



Universal Credit: impact on work incentives

What's coming up

- How do we measure 'work incentives'?
 - Incentive to do paid work, rather than not
 - Incentive to increase earnings a little
- Effect of Universal Credit on
 - Work incentives overall
 - By income
 - For different types of individual

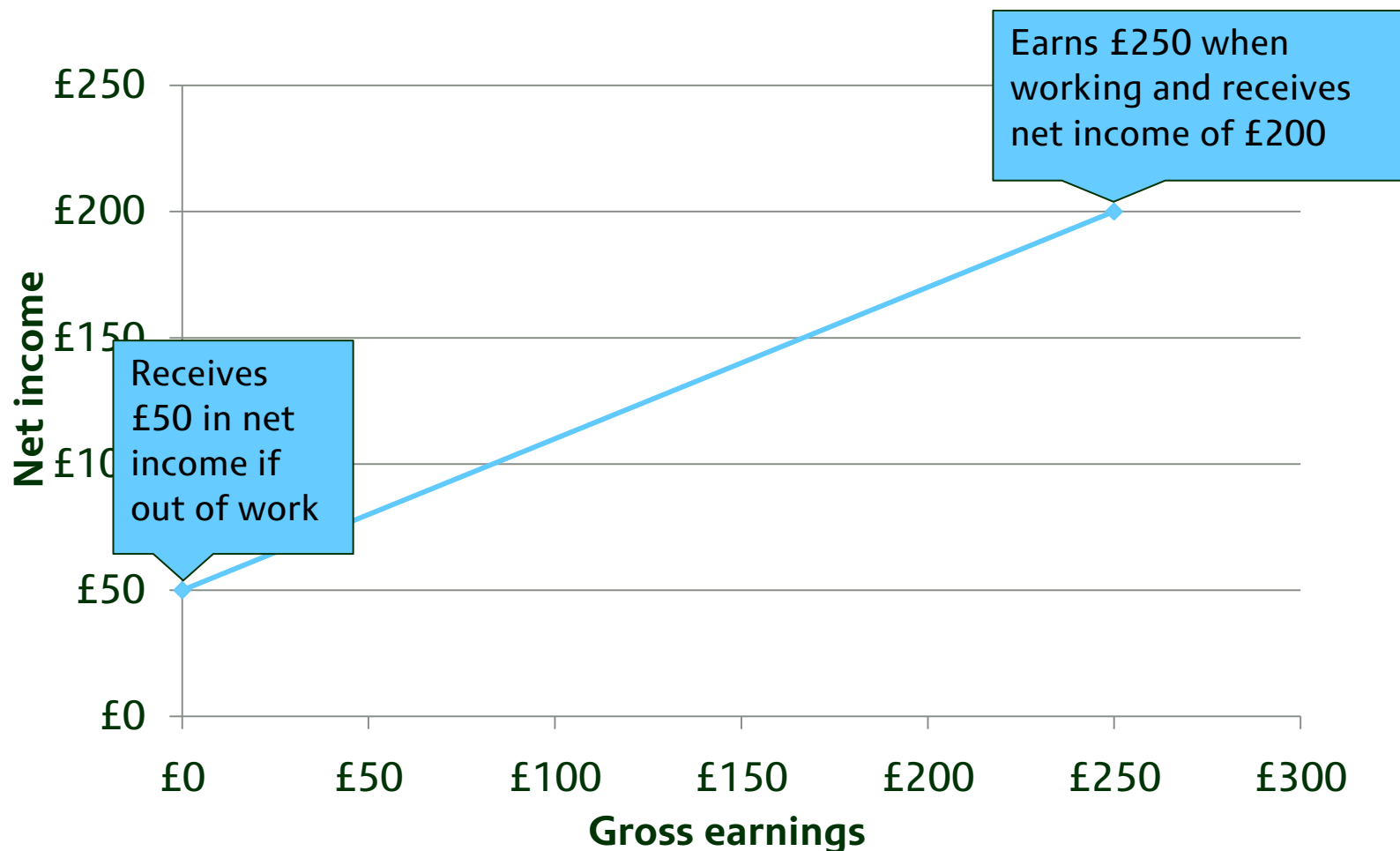
Measuring work incentives

- Incentive to work at all measured by Participation Tax Rate:

$$PTR = 1 - \frac{\textit{net income in work} - \textit{net income out of work}}{\textit{gross earnings}}$$

- This measures the extent to which taxes and benefits distort the decision about whether to work or not
- Answers the question ‘what proportion of my earnings are taken away in taxes and withdrawn benefits when I move into work?’

Example of measuring a Participation Tax Rate



Plugging these into formula gives PTR of $1 - (\pounds200 - \pounds50) / \pounds250 = 40\%$

Measuring work incentives

- Incentive to do paid work, as opposed to not working

- Measured by Participation Tax Rate (PTR):

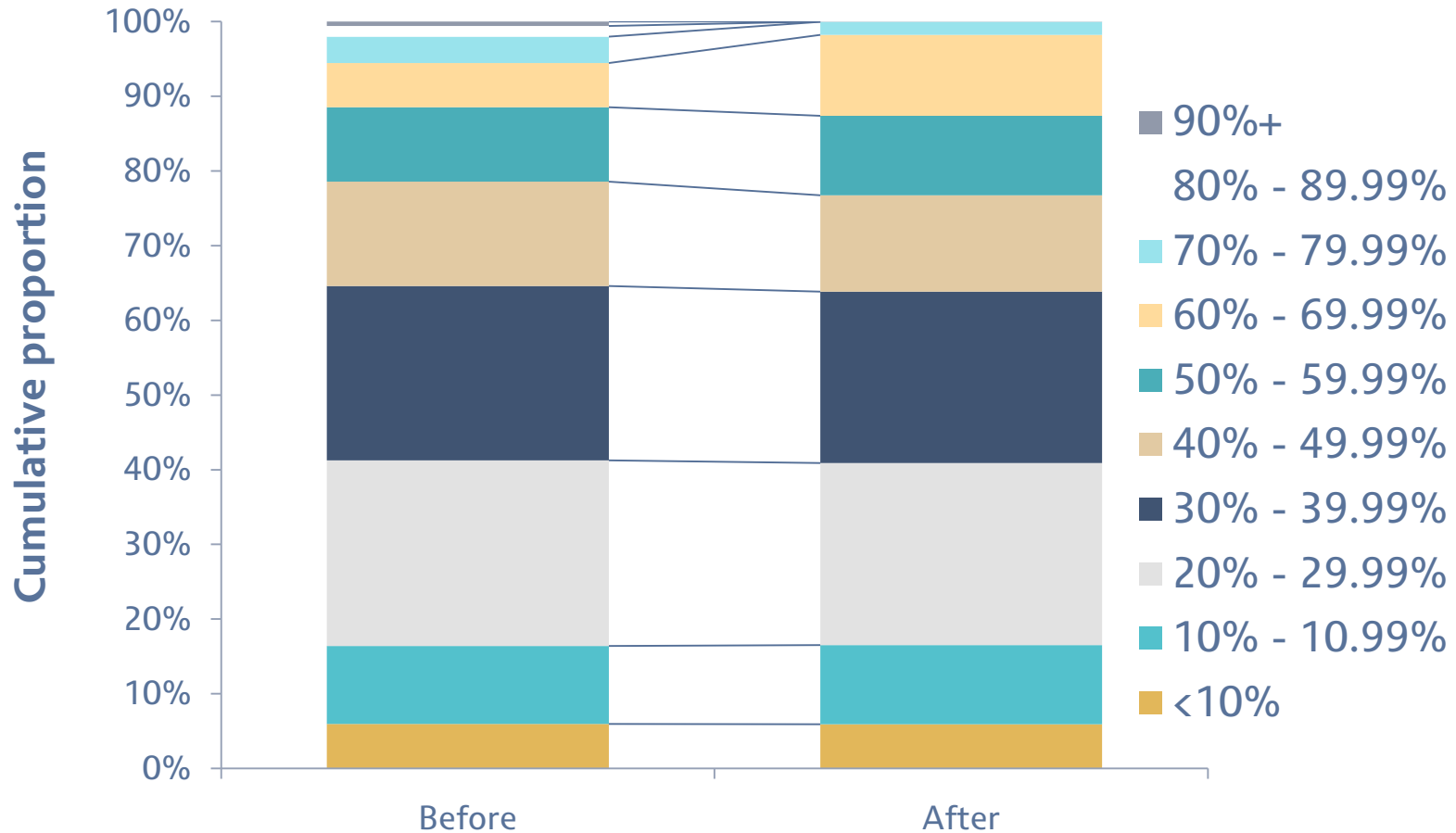
$$PTR = 1 - \frac{\textit{net income in work} - \textit{net income out of work}}{\textit{gross earnings}}$$

