



National Audit Office

# Means Testing

## Detailed Methodology

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**SEPTEMBER 2011**

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**1** This document accompanies *Means Testing*, a report published by the Comptroller and Auditor General in September 2011. It adds further details to the description of the methodology included in the main report at Appendix One.

**2** The purpose of the main report is to identify the risks to value for money that arise from the design of means tests. The policy decision to apply a means test can target spending more effectively than universal provision or contributory schemes. But it has other important consequences, including for administrative costs, work incentives and benefit take-up. We find that the design and implementation of means tests is key to mitigating the risks to value for money.

**3** We define means-tested benefits broadly to include both cash awards, such as Income Support and tax credits, and other services and benefits in kind, such as adult social care and free school meals. Means-tested benefits include all of those which assess eligibility partly on the basis of financial means.

**4** The main elements of our methodology are set out below.

## Document review

**5** Our document review included:

- departmental Impact Assessments for means-tested benefits;
- departmental annual reports and accounts;
- departmental research papers, consultations and related publications, for example on fraud and error;
- third party and academic publications on the benefits system, for example from the Institute for Fiscal Studies, Citizens Advice and the Organization for Economic Cooperation and Development;
- departmental methodological guidance, for example on appraisal of redistributive impacts in the HM Treasury Green Book; and
- other publicly available information, such as the Welfare Benefits and Tax Credits Handbook published by the Child Poverty Action Group.

- 6** The document review aimed to identify:
- the major impacts of means testing and the level of current understanding and measurement of these impacts;
  - the extent to which the impacts of means testing are considered in departmental Impact Assessments; and
  - the major design choices available for means tests and the different forms of means tests that exist.

### Interviews with departments and agencies

**7** We interviewed departments and agencies which administer means-tested benefits as well as HM Treasury. These interviews covered finance, policy and strategy staff. We also spoke to cross-departmental teams such as the Child Poverty Unit and departmental economists. In addition to interviews we conducted briefings on initial findings for the Department for Work and Pensions, HM Revenue & Customs and HM Treasury to test our findings and allow for clarification at an early stage.

- 8** The questions covered the following areas of discussion:
- the impacts of means testing, the trade-offs recognised between different impacts, and how means tests relate to other objectives of benefit programmes;
  - the quality of data and information available on the impacts of means testing, any issues of interpretation or definition in measurement, and clarifications on specific data or analysis, for example the methodology used to calculate unit costs of administering benefits;
  - the design choices and different types of means tests available and the consequences of different design choices; and
  - risks arising from interactions between means tests and current responsibilities for coordinating between means tests.

**9** The interviews aimed to test and refine the findings of our document review and early analysis on the impacts of means testing. At the same time we aimed to understand from departments and agencies the challenges they faced in designing means tests and to identify any further evidence for consideration in our fieldwork.

**10** In particular the interviews allowed us to test and refine the framework of design choices shown in Figure 1 of the report. Early versions of the framework were shared with departments and refined in light of interviews. Throughout our fieldwork we found no evidence that a similar framework had been used by departments and this informed our findings and recommendations on improved learning from experience.

## Expert interviews

**11** We interviewed academic experts on welfare policy and independent bodies such as the Institute for Fiscal Studies and Citizens Advice.

**12** These discussions explored similar questions to departmental interviews but focused on identifying trade-offs created by means testing, exploring recent academic evidence on impacts and identifying risks created by interactions between means tests. We also tested with interviewees whether any framework of design choices existed.

## Analysis of management and statistical information

**13** We based our analysis on data and information relating to the impacts of means testing, including:

- financial data from departmental resource accounts and departments' finance teams on programme expenditure and administrative costs;
- departmental estimates of take-up, claimant numbers, changes in circumstances, fraud and error, overpayments and underpayments;
- departmental and third party research on incentives and claimant burden;
- Office for National Statistics published data on the distribution of income;
- Citizens Advice data on case load and selected case studies; and
- the Department for Work and Pensions's Tax-Benefit model for generating selected case examples.

**14** Our quantitative analysis aimed to identify the impacts of means testing. Where our analysis required us to group data, for example in determining reasons for fraud and error related to means testing, we tested groupings with departments and other relevant parties such as the Office for National Statistics.

**15** Where our analysis required us to adopt a more technically complex methodology we tested our calculations with the Department for Work and Pensions. In Figure 5 of the report we show the redistributive impact of different benefits and taxes. In order to calculate the redistributive impacts we used Office for National Statistics data to identify the cash impacts of benefits and taxes on different deciles (tenths) of the income distribution.<sup>1</sup> We then re-weighted the cash impacts depending on the household's place in the income distribution based on the assumptions described by the Department for Work and Pensions.<sup>2</sup>

<sup>1</sup> Office for National Statistics, *The effects of taxes and benefits on household income 2009-10*, 2011.

<sup>2</sup> D. Fujiwara, *The Department for Work and Pensions social cost-benefit analysis framework*, Department for Work and Pensions Working Paper No. 86, 2010, p. 60. <http://research.dwp.gov.uk/asd/asd5/WP86.pdf>

**16** In the Office for National Statistics's data, a household's place in the income distribution is determined on the basis of its disposable income, equivalised to take account of different household sizes. If the position of a household were instead determined on the basis of its income before benefit payments, or after indirect taxes, this would change the ordering of households and so the income levels of different households, with potentially material effects.

**17** We weighted households in each decile on the basis of their disposable incomes, after direct taxes and cash benefits. This is the approach suggested by researchers who have studied how people's well-being increases as their income rises.<sup>3</sup> We tested this approach with the Department for Work and Pensions and the Office for National Statistics. There are many possible alternative approaches to weighting households, for instance by final income (after benefits in kind and indirect taxes) and by equivalised disposable income. Because poorer households tend to receive relatively more benefits in kind, weighting on the basis of disposable income implies that their welfare weighting is higher than it would be if weighting were on the basis of final income. Different weightings can have a large effect on the redistributive impact of benefits and taxes; using final income would reduce the redistributive impact of means-tested benefits from 75p to 41p per £1 of expenditure.

<sup>3</sup> R. Layard et al., *The marginal utility of income*, Journal of Public Economics, 2008, pp.1846-1857.

