

PRESS RELEASE

Embargoed until Wednesday
3rd March 2010



Shave £1.4 billion off benefits bill - but provide financial incentives to get people into jobs

As the welfare bill heads to £81 billion, think tank calls for radical overhaul of benefits system

Think tank Policy Exchange today identifies savings of £6.5 billion that could be made in the welfare system. This could be achieved through reducing the tax credits and child benefit given to wealthier families, and keeping the value of other benefits in line with that of prices, as opposed to the planned increases.

The report, *Escaping the Poverty Trap*, recommends that part of these savings should be put towards providing financial incentives to encourage those on benefits into jobs. At present, people on benefits can find themselves *worse off* if they chose to take on part time work (16 hours or less a week). The combination of benefit withdrawal and the need to pay Income Tax and National Insurance produces some of the *highest rates of tax on anyone in Britain*.

People on welfare should be incentivised to take up work by raising the 'disregard' (the amount of money that someone is allowed to earn before they start losing benefits) to £92.80 for all benefits. This would mean that anyone on the minimum wage who works for 16 hours keeps everything that they earn. This would give over 2.8 million people a better reason to work.

Raising the disregard would cost £5.1 billion – leaving an overall total saving on the welfare bill of £1.4 billion.

Escaping the Poverty Trap is the most comprehensive report into the disincentives to work that exist in the welfare system. The report uses new calculations of the costs of getting a job - which have not been taken into account in previous studies –to assess the true level of disincentives to work that people on welfare face.

Lawrence Kay, author of the report and research fellow in Policy Exchange's Economics Unit, said:

"The choice between leaving benefits and going into work should be an easy one. If we make these savings, we can significantly increase the amount of money benefit claimants can keep to encourage them to find work, while still reducing the overall welfare bill.

"Part time work can be effective as a 'stepping stone' into the labour market – and those on welfare who work part time are also more likely to have left it eight months later. The social benefits are as great as the economic ones. People in work, and their children, are far less likely to suffer low-well being, mental illness and chronic health conditions."

The report recommends:

Clawing back the 3% increase in the value of some benefits in 2009-2010 by reducing expected rises in their value in the next few years. This would reclaim £700 million.

- The Government is required to ensure that benefits maintain their values relative to the level of prices. But in the 2009 Pre-budget Report, the Chancellor decided to increase the value of all such benefits by 1.5%. This was in spite of a 1.4% decline in RPI to September 2009. The RPI count that would normally be the basis for the increases in benefits linked to RPI in April 2010. The effect was to give people on benefits a real 2.9% rise in the value of their income. HM Treasury, *Pre-Budget Report*, HM Treasury, 2009, pp 79
- The Government could reverse this change over the next few years, and reclaim the £700 million that the Treasury expects this change to cost. This could be done by reducing the increases in the value of affected benefits by a sufficient percentage each year until the money is recouped.

Take away Child Benefit and some of the Child Tax Credit from richer families. This would save £5.8 billion.

- This means tapering away the Family Element of the Child Tax Credit and Child Benefit at 39% once the Child Element of the Child Tax Credit has been exhausted.
- Richer families with children should be able to continue to receive help with childcare, but would not receive tax credits.
- Tax credits would be retained for *low income* working families – the group for which they were originally intended.
- The Family Element of the change would save £1.3 billion a year alone, while applying the same approach to Child Benefit would save a further £4.5 billion a year.

The disregard (the amount of money that someone is allowed to earn before they start losing benefits) should be raised to £92.80 for all benefits, meaning that anyone on the minimum wage who works for 16 hours keeps everything that they earn.

- The case studies showed that the incentives to work fewer than 16 hours are very poor. By raising them to a level that any claimant on any benefit could take advantage of, over 2.8 million people on benefits would see it was worth their while to work. This includes those on income-based JSA, income based IB/ESA and Income Support received for reasons of lone parenthood. http://83.244.183.180/5pc/jsa_prim/ib/ccstatu/a_stock_r_ib_c_ccstatu_aug09.html http://83.244.183.180/100pc/is/ccstatgp/cnage/a_carate_r_ccstatgp_c_cnage_aug09.html
- A claimant would keep all of their main benefit (Jobseeker's Allowance, Income Support and Incapacity Benefit/the Employment and Support Allowance), plus all of their Housing Benefit, Council Tax Benefit and any other add-ons until they earned £92.80.
- By comparison, the disregard at present for someone on Job Seeker's Allowance is £25, and for someone on Income Support with children it is £20.
- **This would cost £5.1 billion – leaving an overall saving of £1.4 billion.**

ENDS

Notes to Editors

A full copy of the report Escaping the Poverty Trap is attached.