- This measures the extent to which taxes and benefits distort the decision about whether to work or not
 - Answers the question ‘what proportion of my earnings are taken away in taxes and withdrawn benefits when I move into work?’
- Incentive to increase earnings slightly
 - Measured by Marginal Effective Tax Rate (METR)
 - Answers the question ‘what proportion of each additional pound earned is taken away in taxes and withdrawn benefits?’

Methodology

- For current workers, use our tax and benefit microsimulation model to calculate what their net income would be if they didn't work
 - Relatively straightforward
- For non-workers, need to estimate how much they would earn, and how many hours they would work if they were to work
- Impute earnings level based on behaviour of existing workers with similar characteristics

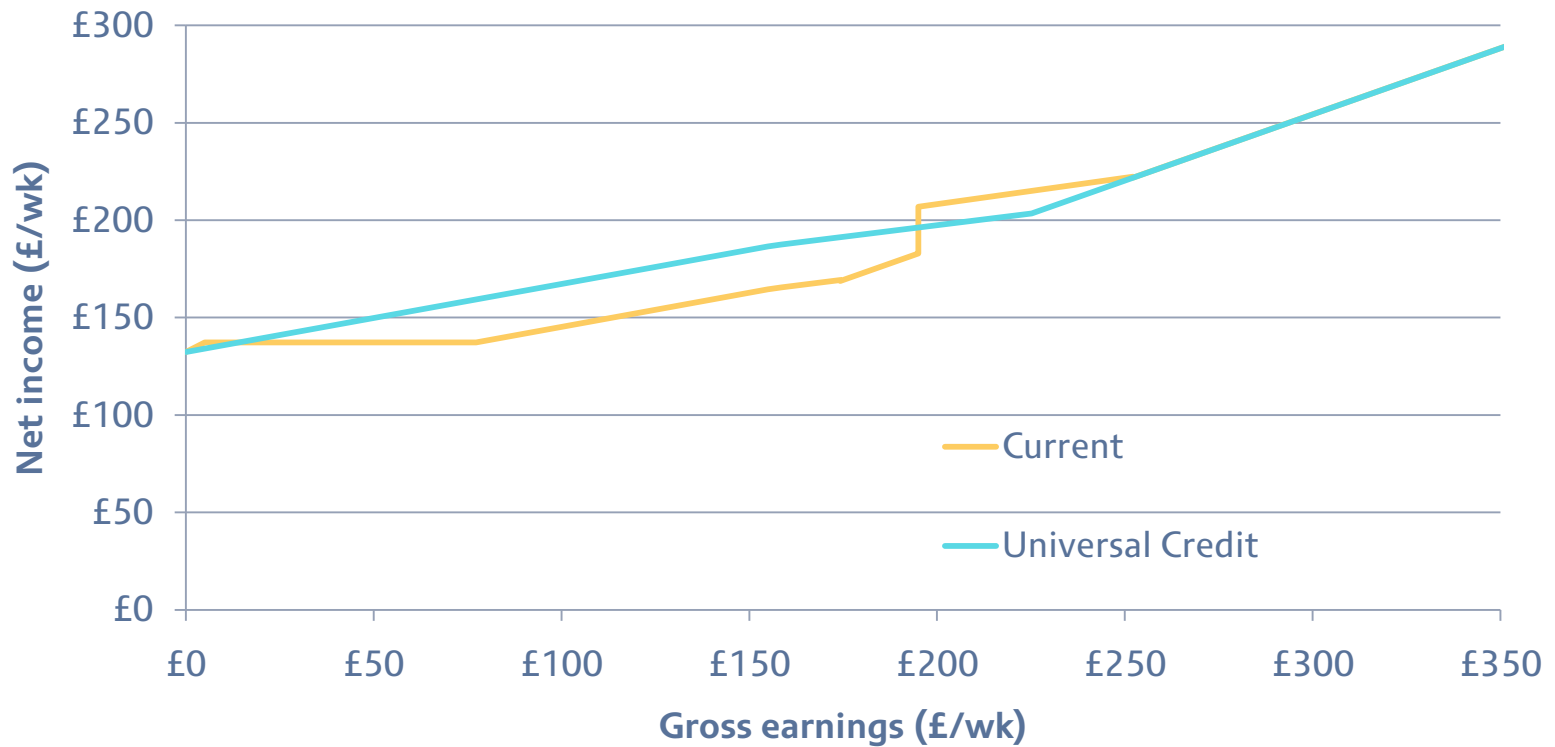
Overall distribution of Participation Tax Rates



