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# Resolution Foundation

BRIEFING

## Back in credit? Universal Credit after Budget 2018

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## Summary

Universal Credit (UC) has garnered many negative headlines over recent months, with the emergence of numerous examples of recipients suffering financial hardship as a result of rigidities and failings in the system. Ahead of parliamentary debate this autumn on the details underpinning the next, difficult, phase of the roll-out – the ‘managed migration’ of legacy benefit recipients – there was widespread expectation that the government would act in order to avoid further adverse outcomes and press. Such action was forthcoming at last month’s Budget. And, while there remains more to do in this regard – not least for those families already moving onto the system under ‘natural migration’ – the decision to further delay the advent of ‘managed migration’, and to introduce ‘run-ons’ of some existing benefits, represents a welcome step.

Less expected, however, was the Budget announcement of a £1,000 increase in work allowances (the amount that can be earned before benefits start being reduced) available to families with children and/or limited capability for work. This measure has an annual cost of £1.7 billion, and alongside smaller spending increases in recent years means that – in total spending terms – the vast majority of cuts made specifically to UC in Summer Budget 2015 have now been reversed.

We provided an initial assessment of this welcome move in our overnight Budget response, but in this note we go further – digging in more detail into where the move leaves UC in terms of its generosity and its impact on work incentives relative to the system it is replacing.

UC work allowances were reduced significantly in Summer Budget 2015, as part of a wider package of working-age benefit cuts. The scale of the reductions differed across family types, ranging from £380 (from £2,810 to £2,430) among renting couples with children to £4,260 (from £9,290 to £5,030) among home-owning single parents. And allowances were withdrawn altogether for non-parents without any disabilities (having previously amounted to £1,400). The £1,000 Budget 2018 boost has therefore left some UC recipients with higher work allowances than were in place before Summer Budget 2015, while some continue to face much lower allowances. In addition, most working UC recipients have benefited from the Autumn

Statement 2016 reduction in the pace at which their award is withdrawn once their earnings rise above their work allowance (the 'taper rate') from 65p for every extra £1 earned to 63p.

By letting qualifying UC recipients earn an extra £1,000 a year before they face the withdrawal of their benefits, the Budget 2018 work allowance increase boosts the 'static' generosity of the system by £630 a year. It means that the number of working families that gain from the switch to UC increases by 200,000 – from 2.2 million families previously to 2.4 million families now. And among working families with children, the number (1.5 million) expected to be better off under UC now matches the number (1.5 million) expected to be worse off.

Crucially, UC's overall impact on incomes still hinges on the extent to which it increases benefit take-up. If the full take-up gain assumed by the Office for Budget Responsibility (OBR) is achieved, then the new system is set to be £1.6 billion more generous than the legacy system would have been by 2023-24, with gains for 700,000 families. However, if this take-up boost isn't forthcoming, then UC will be £1.5 billion less generous than the current system. Such a difference adds further weight to the case for continuing to improve the way in which UC matches the reality of recipients' lives.

Alongside boosting take-up, UC's second key objective is to strengthen the work incentives facing recipients relative to the existing benefit system. The Budget work allowance announcement represents some improvement in this area too, although the extent to which outcomes are better today than they were ahead of Summer Budget 2015 varies by family type. Relative to the pre-Summer Budget 2015 UC system, the various work allowance and taper changes of recent years have:

- » Restored or improved incentives to enter work at low earnings for the 1.3 million renting single parents and the first earner in the 1.3 million renting couples with children eligible for UC.
- » Reduced incentives to enter work at low earnings for home-owning parents who are either single (300,000 eligible for UC) or first earners in couples

(540,000 eligible for UC), and non-parents without disabilities.

- » Continued to overlook incentives to enter work at low earnings for (potential) second earners in the 1.9 million couples with children eligible for UC, only 600,000 of which are currently dual-earning.
- » Continued to offer relatively weak (although slightly improved) incentives for all UC recipients to progress to higher hours or earnings levels, especially once the UC taper rate interacts with employee National Insurance and income tax (when only 25p of each additional £1 earned is kept).

When it comes to work incentives, there are good reasons to support the prioritisation of some of these groups over others. For example, primary earners in couples with children tend to be fairly unresponsive to interactions with the benefit system – typically working full time in any instance. Likewise, it is questionable how much impact incentives have on non-parents without disabilities who have few barriers to work. Support for short-hours working among this group is therefore likely either to be little taken-up, or to represent an unnecessary cost. The retention of the 2015 removal of work allowances for this group can therefore be justified (as long as those resources are reinvested elsewhere in the system).

By contrast, single parents and second earners in couples with children – both very likely to be women – are most responsive to work incentives. As such, it is a concern that UC continues to incentivise single parents (particularly renters) to reduce working hours below the 16 hours backstop present in the tax credits system. It also still fails to sufficiently incentivise work for second-earner parents. UC's relatively un-tested extension of conditionality to those in work is unlikely to be enough to address these concerns.

Building on the Budget work allowance boost, there is therefore a need for further reforms that sharpen financial incentives where they will have the largest effects, weaken the incentives for those transitioning from tax credits to reduce hours or earnings, and make UC more female-friendly. We recommend boosting single parent work allowances, at a minimum, to the equivalent of 15 hours a week on the wage floor, and introducing a second

earner work allowance for those in couples with children.

In relation to incentives to progress, one of UC's major advantages is that it gets rid of the very highest rates at which benefits are withdrawn in the existing system, which can leave people with less than 10p for each additional £1 earned. However, the fact that taxpayers on UC keep just 25p of each additional £1 earned (even less when paying for childcare costs) means that challenges remain. Financial incentives to progress in work should be boosted by gradually lowering the taper rate. In addition, planned progression pilots should test a far more ambitious system of practical support to help low-paid workers progress and secure better-quality roles.

Changes to UC since Summer Budget 2015 have reversed some of the cuts for working families with children and helped to ease the transition onto the new scheme. But these reforms should be seen as merely the start of a process of addressing design flaws. Ultimately, the government must aim to deliver a UC system that improves take-up, sharpens work incentives and supports living standards in the future labour market. With employment at a record high and the number of workless households at a record low, but atypical and insecure employment forms more common than in the past and most workers failing to progress out of low pay a decade later, this is how UC responds to the challenges in today's labour market rather than yesterday's.

## Budget 2018 went further than expected in tackling the delivery and funding challenges facing Universal Credit, though it left issues of design broadly untouched

Last month's Budget delivered plenty of good news in relation to Universal Credit (UC). Action designed to ease the transition of existing benefit recipients as part of the forthcoming 'managed migration' process (costing £0.2 billion a year by 2023-24) had been expected, as too had been the decision to further delay the onset of this process.

### *i* Box 1: The evolution of plans for the 'managed migration' of legacy benefit recipients onto Universal Credit

Budget 2018 stated that the 'managed migration' phase of UC – during which existing benefit recipients will have their current entitlements ended and instead be required to make new claims for UC, with the provision of 'transitional protection' for those who face a less generous entitlement under the new system – is to be delayed. It will now not start in earnest until late-2020, providing the Department for Work and Pensions with time to make improvements to UC's effectiveness.

In addition, the Budget set out a package of practical measures that would ease the transition for those affected by the 'managed migration'. These included the 'running-on' of key out-of-work benefits for an extra two weeks during the transition to UC, building on the Budget 2017 decision to 'run-on' Housing Benefit in the same way. The new package also lowered the rate at which advance payments (provided to UC claimants who don't want to wait five weeks from the point of their claim before receiving any payments) have to be paid back and extended the time over which recipients can do so. In addition, the 12-month grace period that those starting new business have before facing the application of the 'minimum income floor' (MIF)<sup>[1]</sup> was extended to all self-employed people. Finally, the Budget package also continued the relaxation of surplus earnings rules<sup>[2]</sup> in

[1] The 'minimum income floor' caps UC support at the equivalent for a full-time employee job on the wage floor in any month in which self-employed earnings fall below this level.

[2] When people's earnings increase to the extent they are no longer entitled to UC, these rules allow earnings to be tracked in the following six months. Amounts above a given disregard are then taken into account if a person becomes entitled to UC again. The disregard is currently set at a high level, which means these rules will have little effect until the level is reduced in 2020-21.

2019-20.

In laying the 'managed migration' regulations before parliament earlier this month, the government announced further relaxation of requirements, including lengthening the time period within which transitioning families have to make a UC claim.

