'Bad Friday':

The cuts bombshell hitting low income families on Friday 6th April 2012

Introduction

On Good Friday, April 6th 2012, the main tranche of welfare cuts for 2012, totalling over £2 billion, will hit families.

The day will feel like 'Bad Friday' for millions of families, with major risks to family welfare for those worst affected.

The cuts are targeted at families struggling to get by on low earnings. The targeting will be through the tax credits system. It will mean that many families will no longer be better off in work.

And yet even worse pain will still be to come further down the line. Most of the cuts to social security, welfare benefits and tax credits in the coalition government's plans have yet to be implemented, or to have their full impact on families.

A total £20 billion of cuts to social security, welfare benefits and tax credits is planned by 2014. This means that the annual spend by government on direct support for families will be £20 billion lower in 2014 than it was in 2010.

This briefing sets out the cuts that will hit families on 'Bad Friday' and puts them in the context of the full cuts to benefits and tax credits that will have been implemented by 2014/15.

We also look at the implications for child poverty and the dangers to the UK economy – and therefore sustainable deficit reduction – that some economists believe will be a consequence of targeting the cuts to low income families in this way.

What welfare cuts are due in April 2012?

The coalition's cuts this April are particularly focussed on working families.

Table 1 details the specific measures being implemented, alongside the amounts that will be cut for each measure in each of the next four years. Further explanation of these cuts can be found on the HMRC website.[1]

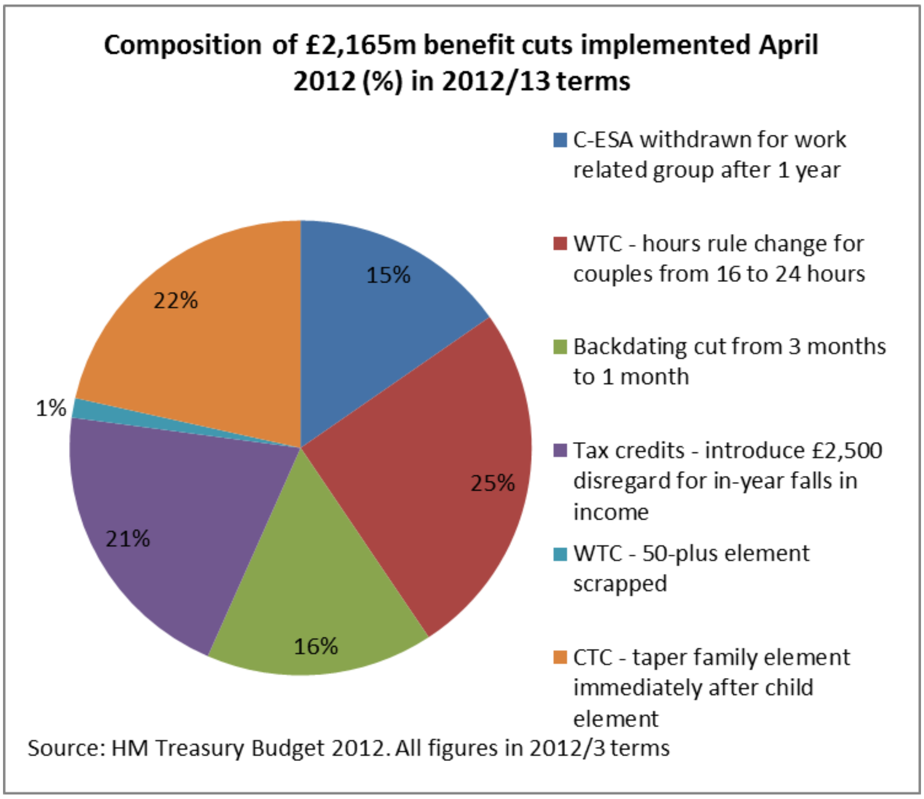
Table 1

	Savings (£million)			
Cuts	**2012-13**	**2013-14**	**2014-15**	**2015-16**
C-ESA withdrawn for work related group after 1 year	330	835	1230	1475
WTC - hours rule change for couples from 16 to 24 hours	550	545	540	550
Backdating cut from 3 months to 1 month	345	355	360	360
Tax credits - new £2,500 disregard for in-year falls in income	445	720	695	690
WTC - 50-plus element scrapped	30	35	35	35
CTC - taper family element immediately after child element	465	440	420	400
Total saved	**2165**	**2930**	**3280**	**3510**

Source: HM Treasury, Budget 2012

Chart 1 shows the relative contribution each cut is making to the total of £2.165 billion cuts to support for families in April 2012 from newly implemented measures.

