Uprating of social security benefits

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Section Social Policy Section

Social security legislation requires the Secretary of State to review the level of certain benefits annually to determine whether they have retained their value relative to the general level of prices. Some benefits must be "uprated" at least in line with prices, while the basic State Pension and standard minimum guarantee in Pension Credit must be increased at least in line with earnings. The current Government has also said that the basic State Pension will be uprated by the highest of earnings, prices or 2.5% (the "triple guarantee").

For other benefits – including Child Benefit, Income Support, Jobseeker's Allowance and Housing Benefit – there is no statutory requirement to uprate. Historically however governments have exercised their discretion by increasing means-tested benefits in line with the "New Rossi index" (RPI less certain housing costs).

Since 1987, benefit rates have changed from April each year, based on the increase in the relevant index (RPI or Rossi) over the twelve months to the previous September. The legislation does not require the use of September figures however.

In the June 2010 Budget it was announced that, from April 2011, the measure of price inflation used for uprating benefits and tax credits would henceforth be the Consumer Prices Index (CPI), rather than the RPI or Rossi.

The September 2011 CPI was 5.2%, up from 4.5% in August and its highest rate of increase since September 2008 (the all-items RPI increased by 5.6% in the twelve months to September 2011, while the Rossi index increased by 6.8%).

Media reports suggested that the Government considered various options – including freezing benefits, increasing some benefits by less than the CPI, or basing the uprating on the average level of the CPI over a six month period – in light of the higher than expected CPI figure. In his Autumn Statement on 28 November, the Chancellor said that while most benefits would rise in line with the CPI from April 2012, the couple and lone parent elements of Working Tax Credit would be frozen and the additional £110 increase in the child element Child Tax Credit over and above CPI – announced last year – would not now go ahead. These measures are expected to yield savings of £1,240 million in 2012-13.

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1 Overview of uprating policies and practices

A statutory duty to increase social security benefits and pensions annually was first introduced by section 39 of the *Social Security Act 1973*, although the first "uprating order" under the statutory duty did not take effect until 7 April 1975. Prior to this, benefits had been uprated at irregular intervals and while most benefits were increased at least in line with price inflation over the medium term, for some – most notably Family Allowances – real values declined considerably over time.[1]

Since the mid-1970s, benefits have been increased by a variety of methods, including by reference to forecasts of increases in prices and earnings, use of historical data on changes in indices, one-off payments, targeting of particular components of benefits, and changes to benefit eligibility rules. The main changes over the period as regards the uprating of benefits include:

- 1974 – decision by the incoming Labour Government to link long-term benefits such as pensions and long-term sickness and disability benefits to the higher of prices or earnings, as measured by the Retail Prices Index (RPI) and Average Earnings Index respectively.
- 1976 – shift to the use of forecasts to estimate movements in prices and earnings.
- 1979 – decision by the incoming Conservative government to link long term benefits to prices only.
- 1983 – shift back to the use of historical price data as the basis for uprating.
- 1983 – introduction of the "Rossi index" (all-items RPI less housing costs) to uprate means-tested benefits.
- 1987 – shift in annual benefit uprating date to April to align it with the tax year.
- 1992 – Rossi index replaced by the "New Rossi index" (all-items RPI minus rent, local taxes and mortgage interest payments).
- 1999 – commitment to uprate the Minimum Income Guarantee (later Pension Credit Standard Minimum Guarantee) in line with earnings.
- 2001 – announcement in the Pre-Budget Report that in future the Basic State Pension would rise by the higher of 2.5% a year or inflation
- 2006 – undertaking in Pensions White Paper to link Basic State Pension to earnings by 2015 at the latest (provisions included in the *Pensions Act 2007*).
- Under the *Pensions Act 2007*, the Requirement to uprate the Standard Minimum Guarantee at least in line with earnings, comes into force for upratings from 2008-09.
- 2010 – June 2010 budget announces that from April 2011 benefits and tax credits would be linked to the Consumer Prices Index (CPI) rather than the RPI or Rossi. "Triple guarantee" announced under which Basic State Pension to rise by the highest of earnings, prices or 2.5%.

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[1] The Family Allowance – first introduced in 1946 and replaced by Child Benefit from 1977, was only uprated four times during its existence

- 2010 – Provisions in the *Pensions Act 2007* requiring Basic State Pension to be uprated at least in line with earnings, brought into force for upratings from April 2011

Further information on upratings since 1974, including the relevant uprating factors for each year, is given in the Appendix to this note.

Historical information on benefits uprating can be found in Jonathan Bradshaw and Tony Lynes, *Benefit Uprating Policy and Living Standards*.[2] Actual rates for selected benefits since 1948, price and earnings data, and other historical information on upratings is given in the DWP *Abstract of Statistics for Benefits, National Insurance Contributions, and Indices of Prices and Earnings*, 2010 edition. Historical tables on benefit rates are also given in the Treasury's *Tax benefit reference manual: 2009-2010 edition*.

More detailed information on uprating policies and practices for social security benefits is given in section 2 below. This is followed by sections on the uprating arrangements for the Basic State Pension/Pension Credit, and for tax credits, respectively. In each case, it is important to distinguish between the **statutory requirements** in relation to uprating, and the **decisions and commitments** governments have made within the relevant statutory framework. In practice, governments have had a considerable degree of discretion in relation to uprating, even where the legislation requires benefits to be uprated annually.

2 Social security benefits

2.1 The statutory framework

The current statutory framework of uprating social security benefits is in sections 150 and 150A of the *Social Security Administration Act 1992*

Section 150(1) of the 1992 Act requires that in each tax year the Secretary of state reviews the rates of various social security benefits and pensions "in order to determine whether they have retained their value in relation to the general level of prices obtaining in Great Britain estimated in such manner as the Secretary of State thinks fit." There is therefore considerable discretion as regards the choice of inflation yardstick.

The requirement to review benefit rates annually does not cover all social security benefits. One-off payments such as the Winter Fuel Payment, the Cold Weather Payment and the Sure Start Maternity Grant are not covered. Earnings disregards and capital limits for means-tested benefits are also excluded.