While these steps are very welcome, there is still more to do to ensure that UC is fully equipped for the last and most challenging phase of its roll-out. As we laid out in our September 2018 briefing, it is essential: that the share of claims being paid in full and on time is increased before roll-out progresses further (where we see a role for the Work and Pensions Select Committee and the Social Security Advisory Committee in ensuring that service standards are hit); that 'transitional protection' is not affected by temporary earnings increases and accounts for unclaimed legacy benefits; and that the government bears the risk of further teething problems during the migration process.

An additional challenge emerging from recent delays to UC's roll-out is that some families who would previously have 'managed migrated' will now migrate 'naturally' due to a change in circumstances requiring them to make a new benefit claim. This will make them ineligible for transitional protection payments and therefore potentially worse off, because in some instances the change in circumstances that lead to a 'natural' migration would not have led to the full removal of transitional protection.

As discussed in Box 1, many of the announcements in this area chime with recommendations we made in September,<sup>[1]</sup> and are therefore welcome.

Action on broader issues of UC design – in relation to the operation of the minimum income floor for the self-employed, access to childcare support, and the frequency with which UC payments can be accessed for instance – was noticeably absent from the package set out in the Budget however. We don't dwell on these features in this note, but we are clear that further reform is required. We have made a number of recommendations in these areas before, and we would also encourage the government to follow the lead of the Scottish government where new flexibilities have been introduced that better match the needs and realities of recipients' lives.<sup>[2]</sup> We will return to outstanding design issues in future months.

Instead, this note focuses on the implications of the unexpected – but also very welcome – move in the Budget to increase work allowances for parents and those with limited capability for work by £1,000, at an initial annual cost of £0.5 billion, rising to £1.7 billion by 2023-24. We provided an initial assessment of this move in our overnight Budget response,<sup>[3]</sup> but now go further. This note provides more detail on what this work allowance increase means for the number of winners and losers under UC, and sets out where it leaves UC in terms of its generosity and its impact on work incentives.

## The Budget 2018 work allowance boost will increase the number of working families left better off by the move to UC by 200,000

Work allowances specify the amount UC recipients can earn before they start to have their awards withdrawn (at a rate of 63p for every £1 earned (after tax) above the allowance, reflecting the UC 'taper rate'). Table 1 sets out the allowances that were in place for different family types ahead of Summer Budget 2015, with the values varying depending on claimants' family status (single or couple, children or not), need for support with disability, and housing status (with lower allowances for renters reflecting the fact that overall UC awards for this group are higher because they include an element to cover housing costs, that is tapered away along with other elements above the work allowance).

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[1] D Finch, [The benefits of moving: Managing the transition of existing claimants to Universal Credit](#), Resolution Foundation, September 2018

[2] These and other implementation recommendations are detailed in: M Brewer, D Finch & D Tomlinson, [Universal remedy: Ensuring Universal Credit is fit for purpose](#), Resolution Foundation, October 2017

[3] Resolution Foundation, [How to spend it: Autumn Budget 2018 response](#), October 2018

**Table 1: Universal Credit-specific welfare changes since Summer Budget 2015 have restored generosity for most in-work renters**

*Impact of successive changes to Universal Credit on families containing a single full-time National Living Wage earner: 2019-20*

|                             | March Budget 2015 | Summer Budget 2015 | Net income change | Autumn Statement 2016        | Budget 2018     |                   | Overall impact on net income |
|-----------------------------|-------------------|--------------------|-------------------|------------------------------|-----------------|-------------------|------------------------------|
|                             | Work allowances   | Work allowances    |                   | Net income change: 63% taper | Work allowances | Net income change |                              |
| <b>Home owners</b>          |                   |                    |                   |                              |                 |                   |                              |
| Single parent               | £9,290            | £5,030             | -£2,770           | +£200                        | £6,030          | +£630             | -£1,940                      |
| Couple with children        | £6,780            | £5,030             | -£1,140           | +£200                        | £6,030          | +£630             | -£310                        |
| No dependent children       | £1,400            | £0                 | -£910             | +£300                        | £0              | £0                | -£610                        |
| Limited capability for work | £8,180            | £5,030             | -£2,050           | +£200                        | £6,030          | +£630             | -£1,220                      |
| <b>Renters</b>              |                   |                    |                   |                              |                 |                   |                              |
| Single parent               | £3,330            | £2,430             | -£580             | +£250                        | £3,430          | +£630             | +£300                        |
| Couple with children        | £2,810            | £2,430             | -£250             | +£250                        | £3,430          | +£630             | +£630                        |
| No dependent children       | £1,400            | £0                 | -£910             | +£300                        | £0              | £0                | -£610                        |
| Limited capability for work | £2,430            | £2,430             | £0                | +£250                        | £3,430          | +£630             | +£880                        |

*Notes:* This analysis assumes that work allowances in place before Summer Budget 2015 are uprated by CPI in 2018-19 and 2019-20. Wider welfare changes that affect UC as well as legacy benefits – including the freeze to working-age benefits and reductions in support for families – are excluded from the analysis. Full-time work is assumed to be 37.5 hours a week. Estimates are rounded to the nearest £10.

*Source:* RF analysis of DWP, *Benefit Rates 2018-19*; OBR (various)

As part of a package of cuts to working-age benefits designed to save the government £12 billion a year by the end of the parliament, then Chancellor George Osborne announced some very significant reductions in these work allowances in Summer Budget 2015. Families with no dependent children and no disability had their allowances removed entirely, while renting single parents faced cuts of more than £4,000. The associated reductions in income were very sizeable.

Philip Hammond subsequently provided some offset to these cuts in Autumn Budget 2016, lowering the UC taper rate to 63p in the pound from its previous level of 65p. As Table 1 shows, this had the effect of boosting UC incomes by between £250 and £300 a year – nowhere near enough to counteract the earlier cuts in most instances, but a step in the right direction.

The Budget 2018 move marks a much more significant advance. By raising awards at a given level of earnings for in-work UC recipients with children or limited work capabilities, this change has an important ‘static’ effect on incomes. Table 1 shows that the original 2015 losses have now been offset for most in-work renting families.<sup>[4]</sup>

As such, the Budget 2018 work allowance increases boost the number of working families who will be better off under UC (once any ‘transitional protection’ has ceased) by around 200,000. As Table

[4] These examples are based on families containing a single earner working full time on the National Living Wage.



2 shows, we estimate that this puts the number of working families gaining from the transition to UC up (from 2.2 million in our analysis last year<sup>[5]</sup>) to 2.4 million.<sup>[6]</sup> And working families with children are now just as likely to be better off (1.5 million) as worse off (1.5 million).

**Table 2: Working parents entitled to legacy benefits are now as likely to gain from the transition to Universal Credit as to be worse off**

*Number of 'gainers' and 'losers' from the transition to Universal Credit among working families entitled to legacy benefits: 2017-18*

|                        | Gainers | Losers |
|------------------------|---------|--------|
| All                    | 2.4m    | 3.0m   |
| Families with children | 1.5m    | 1.5m   |
| Couples                | 1.1m    | 0.9m   |
| Single parents         | 0.4m    | 0.6m   |
| Non-parents            | 0.9m    | 1.5m   |
| By <£50 per week       | 1.5m    | 2.0m   |
| By £50+ per week       | 0.9m    | 1.0m   |

*Notes:* We model a baseline scenario that corresponds to the world in 2017-18 (a year chosen to be consistent with our previous analysis of gainers and losers from the move from legacy benefits to UC) in which the current tax credit system is fully in place, and compare that to a scenario in which UC is fully in place. In both scenarios, we assume that cuts to family support (the removal of the family element and limiting of support for two children) have been fully implemented and that transitional protection has ceased. This is to isolate the impact of the change in support for working families in the steady state system. Estimates are on an entitlement basis, with no adjustment for take-up.

*Source:* RF analysis using the IPPR tax-benefit model

The analysis in Table 2 suggests that the overall number of losers (3 million) will still outweigh the overall number of gainers (2.4 million), but this is because it does not account for any take-up gains associated with the transition to UC. The Office for Budget Responsibility's (OBR's) assessment is that UC could deliver a take-up boost for 700,000 families.<sup>[7]</sup>

Crucially then, take-up is now what will determine whether steady-state UC will overall provide more support to families than the legacy system or not. Without an increase in take-up compared to legacy benefits, the OBR expects UC to be £1.5 billion less generous a year in 2023-24 than the old system would have been. Assuming it achieves the full take-up effect estimated by the OBR, UC will be £1.6 billion *more* generous.<sup>[8]</sup> On this basis, it is even more crucial that the government looks again at how it can improve the responsiveness of UC to its recipients' lives, as discussed above.

