

A Briefing from The Children's Society: Inflation for low-income families and Benefit Uprating

Introduction

The Children's Society supports nearly 50,000 children and young people every year through our specialist services and children's centres. We believe in achieving a better childhood for every child but have a particular focus on children who have nowhere else to turn, such as children living in poverty, young refugees, children at risk on the streets, disabled children and children in trouble with the law. We seek to give a voice to children and young people and influence policy and practice so they have a better chance in life.

We are concerned about recent media reports which have suggested that the Government is considering changes to the method for uprating benefits. This is normally done in line with the rise in the Consumer Prices Index (CPI). Our briefing note shows that low income families¹ with children have faced a particularly high rate of inflation over the last twelve months – around half a percent above the CPI rate. This is a result of disproportionate spending on items – such as food and fuel – which have faced above average rates of inflation. Uprating benefits below CPI would compound this squeeze on their incomes. We urge the Government to uprate financial support to low-income families at least in line with CPI.

Summary

- Analysis shows that inflation for low income families with children, in the year to September 2011, was around **half a percent higher than the headline CPI rate, at around 5.7% compared to 5.2%**.
- Higher inflation for low income families with children is driven by their disproportionately large expenditure on fuel and food costs. **Low-income families with children spend 20% more on fuel as a share of their expenditure** compared to households not living on a low income. **Fuel costs have risen by 18.9%** over the past year.
- **Inflation is slightly higher for low-income working families than low income non-working families.** This is the result of higher expenditure on transport costs, which have seen above average inflation rates. For these families low benefit uprating would compound low growth of earnings.
- **Low-income working families could be amongst the hardest hit by low benefit uprating. A working couple with one child, earning £150 per week and with £170 of housing costs, could lose £893** for 2012-13 by a freeze in benefit rates compared to uprating all benefits by the true inflation rate for low income families of 5.7%.
- **Families with disabled children could also be amongst the hardest hit – a lone parent with a severely disabled child could lose £1124** by a freeze, compared to uprating by 5.7%.
- In 2010 the Government announced that benefits and tax credits would be uprated with CPI as standard rather than the (typically higher) Retail Prices Index (RPI). The Institute for Fiscal Studies (IFS) has said that this change will be a **principle driver of rising child poverty rates** over the next decade.

Part 1. How inflation is impacting on different types of families

Inflation this September, on the Government's preferred measure, CPI, stood at a record high of 5.2%. This was driven by exceptionally high increases in fuel prices, as well as for food, drink and transport costs.

The extent to which households actually experience high inflation rates depends on the proportion of household expenditure spent on different household items. Households that spend relatively more on those items for which prices are rising the fastest will experience a greater impact.

It is possible to re-weight inflation to reflect average expenditure on different categories of item, for different types of households. CPI is made up of 12 categories of household items. These categories, along with the inflation rate for each category in the 12 months prior to September 2011, are shown in Figure 1 in Appendix 1. The headline CPI rate is calculated by weighting each of the categories by the relative share of expenditure across all households, and has been determined through analysis by the Office for National Statistics.

Prices in some expenditure categories e.g. food and non-alcoholic beverages, housing, water and fuel and transport, are increasing considerably faster than other categories of items.

We have identified the proportion of household expenditure on different categories of items for different family types using the Living Costs and Food Surveyⁱⁱ. We used the data to analyse the share of expenditure for families with children living on a low income, and for all households not living on a low income.

The share of expenditure on different categories of items for low income familiesⁱⁱⁱ with children are shown in the Figure 2 in Appendix 1, alongside the relative share used to weight the headline CPI measure.

Low-income families with children spend considerably more of their expenditure on food and non-alcoholic drink, and housing and fuel (for example low-income families with children spend 7.5% of their expenditure on fuel compared with 6.3% for households not on a low income), than provided for in the CPI weighting. In comparison, they spend less on transport, recreation and restaurants and hotels.

