Research and Library Service
Briefing Paper

Paper 17/11 | 21 January 2011 | NIAR 614-10

Economic Impact of Cuts in Annually Managed Expenditure

1 Overview

This paper considers the potential economic impacts of the impending cuts to Annually Managed Expenditure in Northern Ireland. It is shown that there is evidence to indicate that the Coalition Government's plans in respect of welfare reform are *regressive*[1], and will have a particularly detrimental impact upon families with children. Northern Ireland is shown to be particularly vulnerable to these cuts, and, in fact, the evidence indicates that the plans will have a particularly regressive effect locally. Combined with the impending cuts in general public expenditure (i.e. reductions in Departmental Expenditure Limits), and the likelihood of future increases in interest rates, the economic impact of these reforms is likely to be considerable.

[1] Meaning that they will have a disproportionate impact on the poorest members of society.

Executive Summary

- Annually Managed Expenditure (AME) relates to programmes that are demand-led and difficult to forecast. The largest single element of AME is social security spending, i.e. expenditure on welfare.
- The Coalition Government has announced a radical 'shake-up' of the welfare system in the UK. A total of £11bn was taken out of welfare UK-wide as a result of the Budget and another £7bn was removed in the October 2010 Spending Review. ***It is estimated that if Northern Ireland is to receive a proportionate share of the £18bn welfare cuts this could amount to some £500m.***
- Some of the key elements of the reform include:
    - A new 'Universal Credit' will replace the vast majority of current in-work and out-of-work benefits;
    - Disability Living Allowance will be replaced with a new 'Personal Independence Payment';
    - Housing Benefits will be scaled back via changes in the way benefits are calculated and an increase to the age threshold for the Shared Room Rate;
    - Move to the Consumer Price Index (CPI) for the price indexation of benefits, pensions and tax credits.
    - A cap on the total amount of benefits a household can claim;
    - A package of changes to State Pensions
- ***There is some evidence to indicate that previous welfare reforms have been associated with improvements in labour market conditions and average incomes. However, many of these examples relate to periods of relative economic stability;*** applicability to the current environment is thus debatable.
- ***A potential issue with the Coalition's planned Welfare Reform is that it is underpinned by the assumption of availability of jobs. Whether this is a reasonable assumption, in current economic conditions, is debatable.*** This is a particularly pertinent issue for Northern Ireland, where labour market conditions are continuing to deteriorate.
- Analysis undertaken by the Institute for Fiscal Studies indicates that, ***when all UK tax/benefit reform measures are considered (i.e. those announced under New Labour as well as those that resulted from Budget 2010 and Spending Review 2010), the impact will be a regressive one***.
- The analysis indicates that, ***when the distributive effects of welfare reform are assessed on the basis of different family types, it will be particularly painful for families with children***. This evidence is unfavourable from a local economic perspective, given the relatively high rate of 'families with children' in Northern Ireland.

- In addition to this demographic factor, NI is likely to be particularly negatively affected by the welfare changes, for a number of reasons:
  - High rate of economic inactivity in NI.
  - Relative reliance on public sector in NI.
  - Economic conditions remain challenging in NI
  - Deficiencies in childcare are already a recognised impediment to work in NI; planned reform likely to exacerbate this problem.
  - Comparatively high rate of disability in NI, with associated reliance upon Disability Living Allowance (DLA).
  - Housing Benefit Reform and Changes to Mortgage Interest Support may have detrimental impact on (already depressed) housing market in NI.
- The Institute for Fiscal Studies has considered the relative impact upon NI; their ***evidence indicates that, if all measures to be introduced between 2010-11 and 2014-15 are considered, Northern Ireland is expected to undergo the most significant losses in the UK, after London***.
- Furthermore, ***the analysis indicates that the loss for the 'poorest' four quintiles is higher in NI than in the UK as a whole***, (but less for the richest quintile). This suggests that the reform may have a particularly regressive effect in NI.
- A number of additional considerations are highlighted in the paper, including:
  - The paper is confined to a consideration of cuts in AME and, as such, ***omits any consideration as to the economic impacts of cuts in general public expenditure*** (Department Expenditure Limits, DEL); these are considerable and will compound the economic effects of welfare cuts.
  - Some of the planned reforms would appear to be in direct contrast with the evidence in favour of Preventative Spending (refer Research Paper presented to Committee on 19th January 2011). ***For example, the removal of the Sure Start Maternity Grant for a second child and the abolition of the Help in Pregnancy grant (as well as changes to housing benefit and tax credits) will reduce preventative expenditure at what is recognised as the most vital point of intervention (Early Years)***. The evidence on Preventative Spending suggests that this policy could be costly in the medium to long term.
  - The fact that benefits will now be linked to the Consumer Price Index (CPI), rather than the Retail Price Index (RPI) will make future benefits less generous. ***The CPI does not include mortgage costs, whereas the RPI does – this means that, as interest rates start to increase, consumers will not be compensated for rising housing costs***.

2 Introduction

Annually Managed Expenditure (AME) relates to programmes that are demand-led and difficult to forecast. The largest single element of AME is social security spending, i.e. expenditure on welfare[2]. The Coalition Government has announced a radical 'shake-up' of the welfare system in the UK. The plan is a far-reaching one and is likely to result in the most radical reform of the welfare state since its foundation. A total of £11bn was taken out of welfare UK-wide as a result of the Budget and another £7bn was removed in the October 2010 Spending Review. ***It is estimated that if Northern Ireland is to receive a proportionate share of the £18bn welfare cuts this could amount to some £500m[3].***

3 Welfare Reform – Key Changes

It is perhaps worth highlighting, in advance of this discussion, that the term 'welfare reform' implies impending *improvements* in the system. 'Welfare cuts' is arguably a more accurate term to describe the Government's plans; however, the two terms are used interchangeably in this paper.

A recent Assembly research paper for the Committee for Social Development covered the key aspects of the Coalition Government's plans for welfare reform[4]. Members may also wish to be aware that Assembly Research and Library Services will be publishing a Welfare Reform 'Resource Pack', which will provide links to key Government publications; think tank papers; Assembly Questions, Statements and Debates; and press coverage of welfare reform.

Some of the key elements of the reform include[5]:

- A new 'Universal Credit' will replace the vast majority of current in-work and out-of-work benefits;
- Disability Living Allowance will be replaced with a new 'Personal Independence Payment', which will involve a new 'objective' medical assessment process;
- Housing Benefits will be scaled back via changes in the way the benefit is calculated and an increase to the age threshold for the Shared Room Rate;
- Move to the Consumer Price Index (CPI) for the price indexation of benefits, pensions and tax credits.

---

[2] HM Treasury - http://www.hm-treasury.gov.uk/psr_spend_plancontrol.htm#ame

[3] *Debate on Welfare Reform*, Northern Ireland Assembly, 23 November 2010

According to PwC, the figure is slightly lower at £400m – ass per private correspondence with Esmond Birnie, Chief Economist, PWC

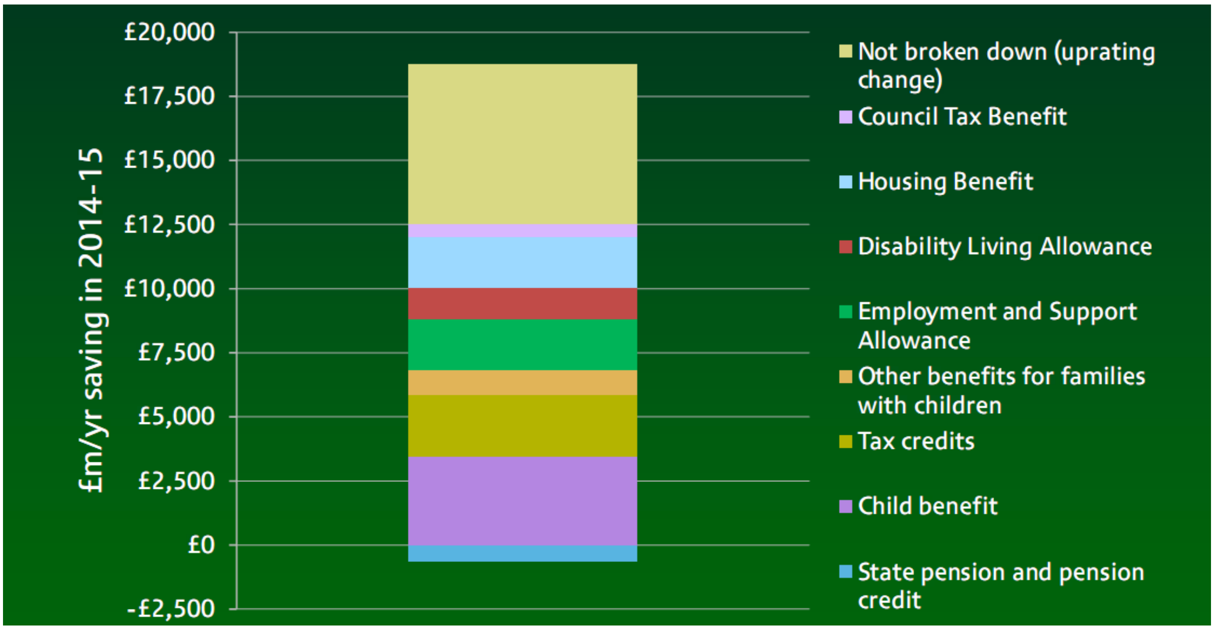
[4] *An Introduction to Welfare Reform*, NI Assembly Research Paper, January 2011

