

Inequality by stealth

Tax allowances and social security in 2019/20

Andrew Harrop

April 2019

Andrew Harrop is general secretary of the Fabian Society

The paper, like all publications of the Fabian Society, represents not the collective views of the society but only the views of the author. This publication may not be reproduced without express permission of the Fabian Society

Summary

This paper updates analysis first undertaken for the Fabian Society's 2016 report [For us all: redesigning social security for the 2020s](#).¹ It is published to coincide with the start of the new 2019/20 tax year which sees the completion of an extraordinary nine-year transition in UK tax and benefit policy, in which the income tax personal allowance has been rapidly increased alongside significant real-terms cuts to the generosity of working-age benefits.

The analysis examines tax allowances and benefits on a like-for-like basis by presenting the cash value of tax allowances and reliefs within the income tax and national insurance systems – ie the amount the government 'spends' by not taxing people in full, from the first pound of their income. It reveals that the government provides similar amounts of support to rich and poor. The tax-benefit system is therefore creating inequality by stealth.

Key Findings

In the new 2019/20 tax year the government will provide more than £7,000 to couples who both work through tax-free allowances in income tax and national insurance. This is equivalent to a weekly basic income of £68 each, but it is only available in full to people earning enough to qualify. The minimum social security available to couples aged 25 to pension age without work is under £6,000 per year. Since 2010/11 the value of tax-free allowances has increased by 84 per cent while the minimum social security payment for a couple without work has increased by 12 per cent.

Households with children continue to receive a higher minimum level of support if they are out of work than in work. But the differences between what is available for non-working and working families is still surprisingly small, except when the state meets housing costs. At a time when minimum social security payments are insufficient to meet basic needs this is a severe hidden injustice.

Looking broadly at all benefits and tax reliefs, the government now provides more support to the richest fifth of non-retired households than to the poorest fifth. Between 2010/11 and 2017/18 the value of government financial support including tax reliefs grew by 6 per cent (£437 per year) for the poorest fifth and by 31 per cent (£1,850 per year) for those in the fourth quintile. On average, households in the fourth and fifth income quintiles receive more in tax reliefs than households in the poorest fifth receive in means-tested benefits.

The UK-wide cost of tax-free allowances for the exchequer was £136bn in the 2018/19 fiscal year, a rise of 43 per cent since 2012/13 in cash terms. By comparison the government spent £94bn on social security for working-age adults and children in Great Britain, a figure that has fallen 0.3 per cent since 2012/13.

The government has presented cuts to social security as a regrettable consequence of austerity. But almost half the cut has not been used to reduce the deficit but to raise tax-free allowances. Spending on UK social security fell by 1.7 percentage points of GDP between 2012/13 and 2018/19, while the value of tax-free allowances increased by 0.8 percentage points of GDP.

Policy recommendations

1. Freeze tax-free allowances for 5 years to rescue social security
2. Create a permanent fiscal 'envelope' for tax-free allowances and social security combined
3. Consider a basic income instead of tax-free allowances but only alongside other options

Findings

1. In 2019/20 the government will provide working couples with more than £7,000 in financial support through tax-free allowances. Couples without work often receive much less than this in social security.

The start of the new tax year on 6th April 2019 sees the completion of an extraordinary nine-year transition in UK tax and benefit policy. Conservative-led governments have rapidly increased the income tax personal allowance, while implementing significant real-terms cuts to the generosity of working-age benefits. As a result, working couples now receive much more financial support from the government than the minimum available to non-working couples aged between 25 and pension age.

Figure 1: Minimum annual financial support for a couple aged 25 to pension age

	2010/11	2019/20	Change
Both not working ¹	£5,343	£5,987	12%
Both employees in full time work ²	£3,841	£7,072	84%

Cash values

The Fabian Society's analysis examines tax allowances and benefits on a like-for-like basis by presenting the cash value of the tax-free allowances within the income tax and national insurance systems – ie the amount the government 'spends' by not taxing people from the first pound of their income. HMRC takes a similar approach when calculating the overall value of tax reliefs and expenditures.ⁱⁱ In our 2016 report *For Us All* we called these allowances 'shadow welfare' because they have the same fiscal effect as social security.

On 6th April 2019 the income tax personal allowance rises to £12,500, reaching a target set in the 2015 Conservative manifesto. The national insurance primary threshold increases to £8,632. Together these tax-free allowances are equivalent to a payment of **£7,072 per year** to a couple who both work sufficient hours to make full use of them. This is the same as paying a basic income of **£68 per week** to each of them.

Figure 1 shows that since 2010/11 the cash value of these tax-free allowances has increased by **84 per cent** (ie £3,230 per couple) despite of a decade of austerity. By contrast the value of the minimum social security payment for a couple without work aged 25 to pension age has increased by **12 per cent** (ie £644 per couple) while inflation (CPIH) has increased by 20 per cent.