Benefits in Britain

- There are now 5.8 million people on welfare in Britain. This is an increase of 373,000, or 6%, in ten years (www.nomisweb.co.uk).
- The welfare bill in 2009/10 will be £81 billion. This is an increase of nearly £2.9 billion, or just over 3%, since 1997/98 (in 2009/20 prices). By next year the change will be £4.5 billion or 5.7% (Department for Work and Pensions, *Benefit Expenditure Tables*).
- in 1997, Tony Blair promised that "...[b]y the end of a 5-year term of a Labour government, I vow that we will have reduced the proportion we spend on the welfare bills of social failure...This is my covenant with the British people. Judge me upon it. The buck stops with me." Tony Blair, Speech to Labour Party Conference, 1 October 1996
- For the last ten years, the number of people receiving Incapacity Benefit and its successor – Employment and Support Allowance – has remained stable (Department for Work and Pensions, *Tabulation Tool*). This is despite the creation of 1.9 million jobs in the same period (In 1999 there were 29,127,000 "workforce" jobs in the economy. By 2009 this figure had risen to 30,897,000. Source: Office for National Statistics).

Disincentives to work.

Nine of the most typical claims for welfare – encompassing Jobseeker's Allowance, Income Support, Incapacity Benefit (the Employment and Support Allowance), Housing Benefit, Council Tax Benefit, Child Benefit, Working Tax Credit and Child Tax Credit – are compared to what a person would earn as they work for between one and 40 hours at the National Minimum Wage.

The financial effect of going into a job is made up of three elements:

- Participation tax rate – how much income someone will lose in benefits if they decide to start working. The higher the rate, the lower financial incentive to work.
- Marginal effective tax rate – how much income someone will lose if they decide to work *more* after taking a job in the first place. This is how much of an hour's wages a person would lose if they were to work a further hour. The higher the rate the lower incentive to work more.
- Costs of work – clothing and travel. Calculated as £23.60 per week. Bradshaw J, Middleton S, Davis A, Oldfield N, Smith N, Cusworth L and Williams J, *A Minimum Income Standard for Britain: What People Think*, Joseph Rowntree Foundation, 2009, pp 36

The table below shows that once these costs have been taken into account some people on benefits are worse off if they take up a part time job, or would be working for a paltry sum in full time work.

Table A: The work incentives faced by the typical benefit claimants studied in this report

Type of welfare claim	Total out-of-work income	Total change in income after 16 hours of work with work costs included	Total change in income after 40 hours of work with work costs included	Average per hour wage after 40 hours of work with work costs included (taking into account the withdrawal benefits)
Jobseeker's Allowance, claimant under 25	122.42	-13.07	51.00	1.28
Jobseeker's Allowance, claimant over 25	151.77	-15.07	30.36	0.76
Jobseeker's Allowance, couple over 25	191.92	-31.75	29.06	0.73
Jobseeker's Allowance, couple over 25 with one child	289.87	8.80	29.06	0.73
Jobseeker's Allowance, couple over 25 with two children	345.98	8.80	29.06	0.73
Income Support, claimant over 25 with one child	249.72	28.3	55.13	1.38
Income Support, claimant over 25 with two children	305.83	28.3	55.13	1.38
Employment and Support Allowance (work group), claimant over 25	177.27	-20.6	30.46	0.76
Employment and Support Allowance (Support Group), claimant over 25	196.02	-39.35	23.9	0.60

Highest tax rates on lowest earners

- When the costs of work are taken into account a person over 25 on Jobseeker’s Allowance will face a participation tax rate that is above 100% for most of the first 20 hours of work, and then just under 100% after that – leaving only a £29.06 gain after 40 hours in employment. See pages 46 – 49.
- Lone mothers get a better deal, but their participation tax rates are still mostly 75% until they have worked for 16 hours, and their marginal tax rates just under 100% as they consider earning a bit more money each week. See pages 60 -68.
- The worst examples of high tax rates on the poor is the group of people in the Employment and Support Allowance Work-Related Activity Group (thought of as being capable of work but in need of a bit more help than ordinary job seekers). After paying the up-front costs of getting a job they face around a 700% marginal effective tax rate on the first hour of work and then, after working for 15 hours, they *lose* £23 for working an extra hour. This means they face a marginal effective tax rate of over 700% *twice* in their working week. The participation tax rate they face is also over 100% for the first 22 hours of any work they might choose to do. See pages 68 – 76.

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