[5] See Table 1 in: M Brewer, D Finch & D Tomlinson, [Universal remedy: Ensuring Universal Credit is fit for purpose](#), Resolution Foundation, October 2017

[6] The number of gainers remains below the number of losers – despite the fact that the Office for Budget Responsibility now expects UC to cost more in steady state than the legacy system would have – because: a) this analysis focuses on entitlement (i.e. assuming full take-up in both the legacy system and UC) so does not capture the take-up increase that the Office for Budget Responsibility accounts for in its UC costings; and, b) this analysis focuses only on working families (although because most out-of-work families have similar entitlements under the legacy system and UC, this is unlikely to have a large impact).

[7] See: Office for Budget Responsibility, [Welfare trends report – January 2018](#), January 2018

[8] Office for Budget Responsibility, [Economic and Fiscal Outlook – October 2018](#), October 2018

## The work allowance boost will also improve work incentives for some, but the overall change since 2015 is complex

As well as these ‘static’ effects on incomes, changes in work allowances and the UC taper rate from Summer Budget 2015 onwards have important implications for the extent to which UC boosts incentives to enter and progress in work. UC’s potential to improve financial incentives to work (and make these more obvious to recipients than was the case with multiple benefits in the legacy system) has received far less attention than other issues in recent UC debates. As such, it is on these incentives that the remainder of this briefing note focuses.

To demonstrate the impact of various incarnations of UC on incentives to enter or progress in work, we present stylised case studies that show how a family’s net annual income varies according to gross earnings (which, for simplicity, we always express in terms of weekly hours worked on the National Living Wage (NLW)). In each instance, we show three different iterations of UC, modelled in 2019-20:

- » The original design of the system, which we take to be that in place immediately **before Summer Budget 2015**.<sup>[9]</sup>
- » The design of UC immediately **after Summer Budget 2015**. As well as the cuts to work allowances above, changes in this scenario include cuts that affect UC but also apply across the welfare system more broadly. These are the four-year freeze to most working-age benefits that began in April 2016, and reductions in support for newly claiming families across tax credits, Housing Benefit and UC (the removal of the family element and limiting support to two children). We assume that these policies are fully rolled out and so apply to all recipient families, to demonstrate the impact of UC and wider welfare changes in steady state.
- » The design of UC today **after Budget 2018**, accounting for the reduction in the taper rate from 65 per cent to 63 per cent in Autumn Statement 2016, and Budget 2018 work allowance increases.
- » We additionally compare the design of **the UC system after Budget 2018** to the design of **the legacy (tax credits) system after Budget 2018**, again modelled in 2019-20.

While the case study families we present are stylised, they are chosen to highlight the main aspects of UC’s effects across the population as a whole. To contextualise our selections, Table 3 summarises the types of families that are eligible for UC. It highlights just how wide-ranging a benefit UC will be once fully rolled out, with almost one-third of working-age families eligible. Of these, around half contain children, with the majority of eligible families without children containing a disabled person or carer (a crucial group that our previous analysis has covered,<sup>[10]</sup> but not a focus of this briefing note). In addition, there is a roughly 50:50 split between working and workless families in the UC-eligible population.

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[9] Some changes to UC’s original design (that on which the Department for Work and Pensions’ 2012 impact assessment was based, for example) had in fact been made prior to Summer Budget 2015, including cash freezes to the value of work allowances in 2014-15 and 2015-16.

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[10] D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

Table 3: Working-age families by Universal Credit eligibility: 2016-17, UK

| Family type                   |                             | All families | Workless families | Single-earner families | Dual-earner families |
|-------------------------------|-----------------------------|--------------|-------------------|------------------------|----------------------|
| Single parent                 | Total                       | 1.9m         | 0.7m              | 1.2m                   | -                    |
|                               | Number entitled for UC      | 1.6m         | 0.7m              | 0.9m                   | -                    |
|                               | % of UC-entitled population | 22%          | 10%               | 12%                    | -                    |
| Couple with children          | Total                       | 6.0m         | 0.3m              | 1.6m                   | 4.1m                 |
|                               | Number entitled for UC      | 1.9m         | 0.3m              | 1.0m                   | 0.6m                 |
|                               | % of UC-entitled population | 26%          | 3%                | 14%                    | 8%                   |
| Single adult without children | Total                       | 11.7m        | 4.0m              | 7.8m                   | -                    |
|                               | Number entitled for UC      | 3.2m         | 2.3m              | 0.9m                   | -                    |
|                               | % of UC-entitled population | 44%          | 32%               | 12%                    | -                    |
| Couple without children       | Total                       | 6.1m         | 0.5m              | 1.2m                   | 4.4m                 |
|                               | Number entitled for UC      | 0.6m         | 0.2m              | 0.3m                   | 0.1m                 |
|                               | % of UC-entitled population | 8%           | 3%                | 4%                     | 1%                   |
| Total                         | Total                       | 25.8m        | 5.4m              | 11.8m                  | 8.5m                 |
|                               | Number entitled for UC      | 7.3m         | 3.5m              | 3.1m                   | 0.7m                 |
|                               | % of UC-entitled population | 100%         | 49%               | 42%                    | 9%                   |

**Notes:** This analysis assumes that UC is fully rolled out, including cuts to support for families (the removal of the family element and limiting support to two children). Estimates are on an entitlement basis, with no adjustment for take-up.

**Source:** RF analysis using the IPPR tax-benefit model

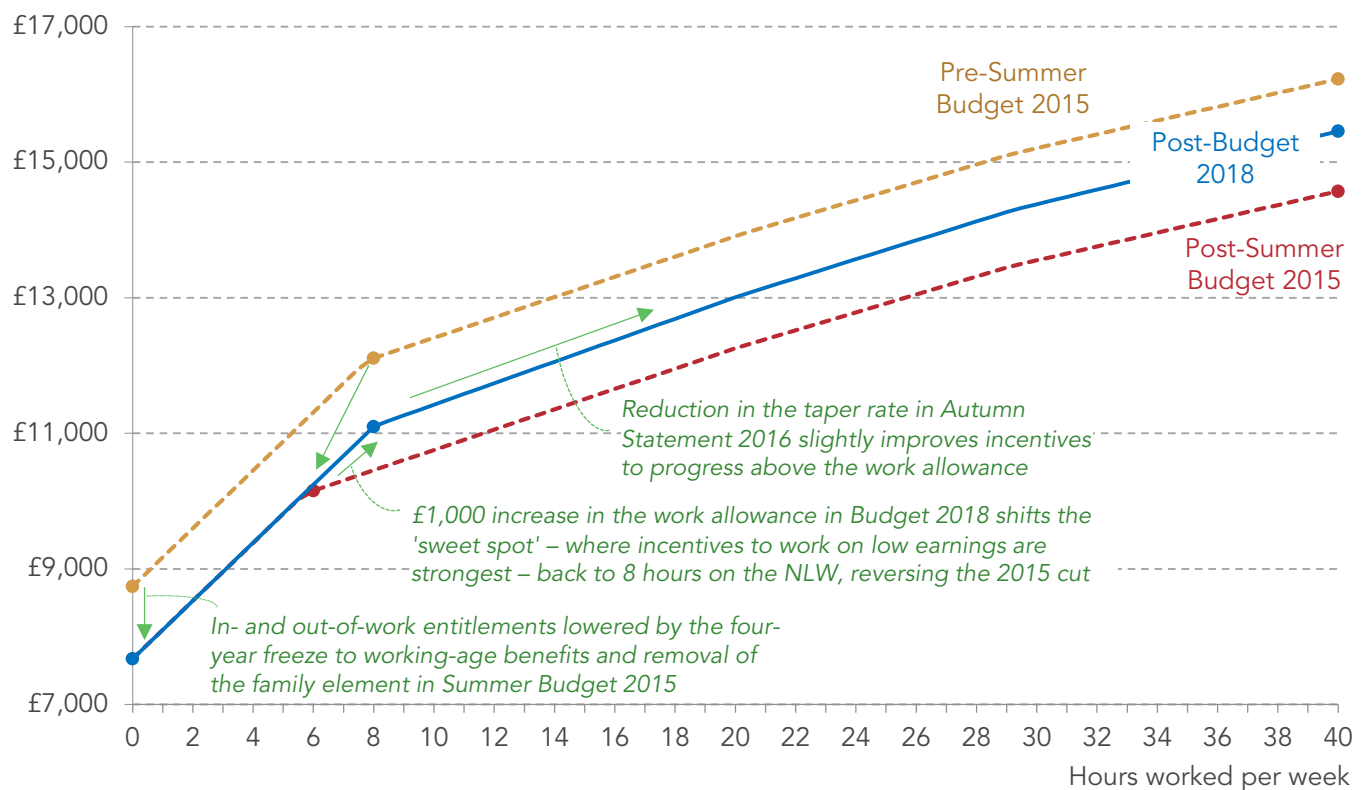
## Renting parents now have similar or better incentives to enter and progress in work compared to those they had before the cuts announced in 2015

Figure 1 shows net annual income at different hours of work on the NLW for a renting single parent with one child under each UC system. Of the 1.6 million single parents eligible for UC shown in Table 3, 1.3 million rent their homes (and 660,000 of these are in work).

