Analysing the impact of the UK Government's welfare reforms in Wales – Stage 2 analysis

Summary of the key findings

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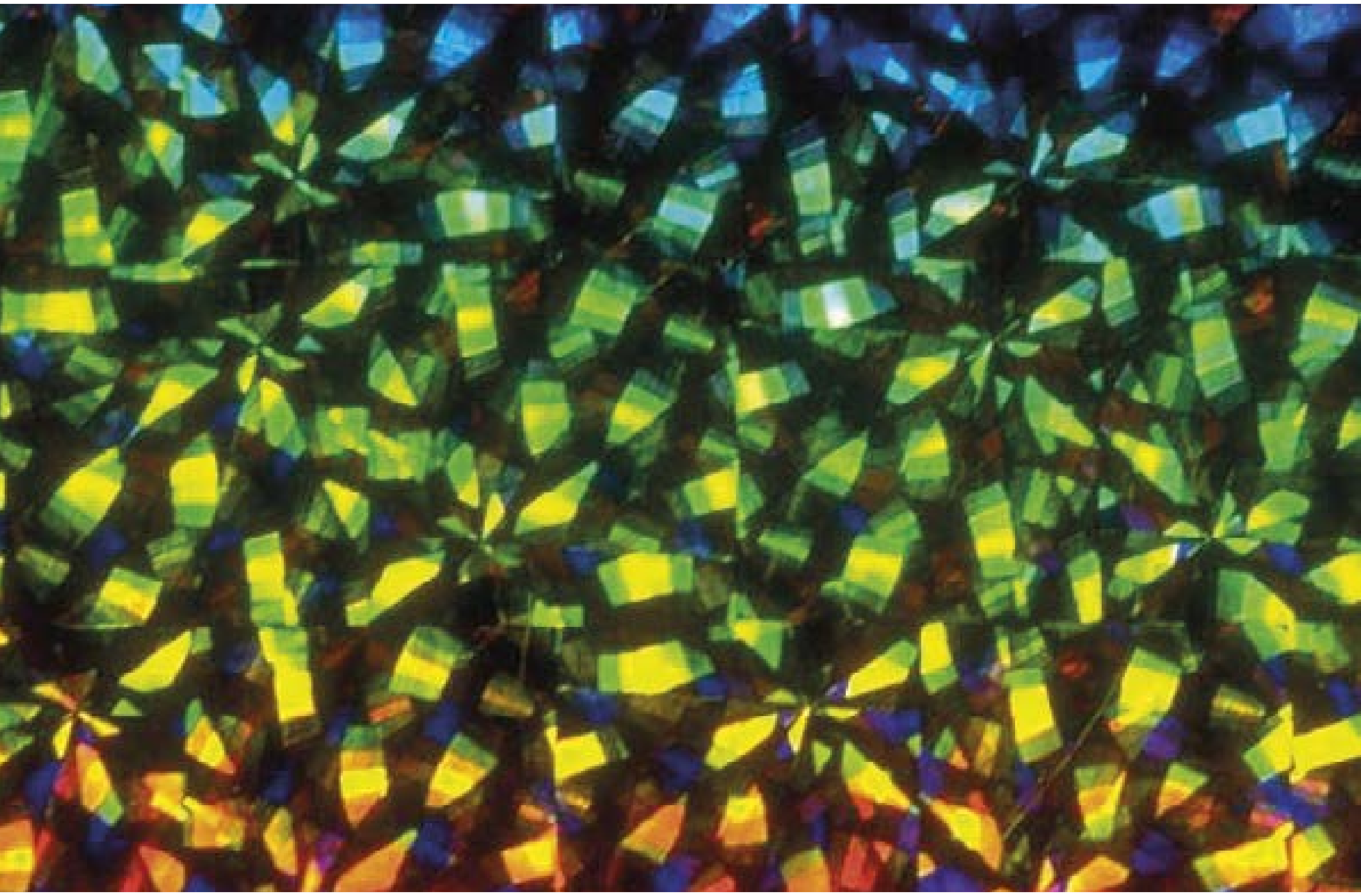

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Audience This report has been produced primarily for the Welsh Government's Ministerial Task and Finish Group on Welfare Reform (the group includes the Minister for Education and Skills; the Minister for Local Government and Communities; the Minister for Housing, Regeneration and Heritage; the Deputy Minister for Children and Social Services) and relevant policy and analytical officials.

