Safe harbour?

Six key welfare policy decisions to navigate this winter

September 2020

Karl Handscomb

Despite the new Job Support Scheme, unemployment is set to rise substantially through the autumn and winter, as the Job Retention Scheme ends and the hospitality sector adjusts to new restrictions. This means many more individuals will soon be dependent on the social security system; and as the economy moves into the next phase of this crisis, the Government has six key welfare decisions to make to help stop those who lost their jobs from being left behind.

With the Job Retention Scheme (JRS) ending at the end of this month, and tougher restrictions affecting hospitality newly in place, we face an autumn and winter of rising unemployment, despite the new Job Support Scheme. Over five million families – around a quarter of all working age households – are currently claiming either Universal Credit (UC) or Working Tax Credit (WTC), and this number will surely grow. With the uncertainty around the virus and the economy continuing, the chances of the newly-unemployed being able to find new work remain low, and so the social security system will be key to supporting these families and preventing undue hardship.

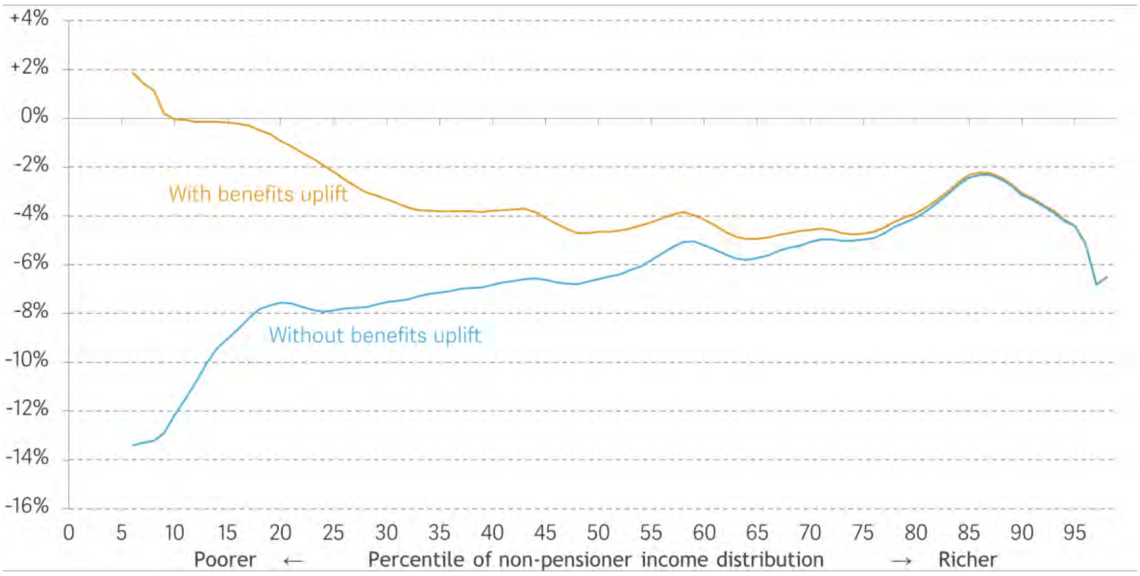
The Chancellor was aware of this in March: "So we will also act to protect you if the worst happens…I'm announcing nearly £7bn of extra support through the welfare system to strengthen the safety net and protect people's incomes." And this support is still important today. To keep on protecting families, the Government has six key welfare decisions to make in the forthcoming weeks to help ensure the social security system can probably protect families in this ongoing in the next phase of this crisis.

1. The poorest households are set to lose £1,000 of their annual income next April

Recognising the increasing reliance on benefits during the pandemic, the Government announced in March a temporary increase to UC and WTC of around £20 per week during 2020-21 – the majority of the £7bn cost of all the extra support. As Figure 1 shows (taken from our Living Standards Audit), this increase helped to offset – at least on average - the initial fall in incomes caused by the labour market effects of the virus for the lowest-income households. Now, the Government risks undoing this protection for the poorest families at a time when they need it most.

