ANNEX 2

THE CHURCH OF ENGLAND

TACKLING POVERTY TOGETHER
CHURCH URBAN FUND

IT ALL ADDS UP:

THE CUMULATIVE IMPACT OF WELFARE REFORM

Over the last three years, the Coalition Government has announced a range of welfare reforms.[1] In the context of economic recession and an unsustainable deficit, the primary aim of these reforms has been to reduce government expenditure. A secondary goal has been to restructure outdated and inflexible parts of the welfare system. Given the complexities of the current system and the trade-offs necessarily involved in any policy decisions, these reforms have proved controversial. The purpose of this report, however, is not to comment on specific reforms, but to further our understanding of their likely impact on individual households.

Each announcement of a new tax or benefit reform has prompted a great deal of analysis of how many households will be affected and by how much. Yet, little has been done to examine the cumulative impact of the reforms. By telling the story of two hypothetical households, this paper explores how household finances will be affected as reforms come into effect over the course of this Government. With some reforms leading to a gain in disposable income and others resulting in a loss, this approach will demonstrate the overall effect of the welfare reforms, taking into account the interactions between different policies.

Some reforms, such as Universal Credit, also aim to address perceived failings in the welfare system by influencing people's behaviour - strengthening, for example, the incentive to find work or move home. Where this is the case, we have tried to highlight the choices facing our two households, and the many others that they represent.

Our case studies focus on two groups that are likely to be affected by multiple reforms: large families living in the private rented sector, and out-of-work disabled adults. Between them, they are impacted in some way by nearly all the major reforms announced in recent years. As a result, they are likely to be disproportionately affected by these changes, although they are by no means the worst affected. Nonetheless, we believe that their stories can usefully highlight the changes that many low income families are likely to experience as a result of recent and forthcoming welfare reforms.

METHODOLOGY

The calculations for our case studies use a spreadsheet-based model that simulates the tax-benefit system for each year from 2010/11 to 2016/17. Results for 2012/13 and 2013/14 have been verified against Lisson Grove's Quick Benefits Calculator[2]. Our model rests on five key assumptions. First, monetary amounts for different years are adjusted for inflation using the Retail Price Index (and shown in 2013/14 prices). Inflation forecasts for 2013/14 and beyond are taken from the Office for Budget Responsibility's latest economic forecasts (March 2013). Second, policy assumptions for future years are based on government announcements made in Budgets and Autumn Statements 2010 - 2013. Third, gross earnings are assumed to rise with inflation and so remain constant in real terms in order to focus on the impact of tax-benefit changes, rather than changes in earnings. Fourth, rents are assumed to rise by 4% per year in nominal terms (in line with average local authority and private rents in England over the last decade). Fifth, the impact of Universal Credit (UC) is modelled on the assumption that households are moved onto the new benefit in 2016/17, with UC allowances and other benefits uprated by a further 1% in April 2016. Further details of our methodology are available on request.

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HOUSEHOLD ONE: MARK AND SARAH

1

Single-earner couple with three young children, renting privately in London.

Our first family lives in east London. The father, Mark, works full-time as a cook in a small restaurant and earns £25,000 per year. His partner, Sarah, stays at home and looks after their three young children. Mark and Sarah live in a three bedroom, privately rented property that costs them £230 per week (the lower quartile of rents in Barking and Dagenham in December 2012). Housing Benefit covers a significant proportion of their rent, but they pay all of their Council Tax.

In 2010, Mark and Sarah are just about getting by. After paying income tax and national insurance, Mark's earned income is £19,410 per year (in 2013/14 prices). These earnings are supplemented by Child Benefit (£2,760 per year) and Child Tax Credits (£6,600 per year). Out of this income, Mark and Sarah pay £3,880 a year towards their rent and £1,470 in Council Tax. This brings their total annual disposable income (after housing costs) to £23,410, placing them just above the poverty line for a family of their size.[3]

In April 2011, Mark's earned income after tax rises to £19,520 (in 2013/14 prices) as a result of a welcome increase in the personal tax allowance. However, an increase in the taper rate of tax credits means that their Child Tax Credit is worth £290 less per year. Child Benefit has also decreased in real terms to £2,620 per year. Out of this income, Mark and Sarah now have to pay an extra £730 per year towards their rent (due to the abolition of the £15 per week excess for tenants with rents lower than their maximum entitlement). Deducting Council Tax and housing costs brings their total annual disposable income to £22,440 - 4% lower than the previous year.