[5] *An Introduction to Welfare Reform*, NI Assembly Research Paper, January 2011

- A cap on the total amount of benefits a household can claim;
- A package of changes to State Pensions

The chart below illustrates the relative scale of each broad reform element; it shows the breakdown of the anticipated total savings in 2014-15. It can be seen that the changes in the method of uprating benefits (i.e. the move to the Consumer Price Index) create the largest saving, followed by changes in Child Benefit, Tax Credits and Housing Benefit. There are also considerable savings associated with cuts in Employment and Support Allowance, Disability Living Allowance and other benefits for families with children.

Figure 1: Welfare Cuts to Date under Coalition Government



Source: Institute for Fiscal Studies

A comprehensive list of the changes announced in the June 2010 Budget and October 2010 Spending Review is attached at Table 2 below.

Table 2: At a Glance - Welfare reform announced in June Budget and Spending Review

	JUNE BUDGET[6]	SPENDING REVIEW [7] (October)
Child Benefit	A three year **freeze on Child Benefit from 2011/12** to help fund significant above indexation increases to Child Tax Credit which the Coalition Government believes is better targeted at low-income families.	From January 2013, **a withdrawal of Child Benefit** from families with a **higher rate taxpayer**. The Coalition Government believe that this will save £2.5 billion a year by 2014-15 and will ensure that people in lower incomes are not subsidising those who are better off.
Child Trust Fund	The Coalition Government announced on 24 May 2010 its intention to reduce and then stop Government contributions to **Child Trust Funds**. It reiterated this point in the June Budget and also announced that the Savings Gateway would not be introduced as the Government believed it was not affordable given the need to reduce the deficit.	
Capping Benefits		From 2013, a **household benefit cap** of around £500 per week will be placed on couple and single parent households. A cap of around £350 per week will be imposed on single adult households. The Coalition Government state that the purpose of the cap is to ensure that no family can receive more in welfare than the median after tax earnings for working households. All Disability Living Allowance claimants, War Widows and working families claiming working tax credits **will be exempt from the cap**.
Contributory Employment and Support Allowance	**Time-limiting contributory ESA** for those in the Work-Related Activity Group to **one year**. The Coalition Government believes that this will save £2 billion per year by 2014-15 and will improve work incentives whilst protecting people with the most severe disabilities and those with the lowest incomes.	
Disability Living Allowance	The Coalition Government announces that it would reform Disability Living Allowance to ensure support is targeted on those with the highest medical need. It also announced that **objective medical assessments** for all DLA claimants would be introduced from 2013-14.	The **mobility component** of Disability Living Allowance will cease to be paid after an individual has been in a hospital or care home for 28 days (84 days for children in hospital)[8].
Housing Benefit and Local Housing Allowance	The Coalition Government announces that it will introduce a **package of reforms to Housing Benefit**. This includes changing the percentile of market rents used to calculate **Local Housing Allowance** rates; capping the maximum Local	The Coalition Government announce an increase to the age threshold for the **Shared Room Rate in Housing Benefit from 25 to 35**. It believes that this will save £215m a year by 2014-15 and will ensure that Housing Benefit rules will reflect

[6] *Budget 2010,* HM Treasury.

[7] *Spending Review 2010,* HM Treasury.

[8] As cited in Department for Work and Pension (2010) Disability Living Allowance reform, p15.

	Housing Allowance payable for each property size; time-limiting receipt of full Housing Benefit for claimants who could be expected to look for work; restricting Housing Benefit for working age claimants in the social rented sector who are occupying a larger property than their household size warrants. From April 2011, **Local Housing Allowance rates will be capped** at £250 per week for a one bedroom property; £290 for a two bedroom property; £340 for a three bedroom property; and £400 per week for four or more bedrooms. The Government contribution to **Discretionary Housing Payments** will be increased by £10m in 2011-12 and £40m in each year from 2012-13. From April 2011, Housing Benefit claimants with a disability and non-resident carer will be entitled to **funding for an extra bedroom**. From April 2013, Housing Benefit awards will be **reduced to 90% of the initial award** after 12 months for **claimants receiving Jobseekers Allowance**. [**Note**: on the 30 November the Coalition Government announced <u>two changes to the timetabling</u> of some of the reforms to provide additional transitional time for existing claimants: All changes that will adjust the way Local Housing Allowance rates are calculated will come into force from April 2011 for <u>new claims</u>. <u>Existing claimants</u> will continue at their current rate of benefit until their claim is reviewed, they will then have a further period of transitional protection at their current Local Housing Allowance rate of up to nine months if there has not been a relevant change in circumstances[9].]	the housing expectations of people of a similar age not on benefits.
Indexation	From April 2011, the Coalition Government will use the **Consumer Price Index (CPI)** for the price indexation of benefits and tax credits. The Government states that CPI provides a more appropriate measure of benefit and pension recipient's inflation experiences than the Retail Price Index (RPI).	
Maternity Payments	The Coalition Government announce that from April 2011, eligibility for **Sure Start Maternity**	

[9] Written Ministerial Statement on Housing Benefit Reform, 30 November 2010. www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101130/wmstext/101130m0001.htm#10113032000021

	Grant will be restricted to the first child only and that the **Health in Pregnancy Grant** will be abolished from January 2011.	
State Pensions, Pension Credit and State Pension Age	The Coalition Government will uprate the basic State Pension by **a triple guarantee of earnings**, prices or 2.5 per cent, whichever is highest, from April 2011. CPI will be used as the measure of prices in the triple guarantee, as for other benefits and tax credits. However, the Government has stated that to ensure the value of a basic State Pension is at least as generous as under the previous uprating rules, the basic State Pension in April 2011 by at least the equivalent of RPI. The Coalition Government also announce that to ensure the lowest income pensioners benefit from the triple guarantee, the standard minimum income guarantee in **Pension Credit** will increase in April 2011 by the case rise in a full basic State Pension.	The Coalition Government announce a **freeze in the maximum Savings Credit** award in **Pension Credit** for four years, thereby limited the spread of means-testing up the income distribution. The Government believes that this will save £330m a year by 2014-15. The Government also announce **acceleration in the pace of State Pension Age equalisation**. Women's State Pension Age will reach 65 in November 2018. The State Pension Age will then increase to 66 for both men and women from December 2018 to April 2020. The Government states that it is also considering future increases to State Pension Age to manage the ongoing challenges in response to the UK's changing demographics.
Support for Mortgage Interest	The rate at which **Support for Mortgage Interest (SMI)** is paid is set at 1.58% above the Bank of England Base Rate. It has been frozen at 6.08% since late 2008. The Government maintain that since interest rates have fallen significantly, SMI will, from October 2010, be paid at the **level of the Bank of England's published Average Monthly Rate.**	The Coalition Government announce the extension of a further year the temporary change to the Support for Mortgage Interest (SMI) scheme, i.e. reducing the waiting period for new working age claimants to 14 weeks and the increase in the limit on eligible mortgage capital to £200,000. These temporary measures were due to expire by January 2011.
Tax Credits	By April 2011, **a reduction in tax credit eligibility** for families with household income above **£40,000**. The Coalition Government announces that further changes to this threshold will be made in 2012-13 to focus tax credits on lower income families. It also announces that it would also increase the rate at which tax credits are withdrawn once household income rises. In his budget speech the Chancellor announces that the Government would[10]: • Remove the baby element for new children from April 2011. • Remove the one-off payment to new workers over 50 from April 2012. • Reduce the income disregarded from £25,000 to £10,000 and then £5,000. • Introduce an income disregard for income falls. • Reduce back-dating from three months to one month. • Decline to introduce the pre-election promise of a new tax credit element for	By April 2011, a reduction in the percentage of **childcare costs** that parents can claim through the childcare element of the Working Tax Credit from 80% to its previous 70% level. The Government believes that this will save £385m a year by 2014-15. A change in the **eligibility rules** so that couples with children **must work 24 hours a week** between them, with one partner working at least 16 hours per week in order to qualify for WTC. The Government believe that this will save £390m a year by 2014-2015. A **freeze in the basic and 30 hour element** of **Working Tax Credit** for three years from 2011-2012. The Government believes that this will save £625m a year by 2014-15.