Average PTRs by earnings

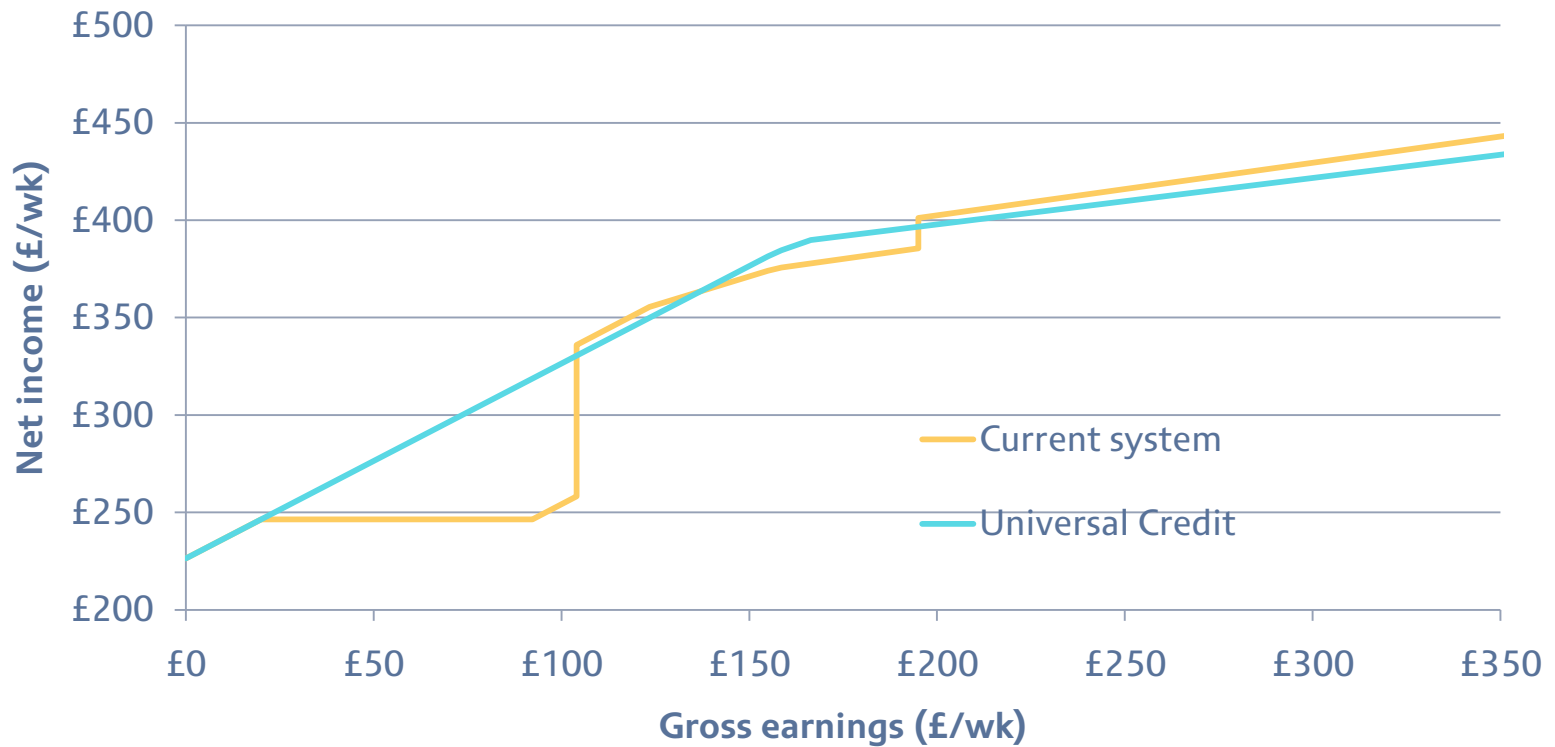


Universal Credit example: single adult, no children



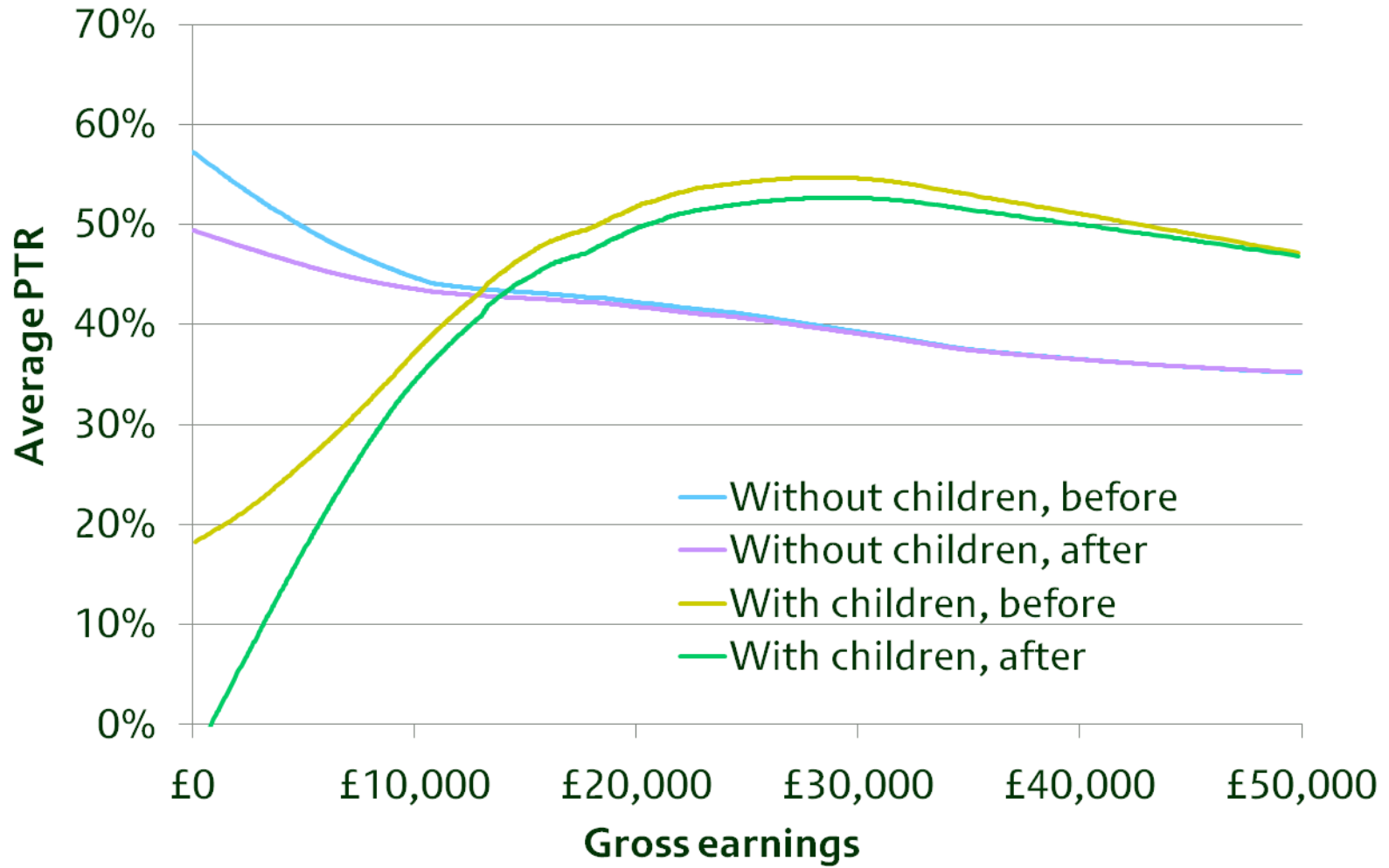
Assumes: £6.50/hr, £60/wk LHA or eligible rent

