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Christina Beatty
Steve Fothergill

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Sheffield Hallam University

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Key points

- *When the current welfare reforms come to full fruition they will take rather more than £1bn a year out of the Welsh economy – equivalent to £550 a year per adult of working age. This is substantially more than the GB average (£470).*

- *Within Wales, the seven main Valleys authorities are the seven hardest hit local authority areas.*

- *The Valleys as a whole can expect to lose around £430m a year as a result of welfare reform – an average of £650 per adult of working age.*

- *New figures on the impact by ward show that in the very worst affected communities – Maerdy and Pen-y-waun (in Rhondda Cynon Taff) and Gurnos (in Merthyr Tydfil) – the estimated loss is expected to average more than £1,000 a year per adult of working age.*

- *In 36 wards across the Valleys, the loss per adult of working age is estimated to be at least £800 a year.*

- *The big loss of benefit income can be expected to have knock-on consequences for consumer spending. Over time, some 3,000 jobs in consumer services might be expected to be lost in the Valleys as a result of the reforms.*

- *Although welfare reform increases the incentive to take up employment and adds to labour supply, there is little prospect in the context of a weak local economy such as the Valleys that the reforms will trigger an increase in local job opportunities.*

- *In the Valleys, and across Wales as a whole, welfare reform will remove almost four times as much, per year, as is received in EU funding for regional development.*

- *There are alternative ways of reducing public spending. 100,000 new jobs in Wales might be expected to save the UK Exchequer around £1bn a year – roughly the same as the expected saving from the present welfare reforms. Job generation on this scale would require the Welsh economy to grow by 3-3.5 per cent a year over five years – a by no means unachievable target.*

THE IMPACT OF WELFARE REFORM ON THE VALLEYS

Scope and purpose of the report

The Westminster Government is implementing welfare reforms that apply to all parts of the UK. The impact of the reforms, however, varies enormously from place to place, not least because benefit claimants are so unevenly spread across the country.

This report looks specifically at the impact of the reforms on the South Wales Valleys – one of the most deprived areas not just in Wales but across Britain as a whole. There is every reason to suppose that the communities of the Valleys are hit exceptionally hard by welfare reform. This report documents the full and disturbing scale of the impact.

The report builds on a 2013 study by the present authors[1] which documented the impact of the welfare reforms, district by district across the whole of Britain. Statistics for each local authority in Wales, drawn from the 2013 report, are presented here. The new report's distinctive contribution is that, for the first time, it drills down the impact of the reforms in the Valleys right down to the level of *electoral wards*, fully exposing the impact on local communities. The report also takes the analysis a stage further by examining the knock-on consequences for business and jobs, and asks whether an alternative strategy based on economic growth and job generation might deliver the same financial savings to the Exchequer.

The welfare reforms

The figures presented in the report cover all the major welfare reforms that have been underway in Wales since 2010. Some of these reforms are now fully in place, others are currently underway and a small number still have a long way to run before coming to full fruition.

In brief, the reforms covered by the present report are:

> ***Housing Benefit – Local Housing Allowance***
> Changes to the rules governing assistance with the cost of housing for low-income households in the private rented sector. The new rules apply to rent levels, 'excess' payments, property size, age limits for sole occupancy, and indexation for inflation.

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[1] C Beatty and S Fothergill (2013) *Hitting the Poorest Places Hardest: the local and regional impact of welfare reform*, CRESR, Sheffield Hallam University.

Housing Benefit – Under-occupation
Changes to the rules governing the size of properties for which payments are made to working age claimants in the social rented sector (widely known as the 'Bedroom Tax')

Non-dependant deductions
Increases in the deductions from Housing Benefit, Council Tax Benefit and other income-based benefits to reflect the contribution that non-dependant household members are expected to make towards the household's housing costs

Household benefit cap
New ceiling on total payments per household, applying to the sum of a wide range of benefits for working age claimants

Disability Living Allowance
Replacement of DLA by Personal Independence Payments (PIP), including more stringent and frequent medical tests, as the basis for financial support to help offset the additional costs faced by individuals with disabilities

Incapacity benefits
Replacement of Incapacity Benefit and related benefits by Employment and Support Allowance (ESA), with more stringent medical tests, greater conditionality and time-limiting of non-means tested entitlement for all but the most severely ill or disabled

Child Benefit
Three-year freeze, and withdrawal of benefit from households including a higher earner

Tax Credits
Reductions in payment rates and eligibility for Child Tax Credit and Working Tax Credit, paid to lower and middle income households

1 per cent up-rating
Reduction in annual up-rating of value of most working-age benefits

A fuller description of each of these reforms, including the timing of implementation and the expected savings to the Exchequer, can be found in the appendix to the 2013 report[2].

The vast majority of these welfare reforms have been initiated by the present Coalition government in Westminster, notably but not exclusively through the *Welfare Reform Act 2012*. Some of the incapacity benefit reforms, however, are Labour measures that pre-date the 2010 general election but are only now taking full effect. They have been included here, alongside the Coalition's reforms, to provide a comprehensive view of the impact of the reforms that are currently underway.

[2] C Beatty and S Fothergill (2013) op.cit.

The Westminster Government's welfare reform agenda is actually somewhat wider than even the long list of changes listed above, but there are sound reasons for not including four remaining elements in the analysis resented here:

- *Universal Credit*. This is scheduled to replace just about all means-tested working age benefits and is arguably the most ambitious reform of all. The introduction of Universal Credit is however distinctly different from the other reforms. Unlike the others, it is not expected to lead directly to a reduction in welfare spending and is better understood as a repackaging of existing benefits that for the first time introduces a consistent withdrawal rate, but the rules governing eligibility are essentially carried over from the existing benefits it replaces.

- *Council Tax Benefit*. The Welsh Government has chosen not to pass on to claimants the Westminster Government's 10 per cent cut in the value of Council Tax Benefit payments.[3]

- *Income Support for lone parents*. The qualifying age of the youngest child has been reduced from under 7 to under 5. The effect is to transfer the lone parent from Income Support to Jobseeker's Allowance at the same payment rate.

- *RPI to CPI for benefits up-rating*. This was introduced from 2011-12 but is really part of a much wider accounting reform, including for example all public service pensions.

When fully implemented, the welfare reforms covered in this report are expected to save the UK Treasury almost £19bn a year.