Section 150(2) of the 1992 Act requires the Secretary of State to lay before Parliament a draft uprating order "Where it appears to the Secretary of State that the general level of prices is greater at the end of the period under review than it was at the beginning of that period". Any changes to benefit rates must come into force to coincide with the beginning of the tax year.[3]

[2] SPRU Social Policy Report No 1, 1995

[3] Section 150(10) requires that changes come into force in the week beginning the first Monday in the tax year, or on such earlier date in April as may be specified

The uprating order must increase the rates of certain benefits "by a percentage not less than the percentage by which the general level of prices is greater at the end of the period than it was at the beginning".[4]

The benefits to which this **statutory requirement to uprate** applies include:

- Attendance Allowance
- Guardian's Allowance
- Disability Living Allowance
- Industrial Death Benefits (existing cases only)
- Industrial Injuries Disablement Benefit
- Carer's Allowance
- Incapacity Benefit
- Additional pensions (including SERPS and Graduated Pension)
- Severe Disablement Allowance
- Widowed Mother's/Parent's Allowance
- Widow's Pension
- Bereavement Allowance

For those benefits covered by section 150 of the 1992 Act where there is no duty to uprate at least in line with prices, the legislation merely states that "if [the Secretary of State] considers it appropriate, having regard to the national economic situation and any other matters which he considers relevant", the draft uprating order may increase benefit rates "by such a percentage or percentages as he thinks fit."

The benefits **without a statutory requirement for uprating** covered by section 150 of the 1992 Act include:

- Child Benefit
- Council Tax Benefit
- Housing Benefit
- Income Support
- Jobseeker's Allowance (contributory and income-based)
- Employment and Support Allowance (contributory and income-related)
- Pension Credit (other than the Standard Minimum Guarantee)
- Maternity Allowance

4 Section 150(2)(a)

- Statutory Maternity Pay
- Statutory Sick Pay
- Statutory Paternity Pay
- Statutory Adoption Pay

2.2 Uprating policy and practice to 2010

For those benefits subject to **statutory uprating** (see above), until 2011 successive governments chose to increase rates annually at least in line with the all-items Retail Price Index (RPI).[5] As noted above however the legislation does not require the use of any particular price measure.

For those benefits covered by section 150 of the *Social Security Administration Act 1992* for which there is **no statutory requirement for uprating**, the arrangements have varied from benefit to benefit.

Child Benefit

Child Benefit was uprated annually for the first few years of the Conservative Government after 1979, but rates were frozen for three successive years from 1988. In his Budget Statement in 1991 the then Chancellor, Norman Lamont, announced a new, higher rate of Child Benefit for the first eligible child. He also gave a commitment to increase Child Benefit in line with inflation from 1992.[6]

The incoming Labour Government continued the previous Government's policy of increasing Child Benefit in line with the RPI, and in his March 1998 Budget, the then Chancellor, Gordon Brown, announced an additional increase of £2.50 a week in the rate of Child Benefit for the first child, over and above the normal uprating, from April 1999. Thereafter until the end of the Labour Government Child Benefit maintained its value in relation to the RPI, for both first and subsequent children.

The current Government announced in the June 2010 Budget that Child Benefit would be frozen for three years from April 2011.

Means-tested benefits

From 1983 means-tested benefits were uprated in line with the "Rossi index" (all-items RPI less housing costs). The switch from the all-items RPI was justified on the grounds that most recipients of Supplementary Benefit (replaced by Income Support in 1988) already had their housing costs supported separately.[7] From 1992 Rossi was replaced by the "New Rossi index" (all-items RPI minus rent, local taxes and mortgage interest payments).

The means-tested benefits uprated by Rossi included Housing Benefit, Council Tax Benefit, Income Support, income-based Jobseeker's Allowance, and income-related Employment

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5 Notwithstanding occasions when Governments have increased benefits by more than the RPI – eg the Labour Government's above-inflation increases in the Basic State Pension rate – and the uprating of certain benefits in April 2010 despite the negative RPI figure for September 2009

6 HC Deb 19 March 1991 cc 179-180

7 HC Deb (SCB) 2 March 1982 c636

and Support Allowance. The contributory versions of JSA and ESA are also uprated in line with the Rossi index.

The Rossi index tends to increase at a slower rate than the all-items RPI. Over the period 1990 to the present as a whole, the RPI increased at an average rate of 3.3% per year, while the Rossi index rose by an average of 3.2% per year.[8] The situation can however vary from one year to the next. Looking at the uprating factors used for each of the 29 benefit upratings since Rossi was first used in 1983 (see the Appendix to this note), the increase in the Rossi index was less than the increase in the all-items RPI on 18 occasions. RPI was less than Rossi at nine upratings, and both indices were the same at two upratings. The September RPI has been lower than the change in the Rossi index over the same period in each of the last four years, largely as a result of reductions in mortgage rates and recent trends in house prices.

Pension Credit Savings Credit

The aim of the Savings Credit element of Pension Credit is to reward people over 65 with modest levels of "qualifying income" (for example, a second pension or capital assets) above the Savings Credit "threshold", up to a maximum. Initially, the threshold was aligned with the basic State Pension (BSP) and the maximum Savings Credit award was set at 60 per cent of the difference between the BSP and Guarantee Credit. However, the Labour Government became concerned that if pursued indefinitely these uprating policies would result in "an increasing proportion of the pensioner population becoming entitled to Savings Credit. To curtail the spread of means-testing, therefore, it announced that from 2008 the Savings Credit threshold would rise in line with earnings and from 2015 the maximum Savings Credit would be frozen in real terms.[9]

In the October 2010 Comprehensive Spending Review the current Government announced however that the Savings Credit maximum would be frozen in cash terms from April 2011 to April 2014. Further background can be found in Library Standard Note SN01439, *Pension Credit*.

Other benefits without a statutory requirement for uprating

For the other benefits listed above without a statutory requirement for uprating – including the Maternity Allowance, Statutory Maternity Pay and Statutory Sick Pay - uprating policies have differed over the years but in recent years the practice has been to increase them each year in line with the RPI.