Universal Credit example: lone parent

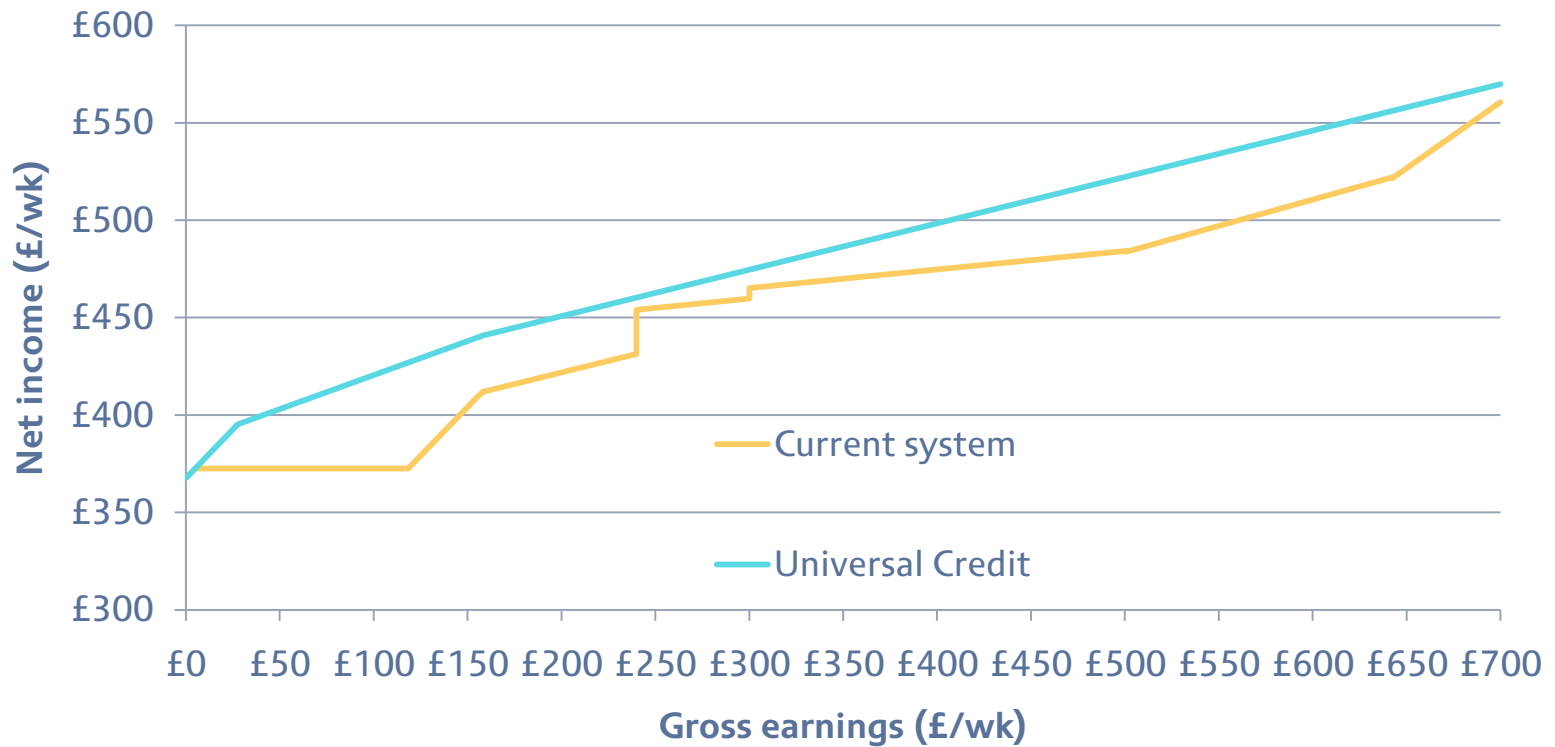


Assumes: £6.50/hr, no rent

How does this vary by different types of individual? – single individuals

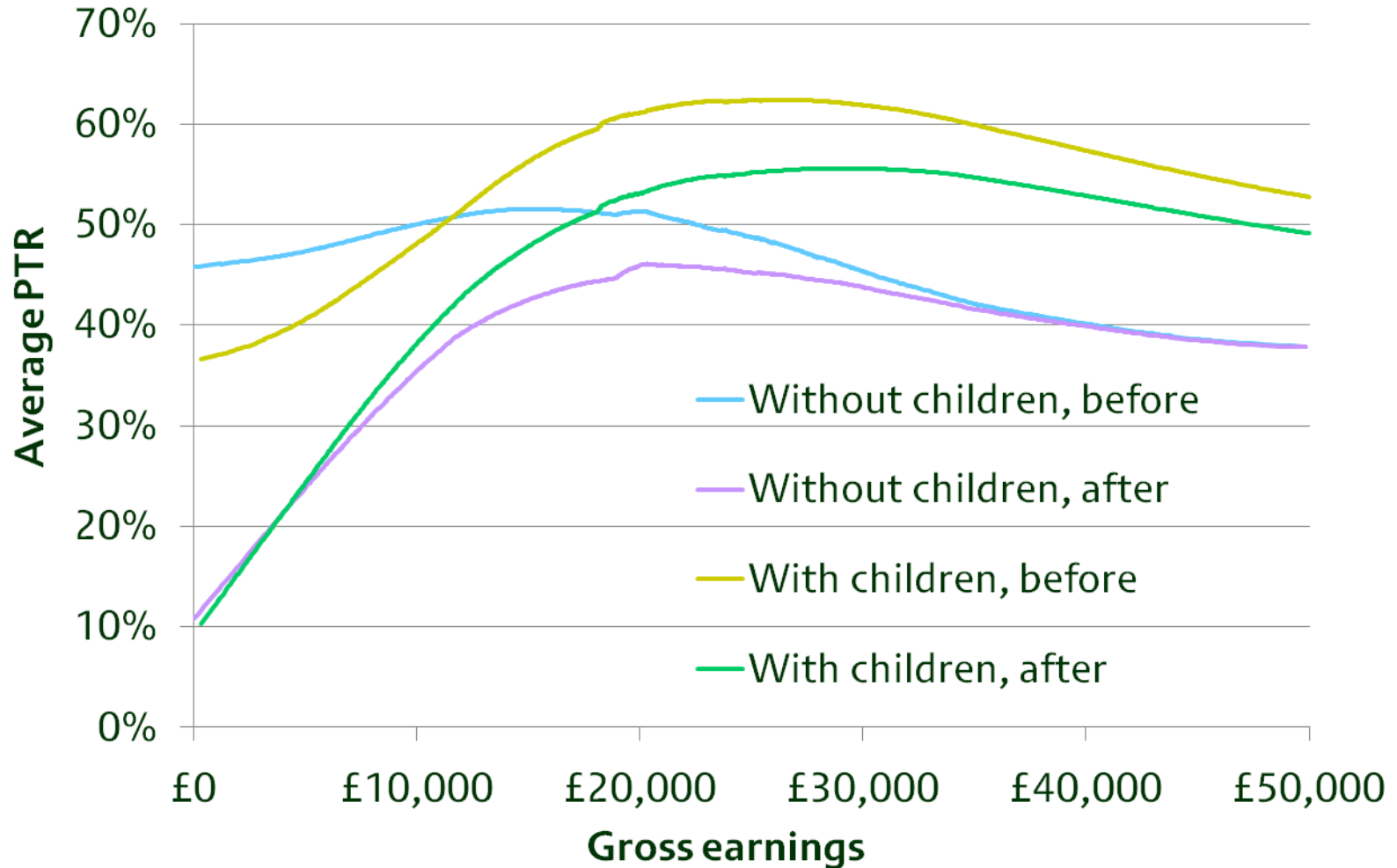


