this is largely the result of Government's decision to "increase provisional departmental spending totals significantly relative to the amounts pencilled in by the Coalition Government in March."[2] See section 4 for more on this.

The effect of higher borrowing in 2016/17 to 2018/19 is that the public finances are now forecast to enter surplus in 2019/20, a year later than forecast in March.

As a percentage of GDP, borrowing is forecast to fall from 3.7% in 2015/16 to 0.3% in 2018/19, before surpluses are recorded in 2019/20 and 2020/21. Government borrowing peaked at 10.2% of GDP in 2009/10 following the financial crisis and recession.

[2] OBR, *Economic and Fiscal Outlook*, July 2014, p 150

Public sector borrowing: OBR forecasts
% of GDP



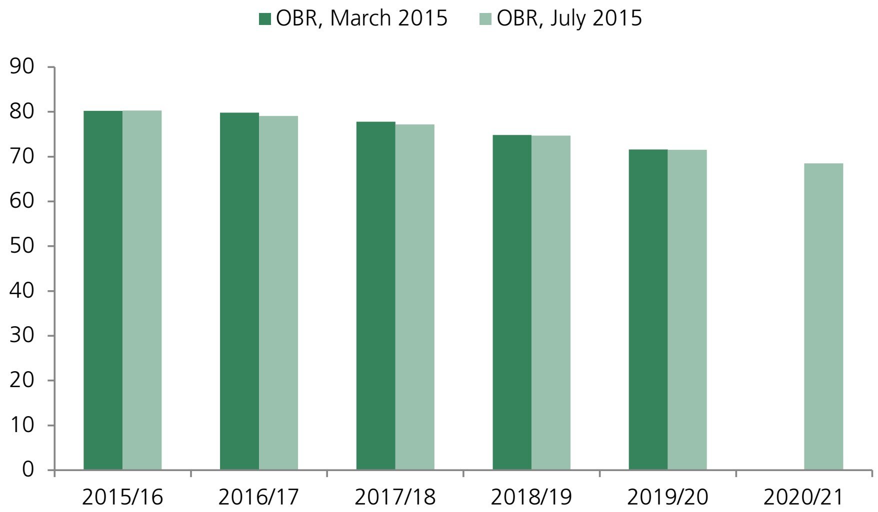
3.2 Public sector debt

OBR forecasts for government net debt are very similar to those published alongside the March Budget.

Debt will fall from 80.3% of GDP in 2015/16 to 68.5% of GDP in 2020/21. Debt in 2007/08, before the recession, was 37% of GDP.

In 2015/16 net debt is forecast to total £1.53 trillion, rising to £1.63 trillion in 2020/21 (GDP is forecast to rise more quickly than public sector net debt, hence net debt falling as a percentage of GDP over this period).

Public sector net debt: OBR forecasts
% of GDP



3.3 Fiscal targets

Fiscal mandate

The fiscal mandate requires that the cyclically-adjusted current balance – a measure of underlying government borrowing that excludes investment spending and effects from the economic cycle – be in surplus by the end of the third year of a rolling five-year period. The third year of this forecast period is 2018/19 and the OBR forecasts that the cyclically-adjusted current balance will be +1.1% in that year, meaning that the government is on track to meet this target.

OBR forecasts: Cyclically adjusted current balance, % GDP

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
OBR, March 2015	-2.1	-0.4	0.8	1.7	1.7	
OBR, July 2015	-1.7	-0.5	0.3	1.1	1.8	1.9

Note: negative figures indicate a deficit, positive figures a surplus

Supplementary target

The supplementary target requires that public sector net debt falls as a share of GDP between 2015/16 and 2016/17. The OBR forecasts that debt will fall during this period (by 1.2 percentage points from 80.3% to 79.1% of GDP).

Public sector net debt, % of GDP

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
OBR, March 2015	80.2	79.8	77.8	74.8	71.6	
OBR, July 2015	80.3	79.1	77.2	74.7	71.5	68.5

3.4 New fiscal targets

The government has revised its fiscal targets, alongside the Summer Budget. If agreed by the House of Commons, the new fiscal mandate will require the public sector budget to be in surplus in 2019/20 and in subsequent years when the economy is in 'normal times'.

The new targets were published in a revised Charter for Budget Responsibility, which sets out the government's fiscal framework, and will be voted on in the House of Commons during the autumn.

The new targets

The current fiscal mandate will be replaced with a target for the budget to be in surplus by the end of 2019/20. Once a headline surplus has been achieved the mandate will require a surplus in each subsequent year.

The supplementary target will also be revised. The new target is for public sector net debt as a percentage of GDP to fall each year to 2019/20.

The new targets will apply during 'normal times'. If annual real growth in the UK economy is less than 1%, the OBR will judge there to have been a significant negative shock, and the economy will be out of normal times.

A budget surplus is achieved when the public sector spends less than it receives from taxes and other receipts.

A significant negative shock is defined as real GDP growth of less than 1% on a rolling 4-quarter-on-4 quarter basis.

If the OBR judges that a negative shock has occurred, or will occur over the forecast period, the fiscal targets will be suspended. The Treasury must then set out a plan to return the budget to surplus including temporary fiscal targets. The plan to bring a budget surplus, and its targets, must be approved by a vote in the House of Commons.

The OBR forecasts suggest that the government are on course to meet the new targets.