2.3 Use of September price data

All benefit upratings since April 1987 have been based on the increase in the relevant price index (the all-items RPI or the Rossi index) in the twelve months to the previous September. From time to time it is suggested that the April uprating could be based on a more recent estimate of inflation. For example, in a PQ in April 2000 Paul Flynn asked what administrative obstacles existed to basing the annual uprating on December price data. In response, the then Social Security Minister, Hugh Bayley, said:

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8 Institute for Fiscal Studies, *The impact in 2012-13 of the change to indexation policy*, IFS Briefing Note 120, October 2011

9 DWP*, Security in retirement: towards a new pensions system*, Cm 6841, May 2006, p121-2

> Using the RPI for the previous December, which would not be published until mid-January, would seriously disrupt the uprating process. Current arrangement, which base the uprating on September's RPI, published in mid-October, allow for the preparation of the uprating schedule and for the uprating review itself to be completed by the end of November. At the end of November a computer scan is run to identify and uprate pension cases. The scan is required at this time to ensure that order books (which cover 20 weeks) containing foils that pass the uprating date are issued with the correct amounts. Processes for uprating other Social Security benefits are similar.[10]

Order books no longer exist, but in a written answer in June 2010 the current Minister for Pensions, Steve Webb, said that September data was still the latest that could be used for April benefit upratings, in light of the time required to make the necessary changes to legislation and benefit systems:

> **Gordon Banks:** To ask the Secretary of State for Work and Pensions pursuant to the answer of 28 June 2010, Official Report, columns 393-94W, on state retirement pensions, for what reasons the month of September is used as the base for these calculations. [5569]
>
> **Steve Webb:** The Consumer Prices Index figure for September is the most up to date that can be used which allows time for the necessary activities involved in changing both the legislation and benefit systems in time for the uprating date in April. This was also true of the Retail Prices Index when that index was used as the benchmark for price inflation.
>
> The September figures are published by the Office for National Statistics in mid-October and feed into the forecasts prepared for the pre-Budget report, The Uprating Statement to Parliament is made in November or December followed by the Uprating Order which is laid and debated in the new year.
>
> This timetable is important so that new claims to state pensions and pension credit, which can be made up to four months in advance, can be processed using the correct rates of benefit. It also allows adequate time to notify all 19 million benefit recipients of any changes to their benefit.[11]

Using historical price data to determine by how much benefits are uprated several months hence has certain unavoidable implications. Where benefits are uprated in line with prices, claimants should (assuming the relevant index reflects their own inflation experiences) be no worse off in real terms over the long run. However, because the April uprating is based on the increase in prices over the 12 months to the previous September, the increase may not reflect the actual increase in the cost of living faced by the claimant at the time. When inflation is increasing, the current uprating arrangements mean that benefits lag behind. However, when inflation is falling (as some expect may happen over the next few months) the opposite will be true and claimants will gain more. Over time however the differences should cancel each other out.

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[10] HC Deb 14 April 2000 c303w

[11] HC Deb 5 July 2010 c109w

2.4 The switch to CPI

In the June 2010 Budget the current Government announced that, from April 2011, benefits and tax credits hitherto uprated in line with either the RPI or Rossi index would henceforth be uprated using the Consumer Prices Index (CPI):

> 1.106 The Government will use the CPI for the price indexation of benefits and tax credits from April 2011. The CPI provides a more appropriate measure of benefit and pension recipients' inflation experiences than RPI, because it excludes the majority of housing costs faced by homeowners (low income households are subsidised separately through Housing Benefit, and the majority of pensioners own their home outright), and differences in calculation mean it may be considered a better representation of the way consumers change their consumption patterns in response to price changes. This will also ensure consistency with the measure of inflation used by the Bank of England. **This change will also apply to public service pensions through the statutory link to the indexation of the Second State Pension. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues.**[12]

The announcement has been controversial for two reasons:

- Views differ on whether the CPI as it currently stands is the most appropriate measure of the inflation experiences of households in receipt of pensions and benefits;[13] and

- The CPI tends to rise more slowly than both the RPI and Rossi (but see the Appendix to this note for occasions over the last 22 years when the September RPI or Rossi has been lower than the CPI).

As noted above, taking the period 1990 to the present as a whole, the RPI increased on average by 3.3% a year and the Rossi index by 3.2%. The CPI however only increased by 2.7% a year on average over the same period.[14] Recent methodological changes could further widen the gap between the CPI and RPI, to around 1% point each year. A difference of this magnitude – if continued – would result in benefits being worth after 30 years only 75% of the amount they would have been had they continued to be uprated by the RPI.

Further analysis of the differences between the CPI and other inflation measures, and of the implications of the change to CPI indexation of benefits, is given in Library Standard Note SN05830, *The CPI – uprating of benefits and pensions*.

The estimated savings from the switch to CPI indexation are substantial, dwarfing those from other welfare reforms announced by the current Government since it came to power. The move to CPI is expected to yield Exchequer savings of £1.5 billion in 2011-12, rising to £10.6 billion by 2015-16 (although this figure also includes savings from the switch to CPI

[12] Budget 2010, HC 61 2010-12, 22 June 2010

[13] See Library Standard Note SN05649, *State Pension Uprating - 2010 onwards*, pp10-11. See also Office for National Statistics, *Implications of the differences between the Consumer Prices Index and Retail Prices Index*, July 2011

[14] Institute for Fiscal Studies, *The impact in 2012-13 of the change to indexation policy*, IFS Briefing Note 120, October 2011

indexation of public service pensions).[15] Furthermore, since the effects of the switch to CPI are cumulative, the savings will continue to grow indefinitely, year on year.

The Opposition has supported the switch to CPI indexation, but only as a temporary measure. Speaking during the Committee Stage of the *Pensions Bill*, the then Shadow Pensions Minister, Rachel Reeves, said:

> We have been clear in debates on benefit uprating that we do not support the decision to adopt permanently the consumer prices index as currently constructed for the determination of benefit uprating and of pension revaluation and indexation. While we support the use of CPI, not RPI, in the short term as a means to reduce the deficit, we do not believe that, on a permanent basis, it is the right way to uprate pensions or other benefits.
>
> Making a permanent change from the use of the retail prices index to the consumer prices index with the impact being felt even after the deficit is long gone is an ideologically driven move that we do not support. While I agree that we need to get the economy back on track and to reduce the deficit, it makes no sense that pensioners and those on the lowest incomes who are least able to bear the burden will be punished by such a change, even when our economy is back on track and the deficit has been eliminated.[16]

3 Retirement Pension and Pension Credit Standard Minimum Guarantee

Section 150A of the *Social Security Administration Act 1992* – inserted by section 5(1) of the *Pensions Act 2007* – provides that the Basic State Pension (Categories A-D Retirement Pensions) and Pension Credit Standard Minimum Guarantee are to be uprated annually at least in line with earnings. The provisions also cover widows'/widowers' pensions in Industrial Death Benefit, since these are linked to the rate of the Category A Retirement Pension. Section 150A(2) states:

> Where it appears to the Secretary of State that the general level of earnings is greater at the end of the period under review than it was at the beginning of that period, he shall lay before Parliament the draft of an order which increases each of the amounts …by a percentage not less than the percentage by which the general level of earnings is greater at the end of the period than it was at the beginning.