Measuring the financial losses

The data sources and methods underpinning the estimates of the financial losses arising from welfare reform are set out in full in the appendix to the 2013 report[4]. Full details of the methods for extending the estimates down to ward level are included in a follow-on report[5]

The starting point is the Treasury's own estimates of the overall financial saving arising from each element of the reforms, published in the *Budget* or in the government's *Autumn Statement*. All estimates in the report are fully consistent with these Treasury figures[6]. The allocation to local authorities and wards is then driven principally by data on claimant numbers and expenditure, published by DWP and HMRC. Where appropriate, the allocation is also informed by the *Impact Assessments* that Westminster departments publish for each element of the reforms. Additional official statistics on earnings are deployed to help

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[3] The reductions in Council Tax Benefit are included in the comparative figures for Great Britain as a whole and for the parts of GB where they have been implemented.
[4] C Beatty and S Fothergill (2013) op.cit.
[5] C Beatty and S Fothergill (2014) *The Local Impact of Welfare Reform*, Scottish Parliament, Edinburgh.
[6] The GB-wide estimates of the impact of the reforms to incapacity benefits, DLA and Council Tax Benefit, the Household Cap and the 'Bedroom Tax' are subject to further detailed adjustment – see appendix to Beatty and Fothergill (2013).

calibrate the impact of the withdrawal of Child Benefit from higher earners, and DWP evidence from pilot schemes helps inform the estimates of the impact of incapacity and disability benefit reforms.

The figures the report presents show the impact *when the reforms have come into full effect*. This is important because some of the reforms, particularly those affecting incapacity and disability benefits, are being implemented in stages over a number of years. In most cases, the figures show the expected impact in the 2014-15 financial year[7].

In comparing the impact on different areas, the report looks in particular at the financial loss *per adult of working age*[8]. A focus on adults of working age (16-64) is appropriate because the welfare reforms impact almost exclusively on this group. By contrast, benefit claimants of pensionable age are largely unaffected[9].

Some of the welfare reforms focus on *households* – the reforms to Housing Benefit for example. Others – the reforms to incapacity benefits for example – are about the entitlement of *individuals*. Additionally, several of the reforms impact simultaneously on the same households and/or individuals. It is possible to estimate how many people are affected by each element of the reforms, and how much they lose. The financial losses can be added together but to avoid counting the same people twice the number of households/individuals affected cannot be summed to an overall total.

Finally, in estimating the impact of the welfare reforms the report *holds all other factors constant*. What this means in practice is that it makes no assumptions about the growth of the UK and Welsh economies, or about future levels of employment and unemployment.

In February 2014 the Welsh Government published its own estimates of the impact of the reforms by local authority[10]. In broad terms, the Welsh Government's estimates deploy the methods used here and in our 2013 report. In detail, the estimates differ. This is mainly because the Welsh Government's figures only cover the reforms introduced by the present Coalition government in Westminster whereas the figures presented here (and in our 2013 report) include the reforms to incapacity benefits initiated by Labour before 2010 but only now coming to fruition at the same time as the Coalition's reform. The Welsh Government's estimates also include the impact of the change from RPI to CPI updating for inflation, which we treat as a wider change in public sector accounting rules rather a welfare reform.

The Welsh Government's estimates of the overall impact of the reforms, on Wales as a whole and on its constituent local authorities, are not fundamentally different from those presented here and the relevant differences are footnoted. However, the Welsh

[7] The exceptions are the DLA reforms, which will not impact fully until 2017-18, and the wider application of means testing to ESA and the 1 per cent up-rating, both of which do not impact fully until 2015-16.
[8] From the 2011 Census of Population.
[9] The main exceptions are a small minority (around 5%) of Housing Benefit recipients in the private rented sector, affected by the reforms to Local Housing Allowance, and a small number of adults of pensionable age who receive Child Benefit.
[10] Welsh Government (2014) *Analysing the impact of the UK Government's welfare reforms in Wales – Stage 3 analysis, Part 2: Impacts in local authority areas*, Welsh Government, Cardiff.

Government has not produced estimates at the ward or neighbourhood level, so the figures here are entirely new.

The impact on Wales as a whole

To provide a context for the local figures on the Valleys, Table 1 shows the estimated impact of the welfare reforms on Wales as a whole. These figures are taken from the 2013 report but have been up-dated to incorporate new data on the household benefit cap and the impact of the 'Bedroom Tax', so in detail they differ a little from those previously published[11]

Overall, when the reforms have come into full effect it is estimated that they will take more than £1bn a year out of the Welsh economy, or £550 a year for every adult of working age[12].

The individual reforms vary greatly in the scale of their impact, in the number of individuals or households affected, and in the intensity of the financial loss imposed on those affected. In Wales, and indeed in the rest of the UK, the biggest financial impact comes from the reform of incapacity benefits – an estimated loss in Wales of £320m a year. Changes to Tax Credits and the 1 per cent up-rating of most working-age benefits from April 2013 also account for substantial sums - £200m and £190m respectively.

Child Benefit changes affect the largest number of households. This is because the three-year freeze in Child Benefit rates up to April 2014 (instead of up-rating with inflation) impacted on all recipients.

The household benefit cap, by contrast, impacts on relatively few households in Wales – just 1,200 according to the latest figures – but the average financial loss for each of these households is relatively large.

As the 2013 report noted, the overall scale of the financial loss in Wales - £550 per adult of working age per year – is substantially above the GB average (£470). Wales is hit far harder than South East England (£370), harder than Scotland (£480) and only marginally less than the North East and North West of England (£560)[13].

It should not escape note, however, that the impact in Wales would have been somewhat higher if the Welsh Government had not avoided passing on the Westminster Government's 10 per cent cut in funding for Council Tax Benefit. The financial burden of this particular welfare reform is being borne by public sector budgets in Wales rather than by benefit claimants.

[11] The figures also take more accurate account of DLA claimants who experience a partial loss of benefit as a result of the changeover to PIP.
[12] The comparable estimates by the Welsh Government, covering a slightly different list of reforms, are £900m p.a. and £500 per adult of working age p.a..
[13] The figures quoted here for GB, the South East, Scotland, the North East and North West are from the 2013 report have not been revised to take account of new data on the impact of the 'Bedroom Tax' and household benefit cap.

Table 1: Impact of welfare reform on Wales

	No of h'holds/individuals adversely affected	Estimated loss £m p.a.	Average loss per affected h'hold/indiv £ p.a.	No. of h'holds/indiv affected per 10,000	Loss per working age adult £ p.a.
Incapacity benefits[(1)(3)]	93,000	320	3,450	480	165
Tax Credits	250,000	200	800	1,900	105
1 per cent uprating[(3)]	n.a.	190	n.a.	n.a.	100
Child Benefit	370,000	130	350	2,860	65
Disability Living Allowance[(1)(2)]	66,000	100	1,550	340	55
Housing Benefit: LHA	70,000	70	1,000	540	35
Housing Benefit: 'Bedroom Tax'	35,000	20	600	270	10
Non-dependant deductions	16,000	20	1,250	120	10
Household benefit cap	1,200	6	4,600	<10	<5
Total	**n.a.**	**1,060**	**n.a.**	**n.a.**	**550**

[(1)] Individuals affected; all other data refers to households
[(2)] By 2017/18
[(3)] By 2015/16
All other impacts by 2014-15

Source: Sheffield Hallam estimates based on official data

The impact by local authority across Wales

Table 2 shows the estimated financial loss by local authority within Wales. The figures for the worst-affected Welsh authorities were first included in the 2013 report; the remainder were released on-line. As with the figures for Wales as a whole, the estimates here have all been up-dated.