[10] Chancellor's June 2010 Budget Speech. www.hm-treasury.gov.uk/junebudget_documents.htm

	infants. The Coalition Government also announces that Frank Field will lead an independent review on poverty which will make recommendations on tackling the underlying causes of poverty. Field's report entitled 'The Foundation Years: preventing poor children becoming poor adults' is subsequently published in December 2010[11].	
Universal Credit		The Coalition Government announces that over the next two Parliaments the complex system of means tested working age benefits and tax credits will gradually be replaced by **Universal Credit**. £2 billion has been set aside in DWP's Departmental Expenditure Limit settlement over the next four years to fund the implementation of Universal Credit.
Winter Fuel Payments and Cold Weather Payments	The Coalition Government gives a commitment to protect key benefits for older people including **Winter Fuel Payments**.	The Coalition Government states that it will make permanent the temporary increases to **Cold Weather Payments** provided in the past two winters so that eligible households receive £25 for each seven day cold spell recorded or forecast where they live (temperature eligibility criteria applies).

[11] Field, F. (2010) The Foundation Years: preventing poor children becoming poor adults. The Report of the Independent Review on Poverty and Life Changes. http://povertyreview.independent.gov.uk/media/20254/poverty-report.pdf

4 What are the Economic Implications of Welfare Cuts?

4.1 The Link between Welfare and the Economy

Occasionally, there is a perceived dichotomy between 'welfare' and 'economy'; however, the two are intricately linked. ***One of the key objectives of the welfare system was, and is, to maintain purchasing power[12].*** The cuts in welfare benefits will have a detrimental impact on the private sector (both in terms of output and employment), due to reduced consumer spending power. According to the International Labour Organisation[13] **cutting welfare benefits *"may not only directly affect social security beneficiaries, and consequently the standards of living of a large portion of the population but also, through aggregate demand effects, slow down or significantly delay a full economic recovery"*.**

4.2 What does the Existing Literature Say?

There is a body of literature which examines the economic impact of previous reforms of welfare states. One such example relates to the mid to late 1990s, when the then President, Bill Clinton, overhauled the United States' welfare system. In 1996, Congress passed the *Personal Responsibility & Work Opportunity Reconciliation Act (*PRWORA). This legislation sought to:

1. Reduce welfare dependence and increase employment
2. Reduce child poverty
3. Reduce illegitimacy

At the time there was considerable opposition to the legislation, with opponents claiming that it would lead to an increase in poverty and other social evils. However, the Act has been shown to have been associated with improvements in each of the key areas[14]. Outcomes that were associated[15] with the passing of the Act include[16]:

- An increase in workforce participation
- An increase in the average income levels of less-skilled single mothers
- A reduction (to a historically low level) of poverty amongst single mothers.

---

[12] Sustaining social order was another key objective of the welfare system (as per Prof. Evason, NICVA seminar, Jan 2011)

[13] http://www.ilo.org/public/english/region/eurpro/moscow/news/2010/1116.htm

[14] *The Impact of Welfare Reform,* The Heritage Foundation, July 2006

[15] I use the term associated to allow for the fact that causation has not been conclusively proven – whilst these outcomes were associated with the legislation, it is possible that there were also attributable to other economic or social factors that occurred concurrently.

[16] *Declining Caseloads/Increased Work,* Blank, R, University of Michigan, October 2000

Therefore, there is some evidence to indicate that previous attempts at welfare reform have been associated with improvements in labour market conditions and average incomes. However, there is a significant difference between the policy adopted by US Congress in the 1990s and the current plans of the Coalition Government; namely the economic environment. ***Much of the success of the PRWORA legislation might be attributed to the strong economy in the US in the 1990s[17].***

For further examples of 'successful' welfare reform, Members may wish to refer to a previous Assembly Research paper, *Rebalancing Public Finances: Lessons from Past Experiences[18].* This provides additional evidence that the scaling back of benefits can, in fact, result in economic progress. However, many of these examples relate to periods of relative economic stability; their applicability to the current environment is thus debatable.

In contrast with the above evidence, there is another body of literature which suggests that forcing people from social assistance into the paid workforce will depress wages within the low wage workforce[19]. This argument implies that ***welfare cuts harm not only those on social assistance, but also the working poor.*** Research by economist Robert Solow into the consequences of moving welfare recipients into the US workforce indicated that[20]:

- Wages can be expected to decline in response to the movement of welfare beneficiaries into the workforce;
- However, it is not necessarily the case that a huge demand for unskilled workers will materialise if wages fall enough (i.e. there are constraints upon employment prospects).

A potential issue with the Coalition's planned Welfare Reform is that it is underpinned by the assumption of availability of jobs. Whether this is a reasonable assumption, in current economic conditions, is debatable. This is a particularly pertinent issue for Northern Ireland, where labour market conditions are continuing to deteriorate[21].

[17] *The Impact of Welfare Reform,* The Heritage Foundation, July 2006

[18] Published on Assist – October, 2010

[19] *Depressing Wages*¸ Canadian Centre for Policy Alternatives, March 2001

[20] *Work & Welfare,* Solow, R., Princetown, 1998

[21] Figures for December 2010 showed that the number of unemployment benefit claimants increased by 300 from the previous month's revised figure

http://www.northernireland.gov.uk/index/media-centre/news-departments/news-deti/news-deti-190111-foster-comments-on.htm

4.3 Distributional Effects of Planned Welfare Reform: Who Will Bear the Brunt?

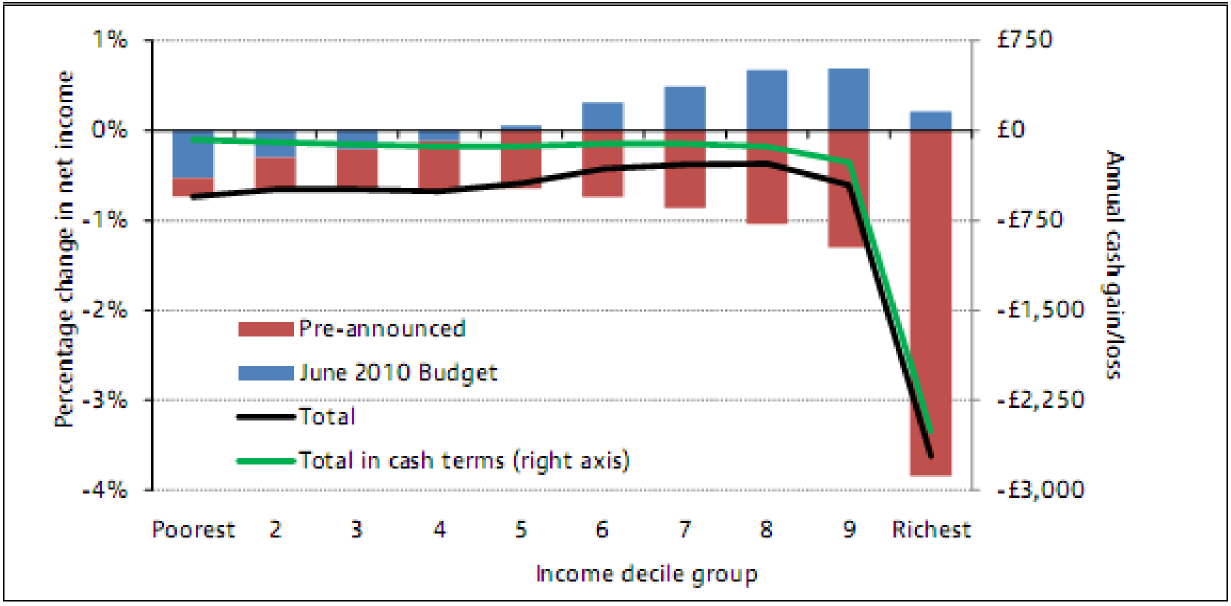
Impact of Measures announced in Budget 2010

The Chancellor described the June 2010 Budget as a 'progressive' one, (meaning that it would hit high earners hardest, whilst relatively protecting those on low incomes). However, the Institute for Fiscal Studies (IFS) has produced evidence which is inconsistent with this. In considering the wider effects of benefit changes announced in the Budget, the IFS concludes that *"our analysis shows that the overall effect of the new reforms announced in the June 2010 Budget is regressive."*

As illustrated in Figure 3, the pre-announced changes (i.e. those attributable to previous Government) to taxes and benefits are progressive and will particularly affect the richest tenth of households[22].