Chart 1



[1] See http://www.hmrc.gov.uk/taxcreditsbudget/index.htm for full explanation of the changes to tax credits.

Who will be worst hit on 'Bad Friday'?

The families who will be losing out most on 'Bad Friday' are:

- **Couples with between 16 and 24 hours work on low pay:**

  The government states that up to 210,000 families (with 470,000 children) face the possibility of losing all £3,870 of their working tax credit due to the hours rule change.

  But do employers have the extra working hours to give? The shop workers union, Usdaw, found that 78% of their members who are in this situation say that their employer has told them there are not sufficient additional hours available for them to work. The organisation Working Families surveyed employers and found that only 17% of them were confident they could meet requests for additional hours from employees affected by the rule change. We therefore expect the majority of families in this situation to lose their tax credits entirely. A government answer to a parliamentary question confirms that this is likely to destroy work incentives by leaving families worse off in work.[2]

- **1.3 million families receiving child tax credit**

  Families will usually get some child tax credit, provided they are not over the income limit of £41,300. But from 'Bad Friday', the income limit will be reduced, taking a total of £465 million out of the purses and wallets of UK families.

  HMRC have published advice on their website estimating that this will mean that families will lose their child tax credit if:
    - you have one child and your annual income is more than around £26,000
    - you have two children and your annual income is more than around £32,000

  These are estimates and should not be communicated as definite thresholds. It is also important for families to know that they may still qualify above these indicative thresholds if:
    - they pay for registered or approved childcare
    - there is a disabled person in the household
    - they have more than two children

- **Families whose annual earnings fall – due to either a lower rate of pay or loss of working hours**

  If your earnings fall, then previously you could have had your tax credits claim adjusted to take account of this. But from 'Bad Friday' you will not be able to have your tax credits adjusted unless your gross earnings have fallen

[2] See answer to PQ number 95428 on 29/2/12 (http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120229/text/120229w0004.htm)

by at least £2,500. This means that you could lose out on nearly £50 a week in gross earnings without being able to have your tax credits adjusted to cushion you and your family against the loss of income.

- **Families who need their tax credits claim backdated**

  UK families will lose out on a total of £345 million this year because of changes to the backdating rules. Under the current system, back dating is possible for up to three months if a household met the qualifying criteria for tax credits during the period.

  But from ‘Bad Friday’, backdating claims cannot be for more than a month, even if the claimant has good cause for not having claimed for a longer period than that.

  Means tested benefits like tax credits tend to have lower take up rates because they are complicated to understand and claim. For this reason, new claims are sometimes slowed down and delayed until a family is advised of entitlement and works out how to navigate the claiming process correctly. Other backdating claims arise out of changes of circumstances. A new child in the family increases entitlement, but putting in the paperwork can easily slip when a family is dealing with the birth of a new child, especially if there are factors like sickness of the mother or new born child.

  Changes can also mean that there is underlying entitlement. For example, if a couple separates, the parent who remains resident with the children has underlying entitlement, but needs to reclaim as a single claimant. The turmoil and uncertainty of a separation can often cause delays to getting the forms prepared and submitted correctly. Underlying entitlement will now be more likely to be lost because of the new one month time-limit.

How much support for families is still to be cut?

The majority of the measures that cut support for families will have begun this year. However, the main impact of these cuts on family incomes and budgets has yet to be felt.

