

Annexes

Annex D

Detailed policy costings

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The below outlines costings for the Commission's proposals on:

- Extending the free childcare offer to 25 hours a week and 47 weeks a year;
- The introduction of a second earner disregard in Universal Credit;^[1]
- An increase in the NICs threshold for older workers;
- A reduction in the lifetime allowance for Pension Tax Relief;
- The means-testing of Winter Fuel Allowance and TV licences,^[2] and
- The extension of NICs past the State Pension Age.^[3]

Unless otherwise specified, tax and benefit costings relate to Great Britain. Childcare is a devolved responsibility and costings in this area apply to England alone.

Childcare

Proposal: extend the current free early education entitlement to cover the 47 weeks a year and provide an additional 10 hours per week at a heavily subsidised rate of £1 per hour.

Cost: we estimate the cost of extending the current free early education entitlement to be £2.1bn

- The 'current offer': all three and four year olds are entitled to 15 hours free early education per week, 38 weeks per year. From 2013 this will be extended to the 20% most disadvantaged two year olds and from 2014 to the 40% most disadvantaged two year olds
- Year round cover is defined as 47 weeks per year (assuming five weeks statutory leave)
- The first 15 hours per week will continue to be provided free at the point of use; the additional 10 hours will be charged at the rate of £1/hour

Scale up the existing free entitlements for 3-4 year olds

- The baseline: 570 hours per child per year at a cost of £1.9bn [2011/12, NAO figures]^[4]
- The new offer:
 - An additional 135 'free' hours per child [9 weeks at 15 hours per week]
 - An additional 470 'cheap (£1/hr)' hours [47 weeks at 10 hours per week]
- To estimate the cost of the additional free hours, we increase current spending in proportion to the additional hours to [$135/570 \times 1.9 =$] £0.45bn
- To estimate the cost of the additional 'cheap' hours we
 - (1) increase current spending in proportion to the additional hours [$470/570 \times 1.9 =$] £1.57m
 - (2) reduce this to reflect the £1/hour fee. The NAO estimates the average rate of local authority funding per entitlement hour in 2010-11 is £3.95. On this basis we assume that the cheap hours (on the basis of a £1/hour fee) can be provided at 75 per cent of the cost of the current offerThe estimated cost of these additional hours is therefore: [$1.57 \times 0.75 =$] £1.18bn
- The total cost of the proposal for 3-4 year olds is: [$1.18 + 0.45 =$] £1.63bn
- This is almost certainly an overestimate because it assumes the same level of take up as the current 15 hour offer

Scale up forthcoming free entitlements for the 40% most disadvantaged 2 year olds

- The baseline (from 2014/15) is 570 hours per child per year at a cost of £760 million in 2014/15^[5]
- The new offer:
 - An additional 135 'free' hours per child [9 weeks at 15 hours per week]
 - An additional 470 'cheap (£1/hr)' hours [47 weeks at 10 hours per week]
- To estimate the cost of the additional free hours, we increase current spending in proportion to the additional hours i.e. [$135/570 \times 0.76 =$] £0.18bn
- To estimate the cost of the additional 'cheap' hours we
 - (1) increase current spending in proportion to the additional hours i.e. $470/570 \times 0.76 =$ £0.63bn
 - (2) there are no equivalent estimates of the hourly cost of providing early education for two year olds, because this provision is yet to be rolled out nationally. As such, we discount these costs at the same rate (25%) as the 3-4 year old offer. This is probably an overestimate of the savings, because the hourly cost of childcare provision for two year olds is higher than that for 3-4 year oldsThe estimated cost of these additional hours is therefore: [$0.63 \times 0.75 =$] £0.47bn
- The total cost for the 40% most disadvantaged 2 year olds is: [$0.18 + 0.47 =$] £0.65bn