Single adults aged under 25 in full time work also receive more through tax-free allowances than the minimum amount available when they are not in work. From 6th April 2019 a single adult aged under 25 in full time work will receive financial support of **£3,536 per year** through income tax and national insurance allowances. By contrast the minimum available to an adult who is out of work aged under 25 is **£3,021 per year**.

Other types of household continue to receive a higher minimum level of support if they are without work than in work. But the differences between what is available for non-working and working households are still surprisingly small. See appendix for charts presenting government financial support for four types of household, as their earnings increase.

¹ 2010/11 annual jobseeker's allowance for a couple both aged over 25, no housing costs; 2019/20 annual universal credit for a couple both aged over 25, no housing or disability costs.

² Assumes both working sufficient hours to make full use of tax-free allowances for income tax and employee/self-employed national insurance. Calculations based on basic rate of income tax outside Scotland.

In the 2019/20 fiscal year:

- **A lone parent with one child** who is not working will receive a minimum of £6,881 per year in universal credit and child benefit. The same parent earning £25,000 per year will receive a minimum of £4,804 in tax relief and child benefit.
- **A couple with two children** neither of whom are working will receive a minimum of £13,340 per year in universal credit and child benefit. The same couple with combined earnings of £40,000 will receive £9,143 in tax relief and child benefit.³

None of these examples include financial support for housing costs. The government only provides a very large amount extra to households with low incomes, compared to those with middle and high incomes, when they are responsible for paying rent. Monthly universal credit payments can more than double to help meet the cost of rent.

But when support for housing is set aside, the state's minimum financial support for households with different incomes is now pretty flat when the combined effects of the government's tax relief and benefit policies are considered side-by-side. Families with decent earnings are receiving similar amounts as families whose only income comes from the state. At a time when minimum social security payments are insufficient to meet basic needs this is a severe hidden injustice.

2. The government now provides more cash support to the richest fifth of working-age households than to the poorest fifth, when tax reliefs are included

The Fabian Society has built on the analysis above to look more broadly at all benefits and tax reliefs, using official survey data. This shows that the government now provides more support overall to the richest fifth of non-retired households than to the poorest fifth.ⁱⁱⁱ

The latest ONS data is for 2017/18 (two fiscal years prior to April's latest increase in tax allowances). This reveals that the poorest fifth of non-retired households received on average **£7,890 per year** in benefits and tax reliefs.⁴ For the richest fifth the value of benefits and tax reliefs is estimated at **£8,650 per year** (using an extremely cautious methodology).⁵

Figure 2 shows that social security benefits are well targeted at low- and middle- income households, but that overall financial support from the state is fairly flat across the income groups. This is because the average annual value of tax reliefs rises in line with the overall income of households, with the 4th and 5th quintiles of the income distribution receiving far more than lower income households. On average households in both these quintiles receive more in tax relief than households in the poorest fifth receive in means-tested benefits.

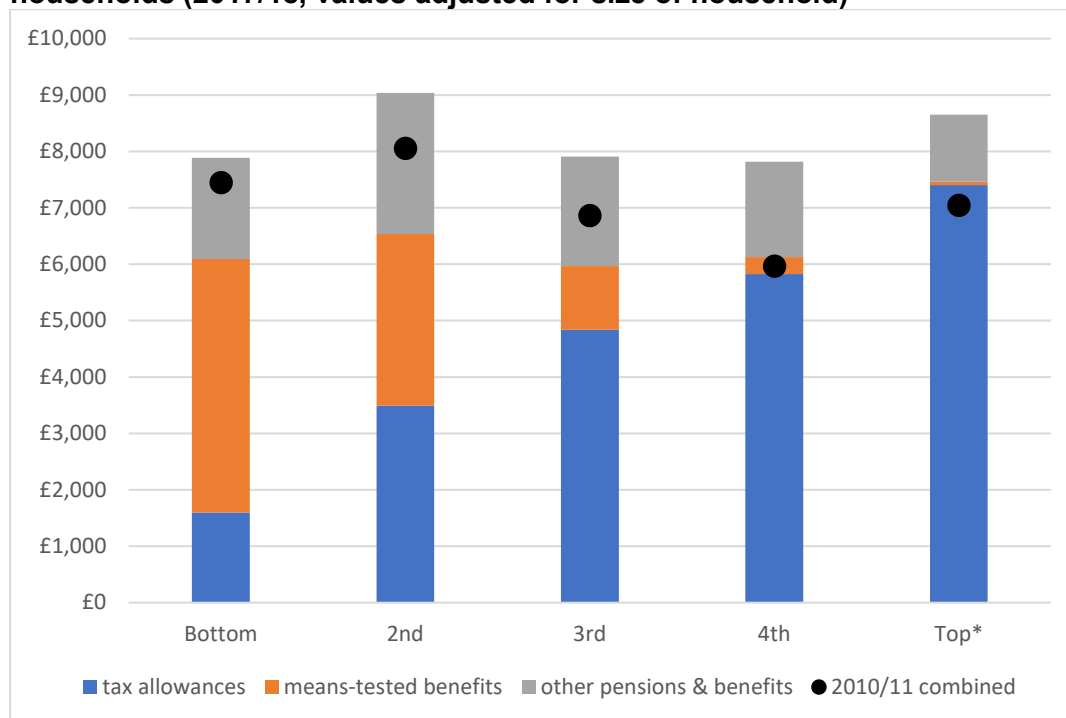
³ The in-work examples include the tax-free allowances for income tax and national insurance and also pension tax relief based on the auto-enrolment minimum employee pension contribution. In the case of the couple, we assume both members of the couple earn enough to make full use of their tax-free allowances.

