Centre for Policy Studies

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Economic Bulletin

THE INDEPENDENCE REVOLUTION MUST GO ON

- The Government's record in reducing dependency on the State is strong, but there is plenty more to do.
- Dependency has fallen by 2.7 percentage points since 2010, but over half of households still receive more in benefits (including benefits in kind) than they pay in taxes.
- Welfare reform appears to be reducing dependency. 19% of households subject to the benefit cap were in work after a year.
- Children growing up in workless households have, on average, poorer key stage 1 attainments, lower cognitive ability and are more likely to be NEET.
- New Government must continue incentivising work by reducing marginal tax rates and carefully evaluating the National Living Wage policy.

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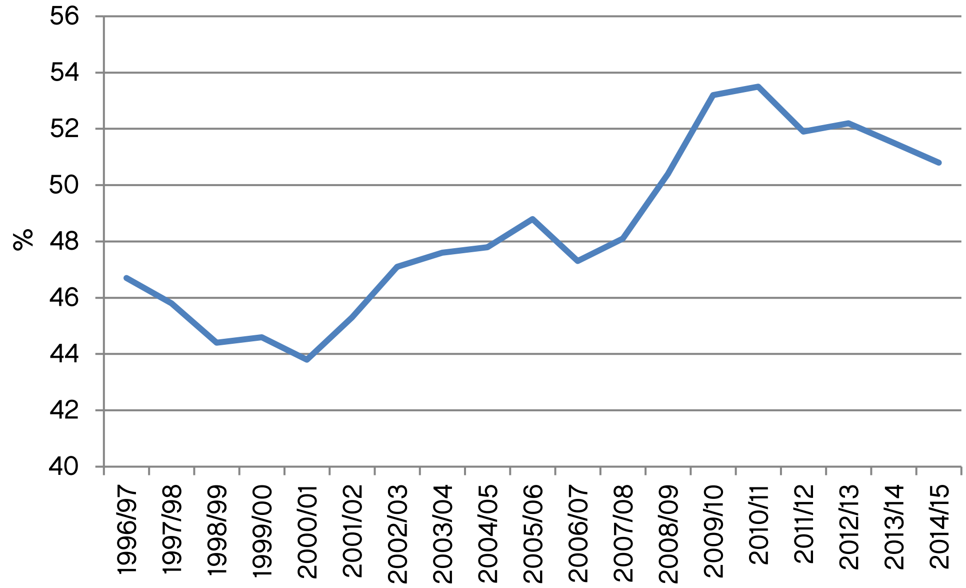
1. NET DEPENDENCY

Recent data from the Office for National Statistics shows that over half of households received more in benefits (including benefits in kind) than they paid in taxes for the year 2014/15. Benefits in kind are goods and services provided by the Government, such as education and health services.

This is the seventh consecutive year where this has been the case. It is estimated that 50.8% of households are net dependents, which is equivalent to 13.6 million UK households. This continues a welcome downward trend since 2010/11, when net dependency was measured at a peak of 53.5%. However, despite net dependency falling this decade, the level remains well above historic levels. In 1979 the proportion of households in net dependency was just 43.1% and this had only increased to 43.8% by 2000/01. However, by the beginning of this decade in 2010/11, net dependency had increased by nearly eight percentage points.

The marked increase in dependency over the New Labour years cannot be attributed to the financial crisis as half of the rise arose by the recession hit in 2007/08 (see Figure 1).

Figure 1: Percentage of households receiving more in benefits than paid in taxes (1997 – 2015)



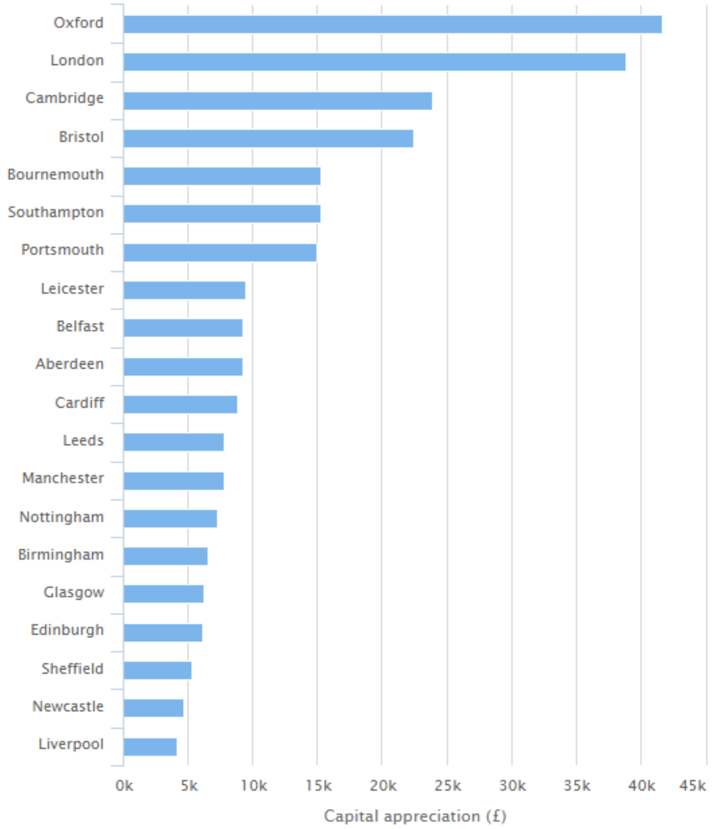
Source: Office for National Statistics (ONS) link