Universal Credit example: couple with children

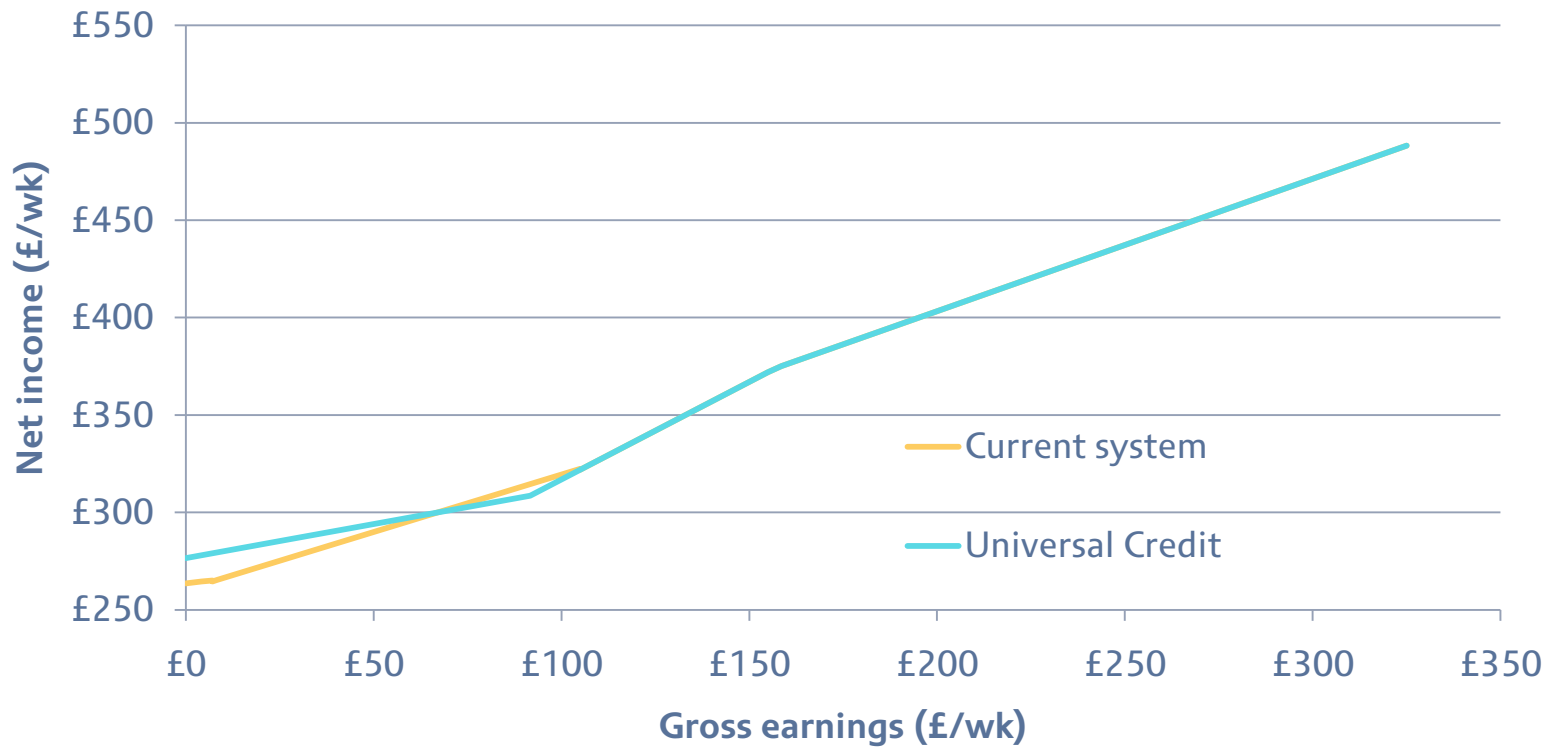


Assumes: £10/hr, £100/wk LHA or rent

How does this vary by different types of individual? –in couple, partner doesn't work