⁴ These findings are derived from the ONS annual series on the effects of tax and benefits on household incomes. We use ONS figures for average benefit incomes and actual tax payments and Fabian Society estimates for household tax liabilities net of tax relief. Results have been equalised for size of household (the cash value is for a 2-adult household). Quintiles are for the income distribution after adjustment for size of household.

⁵ The ONS series reports data on incomes and tax paid by households rather than individual tax payers. It is therefore not possible to calculate what proportion of the household income is made up of income eligible for higher rates of income tax (or over the secondary threshold for national insurance). Our estimates therefore apply the standard rates of income tax and NICs for all income/earnings, which means that tax reliefs for the highest income quintile are considerably understated.

Richer households access more tax relief partly because there are some reliefs where the amount available rises alongside earnings (eg pension tax relief). But the other reason for their extra support is because high-income households are far more likely to contain two people earning enough to make full use of their tax-free allowances.

Figure 2: The cash value of tax reliefs (estimated) and benefits for non-retired households (2017/18, values adjusted for size of household) ^{iv}



Cash values, adjusted for size of households.

*Tax relief for the top quintile is a cautious underestimate, which ignores the effect of higher rate taxes

Tax-free allowances provide the equivalent to a flat-rate payment for anyone who earns enough to qualify (including many low-paid workers). But on aggregate they benefit rich households much more than poor households because low-income households contain more people who do not qualify (or not for the full amount). As a result, an apparently flat-rate form of financial support actually favours the wealthy, an outcome the Fabian Society terms 'regressive universalism'.

Figure 3: the cash value tax reliefs (estimated) and benefits has increased since 2010/11 far more for high than low-income households ^v

	Bottom	2nd	3 rd	4th	Top*	Average
2010/11	£7,448	£8,058	£6,863	£5,965	£7,047	£7,142
2017/18	£7,885	£9,038	£7,906	£7,815	£8,652	£8,410
Change (£)	£437	£980	£1,043	£1,850	£1,605	£1,268
Change (%)	6%	12%	15%	31%	23%	18%

Cash values, adjusted for size of households. Income quintiles of non-retired households, adjusted for size of household

*Tax relief for the top quintile is a cautious under-estimate, which ignores the effect of higher tax rates

This analysis means that the government's decision to increase tax allowances significantly has been very damaging from an egalitarian perspective. This should have been obvious when the policy was first proposed by the Liberal Democrats before the 2010 election – and then significantly extended in the 2015 Conservative manifesto.

Between 2010/11 and 2017/18 the ONS survey data (figure 3) shows that the value of government cash support (including tax reliefs) for the poorest fifth of non-retired households grew by **6 per cent** (ie £437 per year), while for those in the fourth income quintile it grew by **31 per cent** (ie £1,850 per year). Prices increased by 15 per cent (CPIH) over this period.

3. The government ‘spent’ £136bn per year on tax-free allowances in 2018/19, an increase of 43 per cent since 2012/13

HMRC estimates that the overall cost of the tax-free allowances (for income tax and for national insurance paid by employees and self-employed workers) was **£136bn in 2018/19**.^{vi}

This is an increase of **43 per cent** since 2012/13. During the same period inflation has increased by 10 per cent and spending on social security has increased by 7 per cent. Nominal spending on social security for adults of working-age has actually fallen.

Figure 4: Cost to the exchequer of tax allowances and social security payments (nominal)^{vii}

	£ billions (nominal)			% GDP	
	2012/13	2018/19	Change	2012/13	2018/19
UK tax-free allowances (income tax, national insurance contributions by employees and self-employed workers)	£95.2	£135.8	43%	5.6	6.4
UK social security payments	£207.3	£222.3	7%	12.1	10.3
<i>Of which GB social security payments to working-age adults and children</i>	£94.6	£94.2	-0.3%	5.5	4.4

The same point can be made by looking at spending on tax allowances and social security as a percentage of GDP. The government devoted 6.4 per cent of GDP to tax allowances in 2018/19, up from 5.6 per cent in 2012/13. Over the same time social security spending fell from 12.1 per cent of GDP to 10.3 per cent.

These cuts have always been presented by the government as a regrettable consequence of austerity. But these numbers reveal that almost half the cut has not been used to reduce the deficit but re-allocated to raise tax-free allowances. As a share of GDP, spending on social security has fallen by 1.7 percentage points, while the value of tax-free allowances has increased by 0.8 percentage points of GDP.