The Labour Government announced its intention to link the Basic State Pension to earnings in the May 2006 Pensions White Paper.[17] The aim was to restore the earnings link for the BSP in 2012, "subject to affordability and the fiscal position", or by the end of the next Parliament at the latest (ie 2015). Section 5 of the *Pensions Act 2007* made this a statutory requirement. It also provided for the Standard Minimum Guarantee to be uprated at least in line with earnings from 2008-09.[18]

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[15] Budget 2011, HC 836 2010-12, Table 2.2. The IFS comments however that the Treasury estimates may not be an entirely accurate reflection of the fiscal impact of CPI indexation, because of the way the Treasury has chosen to estimate the impact of the change alongside the other benefit and tax credit reforms announced by the Government; see Institute for Fiscal Studies, *The impact in 2012-13 of the change to indexation policy*, IFS Briefing Note 120, October 2011, p3, footnote 5

[16] Pensions Bill Deb 14 July 2011 c293

[17] DWP, *Security in retirement: towards a new pensions system*, Cm 6841, May 2006

[18] Section 5 and 30 (1) (a)

The incoming Government announced that the earnings link would be restored from April 2011.[19] It also gave a commitment – the "triple guarantee" – that the Basic State Pension would be uprated by earnings, prices or 2.5%, whichever was highest, from April 2011. The June 2010 Budget announced that, for 2011-12 only, the Basic State Pension would increase by at least the equivalent of the RPI, and the Pension Credit Standard Minimum Guarantee would increase in April 2011 by the cash rise in the full Basic State Pension.[20]

Further information can be found in Library Standard Notes SN 5649 *State Pension uprating – 2010 onwards* and SN 5649 *Pension Credit*.

A recent briefing note produced by the Institute for Fiscal Studies argues that the rationale for the differential treatment of pensioners and working age claimants as regards uprating has not been made clear, and that the Government needs to set out more systematically its thinking on benefit uprating policy as a whole:

> Given the importance of indexation policy in determining the future shape of the tax and benefit system, it would be helpful for the Government to set out its thinking on such policy systematically. Why should the Basic State Pension rise at a different rate to working-age benefits? Why should it rise at a different rate to public sector pensions? Why should the employer's National Insurance threshold rise at a different rate to the employee's National Insurance threshold? It is important to realise that these questions are separate from the issue of how generous the tax and benefit system should be to particular groups. Justifications for indexation rules should relate to the way in which the generosity of the tax and benefit system to particular groups should *change over time*. For example, if one thought that the Basic State Pension should be higher, this is an argument for raising the level of the Basic State Pension. It is not, in itself, a good argument for increasing it at a *faster rate* year-on-year.[21]

The announcements on State Pension and Pension Credit rates from April 2012 are covered in part 7 of this note.

4 Tax Credits

The statutory provisions relating to the uprating of tax credits are less prescriptive than those for social security benefits (in Sections 150 and 150A of the *Social Security Administration Act 1992*). They are contained in section 41 of the *Tax Credits Act 2002:*

> **41 Annual review**
>
> (1) The Treasury must, in each tax year, review the amounts specified in subsection (2) in order to determine whether they have retained their value in relation to the general level of prices in the United Kingdom as estimated by the Treasury in such manner as it considers appropriate.
>
> (2) The amounts are monetary amounts prescribed—

[19] The *Uprating of Basic Pension etc (Designated Tax Year) Order 2010* (SI 2010 No 2650) provides for 2010-11 to be the designed tax year for the purposes of section 5 (3) *Pensions Act 2007*. (i.e. the first year in which the Secretary of State is required to carry out a review to see if the basic State Pension has kept its value in relation to the general level of earnings).

[20] June 2010 Budget, para 1.107

[21] Institute for Fiscal Studies, *The impact in 2012-13 of the change to indexation policy*, IFS Briefing Note 120, October 2011, p5, original emphasis

(a) under subsection (1)(a) of section 7,

(b) for the purposes of any of paragraphs (a) to (d) of subsection (3) of that section,

(c) under section 9,

(d) under section 11, otherwise than by virtue of section 12, or

(e) under subsection (2) of section 13, otherwise than by virtue of subsection (3) of that section.

(3) The Treasury must prepare a report of each review.

(4) The report must include a statement of what each amount would be if it had fully retained its value.

(5) The Treasury must publish the report and lay a copy of it before each House of Parliament.

The references in subsection (2) are to income thresholds, individual CTC and WTC elements (except the childcare element of WTC), and the maximum in-year income rise disregard.

As with the provisions outlined above covering social security benefits in the *Social Security Administration Act 1992*, the tax credits legislation does not specify the use of any particular inflation measure; nor does it specify the use of data for any particular month.

The most recent *Annual review of certain tax credits monetary amounts under Section 41 of the Tax Credits Act 2002* was published in February 2011 and is available at the HMRC website.