[1] UK Parliament Website (2011), "Welfare Reform Bill, Column GC464" <http://www.publications.parliament.uk/pa/ld201011/ldhansrd/text/111103-gc0001.htm> (accessed 10 October 2012) [2] Adam, S., Browne, J. and Johnson, P., (2012), "Pensioners and the tax and benefit system", Briefing Note BN130, The Institute for Fiscal Studies, London [3] Ibid [4] NAO, Delivering the free entitlement to education for three- and four-year-olds, 2012

Accounting for tax credit savings

- We would expect this policy to yield some direct savings to the Treasury as a result of the reduction in out-of-pocket childcare costs for families currently paying for more than 15 hrs of registered childcare, and claiming the childcare element of working tax credits
- We estimate that the overnight reduction in tax credit spending should yield a saving of around £163 million. This represents a reduction of around 0.54% of total tax credit spending in (£30.2bn in 2011-12).

Combined cost for 2-4 year olds: [1.63 + 0.65] – 0.16 =] £2.12bn

NICs for older workers

Proposal: raising the threshold at which those aged 55+ pay NICs to £10,000 (currently at £7,592)

Cost: the IFS estimates that the cost of raising the NICs threshold to £10,000 would be £0.8bn

This estimate was calculated using the IFS tax and benefit microsimulation model, TAXBEN, run on updated data from the 2009-10 Family Resources Survey. It ignores the likely upside for revenue of any behavioural response to the reform.

Pension tax relief

Proposal: to reduce the maximum tax-free lifetime allowance on pension savings from £1.5 million to £1 million

Revenue raised: £1.0bn -£1.5bn

The Government has published estimates of the additional revenue from reducing the lifetime allowance (LTA) from £1.8m in 2011/12 to £1.5m in 2012/13.^[6] Although the full data and assumptions underlying this calculation are not public, it is possible to extrapolate fairly robust estimates of the revenue from a further reduction to £1 million as follows:

Following HMRC, we assume that: all revenue generated comes from earned income that is diverted from tax-free pension contributions to taxable income; only those aged over 50 change their pension savings behaviour; if the LTA were to remain as it is, individual's savings rates would be constant over their remaining saving period

We estimate the following parameters:

- Number of individuals with savings between £1 – 1.5m: using the Wealth and Assets Survey we estimate there are 82,000 50-59 year olds with private pension wealth of between £1.0 - 1.5m.^[7] We exclude older savers because there is evidence that wealthy individuals tend to retire before the State Pension Age. This is likely to underestimate the total revenue raised.
- Additional revenue per person: due to the absence of public data on the distribution of pension savings, it is difficult to calculate precise estimates for revenue raised by person. Using HMRC estimates, we calculate that the average additional revenue per person from reducing the limit to £1.5m would be £12,500.^[8] If the distribution of pensions pots between £1 - 1.5m was the same as that between £1.5 - 1.8m, the revenue per person would be £18,750 to reflect the greater magnitude of the change in the allowance. The evidence suggests that the distribution of pension savings in this range is broadly the same, suggesting this is a reasonable estimate. For Defined Benefit schemes, we have built in to our estimate the approach that was taken by HMRC in modelling the revenue raised by the 2012 reduction in the lifetime allowance from £1.8m to £1.5m.

Two estimates of the additional revenue raised from reducing the LTA to £1m :

- Lower bound: using HMRC's estimate of an average per person saving of £12,500: £1.0bn
- Upper bound: using an average per person saving of £18,750 to reflect the larger change in allowance: £1.5bn

[5] <http://www.education.gov.uk/childrenandyoungpeople/earlylearningandchildcare/delivery/Free%20Entitlement%20to%20Early%20Education/b0070114/eefortwoyearolds> [6] HMRC and HMT, "Restricting pensions tax relief through existing allowances: a summary of the discussion document responses", 2010 [7] Resolution Foundation analysis using ONS' Wealth and Assets Survey 2006/08 [8] HMRC, "Restricting pensions tax relief: Reduction of the annual and lifetime allowances" Tax Information and Impact Note