Table 2: Overall impact of welfare reform by local authority

	Estimated loss £m p.a.	**Loss per working age adult £ p.a.**
Merthyr Tydfil	27	720
Blaenau Gwent	31	700
Neath Port Talbot	62	690
Rhondda Cynon Taf	100	670
Caerphilly	73	640
Bridgend	53	600
Torfaen	34	590
Denbighshire	33	590
Carmarthenshire	65	580
Newport	52	560
Swansea	86	560
Conwy	36	550
Pembrokeshire	39	540
Anglesey	22	510
Wrexham	44	510
Vale of Glamorgan	73	470
Cardiff	112	470
Flintshire	44	450
Gwynedd	33	440
Powys	34	430
Ceredigion	21	430
Monmouthshire	22	390
Wales	**1,060**	**550**

All impacts by 2014-15 except DLA by 2017/18, incapacity benefits and 1% up-rating by 2015/16

Source: Sheffield Hallam estimates based on official data

What is striking in this list is the extent to which the South Wales Valleys authorities are so hard-hit. The top seven authorities in Wales, in terms of the loss per adult of working age, all cover the Valleys. This is a pattern highlighted in our 2013 report and confirmed by the Welsh Government's own estimates[14]. The biggest single impact falls on Merthyr Tydfil – an estimated loss of £720 a year per adult of working age[15]. Blaenau Gwent, Neath Port Talbot, Rhondda Cynon Taf, Caerphilly, Bridgend and Torfaen are all not far behind.

By contrast, Monmouthshire and Ceredigion, for example, escape relatively lightly with estimated financial losses, per adult of working age, little more than half the level in the worst-hit authorities in the Valleys.

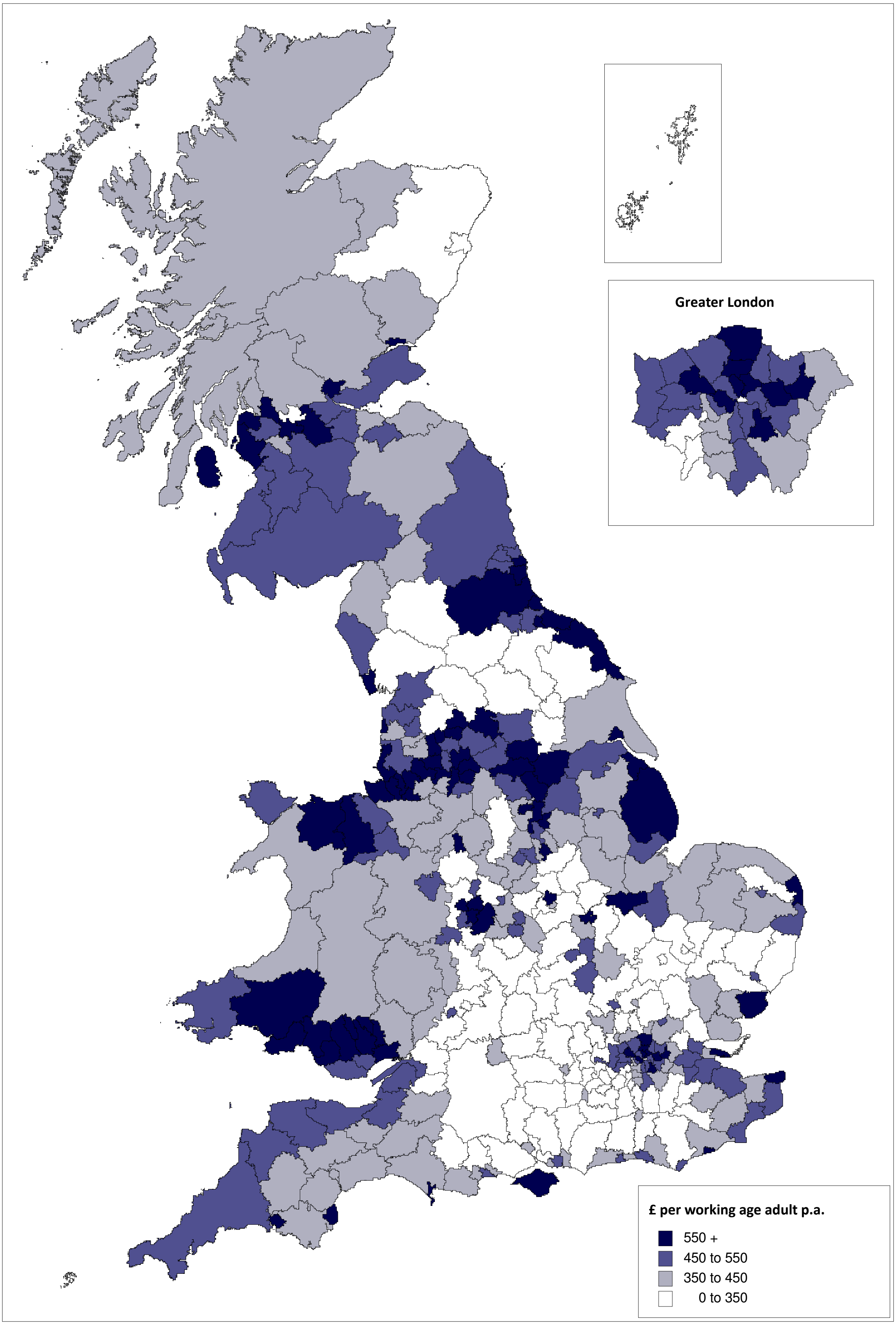
In terms of the absolute sums lost, Cardiff's large population inevitably put it at the head of the list and Swansea comes high up for the same reason. But this does not detract from the observation that in terms of the *intensity* of the financial hit from welfare reform, the Valleys authorities fare worst.

There are no surprises in this geography. It is to be expected that welfare reforms will hit hardest in the places where welfare claimants are concentrated, which tend to be in the poorest areas with the highest rates of worklessness. The South Wales Valleys fit this description as much as anywhere in Britain. In particular, they have long had some of the very highest incapacity and disability claimant rates across the whole of Britain, which makes them especially vulnerable to the major reforms to these benefits. The reforms to incapacity benefits, it is worth underlining, make up the largest single element of the welfare reform package in terms of the anticipated savings to the Exchequer.

