

Resolution Foundation

Resolution Foundation analysis of the 2012 Autumn Statement

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In our initial response to the Autumn Statement, we focused on the government's historic decision to break the link between working-age benefits and prices and instead up-rate most working-age benefits and tax credits by just 1 per cent a year for three years from 2013.¹ The Chancellor argued that such a move was fair because it matched planned increases in public sector pay in the coming years, the implication being that the out of work should not be securing more generous increases than those in work. We pointed out that, far from hitting only the out of work, 60 per cent of the value of the £3.7 billion cut would fall on *in-work* households.²

In this note we look in more detail at the distributional impact of this welfare cut, in combination with the decision to increase the personal tax allowance by a further £235 in April 2013 and the announcement that the higher rate threshold would increase by 1 per cent a year from April 2014. Having considered this new 'fiscal squeeze', we then consider what the OBR's updated projections for earnings and inflation mean for the 'wage squeeze' that has been putting pressure on the budgets of many low to middle income households for the best part of a decade. Finally, we consider the longer-term consequences of these two effects for a series of stylised families.

1 The fiscal squeeze

In Figure 1, we compare the effects of the Autumn Statement's new announcements on income tax and welfare.³ Looking first at benefit up-rating, it is clear that the move is straightforwardly regressive, with households in the bottom decile facing a 1.2 per cent reduction in their post-tax income in 2015-16 as a result. The impact remains significant across the bottom half of the distribution, but is broadly neutral for the top 30 per cent of households.

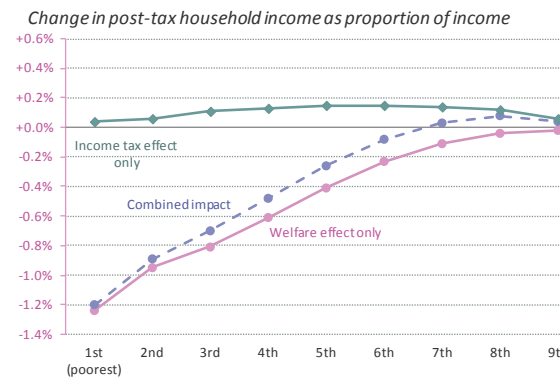
The personal tax allowance increase will benefit all basic rate taxpayers and a significant number of higher rate taxpayers. Meanwhile the below-inflation up-rating of the higher rate income tax threshold (for the 40p rate of tax) counterbalances these gains for people on higher incomes – particularly for those earning more than £100,000, the point at which the personal tax allowance is withdrawn.

¹ Available at http://www.resolutionfoundation.org/us/downloads/autumn-statement-hits-strivers-wage-squeeze-prolon/AUTUMN_STATEMENT_HITS_STRIVERS_AS_WAGE_SQUEEZE_IS_PROLONGED.pdf

² In terms of numbers of people, more than two-thirds (68 per cent) of working-age households in receipt of one of the benefits covered by this week's announcement are in-work. Analysis of the DWP's *Family Resources Survey* shows that there are around 11.5 million working-age households receiving one or more of the benefits and tax credits covered by the new up-rating. Of these, around 7.9 million are in-work and just 3.7 million have no one in work.

³ We do not consider the impact of other announcements (such as those around pension tax relief or fuel duty for instance).

Figure 1: Impact in 2015-16 of income tax and welfare decisions announced in AS 2012



Notes: 'Welfare effect' covers 1 per cent up-rating of most working-age benefits for three years from April 2013. 'Income tax effect' covers the additional increase in personal tax allowance in April 2013 and 1 per cent up-rating of higher rate threshold from April 2014. Income deciles are based on equivalised household income.

Source: Resolution Foundation analysis using IPPR tax benefit model

Taken together however, the welfare cut clearly dominates the income tax giveaway, resulting in overall losses across most of the income distribution. Households lose out on average across the bottom 60 per cent and within the top 10 per cent of the population.

Figure 2 provides more detail, adding the average cash gains and losses in each decile. It shows that households in the poorest ten per cent of the population are set to lose around £150 a year (in 2012-13 prices) in 2015-16 compared with a scenario in which these changes had not been made.