Re-weighting the 12 expenditure categories in figure 1 according to the share of expenditure on each category reveals that **inflation across all low-income families with children was 5.7% in the year to September 2011, 0.5% higher than the headline CPI figure of 5.2%.**

One of the main drivers of higher inflation for low income families in September 2011 and in preceding months has been the sharp increase in the prices of fuel. As shown in Figure 3 in Appendix 1, **in the year to September 2011 fuel prices rose by 19%, including a 22% rise in the price of gas.** Low income families with children spend around 20% more on gas and electricity than households not living on a low income. The sharp rise in the price of fuel is squeezing budgets for all households, but is hitting low income families with children particularly hard.

Analysis also reveals that low-income families with children with adults who are in work faced a slightly higher rate of inflation (5.7%) than low income families with

children where no adult was working (5.6%). This is the result of a higher proportion of expenditure going towards the costs of transport, (as a result of work related transport costs) which rose at a rate of 8.9% in the year to September.

Part 2. Benefit Upating

Although often affected by individual spending decisions, most benefits are uprated as standard in line with inflation^{iv}. Until 2011 the uprating of many benefits was typically in line with the RPI. From 2011 onwards this will be in line with the (typically lower) CPI. The IFS has said that this change will be a principle driver of child poverty over the next ten years^v.

The year-to-September inflation figure is used for calculating the level of uprating. The year-to-September 2011 CPI figure was 5.2% - around 0.9% higher than the OBR forecast in March^{vi}. It has been reported that in response, the Government are considering changing the rate at which benefits are uprated in order to cut expenditure^{vii}. Such changes could include:

1. ***Uprating with the 6 month average CPI rate*** – Prices rose particularly high from September 2010 to September 2011. One option under consideration is to use the 6 month average CPI rate (the average of CPI rate for the year to April through to September 2011). This would give an inflation rate of around 4.5%. This would not enable benefit rates to keep pace with price rises since benefits were last uprated (according to last year's year-to-September inflation rate.)

2. ***Uprating with earnings*** – Earnings growth was exceptionally slow over the last year. One further option would be for the government uprate benefits in line with earnings (by 2.5%).

3. ***Freezes in benefit entitlements*** – A final option would be for the government to freeze benefit rates at current entitlements. A number of benefits have already been frozen (see below).

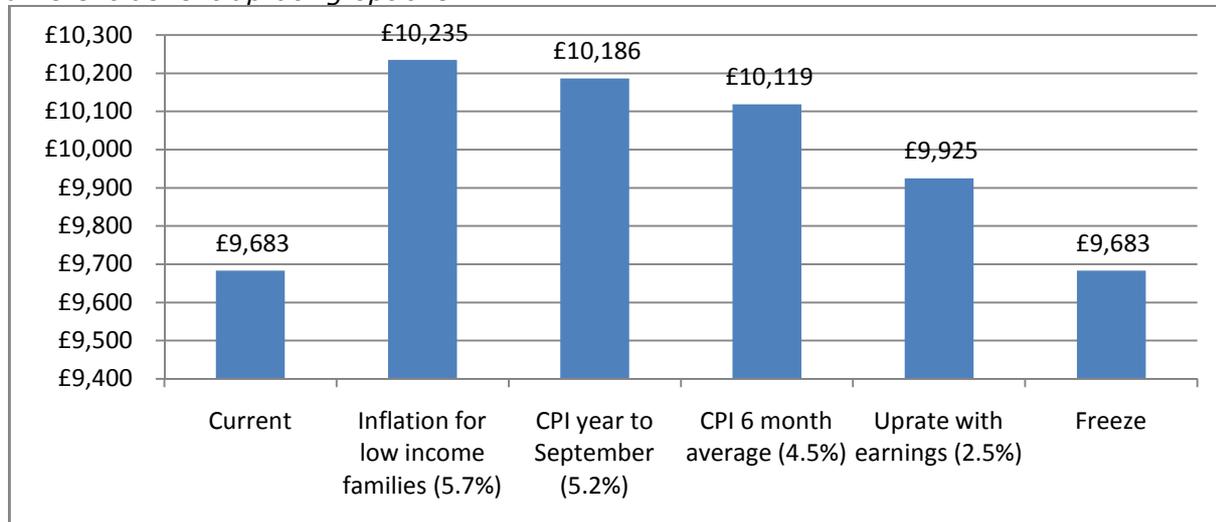
Benefit uprating for 2012-2013 will not only be affected by index linked inflation, since a number of changes to the welfare system announced in the emergency budget and the Comprehensive Spending Review last year will also have an impact. These include:

- 1) The Child element of Child Tax Credit (CTC) will increase by £110 above CPI indexation in 2012/13.
- 2) The basic and 30 hour elements of Working Tax Credit (WTC) will be frozen in 2012/13 and 2013/14.
- 3) Child Benefit will be frozen in 2012 and 2013.
- 4) From 2013/14 maximum Local Housing Allowance entitlement will be uprated with CPI rather than local rents.
- 5) An increasing number of households will see benefits cut as a result of the Housing Benefit caps and changes to entitlement conditions to WTC.

Changes to benefit uprating could affect the support available to families in receipt of a number of benefits, potentially including out of work income replacement benefits (such as Income Support and Job Seeker's Allowance), Child Tax Credit and Working Tax Credit and Housing Benefit and Council Tax benefit. A more detailed list is given in Appendix 2.

Figure 5 below shows the impact of different options for benefit uprating for welfare support for an out of work couple with one child.

Figure 5: Annual income (after housing costs) for out of work couple with one child based on different benefit uprating options^{viii}

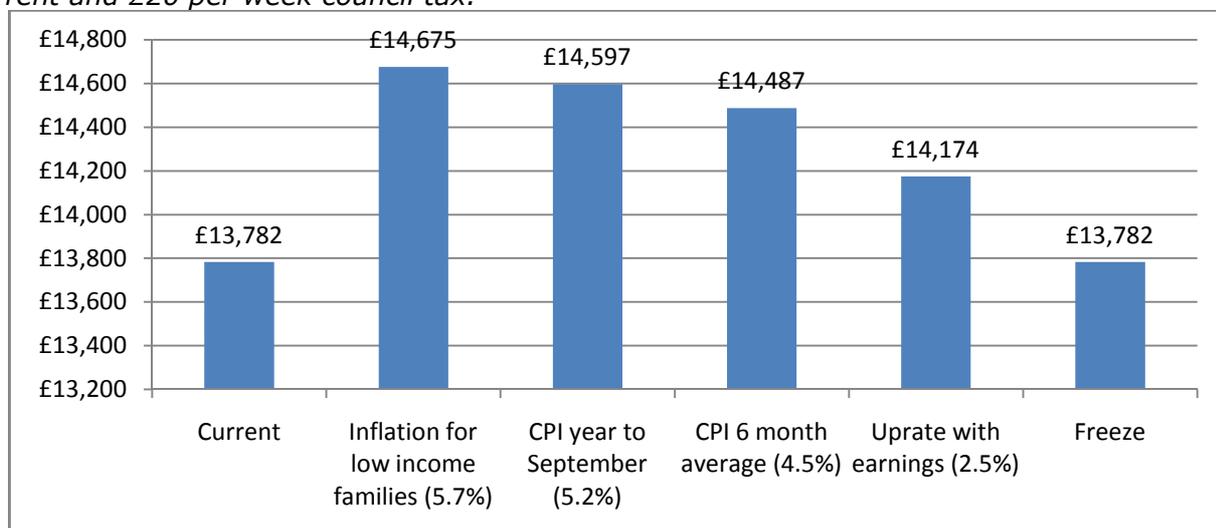


The table shows that a freeze on all benefit increases next year would cost this family £552 compared to uprating all benefits by their true inflation rate of 5.7%.