In some cases this is because there is a time lag before many people become affected (e.g. the time limiting to one year of contribution-ESA). In other cases this is because support is being frozen, so the size of the cut will increase incrementally year on year (e.g. the freezing of elements of working tax credit).

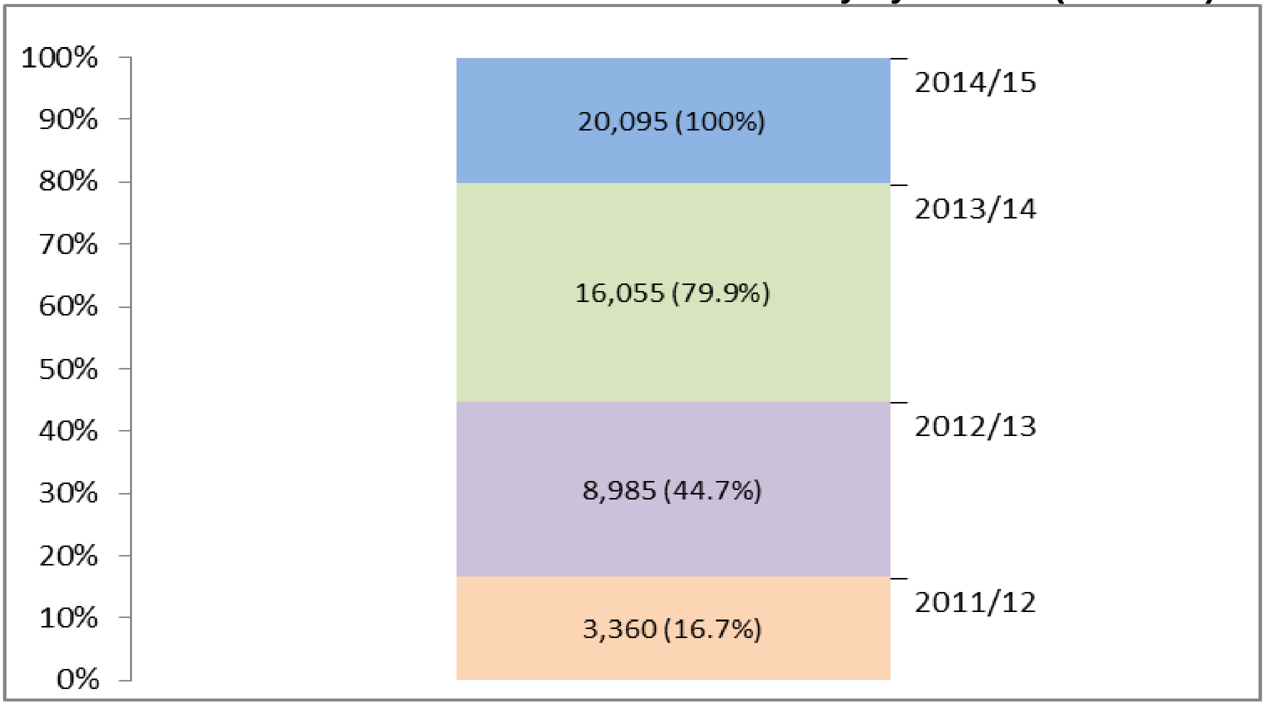
Chart 2 below uses the in-year totals of the government's welfare benefit and tax credit cuts for the years 2011/12 to 2014/15 (the end of the government's current spending period). It shows the timetabling of how these in-year totals reach more than £20 billion annually by 2014/15.

Presenting the information in this way is a stark reminder of the extent to which most of the pain is still to come for families.

In 2011/12, the total loss to families from welfare benefit and tax credit cuts was £3.360 billion. This year it will be well over double that, at £8.985 billion. However, this is still not even half the full amount of cuts that families will be experiencing by 2014/15. During the current year, families will still be waiting for 55% of the full welfare and tax credit cuts to hit them.

Chart 2

How welfare cuts accumulate to £20 billion annually by 2014/15 (£ million)



Source: Figures from HM Treasury

What will be the impact on child poverty?