We find that, whether in or out of work, incomes are lower across the board under UC systems since Summer Budget 2015, owing to the impact of the benefits freeze and removal of the family element. These wider changes in overall generosity interact with changes in work allowances in respect to financial work incentives, offsetting to some extent the impact of reducing support for working families by also reducing the value of out-of-work support (and therefore pushing back upwards on the *relative* ratio between in-work incomes and out-of-work incomes).

**Figure 1: The restored UC work allowance for renting single parents improves incentives to enter work and re-establishes an earnings ‘sweet spot’ at 8 hours on the NLW**

Net annual income after housing costs for a renting single parent with one child earning the National Living Wage, Universal Credit system: 2019-20



**Notes:** This analysis assumes that UC is fully rolled out, including cuts to support for families (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. Rent is assumed to be £135 a week, and all adults are assumed to be aged 25-and-over.  
**Source:** RF analysis using the RF microsimulation model

Turning in more detail to incentives to enter work at low earnings, under the pre-Summer Budget 2015 UC system this family’s work allowance is exhausted at 8 hours on the NLW. We refer to the point at which work allowances are exhausted as a ‘sweet spot’ – where a worker retains full access to their out-of-work entitlement, and above which awards are reduced by at least the prevailing UC taper rate for each additional £1 earned. Workers (particularly single parents and second earners who are most responsive to financial incentives)<sup>[11]</sup> therefore have strong incentives to enter work at this ‘sweet spot’, and may also be inclined to fit working hours to sweet spots given the significant degree of income cushioning the system provides down to that point.

Budget 2018 changes restore this single parent renter’s ‘sweet spot’ to 8 hours on the NLW, thereby reversing the potential impact of Summer Budget 2015 on working patterns where there was an increased risk of single parents becoming trapped at very low levels of earnings (with the sweet spot reduced to 6 hours on the NLW). The financial incentive is actually stronger because the cash gain upon entering work is the same, but income when out of work is now lower because

[11] See: D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

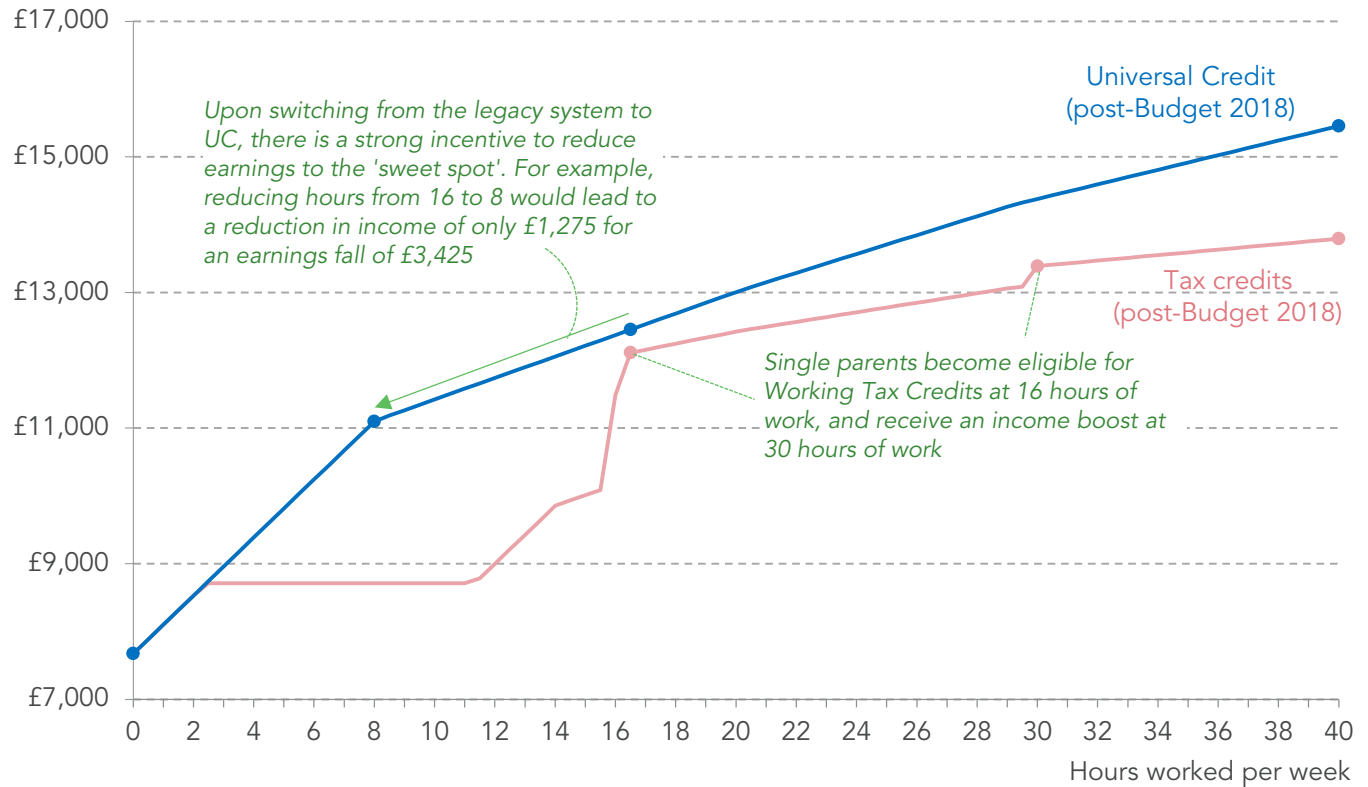
of the benefit freeze and removal of the family element.

The final change of note in Figure 1 relates to income beyond the ‘sweet spot’ point at which the work allowance has been exhausted. For this family, and indeed all the case studies shown in this briefing note, the Autumn Statement 2016 reduction in the taper rate increases the rate at which net income grows with earnings in the post-Budget 2018 scenario, compared to the post-Summer Budget 2015 scenario. This represents a slight strengthening of incentives to progress in work, although taxpayers will still keep only 25p of each additional £1 earned.

These work incentive effects are put into context via a comparison of UC with the legacy (tax credits) system, shown in Figure 2.

**Figure 2: The transition from tax credits to UC presents the risk that single parent renters will significantly reduce hours and/or earnings**

Net annual income after housing costs for a renting single parent with one child earning the National Living Wage, Universal Credit system compared to tax credits system: 2019-20



**Notes:** This analysis assumes that UC is fully rolled out, as are cuts to support for families across the UC and legacy systems (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. Rent is assumed to be £135 a week, and all adults are assumed to be aged 25-and-over.

**Source:** RF analysis using the RF microsimulation model

On the positive side, this shows that this NLW-earning single parent renter paying £135 per week in rent is as well or better off at all earnings levels upon switching from the legacy system to

UC,<sup>[12]</sup> and that UC provides stronger incentives to progress beyond 16 hours of work. However, with a clear ‘sweet spot’ at 16 hours of work a week under the legacy system due to hours rules in tax credits, there is a strong risk that those clustered at this point reduce earnings to their work allowance when migrating to UC.

The chance of single parents clustering around sweet spots in this way is material: in 2016-17, 370,000 (55 per cent) of the 660,000 working single parent renters who will be eligible for UC worked fewer than 25 hours a week, with 130,000 of them clustered at the tax credits sweet spot of exactly 16 hours a week. That’s why our 2015 review of UC recommended boosting work allowances for single parents to at least 15 hours on the wage floor.<sup>[13]</sup> The government might consider the extension of conditionality to those in work to be enough to address these concerns. However, experience tells us that employment success (such as rising maternal employment rates) is the product of both strong financial incentives and support.

The incentives associated with the same iterations of the UC system for a first earner in a couple with one child that rents their home (1.3 million of the 1.9 million couples with children eligible for UC rent their homes) are shown in Figure 3. It is a similar picture although, in this instance, the ‘sweet spot’ post-Budget 2018 is higher (at 8 hours a week on the NLW) than it was under the pre-Summer Budget 2015 system (7 hours a week on the NLW).