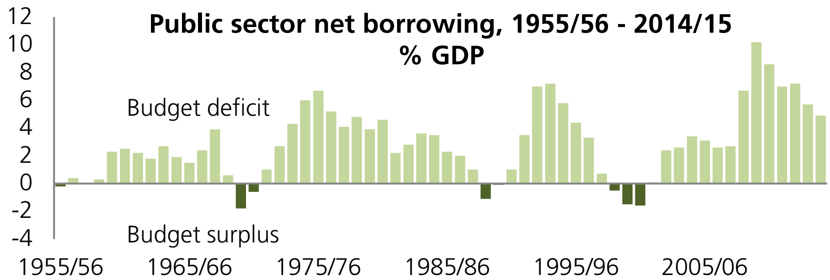
The welfare cap rule is unchanged in the revised Charter for Budget Responsibility.

Previous budget surpluses and non-normal times

The OBR has said, of the new fiscal mandate, that:

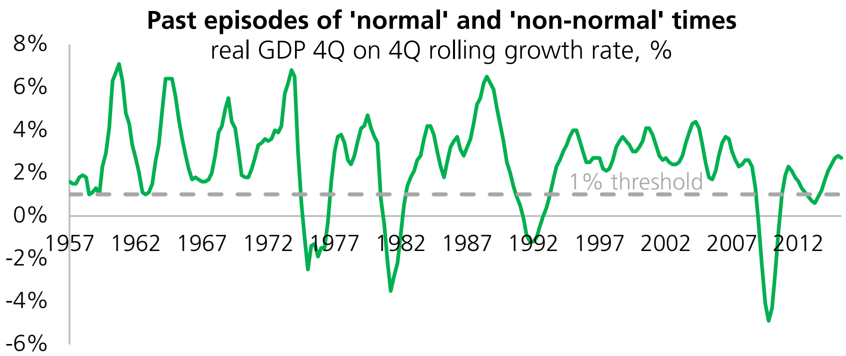
> This is ambitious relative to the fiscal performance of past governments.[3]

Over the past six decades budget deficits have been the norm. Since 1955/56 the UK's public sector budget has been in surplus in only eight years; the last surplus was recorded in 2000/01. OBR forecasts suggest that the UK is set to return to surplus in 2019/20.



source: ONS. Public Sector Finances

The OBR calculates that since 1957 there have been 40 quarters in which the economy was in non-normal times; equivalent to 17% of all the quarters between 1957 and 2015 Q2.[4]



3 OBR. Economic and fiscal outlook July 2015, 8 July 2015, para 5.18
4 OBR. Economic and fiscal outlook July 2015, 8 July 2015, para 5.21-5.24

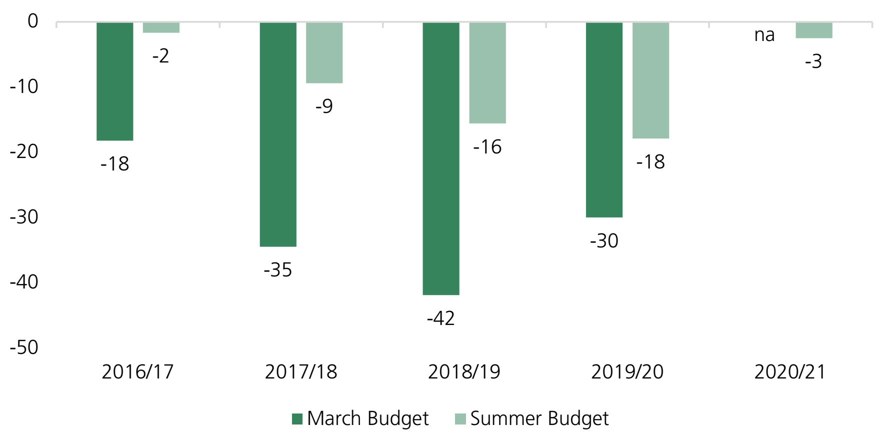
4. Public spending

Figures published alongside the Summer Budget show that public spending will fall in real terms over the course of this Parliament, but by less than Coalition Government plans set out in the March Budget suggested.

In 2015/16 departmental spending will be £315 billion.[5] The Summer Budget shows spending falling in each year to 2019/20, by which time, it will be £18 billion lower in real terms. Spending is then forecast to rise in 2020/21 to £313 billion, £3 billion less than the 2015/16 figure.

The plans in the March Budget suggested that by 2018/19, spending would have fallen by £42 billion, more than double the reduction planned in the Summer Budget. The March Budget also planned to achieve the total reductions a year earlier than the Summer Budget.

Cumulative real terms change in departmental spending
£ billions, from 2015/16



However, the Government's decision to delay and reduce the changes to departmental spending compared to the March plans contribute to the fact that the OBR now forecasts the public finances to enter surplus a year later, in 2019/20. Forecasts suggest the Government will borrow £6 billion in 2018/19. At the time of the March Budget, forecasts suggested a surplus of £5 billion in that year.

In addition to setting out the overall path for departmental spending over this Parliament, the Budget also included some spending commitments. Defence spending will increase to 2% of GDP so that the UK meets the NATO target in each year of the decade. NHS spending will increase by £8 billion a year by 2020/21. These commitments, combined with earlier promises to protect the schools and international aid budgets mean that 'unprotected' departments see significant real terms budget reductions of around 13% between 2015/16 and 2019/20. On top of reductions in the last Parliament the budgets of the unprotected departments will be a third lower in real terms in 2019/20 compared to 2010/11, according to analysis from the IFS.