To emphasise the point that the Valleys are especially hard hit by welfare reform, Figure 1 shows the financial loss per adult of working age across all GB local authority districts. This map is taken from the 2013 report[16] and shows that the starkest contrast is not with other parts of Wales but with much of southern England outside London. In parts of Surrey, Berkshire, Hampshire, Oxfordshire and Buckinghamshire, and a few other places besides, the financial loss per adult of working age is estimated to be barely more than a third of the level in the Valleys.

[14] Welsh Government (2014) op.cit.
[15] The Welsh Government's estimates, for a slightly different list of welfare reforms, puts the figure for Merthyr Tydfil at £580 per adult of working age p.a., just behind Blaenau Gwent (£585) and Neath Port Talbot (£606). The lower figures from the Welsh Government for these and a number other authorities reflect in particular the omission of the incapacity benefit reforms initiated before 2010, which have an especially large impact in these areas.
[16] The estimates here have not been revised.

Figure 1: Overall financial loss arising from welfare reform, by local authority



Source: Sheffield Hallam estimates based on official data

The impact in the Valleys

For the sake of simplicity, 'the Valleys' are defined here as comprising the seven main Valleys authorities[17] – from east to west, Torfaen, Blaenau Gwent, Caerphilly, Merthyr Tydfil, Rhondda Cynon Taf, Bridgend and Neath Port Talbot – plus adjacent parts of Carmarthenshire, Swansea and Powys (in the Ystradgynlais area) that share the same geography and historical connection to the coal industry. The Valleys, as defined here, have:

- A total population of 1,040,000 (34 per cent of Wales as a whole)[18]
- A working age (16-64) population of 660,000 (also 34 per cent of Wales as a whole)[19]
- A total of 108,000 out-of-work benefit claimants, which represents a claimant rate of 16.3 per cent (Wales average: 13.3)[20]
- A grand total of 135,000 benefit claimants of working age, including those in work, which represents a claimant rate of 20.4 per cent (Wales average: 16.7)[21]

Table 3 shows the financial loss arising from welfare reform across the Valleys as a whole. When the reforms have come to full fruition, the total loss in the Valleys is estimated to be £430m a year. This equates to £650 a year for every adult of working age living in the Valleys (including non-claimants). This financial 'hit' is £100 a year greater than the average across Wales, confirming that the Valleys – a relatively poor area – are hit especially hard by welfare reform.

By far the largest financial loss in the Valleys - £150m a year – arises from the reforms to incapacity benefits. As noted earlier, the incapacity benefit reforms include measures initiated by Labour, notably the new medical test (the Work Capability Assessment), and the Coalition's own time-limiting of non-means tested entitlement for all but the most severely ill or disabled. Time-limiting kicks in twelve months after the medical test, and re-testing of existing claimants is still not completed, so with much of the impact of time-limiting is still to be felt.

Other major sources of financial loss in the Valleys include reductions in Tax Credits and below-inflation uprating of the main working-age benefits. The reforms to Disability Living Allowance also account for large sums – and often the impact will be on the same people who are losing out from the reforms to incapacity benefits.

[17] Including the parts of Bridgend and Neath Port Talbot that lie outside the Valleys
[18] 2011 Census of Population
[19] 2011 Census of Population
[20] DWP, November 2013. Out-of-work benefit claimants include all claimants of JSA, IB/ESA and Income Support as a lone parent.
[21] DWP, November 2013. In-work benefit claimants include those in receipt of Housing Benefit and DLA but exclude those in receipt of Tax Credits.

Table 3: Impact of welfare reform on the Valleys

	No of h'holds/individuals adversely affected	Estimated loss £m p.a.	Loss per working age adult £ p.a.
Incapacity benefits(1)(3)	43,000	150	225
Tax Credits	91,000	75	110
1 per cent uprating(3)	n.a.	75	110
Child Benefit	135,000	45	70
Disability Living Allowance(1)(2)	28,000	45	70
Housing Benefit: LHA	25,000	20	30
Housing Benefit: 'Bedroom Tax'	15,000	10	15
Non-dependant deductions	6,000	7	10
Household benefit cap	400	2	<5
Total	**n.a.**	**430**	**650**

(1) Individuals affected; all other data refers to households
(2) By 2017/18
(3) By 2015/16
All other impacts by 2014-15

Source: Sheffield Hallam estimates based on official data

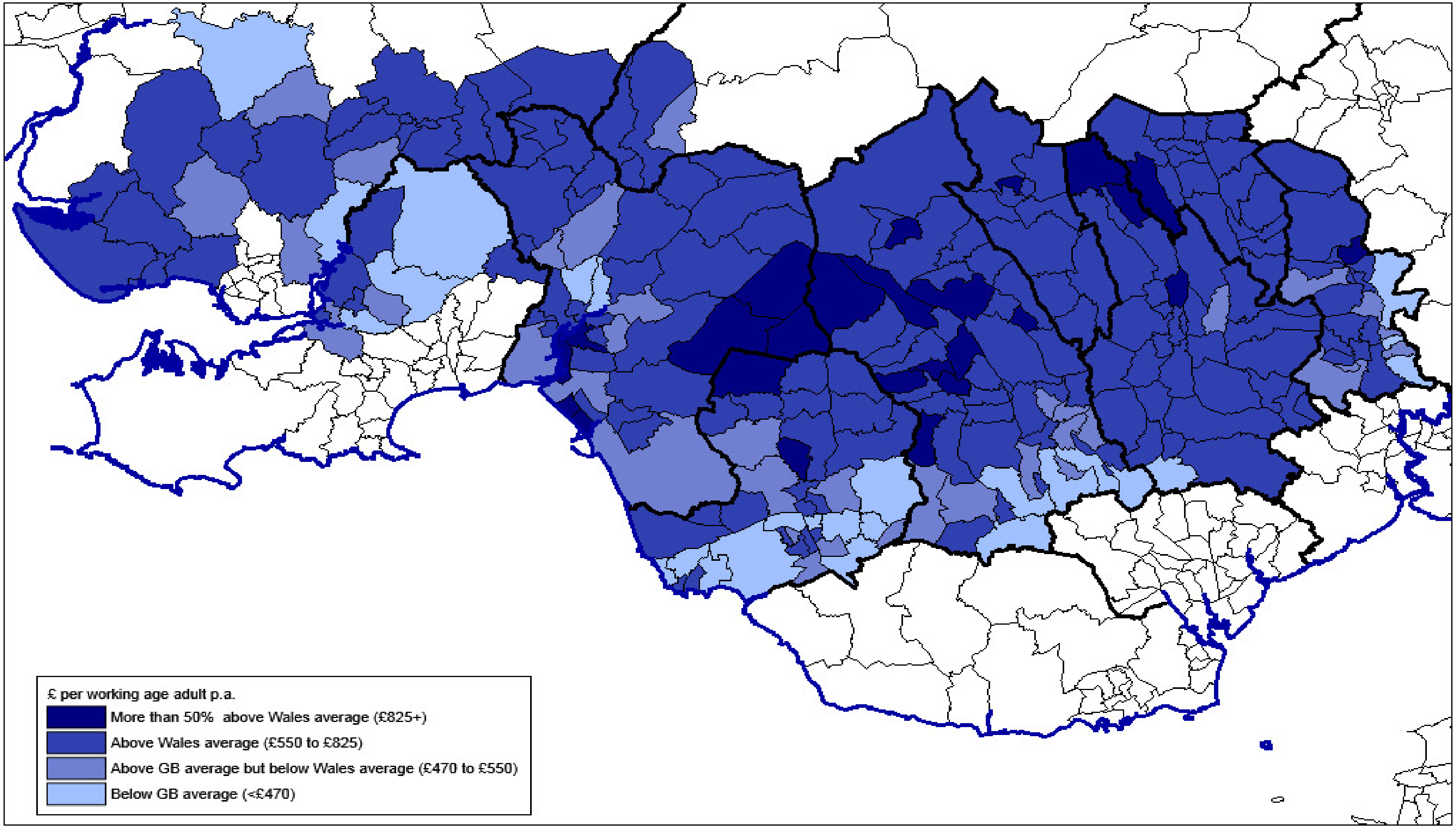
The estimated financial loss in the Valleys, by ward, is mapped in Figure 2. The figures for each ward are listed in the Appendix. These ward-level estimates are wholly new[22].