However, ***measures that were announced by the Coalition Government in the June 2010 are estimated to be regressive***, with the lowest income groups losing out the most and higher earners in fact benefitting from the reforms. Figure 4 shows that the changes to be introduced by 2014 are also regressive within the bottom 90% of earners. However, the richest 20% of households lost the most both in cash and percentage terms.

Figure 3: The Effect of Direct Tax and Benefit Reforms to be introduced between June 2010 and April 2012 by Household Income Decile Group

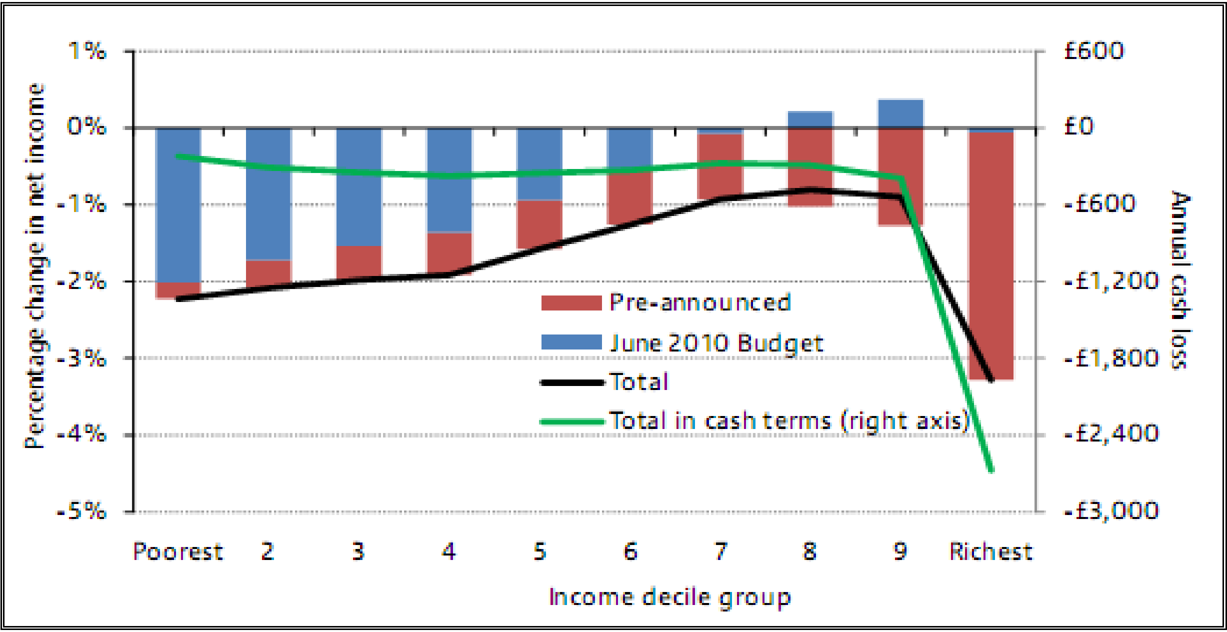


Source: IFS

[22] This is principally due to increases in National Insurance rates and the restriction of tax relief on pension contributions for high-income individuals

http://www.ifs.org.uk/bns/bn108.pdf

Figure 4: The Effect of Direct Tax and Benefit Reforms to be introduced between June 2010 and April 2014 by Household Income Decile Group



Source: IFS

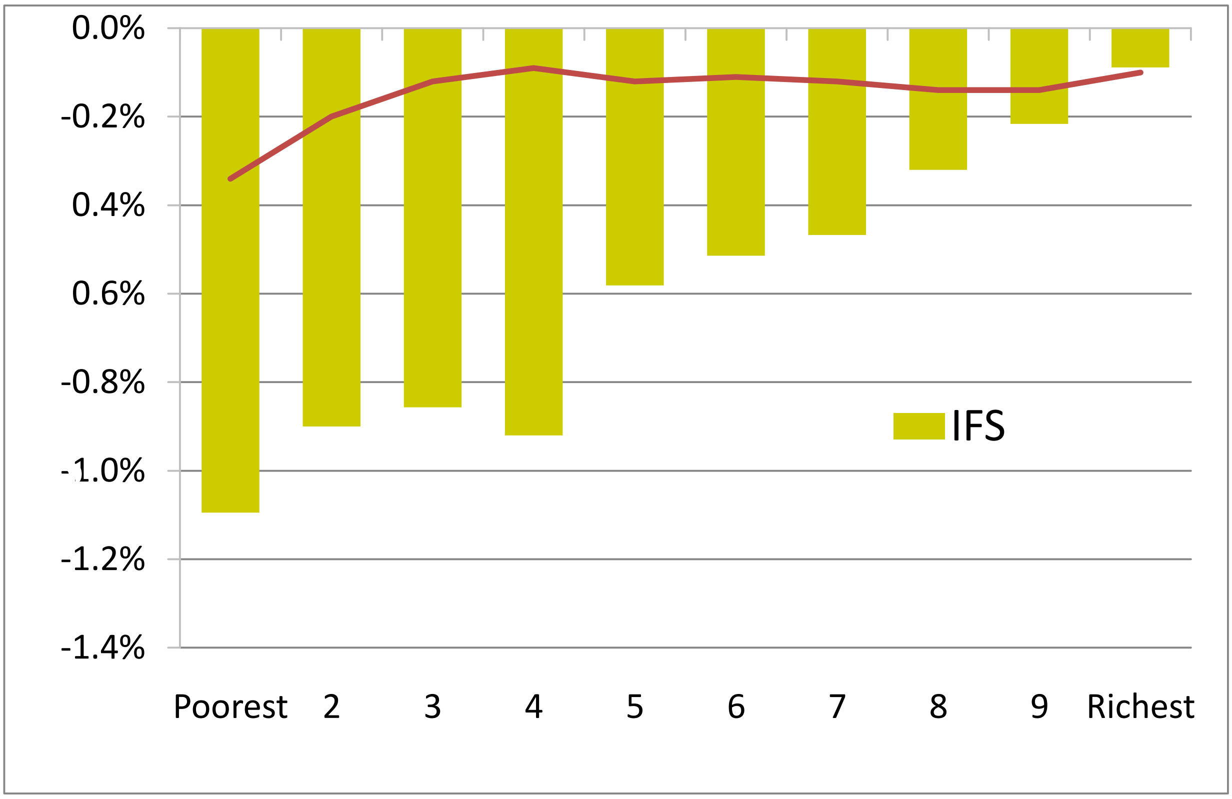
<u>Impact of Measures announced in Spending Review 2010</u>

Work carried out by the Institute for Fiscal Studies suggests that the measures that were announced in the October 2010 Spending Review are also regressive, when considered over the period until 2012-13[23]. Figure 5 shows that the Spending Review announcements will be particularly painful for the 'poorest half' of the population (income declines 1 (Poorest) to 5). The cuts are regressive both on the basis of HM Treasury's analysis (the red line shown on Figure 5) and that of the IFS.