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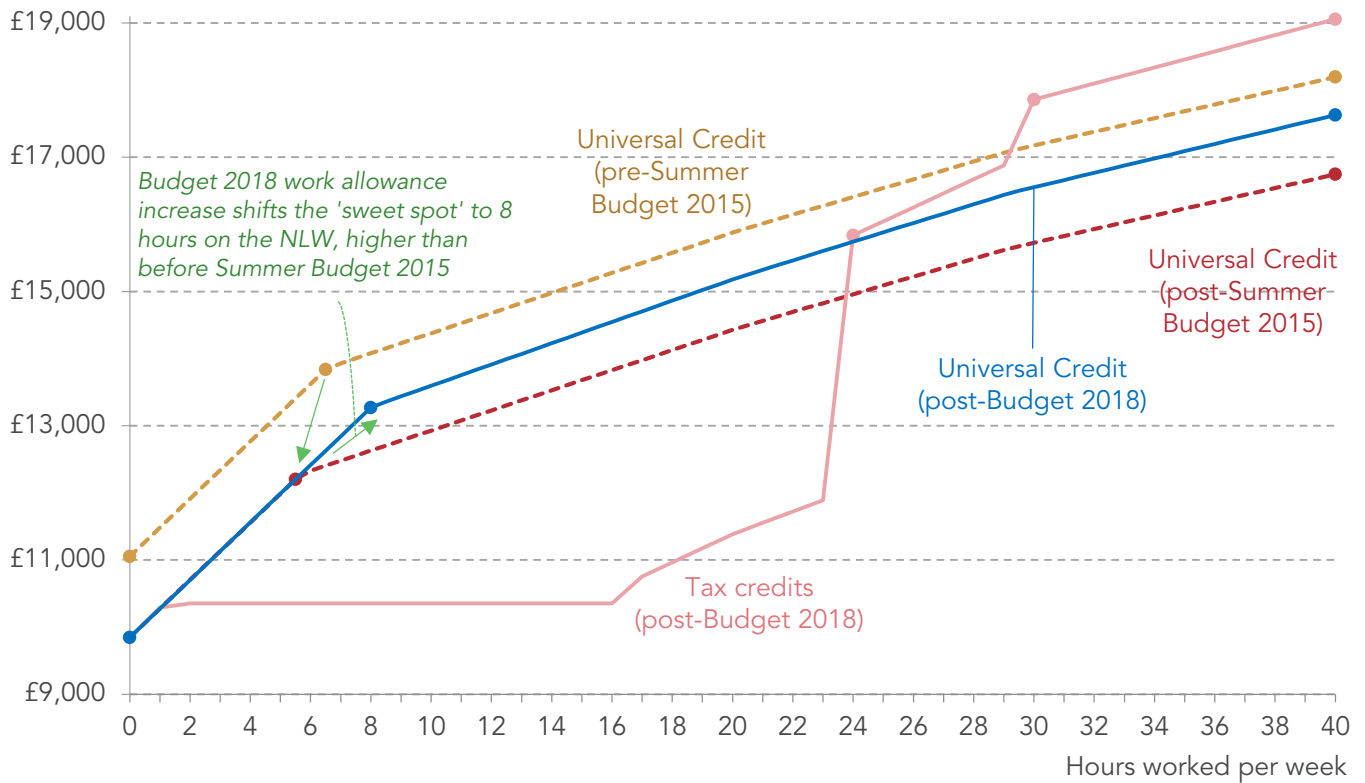
[12] This does not mean that all working single parent renters are better off on UC than in the legacy system. For example, lower housing costs can flip the picture in favour of the tax credits system. Coupled with a generally less generous system for the smaller group of working single parent home owners discussed below (and other differences between the legacy system and UC such as reduced support for those aged under 25), this is why the number of working single parents who lose from the switch to UC remains slightly higher than the number who gain, as shown in Table 2.

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[13] D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

**Figure 3: Single-earning parents in couples that rent now have a higher UC work allowance than before the 2015 cuts**

Net annual income after housing costs for a renting, single-earning couple with one child earning the National Living Wage, Universal Credit system compared to tax credits system: 2019-20



**Notes:** This analysis assumes that UC is fully rolled out, as are cuts to support for families across the UC and legacy systems (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. Rent is assumed to be £135 a week, and all adults are assumed to be aged 25-and-over.

**Source:** RF analysis using the RF microsimulation model

As with the single parent renter above, Figure 3 also shows that this remains well below the point at which the ‘sweet spot’ applies under the legacy system (24 hours a week for first earners in couples, representing the point at which Working Tax Credit becomes available). However, as we’ve previously discussed, primary earners in couples tend to be largely unresponsive to changes in financial incentives to work.<sup>[14]</sup> The risk of reducing earnings is less of a concern in this instance therefore. While the income boost for working single-earner couples with children delivered by the work allowance increase in Budget 2018 is welcome, improving work incentives for more responsive groups appears a more immediate priority than those for first earners shown here.

[14] D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

Overall, the combination of work allowances at least as high as they were prior to Summer Budget 2015 and a slightly reduced taper rate leaves renting parents (that is, single parents and first earners in couples with children) with similar or better work incentives than intended in UC's original design. For renting single parents, though, high risks of reduced working hours relative to the tax credits system remain.

### **Home owners and non-parents without disabilities have weaker incentives to enter work than they did prior to the 2015 cuts**

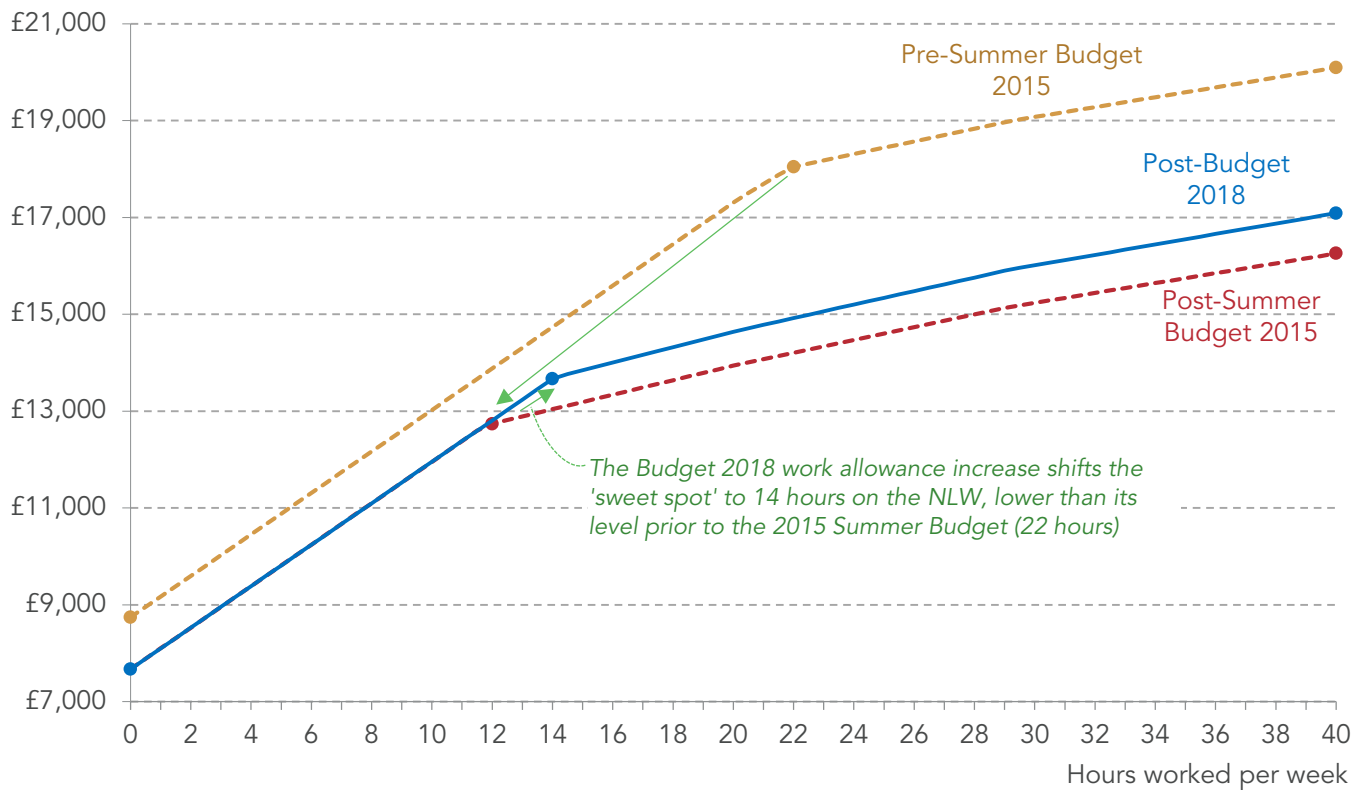
Other groups have weaker work incentives today than those under the UC system envisaged prior to the Summer Budget 2015 changes. One such group is home owners, with the example of a single parent home owner with one child shown in Figure 4.