The *Tax Credits Bill 2001-02* as introduced did not include provisions relating to uprating. At the Committee Stage in the Lords on 23 May 2002, the then DWP Minister Baroness Hollis of Heigham tabled a new clause (now section 41 of the Tax Credits Act 2002) requiring the Treasury to review the levels of tax credits elements on an annual basis. In response to Earl Russell (the then Liberal Democrat Work and Pensions spokesman), Lady Hollis said:

> It is not right to apply the provisions in Part X of the Social Security Administration Act 1992 to the new tax credit, as the amendment would do, because they are not part of the social security system. However, he may be concerned with the principle that there will be regular uprating. The Bill is designed to strike the balance between parliamentary scrutiny and flexibility. We believe that [the new clause, later to become s41] is more appropriate than attaching tax credits to the provisions of Section 150 of the Social Security Administration Act. Under the proposed new clause the process of setting and reviewing the rates of the new tax credit will be highly transparent and visible. This year the rates and thresholds of the new tax credits were properly a matter for the Chancellor's Budget and the Budget process is already the subject of an enormous amount of scrutiny. This will be true year after year. The new clause on annual review takes the Government's commitments further. It requires the Treasury annually to review the monetary amounts in the Bill against appropriate measures of prices, to prepare a report on that review and to lay that report before the House. I hope that that will meet the noble Earl's concerns.[22]

[22] HL Deb 23 May 2002 c CWH 143

The Labour Government's main commitment was to uprate the per child elements of Child Tax Credit in line with earnings, and Working Tax Credit elements (except the childcare element) in line with prices (as measures by the RPI)[23], although in some years CTC and WTC elements were increased by more than indexation on this basis would have required, most often for Child Tax Credit. Other amounts were changed only on an ad hoc basis, including the childcare element of WTC, the first income threshold for families eligible for WTC, and in the in-year income increase disregard. Some elements remained unchanged since the introduction of tax credits in 2003, including the CTC family element and baby addition, and the second (upper) income threshold.[24]

In the June 2010 Budget and October 2010 Comprehensive Spending Review the current Government gave undertakings to increase the child element of Child Tax Credit in April 2011 and April 2012 over-and-above the normal indexation. For these purposes, "indexation" means in line with the Consumer Prices Index, following the announcement in the June 2010 Budget that indexation of benefits, tax credits and public service pensions would be in line with the CPI from 2011-12 onwards.

The above-indexation increases in the child element of Child Tax Credit would be £180 from April 2011 (£150 announced in the June 2010 Budget and an additional £30 announced in the October CSR) and a further £110 from April 2012 (£60 announced in the June 2010 Budget and an additional £50 in the October CSR). The June 2010 Budget stated explicitly that the additions then announced would be "above CPI indexation."[25] In his statement on the Comprehensive Spending Review on 20 October 2010, the Chancellor said that the further above-indexation increases to Child Tax Credit were intended to ensure that low-income families with children were "protected from the adverse effects" of the other welfare measures the Government had announced, because the Government was "committed to ending child poverty." He went on:

> This will mean annual increases of £180 and then £110 above the level promised by the last Government, and it will provide support to 4 million lower-income families. And I can confirm that using the same model we inherited, the spending review will have no measurable impact on child poverty over the next two years…[26]

The child elements of Child Tax Credit – including the disabled and severely disabled child elements – duly increased by CPI plus £180 from April 2011. Working Tax Credit elements increased in line with the CPI, except for the childcare element and the Basic and 30 Hour elements.[27] The Basic and 30 Hour elements of WTC are being frozen for three years from 2011-12, following an announcement in the October 2010 CSR.

However, these changes have to be seen in the context of the wider package of tax credit measures being implemented in the run-up to the introduction of Universal Credit, including the increase in the taper rate, reductions in the second income threshold, abolition of the CTC baby element and WTC 50+ element, reductions in the disregard for in-year income increases, the reduction of the WTC childcare element, stricter rules on backdating awards,

[23] HL Deb 20 June 2002 cc 916-917

[24] A table giving all tax credits rates and thresholds from 2003-04 to 2010-11 is included in an appendix to the HMRC publication *Personal Tax Credits: Provisional Statistics - Main Tables*

[25] June 2010 Budget, HC 61 2010-12, para 2.40

[26] HC Deb 20 October 2010 cc958-959

[27] CTC and WTC rates for 2010-11 and 2011-12 are given in the *Annual review of certain tax credits monetary amounts under Section 41 of the Tax Credits Act 2002* published in February 2011.

and the increase in the WTC working hours threshold for couples to 24 hours.[28] Taken together, the Government expects that changes to tax credits will yield net savings of £3 billion a year by 2015-16.[29]

Further information on tax credit rates from April 2012 is given in part 7 of this note.

5 Announcement of the September CPI and reactions

The September 2011 CPI was 5.2%, up from 4.5% in August and its highest rate of increase since September 2008 (the all-items RPI increased by 5.6% in the twelve months to September 2011, while the Rossi index increased by 6.8%). If used as the basis for the April 2012 uprating, the higher than expected September CPI could have added an additional £1.8 billion to benefits and tax credit spending in 2012-13, compared with previous forecasts.[30] The October data indicate show inflation easing on all three measures: the annual increase in the CPI fell to 5.0%, the RPI to 5.4% and Rossi to 6.6%.[31]

The fact that the September CPI was higher than expected would not – if used as the basis of the April 2012 uprating – confer a *long-term* advantage on benefit claimants. As some media reports[32] have acknowledged, if the September CPI is a "spike", the uprating factor for April 2013 will be correspondingly lower, since the "base" month for next year's calculation will be higher September 2011 figure.[33] The effect is merely to bring forward some additional spending. In the long-term, the current arrangements should ensure that benefits merely rise in line with inflation.

Nevertheless, the higher than expected September CPI focused attention on whether the Government should depart from the "default" arrangements for uprating benefits for this year only (ie from April 2012), or change the basis for uprating permanently.

Media reports suggested that options considered included:

- A freeze on benefits in April 2012
- Uprating benefits by less than the CPI, or in line with earnings
- Basing uprating on the average level of the CPI over six months, rather than a single month

6 Alternatives to the current arrangements

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28 A Low Incomes Tax Reform Group factsheet, *What's next for tax credits?* sets out the timetable for these and other planned changes and discusses their impact.

29 Budget 2011

30 IFS press release, *High September inflation increases welfare spending, but benefit recipients lose from new indexation rules*, 18 October 2011

31 For the latest RPI and CPI figures see the *Library Economic Indicators update: Inflation*

32 "Little benefit" [leader article], *Financial Times*, 3 November 2011; "Invalid Adjustment: Government should focus on the inflation of claimants, not benefits" [leader article], *The Times*, 15 November 2011

33 The April 2013 uprating would be based on the increase in CPI between September 2011 and September 2012

6.1 A benefits freeze?

Freezing benefits would have yielded substantial savings, but it would be difficult to freeze *all* benefits because of the statutory duty to uprate certain benefits in line with prices, and the Basic State Pension and Pension Credit Standard Minimum Guarantee in line with earnings (see above).