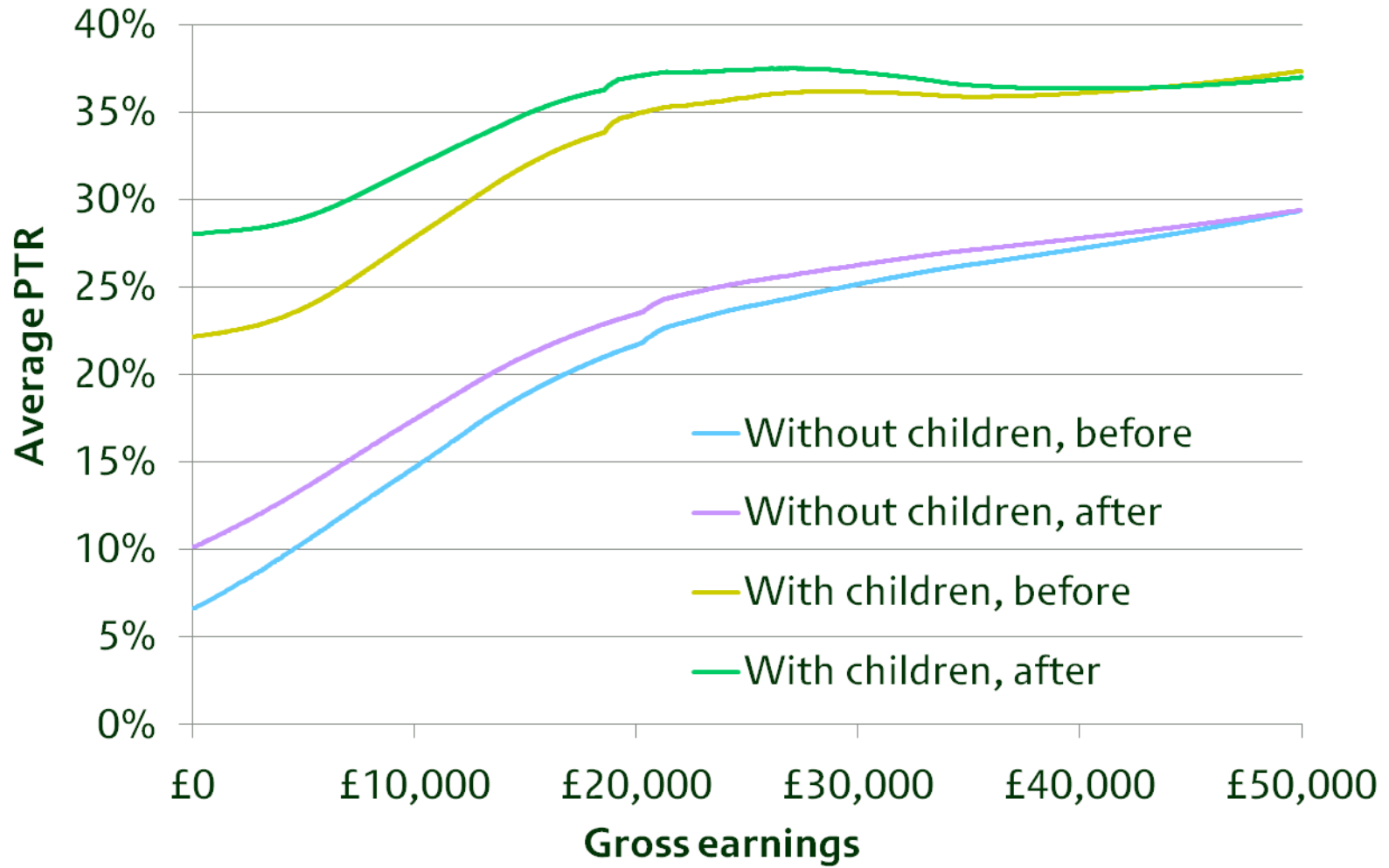


Universal Credit example: 2nd earner in couple without children



Assumes: Main earner on £245/wk, 2nd earner on £6.50, £80/wk LHA or rent

How does this vary by different types of individual? –in couple, partner works



Effect of Universal Credit on PTRs – summary

- Universal Credit strengthens the incentive for single individuals to do low-paid work
- Universal Credit particularly strengthens the incentive for couples to have one person in work rather than none...
- ... but weakens the incentive for both members of a couple to work, rather than just one
- These both come about because Universal Credit gives more support to single-earner couples than the current system, but this additional support is taken away more quickly than in the current system when the second earner moves into work

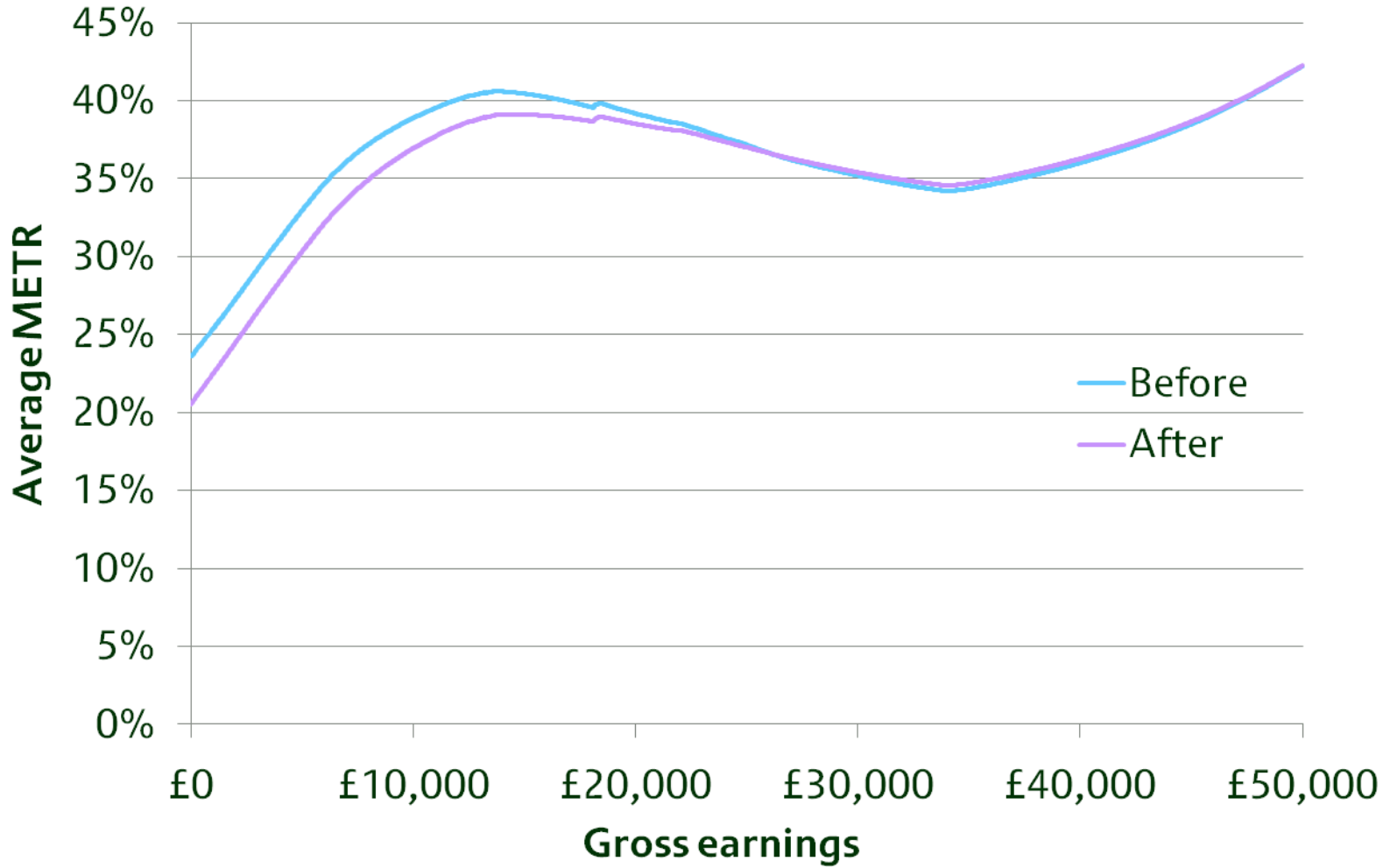
Changes in METRs among workers

- Most unaffected – not entitled to means-tested benefits or tax credits before or after reform
- Around 1.7 million workers see their METRs fall, in particular
 - 600,000 see METR fall from between 77% and 96% to 76.2%
 - Taxpayers who face withdrawal of multiple benefits under the current system
 - 350,000 see METR fall from >80% to 65%
 - Non-taxpayers who face withdrawal of multiple benefits or an out-of-work benefit in the current system
 - 400,000 see METR fall from more than 70% to around 32%
 - Taxpayers who lose entitlement to tax credits
 - 200,000 see METR fall to zero
 - Second earners in couples who lose entitlement to benefits and tax credits