Uprating by the CPI 6 month average rather than the year to September would cost the family £116 compared to uprating by their "true" 5.7% inflation rate – **this would undo all the positive investment promised as a result of the £110 additional investment in the child element of child tax credit for April 2012, which was promised in order to avoid rising levels of child poverty.**

A working family on a low income is also likely to be hit by changes to in work benefits including Housing Benefit and Council Tax Benefit, Working Tax Credit and Child Tax Credit, and Child Benefit. For example, Figure 6 below shows benefit income for a couple with one child with one adult in work, earning £150 per week, and with £150 rent and £20 per week council tax.

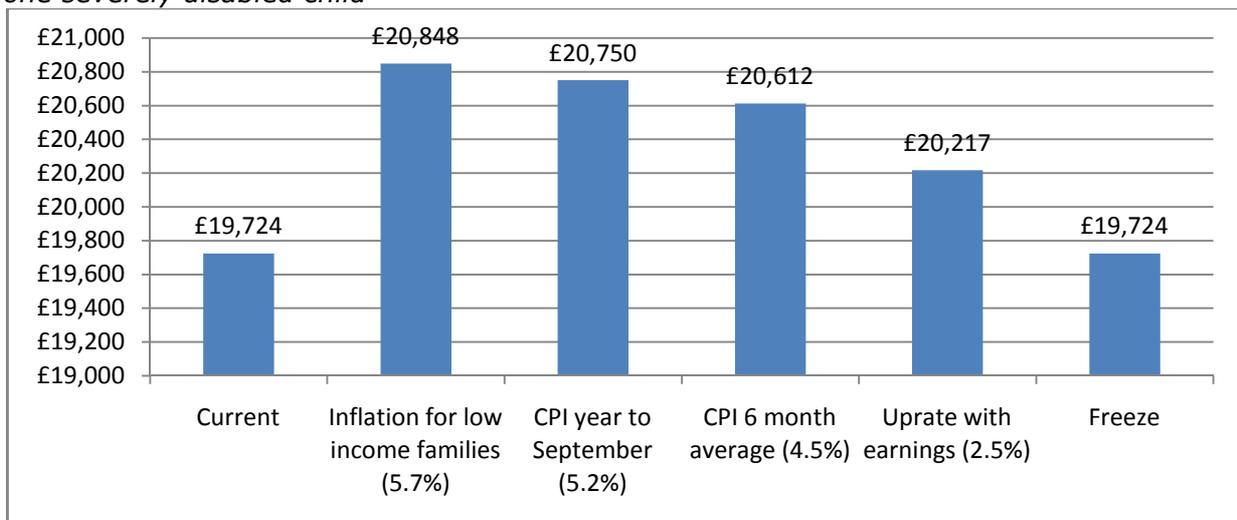
Figure 6. Benefit income for couple with one child, earning £150 per week and with £150 rent and £20 per week council tax.



As can be seen, a benefit freeze would cost the family above around £893 compared to uprating their benefit receipt by 5.7%. For working families, such cuts to could be compounded by low earnings growth.

The losses for families with disabled children could also be particularly severe. The following chart shows income for a lone parent with a severely disabled child in receipt of the High Rate Care component of DLA, and the High Rate Mobility component. The Lone Parent is in receipt of carer's premium on their Income Support for looking after them.

Figure 7: Annual income (after housing costs) for Lone Parent acting as full time carer for one severely disabled child^{ix}



A freeze would cost them £1124 compared to uprating in line with inflation for a low income family with children. Uprating in line with the 6 month CPI average would cost them £236.

Were low benefit uprating to be repeated in future years, these losses shown in figures 5, 6 and 7 would be likely to become increasingly severe.