Figure 1 **The benefit increases protected the poorest families from the largest income shock in the crisis**

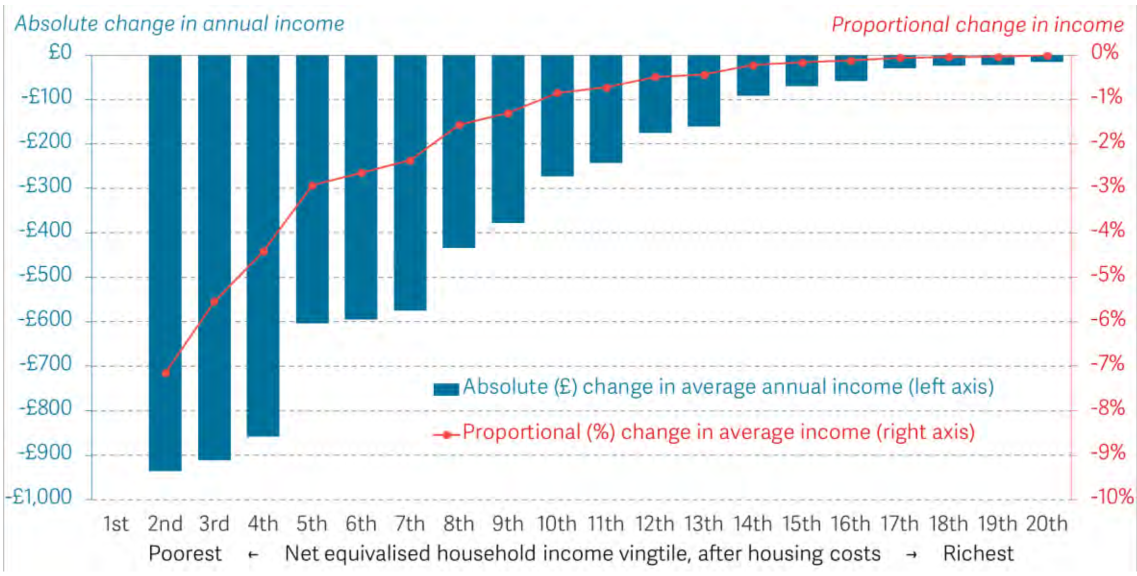
Average annual growth in real (CPI-adjusted) equivalised disposable household income (after housing costs), before and after benefits changes: May 2020, UK



Notes: Reproduced from: D Tomlinson et al., The Living Standards Audit 2020, Resolution Foundation, July 2020. We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of this group's income data.
Source: RF analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

Figure 2 **Discontinuing the £20 a week increase will leave the poorest families 7 per cent worse off net year**

Impact on average household income by vingtile, of not retaining UC & tax credit boost in 2021-22: UK



Notes: Reproduced from: T Bell et al., The Winter (Economy Plan) is coming, Resolution Foundation, September 2020. We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of this group's income data.
Source: RF analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