2. WELFARE REFORM – IS IT INCREASING DEPENDENCY?

A study looking at the town of Oxford specifically concluded that the higher a benefit claimant's shortfall in weekly housing benefit, the less chance of their finding a job. It goes further by suggesting that for every £1 increase in a claimant's weekly loss, the odds of getting employed fall by 2%. Some have used these conclusions to imply that the Government's welfare reform programme is leading to benefit claimants becoming less likely to enter the workplace. For example, the Guardian ran with the headline *"Docking welfare payments is not incentive to work, report claims."*

There are a number of reasons to be sceptical about this claim. According to the UK Cities House Price Index, Oxford is facing a number of specific issues relating to the housing market. Oxford's house prices have grown at four times the rate of the UK average over the past year and its house price to earnings ratio is now equivalent to that in London. This will undoubtedly lead to a huge distortion of results in analysing the impact of welfare reform. It is also notable that the study's conclusions are based on 141 respondents from Oxford, which is a very small sample size.

Figure 2: Average House Price Increases by City (May 2014 – May 2015)



Source: Highcharts.com

3. WELFARE REFORM APPEARS TO BE REDUCING DEPENDENCY

Unlike the study focusing on Oxford, the Department for Work and Pensions has conducted a study into the behavioural impact of the benefit cap across the country as a whole. A sample size over seven times as large as the Oxford study was used.

This study found that 19% of capped households were in work after a year compared to just 11% of uncapped households. It also concluded that the greater the amount by which benefit was reduced by the cap, the greater the proportion of people moving into employment. This provides evidence to suggest that at least parts of the Government's welfare reform are encouraging some workless households into the labour force.

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The Government's record on employment is robust. There is strong evidence to suggest that welfare reforms have helped bring about increases in household incomes by boosting employment levels. While non-pensioner welfare spending has remained virtually flat since 2010 (meaning a reduction in real terms), unemployment and workless households in the UK have fallen dramatically. Unemployment is down from a peak of 8.5% in 2011 to less than 5% currently, and the number of workless households has fallen by 684,000 from the period 2010 to 2015, according to the Labour Force Survey.

Despite common misconceptions, the Government's strong record on reducing unemployment has led to a reduction of income inequality. The UK's Gini Coefficient – the most popular measurement of inequality – has fallen from 33.7 to 32.4 over the period 2010/11 to 2014/15.

4. SOCIAL COSTS OF WELFARE DEPENDENCY

Long-term welfare dependency can have major social and economic consequences for society. Evidence suggests that young people from income support families are much more likely than other young people to leave school early and to become unemployed. There is a particular issue with so-called "intergenerational transmission" of worklessness.

A Department for Education report concludes that children growing up in workless households have poorer key stage 1 writing, reading, maths and science attainment. They also have, on average, lower cognitive ability. Furthermore, young people whose parents experienced two and three years of worklessness had an increased risk of being NEET and also spent more months being NEET – even when a range of linked socio-economic risks and protective factors were taken into account.

This highlights the social cost of welfare dependency and need to reduce welfare dependency in society.

5. WHAT NEXT?

Although the Government's record on employment growth is strong, there are still areas where new policies can help incentivise people into work. For example, it is vital that the Government reduces marginal tax rates for the low paid. It is welcome that George Osborne scrapped his planned changes to tax credits in the Autumn Statement last year, which may have increased marginal tax rates to up to 93% for some workers. However, marginal rates of tax can still be up to 73% for some low paid workers.

The Government's new universal credit system will withdraw income at a rate of 65%, which is a significant step in the right direction. It is particularly welcome that marginal tax rates will tend to fall for those on lower incomes, according to the Institute of Fiscal Studies. It is, however, regrettable that the new system will be only fully functional by 2021.

The Government's policy of a new national living wage could also help incentivise the low-paid into work. This policy would mean that the pay of those on the national minimum wage grew four times faster than average salaries.

The Office for Budget Responsibility projects that the UK economy will create 1.1 million new jobs over six years. However, it also projects that there will be 20,000 to 120,000 fewer jobs created as a result of the Government's National Living Wage policy. This highlights the need for the Government to carefully monitor the employment effects of this policy on an annual basis. If there is strong evidence to suggest that the National Living Wage is having a detrimental impact on job creation, the Government should review its policy in this area. Significantly lower job creation will inevitably lead to an increasing propensity for dependency.

6. CONCLUSION

The Government has made progress in reducing dependency. However, the new Government should be bolder, aiming for the dependency levels that were observed in the early 2000s. This should involve continuing the Government's welfare reform programme, cutting marginal tax rates on the lowest paid and carefully reviewing the impacts of the new National Living Wage.

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