Given the extraordinary funding crisis the social security system has faced in recent years, this sustained tax/benefit strategy is deeply disturbing.

Policy Responses

Decisions since 2010 to increase the value of tax-free allowances and to cut social security entitlements have made the UK tax-benefit system much less progressive and redistributive than a decade ago.

So what should a future government do about it? This question was examined in great detail in the Fabian Society's 2016 report *For Us All* and this chapter provides a brief update based on that report's ideas.

The Fabian Society is also in the midst of a project [Poverty and social security: where next?](#) which is exploring options for long-term reform of social security (but not tax reliefs). The project is designed to coincide with a major review of social security policy by the Labour party and a final report will be published later in 2019.

For the time being, this paper looks at the question of the balance between tax allowances and benefits only. Overall, the goal should be to establish a fiscal system that allocates less to tax-free allowances and more to social security because this will achieve more egalitarian outcomes for any given amount of money.

Recommendation 1: freeze tax-free allowances for five years to rescue social security

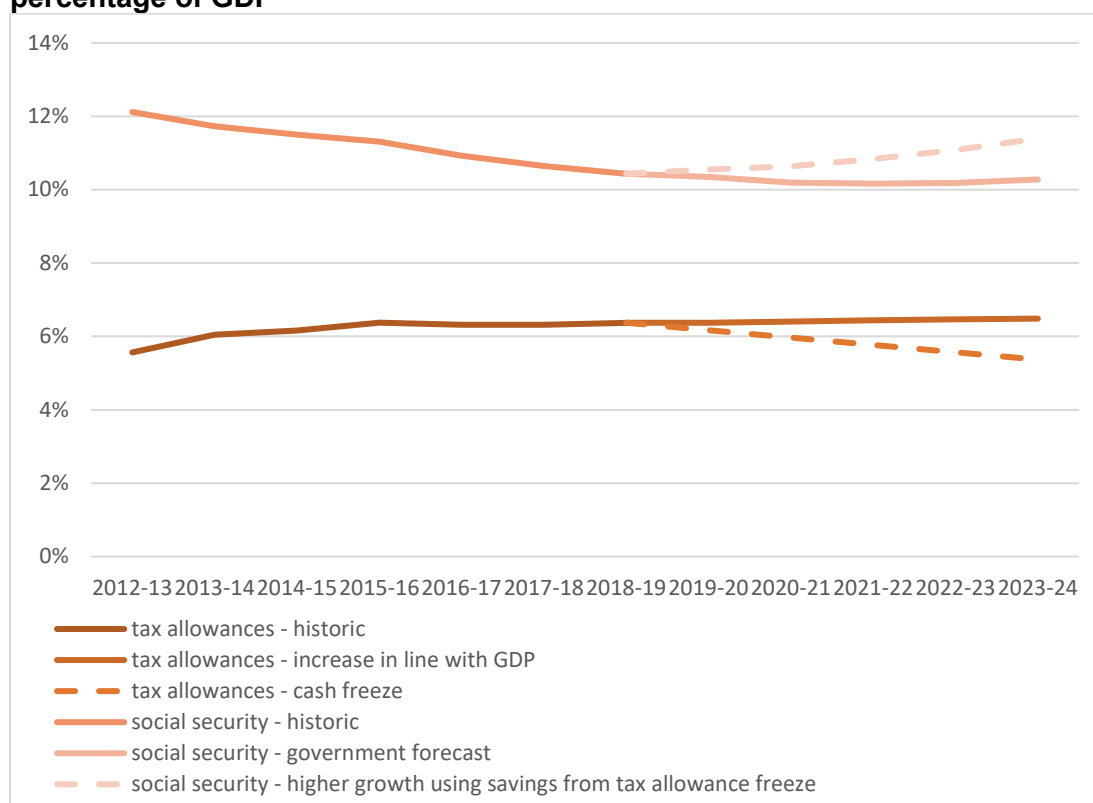
Politicians should commit to reversing the direction of recent policy and prioritise spending on benefits over tax-free allowances for at least five years. The most straightforward way to do this would be to announce that all tax-free allowances will be frozen in cash terms for the life of a parliament. On the assumption that nominal earnings would rise during that time, this policy would generate significant new revenues that could then be ploughed back into social security where the spending would have far more progressive impacts.

As this would be a cash freeze no one would see their income visibly fall. They would just end up paying more tax than they might have otherwise the next time their taxable income increased. On the other hand, some people's real incomes would be likely to decline, if they did not benefit from either higher social security or higher earnings over the life of the tax allowance freeze.

After five years this approach could generate £28bn per year of extra revenue for the exchequer.⁶ Figure 5 illustrates how this switch would be sufficient to return social security spending to the same share of national income seen at the time of the 2015 election - thus reversing the impact of austerity measures introduced since that time.