[5] The resource Departmental Expenditure Limits (rDEL).

5. National Living Wage

During the Financial Statement the Chancellor announced the introduction of a new requirement in minimum wage legislation, described as a "National Living Wage" (NLW).[6] The key features of the NLW are:

- it will be available to workers aged 25 and over;
- it will be at an initial rate of £7.20 per hour; and
- it will be introduced from April 2016.

If the NLW is set at £7.20 per hour, it will be 50p higher than the comparable National Minimum Wage rate. The Chancellor indicated that the initial rate of £7.20 is based on a Resolution Foundation review of the National Minimum Wage, chaired by Professor Sir George Bain (founding Chair of the Low Pay Commission).[7]

5.1 The National Living Wage, the Living Wage and the National Minimum Wage

The NLW is distinct from the existing Living Wage, currently set at £7.85 per hour outside London, and £9.15 per hour in London. The Living Wage is paid voluntarily by employers and set according to the cost of achieving an adequate standard of living.[8]

The NLW will sit alongside the existing National Minimum Wage, which is prescribed at different rates for:

- apprentices £2.73;
- those under 18 £3.79;
- those 18 to 20 £5.13;
- and those 21 and over £6.50.[9]

It appears that once the NLW is introduced the 21-and-over National Minimum Wage rate (£6.70 from October 2015) will become a 21-24 rate, with the NLW applying to those 25 and over. This has led some to describe the NLW as a new minimum wage rate rather than a living wage as described above;[10] or, as the Office for Budget Responsibility (OBR) describes it, a "Living Wage Premium … that will apply on top of the National Minimum Wage".[11]

5.2 Setting the National Living Wage

It is not entirely clear how the NLW will be implemented. Currently, the National Minimum Wage Act 1998 provides the skeleton for minimum

6 HC Deb 8 July 2015 c338
7 See: Resolution Foundation, *More than a minimum: The review of the minimum wage – Final report*, March 2014; HC Deb 8 July 2015 c338
8 See: *The Living Wage*, Commons Briefing Paper SN06675, June 2015
9 See: *The National Minimum Wage: rates and enforcement*, Commons Library Briefing SN06898, October 2014
10 The Institute for Fiscal Studies in particular has avoided using the term National Living Wage, referring to the NLW as a "higher minimum wage for those over 25" (see below)
11 OBR, *Economic and Fiscal Outlook*, Cm 9088, July 2015, p199

wage law, fleshed out by the National Minimum Wage Regulations 2015 (SI 2015/621). The rates are set annually by additional regulations, which come into force each October. It may be that the NLW requires new primary legislation.

The National Minimum Wage is set by Government with the advice of the Low Pay Commission, who make annual recommendations in response to a remit set by Government. The Budget document indicates that the NLW will form a new aspect of the Low Pay Commission's remit:

> The government will ask the Low Pay Commission (LPC) to set out how the new NLW will reach 60% of median earnings by 2020. Based on the OBR's earnings forecasts, this means that the NLW will reach the government's target of over £9 by 2020.[12]

The NLW's basis on 60 per cent of median earnings follows the recommendations of the aforementioned Resolution Foundation review, which concluded:

> Our view, based on UK and international evidence, is that a wage-floor worth 60 per cent of the median wage is a reasonable lodestar, indicating the most that a minimum wage could contribute to the goal of reducing low pay over the medium to long term.[13]

In their analysis of the Budget announcements, the OBR estimated that (based on an assumption that median earnings will rise in line with average earnings):

> the NLW will rise from £7.20 in April 2016 (equivalent to around 55 per cent of estimated median hourly earnings for employees aged 25 and over) to around £9.35 in April 2020 (reaching 60 per cent of expected median hourly earnings for that group) in steps that imply the rise relative to median hourly earnings is a straight line. The effective minimum wage for the affected age group will therefore be over 13 per cent higher in 2020 than would otherwise have been the case.[14]

5.3 Impact

In terms of its direct effect on earnings, the OBR estimates that:

> around ¾ million people aged 25 and over would move from receiving the NMW to the higher NLW. Just under an additional 2 million people would move from having hourly earnings between the £8.25 assumed NMW and the £9.35 assumed NLW to at least the NLW. Hourly earnings of around £9.35 would place an individual at the 16th percentile of the earnings distribution. Assuming that spillover effects extend to the 25th percentile implies that an addition 3½ million people will also be affected, taking the total number of people affected to around 6 million.[15]

According to the OBR, assuming no change in employment or hours worked, the NLW would result in a 0.3 per cent increase in whole

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12 HM Treasury, *Summer Budget 2015*, HC 264, July 2015, p37
13 Resolution Foundation, *More than a minimum: The review of the minimum wage – Final report*, March 2014, p10
14 OBR, *Economic and Fiscal Outlook*, Cm 9088, July 2015, p200
15 Ibid., p201

economy compensation of employees,[16] which employers could respond to in a variety of ways, including: reducing hours; reducing jobs; replacing over 25s with younger workers; or increasing prices.[17] It estimates that as a result of the NLW, by 2020 there will be 60,000 fewer jobs than there would otherwise have been.[18]

