

## Briefing Note: New IFS research challenges Chancellor's 'progressive Budget' claim (Institute for Fiscal Studies)

### Full Report: 'The distributional effect of tax and benefit reforms to be introduced between June 2010 and April 2014: a revised assessment' 25<sup>th</sup> August 2010

The full report can be downloaded at - <http://www.ifs.org.uk/publications/5246>

#### Context

The Chancellor claimed the June 2010 budget would be 'progressive'. Initial analysis showed this not to be true if measures were looked at in isolation, or if their effects were considered over the longer-term. However, HM Treasury and IFS analysis of the distributional effect of Budget measures did not include the effects of some benefit changes that were difficult to allocate precisely to households. These measures represent £4.1 billion of the £11 billion of welfare cuts.

The report attempts to allocate the effects of these changes to housing benefit, Disability Living Allowance and tax credits to households. This is based on some assumptions about the impact of the changes.

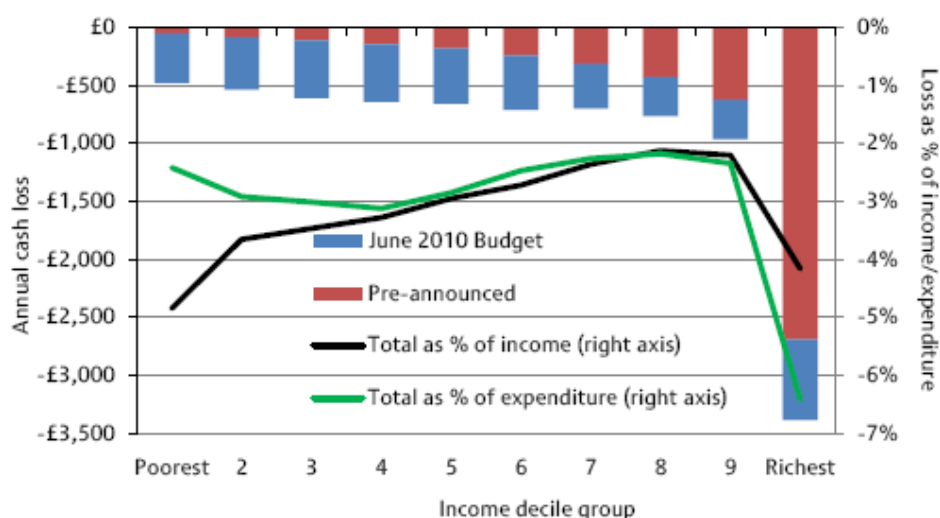
The IFS post-budget briefing highlighted that many of the progressive tax rises that will be introduced over the next two years were announced by the previous Government, and that the budget measures scheduled to come in between 2012-14 are mostly regressive.

#### Findings

Once all the benefit cuts are considered, the **tax and benefit changes announced in the emergency Budget are clearly regressive** as, on average, they hit the **poorest households more than those in the upper-middle of the income distribution** in cash, let alone percentage terms.

The distributional effect of all tax and benefit reforms due to be implemented by 2014-15 is **clearly regressive within the bottom nine decile groups of the income distribution when losses are expressed as a percentage of net income**, although it is less clear cut when losses are expressed as a proportion of expenditure.

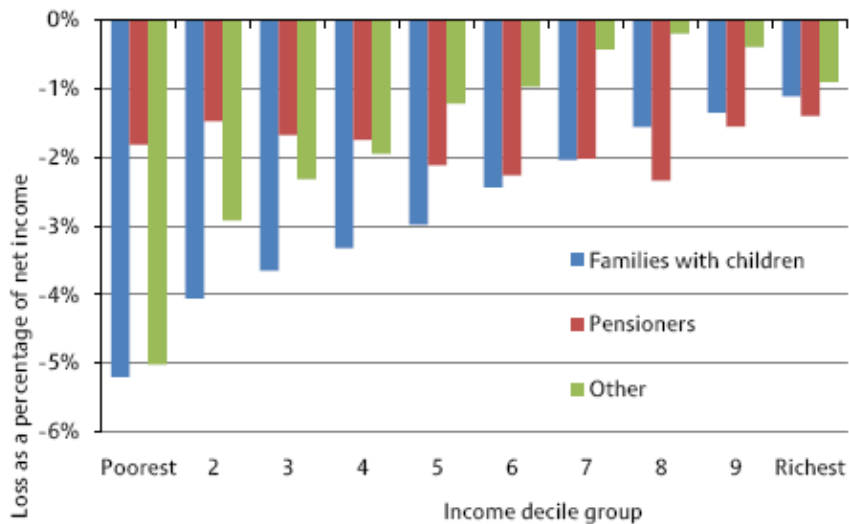
Figure 3.3: The effect of all tax and benefit reforms to be introduced between June 2010 and April 2014 by household income decile group



The report considers the impact of tax and benefit reforms on different sorts of households.

- Low income households of working age lose the most as a proportion of income.
- Households of working age without children in the upper half of the income distribution lose the least. They do not lose out from the cuts in welfare spending, and they are the biggest beneficiaries from the increase in the income tax personal allowance.

**Figure 4.3: The effect of tax and benefit reforms announced in the June 2010 Budget to be introduced by April 2014 by income decile group and household type**



For pre-announced reforms, the main difference is by income decile group – there is little difference between family types within each decile group. The measures announced in the June 2010 Budget are regressive within families with children and those of working age without children, but affects all pensioners relatively equally.

### Linking benefits to the Consumer Price Index

The biggest change to benefits policy in the June 2010 Budget is the decision to link benefits with the Consumer Price Index (CPI) rather than the Retail Prices Index (RPI). This is very likely to mean less generous benefit payments in the future. There are two reasons the government has given for this decision...

1. **The difference in the way the CPI is calculated makes it a better measure of inflation** – this is because the way it is calculated allows for the fact consumers are able to protect themselves from price changes by substituting towards relatively cheaper goods. The report considers this to be a sound rational reason.
2. **The CPI's coverage better reflects the spending of those receiving benefits** – this argument is considered questionable. The proportion of benefit recipients who are 'insulated' from changes in costs excluded from the CPI (mortgage interest payments and council tax payments are excluded costs most relevant) is very small. Only 23% are unaffected. These costs are included in the previously used RPI.

**N.B.** It is important to note also that the CPI due to the formula effect and the fact that the items excluded from it tend to rise in price more quickly than average prices, tends to give a lower rate of inflation than either the Rossi or RPI. This means the decision to link benefits to the CPI is likely to save the government money.