⁶ compared to if the cost of the tax-free allowances were to rise in line with the OBR's central projection for nominal GDP

Figure 5: Projections for spending on tax-free allowances and social security as a percentage of GDP^{viii}



Recommendation 2: Create a permanent fiscal ‘envelope’ for tax-free allowances and social security combined

The five-year freeze in tax-free allowances should be accompanied by a longer term framework which would see the government set a **target for the combined fiscal resources** to be allocated to tax-free allowances and social security. This threshold would be set as a percentage of GDP so that spending would automatically rise in line with future increases in national prosperity. The benchmark would need to be determined in a way that took account of the economic cycle because social security spending is an ‘automatic stabiliser’ that is intended to rise during downturns.

In 2019/20 the combined resources allocated to tax-free allowances and social security is 16.7 per cent of GDP. This is down from 17.7 per cent in 2012/13. However, rather than aiming to reduce the share of GDP available in future, the goal should be for the envelope to grow or remain stable as a proportion of GDP, as is the case today with international development and defence spending. This will ensure that as the economy grows, financial support for household living standards will grow proportionately.

A single declared envelope that combines tax-free allowances and benefit spending will help break down today’s artificial distinction between tax revenue foregone and cash payments made. This divide exists in the minds of most politicians, journalists and members of the public, even though they are identical measures from a fiscal perspective. The combined envelope will also help reposition working-age social security as a positive form of spending, by presenting it as part of a package alongside tax allowances and state pensions which are both already popular.

Once the combined envelope has been set for the coming years, the government would then be able to consider making changes to the allocation of resources within it. As we have seen, the same total would achieve far more egalitarian, poverty-reducing outcomes if the resources were transferred away from tax reliefs towards universal or means-tested benefits.

Further slow changes could be made by continuing to freeze the cash value of the tax-free allowances for 10 years or more. All of the new resources in the combined envelope could then be spent on social security. Alternatively, progress could be achieved more quickly by cutting the tax-free allowances. However, this faster approach is likely to create controversy as some people would end up worse off in cash terms, if they lost more in tax-free allowances than they gained in new social security spending.

Recommendation 3: Consider a basic income instead of tax-free allowances but only alongside other options

The expansion of universal benefits should be considered as part of any broader debate on the long-term allocation of resources within a single fiscal envelope for tax-free allowances and social security.

We already have the state pension and child benefit, which are both close to being universal, as well as universal disability benefits. But there is growing interest in a more radical approach to universal social security, with a number of organisations proposing to switch the resources now taken up by tax-free allowances to create flat-rate payments for everyone (ie a modest universal basic income). Versions of this idea have been proposed recently by the Fabian Society, Compass, the New Economics Foundation and Karen Buck MP and Declan Gaffney among others.^x

Compared to tax allowances, this policy would provide a simple, regular payment, whether you were in or out of work, so it would benefit households without work or with low earnings. If payments were available for children and pensioners, not just working-age adults, allocations would also reflect the size of each household, which is not the case with tax-free allowances.

For these two reasons a new flat-rate payment in place of tax-free allowances, made in addition to existing means-tested benefits, would be extremely progressive and would significantly reduce poverty. This stands in contrast to proposals for universal basic income that replace means-tested benefits. This is not a progressive option and should not be pursued by policy makers committed to tackling inequality and eradicating poverty.

If all the existing expenditure on tax-free allowances was distributed uniformly to every man, woman and child in the UK it would create a universal payment of £40 per week each. However, such flat-rate payments could not be introduced overnight because a large number of people would lose significantly more than they gained.⁷ The Fabian Society's 2016 report *For Us All* argued that a basic income along these lines should only be introduced gradually over a decade or more to avoid cash losers.

⁷ Recent proposals from Compass and the New Economics Foundation have sought to avoid creating low income 'losers' but they only achieve this by proposing significant tax rises, apart from the transfer of resources from the existing tax-free allowances. This would have opportunity costs. There is a good case for raising personal taxes but there would be many other claims on the money – including health and social care, education and means-tested social security.

But there is also the broader question of whether a flat-rate UBI would be the best way to use whatever resources are to be freed-up from freezing or cutting tax-free allowances. Even within the domain of universal benefits, in the context of today's benefit system, there would be a good case for initially spending any extra money on children not adults – or on working age-adults not pensioners.

Alternatively, the same resources could be used to transform universal credit into a far more generous means-tested system, along the lines of Gordon Brown's original vision for tax credits. Given the desperate state of the means-tested system this would probably need to be the first priority, over the creation of a new universal payment.