Over the next few years, their disposable income continues to fall. Child Benefit and most income-related benefits are now being uprated by just 1% or less annually and, therefore, are not keeping up with inflation. So every year Mark and Sarah in effect get a little less money. Their rent is also rising faster than the Local Housing Allowance rate for their area, so the proportion of their housing costs being met is declining annually.

Mark is particularly worried about losing his job when a cap on the total benefits going to out-of-work families is introduced from the middle of 2013. If he were unable to find another job within nine months, his disposable income would fall to just over £13,000 per year, making it extremely difficult for a family of his size to stay in London without getting into debt. Sarah's family have tried to persuade them to move near to them in Ipswich, where rents are much lower. However, this would only save them a few hundred pounds per year, so they decide to remain in London where Mark has many more job opportunities.

2010/11	
Earned income (after tax)	£19,410
Child Benefit	£2,710
Tax Credits	£6,600
Rent (less housing benefit)	-£3,880
Council Tax	-£1,470
Total disposable income (after housing costs)	**£23,410**

2011/12	
Earned income (after tax)	£19,520
Child Benefit	£2,620
Tax Credits	£6,310
Rent (less housing benefit)	-£4,610
Council Tax	-£1,400
Total disposable income (after housing costs)	**£22,440**

2015/16	
Earned income (after tax)	£19,850
Child Benefit	£2,360
Tax Credits	£5,130
Rent (less housing benefit)	-£5,640
Council Tax	-£1,240
Total disposable income (after housing costs)	**£20,480**

In September 2013, with two of their three children now at school, Sarah considers returning to work. However, if she were to do this, four-fifths of her earnings would be deducted through higher tax and lower benefits. That said, the extra money from a suitable part-time job (paying £8 an hour for 16 hours a week) would just about offset the fall in household income since 2010/11, provided that Mark's parents are able to look after their youngest child.

By 2015/16, Mark's earned income after tax has risen to £19,850 (in 2013/14 prices) due to further increases in the personal tax allowance. However, the value of Child Benefit has fallen to £2,360 per year and Child Tax Credits are now worth just £5,130 per year. Out of this income, Mark and Sarah now pay £5,640 per year towards their rent – a considerable increase on previous years. However, a freeze in Council Tax means they are paying £240 less per year in real terms. Overall, their total annual disposable income (after housing costs) has fallen to £20,480– a reduction of 13% since 2010/11. That reduction leaves this family on the brink of poverty[4] and puts their children among the 600,000 at risk of falling into absolute poverty between 2010 and 2015, as a result of tax and benefit changes implemented over this period.[5]

Sometime around 2016/17, Mark and Sarah will be transferred onto Universal Credit. This will be a welcome move since, as a working household, they will benefit from changes designed to strengthen work incentives. Their total disposable income will increase by an estimated £1,700 per year[6]. Significantly, if Mark's earnings were now to increase, he would keep a much higher proportion of additional income than under the current system. This may well motivate him to take on extra overtime. Working in a sector with a rapid turnover of jobs, Mark will also benefit from the added security of knowing that transitions into and out of employment should be a lot simpler under the new system. It is worth noting, however, that this family will still be substantially worse off in financial terms than they were six years previously.