Since the baseline year for the government's target, child poverty has been reduced by 900,000. However, the Institute for Fiscal Studies has warned that under the government's current spending plans, the recent years of progress will be put into reverse.[3]

Table 2 below shows child poverty actual figures and projections for key years.

Table 2

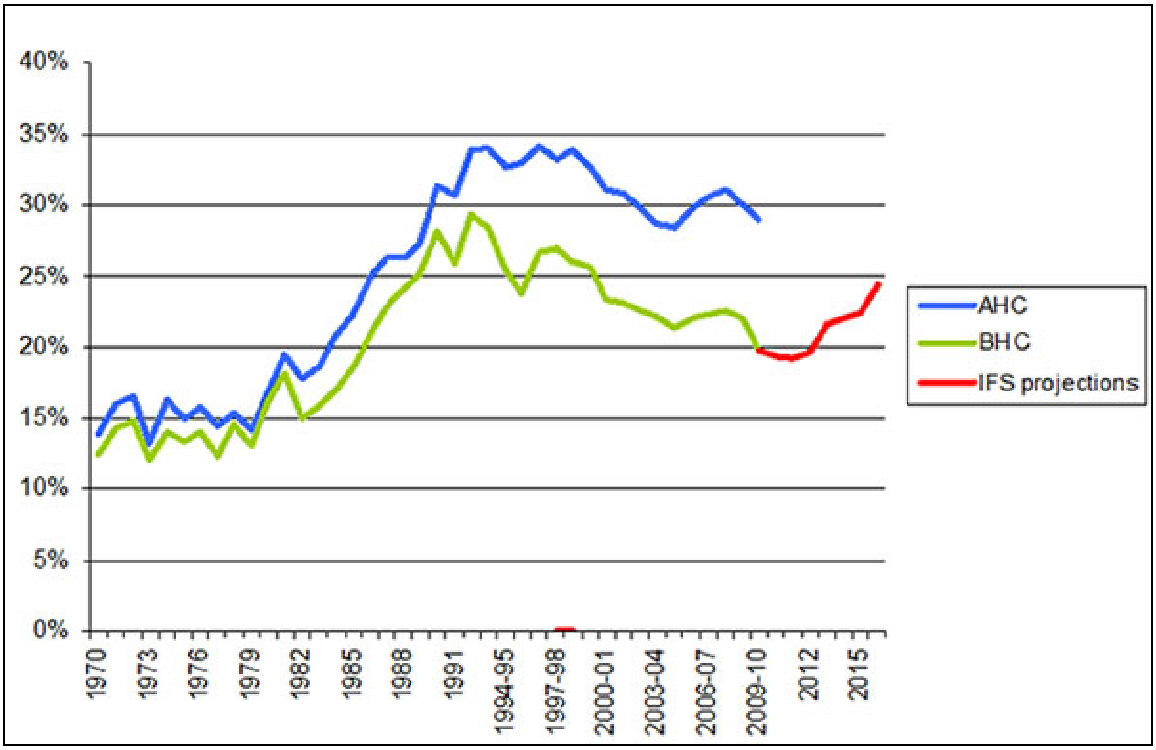
		Before housing costs	After housing costs
Baseline year	98/99:	3.4 million	4.4 million
Latest official figures	09/10:	2.6 million	3.8 million
IFS estimate for	*10/11*:	2.5 million	3.5 million
IFS estimate for	*20/21*:	3.3 million	4.3 million
Govt target for	**20/21:**	**1.3 million***	N/A

* 10% of children based on 2010/11 population count

Sources: HBAI 1998/99-2009/10 (rounded figures before housing costs); Children and Working-Age poverty from 2010 to 2020, IFS 2010.

Chart 3 shows the changes that have occurred to the level of UK child poverty, both before housing costs (BHC) and after housing costs (AHC) since 1970, plus the forthcoming trend of increasing child poverty predicted by the IFS (shown in red).