For context, of the 1.6 million single parents eligible for UC shown in Table 3, 300,000 own their homes (and 230,000 of these are in work).



**Figure 4: Home-owning parents have a lower earnings ‘sweet spot’ than before the 2015 cuts**

Net annual income after housing costs for a home-owning single parent with one child earning the National Living Wage, Universal Credit system: 2019-20



*Notes:* This analysis assumes that UC is fully rolled out, including cuts to support for families (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. All adults are assumed to be aged 25-and-over.

*Source:* RF analysis using the RF microsimulation model

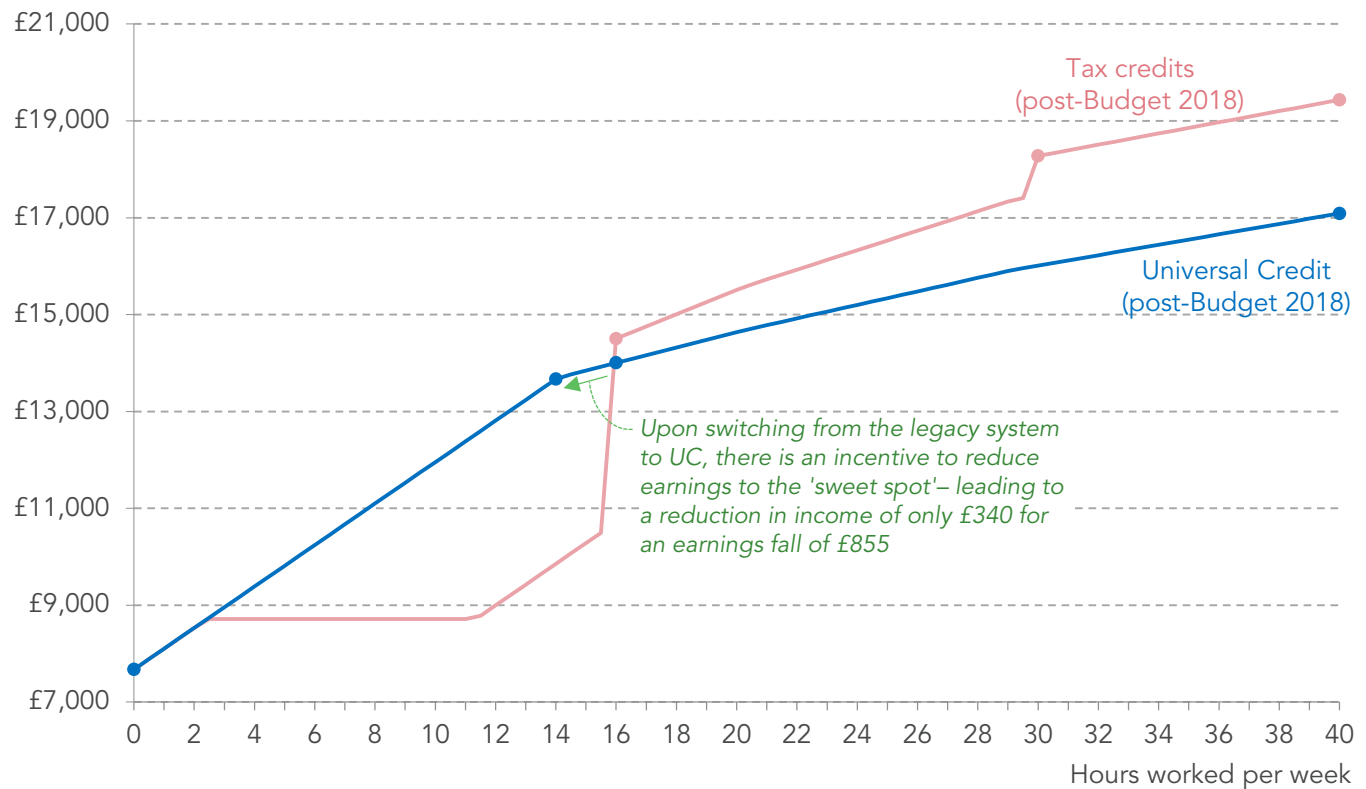
Figure 4 shows that the ‘sweet spot’ at which incentives to work on low earnings are strongest for single parent home owners has shifted up to 14 hours a week on the NLW as a result of the Budget 2018 changes, but remains well below where it was pre-Summer Budget 2015 (22 hours a week on the NLW).<sup>[15]</sup>

Figure 5 sets this latest iteration of UC for a home-owning single parent against the incentives faced under the legacy (tax credits) system. The risk of shifting down to or getting trapped at very low earnings is not as acute here as for single parent renters (shown in Figure 2). However, the fact that home-owning single parents migrating from legacy benefits will have a stronger incentive to reduce earnings somewhat when freed from the tax credits 16-hours-rule (more-so than implied by Figure 5 if their hourly rate is above the NLW) is sub-optimal.

[15] ‘Sweet spots’ for first earners in home-owning couples are the same, apart from under the pre-Summer Budget 2015 scenario, in which the sweet spot lies at 16 hour per week on the NLW. Of the 1.9 million couples with children eligible for UC, 540,000 own their homes.

**Figure 5: Home-owning single parents now have a lower earnings ‘sweet spot’ under UC than they face under the legacy system**

Net annual income after housing costs for a home-owning single parent with one child earning the National Living Wage, Universal Credit system compared to tax credits system: 2019-20



**Notes:** This analysis assumes that UC is fully rolled out, as are cuts to support for families across the UC and legacy systems (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. All adults are assumed to be aged 25-and-over.  
**Source:** RF analysis using the RF microsimulation model

For some the flexibility the work allowance provides may better suit their working pattern, but importantly incentives to progress are noticeably weaker beyond this point (because the UC taper rate of 63 per cent is much higher than the tax credits taper rate of 41 per cent).

Another group now facing reduced (indeed, entirely removed) UC work allowances – and therefore weaker incentives to enter work at low earnings – than under the pre-Summer Budget 2015 UC system is non-parents without disabilities (as mentioned above, a large share of UC-eligible families without children contain a disabled person or carer).<sup>[16]</sup>

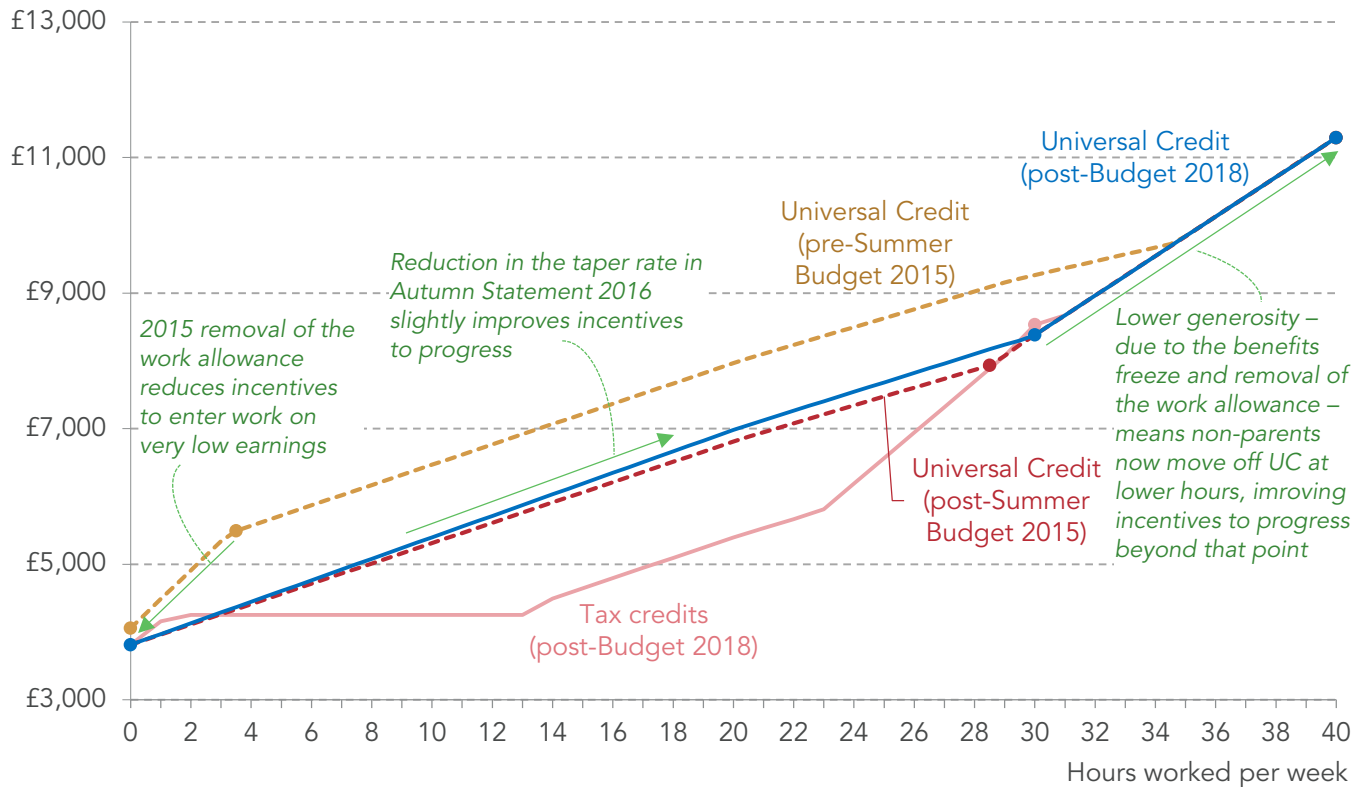
Figure 6 sets out the implications for a single non-parent renter. It shows that prior to the removal of the work allowance, non-parent renters working close to full-time hours on the wage floor would have become eligible for in-work benefits when moving from the legacy system to UC, and therefore faced much smaller income losses when reducing working hours. As such, the original design of the system appeared to do *too much* to support short-hours working – or a potential