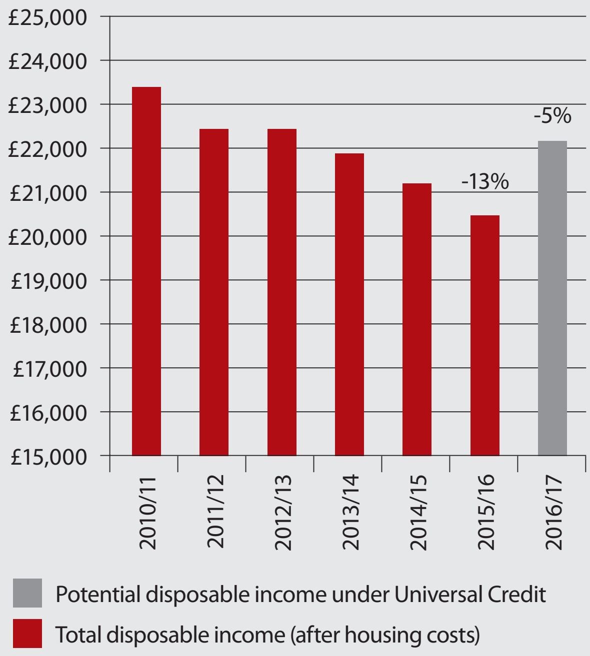
In summary, between 2010/11 and 2015/16, Mark and Sarah:

- **gain £450 per year** because of changes to Income Tax and National Insurance.
- **lose £1,470 per year** due to reductions in tax credits.
- **lose £1,760 per year** in Housing Benefit because of restrictions to Local Housing Allowance rates.
- **gain £240 per year** from a freeze in Council Tax charges.
- **lose £400 per year** in the real value of Child Benefit.

Overall, this family is **worse off by around £2,900 per year** by the end of this five year period - a **13% fall in their disposable income**.

Taking Universal Credit into account, the fall in income is around £1,300 per year - a 5% fall from 2010/11.

Figure 1: Mark and Sarah's annual disposable income (after housing costs), 2010/11 to 2016/17



HOUSEHOLD TWO: SAM

2

Single man of working-age, disabled and a local authority tenant in the north east.

Our second case study concerns Sam. At the start of our six year period, Sam is 55 years old and living alone in a two bedroom council property in the north east. He used to share this flat with his grown-up daughter, but a few years ago she went to live with her partner in Leeds. Sam is disabled and has been claiming Incapacity Benefit at the long-term rate for almost five years. As a result of his disability, Sam's rent and Council Tax are paid in full by the government.

In 2010, Sam is struggling financially. As he is out of work, he has no earned income and pays no tax, but also receives no money via tax credits. Sam does not qualify for Disability Living Allowance as he does not satisfy the mobility or care requirements of the benefit. He does however, qualify for Incapacity Benefit which is worth £5,340 per year (in 2013/14 prices). As Sam does not have to pay rent (£3,220 per year) or Council Tax (£800 per year), he has a total disposable income (after housing costs) of £5,340. This places him well below the poverty line for single adults.

In early 2012, Sam receives a letter inviting him to a Work Capability Assessment. Employment Support Allowance (ESA) was introduced in 2008 and, from 2010, all existing claimants of Incapacity Benefit are being re-tested to see if they qualify for the new benefit. Sam is quite nervous about this assessment; he has long-term mental health problems, but it can be difficult to prove how much this affects him on a day-to-day basis.[7]

Sam attends his assessment in March 2012, is judged fit for work and, in the following month, is moved from Incapacity Benefit to Jobseeker's Allowance (JSA). He now receives the single rate of JSA which is £3,820 per year. His rent is still covered by Housing Benefit and his Council Tax continues to be met by Council Tax Benefit. However, as a result of the switch from Incapacity Benefit to JSA, Sam's annual disposable income (after housing costs) has fallen to £3,820.

Now that Sam is receiving JSA, he is expected to spend two hours a day searching for jobs online and to visit the Jobcentre every week to tell his adviser how many job applications he has made. He is also expected to apply for any relevant job within a one and a half hour journey of his home by public transport. This is potentially problematic, as a significant proportion of his wage may be taken up in transport costs.