For those benefits not subject to statutory uprating, a freeze in rates would have been *possible* – Child Benefit has already been frozen for three years, along with some elements of Working Tax Credit – but would have been difficult in light of the Government's commitment to uprate most benefits in line with the CPI. Coming so soon after the switch to the (less generous) CPI, and in the light of the Government's wider welfare reform programme which will lead so substantial reductions in planned expenditure over the next few years, a freeze on benefits might have been seen as unacceptable.

For the principal income replacement benefits, extra-costs disability benefits and means-tested benefits, a decision to freeze rates would also have been historically unprecedented, at least since statutory provisions on uprating have existed. Freezing some benefits while uprating others would also have raised issues of equity in the treatment different claimant groups.

6.2 Uprate benefits by less than the CPI?

Recent media reports suggested that some Government sources believed raising benefits by the full 5.2% of the September CPI would have been difficult to justify against the backdrop of the two-year pay freeze for public sector workers and pay cuts or only minimal pay rises for many in the private sector.[34] It was suggested that, as a temporary measure, benefits should instead have increased in line with earnings from next April. Some commentators have gone further, suggesting that benefits should be permanently linked to the lower of prices or earnings.

Average weekly earnings (three-month average including bonuses) for the whole economy rose by 2.3% in September compared with a year ago. Average weekly earnings excluding bonuses rose by 1.7% over the same period.[35]

The current statutory framework protects the value of some benefits against inflation, but or other benefits the Government could have decided to uprate them by less than the full CPI, although again would have gone against commitments already made.

A decision not to uprate some benefits fully in line with inflation would not have been without precedent. In 1975, prices had risen sharply but the rate of increase slowed down in 1976. Under the then uprating arrangements, benefit and pension increases from November 1976[36] would have been based on increases in prices or earnings over the year to March 1976. However, in April 1976, the then Secretary of State for Health and Social Security, Barbara Castle, announced that the Government had decided to switch over from a "historic" to a "forecasting" method and to base the uprating instead on an estimate of what inflation would be between the two upratings (ie November 1975 – November 1976). She said:

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[34] See for example "Millions to lose out as benefits are curbed", *The Times*, 18 November 2011

[35] Commons Library Standard Note SN02795, *Average Earnings: Economic Indicators page*

[36] See the Appendix to this note

> Now that the rate of inflation is coming down it would no longer be appropriate to base the uprating on a reference period which lies wholly in the past. However we are confident that the proposed increases of 15 per cent will be considerably larger than the actual and likely movements of earnings and prices from the time of the last uprating to November. …
>
> It is clear that if we had adopted the historic method an additional burden would have been put on the worker and the wage earner of £500 million for this uprating, and it would have had inevitable consequences in due course for the contribution rate.
>
> I ask the House to say whether, in striking a balance at a time of difficulty between carrying out in full our promises to pensioners and recognising the heavy sacrifices that we are asking wage earners to make, we have not achieved social justice.[37]

The switch to forecasting was widely seen at the time as a way of saving money because it missed out eight months of high inflation (March 1975 – November 1975, when prices rose by 16%). More recent commentators have called the Labour Government's decision a "massive economy measure."[38]

Not increasing benefits fully in line with inflation would however have entailed a real-terms cut in living standards. While wage earners may be able to cope with a reduction in real income, the same may not be true of benefit claimants, particularly those in receipt of means-tested out-of-work benefits such as Income Support or income-based Jobseeker's Allowance who are, by definition, receiving the minimum amount deemed necessary to meet their needs. Linking benefits to the lower of prices or earnings could, over time, lead to a significant erosion of benefit rates if there are regular periods when earnings rise less slowly than prices. The downward "ratchet" effect could result in claimants in the future receiving significantly less than the law currently says they need to live on.

6.3 Uprate benefits by a six-month average of the CPI?

Some media reports suggested that the Government considered basing the April 2012 rating on the average level of the CPI over a six month period, instead of the September CPI alone. This, it was argued, would give a better measure of inflation over the year as a whole.

As the following chart illustrates, basing the April 2012 uprating on the average CPI increase in the 6 months to September 2011, rather than the increase in the CPI to September 2011, would have meant that benefits rose by 4.6%[39] instead of 5.2%.

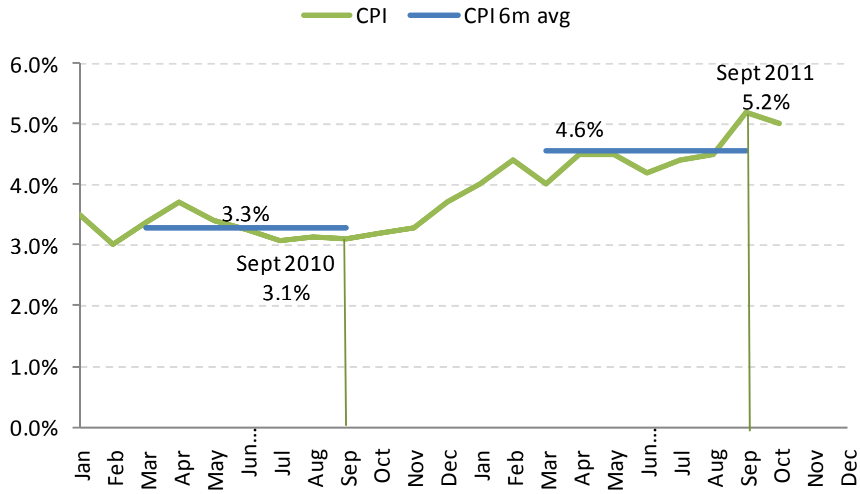
[37] HC Deb 7 April 1976, c 426 and 431

[38] Jonathan Bradshaw and Tony Lynes, *Benefit Uprating Policy and Living Standards*, SPRU Social Policy Report No 1, 1995

[39] Rounded to the nearest decimal point

Annual CPI increases and 6 month average increase to September

(Jan 2010 to Oct 2011)



What would be the long-term implications be of moving to a six month average measure? The following table shows how a CPI-based uprating on the average for the six months to September would have compared with a September-based uprating for each year since 1989:[40]

[40] Table and analysis produced by Richard Cracknell, Library Social and General Statistics Section