Overview This report includes the summary of the analysis that has been undertaken internally by Knowledge and Analytical Services (Welsh Government) as part of Stage 2 of the Welsh Government's programme of research to assess the impact of the UK Government's welfare reforms in Wales. The remainder of the Stage 2 analysis has been undertaken externally by the Institute for Fiscal Studies and can be accessed via the following link:

www.wales.gov.uk/educationandskills

Action required None – for information only.

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Additional copies This document can be accessed from the Welsh Government's website at www.wales.gov.uk/educationandskills

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Introduction

The Welsh Government's Ministerial Task and Finish Group on Welfare Reform[1] has commissioned a programme of research to analyse the impact of the UK Government's welfare reforms in Wales, with the aim of providing evidence to assist with future decision making. The results of this research will be used to help target the Welsh Government's efforts to mitigate (where possible) any negative implications of welfare reform, and to continue to prioritise resources to reduce poverty in Wales, thereby contributing to the commitments made in the Programme for Government.

The findings from Stage 1 of this research programme were published in February 2012 and justified many of the Welsh Government's concerns about the scope and scale of the changes that the UK Government is driving through within their wider welfare reform agenda. Since then, the UK Government's Welfare Reform Bill has received royal assent, legislating for the biggest changes to the welfare system for more than 60 years. Also, the Autumn Statement 2012 has outlined a welfare reform package that will save a further £3.7 billion in 2015–16, adding to measures announced in 2010 that will save £18 billion[2] from welfare spending by 2014–15. For those changes that have already been implemented, evidence is becoming available on their early effects. Meanwhile, the Stage 2 research has progressed and was completed in December 2012. This consists of the four interrelated elements listed below, which have been undertaken via a combination of internal and external research. The internal research (summarised in this report) covers elements 1, 2 and 3. In addition, the Welsh Government commissioned the Institute for Fiscal Studies (IFS) to undertake research into element 4, with some coverage also given to research elements 1 and 3.

The externally commissioned research can be found in *An ex-ante analysis of the effects of the UK Government's welfare reforms on labour supply in Wales* by Adam and Phillips (2013) which can be accessed via www.wales.gov.uk/educationandskills

1 Includes the Minister for Education and Skills; the Minister for Local Government and Communities; the Minister for Housing, Regeneration and Heritage; and, the Deputy Minister for Children and Social Services.

2 This excludes the cost of UC in Great Britain, estimated at £2 billion.

Stage 2 analysis

1. Estimated direct effects of the main welfare reforms on household incomes in Wales.
2. Potential social impacts of welfare reform and implications for devolved public services in Wales.
3. How the reforms are likely to change expenditure patterns and further consideration of the wider economic impacts.
4. Impact of the welfare reforms on labour supply in Wales.

Key findings

- The Welfare Reform Act 2012 introduces the greatest changes to welfare benefits in 60 years. The reforms announced in 2010 are estimated to save over £18 billion by 2014–15 (around 8 per cent of the UK budget for social security benefits and tax credits). In addition, further welfare cuts have been announced in the Autumn Statement 2012, which amount to £3.7 billion by 2015–16.
- In order to get a better understanding of the impact of these cuts in Wales, the Welsh Government's Ministerial Task and Finish Group on Welfare Reform has commissioned a three-stage programme of research. The Stage 1 research was published on the Welsh Government's website in February 2012.
- This report, produced by the Welsh Government, summarises part of the Stage 2 research and covers the following areas:
  - estimated direct effects of the main welfare reforms on household incomes in Wales
  - wider economic and social impacts of welfare reform and potential implications for devolved public services in Wales.
- The remainder of the Stage 2 research has been undertaken externally by the Institute for Fiscal Studies (IFS). The findings from this research can be found in *An ex-ante analysis of the effects of the UK Government's welfare reforms on labour supply in Wales* by Adam and Phillips (IFS, 2013). The report can be accessed via www.wales.gov.uk/educationandskills

Estimated direct effects of the main welfare reforms on household incomes in Wales

- For the welfare reforms analysed, the largest potential estimated impacts in Wales as a direct result of the announced policy changes are as follows[3].
  - Around 350,000 working-age benefit claimants and 330,000 families in receipt of tax credits have already incurred, and will continue to incur, income losses as a result of the switch to up-rating most benefits by the Consumer Price Index (CPI) rather than the Retail Price Index (RPI). Total annual income losses in Wales are estimated to be £90 million in 2011–12 increasing to around £600 million in 2015–16. This is by far the largest impact in terms of the scale of income lost.