To help offset some of the employer costs associated with the NLW, the Government announced that, alongside a reduction in corporation tax, it will increase the National Insurance contributions Employment Allowance from £2,000 to £3,000 a year:

> This will help all businesses and charities, particularly smaller ones, with additional wage costs. As a result, up to 90,000 employers will see their employer NICs liability reduced to zero. When introduced in 2014, the Employment Allowance offset the NICs costs of employing 4 workers full time on the NMW. The increase in the Employment Allowance will mean firms will be able to continue to employ 4 workers full time on the new NLW next year, without paying any NICs.[19]

As to the interaction with reductions in tax credits (see section 6), the Institute for Fiscal Studies (IFS) has said:

> quite different groups are affected by the different policies. They have different aims and different effects. Many of the gainers from the higher wage are single childless or married to someone on higher earnings. They are outside the tax credit system altogether.[20]

Although the IFS sees the policies as targeting different groups, they note that the more important tax credits are to a worker's income "the less likely they are to be compensated by the higher minimum wage" and that "the increase in the minimum wage simply cannot provide full compensation for the majority of losses that will be experienced by tax credit recipients".[21]

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16 Ibid., p202
17 Ibid., p203
18 Ibid., p204
19 HM Treasury, *Summer Budget 2015*, HC 264, July 2015, p34
20 IFS, *Summer post-Budget briefing, Paul Johnson's opening remarks: 9 July 2015*, p3
21 Ibid.

6. Welfare measures in the Budget

The Government had been expected to announce additional welfare savings of £12 billion a year by 2017-18. The welfare measures in the Budget are expected to produce savings of £12 billion, but not until 2019-20. By 2020-21, the welfare measures are expected to yield savings of £13 billion a year.

A package of changes to tax credits and to Universal Credit will result in savings of £5.8 billion a year by 2020-21. A four-year freeze in working-age benefits is expected to save £4 billion by 2020-21. Changes to housing benefits and Support for Mortgage Interest will save £2.0 billion, abolishing the Employment and Support Allowance Work-Related Activity Component for new claims £640 million, and reductions in the household benefit cap a further £0.5 billion.

6.1 Four year benefits freeze

The Government had originally proposed a two-year freeze for most working-age benefits, estimated to save around £1 billion by 2017-18. The proposed four-year freeze to 2019-20 saves considerably more. The largest savings come from tax credits (£2.0 billion in 2020-21), followed by Child Benefit (£0.6 billion) and Employment and Support Allowance (£0.6 billion).[22]

The benefits affected include Jobseeker's Allowance, ESA (but not the Support Component), Income Support, Child Benefit, applicable amounts in Housing Benefit, Local Housing Allowance rates, tax credit elements and equivalent rates in Universal Credit. Statutory payments including Statutory Maternity Pay and Statutory Sick Pay, disability and carer additions, extra-costs disability benefits such as DLA and Personal Independence Payment, and the ESA Support Component, will continue to rise in line with the Consumer Price Index (CPI). Pensioner benefits are unaffected.

The OBR expects the CPI to rise by a cumulative 4.8 per cent over the period 2016-17 to 2019-20.[23] If this is the case, the basic rate of JSA for example would fall in real terms from its current level of £73.10 a week to £69.75 a week.

The IFS estimates that the freeze would affect 13 million families, who would lose £260 a year on average (7.4 million of whom are in work, losing £280 a year on average).[24]

The four year freeze follows three years in which increases in most working age benefits have been limited to 1% a year.[25] The IFS estimates that the cumulative effect on benefits affect by 1% uprating

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22 OBR, *Economic and Fiscal Outlook*, Cm 9088, July 2015, para 4.101
23 Ibid.
24 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015
25 For background see Library briefing RP 13/01, *Welfare Benefits Uprating Bill*

and the proposed freeze will be a total real terms cut of 8% between 2012 and 2019.[26]

6.2 Tax credits and Universal Credit

The biggest single area of welfare savings involves changes to tax credits and to Universal Credit (which is replacing tax credits and means-tested benefits for people of working age). The overall package is estimated to save £4.6 billion in 2016-17, rising to £5.8 billion in 2020-21. The changes will see expenditure on tax credits return to 2007-08 levels in real terms. The main savings[27] arise from:

- reducing the income threshold in tax credits and UC work allowances (£3.4 billion a year by 2020-21);
- limiting the child element of tax credits and UC to two children for new claims and births after April 2017 (£1.4 billion a year by 2020-21);
- increasing the tax credits withdrawal rate (taper) from 41% to 48%, so that tax credits reduce more sharply as income increases (saving £1.5 billion in 2016-17, declining to £245 million by 2020-21); and
- removing the family element in tax credits and UC (and the family premium in Housing Benefit) for new claims from 2016 or 2017 (saving £675 million a year by 2020-21)

The IFS estimates that the long-run savings from some of the measures will be even greater (as transitional protection for existing families declines). It estimates the long-run savings from the abolition of the family element at around £2 billion a year, and from removing tax credit/UC support for third and subsequent children at around £3 billion a year.[28] At April 2015, just under 900,000 families (of whom 590,000 were in work) were receiving tax credits for three or more children.[29]

The measures whose impact will be felt most immediately (from April 2016) are the increase in the tax credit taper to 48%, and the cut in the tax credits income threshold (the point at which tax credits start to be withdrawn) from £6,420 a year to £3,850. The following chart from the OBR's July 2015 *Economic and Fiscal Outlook* report[30] illustrates the impact of these measures, along with the four year freeze in tax credit elements, in 2019-20 for a couple with one child, where both adults work.