After three months Sam still has not found a job and so is moved onto the Work Programme, which provides more intensive support for the long-term unemployed. Sam is keen to work and knows that even a low paid job could leave him substantially better off, especially since he no longer receives Incapacity Benefit. He also knows that the odds are not good for people like him. Just 14% of those with severe mental health problems are employed[8] and only 3.6% of people referred to the Work Programme have moved into sustainable employment[9].

In 2013, new under-occupancy rules come into effect. Sam is found to be under-occupying his property by one bedroom and therefore his Housing Benefit is reduced by 14%. He decides not to move to a smaller property –

2010/11	
Earned income (after tax)	£0
Incapacity Benefit	£5,340
Tax Credits	£0
Rent (less housing benefit)	£0
Council Tax	£0
Total disposable income (after housing costs)	**£5,340**

2011/12	
Earned income (after tax)	£0
Jobseekers Allowance	£3,820
Tax Credits	£0
Rent (less housing benefit)	£0
Council Tax	£0
Total disposable income (after housing costs)	**£3,820**

2013/14	
Earned income (after tax)	£0
Jobseekers Allowance	£3,730
Tax Credits	£0
Rent (less housing benefit)	-£460
Council Tax	-£150
Total disposable income (after housing costs)	**£3,140**

there are no one bedroom properties available in his town and moving to a different town would be too destabilising for him. As he will now have to pay £460 per year towards his rent, he starts cutting down on the amount of food he buys and only puts the heating on when it gets very cold.

Sam is also affected by the localisation of Council Tax Support. His local authority has introduced a minimum Council Tax charge of 20% which means that Sam will now have to pay £150 per year in Council Tax[10]. His JSA has also fallen in real terms due to less generous benefit uprating, and, as a non-taxpayer, he does not benefit from increases in the personal tax allowance. The result of all these changes is that Sam's total annual disposable income (after housing costs) has fallen to £3,140. As times are tough, Sam applies for an emergency loan from the local authority to help him repair his fridge, but this is rejected due to a lack of funding.

2015/16	
Earned income (after tax)	£0
Jobseekers Allowance	£3,600
Tax Credits	£0
Rent (less housing benefit)	-£470
Council Tax	-£140
Total disposable income (after housing costs)	**£3,000**

In the final year of our case study, Sam is still out of work and still receiving JSA which, failing to keep up with inflation, has fallen to £3,600 per year in real terms. He remains in the same council property, so continues to pay the bedroom tax and the minimum Council Tax charge. His total annual disposable income (after housing costs) is now £3,000 per year, or just under £60 a week – a 44% reduction since 2010/11.

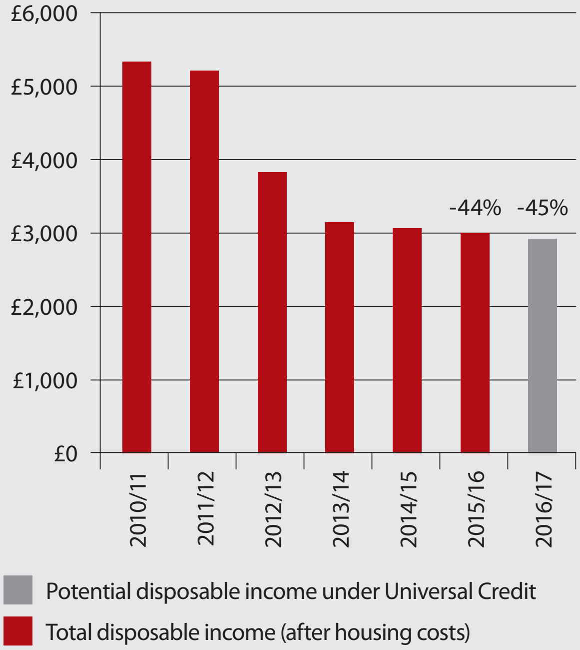
Sam expects to be moved across to Universal Credit in the near future. Under this new benefit, the amount he receives will not change significantly. It will, however, be paid monthly, unlike JSA which is paid fortnightly, and the full amount will be paid into his bank account, whereas his Housing Benefit currently goes directly to the housing association. As he is constantly struggling on a very small budget, it may be hard not to spend this additional cash on other household essentials.