3 Note: Figures may not sum due to rounding.

Furthermore, there will be an additional negative impact on incomes in Wales (around £113 million in 2015–16) as a result of the recently announced decision to up-rate most working-age benefits, certain elements of tax credits (both from 2013–14 to 2015–16), and Child Benefit (CB) (from 2014–15 to 2015–16) by 1 per cent rather than prices. However, the impact of this cap will depend crucially on the out-turn for inflation over the next few years.

- Approximately 42,500 claimants are estimated to lose their entitlement to Disability Living Allowance (DLA) by May 2018, equivalent to around £55–83 per week on average in Wales. This amounts to a total annual income loss in Wales of £122–183 million by 2018–19.
- Around 56,000 claimants are estimated to have their benefit income reduced by up to £89 per week as a result of the time-limiting policy for contributory Employment and Support Allowance (ESA). The total annual income loss in Wales could potentially be around £132 million by 2015–16.

- Further negative impacts, albeit on a smaller scale, include the following.
  - Over 48,500 Housing Benefit (HB) recipients are estimated to have lost £9 per week on average from the April 2011 reforms, amounting to an annual loss in Wales of £23 million.
  - Around 370,000 families and 640,000 children are likely to be affected by the freezing of CB rates for three years from 2011–12. Average weekly losses per family are estimated to be around £2.50 in 2013–14, amounting to a total annual loss of £47 million in Wales.
  - Over 3,000 HB recipients are likely to have been affected by the change in the age threshold for the shared accommodation rate, losing around £24 per week. The total annual loss in Wales is estimated to be £4 million.
  - One thousand two hundred claimants are estimated to have been affected by the abolition of youth provisions under contributory ESA, with average weekly losses per claimant likely to be around £25. In total, ESA youth payments in Wales are estimated to be reduced by around £1.7 million by 2015–16.
  - The increase in the working hours rule for couples with children and the removal of the second income threshold that form part of the changes to tax credits are estimated to have an impact on approximately 9,400 and 43,500 households

respectively, with maximum weekly income losses per household of around £74 and £10. Likewise, annual losses in Wales are expected to be up to £36 million and £24 million.

- The extension of Lone Parent Obligations in May 2012 will have affected lone parents claiming Income Support (IS) with a youngest child aged 5 or 6, with the majority expected to move on to Jobseeker's Allowance (JSA). In February 2012, there were around 5,000 lone parents in Wales in that category. It is estimated that up to 1,250 affected lone parents in Wales could move into work given the increased focus on work preparation and obligations to look for work.
- Around 31,000 families in Wales are expected to incur income losses of £25 per week on average as a result of the taper rate applied to CB. A total annual income loss of £41 million in Wales could result.
- The April 2013 HB reforms will increase Local Housing Allowance (LHA) rates by CPI rather than actual rents and will cut the amount of benefit paid to claimants under-occupying socially rented properties. Average weekly losses per person are estimated at £6 and £12 respectively, with annual losses in Wales totalling £40 million. A further change will be made to the up-rating policy for LHA rates from 2014–15 for two years. This will involve the increase in rates being capped at 1 per cent.
- Around 1,500 households in Wales are estimated to have their benefit income reduced by around £70 per week on average as a result of the Household Benefit Cap in 2013–14. The total annual income loss in Wales is anticipated to be around £5 million.
- Programme funding for those elements of the Social Fund that are being transferred to the Welsh Government is estimated to be reduced from £11.7 million in 2011–12 to £10.2 million in 2013–14 and 2014–15, while need is expected to increase.
- The UK Government will devolve responsibility for providing support for low-income families with their council tax and will cut funding by 10 per cent from 2013–14. However, the Welsh Government will be making up the shortfall in funding for council tax support in Wales in 2013–14 ensuring that those people eligible for support will continue to receive their full entitlement.
- Overall, Universal Credit (UC) is expected to increase household incomes in Wales by £22 million (excluding transitional protection) in 2014–15. However, this is significantly offset by the income losses estimated from the other welfare reforms.