Across the Valleys as a whole there is variation from place to place. To a significant extent reflects residential segregation between 'richer' and 'poorer' neighbourhoods. As elsewhere in Britain, the welfare reforms impact most on the poorest areas[23]. In the Valleys, the poorest neighbourhoods tend to comprise older terraces or social housing.

But in addition there is a discernible pattern whereby many of the wards towards the heads of the Valleys are hit harder by the reforms than some of those nearer Cardiff and the M4 corridor. This is a familiar pattern, rooted in the divergence in economic trends between the coast and the Valleys. Job growth in Cardiff (in particular) has opened up commuting opportunities for residents in the lower parts of the Valleys but much less so for those living further up the Valleys. Worklessness and deprivation has become especially concentrated in the upper parts of the Valleys, and these are often the areas then hit hardest by welfare reform.

[22] The ward level estimates are subject to a greater margin of error than the local authority figures. This is principally because in Wales the match between Lower Super Output Areas (the main unit for which official statistics are available) and wards is imperfect. The estimates here apply a 'best fit' approach.
[23] See comparisons with the Indices of Deprivation in C Beatty and S Fothergill (2013) op.cit.

Figure 2: Financial loss arising from welfare reform, Valleys wards



Source: Sheffield Hallam estimates based on official data; contains National Statistics data © Crown copyright and database right 2013

Table 4: Valleys wards with the highest financial loss arising from welfare reform – Top 40

Authority	Ward	Overall financial loss per adult of working age £ per year
Rhondda Cynon Taf	Maerdy	1,050
Rhondda Cynon Taf	Pen-y-waun	1,040
Merthyr Tydfil	Gurnos	1,010
Neath Port Talbot	Gwynfi	940
Neath Port Talbot	Cymmer	930
Caerphilly	Twyn Carno	930
Neath Port Talbot	Neath East	930
Bridgend	Bettws	920
Rhondda Cynon Taf	Penrhiwceiber	920
Bridgend	Caerau	920
Rhondda Cynon Taf	Tylorstown	910
Neath Port Talbot	Sandfields West	910
Neath Port Talbot	Briton Ferry West	890
Rhondda Cynon Taf	Gilfach Goch	870
Rhondda Cynon Taf	Treherbert	850
Rhondda Cynon Taf	Aberaman South	850
Torfaen	Trevethin	850
Caerphilly	Moriah	850
Neath Port Talbot	Glyncorrwg	840
Neath Port Talbot	Sandfields East	840
Caerphilly	Aberbargoed	840
Rhondda Cynon Taf	Cwm Clydach	830
Blaenau Gwent	Tredegar Central and West	830
Rhondda Cynon Taf	Trealaw	830
Rhondda Cynon Taf	Llwyn-y-pia	830
Caerphilly	Bargoed	820
Rhondda Cynon Taf	Mountain Ash West	820
Rhondda Cynon Taf	Cymmer	820
Neath Port Talbot	Neath North	810
Neath Port Talbot	Aberavon	810
Merthyr Tydfil	Penydarren	800
Cearphilly	Pontlottyn	800
Caerphilly	New Tredegar	800
Merthyr Tydfil	Merthyr Vale	800
Neath Port Talbot	Ystalyfera	800
Rhondda Cynon Taf	Glyncoch	800
Rhondda Cynon Taf	Ynyshir	790
Carmarthenshire	Ammanford	790
Blaenau Gwent	Nantyglo	790
Caerphilly	St James	790

Source: Sheffield Hallam estimates based on official data

Strikingly, every ward in Merthyr Tydfil and every ward in Blaenau Gwent – both authorities towards the upper end of the Valleys – can expect financial losses from welfare reform that are above the average for Wales.

Table 4 lists the 40 wards in the Valleys facing the greatest financial loss per adult of working age. One of the shocking statistics here is that three wards – Maerdy and Pen-y-waun (both in Rhondda Cynon Taff) and Gurnos (in Merthyr Tydfil) – face a loss of more than £1,000 a year per adult of working age. This is a loss averaged across the *whole population* of these wards, including non-claimants, Some of the loss will have already occurred but in mid-2014 a substantial portion, including a large part of the impact of incapacity benefit reform and most of the impact of DLA reform, is still in the pipeline.

In no fewer than 36 wards across the Valleys, the financial loss is estimated to be at least £800 a year per adult of working age.

The knock-on consequences for employment

The loss of income arising from welfare reform can be expected to have a negative impact on employment, especially in the areas (like the Valleys) where the reduction in average income is large. Many jobs are supported by consumer spending: if spending falls, job loss will normally follow. Estimating the scale of these knock-on consequences is not straightforward. In the context of the Valleys a number of steps required.