[23] This is in contrast with HMT's assessment that whilst welfare changes were regressive, the overall package of tax and benefit changes by 2012-13 is progressive. The reason for the difference is that, on the assertion that there was not sufficient data to attribute changes in tax, tax credits or benefits to individuals, HMT did not account for Housing Benefit, Employment and Support Allowance, Disability Living Allowance, Council Tax Benefit, or the way in which in-year income changes affect tax credit awards. The IFS has estimated the distributional impact of these changes – accordingly, whilst their estimates may be less precise, they should be more complete.

www.ifs.org.uk/publications/5313

***Figure 5: Distributional Impact of Welfare Measures Announced in the Spending Review to be in place by 2012-13*[24]**



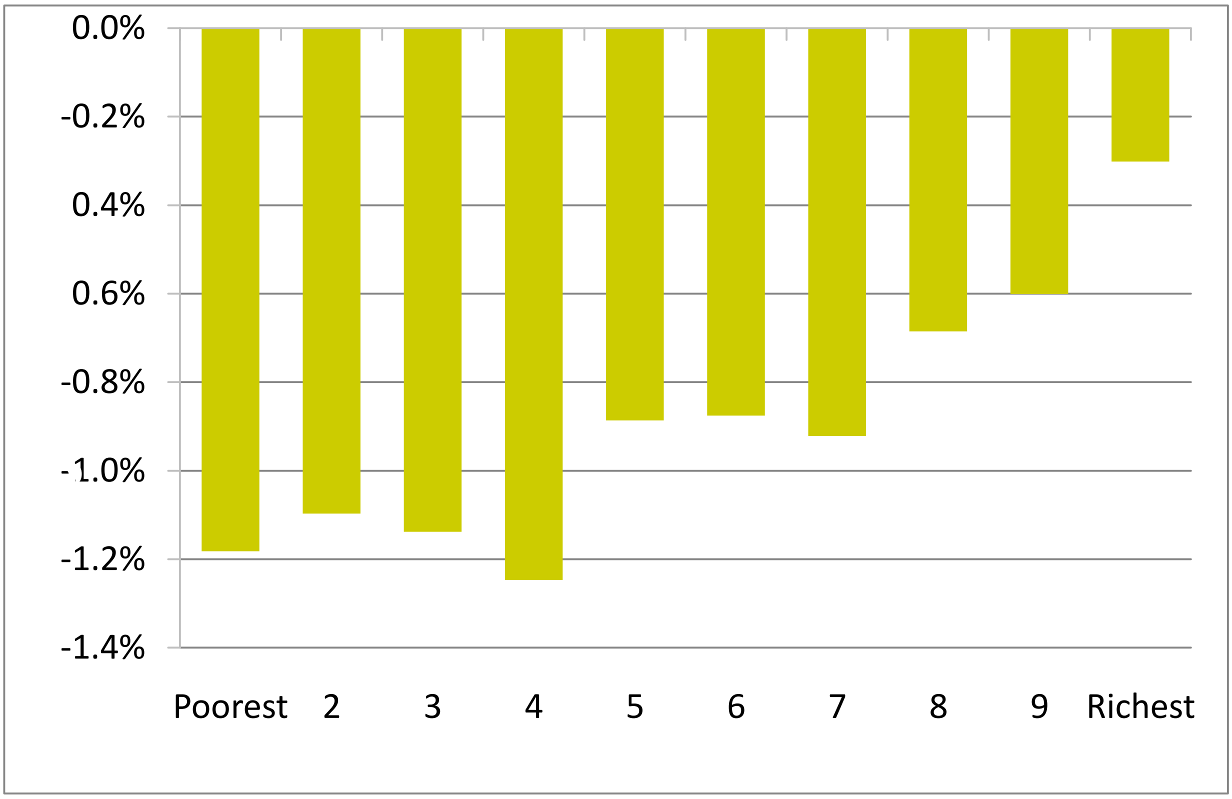
Source: IFS

However, the plans are less regressive when considered over the period until 2014-15 (by which time Child Benefit cuts will have been fully implemented). Figure 6 shows that the distributional impact of the measures is slightly more evenly allocated when considered over this longer time period[25]. However, the top income deciles (the wealthiest members of the population) continue to be comparatively protected from the effect of the cuts; the richest category loses approximately 0.3% of income, whereas the poorest lose almost 1.2%.

[24] This shows the change in net income by each income decile group

[25] It should be noted that the remaining omission from this analysis is the impact of the Universal Credit

Figure 6: Distributional Impact of Welfare Measures Announced in the Spending Review to be in place by 2014-15[26]



<u>Impact of All Measures (Including those that were 'Pre-announced'[27])</u>

When all tax/benefit reform measures are considered (i.e. those announced under New Labour as well as those that resulted from Budget 2010 and Spending Review 2010), the IFS estimates that the impact will be a regressive one. Figures 7 and 8 indicate that:

- Reforms to be implemented by 2012-13 are slightly regressive or flat within the bottom 90% of households (i.e. with the exception of the 'richest', or 10th, decile);
- Reforms by 2014-15 are more obviously regressive within the bottom 90%;
- The regressive impact is the result of reforms announced by the current Government, both in the Budget 2010 and in Spending Review 2010.

[26] This shows the change in net income by each income decile group

[27] I.e. those that were announced by previous Government

Figure 7: Distributional Impact of Tax and Benefit Measures to be in Place by 2012-13

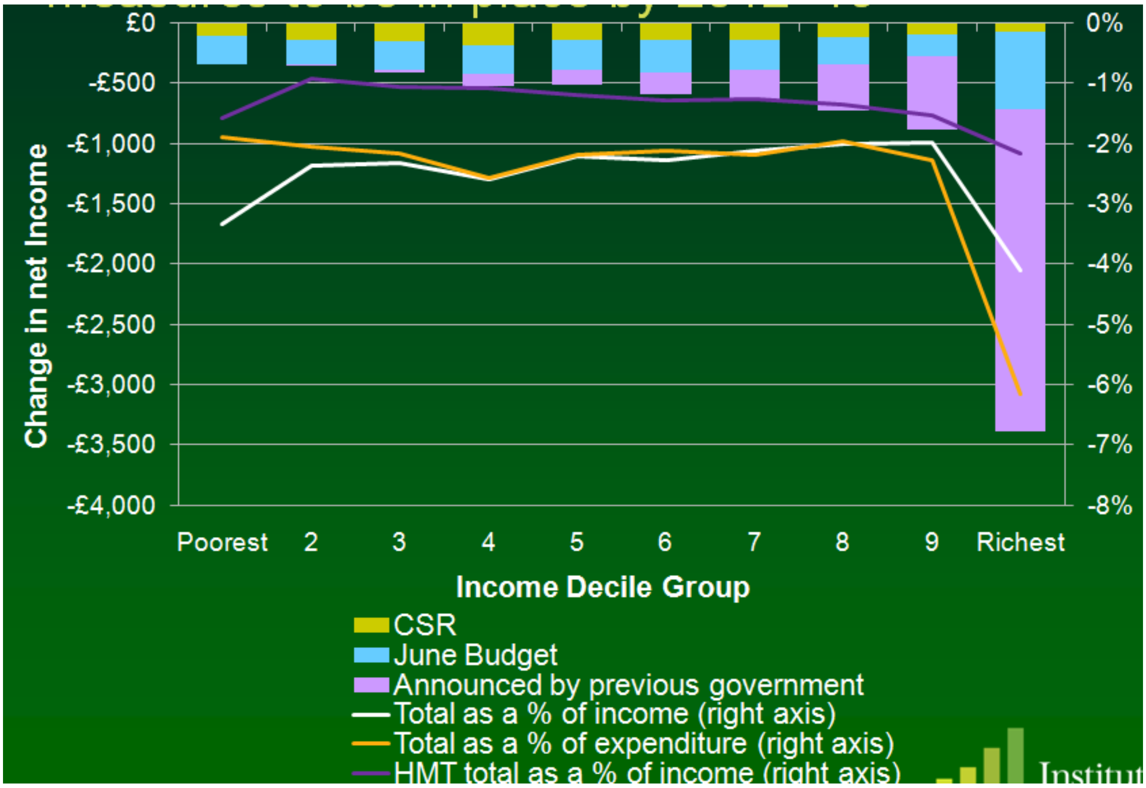
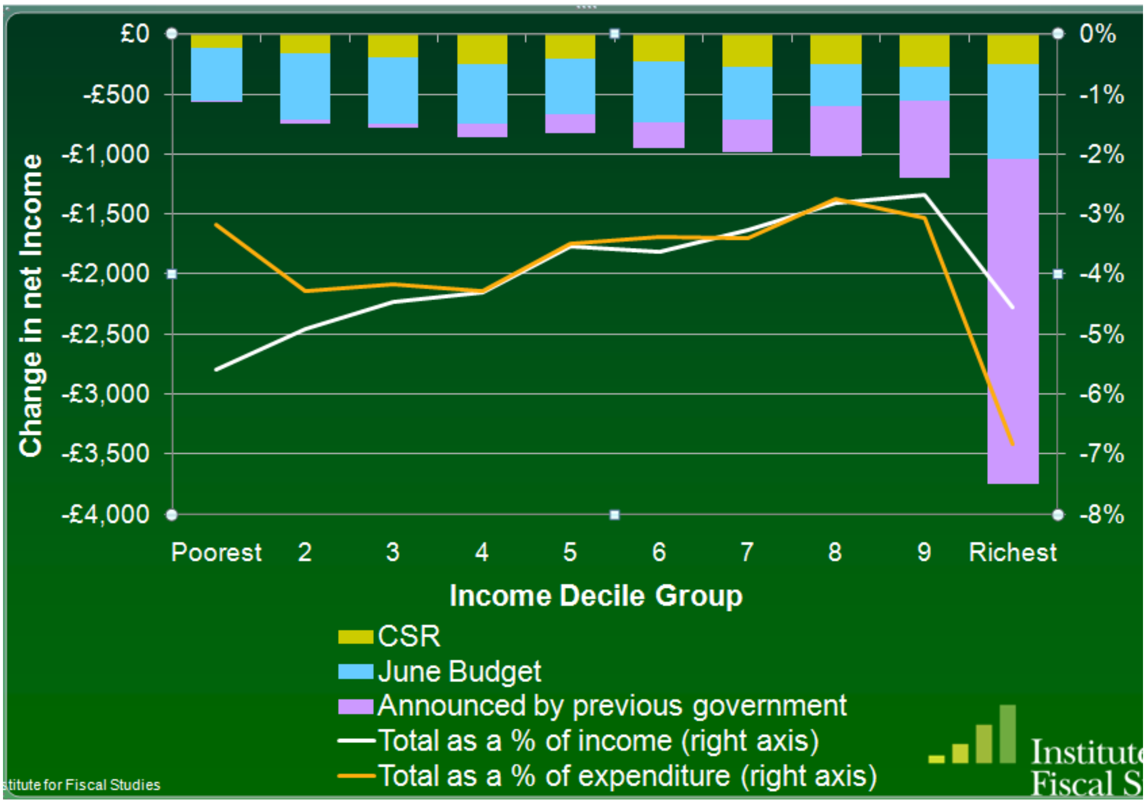


