



The distributional and work incentive effects of universal credit

Stuart Adam

CPAG Secure Futures seminar, London, 10 October 2013

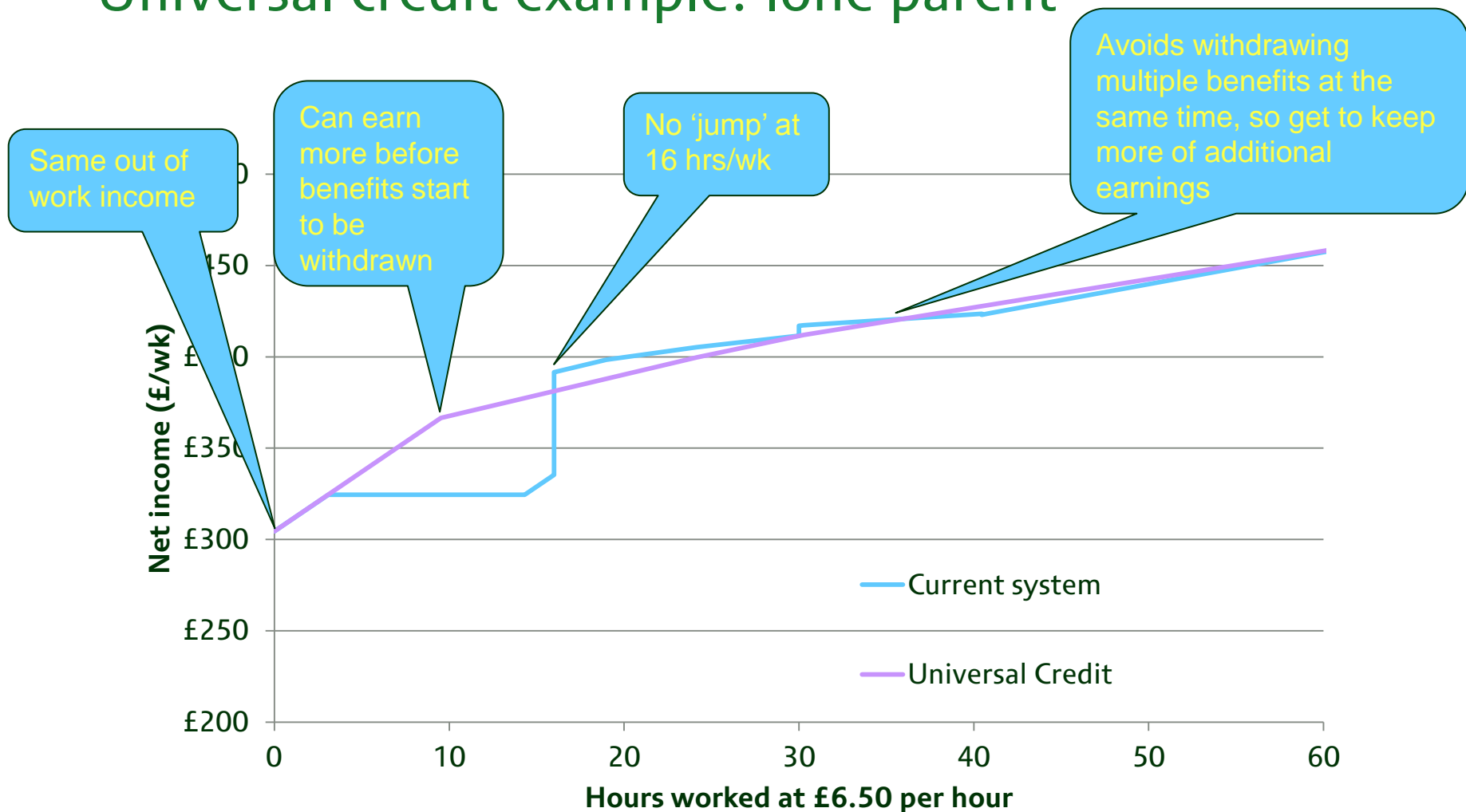
Context

- Real earnings have fallen
 - Making people worse off
 - And weakening work incentives
 - Benefits have been cut
 - Making people worse off
 - And strengthening work incentives
- See www.ifs.org.uk/publications/6853

Universal credit

- Radical reform of the benefits system
- Being phased in between April 2013 and December 2017
- One benefit to replace 6 existing means-tested working-age benefits
 - IS, income-based JSA, income-based ESA, CTC, WTC, HB
 - Council tax benefit localised instead
- Roughly revenue-neutral overall

