Universal Credit: a preliminary analysis

Mike Brewer, James Browne and Wenchao Jin
Background

• Universal Credit will be a substantial welfare reform, integrating all means-tested benefits and tax credits for working-age adults
  – Government’s view based on Centre for Social Justice report
  – Past IFS work has recommended integrating benefits and tax credits

• Fast-moving policy area
  – Consultation over the summer
  – Spending Review: £2bn to pay for introduction
  – White Paper in November 2010
  – Welfare Reform Bill due imminently
  – Universal Credit to begin in 2013

• This paper based on details in White Paper
Outline

• What is Universal Credit
  – Government’s objectives
  – How will it work?
    • Maximum entitlement
    • Withdrawal as income rises
    • Some examples
  – Other details

• Our new empirical work
  – Winners and losers, and cost to government
  – Work incentives

• Not covering administration or operational details, conditionality or impact on poverty
What is Universal Credit?

- Universal Credit is a means-tested benefit, based on family income, which will replace means-tested benefits and tax credits for working-age adults
  - Replaces Income Support, income-based Jobseeker’s Allowance (JSA) and Employment and Support Allowance (ESA), Housing Benefit, Child Tax Credit, Working Tax Credit
  - Unclear what will happen to Council Tax Benefit
  - Pension credit not replaced
  - Administered by DWP, and paid monthly based on previous month’s circumstances
Perceived problems with the current system

Receive three different means-tested benefits/TCs

Rapid withdrawal; weak incentives

Different in-and out-of work benefits

Multiple (simultaneous) withdrawal; weak incentives and horrible interactions

Assumes: couple with 2 children, 1 earner @ £6.50/hr, £80/wk LHA or eligible rent
The brave new world

Same entitlement to benefits if do not work
Earnings disregard
Slower withdrawal
Single system: no horrible interactions, less churn between programmes, and less chance of non-take-up

Assumes: couple with 2 children, 1 earner @ £6.50/hr, £80/wk LHA or eligible rent. Ignores child benefit.
How is Universal Credit calculated

• Calculate maximum entitlement

• Calculate size of earnings disregard

• Calculate earned income, unearned income and imputed income from capital

• Calculate final award
## Universal Credit: calculating maximum entitlement

<table>
<thead>
<tr>
<th>Universal Credit</th>
<th>Current system</th>
<th>Example: couple, 2 children, LHA rate of £80/wk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal amount</td>
<td>Income support/jobseekers allowance</td>
<td>£113.40/wk</td>
</tr>
<tr>
<td>Child additions</td>
<td>Child tax credit</td>
<td>£119.90/wk</td>
</tr>
<tr>
<td>Housing addition</td>
<td>Housing benefit</td>
<td>£80/wk</td>
</tr>
<tr>
<td>Disability or carers addition</td>
<td>Disability or carers premia in means-tested benefits</td>
<td>£0/wk</td>
</tr>
</tbody>
</table>
How is Universal Credit withdrawn as income rises?

• Net-of-tax earned income subject to 65% withdrawal rate
  – **Lower** withdrawal rate than out-of-work means-tested benefits, so extends further up earnings distribution (and means WTC not needed)
  – **Higher** withdrawal rate than tax credits (65% of net earnings is greater than 41% of gross earnings)
  – The earnings disregard depends on family type & housing costs

• Unearned income (including income from some other benefits) subject to 100% withdrawal rate with no disregard
  – **Same** withdrawal rate as out-of-work means-tested benefits
  – **Higher** withdrawal rate than tax credits (100% is greater than 41%)

• Income from savings is imputed and capital rules mean those with savings > £16,000 get nothing
  – **Same** rules as out-of-work means-tested benefits
  – **Much harsher** than tax credits: £16,000 of savings would reduce tax credit eligibility by £1.42/wk
Universal Credit: full example of withdrawal

- Couple with 2 children, earning £400/wk, renting at £80/wk, savings of £10,000

<table>
<thead>
<tr>
<th>Calculation</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Calculate maximum entitlement</td>
<td>£313.30/wk</td>
</tr>
<tr>
<td>Calculate earnings disregard</td>
<td>£5,700 – 1.5*£4,160, but minimum of £1,300 for this family</td>
</tr>
<tr>
<td>Calculate net earnings</td>
<td>£322.31/wk (equivalent to £400/wk after deducting NI and income tax)</td>
</tr>
<tr>
<td>Calculate imputed income from capital</td>
<td>(£10,000-£6,000)/250 = £16</td>
</tr>
<tr>
<td>Final calculation:</td>
<td>£313.30 – £16 – 0.65*(£322.31 – £25) = £104.05/wk</td>
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</tbody>
</table>
Universal Credit example: single adult, no children

- Same out of work income
- Slower withdrawal, so stronger work incentives
- No “notch” at 30 hrs/wk

Assumes: £6.50/hr, £60/wk LHA or eligible rent
Universal Credit example: lone parent

- Same out of work income
- Slower withdrawal, so stronger work incentives
- No “notch” at 16 hrs/wk
- Faster withdrawal, so weaker incentives to earn more, & long-run loser

Assumes: £6.50/hr, no rent
Universal Credit example: couple with children

- Slower withdrawal, so much stronger work incentives
- No “notch” at 24 hrs/wk
- Slower withdrawal, so stronger incentives to earn more
- Faster withdrawal, so weaker incentives to earn more

Same out of work income

Better off under Universal Credit regardless of hours worked

Assumes: £10/hr, £100/wk LHA or rent

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Universal Credit example: 2\textsuperscript{nd} earner in couple without children

Assumes: Main earner on £245/wk, 2\textsuperscript{nd} earner on £6.50, £80/wk LHA or rent
But it’s not as simple as all that...

- Many details unresolved, or unclear, in White Paper
- Some thorny policy issues include
  - Carer’s Allowance: inside or outside Universal Credit?
  - Council tax benefit: inside or outside Universal Credit, and how to localise?
  - Childcare element of working tax credit: how to replace?
- Decisions also needed on
  - conditionality: who is subject, and how much Universal Credit to sanction
  - in-kind passported benefits
  - support for mortgage interest
  - disability additions
  - rates for students and those under 25
  - housing element for those in social housing
### Timetable for transition

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<thead>
<tr>
<th>Time Period</th>
<th>Description</th>
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<tr>
<td>From October 2013</td>
<td><strong>No new claims of out-of-work benefits:</strong> will claim Universal Credit instead</td>
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<td></td>
<td><strong>Families leaving out-of-work benefits will claim Universal Credit</strong></td>
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<tr>
<td>From April 2014</td>
<td><strong>No new claims of tax credits:</strong> will claim Universal Credit instead</td>
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<td>April 2014 to October 2017</td>
<td><strong>Remaining claimants of benefits and tax credits moved to Universal Credit</strong></td>
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<td><strong>Transitional protection:</strong> families protected in cash-terms at point of transition while circumstances unchanged</td>
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