The starting point is the reduction in household disposable income. The estimate published by the Welsh Government is that in 2015/16, when most of the welfare reforms are nearing fruition, total disposable household income in Wales will be around £45bn[24]. The estimate in this report is that across Wales as a whole the loss of income arising from welfare reform is £1,060m a year. Putting the two figures together indicates that:

- **Welfare reform can be expected to reduce household disposable income in Wales as a whole by around 2.4 per cent**

This reduction in income does not of course fall equally on all households and individuals. Some will be hit much harder than other. The reduction of 2.4 per cent is an average across the whole population.

The Valleys, however, are hit harder than Wales as a whole – the estimates presented earlier indicated that, per adult of working age, the financial loss in the Valleys is 18 per cent above the Wales average. Additionally, average incomes are somewhat lower in the Valleys, even before the impact of the welfare reforms. With these points in mind:

- **In the Valleys, the reduction in household disposable income can be expected to be around 3 per cent.**

[24] Welsh Government (2014) op.cit.

Again, this figure is an average across the whole population. Some Valley residents are hit much harder than others.

The next issue is whether a reduction in *income* of this magnitude leads to a commensurate reduction in *spending* – the alternative is that households save less, take on more debt or draw down savings to sustain expenditure. In practice, most of the households adversely affected by welfare reform are towards the lower and middle part of the income spectrum[25]. It is reasonable to expect, therefore, that the reduction in income will be more or less fully passed through to a reduction in spending.

Household spending goes on a wide range of goods and services – food, housing, utility bills, transport, leisure and entertainment, clothing, holidays, etc. Some of this spending leaks straight out of the local economy; other elements support local jobs in shops and consumer services. Without knowing exactly how households adjust their spending in response to lower of income it is difficult to predict the reduction in spending under each heading. A reasonable assumption is that the fall in spending that supports jobs in the local economy (in shops for example) will, in percentage terms, be at least as great as the reduction in income.

In the Valleys there is a further complication because a proportion of residents' retail and leisure spending takes place in Cardiff, Swansea and Newport. However, among the poorer groups hit most by welfare cost, it is reasonable to assume that a higher proportion of spending occurs locally because, for poorer households, travel is less affordable. Accordingly, the reduction in consumer spending in the Valleys themselves, in local shops and businesses, is likely to be larger than the average reduction in income. A reasonable conclusion would therefore be that:

- **As a result of welfare reform, consumer spending in the Valleys might be expected to fall by around 4 per cent.**

The most recent official data[26], for 2012, shows that in the Valleys (as defined here) there were 68,000 jobs in the seven main sectors supported by local consumer spending[27]. This figure excludes the self-employed. These jobs accounted for 21 per cent of all the employee jobs located in the Valleys. Following the logic above, if employment in these sectors in the Valleys falls in line with the reduction in consumer spending:

- **A knock-on consequence of welfare reform is likely to be the loss of around 2,700 jobs (or perhaps around 3,000 including the self-employed) in consumer services in the Valleys.**

[25] The notable exception is the withdrawal of Child Benefit from higher earners.
[26] Business Register and Employment Survey
[27] Motor trade (45), Retailing (47), Food and beverage services (56), Gambling and betting (92), Sports and recreation (93), Repair of household goods (95), Other personal services (96). Numbers in brackets refer to industry codes in the 2007 Standard Industrial Classification.

In practice, this job loss is likely to be neither swift nor automatic. In the short run, lower revenue may lead to lower profits, and incomes rather than jobs will feel the squeeze. By 2014 some of the job loss may already have occurred, bearing in mind that welfare reform has now been underway for some while. Conversely, some of the biggest impacts on incomes in the Valleys, arising from the reforms to incapacity and disability benefits, are still in the pipeline. There can be no doubt, however, that the knock-on consequences of welfare reform will add a further twist to the already serious problem of town centre decline and vacant commercial property across much of the Valleys.

Similar arithmetic can be applied to Wales as a whole. If the expected reduction in household disposable income across Wales – 2.4 per cent – is translated into a similar proportional fall in employment in consumer services (currently just under 260,000) around 6,000 employee jobs are likely to be lost, or perhaps 7,000 jobs including the self-employed. What should not escape note here is that almost half this job loss can be expected to be in the Valleys.

The prospects for recovery

Westminster ministers take the view that the welfare reforms will increase the financial incentives to take up employment and because more people will look for work more people will find work. In this view, employment will be higher and the loss of benefit income will be offset by an increase in earnings.

There is no question that the welfare reforms increase the financial incentive to work. On the other hand, even before the reforms began most out-of-work claimants would have been financially better off in work. Financial disincentives only came into play for relatively small numbers at specific cut-off points in the system. It is these cut-offs that Universal Credit is intended to address by ensuring that claimants are financially better off in work in all circumstances.

Additionally, it is worth remembering that several of the welfare reforms – the changes to Tax Credits, to Child Benefit and Housing Benefit for example – impact extensively on those who are already in employment. Many of those in employment are unlikely to be able to increase their working hours to offset the loss of income. Relatively few employers can offer this flexibility.

Westminster ministers' view of the way the labour market will adjust assumes, crucially, that extra labour supply leads to extra labour demand from employers. Whether labour markets really do work in this way is deeply questionable. Taking the very long view – over decades – the forces of demand and supply do certainly lead to adjustments in wage levels, and when wages fall in response to extra labour supply it adds to firms' competitiveness and encourages extra employment. There are also specific times and places where a shortage of labour can bottle-up economic growth – parts of southern England before the 2008 recession are perhaps an example.

But at times of low growth, or in places where the local economy is relatively weak and already has a substantial pool of unemployed labour, the likelihood of an increase in labour supply triggering an increase in employment is low. Some individuals will undoubtedly find work to compensate for the loss of benefit income but whether the *overall* level of employment will be any higher as a result is questionable. More often than not, they will simply fill vacancies that would have gone to other jobseekers.

The key problem here for the Valleys is that, as much as anywhere in Britain, they fit the model of a 'weak local economy' with a 'substantial pool of unemployed labour'. In the Valleys, any additional labour market engagement as a result of welfare reform is most unlikely to result in a higher overall level of employment.