In summary, between 2010/11 and 2015/16, Sam:

- has no earnings and so does not benefit from tax changes.
- **loses £1,750 per year** as a result of being moved from Incapacity Benefit to Jobseeker's Allowance, which then fails to keep up with inflation.
- **loses £470 per year** in Housing Benefit, because he is found to be under-occupying his two bedroom home.
- **loses £140 per year** when the local authority introduces a minimum Council Tax charge.

In total, Sam is **worse off by around £2,300 per year** by the end of this five year period as a result of tax and benefit reforms - a **reduction of 44% in his disposable income** (after housing costs). Universal Credit will not significantly affect Sam's financial situation.

Figure 2: Sam's annual disposable income (after housing costs), 2010/11 to 2016/17



CONCLUSION

Although hypothetical, our case studies illustrate how thousands of households are likely to see a considerable reduction in their income over the six year period from 2010/11 to 2016/17. Whilst some reforms, such as the increase in the personal tax allowance and the freeze in Council Tax, increase the disposable income of certain households, these gains are more than offset by other reforms, such as those to Housing Benefit and tax credits.

According to the Institute of Fiscal Studies, the overall impact of recent tax and benefit changes will be to reduce the incomes of the poorest families with children by an average of 5 - 7% by 2015/16[11]. Mark and Sarah - the first of our two examples – experience a greater reduction in their disposable income because they are living in private rented accommodation. However, those families affected by the total benefit cap will be even worse off than Mark and Sarah. Additionally, many families with older children will also be affected by the abolition of the Educational Maintenance Allowance (worth over £1,000 per year) and families with very young children will lose the baby element of Child Tax Credit (worth over £500 per year).

Sam - the second of our case studies - is a more extreme example. After all, most working age adults are not disabled and not all disabled adults will be affected by the bedroom tax. However, he is by no means an isolated case[12]. By March 2014, 1.5 million Incapacity Benefit claimants will have been reassessed for ESA. So far, nearly one in three of those assessed have been judged fit for work, but only a minority have found employment[13]. In addition, an estimated 420,000 disabled people will be hit by the new under-occupancy penalties (commonly known as the bedroom tax) from April 2013.

Our case studies also explore the impact of the new Universal Credit. As a working couple, Mark and Sarah gain substantially from this, suggesting that this policy may well help to make work pay. In contrast, the new benefit is not as generous to lone parents, particularly those in receipt of child maintenance, or to those, like Sam, on out-of-work benefits. His finances will be unaffected by Universal Credit, while others, including families with disabled children and the most severely disabled adults who live alone, will experience a substantial reduction in their income in the longer-term.

The Government hopes that recent tax and benefit reforms will not only increase incentives to work, but also encourage greater personal responsibility and allow a more efficient use of the social housing stock. These intended outcomes are potentially significant, but far more difficult to predict. Only time will tell if they materialise.

As our case studies indicate, the impact of recent reforms is not purely financial. There are practical and emotional consequences when families have to consider changing jobs or moving house, or disabled people undergo medical assessments, start looking for work, or cut back on essential spending. In our third and final report on welfare reform, we will be exploring these wider dimensions through interviews with local churches and faith-based organisations actively involved in supporting the people most directly affected by the reforms.