- The findings outlined above are intended to provide an indication of the number of claimants that could potentially be affected by each of the main welfare reforms and the estimated direct income losses in Wales. The analysis is not intended to provide an aggregate figure of the loss to household incomes in Wales as a result of the cumulative impact of the welfare reforms. Therefore, it would be inappropriate to simply sum each of the estimated income losses from individual reforms, partly because they are not based on prices from the same year (given the varying timescales for the introduction of the reforms) and also because the analysis is partial. However, as part of the externally commissioned Stage 2 research, Adam and Phillips (2013) have assessed the aggregate impact of the majority of the welfare reforms announced before December's Autumn Statement on household incomes in Wales and estimate that there will be a direct loss of income of around £590 million in 2014–15. This equates to around £7.26 per family per week on average[4], roughly 1.5 per cent of their net income. The analysis by Adam and Phillips (2013) is not directly comparable with that contained in this report as the coverage of the analyses differ as do some of the assumptions made and data sources used. Both analyses should be treated as indicative.
- Adam and Phillips (2013) also report that the biggest average losses from the welfare reforms are expected to be experienced by low–middle income families in Wales. By family type, overall, the biggest average losses are likely to be incurred by non-working families with children. Pensioners, and families without children in which all adults work, will be largely protected from the cuts. Furthermore, additional analysis by Crawford, Joyce and Phillips (2012) suggests that the benefit cuts will hit Wales slightly harder than the UK as a whole due to its higher levels of welfare dependency.

Wider economic and social impacts of welfare reform and potential implications for devolved public services in Wales

- As summarised above and identified in the Stage 1 Report and the externally commissioned research undertaken by Adam and Phillips (2013), the UK Government's welfare reforms will have far-reaching impacts for benefit claimants, particularly low–middle income households and non-working families with children. As a result, there are expected to be implications for the devolved public services that support them.

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4 This average loss has been calculated for all households in Wales rather than just those households directly affected by the welfare reforms.

- The welfare reforms could potentially have a direct negative impact on claimants' **health** via a reduction or loss of benefit income due to tighter eligibility criteria, conditionality requirements and tougher sanctions; increased poverty levels; new, uncertain and stricter medical assessments; appeals and reassessments; budgeting problems associated with direct, monthly benefit payments; the migration of claimants into cheaper, poorer-quality and possibly overcrowded housing; and a combination of less financial resource and increasing demand for support from the Social Fund and Independent Living Fund (ILF). There may also be indirect income effects on entitlement to a number of health-related passported benefits. These impacts are likely to lead to increased pressure on health services in Wales. However, if the reforms are successful in getting people into work, these negative impacts will be counteracted (to some extent) by the positive effects on health that are associated with employment. Transitional protection will also soften the blow for some claimants.

- Given the relationship between low income, poverty, and demand for social care, the effects of welfare reform may place **social care services** in Wales under increased pressure, especially in the longer term. In particular, informal carers may be further relied on as claimants lose some or all of the financial support and services they once relied on. For those who are forced to migrate to cheaper areas, this may result in the loss of informal support networks and disruption to formal care delivery. This migration effect will impact on the distribution of service needs across Wales with some areas (particularly those that are deprived) facing increased demand. Foster carers are also expected to be negatively impacted due to the new under-occupancy rules in the social rented sector. Funding cuts to the ILF will further add to these problems. However, as with health, employment effects could have a positive impact on service needs and demand.

- Potential impacts on **housing** services relate to housing affordability, rent arrears, evictions and homelessness due to benefit cuts, direct and monthly payments, and sanctions, which may create budgeting problems. Although time-limited transitional protection and an increase in discretionary housing payments (DHP) will be available, the latter is small in scale compared to the extent of the HB cuts. In addition, funding available via Support for Mortgage Interest (SMI) will be reduced. As a result, landlords may incur additional costs in rent collection and managing tenancies, and may face increased pressure to reduce rent levels resulting in lower incomes from their properties. There is also a risk of a reduction in properties let to HB claimants in the private rented sector, and there may be a particular shortage of suitable properties for those affected by the extension to the Shared Accommodation Rate and the under-occupancy rules. Families may be forced to cheaper (and already deprived) localities leading to increased housing pressures in these areas, particularly for bed and breakfast and temporary accommodation where supply is unable to meet demand. This may give rise to overcrowding and residence in poorer-quality housing. However, there may be some offsetting positive impacts such as claimants seeking employment to make up shortfalls in rent and a potentially more efficient use of social housing given the under-occupation rules.