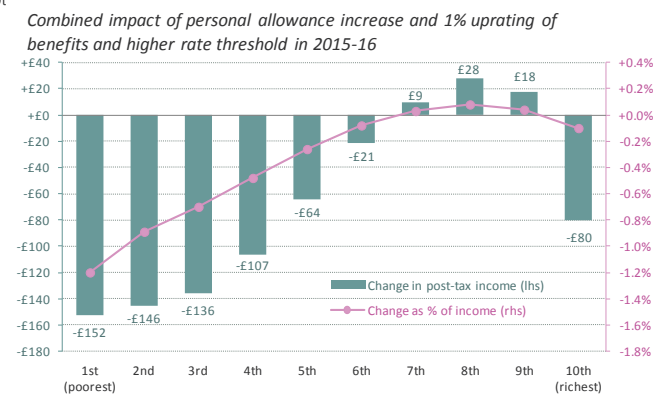
Families with children will be hit particularly hard, reflecting the inclusion of Child Tax Credit and Child Benefit in the decision.

Figure 3 details the average effects on different family types across the entirety of the earnings distribution. It shows that single parents stand to lose an average of nearly £330 (in 2012-13

prices), or 1.5 per cent of post-tax income in 2015-16.

In contrast, couples without children – many of whom are in the top half of the income distribution and who can potentially benefit twice from the personal tax allowance – are set to make a very modest gain.

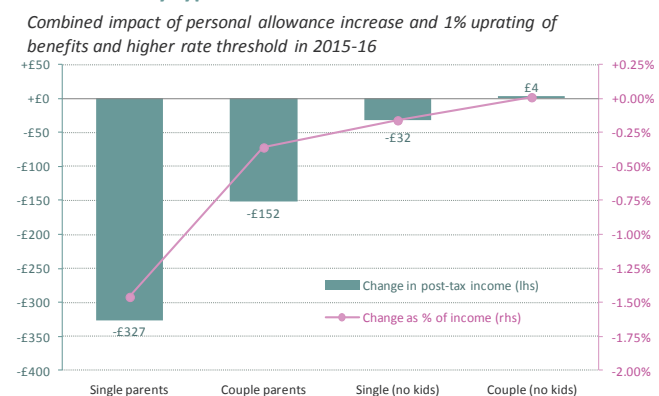
Figure 2: Cash and proportional impacts in 2015-16 of income tax and welfare decisions announced in AS 2012



Notes: Covers 1 per cent up-rating of most working-age benefits for three years from April 2013, the additional increase in personal tax allowance in April 2013 and 1 per cent up-rating of higher rate threshold from April 2014. Does not include changes to pension tax relief or any impact of cancellation of fuel-duty and Council Tax freezes. Cash figures are in 2012-13 prices.

Source: Resolution Foundation analysis using IPPR tax benefit model

Figure 3: Cash and proportional impacts in 2015-16 of income tax and welfare decisions announced in AS 2012 by family type



Notes: Covers 1 per cent up-rating of most working-age benefits for three years from April 2013, the additional increase in personal tax allowance in April 2013 and 1 per cent up-rating of higher rate threshold from April 2014. Does not include changes to pension tax relief or any impact of cancellation of fuel-duty and Council Tax freezes. Pensioner households are excluded from this analysis. Cash figures are in 2012-13 prices.

Source: Resolution Foundation analysis using IPPR tax benefit model

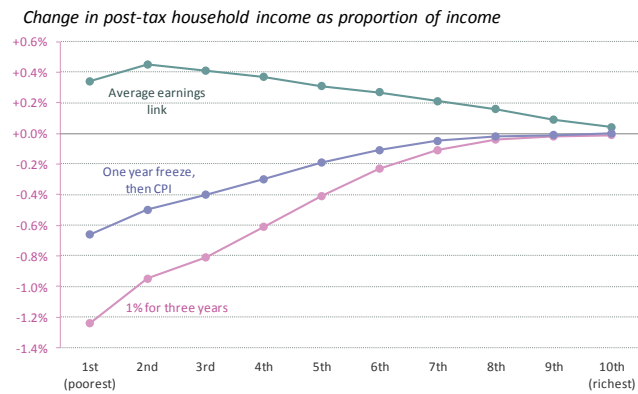
With the link between benefits and prices now broken, there is an open question as to what up-rating principle will hold post 2015-16. Finally in this section, therefore, Figure 4 looks at alternative approaches the government could have taken to up-rating working-age benefits and tax credits.