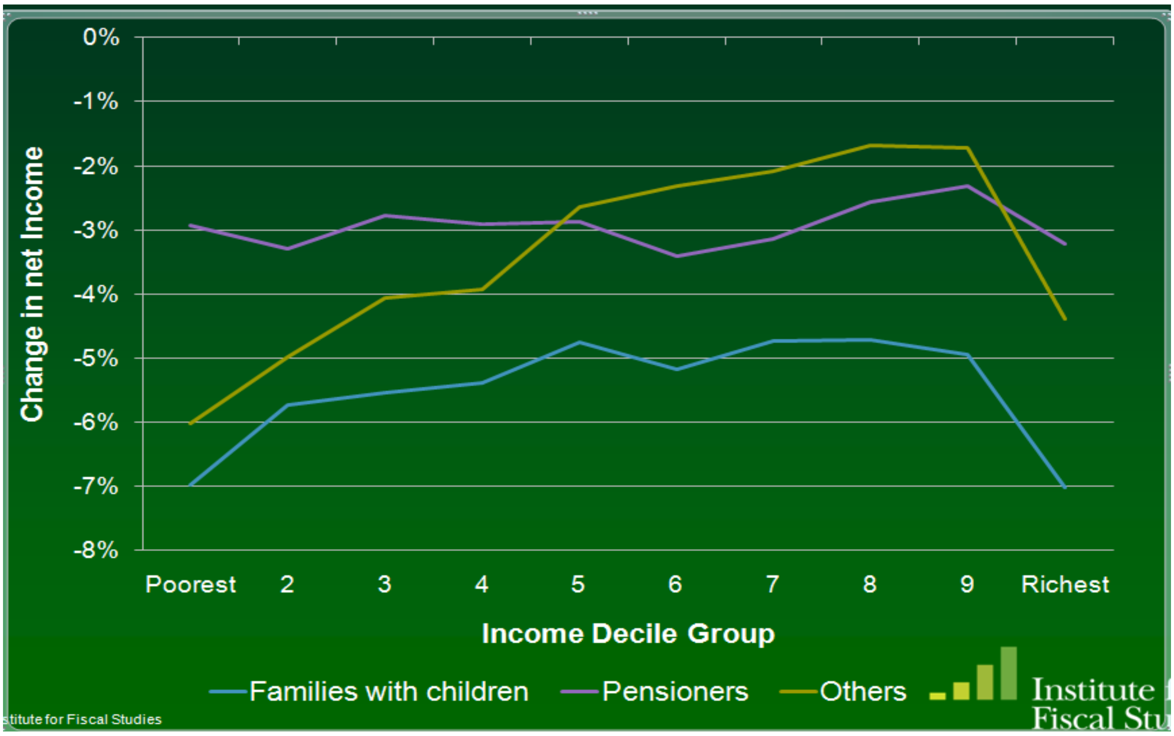
Figure 8: Distributional Impact of Tax and Benefit Measures to be in Place by 2014-15



Impact By Family Type

When the distributive effects of welfare reform are assessed on the basis of different family types (Figure 9), it emerges that Welfare Reform will be particularly painful for families with children.

Figure 9: Distributional Impact of Measures to be in Place by 2014-15 by Family Type



This evidence is unfavourable from a local perspective, given the relatively high rate of 'families with children' in Northern Ireland[28]. ***This implies that the cuts will be relatively burdensome for NI in that a greater proportion of the population will be exposed to the largest losses.***

[28] According to the IFS, there is a particularly high rate of families with children in NI

The Impact of Tax and Benefit Reforms to be Introduced between 2010-11 and 2014-15 in NI, Institute of Fiscal Studies, 2010

5 A Disproportionate Impact on Northern Ireland?

5.1 A Relative Vulnerability?

Northern Ireland is likely to be particularly negatively affected by the welfare changes, for a number of reasons:

- ***Northern Ireland has a particularly high rate of economic inactivity***, meaning that a relatively large proportion of the population will be affected by the proposed reforms.
- ***Relative reliance on public sector in Northern Ireland.*** The impending cuts in public expenditure (Departmental Expenditure Limits, DEL) will thus have a disproportionate impact on NI, compounding the effects of welfare cuts (AME).
- ***Much of the reform in respect of unemployment benefits appears to presume the availability of surplus employment. The validity of this assumption is debatable in the current economic climate, particularly in NI***, given our relatively small private sector (and associated inability to 'pick up the slack' from public sector cuts and/or job losses) and the fact that labour market conditions are continuing to decline[29].
- ***NI has a relatively high proportion of households with children*** (as shown in figure 9 above); the IFS analysis indicates that this group will particularly lose out from the impending tax and benefits reform.
- ***Economic conditions remain challenging in NI*** unlike in many other UK regions that are officially 'in recovery'.
- ***Deficiencies in child care are already a recognised impediment to work***. There is a lack of developed infrastructure for child care in NI, with no lead government department and no statutory duty on public authorities to provide adequate childcare. A survey by Employers for Childcare among unemployed women found that a lack of suitable childcare was the most significant barrier to finding work[30]. This will be exacerbated by proposed reduction in Working Tax Credit to help with child care costs, from 80% to 70%. ***The planned reform is underpinned by the assumption that there is sufficient, accessible childcare in place; it could be argued that this is not the case in NI.***
- ***There is a comparatively high rate of disability in Northern Ireland, with an associated reliance upon Disability Living Allowance (DLA***). As of 31 May

[29] http://www.northernireland.gov.uk/index/media-centre/news-departments/news-deti/news-deti-190111-foster-comments-on.htm

[30] *The Childcare Barrier,* Kinnear, H., Employers for Childcare, 2003

2010, there were 183,710 claimants in Northern Ireland, representing the highest rate in the UK (refer Table 10). At a rate of 102.7 claimants per 1,000 members of the population, approximately 1 in 10 people claim DLA in Northern Ireland; this compares to almost half the number of claimants (1 in 5 approximately) in Great Britain. This makes a relatively high proportion of the local population particularly vulnerable to the reform of DLA benefits.

Table 10: Disability Living Allowance by Region (31 May 2010)

Country/Government Office Region	Allowances ('000s)	Allowances per 1,000 population
Great Britain	**3,157.3**	**52.6**
Unallocated	3.4	
England	**2,569.8**	**49.6**
North East	176.2	68.2
North West	473.5	68.6
Yorkshire and Humber	295.2	56.1
East Midlands	230.9	51.9
West Midlands	303.2	55.8
East	226.9	39.3
London	315.7	40.7
South East	311.8	37.0
South West	236.4	45.2
Wales	**242.0**	**80.7**
Scotland	**342.4**	**65.9**
Northern Ireland	**183.7**	**102.7**

Source: Department for Social Development, Disability Living Allowance, Summary of Statistics. 31 May 2010[31]

- ***Housing Benefit Reform and Changes to Mortgage Interest Support may have detrimental impact on local housing market.*** Having experienced an extreme spike in prices, the Northern Ireland property market has since undergone severe price corrections; and unlike in many other UK regions, prices are continuing to fall. ***Many homeowners are already struggling with repayment capacity and the prospect of repossession. This may be exacerbated by the planned reform of Housing Benefit and reduction in Mortgage Interest Support from 6.08% to approximately 3.63%***[32].