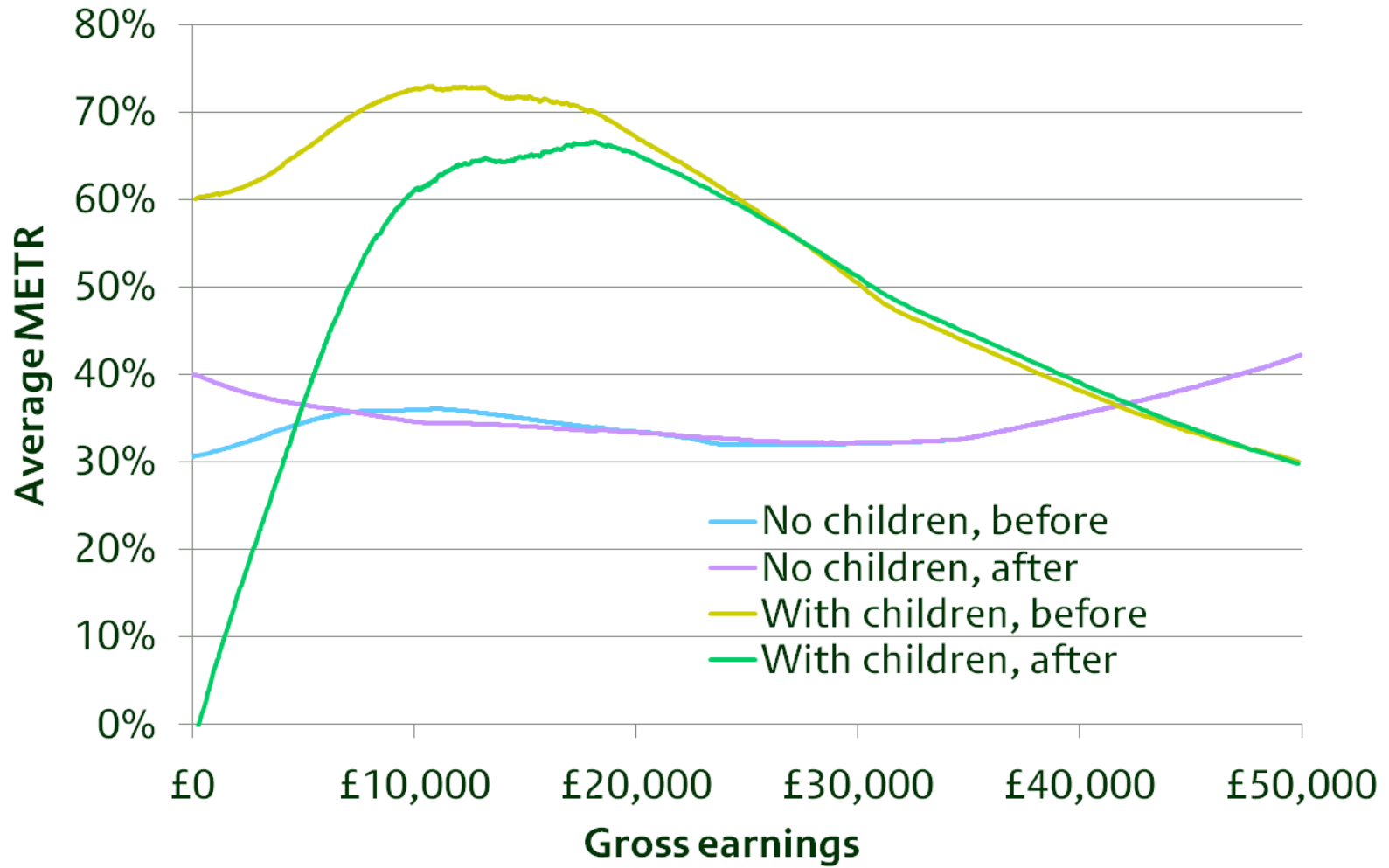
Changes in METRs among workers

- Around 1.8 million see their METRs increase, in particular
 - 900,000 see their METRs increase from 73% to 76.2%
 - Withdrawal rate of Universal Credit is higher than that for tax credits alone
 - 300,000 see their METRs increase from 32% to 76.2%
 - Taxpayers who become entitled to Universal Credit
 - 350,000 see their METRs increase from 0% or 41% to 65%
 - Second earners in couples who face withdrawal of Universal Credit, but are non-taxpayers
- How does this differ across the earnings distribution?