We assume a baseline in which the personal tax allowance and higher rate threshold changes announced in the Autumn Statement go ahead but working-age benefits continue to be increased in line with prices. We then compare other scenarios to this baseline, showing the distribution of gains and losses.

We see that the choice the government made – a three year up-rating of 1 per cent – results in the biggest losses to households (and therefore generates the greatest savings to government). It leads to losses roughly twice as large as would have occurred under a one year freeze (assuming a subsequent return to CPI up-rating). It hits households on lower incomes particularly hard.

In contrast, linking working-age benefits to earnings (across the whole economy rather than the public sector figure quoted by the Chancellor), would boost incomes across the distribution, with those in the bottom half benefitting by somewhere between 0.3 per cent and 0.5 per cent of their post-tax income in 2015-16. There would however, be a clear fiscal cost.

Figure 4: Proportional impacts in 2015-16 of alternative working-age benefit up-rating options



Notes: '1% for three years' covers the changes to working-age benefits announced in the Autumn Statement. 'Average earnings link' assumed benefits are up-rated in line with the OBR's projection for average earnings. 'One year freeze, then CPI' holds the value of all relevant working-age benefits constant in 2013 then reverts to the default CPI up-rating.

Source: Resolution Foundation analysis using IPPR tax benefit model

2 The wage squeeze

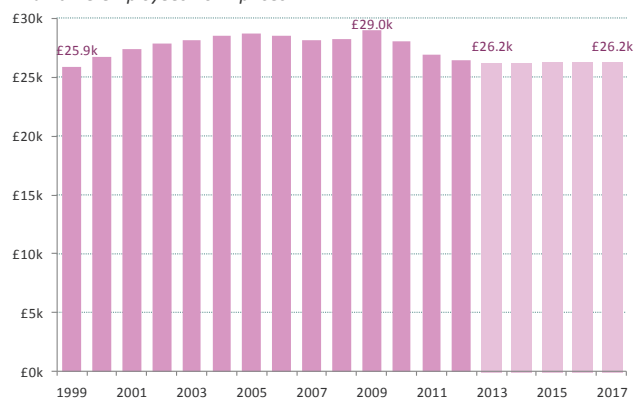
This new stage in the ‘fiscal squeeze’ comes on top of a worsening ‘wage squeeze’. Even before the economic downturn, earnings across much of the population were flat-lining; since the start of the recession in 2008, large swaths of the workforce have been faced with real-terms wage cuts. The latest OBR projections for earnings and RPI inflation show how these real-terms wage trends will develop at various points in the earnings distributions in the coming years.

Figure 5 details the median annual wage among full-time workers in the period from 1999. Having grown relatively strongly in the earlier period, median earnings appeared to stagnate from around 2003. Wages are now expected to fall from their 2009 peak of £29,000 to a low of £26,200 in 2013. And recovery is set to be very slow: on central projections, median earnings are now forecast to have barely grown by 2017, when they will still be no higher than at the turn of the millennium.

Figure 6 shows this trend alongside figures for the 25th and 90th percentiles of the distribution. It highlights the gap between the middle and the top, but also makes clear the extent to which the wage squeeze has reached up the distribution: projected 90th percentile wages of £53,400 in 2017 would be no higher than in 2002.

Figure 7 presents these wage trends as indices. Despite the relatively poor wage performance of the 90th percentile described above, a clear gap developed between low and middle wages and those at the top over the course of the 2000s. While all parts of the distribution were similarly affected during the downturn, a return to previous trends would result in a further widening of the gap.

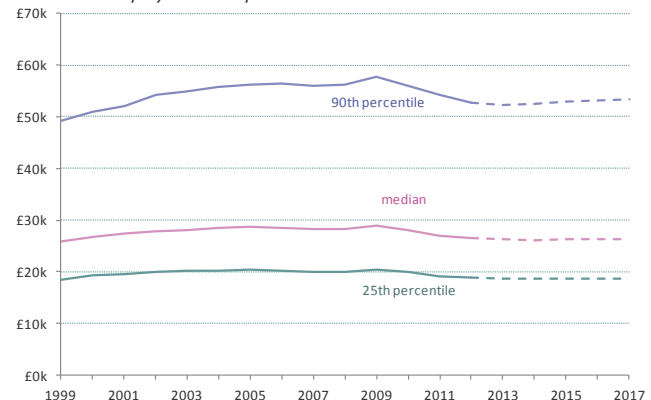
Figure 5: Median annual salary among full-time workers
Full-time employees 2012 prices



Note: Figures adjusted using RPI.