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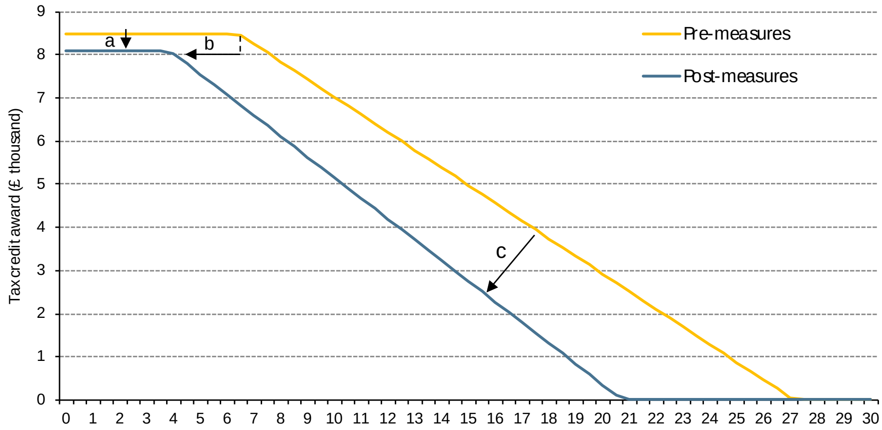
26 Ibid.

27 The Budget also announced a reduction in the in-year income disregard – which allows income increases below a certain amount to be disregarded when calculating entitlement to tax credits – from £5,000 to £2,500 from April 2016, saving £250 million a year by 2018-19. The previous Government had already reduced the disregard from £25,000 to £10,000 in April 2011, and to £5,000 in April 2013. The further reduction will increase the number of tax credit overpayments

28 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015

29 HMRC, Child and Working Tax Credits Statistics: April 2015, Table 3.2

30 Cm 9088, Chart 4.10, p126



Source: OBR

The freeze in tax credit elements reduces the maximum tax credit award in real terms (marked 'a' in the chart). For working families, the maximum tax credit award starts to be withdrawn earlier because of the reduction in the threshold from £6,420 to £3,850 (b), and at the faster rate of 48 pence in the pound (c). The combined effect is to reduce tax credit awards significantly for working families, and to take some families out of tax credits altogether – in this example, the tax credit award is extinguished at £21,000 instead of £27,000.

Looking further ahead, the introduction of the two child limit, and in particular the cuts to the Universal Credit work allowances (the amounts claimants can earn before their UC award starts to be withdrawn) significantly alters the parameters of Universal Credit and therefore any assessment of the impact of UC, both in terms of gainers and losers, and on work incentives. The Government has always emphasised that work allowances, more generous than existing earnings disregards in the benefits system, are integral to the aim of ensuring that, under UC, "work pays."[31] Under the Budget proposals, work allowances are abolished completely for non-disabled households without children, and reduced for most other groups. The IFS estimates that, as a result, just over three million families will lose an average of just over £1,000 a year. It also reduces the incentive on the first earner in a family to enter work.[32]

The IFS also questions claims that a new, higher "National Living Wage" (see section 5) would compensate for reductions welfare spending. Speaking at it post-Budget briefing on 9 July, the Institute's Director, Paul Johnson, commented:

> …the key fact is that the increase in the minimum wage simply cannot provide full compensation for the majority of losses that will be experienced by tax credit recipients. That is just arithmetically impossible. The gross increase in employment income from the higher minimum wage is about £4 billion. Welfare spending as a whole is due to fall by £12 billion and, even excluding the effects of the four year freeze tax credit spending is due to be cut by getting on for £6 billion. And of course many of

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31 See for example DWP, Universal Credit at Work, October 2014, p6

32 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015

> the recipients of the higher minimum wage will not be tax credit recipients. Unequivocally, tax credit recipients in work will be made worse off by the measures in the Budget on average.[33]

6.3 Housing support

Housing Benefit

The Budget includes several measures which are aimed at reducing expenditure on Housing Benefit and, in due course, the housing element of Universal Credit:

- As noted previously, the applicable amounts in Housing Benefit and Local Housing Allowance[34] rates will be frozen for four years from 2016-17. There will be some provision for high rent areas.
- The family premium for Housing Benefit will be removed for new claims and new births from April 2016.
- In order to ensure consistency with the changes to tax credits, an equivalent change to limit support to two children from April 2017 will be made to Housing Benefit. There will be some protection for existing claimants.
- The backdating of Housing Benefit will be reduced from six months for working-age claimants and three months for pensioners to a maximum of four weeks.
- Housing Benefit entitlement for young people aged 18-21 will be restricted from April 2017. There will be exemptions for parents whose children live with them, vulnerable groups and those who were living independently and working continuously for the preceding six months.

Savings from the first three measures have been included in the estimates for the wider benefits freeze and changes to Tax Credit and Universal Credit. The backdating restriction is estimated to save £10m in 2016-17[35] while restricting access to Housing Benefit for some 18-21 year olds will produce estimated savings of £40m in 2020-21.[36]

Additional information and comment on the restriction of Housing Benefit for 18-21
year olds can be found in Library Briefing Paper 06473, Housing Benefit: withdrawing entitlement from young people.