There is an additional complication. In the Valleys, and elsewhere, worklessness on benefit has mostly come to rest with those least able to secure and maintain a foothold in the labour market – men and women with health problems or disabilities, those with few formal qualifications, low-grade manual work experience and, very often, those towards the latter part of their working lives. The very large numbers of incapacity claimants in the Valleys fit this model very well. In a competitive labour market these men and women, who often face the full impact of welfare reform, are rarely employers' first choice. The welfare reforms are not set to deliver an expanded workforce of computer programmers, doctors, trained engineers or electricians. A prudent assumption would therefore be that:

- **In the context of the South Wales Valleys, welfare reform is most unlikely to result in higher employment levels.**

Comparisons between the financial loss arising from welfare reform and the regional development funding coming to the Valleys from the European Union underline the scale of the problem. One of the compensations for being a less prosperous region is that West Wales & the Valleys has retained entitlement to the highest level of regional aid from the EU. Over the period 2014-20 this EU aid is worth just over €2bn, or around £1.6bn at the current exchange rate. Averaged over the spending round, the EU funding is worth around £230m a year. The Valleys (as defined here) account for just over half the population in this wider area and if they receive a proportional share of the EU funding they might expect around £120m a year.

This major flow of funding for economic development has rightly been welcomed. Across Wales as a whole (including East Wales) the funding from the EU is worth around £275m a year.

However, as the figures presented earlier showed, the estimated financial loss arising from welfare reform, once the reforms have come to full fruition, is £1,060m a year. In the Valleys the estimated loss is £430m a year. What this means is that:

- **In the Valleys, and across Wales as a whole, welfare reform will remove almost four times as much, per year, as is received in EU regional aid.**

A better way forward

If the welfare reforms cannot be expected to raise employment, at least not in places such as the Valleys and probably across much of the rest of Wales as well, their remaining justification – arguably the most important all along – is that they save the Exchequer money and help reduce the budget deficit.

But if the aim is to reduce spending on welfare, lowering the financial value of benefits and introducing new restrictions on eligibility is not the only way. Economic growth and the creation of new jobs also have the potential to reduce spending on welfare.

To illustrate this point, Table 5 presents a simple calculation. This shows the financial savings to the Exchequer of creating 100,000 new jobs in Wales. A broadly similar calculation, on which the present figures are based, was included in an earlier report on the Welsh labour market[28] to illustrate the financial savings arising from a job creation programme.

Table 5: Estimated annual financial saving to UK Exchequer of 100,000 new jobs in Wales

		£m
	Savings on out-of-work benefits	500
Plus	Savings on Housing Benefit	200
Plus	Savings on Council Tax Benefit	50
Plus	Income tax revenue	200
Plus	Employees NI contribution	80
Less	Tax Credits	30
Equals	**NET SAVING TO EXCHEQUER**	1,000

Source: Sheffield Hallam estimates

The figures in Table 5 assume that the creation of 100,000 new jobs in Wales leads to a commensurate reduction in out-of-work benefit claimant numbers. In practice the new jobs themselves would not all go to men and women coming off benefit – many would be filled by people moving from existing jobs – but by creating 'vacancy chains' the new employment opportunities might eventually be expected to feed through to lower numbers on benefits[29]. The savings to the Exchequer on out-of-work benefits would be complemented by further savings in Housing Benefit and Council Tax Benefit. The figures in Table 5 assume that average earnings in the new jobs are around £20,000 a year – rather less than average

[28] C Beatty and S Fothergill (2011) *Tackling Worklessness in Wales*, Industrial Communities Alliance, Barnsley.

[29] This assumes of course no sharp increase in alternative source of labour supply, such as migrant workers or more over-65s remaining in work.

earnings across the economy as a whole – allowing an estimate of the additional tax revenue and, offsetting this, spending on Tax Credits.

The figures in Table 5 should be regarded as no more than approximate, but they illustrate the point that an additional 100,000 jobs in Wales might be expected to save the UK Exchequer around £1bn a year.

The significance of this calculation is that in Wales the welfare reforms are estimated to save the Exchequer a broadly similar sum – an estimated £1,060m a year according to the figures presented earlier. Or to put this another way, in Wales an alternative to welfare reform with much the same effect on UK public finances, would be to generate 100,000 new jobs.

An increase of 100,000 jobs in Wales would require an increase in employment in Wales of a little over 7 per cent[30]. Labour productivity in the UK normally tends to increase by around 2 per cent a year (though it has grown considerably more slowly since 2008) so to deliver an increase in employment of 7 per cent over a five year period the Welsh economy would need to grow by 1-1.5 per cent a year faster than productivity – a growth rate of 3-3.5 per cent a year. This is by no means an unachievable target.

It is not the purpose of the report to set out an agenda for delivering higher growth and higher employment in Wales but it is worth logging some of the potential ways forward:

- Sustaining a high rate of growth in the UK economy by maintaining a competitive exchange rate and low interest rates, avoiding over-rapid deficit reduction, and by interventions to foster investment in skills and equipment

- Rebalancing the UK economy away from an over-reliance on consumer spending and debt and towards manufacturing and exports in order to provide a more sustainable basis for growth

- Rebalancing the economy away from a dependence on London in favour of the regions, including Wales

- Providing financial support to businesses to promote investment and to create and protect jobs. In the Valleys, EU State Aid rules allow far more generous support than almost anywhere in Britain.

- Using the full range of tools available to government to promote growth and jobs, including public procurement and investment in infrastructure

- Delivering a job creation programme to boost employment levels in the weakest local economies

[30] The official statistics for February to April 2014 show that the total number of people in work in Wales stands at 1,373,000.

- Refashioning welfare-to-work programmes to deliver investment in skills for the out-of work and address health barriers to working

The point here is that there is an alternative to welfare reform – economic growth and job generation – that has the potential to deliver the same financial savings.

Jobs Growth Wales is a good example of what can be achieved. The scheme provides job opportunities for unemployed 16-24 year olds for a six month period, paid at or above the national minimum wage. The jobs are required to be additional to positions that would anyway be filled. Welsh Government data[31] shows that by August 2014 the scheme had generated more than 15,000 job opportunities, of which almost 12,000 had been filled.

Concluding remarks

Wales in general, and the Valleys in particular, have not been singled out to be the targets of welfare reform. But policies initiated in Westminster often have very different impacts in different places, and welfare reform is no exception.

What the evidence in this report shows is that Wales is hit harder than average by welfare reform, and the Valleys are hit exceptionally hard. Within the Valleys, there are some communities where the average financial loss is estimated to be £1,000 a year per adult of working age.

Loss of income on this scale hurts. It also has knock-on consequences for local spending and local employment. The estimate here is that in the Valleys perhaps 3,000 jobs in consumer services might disappear as a result. There is also little prospect in weak local economies with high levels of worklessness that welfare reform will trigger a spontaneous expansion of local job opportunities.

Over the years, public policy has often worked hard to try to even up the life chances of people living in different parts of the country. The South Wales Valleys, long afflicted by the loss of jobs in coal, steel and manufacturing, have been the target of many regeneration efforts, some more successful than others. Welfare reform unequivocally works in the opposite direction: the poor will become poorer, and the poorest areas will fall further behind.