Couple with three young children, one full-time worker on £25,000/year, private renters in a three bedroom property in east London

£s per year (2013/14 prices)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	Change: 2010/11-2015/16	Universal Credit*: Change: 2010/11-2016/17
Gross Earnings	25000	25000	25000	25000	25000	25000	**0**	0
Income Tax and NI	-5590	-5480	-5390	-5190	-5130	-5150	**450**	420
Child Benefit	2760	2620	2530	2450	2410	2360	**-400**	-450
Tax Credits	6600	6310	6170	5770	5460	5130	**-1470**	
Rent (less Housing Benefit)	-3880	-4610	-4520	-4850	-5270	-5640	**-1760**	-1500
Council Tax (less Council Tax Benefit)	-1470	-1400	-1360	-1310	-1280	-1240	**240**	280
Total annual disposable income (after housing costs)	**£23,410**	**£22,440**	**£22,450**	**£21,890**	**£21,210**	**£20,480**	**-£2,940**	**-£1,260**
Change in total income from 2010/11	-	*-4%*	*-4%*	*-7%*	*-9%*	***-13%***		*-5%*

Single disabled working age adult, not in paid work, social tenant, two bedroom property in the North East

£s per year (2013/14 prices)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	Change: 2010/11-2015/16	Universal Credit*: Change: 2010/11-2016/17
Gross Earnings	0	0	0	0	0	0	**0**	0
Income Tax and NI	0	0	0	0	0	0	**0**	0
Incapacity Benefit/ JSA	5340	5240	3820	3730	3670	3600	**-1750**	
Tax Credits	0	0	0	0	0	0	**0**	-2290
Rent (less Housing Benefit)	0	0	0	-460	-460	-470	**-470**	
Council Tax (less Council Tax Benefit)	0	0	0	-150	-140	-140	**-140**	-130
Total annual disposable income (after housing costs)	**£5,340**	**£5,240**	**£3,820**	**£3,140**	**£3,080**	**£3,000**	**-£2,350**	**-£2,420**
Change in total income from 2010/11	-	*-2%*	*-29%*	*-41%*	*-42%*	***-44%***		*-45%*

**Universal Credit replaces tax credits, Housing Benefit, Jobseeker's Allowance and most other income-related benefits.*

REFERENCES

1 Please see 'Guide to Welfare Reforms 2010 – 2017' (Church Urban Fund and the Church of England, March 2013), where each reform mentioned here is explained in more detail.

2 Please see **www.lissongrovebenefits.co.uk**

3 In 2010/11, Mark and Sarah's adjusted household income is approximately 70% of the UK median (where 60% is commonly used as the poverty threshold).

4 Their disposable annual income of £20,480 in 2015/16 is equivalent to £18,230 in 2010/11 prices or £219 per week, compared with an after housing costs poverty threshold of £224 per week (for a couple with three younger children in 2010/11).

5 According to analysis done by Landman Economics, March 2013: **http://bit.ly/138459R**

6 This calculation assumes that either Mark or Sarah are aged 25 or over, and that all the elements and work allowances within Universal Credit are uprated by 1% in 2016/17 (as has already been announced for 2014/15 and 2015/16).

7 The Work Capability Assessment has come under heavy criticism from disability groups and others. A large number of disabled people found fit for work have appealed against their decision and 38% of these appeals have been successful, indicating serious problems with the test (see for example: **http://bbc.in/V2DepK**).

8 According to evidence submitted to parliament by mental health organisations, December 2010: **http://bit.ly/14brveR**

9 Work Programme Outcome Statistics, DWP, February 2013: **http://bit.ly/WZkdYL**

10 This is higher than the minimum charge in many local authorities in 2013/14. However, minimum charges are likely to be raised in future years when the transitional grant scheme is no longer in place; to benefit from this scheme, councils must keep the minimum charge to 8.5% or less.

11 The lower bound figure includes the full impact of Universal Credit (Figure 7.7, IFS Green Budget, February 2013). The upper bound figure excludes Universal Credit and was provided on request by James Browne at the IFS. These are averages for the two poorest deciles.

12 According to Demos, 534,300 disabled people will be affected by multiple welfare reforms, losing in total between £6,300 and £23,300 over the period to 2017 (see: **http://bit.ly/16XiJzI**).

13 DWP follow-up surveys of former Incapacity Benefit claimants who had been deemed 'fit to work' found that only 15-29% were in work. Information released to member of the public after a Freedom of Information request: **http://bit.ly/QTBXwz**.

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