Support for mortgage interest

The Support for Mortgage Interest (SMI) scheme provides help with mortgage costs is to claimants of certain means-tested benefits for people not in full-time work. As part of a package of temporary measures introduced by the Labour Government in January 2009 to help people affected by the economic downturn, the cap on mortgage loans attracting support was increased to £200,000 for new working age claims.[37]

33 IFS Post-Budget Analysis: Opening remarks, 9 July 2015
34 LHA is payable to eligible claimants living in the private rented sector.
35 HM Government, Summer Budget 2015: Policy Costings, July 2015, p187
36 ibid
37 See Commons briefing paper SN06618, Support for Mortgage Interest scheme

The Government proposes to maintain the loan cap at £200,000 beyond April 2016, but to replace SMI from April 2018 with a scheme under which support for homeowners would be provided in the form of an interest-bearing loan, secured against the mortgaged property. Net savings of £255 million a year are expected by 2020-21.

The 2010 Government launched an "informal call for evidence" in December 2011 on proposals to reform SMI. Under the plans set out then, SMI would be recouped via a charge on the property.[38]

6.4 Social housing rents

Rent reductions

All social landlords will be required to reduce their rent levels by 1% per year over the four years from 2016-17 – they are currently subject to rent increases of CPI + 1%. The aim of this measure is to reduce the cost of Housing Benefit and UC paid to tenants in social housing. Measures to introduce this requirement have been included in the *Welfare Reform and Work Bill.*

According to the IFS analysis:

- This represents a cut of 12% in rents on average compared with the current policy of rents increasing annually by CPI + 1%.
- 1.2 million households in social rented housing who are not reliant on Housing Benefit will gain an average of £700 per year (current prices).
- The 2.7 million households who are reliant on Housing Benefit will not gain but work incentives for this group will be strengthened.
- Social landlords' income will be reduced by around £2.5bn in today's prices.[39]

The Office for Budget Responsibility has commented on the potential impact the measure will have on landlords' ability to invest in housing:

> …the 1 per cent a year reductions in social sector rents for four years from April 2016 announced in this Budget will directly reduce social landlords' rental income. We expect that this will reduce their ability and willingness to invest in housing, so we have lowered our forecast for residential investment, proportionate to the expected reduction in rental income. The effect is to reduce the level of private residential investment by around 0.7 per cent by the end of the forecast period, which is broadly consistent with a reduction in housebuilding of 4,000 in 2020-21. Over the forecast period, our assumptions suggest around 14,000 fewer affordable homes will be built. We do not expect private sector house-builders to offset this effect to any material degree.[40]

Pay to Stay

From 2017-18 social landlords will be required to charge high income social tenants in England a market, or closer to market rent. These

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38 For details of the December 2011 proposals and a summary of responses to them see section 6 of Commons briefing paper SN06618
39 ibid
40 OBR, *Economic and Fiscal Outlook*, Cm 9088, July 2015, p41

higher incomes will be £30,000 and £40,000 in London. The additional rental income collected by local authorities will be returned to the Exchequer in order to help pay down the deficit; housing associations will be expected to reinvest the additional rental income in housebuilding. Consultation on the detail of this measure is expected in due course.

The IFS estimates that this is likely to affect around 10% of social tenants. It is expected to yield £240m in 2020-21.[41] Concerns have been raised around the potential disincentive for social tenants to increase their incomes. The National Housing Federation has said:

> Given the scale of the housing crisis, it is understandable that Government is looking for higher earners to pay what they can afford for their housing.
>
> "Housing associations would like to work with the Government to find a way to make sure tenants pay a rent that reflects their household earnings, but would encourage them to avoid more red tape or blanket approaches to dealing with housing and welfare challenges.
>
> "As independent businesses, housing associations need the flexibility to set their own rents in a way which reflects government spending constraints, their own charitable status, local housing markets and people's ability to pay."[42]

6.5 ESA in the Work-Related Activity Group

Employment and Support Allowance (ESA) is an income-replacement benefit for people identified as having a "limited capability for work" as a result of sickness or disability.[43] Claimants may be placed in the "Support Group" or, if they are assessed as capable of undertaking some form of work-related activity, the Work-Related Activity Group (WRAG). Once assessed, claimants receive a basic weekly benefit of £73.10, plus either £36.20 (if in the Support Group) or £29.05 (if placed in the WRAG).[44]

In his Budget speech the Chancellor referred to the "perverse incentive" whereby ESA claimants in the WRAG received more money than claimants of Jobseeker's Allowance "but get nothing like the help to find suitable employment," noting that while the JSA caseload had fallen by 700,000 since 2010, over the same period the numbers on incapacity benefits including ESA had fallen by just 90,000, despite 61% of claimants in the WRAG saying they wanted to work.[45] The Government proposes to align ESA rates for those in the WRAG with JSA (currently £73.10 for people aged 25 and over) for new claims from April 2017, while providing "new funding for additional support to help

41 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015
42 NHF Press Release, Emergency Budget, 9 July 2015
43 For further information see Commons Briefing papers CBP07181, Employment and Support Allowance: An introduction
44 The precise amount of benefit payable will however depend on the claimant's circumstances
45 HC Deb 8 July 2015 c333

claimants return to work."[46] It says that this will "ensure the right incentives and support are in place for those closer to the labour market to help them make this transition when they are ready."[47] ESA claimants in the Support Group are unaffected. Savings of £640 million a year are expected by 2020-21.