Universal credit example: lone parent

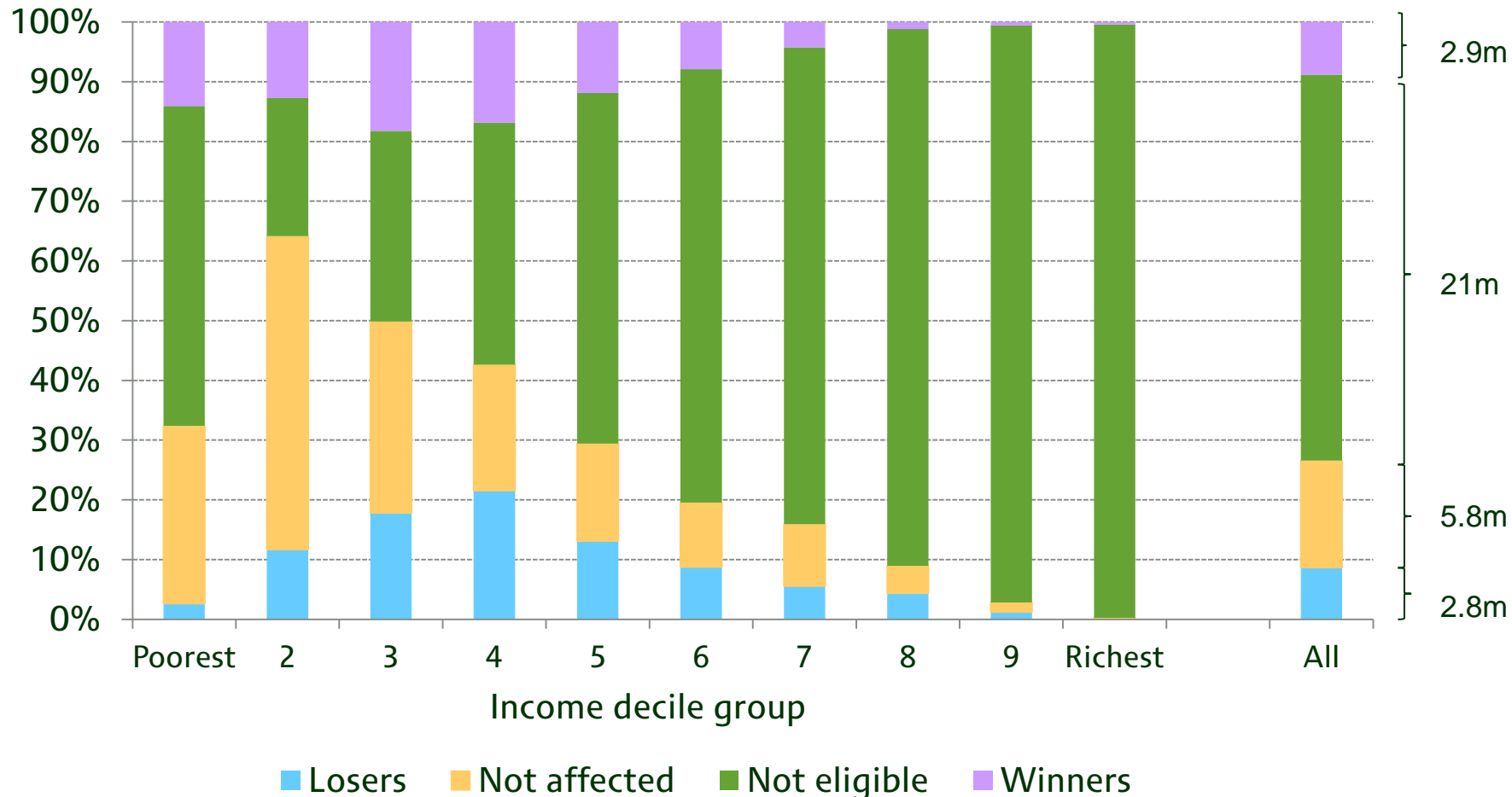


Assumes: wage £6.50/hr, 2 children, no other income, £80/wk rent. Ignores council tax and rebates