[31] Welsh Government, statistical release 28 August 2014

APPENDIX: Estimated financial loss arising from welfare reform, by ward

	Loss per working age adult £ p.a.		Loss per working age adult £ p.a.
Blaenau Gwent		**Caerphilly**	
Abertillery	690	Aber Valley	720
Badminton	570	Aberbargoed	840
Beaufort	640	Abercarn	590
Blaina	710	Argoed	730
Brynmawr	640	Bargoed	820
Cwm	630	Bedwas	600
Cwmtillery	740	Blackwood	550
Ebbw Vale North	720	Cefn Fforest	730
Ebbw Vale South	650	Crosskeys	600
Georgetown	630	Crumlin	560
Llanhilleth	740	Darren Valley	710
Nantyglo	790	Gilfach	700
Rassau	670	Hengoed	780
Sirhowy	730	Llanbradach	590
SixBells	640	Maesycwmmer	550
Tredegar Central & West	830	Morgan Jones	600
Bridgend		Moriah	850
Aberkenfig	520	Nelson	570
Bettws	920	New Tredegar	800
Blackmill	750	Newbridge	620
Blaengarw	690	Pengam	720
Brackla	510	Penmaen	490
Bryncethin	510	Penyrheol	620
Bryncoch	630	Pontllanfraith	620
Bryntirion	460	Pontlottyn	800
Caerau	920	Risca East	580
Cefn Cribwr	600	Risca West	580
Cefn Glas	500	St. Cattwg	660
Coity	350	St. James	780
Cornelly	680	St. Martins	420
Coychurch Lower	380	Twyn Carno	930
Felindre	510	Ynysddu	570
Hendre	450	Ystrad Mynach	560
Litchard	360	**Carmarthenshire**	
Llangeinor	580	Ammanford	790
Llangewydd and Brynhyfryd	580	Betws	560
Llangynwyd	530	Burry Port	700
Maesteg East	740	Garnant	690
Maesteg West	710	Glanamman	700
Morfa	740	Glyn	540
Nant-y-moel	710	Gorslas	540
Newcastle	570	Hendy	440
Newton	420	Hengoed	590
Nottage	410	Kidwelly	670
Ogmore Vale	680	Llanddarog	410
Oldcastle	500	Llandybie	560
Pendre	600	Llangennech	540
Penprysg	460	Llangyndeyrn	630
Pen-y-fai	410	Llannon	580
Pontycymmer	720	Pembrey	630
Porthcawl East Central	780	Penygroes	570
Porthcawl West Central	710	Pontamman	610
Pyle	660	Pontyberem	560
Rest Bay	380	Quarter Bach	650
Sarn	750	Saron	590
Ynysawdre	610	Trimsaran	700
		Tycroes	480

	Loss per working age adult £ p.a.		Loss per working age adult £ p.a.
Merthyr Tydfil		**Powys**	
Bedlinog	740	Aber-craf	520
Cyfarthfa	690	Cwm-twrch	550
Dowlais	750	Ynyscedwyn	570
Gurnos	1,010	Ystradgynlais	740
Merthyr Vale	800	**Rhondda Cynon Taf**	
Park	660	Aberaman North	740
Penydarren	800	Aberaman South	850
Plymouth	670	Abercynon	730
Town	630	Aberdare East	690
Treharris	640	Aberdare West / Llwydcoed	630
Vaynor	640	Beddau	520
Neath Port Talbot		Brynna	520
Aberavon	810	Church Village	510
Aberdulais	650	Cilfynydd	600
Allt-wen	550	Cwm Clydach	830
Baglan	520	Cwmbach	740
Blaengwrach	720	Cymmer	820
Briton Ferry East	770	Ferndale	720
Briton Ferry West	890	Gilfach Goch	870
Bryn and Cwmavon	690	Glyncoch	790
Bryn-coch North	410	Graig	620
Bryn-coch South	560	Hawthorn	650
Cadoxton	440	Hirwaun	720
Cimla	490	Llanharan	520
Coedffranc Central	690	Llanharry	610
Coedffranc North	570	Llantrisant Town	420
Coedffranc West	490	Llantwit Fardre	390
Crynant	550	Llwyn-y-pia	830
Cwmllynfell	590	Maerdy	1,040
Cymmer	930	Mountain Ash East	670
Dyffryn	640	Mountain Ash West	820
Glyncorrwg	840	Penrhiwceiber	920
Glynneath	670	Pentre	690
Godre'r graig	680	Pen-y-graig	770
Gwaun-Cae-Gurwen	760	Pen-y-waun	1,040
Gwynfi	940	Pont-y-clun	400
Lower Brynamman	690	Pontypridd Town	480
Margam	530	Porth	680
Neath East	930	Rhigos	610
Neath North	810	Rhondda	580
Neath South	760	Rhydfelen Central / Ilan	470
Onllwyn	750	Taffs Well	460
Pelenna	640	Talbot Green	610
Pontardawe	700	Ton-teg	440
Port Talbot	660	Tonypandy	670
Resolven	640	Tonyrefail East	730
Rhos	480	Tonyrefail West	670
Sandfields East	840	Trallwng	530
Sandfields West	900	Trealaw	830
Seven Sisters	690	Treforest	470
Tai-bach	720	Treherbert	850
Tonna	480	Treorchy	680
Trebanos	580	Tylorstown	910
Ystalyfera	800	Tyn-y-nant	650
		Ynyshir	790
		Ynysybwl	610
		Ystrad	750

	Loss per working age adult £ p.a.
Swansea	
Clydach	650
Gorseinon	650
Gowerton	470
Kingsbridge	420
Llangyfelach	390
Lower Loughor	630
Mawr	440
Penllergaer	550
Penyrheol	590
Pontardulais	600
Upper Loughor	520
Torfaen	
Abersychan	700
Blaenavon	650
Brynwern	720
Coed Eva	500
Croesyceiliog North	500
Croesyceiliog South	430
Cwmyniscoy	720
Fairwater	550
Greenmeadow	600
Llantarnam	550
Llanyrafon North	490
Llanyrafon South	360
NewInn	430
Panteg	490
Pontnewydd	630
Pontnewynydd	560
Pontypool	610
Snatchwood	660
St. Cadocs and Penygarn	770
St. Dials	690
Trevethin	850
Two Locks	510
Upper Cwmbran	700
Wainfelin	540

Source: Sheffield Hallam estimates based on official data

Sheffield Hallam University | Centre for Regional Economic and Social Research

Sheffield Hallam University
Unit 10, Science Park
City Campus
Howard Street
Sheffield S1 1WB

+44 (0)114 225 3073
e: cresr@shu.ac.uk
w: shu.ac.uk/cresr

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