Source: RF analysis of ONS, ASHE, ONS, Quarterly National Accounts, ONS, Labour Force Survey & OBR, Fiscal and economic outlook

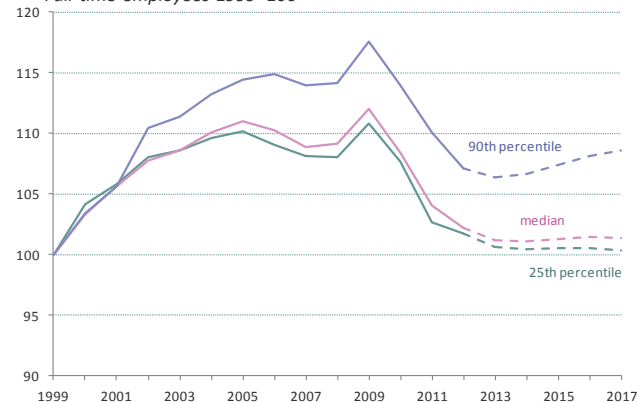
Figure 6: Annual salary by position in the earnings distribution
Full-time employees 2012 prices



Note: Figures adjusted using RPI.

Source: RF analysis of ONS, ASHE, ONS, Quarterly National Accounts, ONS, Labour Force Survey & OBR, Fiscal and economic outlook

Figure 7: Salary indices by position in the earnings distribution
Full-time employees 1999=100



Note: Figures adjusted using RPI.

Source: RF analysis of ONS, ASHE, ONS, Quarterly National Accounts, ONS, Labour Force Survey & OBR, Fiscal and economic outlook

3 The overall squeeze: case studies

Taking these fiscal and wage squeezes together, we can consider the impacts on a sample of four 'typical' low to middle income households. In the case studies that follow, we model the direct impacts of the changes in salaries (based on recent trends in wages in the lower half of the income distribution) and changes in income tax, National Insurance, tax credits, Child Benefit and Education Maintenance Allowances that have taken place since 2010-11. We do not include the effects of changes in local taxes such as Council Tax, or indirect taxes such as VAT or fuel duty.

In each instance, we provide a breakdown of household income and changes, along with an assessment of the direct cash impact of the Autumn Statement announcements on the personal tax allowance and the up-rating of working-age benefits and the higher rate income tax threshold. We assume no change in family composition or circumstances (e.g. children do not age and people remain in their jobs, families therefore continue to need the same level of childcare cover etc) over the period.

The single-earner couple

We look first at Aaron and Sophie, they are a couple with three children aged 3, 5 and 7 and are reliant on Aaron's wage alone. In 2010-11 he earned around £48,850 a year (in 2012-13 prices) and the family qualified for £592 of Child Tax Credit (CTC) and £2,659 of Child Benefit. An increase in the pace at which tax credits were withdrawn means that the family lost their entitlement to CTC in 2011-12. They have also been hit by the freezing of Child Benefit rates. They have however benefitted from above-inflation increases in the personal tax allowance.

By 2015-16, their post-tax income is set to be £4,080 (or 10.5 per cent) lower in real-terms than in 2010-11, driven entirely by the wage squeeze (accounting for a loss of £4,230). Tax and benefit changes have had a positive net effect (of £140 in 2015-16), though this boost is set to shrink over the next three years. The Autumn Statement announcements on income tax and benefits serve to reduce their income by £120 in 2015-16 compared with expectations before Wednesday.

Aaron & Sophie

Three children, aged 3, 5 and 7; single-earner working 35 hours a week

	2012-13 prices (£)	2012-13	2013-14	2014-15	2015-16	Change from 2010-11		
						in 2013-14	in 2014-15	in 2015-16
Gross earnings		45,147	44,664	44,584	44,623	-4,185	-4,266	-4,226
Post-tax earnings		32,964	32,665	32,593	32,542	-3,006	-3,078	-3,130
Child Tax Credit		0	0	0	0	-592	-592	-592
Child Benefit		2,449	2,378	2,342	2,296	-281	-316	-363
Total household income		35,413	35,043	34,935	34,837	-3,879	-3,986	-4,084
<i>of which: resulting from change in gross earnings (the wage squeeze)</i>						-4,185	-4,266	-4,226
<i>resulting from changes in taxes, benefits and tax credits (the tax/benefit squeeze)</i>						+307	+279	+142
<i>resulting from changes announced in Autumn Statement 2012</i>						+46	-54	-122
<i>Proportionate change in total income</i>						-10.0%	-10.2%	-10.5%