[31] As cited in *An Introduction to Welfare Reform*, NI Assembly Research Paper, January 2011

[32] As outlined in Table 2, the rate at which **Support for Mortgage Interest (SMI)** is currently paid is set at 1.58% above the Bank of England Base Rate (it has been frozen at 6.08% since late 2008). However, as part of the June 2010 Budget the Coalition Government announced that since mortgage interest rates have fallen considerably, the rate of SMI will be paid at the level of the Bank of England Average Monthly Rate (approximately 3.63%)

Changes to the way in which Housing Benefit will be calculated will be detrimental for many claimants (refer Assembly Research Paper on Welfare Reform, p.31)[33]. ***In economic terms, the effect of lowering benefits will be to reduce individuals'/families' spending power, with detrimental effects for the local private sector and wider economy. Furthermore, it is possible that landlords may face rising rent arrears as tenants' benefits are reduced and they struggle to meet payments (although this is likely to be a short-term issue as tenants would eventually move to more affordable housing, either voluntarily or by eviction order).***

5.2 Estimated Impact on Northern Ireland

According to the Minister for Social Development, the extent of the impacts will be as follows[34]:

- Some 7,500 people (out of 15,000 recipients) will be disadvantaged by the impact of the reduction in mortgage interest support[35] to 3.63%;
- Over 1,000 people will be affected by the change to baby tax credit;
- Approximately 454 households will be affected by local housing allowance monetary caps;
- Around 7,200 households will be affected by the removal of the excess payment of £15;
- The change in the setting of the rate to be consistent with rents in the thirtieth percentile will affect 38,000 people who are in receipt of housing benefit.

The Department for Social Development has commissioned work into the estimated *economic impacts* of welfare reform in Northern Ireland; this should be useful in *quantifying* the effects of the cuts, however, this research is yet to be published.

In the absence of this analysis, the only body of evidence appears to be that provided by the Institute of Fiscal Studies. The IFS examined how the average loss from tax and benefit reforms in Northern Ireland might differ, if at all, from the UK average. It also considered NI households by income quintiles and compared the effects of welfare reform on each with those of the UK counterparts. Figure 11 below shows that ***when the analysis is restricted to an examination of the period between 2010-11 and 2012-13, the effects are broadly similar across UK regions (with the exception of London[36])***.

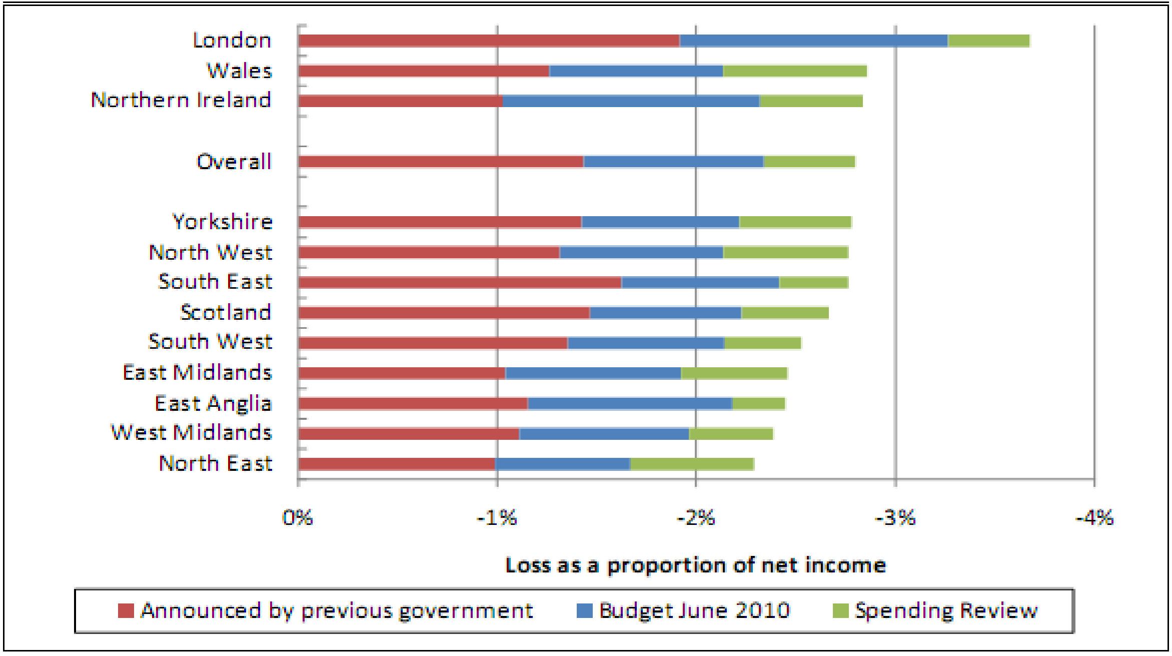
[33] *An Introduction to Welfare Reform*, NI Assembly Research Paper, January 2011

[34] Welfare Reform, *Northern Ireland Assembly,* 23 November 2010

[35] As outlined in table 2, the rate is being reduced to 3.63%

[36] London has a disproportionately large share of the richest individuals in the UK. Households located there are also particularly affected by the cuts to Housing Benefit because London is a high rent area.

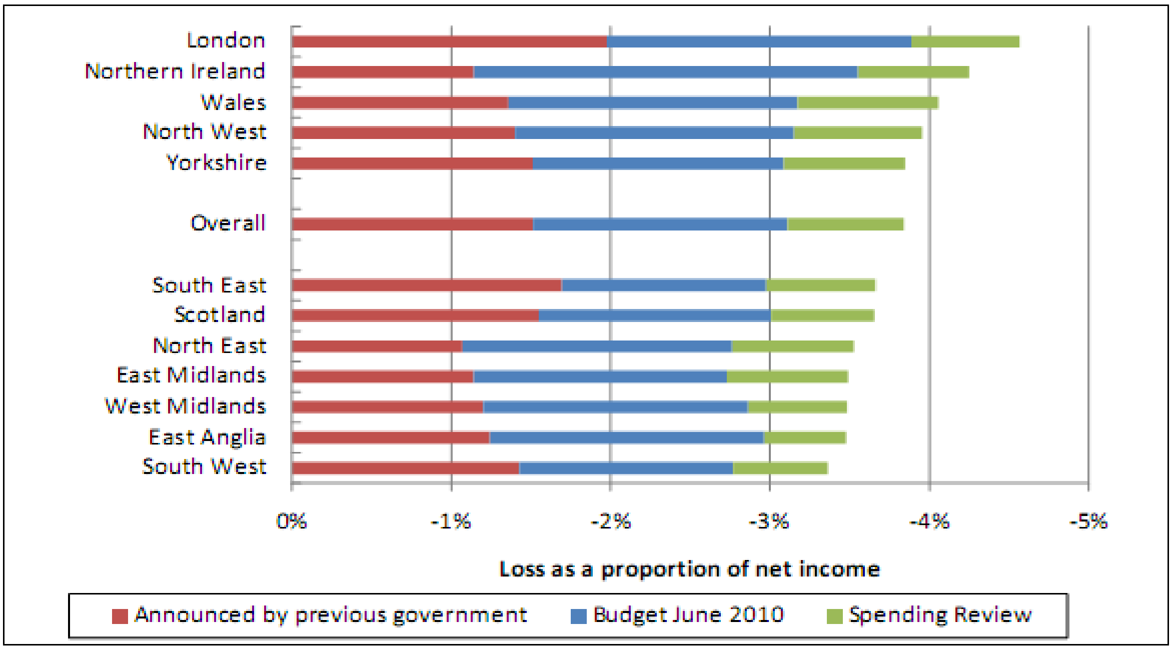
Figure 11: The effect of all tax and benefit reforms to be introduced between 2010-11 and 2012-13 by region



Source: IFS

However, when the analysis is extended to encompass all measures to be introduced between 2010-11 and 2014-15**,** it is estimated that Northern Ireland will fare particularly badly (Figure 12). ***Northern Ireland is expected to undergo the most significant losses in the UK between 2010-11 and 2014-15, after London.***

Figure 12: The effect of all tax and benefit reforms to be introduced between 2010-11 and 2014-15 by region



Source: IFS

If households are divided into quintile groups based on income levels, analysis by the IFS indicates that the loss for the poorest four quintiles is higher in Northern Ireland than in the UK as a whole, but less for the richest quintile (refer Figures 13 and 14). As discussed above, this is because the poorest households in NI lose more from the reform of DLA, whilst the richest households are less affected than those in the UK due to lower average income levels.