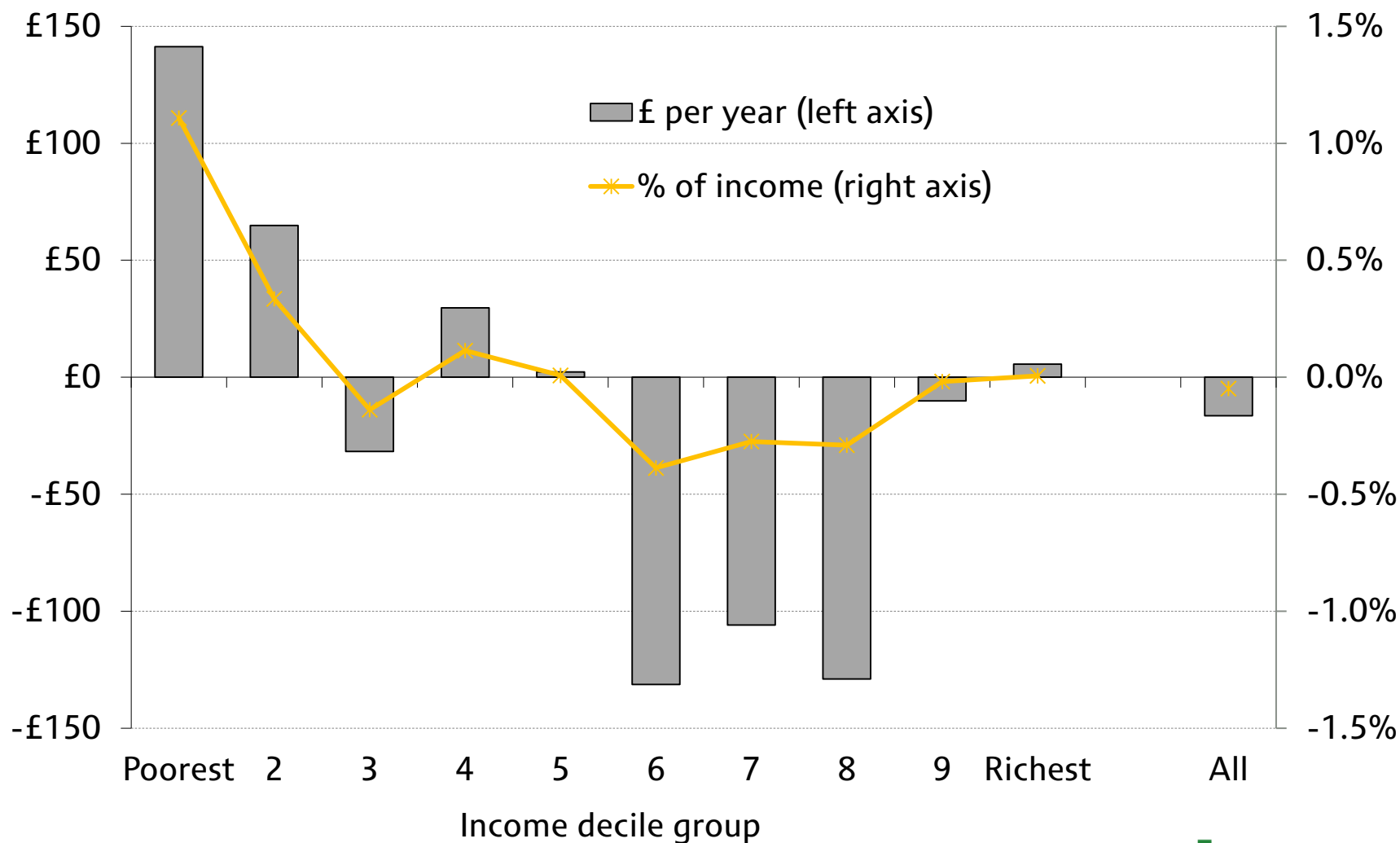
Winners and losers

- 2.9 million (8.8%) working-age families will see higher entitlements
- 2.8 million (8.7%) will see lower entitlements
- 5.8 million (18.2%) will see no change in entitlements
- 21 million (67%) get no means-tested benefits under either system

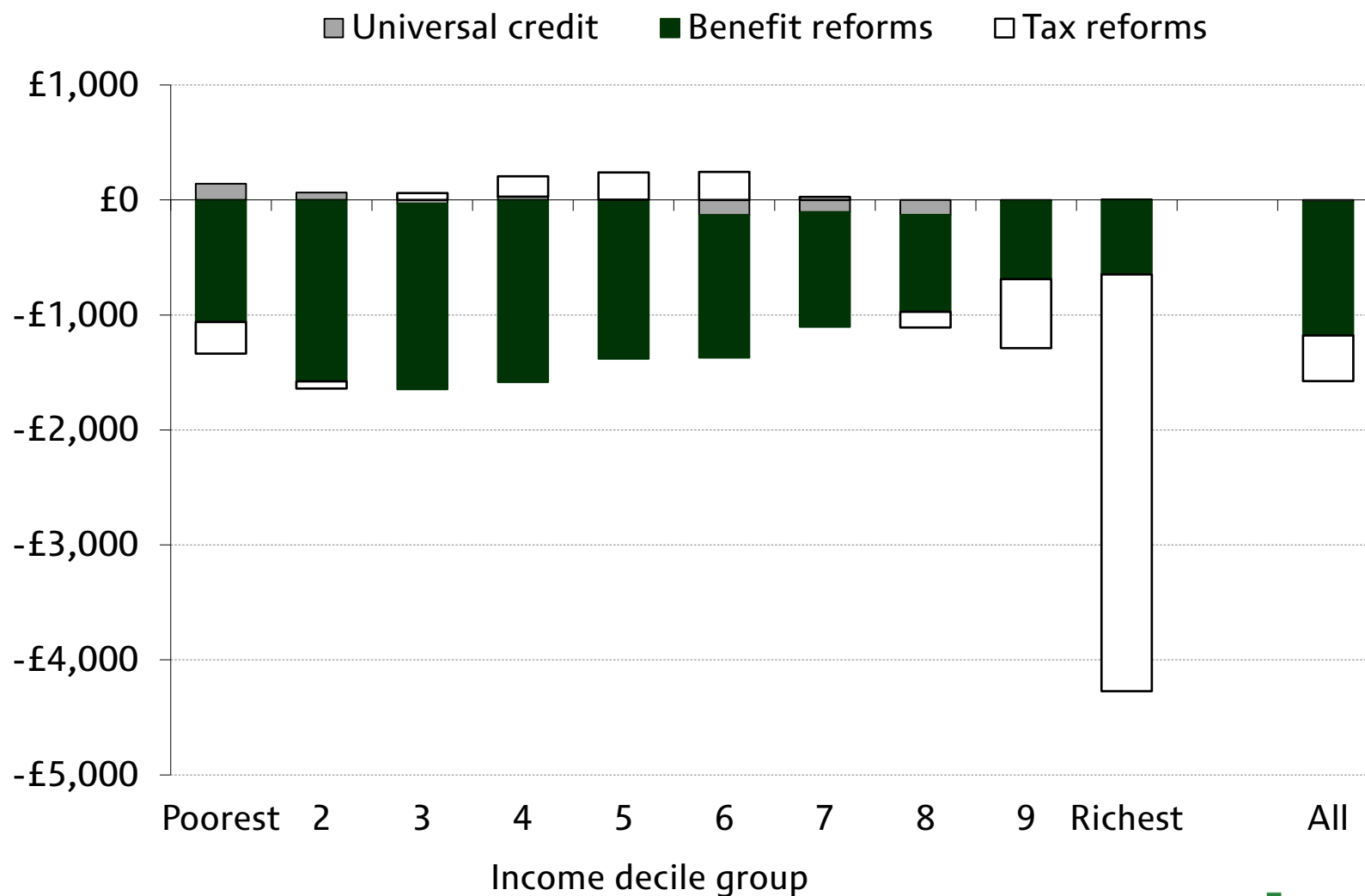
Winners and losers, by income decile group