- **Educational outcomes** may also be affected by the welfare reforms. As well as the potentially negative effect of reduced income and increased poverty on educational outcomes, the migration effects that may result from the HB reforms may have particular consequences for access to high-performing schools (and their associated positive educational outcomes), continuity of educational provision, and pressure on school places. There may also be detrimental impacts on educational attainment for those families who lose entitlement to free school meals (FSM). However, at the same time, some families may gain entitlement to education-related passported benefits. Skills provision, careers information, advice and guidance, and student finance are other services and budgets that may be affected. With regards to the impact of DWP's welfare-to-work programme, commentary by the National Audit Office (NAO) suggests that performance to date has been much lower than the minimum requirement for the programme and DWP's core expectation. Skills conditionality (SC) has also been introduced in Wales. Although this may lead to an increase in benefit sanctions due to non-compliance, in some cases it may enhance employment prospects.

- In terms of **economic development**, the key impacts relate to household income (from benefits/tax credits and earnings), expenditure, employment, self-employment and economic output. Adam and Phillips (2013) estimate that the UK coalition government's welfare reforms announced before December's Autumn Statement will reduce total benefit and tax credit entitlement in Wales by around £590 million (or £520 million if UC is included). However, the same study predicts that improved work incentives will have a positive, albeit modest, impact on labour supply in Wales (e.g. central estimate: working-age employment +0.3 percentage points or around 5,000 people and aggregate gross earnings +0.5 per cent or £149 million), although there remains a great deal of uncertainty regarding the size of this impact. Labour demand will be an important influence on outcomes, particularly in the short-term. The self-employed, particularly the low paid, will be affected by major changes under UC. Specifically, established self-employed claimants will be assumed to earn at least a minimum income level set by the Department for Work and Pensions (DWP), which (rather than actual earnings) will be used to calculate claimants' UC awards. There will also be administrative burdens from monthly income reporting requirements. These changes could possibly increase the demand for Welsh Government business support services, particularly financial support. There is also the possibility of negative spill-over effects from the welfare reforms on the employment and wages of people who are not directly affected by the reforms. Further wider economic impacts may be caused by changes in spending (by those whose income is affected directly through changes in entitlements, via changes in employment and hours of work, or via spill-over effects). For example, the Office for Budget Responsibility (OBR) estimates that policy changes that have a direct effect of reducing welfare spending by 1 per cent of Gross Domestic Product (GDP) (such as those implemented or due to be implemented by the UK coalition government) will lead to a reduction in GDP of 0.6 per cent in the short run. However, other estimates by the International Monetary Fund (IMF) and also US-based studies of periods of economic weakness suggest that the multiplier effects may be even larger.

- **Communities and Social Justice** services and budgets may be affected as a result of possible negative impacts of the welfare reforms on poverty, financial inclusion, benefit/debt advice (which will also be affected by the UK Government's changes to legal aid), crime, antisocial behaviour, domestic abuse, and digital inclusion. There may also be increased pressure on the successor to the Social Fund in Wales given that the budget that will transfer to the Welsh Government will be reduced in 2013–14 and then frozen in 2014–15 rather than growing year-on-year while need is expected to increase. However, there may be some positive impacts via improved work incentives and subsequent moves into the labour market.

- There will be a number of consequences for **local government** services and budgets in Wales. These include a likely increase in demand for services such as welfare rights and information, online claiming assistance, debt advice and debt recovery/eviction, budgeting support, employment support, and applications for benefits and other financial support (e.g. DHP). As well as this increased demand, there is also the impact of reduced funding streams including for the establishment of a new council tax support scheme. However, the Welsh Government has recently announced that it will make up the shortfall in funding transferred from the UK Government for council tax support in 2013–14. Although the new scheme could increase the financial risk faced by local authorities (LAs), it may also lead to some desirable effects such as promoting employment and growth in the local economy. In addition, there will be other direct operational impacts for LAs that are associated with the changes to HB under UC.