Notes: All increases in rates and thresholds and earnings based on information in Budget 2011, Autumn Statement 2011, Budget 2012 and Autumn Statement 2012. Budget 2011 measures specified here include shift to CPI indexation of direct taxation and above inflation increase in income tax personal allowance in 2012-13. Autumn Statement measures relate to removal of the above-indexation increase in the child element of the CTC and the freezing of the couple and single parent elements of the WTC. Fuel duty changes are absorbed in the underlying inflation forecasts. Budget 2012 measures include the above-inflation increase in the personal allowance in 2013-14. Autumn Statement 2012 measures include £235 increase in the personal tax allowance in 2013 and the 1% uprating of working-age benefits, tax credits and the higher rate threshold.

Source: RF calculations based on stylised family

The dual-earner couple reliant on childcare

Ben and Mandie have two children – aged under 1 and 4 – and are both in work. Between them they earned £42,336 in 2010-11 and qualified for £4,748 in Working Tax Credit (WTC), including help with childcare costs, £6,177 in CTC and £1,902 in Child Benefit. Real-terms cuts in various tax credit elements – particularly childcare support – and Child Benefit contribute to a tax-benefit squeeze of £2,540. Combined with a wage squeeze of £3,660, their overall real-terms post-tax income is set to be £6,200 (13.4 per cent) lower in 2015-16 than in 2010-11.

Ben & Mandie

Two children, aged under-1 and 4; dual-earners working 42 hours a week in total

2012-13 prices (£)	2012-13	2013-14	2014-15	2015-16	Change from 2010-11		
					in 2013-14	in 2014-15	in 2015-16
Gross earnings	39,127	38,709	38,639	38,674	-3,627	-3,697	-3,662
Post-tax earnings	31,671	31,793	31,768	31,760	-1,596	-1,621	-1,630
Working Tax Credit	2,170	1,874	1,500	1,011	-2,874	-3,247	-3,737
Child Tax Credit	5,925	5,811	5,720	5,603	-366	-457	-573
Child Benefit	1,752	1,701	1,675	1,642	-201	-227	-261
Total household income	41,518	41,180	40,664	40,016	-5,037	-5,552	-6,201
<i>of which: resulting from change in gross earnings (the wage squeeze)</i>					-3,627	-3,697	-3,662
<i>resulting from changes in taxes, benefits and tax credits (the tax/benefit squeeze)</i>					-1,410	-1,855	-2,538
<i>resulting from changes announced in Autumn Statement 2012</i>					+52	-135	-271
Proportionate change in total income					-10.9%	-12.0%	-13.4%

Notes: All increases in rates and thresholds and earnings based on information in Budget 2011, Autumn Statement 2011, Budget 2012 and Autumn Statement 2012. Budget 2011 measures specified here include shift to CPI indexation of direct taxation and above inflation increase in income tax personal allowance in 2012-13. Autumn Statement measures relate to removal of the above-indexation increase in the child element of the CTC and the freezing the couple and single parent elements of the WTC. Fuel duty changes are absorbed in the underlying inflation forecasts. Budget 2012 measures include the above-inflation increase in the personal allowance in 2013-14. Autumn Statement 2012 measures include £235 increase in the personal tax allowance in 2013 and the 1% uprating of working-age benefits, tax credits and the higher rate threshold.

Source: RF calculations based on stylised family

The working single mother

Nikki is a single mother with two children, aged three and 17. She works full-time and relies on childcare for her young daughter. In 2010-11 she earned £30,395 (in 2012-13 prices) and received substantial support in the form of CTC, WTC (including childcare support), Child Benefit and her son received an Education Maintenance Allowance (EMA) while still in college. Subsequent removal of EMAs and cuts in childcare support and other benefits means she is set to be £4,570 worse off in 2015-16 (a fall of 13.2 per cent), with £2,600 of this coming from a wage squeeze and £1,940 the result of the tax-benefit squeeze. The Autumn Statement measures covered here will reduce her 2015-16 income by £317.