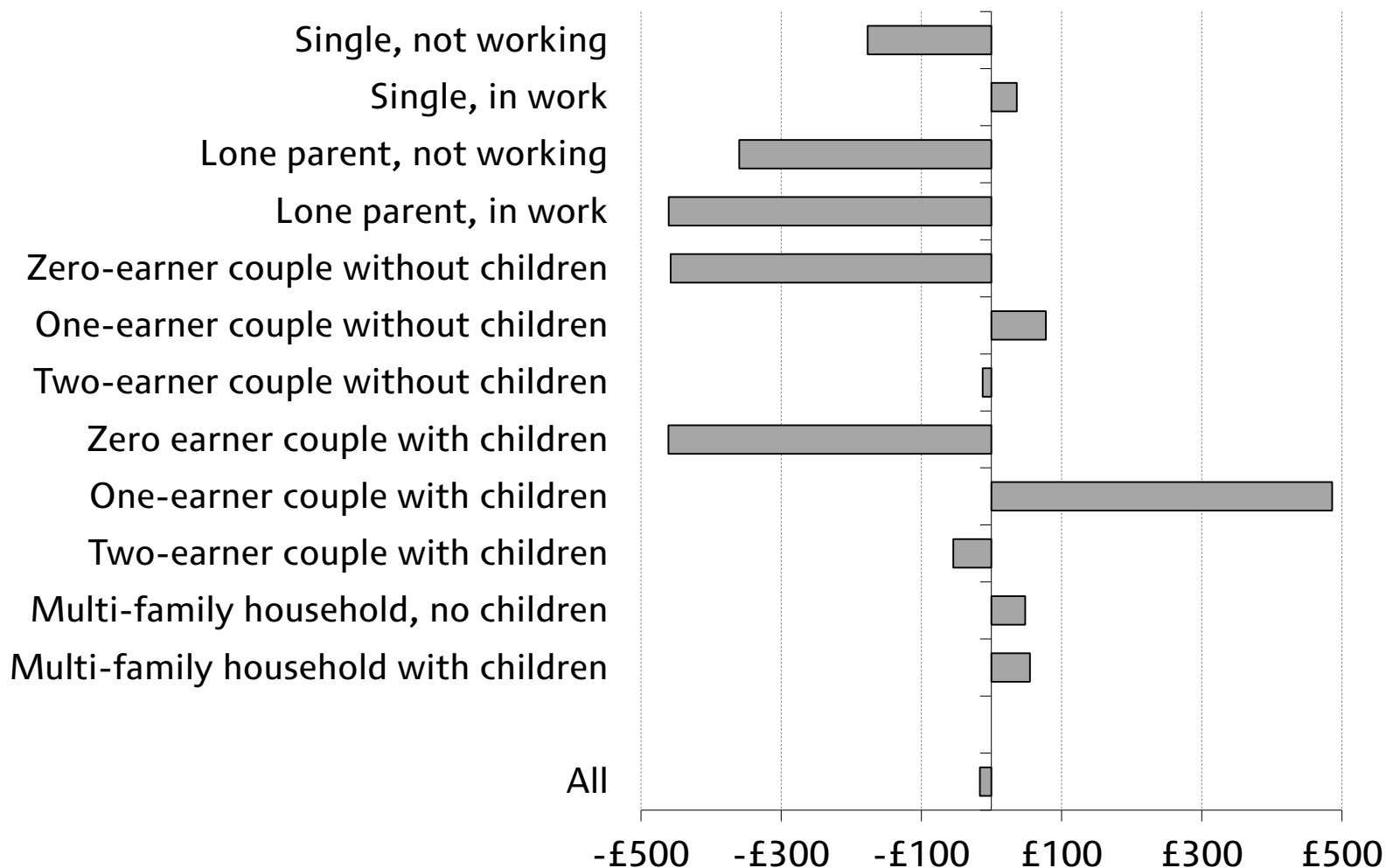
Distributional impact of universal credit