Figure 13: The effect of tax and benefit reforms to be introduced between 2010-11 and 2014-15 by UK household income quintile group

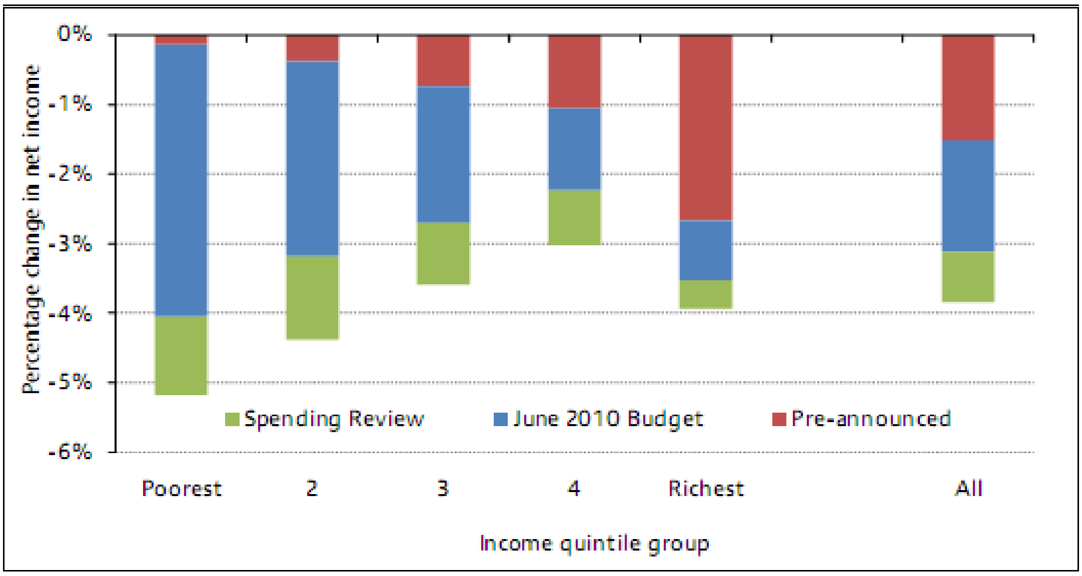
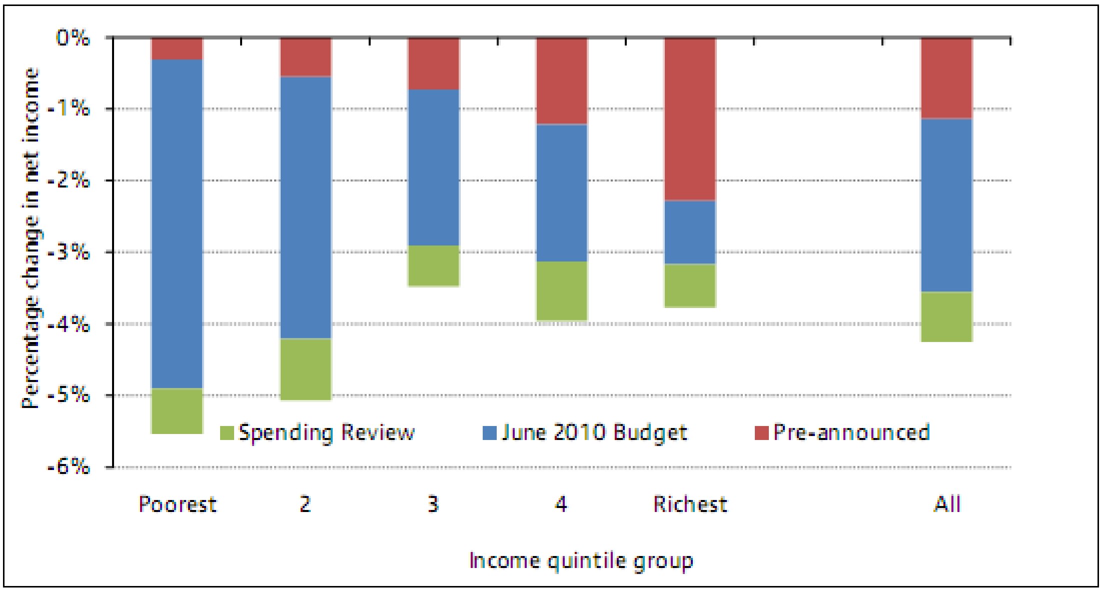


Figure 14: The effect of tax and benefit reforms to be introduced between 2010-11 and 2014-15 by UK household income quintile group, NI households only



5.3 Additional Considerations

- It is perhaps worth re-iterating that this paper is only concerned with cuts in Annually Managed Expenditure (AME). As such it ***omits any consideration as to the economic impacts of cuts in general public expenditure*** (Department Expenditure Limits, DEL); these are considerable and will compound the economic effects of welfare cuts.

- Furthermore, ***the potential impacts do not account for the inevitability of future interest rate hikes*** (given ongoing inflationary pressures). This will further erode income levels with a detrimental impact on consumption/expenditure.

- Members of the Committee are aware of the evidence which exists in respect of the potential financial benefits associated with Preventative Spending (refer Research Paper presented to Committee for Finance and Personnel on 19th January 2011). It is perhaps worth highlighting that elements of the planned reform are in direct contrast with this evidence. ***For example, the removal of the Sure Start Maternity Grant for a second child and the abolition of the Help in Pregnancy grant (as well as changes to housing benefit and tax credits) will reduce preventative expenditure at what is recognised as the most vital point of intervention (Early Years)***. The evidence on Preventative Spending suggests that this policy could be costly in the medium to long term.

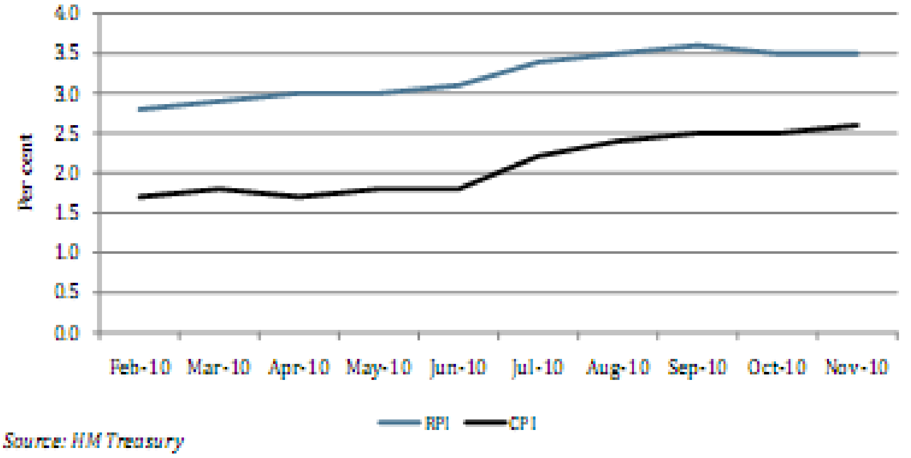
- The most significant change to welfare policy is arguably the announcement in the June 2010 budget that benefits would be linked to the Consumer Price Index (CPI), rather than the Retail Price Index (RPI) or Rossi Index from April 2011. This will make future benefits less generous, (refer Table 13). It is estimated that moving to this index will save the Government £1.2bn in 2011-12, rising to £5.8bn in 2014-15[37]. ***The CPI does not include mortgage costs, whereas the RPI does[38] – this means that, particularly as interest rates start to increase, consumers may not be fully compensated for inflationary pressures in respect of the cost of housing***.

[37] Based on compounded savings.

The Distributional Effect of Tax and Benefit Reforms to be introduced between June 2010-April 2014: a Revised Assessment, Institute of Fiscal Studeis,

[38] http://www.statistics.gov.uk/articles/nojournal/CPI_and_RPI_The_2010_Basket_of_Goods_and_Services.pdf

Table 15: Average Forecasts for RPI and CPI in 2011



Source: HM Treasury