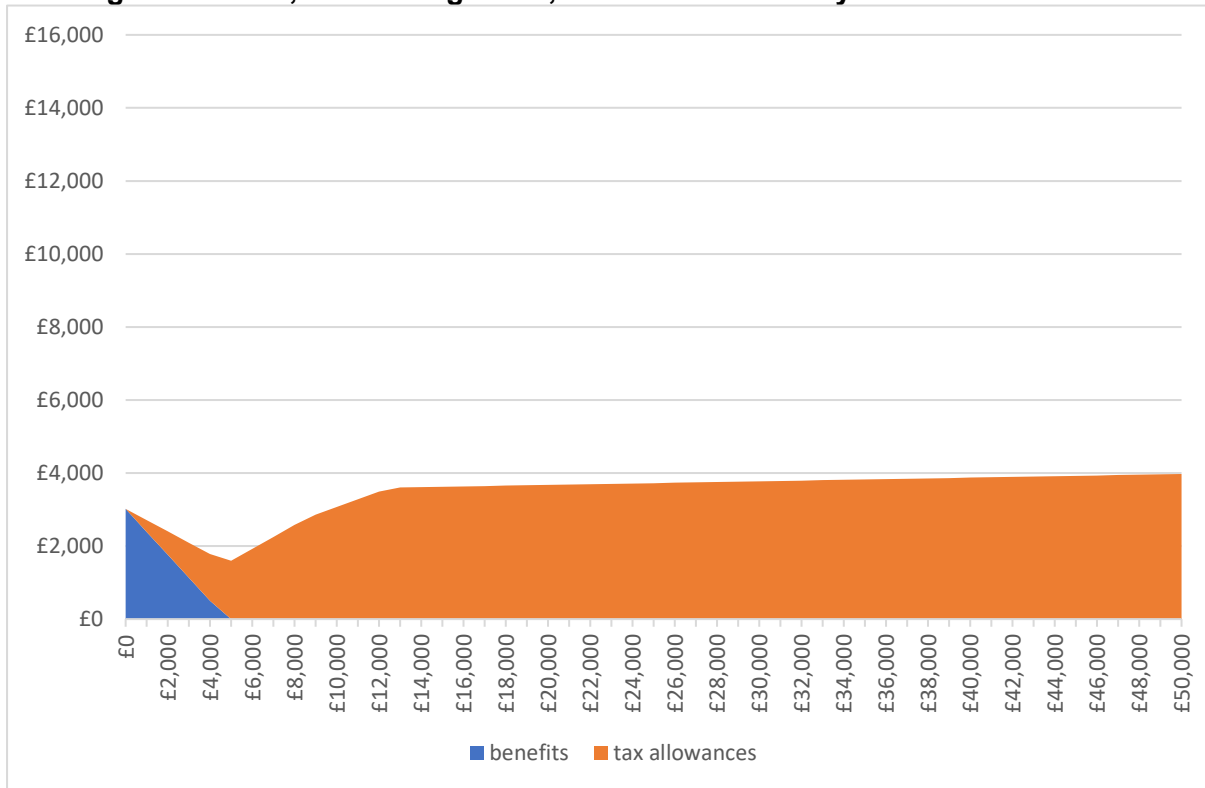
A flat-rate credit for all is an attractive long-term option, especially as it would provide people in work with some compensation for the gradual erosion in the value of their tax-free allowances. But the necessary debate on reducing the value of tax allowances should not be collapsed into a narrow discussion about universal basic income.

Policy makers should instead start by asking how the combined fiscal envelope proposed here can best be used to maximise and equalise living standards. In developing a strategy they should take into account the outcomes they want to achieve, the total size of the fiscal envelope available, and the real-world constraints created by existing policies. Decisions on the balance between tax-free allowances, universal payments, contribution-based support and means-testing should flow from there.

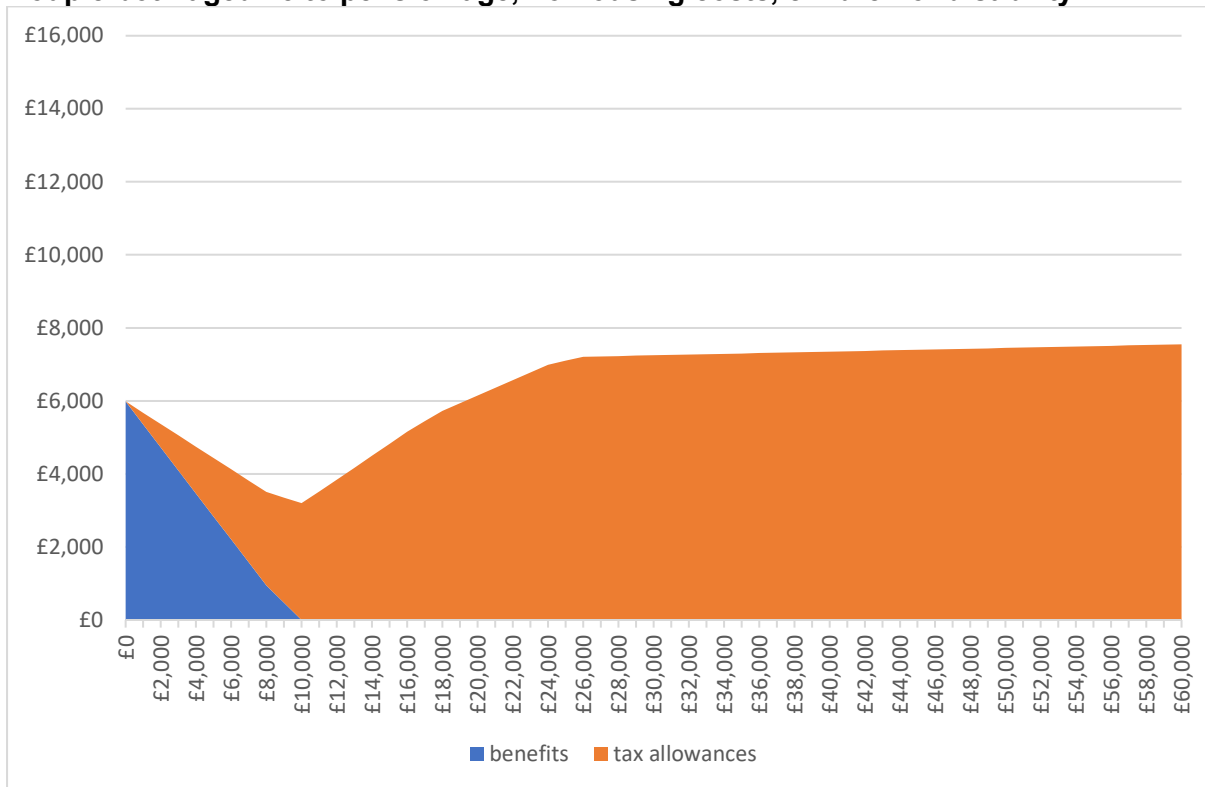
It would be wrong to decide in isolation to introduce a universal basic income and then work backwards to work out how to pay for it, irrespective of other considerations.