Distributional impact of coalition reforms

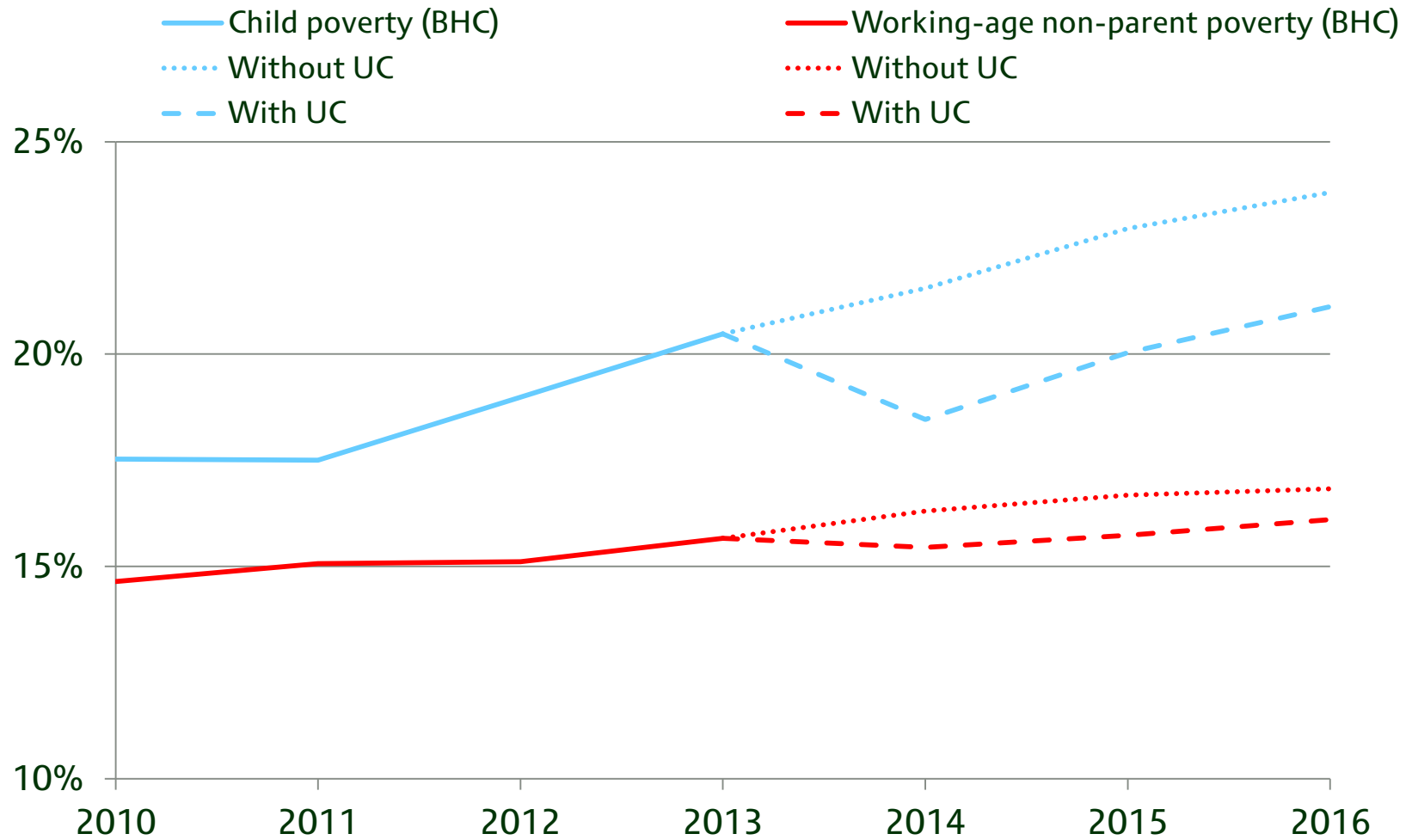


Distributional impact of universal credit



What does this imply for relative poverty rates?

NB take-up assumptions important here



Two kinds of financial work incentives

- Incentive to be in paid work at all
 - Replacement rate (RR): out-of-work income / in-work income
 - Participation tax rate (PTR): proportion of total earnings taken in tax and withdrawn benefits
- Incentive for those in work to increase their earnings
 - Effective marginal tax rate (EMTR): proportion of an extra £1 of earnings taken in tax and withdrawn benefits
- ❖ In all cases, higher numbers = weaker incentives

Effect of UC on work incentives

UC gets rid of many of the very weakest work incentives:

- reduces number of people with PTRs >75% by half (1.5m)
- reduces number of people with EMTRs >85% by more than 90% (0.5m)

Effect on average work incentives:

	Percentage point change in average:		
	RR	PTR	EMTR
Single, no children			
Lone parent			
Partner not working, no children			
Partner not working, children			
Partner working, no children			
Partner working, children			
All	–0.7	–0.7	–0.1

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Effect on average work incentives:

	Percentage point change in average:		
	RR	PTR	EMTR
Single, no children	–0.9		
Lone parent	+0.3		
Partner not working, no children	–3.2		
Partner not working, children	–5.7		
Partner working, no children	+0.1		
Partner working, children	+0.9		
All	–0.7	–0.7	–0.1

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Effect on average work incentives:

	Percentage point change in average:		
	RR	PTR	EMTR
Single, no children	–0.9	–1.5	
Lone parent	+0.3	+3.6	
Partner not working, no children	–3.2	–3.4	
Partner not working, children	–5.7	–10.7	
Partner working, no children	+0.1	+0.1	
Partner working, children	+0.9	+2.5	
All	–0.7	–0.7	–0.1

Effect of UC on work incentives

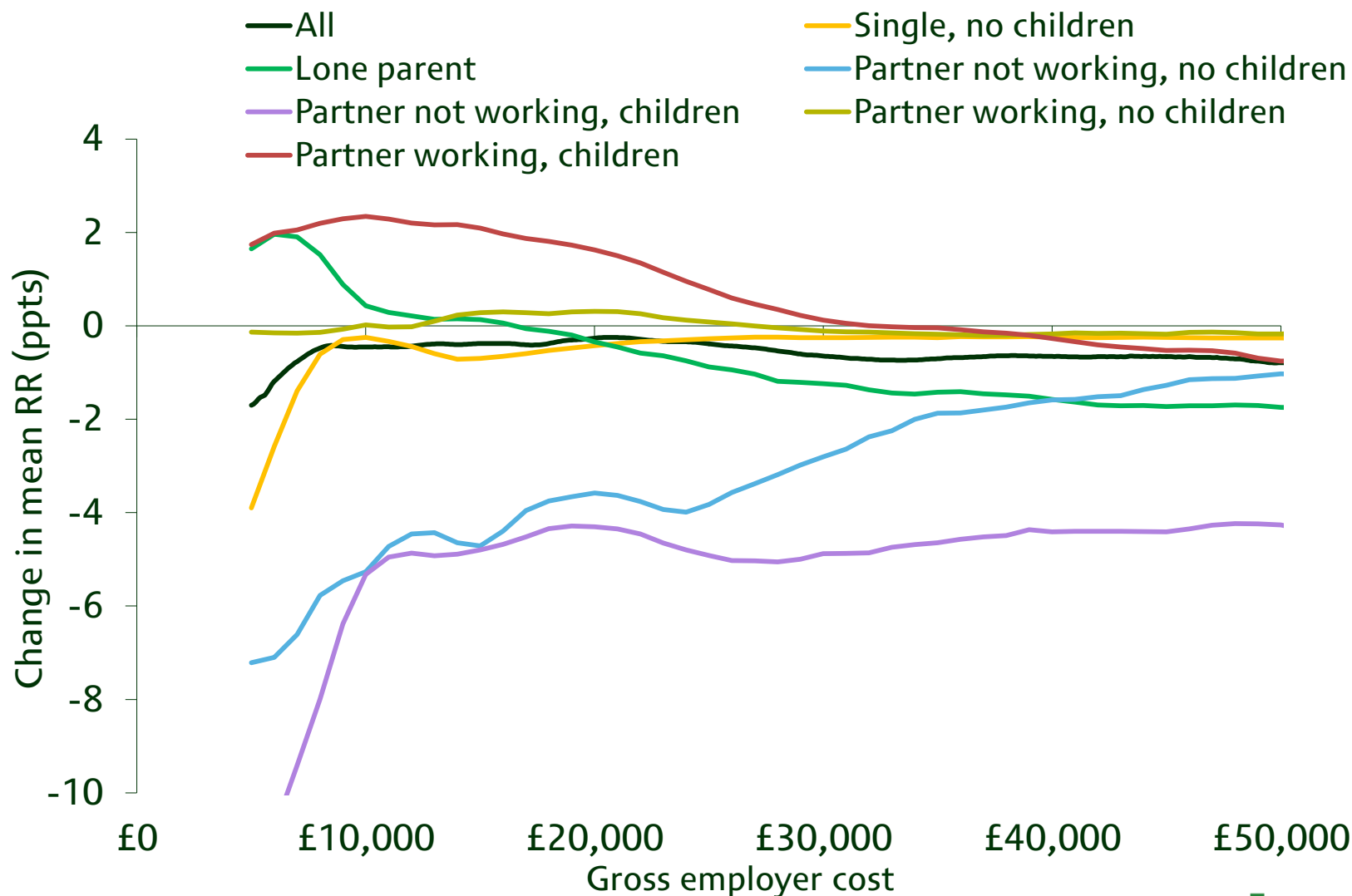
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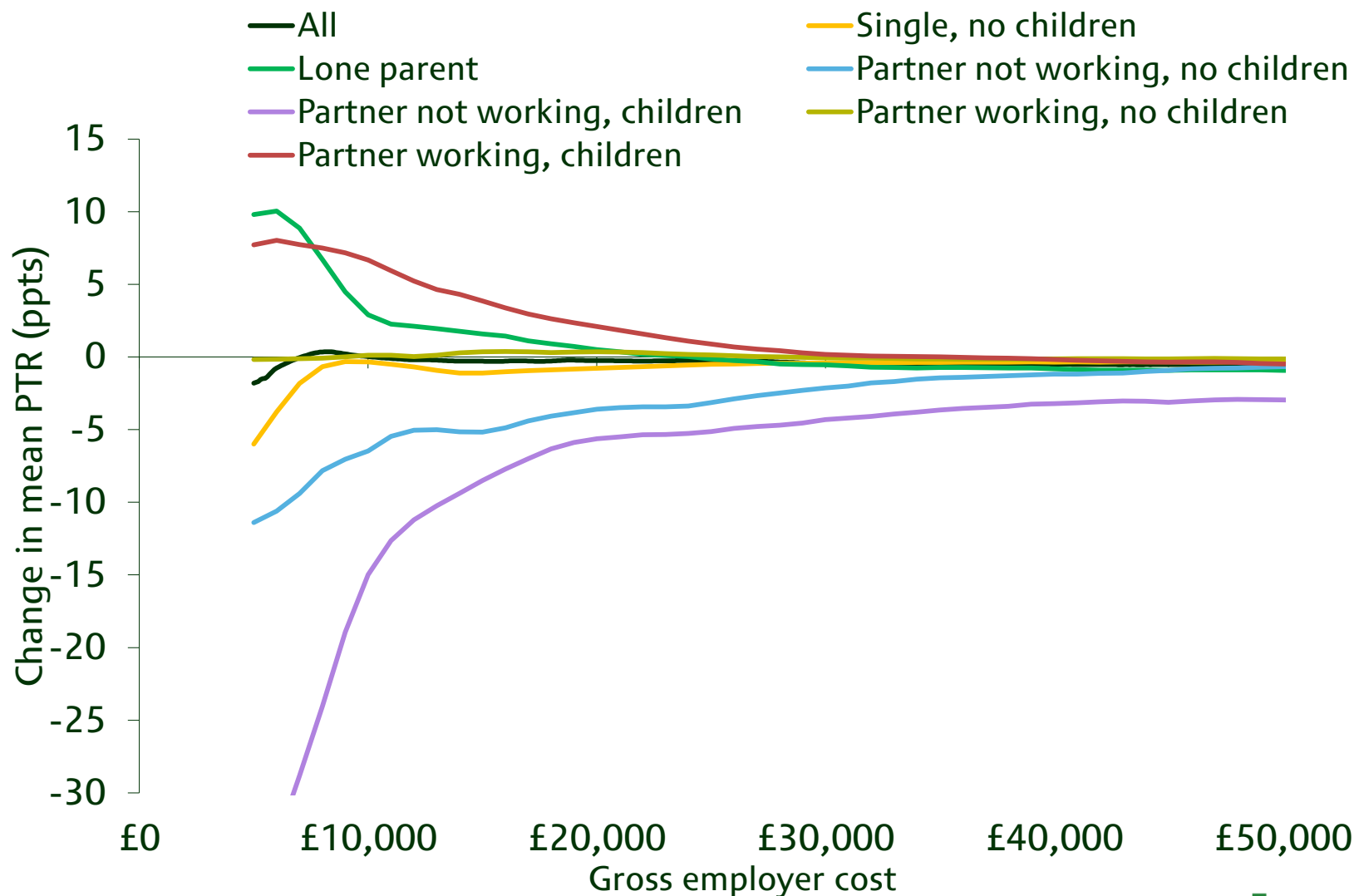
Effect on average work incentives:

	Percentage point change in average:		
	RR	PTR	EMTR
Single, no children	−0.9	−1.5	+0.7
Lone parent	+0.3	+3.6	−5.2
Partner not working, no children	−3.2	−3.4	−0.4
Partner not working, children	−5.7	−10.7	+1.2
Partner working, no children	+0.1	+0.1	−0.3
Partner working, children	+0.9	+2.5	+0.0
All	−0.7	−0.7	−0.1

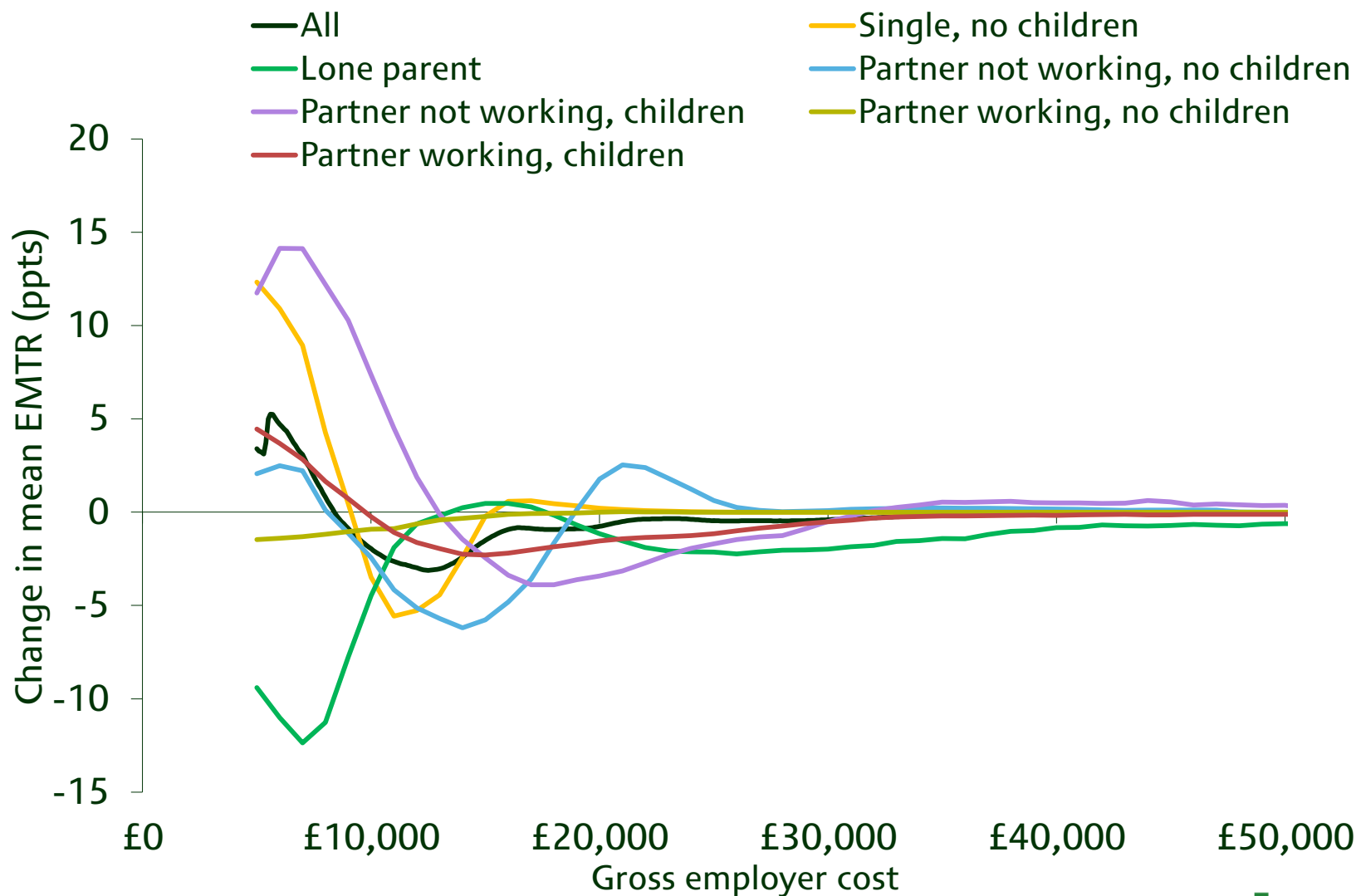
Effect of UC on average RR, by earnings



Effect of UC on average PTR, by earnings



Effect of UC on average EMTR, by earnings



Universal credit: non-financial aspects

- Better admin and smoother transitions may ease moves into work
 - If can operate successfully with Real Time Information
 - Simpler support with more transparent incentives may help
 - Though lose the salience of a working tax credit
 - And quicker response of support to earnings may be prominent
 - Conditionality may extend to many more people, esp. in couples
 - JSA conditions now apply up to 16 hours or £76 (£121 for couples)
 - UC may extend to 35 x min wage = £213 (£416 for couples)
- Little empirical evidence on likely impact of these

How might UC be changed?

- A number of trade-offs to which there are no easy answers
 - Work incentives vs. redistribution
 - Incentives to be in work vs. for those in work to earn more
 - Incentives for 1st vs. 2nd earners
 - Very weak incentives for a few vs. quite weak incentives for many
 - Theoretical optimality vs. practical considerations
- Focus work incentives on those who are most responsive
 - Increase generosity for those with kids <5, reduce for those with older kids
- Sensible uprating policy
 - Nothing should be frozen in cash terms by default
 - Housing element shouldn't depend on 2012-13 local rent levels forever
- Sort out interaction with council tax support...

Universal credit and council tax support

- Localised council tax support undermines goal of simplification
 - Extent to which undermines work incentives depends on LAs' choices
- Two key issues in design of council tax support schemes:
 1. Count UC as income in the CTS means test?
 - Doing so reduces maximum EMTR, but spreads over more people
 - Also implications for unearned income and childcare
 2. What to do about passporting when separate out-of-work benefits disappear?
 - 2/3 of CTB claimants passported by receipt of an out-of-work benefit
 - Under UC, no equivalent 'yes/no' indicator → massive extra admin?
 - Mitigated if DWP transfers UC claim data quickly to councils
 - Making the IT project even more complicated?

Conclusions

- Big gainers are 1-earner couples with children
 - Lone parents and 0-earner couples lose, on average
 - Nevertheless slightly progressive overall
- Slightly strengthens financial work incentives, on average
 - Ambiguous effects for lone parents
 - Expect more 1-earner couples, fewer 0-earner and 2-earner couples (though other benefit reforms have the opposite effect, more strongly)
 - Removes many of the weakest work incentives
- Non-financial incentives might also be important



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