[16] As in this case, all other case studies presented in this briefing note assume no disability-related financial support among family members.

reduction in workloads supplemented by the state – for a group with few barriers to work.<sup>[17]</sup> That’s why our 2015 review of UC concluded that the work allowance for non-parents without disabilities be removed, with spending prioritised elsewhere in the system.<sup>[18]</sup>

**Figure 6: Non-parents now have no work allowance, reducing their incentive to enter work at low hours, but meaning they lose UC entitlement altogether at a lower level of earnings**

Net annual income after housing costs for a renting single adult earning the National Living Wage, Universal Credit system compared to tax credits system: 2019-20



Notes: This analysis assumes that UC is fully rolled out. For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. Rent is assumed to be £75 a week, and all adults are assumed to be aged 25-and-over. Tax credits refers to the legacy system. A person with no children or disability is only entitled to Working Tax Credit when aged 25-and-over and working at least 30 hours a week.

Source: RF analysis using the RF microsimulation model

[17] It is also important to consider that UC extended in-work support to under-25s without children for the first time (they are not eligible for Working Tax Credit).

[18] D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

Figure 6 also shows that the removal of the work allowance for non-parents without disabilities in Summer Budget 2015 means this group now moves off UC altogether at lower hours (or earnings levels),<sup>[19]</sup> above which incentives to work more are much stronger. Combined with a lower taper rate, this change means that non-parents without disabilities now face similar or stronger incentives to progress (and greater dis-incentives to reduce hours or earnings) at all earnings levels above 4 hours a week on the NLW, compared to the pre-Summer Budget 2015 UC system.

## Incentives to work remain weak for second earners

As mentioned above, second earners in couples with children tend to be relatively responsive to work incentives. However, their work incentives were not prioritised in the original design of UC (which was explicitly targeted at reducing workless households),<sup>[20]</sup> and recent changes barely alter this picture.

Figure 7 shows how net family income varies with the earnings of a second earner in a renting couple with one child. For context, of the 1.9 million UC-eligible couple families with children shown in Table 3, only 600,000 are dual-earning (390,000 of whom rent their homes). Many factors will drive this outcome, but the relatively weak incentives for second-earner parents to enter work in the tax credits system is likely to be one. Their incentives are weaker still under UC.

While generosity has recently improved compared to the post-Summer Budget 2015 picture due to the restoration of the work allowance that is used up by the first earner, incentives for a second earner to work at low earnings are now weaker (because the family is now better off than previously with a single earner). Second earners' work incentives remain much weaker than for primary earners in couples, and single parents. A second earner working 8 hours a week at the NLW would be only £1,265 per year better off in work than they would out of work, despite gross earnings of £3,425.

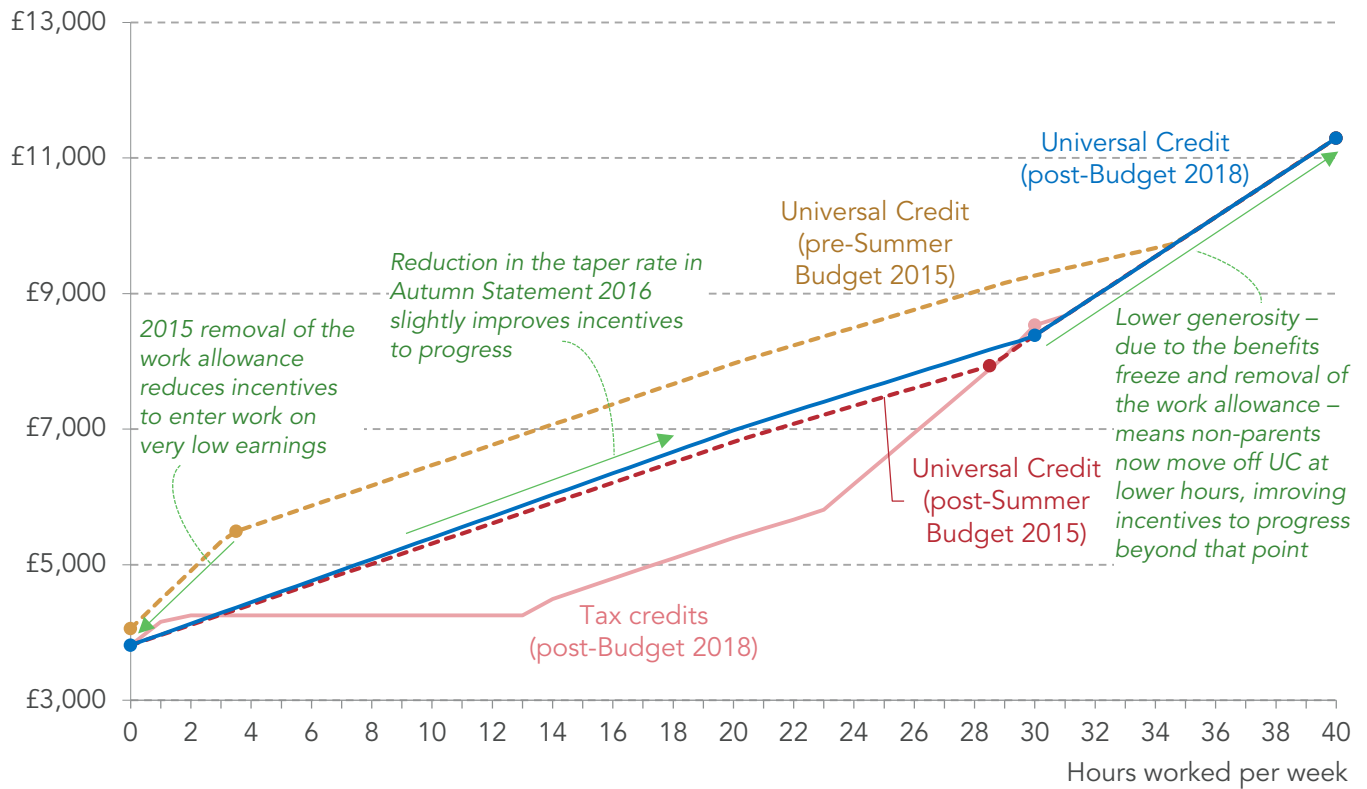
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[19] Indeed, home owners and those with lower housing costs move off UC at even lower earnings levels than shown in the stylised example in Figure 6.

[20] Department for Work and Pensions, [Universal Credit impact assessment](#), December 2012

**Figure 7: Second earners in couples face weak incentives to enter work**

Net annual income after housing costs for a renting, dual-earning couple with one child, in which the second earner earns the National Living Wage, Universal Credit system compared to tax credits system: 2019-20



**Notes:** This analysis assumes that UC is fully rolled out, as are cuts to support for families across the UC and legacy systems (the removal of the family element and limiting support to two children). For simplicity, we ignore council tax and the (now localised) system of support towards paying council tax bills. Tax and National Insurance thresholds are those announced in Budget 2018. Rent is assumed to be £135 a week, and all adults are assumed to be aged 25-and-over. The first earner is assumed to work 37.5 hours a week on the NLW.