It should be remembered that any changes to uprating of support need to be put in the context of wider changes within the welfare system, which will severely erode the support which many families receive. These include changes to levels of eligible housing costs for the purposes of calculating Local Housing Allowance entitlement, changes to eligibility criteria for WTC, and cuts to a number of maternity benefits (including the Sure Start Maternity Grant, the baby element of Child Tax Credit).

The impact of high inflation, and potential changes to benefit uprating, on children in families on a low income

If families are unable to afford the same goods and services which they were able to afford the same time last year, as a result of income being uprated slower than inflation, this is going to squeeze expenditure.

Fuel and food costs face particularly high rates of inflation, which will make it particularly hard for parents to ensure that their children have a warm home and a

good diet. Family trips out could also become harder as inflation on transport costs has been particularly high.

Were the government to reduce or freeze the planned uprating for disability benefits, then (as shown in figure 5) the impact on children in families affected by disabilities would be particularly severe. Recent research by the Children's Society has shown that 4 in 10 disabled children live in poverty once the additional costs of disability are accounted for,^x changes to uprating could have a particularly severe effect on this group.

Families may shift expenditure between different household items in order to balance budgets. Families may need to shift more of their expenditure to less "flexible" items of expenditure such as fuel, meaning that spending on other areas (such as food, clothes and shoes) is cut back. Alternatively, families may increase reliance on credit in order to fill gaps in family budgets.

3. Conclusion

Rates of benefit uprating need to reflect price increases so that families are able to afford the key items they need for a decent standard of living. Uprating by CPI for the year to September 2011 already underestimates the true rises in living costs, because of higher proportions of expenditure amongst low income households go towards items like fuel and food, which have faced above average levels of inflation.

As can be seen, changes to benefit uprating conditions would not only affect families in receipt of out of work income replacement benefits. Low income working families would be hit hard by any changes.

This would compound the current low earnings growth that working families are facing, as well as already announced freezes in Child Benefit and the basic and 30 hour elements of Working Tax Credit. Children in low income families need to be protected by ensuring that benefits remain up-rated in line with rising prices.

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Appendix 1:

Figure 1: inflation rates for year to September 2011, for different categories of item

01	Food and non-alcoholic beverages	6.4%
02	Alcoholic beverages and tobacco	10.0%
03	Clothing and footwear	2.1%
04	Housing, water, electricity, gas and other fuels	8.6%
05	Furniture, household equipment and maintenance	5.3%
06	Health	3.6%
07	Transport	8.9%
08	Communication	5.9%
09	Recreation and culture	-0.6%
10	Education	4.6%
11	Restaurants and hotels	4.7%
12	Miscellaneous goods and services	2.4%

Figure 2: Category expenditure as a proportion of overall household expenditure for low income families, and by CPI weighting assumptions