Chart 3



[3] See *Child and Working-Age Poverty from 2010 to 2020* (http://www.ifs.org.uk/comms/comm121.pdf)

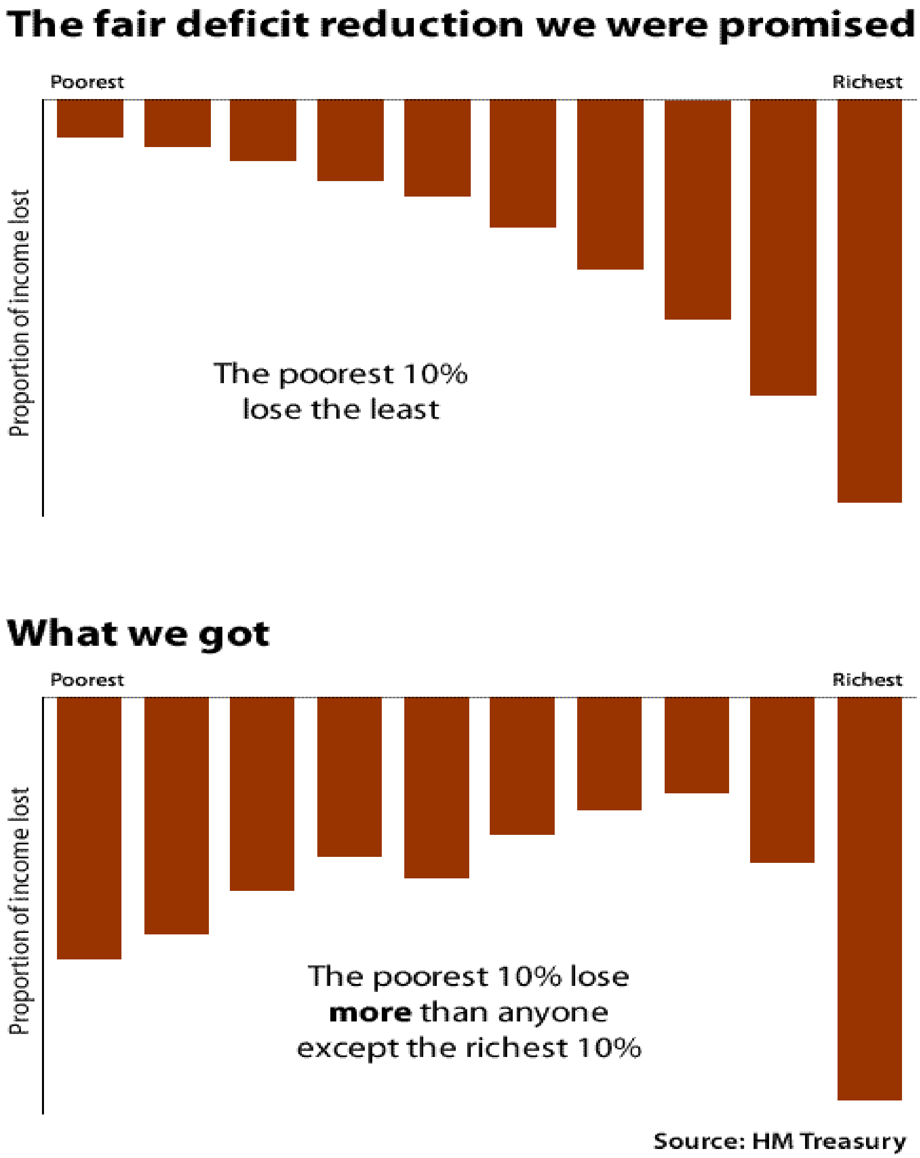
Is this approach to deficit reduction fair?

The government promised that the broadest shoulders would take the greatest burden and that their approach to deficit reduction would be fair.

To meet a common sense understanding of fairness, this should apply across the population. However, whilst the richest 10% of the population is contributing the largest proportion of income to deficit reduction, the second biggest contribution is from the poorest 10%.

In fact after the top 10%, the rest of the distribution of the burden is almost entirely regressive, as shown in Chart 4 below, which uses the Treasury's own analysis of how the cuts hit households in 2012/13.[4] The three deciles making the smallest contribution to deficit reduction are in the wealthiest half of the population.