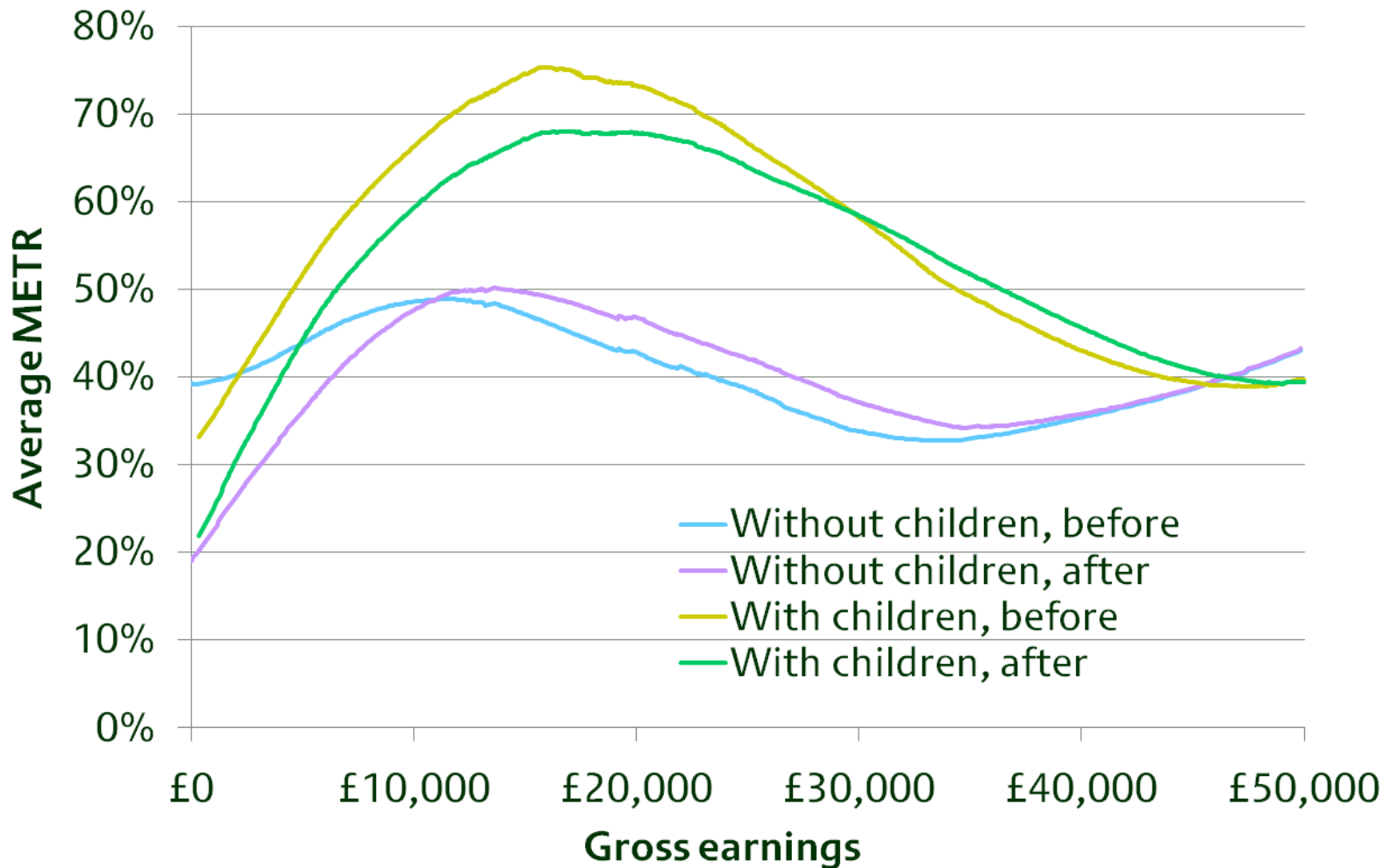
Average METRs by earnings



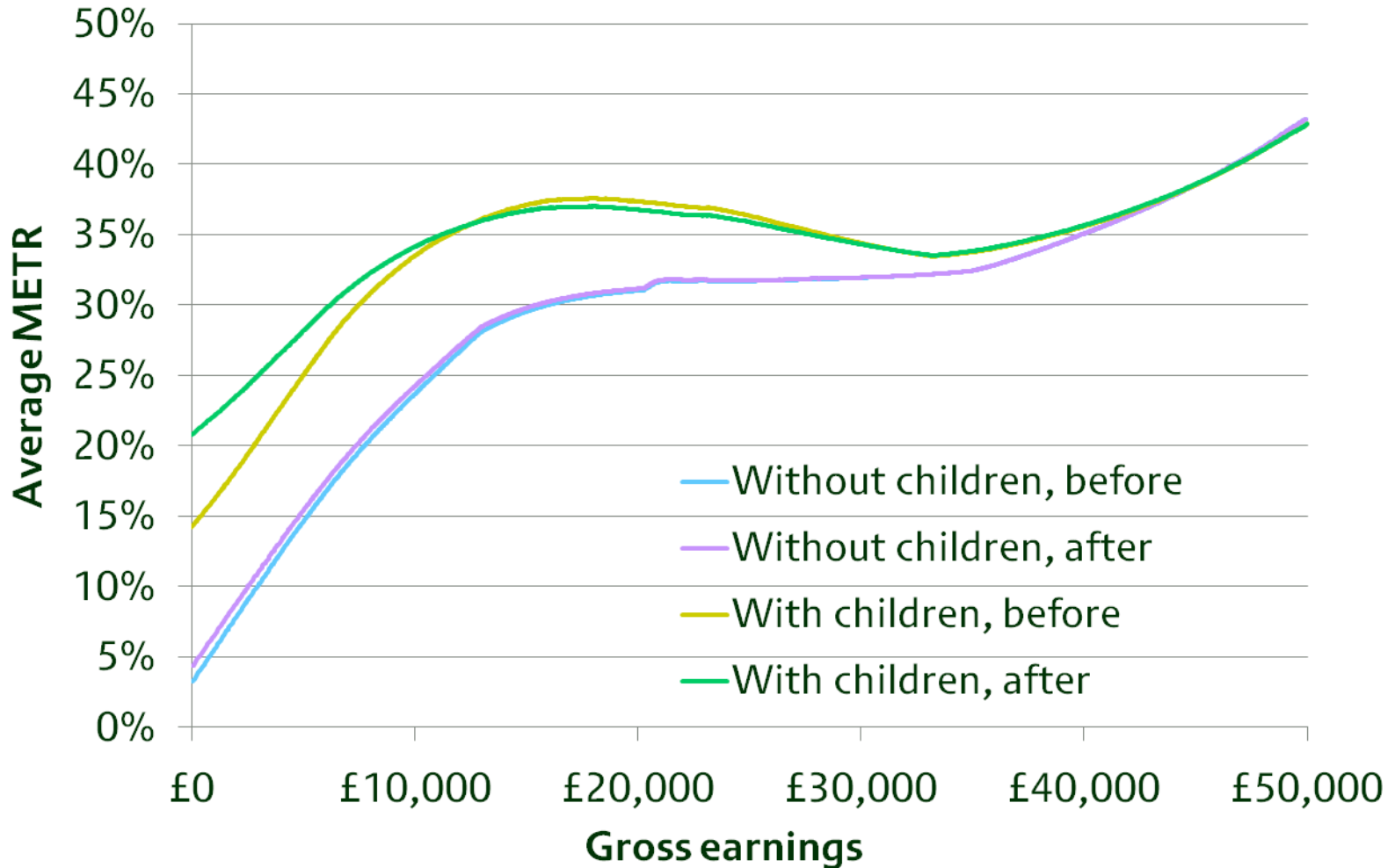
How does this vary by different types of worker? – single individuals



How does this vary by different types of worker? – single earner couples



How does this vary by different types of worker? – two-earner couples



Effect of Universal Credit on METRs – summary

- Roughly equal number of individuals see METRs rise or fall, but, among those whose METR increases, most only increase by a small amount (5 percentage points or less)
- Small increase in METRs for low earning single adults without children
- Big decrease in METRs for low earning lone parents
 - Generous disregard, very high METRs of 80%–96% under current system reduced to 76.2% or less
- Single earner couples have lower METRs at low earnings, but higher METRs at higher earnings
 - Increased generosity leads to means-testing extending further up income distribution
- Higher METRs for low-earners in 2-earner couples with children
 - Higher withdrawal rate for Universal Credit than tax credits

Work incentives: conclusion

- Incentive to work for low earnings stronger under Universal Credit for single people and those in couples whose partner doesn't work
 - Higher earnings disregard and lower withdrawal rate than current out-of-work benefits
 - These individuals have the weakest work incentives under the current system
- However, Universal Credit will weaken incentive for couples to have both members in work rather than just one
 - This is because it will have a higher withdrawal rate than current tax credit system
- Similarly, those with weakest incentives to increase earnings at the moment (low earners with children) will see METRs reduced...
- ...but METRs increase slightly for those on higher earnings and for low-earners in 2-earner couples