Nikki

Two children, aged 3 & 17 (still in education); single-parent working 32.5 hours a week

2012-13 prices (£)	2012-13	2013-14	2014-15	2015-16	Change from 2010-11		
					in 2013-14	in 2014-15	in 2015-16
Gross earnings	28,092	27,791	27,741	27,766	-2,604	-2,654	-2,629
Post-tax earnings	21,634	21,634	21,611	21,612	-1,428	-1,451	-1,450
Working Tax Credit	2,145	1,933	1,663	1,307	-1,827	-2,097	-2,453
Child Tax Credit	5,925	5,811	5,720	5,603	+226	+135	+18
Child Benefit	1,752	1,701	1,675	1,642	-201	-227	-261
EMAs	0	0	0	0	-423	-423	-423
Total household income	31,456	31,079	30,669	30,164	-3,654	-4,063	-4,569
<i>of which: resulting from change in gross earnings (the wage squeeze)</i>					-2,604	-2,654	-2,629
<i>resulting from changes in taxes, benefits and tax credits (the tax/benefit squeeze)</i>					-1,049	-1,409	-1,939
<i>resulting from changes announced in Autumn Statement 2012</i>					+7	-180	-317
Proportionate change in total income					-10.5%	-11.7%	-13.2%

Notes: All increases in rates and thresholds and earnings based on information in Budget 2011, Autumn Statement 2011, Budget 2012 and Autumn Statement 2012. Budget 2011 measures specified here include shift to CPI indexation of direct taxation and above inflation increase in income tax personal allowance in 2012-13. Autumn Statement measures relate to removal of the above-indexation increase in the child element of the CTC and the freezing the couple and single parent elements of the WTC. Fuel duty changes are absorbed in the underlying inflation forecasts. Budget 2012 measures include the above-inflation increase in the personal allowance in 2013-14. Autumn Statement 2012 measures include £235 increase in the personal tax allowance in 2013 and the 1% uprating of working-age benefits, tax credits and the higher rate threshold.

Source: RF calculations based on stylised family

The childless couple

Some families have done better than others – particularly those without children. Josh and Katie are just such a couple. They have not qualified for any benefits over the period and have therefore been unaffected by cuts in welfare spending. They have however benefited from above-inflation increases in the personal tax allowance. In 2010-11, their combined earnings were £21,168 (in 2012-13 prices), resulting in a net income of £18,377.

However, while the income tax changes will have boosted their incomes by £920 in 2015-16 (with £46 of this due to the Autumn Statement measures), these gains will have been more than offset by the wage squeeze. Even for this couple, post-tax income is set to fall by 5 per cent over the period.

Josh & Katie

Couple, no children; dual earners, one working full-time, one part-time

2012-13 prices (£)	2012-13	2013-14	2014-15	2015-16	Change from 2010-11		
					in 2013-14	in 2014-15	in 2015-16
Gross earnings	19,564	19,354	19,320	19,337	-1,814	-1,848	-1,831
Post-tax earnings	17,441	17,485	17,469	17,467	-893	-908	-911
Total household income	17,441	17,485	17,469	17,467	-893	-908	-911
<i>of which: resulting from change in gross earnings (the wage squeeze)</i>					-1,814	-1,848	-1,831
<i>resulting from changes in taxes, benefits and tax credits (the tax/benefit squeeze)</i>					+921	+940	+920
<i>resulting from changes announced in Autumn Statement 2012</i>					+46	+45	+46
<i>Proportionate change in total income</i>					-4.9%	-4.9%	-5.0%

Notes: All increases in rates and thresholds and earnings based on information in Budget 2011, Autumn Statement 2011, Budget 2012 and Autumn Statement 2012. Budget 2011 measures specified here include shift to CPI indexation of direct taxation and above inflation increase in income tax personal allowance in 2012-13. Autumn Statement measures relate to removal of the above-indexation increase in the child element of the CTC and the freezing the couple and single parent elements of the WTC. Fuel duty changes are absorbed in the underlying inflation forecasts. Budget 2012 measures include the above-inflation increase in the personal allowance in 2013-14. Autumn Statement 2012 measures include £235 increase in the personal tax allowance in 2013 and the 1% uprating of working-age benefits, tax credits and the higher rate threshold.

Source: RF calculations based on stylised family

The Resolution Foundation

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- undertaking research and economic analysis to understand the challenges facing people on a low to middle income;
- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision-making and bring about change.

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