Chart 4



[4] *Impact on households: distributional analysis to accompany the Autumn Statement 2011*, HMT (http://cdn.hm-treasury.gov.uk/as2011_distributional_analysis.pdf)

What might the economic impact be?

The cuts to welfare carry an economic risk as well as a social risk. But the government has failed to conduct a proper assessment of that risk.

Costs of child poverty:

Research by the Joseph Rowntree Foundation suggests that the UK's high rate of child poverty cost the economy around £25 billion a year. Of this, around £17 billion is a cost to the Exchequer.[5]

This results from extra public expenditure on services (e.g. health, children's services, personal care and disability services, welfare to work services, policing), and lost productivity as a result of factors like low educational attainment and worse health.

By taking an approach to deficit reduction that relies heavily on cutting support for low income families, the coalition is in danger of allowing the economic costs of child poverty to continue and worsen. In the medium to long term, this will hinder rather than help to reduce the deficit.

Fiscal hindrance:

The £20 billion of welfare benefit and tax credit cuts represent a direct reduction in GDP of around 1.3%.[6] But the actual drag on GDP is likely to be worse because of the fiscal hindrance impact.

Economists generally recognise the importance of spending by low income families in the economy. Low income families have the highest marginal consumption rates. In other words, they go out and spend their money straight away in their local shops and services to meet basic spending needs; whereas wealthier households are more likely to save money, or spend it outside of the UK economy.

An International Monetary Fund analysis of fiscal stimulus options, contributed to by economists from the EU, ECB, Federal Reserve, OECD and Bank of Canada, suggests that transfers to 'hand-to-mouth' and' credit-constrained' consumers provide higher economic multipliers.[7]

This is why many countries made support for low income households a central part of their fiscal stimulus policies in 2008 and 2009. A joint report by the International Labour Organization and the International Institute for Labour Studies reviewing global fiscal stimulus stated:

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[5] D Hirsch, *Estimating the cost of child poverty,* Joseph Rowntree Foundation, 2008 (http://www.jrf.org.uk/sites/files/jrf/2313.pdf)
[6] UK GDP is approximately £1,500 billion, so £20 billion is around 1.3% of GDP.
[7] See D Laxton, *'Effects of fiscal stimulus in structural models'*, IMF 2009 (http://www.imf.org/external/np/seminars/eng/2009/fispol/pdf/laxton.pdf)

> "During the crisis, social and cash transfers not only assisted those in need, but by putting cash in the hands of those most likely to spend it, helped to shore up household consumption. For this reason, countries that strengthened the policies towards income transfers managed to recover faster than others."

However, when deep welfare benefit and tax credit cuts dramatically reduce income transfers to low income families, a reverse effect must be expected: fiscal hindrance.

It has been suggested that the economic multiplier for income transfers to low income families is around 1.6.[8] This means that for every pound transferred in this way, GDP increases by £1.60.

If this estimate is right then, conversely, £20 billion of benefit cuts might pose the threat of depressing GDP by as much as £32 billion.

A robust assessment of this risk is still lacking. Further work is urgently needed to more accurately estimate the fiscal hindrance that may be caused by the cuts and the economic impact it will have.

It would be of great value for the Treasury, or Office for Budgetary Responsibility, to conduct and publish an analysis so that we have a much better understanding of the extent to which these cuts pose an economic risk which may actually be detrimental to deficit reduction.