Appendix – minimum state financial support for different family types as household earnings rise

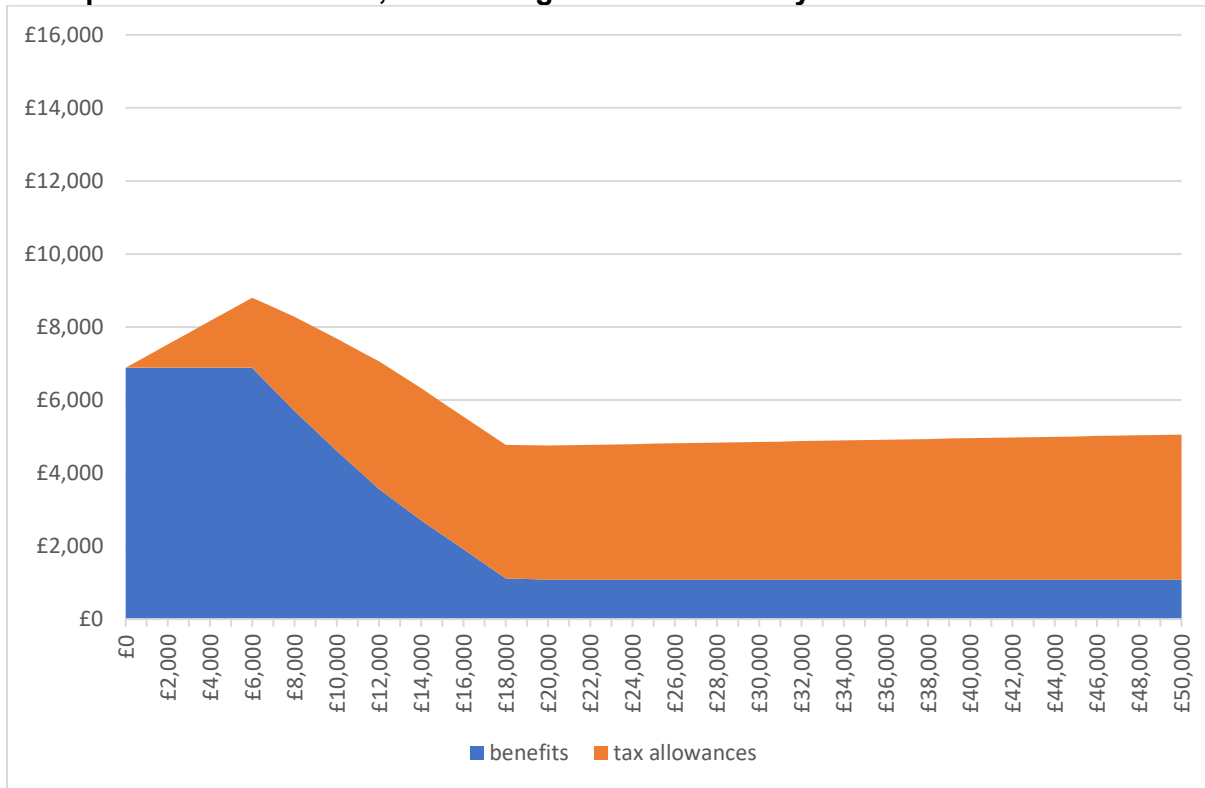
Adult aged under 25, no housing costs, children or disability