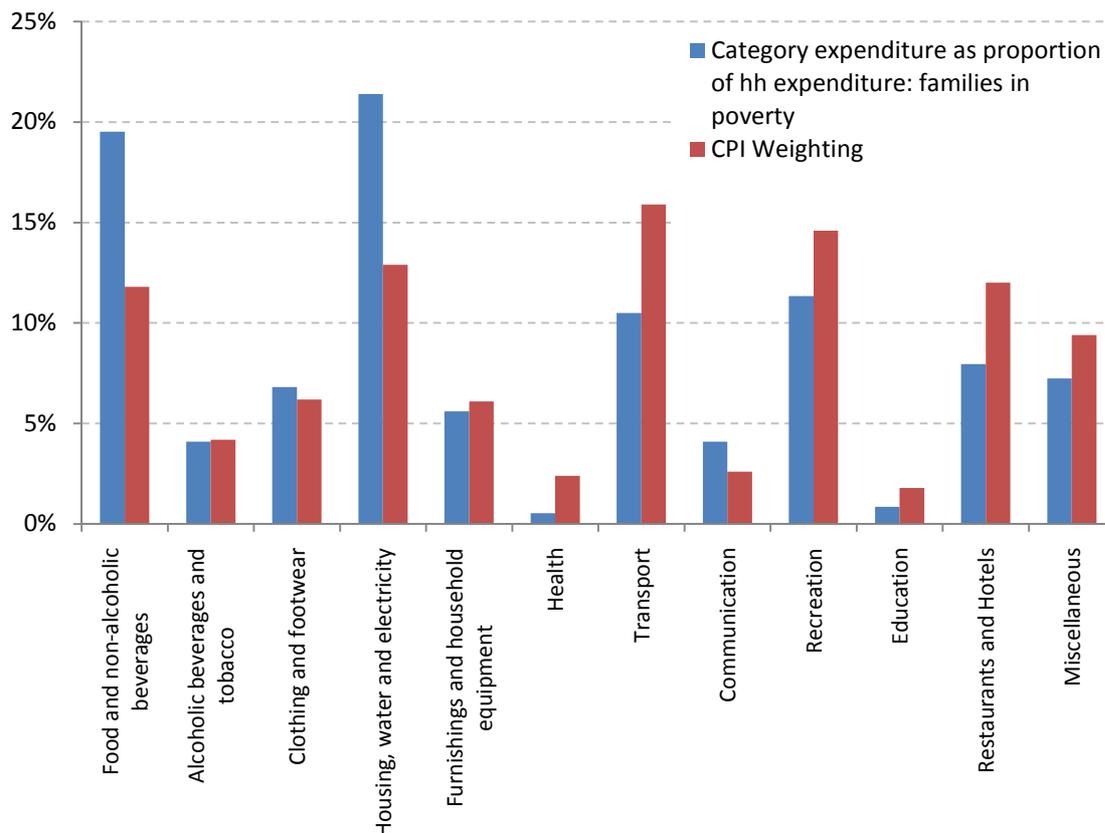
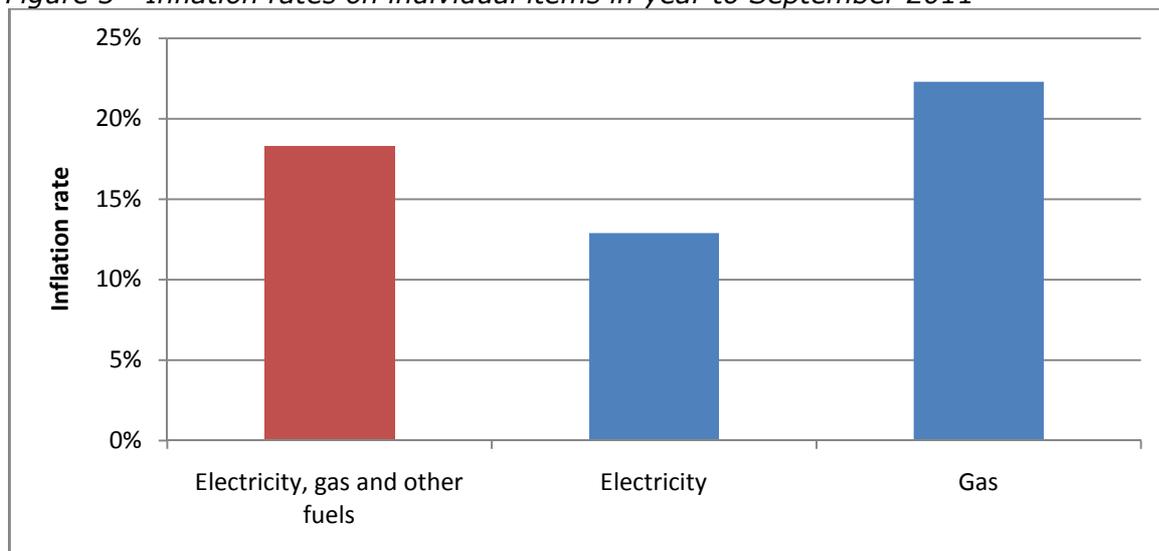


Figure 3 - Inflation rates on individual items in year to September 2011



Appendix 2: **Benefits which could be affected by changes in uprating**

1) Child Tax Credit

CTC is a means tested benefit paid to both working and non-working households with children. The Government announced that in April 2012 the child element of CTC would be increased by CPI + £110. It was announced that this would be funded through a freeze on Child Benefit (see below) and that these changes would help to ensure that child poverty did not increase. Uprating below CPI will undermine this positive investment.