**Source:** RF analysis using the RF microsimulation model

The number of workless households in the UK is at record low and dual-earning is increasingly important for low-income living standards.<sup>[21]</sup> For example, just 5 per cent of children living in couple families in which both adults are in full-time work are in poverty, compared to 34 per cent of children living in couple families with only one full-time worker.<sup>[22]</sup> As such, objectives need to be refocused in this direction in order to make UC fit for today’s living standards challenges. That’s why we have previously recommended the introduction of a second earner work allowance, initially at a level equivalent to 7 hours a week on the NLW (and funded by the abolition of the married couple’s allowance in the income tax system which acts as a disincentive for second earners), with a view to boosting it to the equivalent of 15 hours a week on the NLW in the longer term.<sup>[23]</sup>

[21] Office for National Statistics, [Working and workless households in the UK: April to June 2018](#), August 2018

[22] Department for Work and Pensions, [Households below average income: 1994/95 to 2016/17](#), March 2018

[23] M Brewer, D Finch & D Tomlinson, [Universal remedy: Ensuring Universal Credit is fit for purpose](#), Resolution Foundation, October 2017

Like similarly responsive single parents, this group has traditionally been overwhelmingly made up of women. The introduction of a second earner work allowance would therefore go some way to making UC more female-friendly. However, it is worth noting that it is caring responsibilities rather than gender that appears to be the dominant factor in explaining responsiveness. Previous research has shown, for example, that women without children tend to be less responsive to changes in financial work incentives than mothers.<sup>[24]</sup> Second-earning fathers in couples might therefore be expected to exhibit similar responsiveness to work incentives to second-earning mothers. Indeed, the increasing number of fathers in this position (the number of low-paid coupled fathers working part time doubled between 2002 and 2016)<sup>[25]</sup> is likely to reflect improved female earnings pre-children, a sign that financial trade-offs *do* have an effect on work decisions for this group.

## Despite some improvement associated with the reduction in the taper rate, all UC recipients continue to face relatively weak incentives to progress

Beyond the work incentives faced by second earners in particular, Figure 7 also serves to highlight the fact that across the board UC recipients face relatively weak incentives to progress beyond work allowances. In particular, at the point at which both employee National Insurance and income tax have kicked in (30 hours a week on the NLW in 2019-20), workers keep just 25.2p of each additional £1 they earn until they move off UC. While this is higher than the figure prior to Autumn Statement 2016 (23.8p), there is a need to do more to improve incentives to progress via means other than the relatively un-tested and blunt instrument of in-work conditionality that exists within UC.

We have previously recommended improving incentives to increase earnings by gradually lowering the taper rate, and trialling a range of other financial incentives for progression, including time-limited conditional payments and additional childcare support. The funding approved at Autumn Statement 2017 for UC progression pilots represents an important opportunity to test ambitious new approaches. Beyond financial incentives, there is a need for the government to be far more ambitious in trialling a range of forms of in-work support in order to boost earnings progression, as well as dramatically improving careers guidance and making progression a core objective of government policy.<sup>[26]</sup>

Employment is at a record high and household worklessness a record low, but atypical and insecure employment forms are more common than in the past. By contrast (and partly as a result), in-work poverty is rising, with two-thirds of children living in poverty now living in families in which someone works.<sup>[27]</sup> In addition, most workers fail to progress permanently out of low pay over a decade.<sup>[28]</sup> On this basis, greater emphasis on boosting financial incentives and other support for progression should form a central element of a benefit system designed to work with the grain of today's labour market.

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[24] D Finch, [Making the most of UC: Final report of the Resolution Foundation review of Universal Credit](#), Resolution Foundation, June 2015

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[25] M Brewer, D Finch & D Tomlinson, [Universal remedy: Ensuring Universal Credit is fit for purpose](#), Resolution Foundation, October 2017

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[26] M Brewer, D Finch & D Tomlinson, [Universal remedy: Ensuring Universal Credit is fit for purpose](#), Resolution Foundation, October 2017

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[27] Department for Work and Pensions, [Households below average income: 1994/95 to 2016/17](#), March 2018

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[28] C D'Arcy & A Hurrell, [Escape plan: Understanding who progresses from low pay and who gets stuck](#), Resolution Foundation, November 2014

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**i** Box 2: Universal Credit reforms in the context of wider welfare cuts

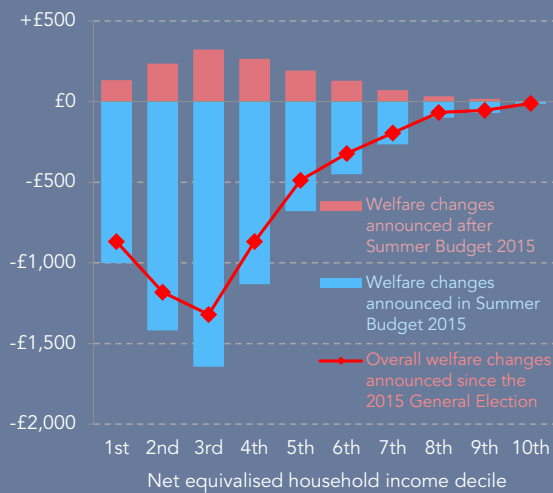
As shown in the various figures set out in this report, non-UC specific welfare cuts are evident in the lower net incomes that families on UC experience relative to the pre-Summer Budget 2015 baseline both when in and out of work. These same cuts also affect the generosity of legacy benefits of course. And, while relatively few families are yet to move onto UC, around 10 million existing benefit claimants have already been affected by three years of frozen benefit rates. A smaller number have also been affected by the removal of the family element and limiting of support to two children.

Some families will lose out to a far greater extent than suggested by the stylised case studies in this briefing note then. For example, the limiting of support to two children, combined with the removal of the family element and the four-year benefits freeze, mean that in 2023-24 a dual-earning renting couple with three children receiving in-work benefits will be nearly £3,500 per year worse off than they would have been under a pre-2015 Summer Budget system.<sup>[1]</sup>

Overall, only around one-quarter of the welfare cuts introduced in Summer Budget 2015 have been reversed by funding boosts to UC at recent fiscal events, as Figure 8 shows for those measures directly affecting family budgets. Over half of the remaining cuts are yet to take effect,<sup>[2]</sup> and as such the broader welfare picture over the coming years remains less rosy.

**Figure 8: Recent changes to Universal Credit have only unwound around a quarter of the welfare cuts announced in Summer Budget 2015**

*Impact of welfare policies announced since the 2015 General Election on net household income: 2023-24*



**Notes:** Net income is measured before housing costs are accounted for. As well as policies listed earlier in this briefing note, changes announced in Summer Budget 2015 include cuts to support for the work-related activity group in Employment and Support Allowance. 2015 Summer Budget changes exclude reductions in social rents which do not directly affect household income. 85 per cent of UC recipients are assumed to be new claims in 2023-24, with reductions in support for families apportioned accordingly.

**Source:** RF analysis of OBR, Policy measures database; OBR, Economic and Fiscal Outlook (various), using the IPPR tax-benefit model

[1] Resolution Foundation, How to spend it: Autumn Budget 2018 response, October 2018

[2] Resolution Foundation, How to spend it: Autumn Budget 2018 response, October 2018

Additionally, while Budget 2018 brought some good news for UC, we shouldn't lose sight of the ongoing impact of wider reductions in the generosity of the welfare system (see Box 2). Further efforts to boost incentives to enter and progress in work when in receipt of UC should be complemented by mitigations to these wider welfare changes that bear down on workless and the most vulnerable families, as well as affecting those in work.

## Conclusion

The steps taken by the government in Budget 2018 undoubtedly represent good news for UC. Practical changes to the process of ‘managed migration’ offer an important opportunity to better handle what could be a very difficult implementation phase, protecting recipients from unnecessary financial difficulty and the UC system itself from further unwanted headlines. More unexpectedly, the £1.7 billion boost to work allowances will deliver clear cash gains to lower-income working families with children. Coming on top of the Autumn Budget 2016 reduction in the UC taper rate, the move will leave some recipients better off than they were due to be ahead of Summer Budget 2015, and crucially also sharpens work incentives.

However, these recent reforms should be seen as the *start* of a broader process. UC generosity is improved, but many households continue to face income hits relative to their expected pre-Summer Budget 2015 position. Financial work incentives too are improved for some, but remain worryingly weighted towards avoiding worklessness in households rather than supporting secure work and earnings progression. More fundamentally, UC continues to be a system that too often achieves operational simplicity by imposing systemic rigidity on its users. Delivering a benefit system that improves take-up, sharpens work incentives and supports living standards for the future labour market will require further reform yet.



# Resolution Foundation

*Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:*

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- » *developing practical and effective policy proposals; and*
- » *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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