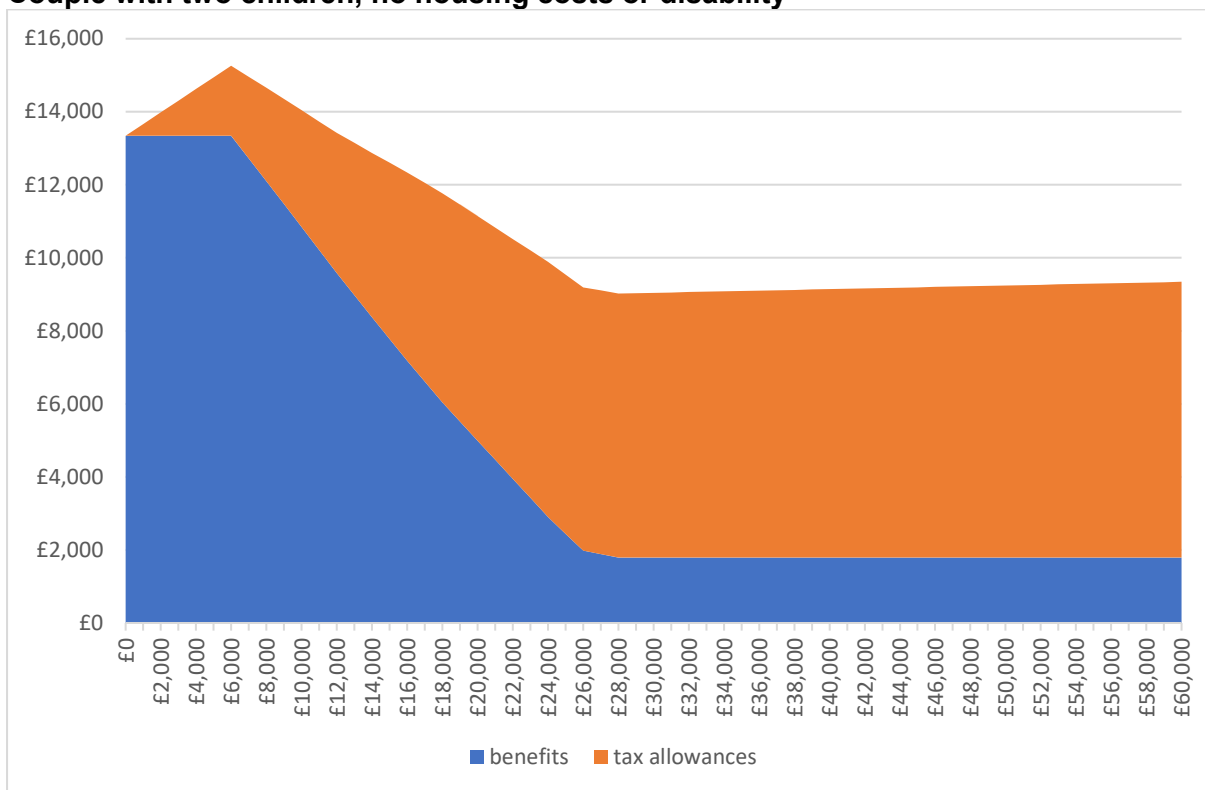
Couple both aged 25 to pension age, no housing costs, children or disability



Lone parent with one child, no housing costs or disability



Couple with two children, no housing costs or disability



References

- ⁱ Harrop A, For us all: redesigning social security for the 2020s, Fabian Society, 2016
- ⁱⁱ Estimated costs of principal tax reliefs (January 2019), HMRC, 2019
- ⁱⁱⁱ Effects of tax and benefits on household income: historical datasets, ONS, 2018
- ^{iv} Effects of tax and benefits on household income: historical datasets, ONS, 2018; The effects of taxes and benefits on household income, disposable income estimate: 2018, ONS, 2019
- ^v Effects of tax and benefits on household income: historical datasets, ONS, 2018; The effects of taxes and benefits on household income, disposable income estimate: 2018, ONS, 2019
- ^{vi} Estimated costs of principal tax reliefs (January 2019), HMRC, 2019
- ^{vii} Estimated costs of principal tax reliefs (January 2019), HMRC, 2019; Benefit expenditure and caseload tables 2018, DWP, 2018; Public finances databank, OBR, 2019
- ^{viii} Estimated costs of principal tax reliefs (January 2019), HMRC, 2019; Benefit expenditure and caseload tables 2018, DWP, 2018; Public finances databank, OBR, 2019
- ^{ix} Harrop A, For us all: redesigning social security for the 2020s, Fabian Society, 2016; Buck K and Gaffney, D “The practical response to our widening inequality? A partial basic income”, Left Foot Forward, 3 September 2018; Stirling, A and Arnold, S, Nothing personal: replacing the personal tax allowance with a weekly national allowance, New Economics Foundation, 2019; Lansley, S and Reed, H, Basic income for all: from desirability to feasibility, Compass, 2019