CPI: annual % change to September and average for 6 months to September

Year	Apr-Sept average	September	Difference
1989	5.2%	5.2%	0.0%
1990	7.1%	8.1%	1.0%
1991	8.0%	7.1%	-0.9%
1992	3.8%	3.0%	-0.8%
1993	2.7%	3.0%	0.4%
1994	1.9%	1.5%	-0.4%
1995	2.6%	3.0%	0.4%
1996	2.4%	2.3%	-0.1%
1997	1.8%	1.8%	0.0%
1998	1.6%	1.4%	-0.2%
1999	1.3%	1.2%	-0.1%
2000	0.7%	1.0%	0.3%
2001	1.5%	1.3%	-0.2%
2002	1.0%	1.0%	0.0%
2003	1.3%	1.4%	0.1%
2004	1.3%	1.1%	-0.2%
2005	2.2%	2.5%	0.3%
2006	2.3%	2.4%	0.1%
2007	2.2%	1.8%	-0.4%
2008	4.1%	5.2%	1.1%
2009	1.8%	1.1%	-0.7%
2010	3.3%	3.1%	-0.2%
2011	4.6%	5.2%	0.7%

So, for 23 upratings a six month average-based uprating compared to a September-based one would have been:

- The same on 3 occasions
- Higher on 11 occasions
- Lower on 9 occasions (including the period ended September 2011)

In the long run there is little difference between the two methods – taking each year 1989 to 2011 gives a cumulated increase of 88.3% for the six month average and 88.5% for the September-based increase. In the long run therefore, claimants would have experienced the same increase in benefit rates under an average CPI figure as they would have had under September-based uprating.

However, moving *from* September-based uprating to uprating based on the average increase in the CPI over the six months to September 2011 would have entailed a one-off real terms cut in benefit rates. There would also be year-on-year savings for the Exchequer, as benefit rates after 2012-13 would have increased from a lower base than would have been the case without the switch.

7 Announcements in the Autumn Statement

In his Autumn Statement on 29 November 2011, the Chancellor announced that while benefits and the Basic State Pension would rise by the full 5.2% of the September CPI from April 2012 (and the Pension Credit Standard Minimum Guarantee by the same cash rise as the Basic State Pension), the couple and lone parent elements of Working Tax Credit would be frozen and the additional £110 increase in the child element Child Tax Credit over and above CPI – announced last year – would not now go ahead:

> Turning to welfare payments, the annual increase in the basic state pension is protected by the triple lock introduced by this Government. This guarantees a rise either in line with earnings, prices or 2.5%, whichever is greater. It means that the basic state pension will next April rise by £5.30 to £107.45—the largest ever cash rise in the basic state pension and a commitment of fairness to those who have worked hard all their lives. I wanted to make sure that poorer pensioners did not see a smaller rise in their income, so I can confirm today that we will also uprate the pension credit by £5.35 and pay for that with an increase in the threshold for the savings credit.
>
> I also want to protect those who are not able to work because of their disabilities and those who, through no fault of their own, have lost jobs and are trying to find work, so I can confirm that we will uprate working-age benefits in line with September's consumer prices index inflation number of 5.2%. That will be a significant boost to the incomes of the poorest, especially when inflation is forecast to be considerably less than that by next April. We will also uprate with prices the disability elements of tax credits, and increase the child element of the child tax credit by £135 in line with inflation too. But we will not uprate the other elements of the working tax credit this coming year; and given the size of the uprating this year, we will no longer go ahead with the additional £110 rise in the child element, over and above inflation, that was planned. By April 2012, the child tax credit will have increased by £390 since the coalition came into power. The best way to support low-income working people is to take them out of tax altogether, and our increases in the income tax personal allowance this year and next will do that for over 1 million people.[41]

The tax credit changes are expected to yield savings of £1,240 million in 2012-13 (£975 million from Child Tax Credit and £265 million from Working Tax Credit), and around the same in subsequent years.[42] As a result of the changes, families with children will from April 2012 receive up to £110 less a year per child than they would have done under the previous plans. Lone parents and couples receiving the couple/lone parent element of WTC will in addition lose up to £100 a year.

The decision not to go ahead with the planned £110 increase in the child element of Child Tax Credit over and above the CPI is controversial since the Government had previously argued that this would ensure that its reforms would have no measureable impact on child poverty up to 2012-13 (see part 4 of this note). As a result of measures announced in the Autumn Statement, the Government estimates that relative child poverty will increase by around 100,000 in 2012-13, when measured against previously announced policies.[43]

Advice organisations and pressure groups have expressed disappointment at the Autumn Statement announcement. The Chief Executive of Citizens Advice, Gillian Guy, said:

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[41] HC Deb 29 November 2011 cc802-803
[42] Autumn Statement 2011, Cm 8231, Table 2.1
[43] HM Treasury, *Distributional analysis to accompany the Autumn Statement 2011*, para 1.11

> The Chancellor has broken the promise he made in last year's Budget to protect families on the lowest incomes from the impact of last year's harsh cuts by increasing child tax credits above inflation, leaving them now with no protection at all. It's astonishing that George Osborne could think it fair that the lowest paid families who can least afford it should pick up the bill for kick-starting the recovery at a time when they are battling with hikes in fuel bills, rising rent and food costs. Make no mistake, this means children in the poorest homes are at risk of going cold and hungry to pay for the new schemes the Chancellor has announced today.[44]

The Chief Executive of Child Poverty Action Group, Alison Garnham, said:

> Britain's poorest families have been abandoned today and left to face the worst. The increase in child tax credit that the Chancellor said last year was there to stop child poverty rising for at least two years has been cancelled today.
>
> Warnings of a bleak future of rising child poverty have not just been ignored, the government has actively decided to let child poverty rise. This is not the fairness we were promised and it will cost the nation dearly in years to come.
>
> The extension of early years childcare [also announced in the Autumn Statement] is obviously welcome, but all the evidence shows it's no silver bullet for ending child poverty if children are made poorer at home. Child poverty is only going to go up and this government has no plans to stop it.[45]

Gingerbread warns that the tax credit changes will increase child poverty and undermine work incentives, with lone parents being particularly affected. Its Chief Executive, Fiona Weir, said:

> The families who will be hit by the raid on tax credits are those that are determined to work despite low wages and high childcare costs – exactly those people the Chancellor says are 'doing the right thing'.
>
> Single parents are twice as likely to receive Working Tax Credit as couples with children, and for many work would not be an option without the support it provides.
>
> The government has also tucked away in Treasury documents the fact that previous commitments to make an above inflation increase of £110 in child tax credit in 2012 will no longer go ahead. This was explicitly intended to prevent further increases in child poverty rates, which must now be inevitable.
>
> The result of these decisions will be more children in poverty, and more single parents who can't afford to work. It's an ill-advised move for a Chancellor who says he doesn't want to increase child poverty and pledges to make work pay.
>
> 36% of all single parents are WTC claimants, compared to just 15% of couples with children, meaning that single parents are twice as likely to be in the WTC group as couples with children.[46]

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44 Citizens Advice press release, *Citizens Advice response to Chancellor George Osborne's autumn statement*, 29 November 2011

45 CPAG press release, *Government abandons low income families in child poverty u-turn*, 29 November 2011

46 Gingerbread press release, *Tax credit raid will increase child poverty and discourage work*, 29 November 2011

Press reports since the Autumn Statement suggest that the Secretary of State for Work and Pensions, Iain Duncan Smith, is unhappy with the decision to uprate out of work benefits by the full 5.2% of the September RPI, because of the effect on work incentives.[47]

[47] "Vow to undo benefits hike", *Sunday Times*, 4 December 2011; "Incentive to work has been cut, says Iain Duncan Smith", *The Telegraph*, 5 December 2011

Appendix: Uprating arrangements and factors, 1974-2011

Uprating date	Period used for uprating	Method	Factors used for Uprating[1]			
			CPI[2]	RPI[3 4]	Rossi[5]	Earnings
22 Jul 74	Oct 73 - July 74	Forecast		17.1%		
07 Apr 75	Feb 74 - Nov 74	Historical		13.3%		16.0%
17 Nov 75	Aug 74 - May 75	Historical		13.2%		14.6%
15 Nov 76	Nov 75 - Nov 76	Forecast		15.0%		
14 Nov 77	Nov 76 - Nov 77	Forecast		13.0%		14.4%
13 Nov 78	Nov 77 - Nov 78	Forecast		7.1%		11.5%
12 Nov 79	Nov 78 - Nov 79	Forecast		17.5%		19.5%
24 Nov 80	Nov 79 - Nov 80	Forecast		16.5%		
23 Nov 81	Nov 80 - Nov 81	Forecast		9.0%		
22 Nov 82	Nov 75 - Nov 82	Forecast		11.0%		
21 Nov 83	May 82 - May 83	Historical		3.7%	4.3%	
26 Nov 84	May 83 - May 84	Historical		5.1%	4.7%	
25 Nov 85	May 84 - May 85	Historical		7.0%	5.1%	
28 Jul 86	May 85 - Jan 86	Historical		1.1%	1.2%	
06 Apr 87	Jan 86 - Sep 86	Historical		2.1%	2.0%	
11 Apr 88	Sep 86 - Sep 87	Historical		4.2%	3.2%	
10 Apr 89	Sep 87 - Sep 88	Historical		5.9%	4.7%	
09 Apr 90	Sep 88 - Sep 89	Historical	5.2%	7.6%	5.2%	
08 Apr 91	Sep 89 - Sep 90	Historical	8.1%	10.9%	8.1%	
06 Apr 92	Sep 90 - Sep 91	Historical	7.1%	4.1%	7.0%	
12 Apr 93	Sep 91 - Sep 92	Historical	3.0%	3.6%	3.6%	
11 Apr 94	Sep 92 - Sep 93	Historical	3.0%	1.8%	3.5%	
10 Apr 95	Sep 93 - Sep 94	Historical	1.5%	2.2%	1.8%	
08 Apr 96	Sep 94 - Sep 95	Historical	3.0%	3.9%	3.0%	
07 Apr 97	Sep 95 - Sep 96	Historical	2.3%	2.1%	2.6%	
06 Apr 98	Sep 96 - Sep 97	Historical	1.8%	3.6%	2.4%	4.2%
12 Apr 99	Sep 97 - Sep 98	Historical	1.4%	3.2%	2.1%	4.8%
10 Apr 00	Sep 98 - Sep 99	Historical	1.2%	1.1%	1.6%	4.4%
09 Apr 01	Sep 99 - Sep 00	Historical	1.0%	3.3%	1.6%	4.0%
08 Apr 02	Sep 00 - Sep 01	Historical	1.3%	1.7%	1.7%	4.3%
07 Apr 03	Sep 01 - Sep 02	Historical	1.0%	1.7%	1.3%	3.6%
12 Apr 04	Sep 02 - Sep 03	Historical	1.4%	2.8%	1.8%	3.9%
11 Apr 05	Sep 03 - Sep 04	Historical	1.1%	3.1%	1.0%	4.1%
10 Apr 06	Sep 04 - Sep 05	Historical	2.5%	2.7%	2.2%	3.4%
11 Apr 07	Sep 05 - Sep 06	Historical	2.4%	3.6%	3.0%	4.4%
11 Apr 08	Sep 06 - Sep 07	Historical	1.8%	3.9%	2.3%	3.5%
10 Apr 09	Sep-07 - Sep-08	Historical	5.2%	5.0%	6.3%	3.2%
12 Apr 10	Sep-08 - Sep-09	Historical	1.1%	-1.4%	1.8%	1.8%
11 Apr 11	Sep-09 - Sep-10	Historical	3.1%	4.6%	4.8%	1.3%

Notes

1. The actual factors used for a particular benefit for a particular year not necessarily that shown – see *DWP Abstract of Statistics for Benefits, National Insurance Contributions, and Indices of Prices and Earnings*, 2010 edition, pp7-8.
2. From April 2011 only. Earlier figures included for comparison.
3. Replaced by CPI from April 2011.
4. Despite the negative RPI figure for September 2009, many benefit rates increased from April 2010.
5. Rossi index from 1983-1991; New Rossi from 1992. Replaced by CPI from April 2011.

Source

House of Commons Library Social and General Statistics Section. Derived from DWP *Abstract of Statistics for Benefits, National Insurance Contributions, and Indices of Prices and Earnings*, 2010 edition, Table 1.