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

Net income (£/wk)

Current system

Universal Credit

Hours worked at £6.50 per hour

£200

£250

£300

£350

£400

£450

£500

0

10

20

30

40

50

60

Same out of work income

Can earn more before benefits start to be withdrawn

No ‘jump’ at 16 hrs/wk

Avoids withdrawing multiple benefits at the same time, so get to keep more of additional earnings

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

- Losers: 2.9m
- Not affected: 2.8m
- Not eligible: 5.8m
- Winners: 21m

Income decile group:
- Poorest
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- Richest
- All

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Distributional impact of universal credit

- £150
- £100
- £50
- £0
- £50
- £100
- £150

Poorest 2 3 4 5 6 7 8 9 Richest All

Income decile group

£ per year (left axis)
% of income (right axis)
Distributional impact of coalition reforms

- Universal credit
- Benefit reforms
- Tax reforms

Income decile group

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Distributional impact of universal credit

Single, not working
Single, in work
Lone parent, not working
Lone parent, in work
Zero-earner couple without children
One-earner couple without children
Two-earner couple without children
Zero earner couple with children
One-earner couple with children
Two-earner couple with children
Multi-family household, no children
Multi-family household with children
All

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What does this imply for relative poverty rates?

NB take-up assumptions important here

Source: J. Browne, A. Hood and R. Joyce (2013), *Child and working-age poverty in Northern Ireland from 2010 to 2020*
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:

<table>
<thead>
<tr>
<th>Category</th>
<th>RR</th>
<th>PTR</th>
<th>EMTR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, no children</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lone parent</td>
<td></td>
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</tr>
<tr>
<td>Partner not working, no children</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Partner not working, children</td>
<td></td>
<td></td>
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<tr>
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<td></td>
<td></td>
</tr>
<tr>
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<td>–3.2</td>
</tr>
<tr>
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<td>Partner working, no children</td>
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<td>-1.5</td>
<td>+0.7</td>
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<tr>
<td>Lone parent</td>
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<td>+3.6</td>
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<tr>
<td>Partner working, no children</td>
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<td>+0.1</td>
<td>-0.3</td>
</tr>
<tr>
<td>Partner working, children</td>
<td>+0.9</td>
<td>+2.5</td>
<td>+0.0</td>
</tr>
<tr>
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<td>-0.7</td>
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<td>-0.1</td>
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Effect of UC on average RR, by earnings

- All
- Lone parent
- Partner not working, children
- Partner working, children

Change in mean RR (ppts)

Gross employer cost

- Single, no children
- Partner not working, no children
- Partner working, no children

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Effect of UC on average PTR, by earnings

- Change in mean PTR (ppts)
- Gross employer cost
- £0 - £50,000

- All
- Lone parent
- Partner not working, children
- Partner working, children
- Single, no children
- Partner not working, no children
- Partner working, no children
Effect of UC on average EMTR, by earnings

- All
- Lone parent
- Partner not working, children
- Partner working, children
- Single, no children
- Partner not working, no children
- Partner working, no children

Change in mean EMTR (ppts)

Gross employer cost

- £0
- £10,000
- £20,000
- £30,000
- £40,000
- £50,000
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
The distributional and work incentive effects of universal credit

Stuart Adam

CPAG Secure Futures seminar, London, 10 October 2013