2) Working Tax Credit

WTC is paid to low income working households (whether with or without children). Last year the Government announced that two key elements of WTC (the basic and 30 hour elements) would be frozen for three years, uprating for other elements (such as the disability element – paid to disabled workers) has been changed from RPI to CPI. Low income working families with disabled workers would therefore be affected by further changes to benefit uprating.

3) Child Benefit

Child Benefit is a non-means tested benefit for children. Last year child benefit was frozen for three years. Any further changes to uprating of support for children and families would serve to further undermine this freeze in support.

4) Out of work income replacement benefits

Out of work income replacement benefits (such as Job Seeker's Allowance, Income Support and Employment Support Allowance) are typically uprated with inflation (now CPI rather than RPI). Further cuts to this support would have a substantial impact on the lowest income families.

5) Housing Benefit and Council Tax Benefit

The level of support which working families receive in Housing Benefit and Council Tax Benefit is affected by the uprating of other benefits, since these affect the household "personal allowance", (the amount of money the household can earn before means based deductions are made from their HB/CTB entitlement). Changes to benefit uprating would therefore affect the amount of support which could be received by working families.

From 2013, Local Housing Allowance (Housing Benefit for people in private rental housing), is to be linked to CPI rather than to local rents. This is already a deeply worrying change, since in some areas rental prices go up considerably faster than inflation, changes which cut the rate of uprating in the future could make it more likely that rents will rise faster than support is uprated.

6) Disability Living Allowance

Disability Living Allowance is a non-means tested benefit paid to help disabled people (both adults and children) with their care and mobility needs. It is currently uprated with CPI. Cuts to the level of support provided would impact upon families affected by disabilities, who are already disproportionately likely to be living in poverty.^{xi}

ⁱ In this paper, a household is considered to be living on a low income if they have a household income of less than 60% of equivalised median income – (a household is typically considered to be living in poverty according to the same measure.)

ⁱⁱ using the 2009 dataset, the most recent year publicly available

ⁱⁱⁱ See point 1

^{iv} it should be noted that some benefits – such as the family element of child tax credit – are not uprated as standard.

^v Brewer, Browne and Joyce (2011) "Child and Working Age Poverty and Inequality in UK: 2010" IFS: London

^{vi} <http://www.guardian.co.uk/politics/reality-check-with-polly-curtis/2011/oct/18/how-much-will-higher-inflation-cost-the-government>

^{vii} <http://www.ft.com/cms/s/0/69628844-057f-11e1-8eaa-00144feabdc0.html#axzz1dsoBSRph>

^{viii} Note that this table reflects prospective incomes if all household benefit receipt was uprated according to the options suggested. This is not entirely reflective of standard uprating. For instance, the family element of child tax credit (worth £545) is not uprated as standard. In addition, this does not register the £110 additional uprating of the child element of child tax credit.

^{ix} As with figure 5, this represents different uprating options – not actual benefit changes for April 2012. It should be noted that although the uprating for a low income family is shown, the additional support received for disability related costs push the family above the poverty threshold – however, once this additional support is deducted to pay for the additional costs of disability, the family *is* pushed below the poverty line.

^x The Children's Society (2011) "4 in every 10: Disabled children living in poverty" The Children's Society: London

^{xi} It should also be noted that there is some question over the Government's ability to change the uprating of Disability Living Allowance for next April as a result of statutory uprating which means that a change in legislation would be needed if the Government decided not to uprate DLA with prices.