[8] See:

- D Elmendorf and J Furman, *'If, When and How: A Primer for Fiscal Stimulus'*, The Brookings Institution, 2008 (http://www.brookings.edu/papers/2008/0110_fiscal_stimulus_elmendorf_furman.aspx).
- I Jackson and G Pugh, *'The regeneration effects of "fair wages"',* Staffordshire University, New Economics Foundation and UNISON, 2005 (http://www.lm3online.org/documents/Regeneration%20effects%20of%20fair%20wages.pdf). This study looked at the regeneration implications of redistribution through earnings when increases were made to care workers wages. It also quotes other local studies which suggest similar multiplier effects.
- Coenen et al., *'Effects of Fiscal Stimulus in Structural Models'*, IMF Working Paper 10/73, 2010 (http://www.relooney.info/0_New_7038.pdf)

Recommendations

Sound social and economic policy must be responsive to changes in circumstances. The current economic circumstances are far more adverse than those that had been predicted for 2012 by the Office for Budgetary Responsibility at the time the tax credit changes were announced in autumn 2010.

The government should therefore pursue a sensible and responsible course of action by reviewing and modifying policies in the light of the current situation.

This should include:

1) **Postpone the change to the hours rule for couples claiming working tax credits**

   The policy was designed in 2010 when the OBR predicted the economy would be back to strong growth. But the circumstances are now different and the evidence suggests that the policy cannot now be implemented without damaging social and economic consequences. It will dramatically worsen child poverty in its extent and severity; and it will create a situation whereby people are better off leaving their jobs to the detriment of the economy. The introduction of the Universal Credit next year will get rid of hours rules, and the cliff edges they create, altogether. The sensible option would be to postpone this change until the new system under Universal Credit is in place.

2) **Rebalance the ratio of spending cuts to tax rises**

   The ratio of spending cuts to tax rises is currently around 4:1. This is dramatically different to the 1:1 ratio that the Conservative government adopted following the recession in the early 1990s. A major problem with this ratio is that it almost guarantees that the distribution of the burden will fall disproportionately on those at the lower end of the income distribution. As a result the government is clearly failing the Fairness Test – as demonstrated by the Treasury's own analysis of the 'Impact on Households'. The government should urgently review its approach if it is to keep its commitment to fairness. Otherwise its promise not to pass on the burden to children tomorrow will just mean placing the burden directly on children today instead. Rebalancing the ratio would allow other cuts targeted to children and families – such as the freezing of child benefit and cuts to child tax credit – to be substituted by policies that ensure a fairer burden is carried by those households in the wealthiest half of the population that are currently making the smallest contribution.

3) **A detailed analysis of the economic impacts of welfare cuts**

   The economic literature from institutions such as the International Monetary Fund and the International Labour Organization suggests that there are economic risks to steep cuts to welfare benefits and tax credits that have not yet been properly analysed and considered by government. The government's policy should be based on a thorough analysis of all relevant evidence. In particular, the potentially damaging impacts to the economy of fiscal hindrance must be fully examined. The Treasury should either conduct an analysis of this risk itself, or should commission the Office for Budgetary Responsibility to do it.

4) Tougher action on tax cheats, to increase the role tax justice can play in reducing the deficit.

The government recognises that tens of billions of pounds is lost each year to tax cheats. Ministers deserve credit for taking seriously the need to get tougher on tax cheats who use evasion, or avoidance. However, the pace of progress could be improved. As well as closing loopholes and looking at ideas like a general tax avoidance law, the government must invest more in enforcement. Cuts to HMRC staff are currently threatening to weaken the enforcement framework because the lack of capacity will make it easier for fraudulent behaviour to go undetected. This is an investment that will more than pay for itself, and can therefore take the pressure off the need for cuts.

Governments also have a duty to uphold the public ethic that underlies taxation. When politicians argue against a tax rise on the basis that people will only try and cheat the system, they erode the public ethic and make avoidance more likely. The Cabinet Office's behavioural insights team has already had some success in reducing tax fraud and error by reviewing the communications sent out to taxpayers by HMRC. They should give further consideration to the language used by ministers around taxation and how it can strengthen, rather than undermine, the public ethic on which revenue collection depends.

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About CPAG

CPAG promotes action for the prevention and relief of poverty among children and families with children. To achieve this, CPAG aims to raise awareness of the causes, extent, nature and impact of poverty, and strategies for its eradication and prevention; bring about positive policy changes for families with children in poverty; and enable those eligible for income maintenance to have access to their full entitlement.