At November 2014, 492,000 ESA claimants were in the WRAG (of whom 248,000 were suffering from mental and behavioural disorders); and 1,180,000 were in the Support Group (a further 529,000 ESA claimants were in the assessment phase).[48]

Paul Farmer, Chief Executive of Mind, said they were "extremely disappointed" at the ESA announcement, which would "make people's lives even more difficult and will do nothing to help them return to work." He added:

> "People being supported by ESA receive a higher rate than those on JSA because they face additional barriers as a result of their illness or disability, and typically take longer to move into work. Almost 60 per cent of people on JSA move off the benefit within 6 months, while almost 60 per cent of people in the WRAG need this support for at least two years. It is unrealistic to expect people to survive on £73 a week for this length of time. We're concerned that the impact of these changes will be felt by our overstretched NHS services, as these cuts hit individual's mental health as well as their pockets."
>
> "It is insulting and misguided to imply that ill and disabled people on ESA will be more likely to move into work if their benefits are cut. The vast majority of people with mental health problems want to work but face significant barriers as a result of the impact of their condition and the stigma they often face from employers."[49]

The IFS comments that abolishing the addition for ESA WRAG claimants strengthens the incentive for claimants to try to get into the ESA Support Group,[50] a point also made by Ben Baumberg of the University of Kent, who argues that it could thereby discourage claimants from risking work. He also states that removal of the addition could lead to an increase in the proportion of claimants placed in the Support Group on the grounds that being put in the WRAG would be a risk to their health.[51]

The proposal also involves the abolition of the Limited Capability for Work element in Universal Credit. For adults therefore, only those in the Support Group will receive additional support for disability with their UC award.[52]

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46 Ibid.
47 Summer Budget 2015, HC 264 2015-16, para 41
48 DWP Tabulation Tool
49 Budget benefit cut 'insulting and misguided', Mind press release, 8 July 2015
50 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015
51 Ben Baumberg, Why the Budget's cut to ESA may backfire, Rethinking Incapacity blog, 8 July 2015
52 UC claimants in the WRAG may still however benefit from the higher work allowance for those with a "limited capability for work." See Commons Briefing

6.6 The Benefit Cap

The proposal to reduce the Benefit Cap from £26,000 for families with children to £23,000 (£440 a week) was included in the Conservative Party's 2015 Manifesto[53] and had been widely trailed prior that (see Library Briefing Paper 06294, The Benefit Cap)

The Chancellor announced that the reduction to £23,000 for families would apply in London (£15,410 for single people and couples) while the cap will be reduced further to £20,000 (£13,400 for single people and couples) outside of Greater London. The reductions will take effect in April 2016. Measures to reduce the cap have been included in the *Welfare Reform and Work Bill.* The existing link between the level of the cap and estimated average earnings is to be removed. Existing exemptions from the cap will remain in place.

Around 23,000 households are currently subject to the £26,000 cap – most of these are larger families and/or those living in a high rent area.[54] The IFS estimates that the measure will save £200m in 2020-21 after other changes.[55] Certain families stand to lose a maximum of £6,000 (£3,000 in London).[56]

Discretionary Housing Payments will be funded by £800m over the next five years. Funding in 2015-16 is £125m.

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papers SN06548, Draft Universal Credit Regulations 2013, section 6, for information on support for disabled people in UC

[53] Conservative Party Manifesto 2015, p25

[54] DWP, Benefit cap: number of households capped to February 2015, 14 May 2015

[55] Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015

[56] Ibid

7. Welfare measures: statistics

Changes to tax credits income thresholds and taper rates

- The reduction in the income threshold in tax credits from £6,420 to £3,850 per year in April 2016 is likely to affect all in-work households in receipt of tax credits. In April 2015 this stood at around 3,277,300 families with around 5,162,500 children.

- At this time there were 2,513,600 families whose working tax credit entitlements were tapered at the 41% rate. In other words, their award was withdrawn at a rate of 41 pence for every extra pound earned over the £6,420 threshold. From April 2016 the lowering of the threshold is likely to mean that all working tax credit claimants will now be subject to the 48% withdrawal on income over £3,850, including the 763,700 families that previously received their full entitlement.

Limiting the child element

- The Budget limits tax credit support to two children so that any child born into a family with two or more children after April 2017 will not be eligible for additional support.

- At present there are 898,600 families with three or more children that receive child tax credit. Of the 7,637,000 children the child element is claimed for, 1,309,200 of them (17%) are the third or subsequent child in the family.

- The ability to claim the £2,780 child element for no more than two children will not be applied to current claims but to future births as of April 2017. However, it will also apply to new Universal Credit claimants after this date which includes previous claims with an interruption of six months or more. The expected number of families or children who will be affected by this restriction from 2017 has not been published.

Withdrawal of family element

- At present, the Family Element of child tax credit entitles any family with children to an annual amount of £545. In April 2015 there were 4,008,600 families in receipt of this, but it will no longer be available to new claims after April 2017.

Freezing working-age benefit rates

- The Budget also announced a freeze of working-age benefits for four years from 2016-17 to 2019-20. The Institute for Fiscal Studies (IFS) have stated that 13 million families will lose £260 a year on average as a result of the freeze and of this group, 7.4 million in work families stand to lose £280 a year on average.[57]

- The table below details the number of claimants of various types of working-age benefit based on recent data.

Working-age benefit caseloads in Great Britain

Benefit Type	Number of claims
Child Benefit	7,195,865
ESA and incapacity benefits	2,439,000
Job Seekers' Allowance	704,000
Income Support	762,000
Local Housing Allowance	1,400,000
Tax Credits	4,566,900

Source: DWP benefit expenditure and caseload tables
HMRC personal tax credits statistics
HMRC child benefit statistics

Note: Due to overlap between groups, summing the number of claims is not equal to the total due to double-counting

Restricting housing benefit entitlement for young people

- Automatic entitlement to housing support for new claims in Universal Credit will be removed from 18 to 21 year olds out of work from April 2017. As of February 2015, the number of out-of-work housing benefit claimants aged 18-21 with no child dependents stood at 4,333.

- While this only applies to new cases, even if current claims were subject to this limitation the actual number affected would likely be lower due to exemptions of vulnerable young people.

Reduction of the benefit cap

- The Budget also announced a lowering of the cap on the total amount of benefits an out of work family can receive from £26,000 to £20,000 (£23,000 in London). While there are no figures published on the number of families that are expected to be affected by this change, IFS figures indicate that 23,000 families have had their benefits capped at the current level.[58]

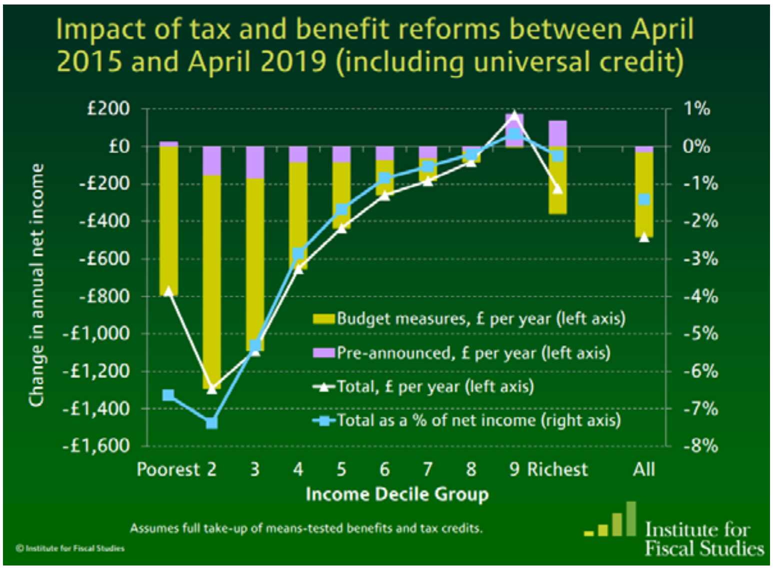
[57] http://www.ifs.org.uk/uploads/publications/budgets/Budgets%202015/Summer/Hood_distributional_analysis.pdf
[58] Ibid

8. IFS's distributional analysis

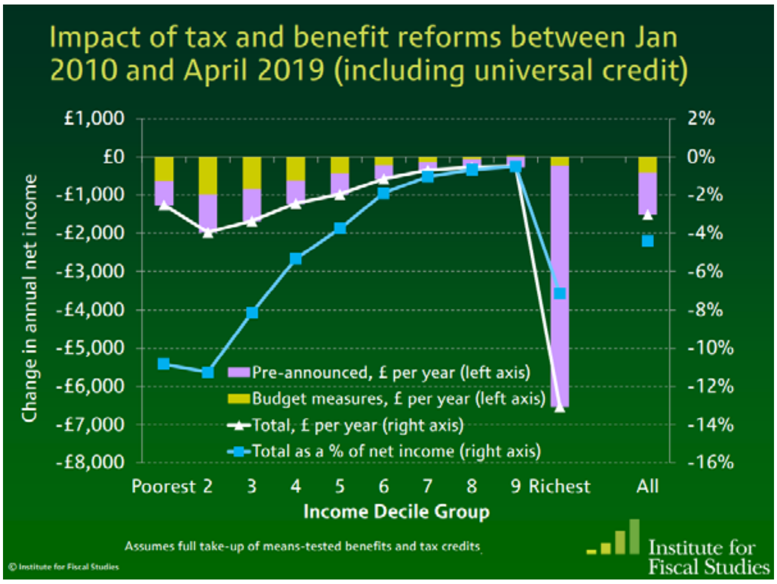
As part of their post-Summer Budget briefing, the Institute for Fiscal Studies (IFS) published a household distributional impact of tax and benefit changes.[59]

The analysis, shown below, looks at changes between April 2015 and April 2019. All tax and benefit reforms affecting households are included, except the ending of housing benefit entitlement for 18-21 year olds out of work.

The analysis includes pre-announcements as well as measures included in the Summer Budget and assumes that measures which only affect new claimants are fully in place.



The IFS also produced analysis for the period between January 2010 and April 2019.



[59] Institute for Fiscal Studies, Post-Budget Analysis: Benefit changes and distributional analysis

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