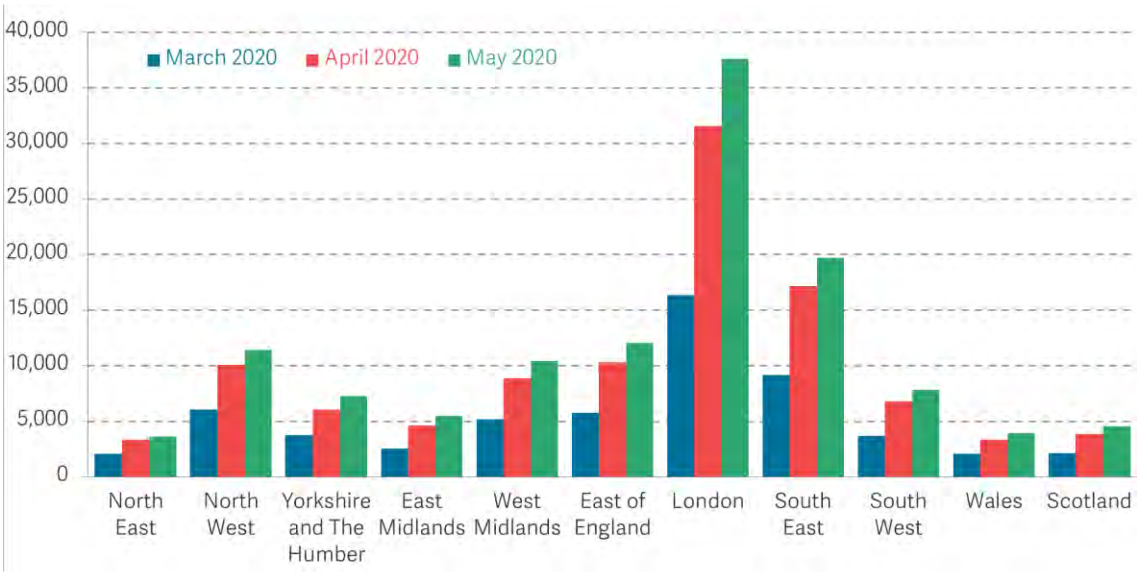
This benefits increase, costing £7 billion this year, is an expensive policy. But the case for continuing with it is very strong. The cut to UC this coming April will see over six million families worse off by £1,000 per year – that is almost twice the number of families that would have been affected by the, eventually reversed, tax credit cuts planned for 2016. Figure 2 shows our current forecast that poorest families will suffer a huge 7 per cent fall in income if the £20 per week increase is removed in April.

2. The Benefit Cap means that 124,000 families on UC did not receive the full £20 per week benefits increase earlier this year, and thousands more are likely to see a fall in their benefit as the grace period runs out

Although the standard allowance for UC increased in April, there was no increase in the Benefit Cap. This limits the total benefits that most families can receive to £20,000 per year (£23,000 in London), and most single adults to £13,400 per year (£15,410 in London). This means that families with high housing costs, typically families with children, did not see their income from benefits rise in April. This is reflected in the latest data for May 2020 which shows that 7 per cent of UC claims with children in receipt of payment are subject to the benefit cap, compared to less than 1 per cent of UC claims without children. Figure 1 shows how the 124,000 Universal Claims subject to the Benefit Cap in August - 65,000 more than in March – are distributed by region across the UK, highlighting the concentration of capped families in London, reflecting the higher housing costs.

Figure 3 **The Benefit Cap is affecting nearly double the number of households since the crisis started**

Number of households on Universal Credit affected by the Benefit Cap by region



Source: Stat Xplore, DWP.

But there are some important exemptions from the Benefit Cap, reflecting the intention that it should not penalise those who are in work, or cannot work due to health conditions. Crucially, there has always been a grace period of nine months for those who were in work before they had to claim UC (claimants had to have consistently met the earnings threshold for twelve months before having stopped working). The principle is to avoid penalising those who until recently have been in work, but then encouraging them back into work as the grace period ends and the benefit cap binds.

November will mark nine months since the start of this crisis, and so this is when the Benefit Cap will kick in for those families who claimed UC when the crisis began. But ending the grace period is clearly at odds with the current economic climate. For an example single parent in a high housing cost area, not qualifying for the grace period could be the difference in benefit of £57 per week – or a quarter of their income after housing costs.[1]

To better support families who have lost income during the crisis and have not yet had the opportunity to go back to work, the Government should extend the grace period for the Benefit Cap. It should also consider the level of the cap and the reasonableness of the policy – especially for younger claimants – during the ongoing crisis.

3. To provide additional support to self-employed benefit claimants, the Govenrment should consider extending or adapting the Minimum Income Floor

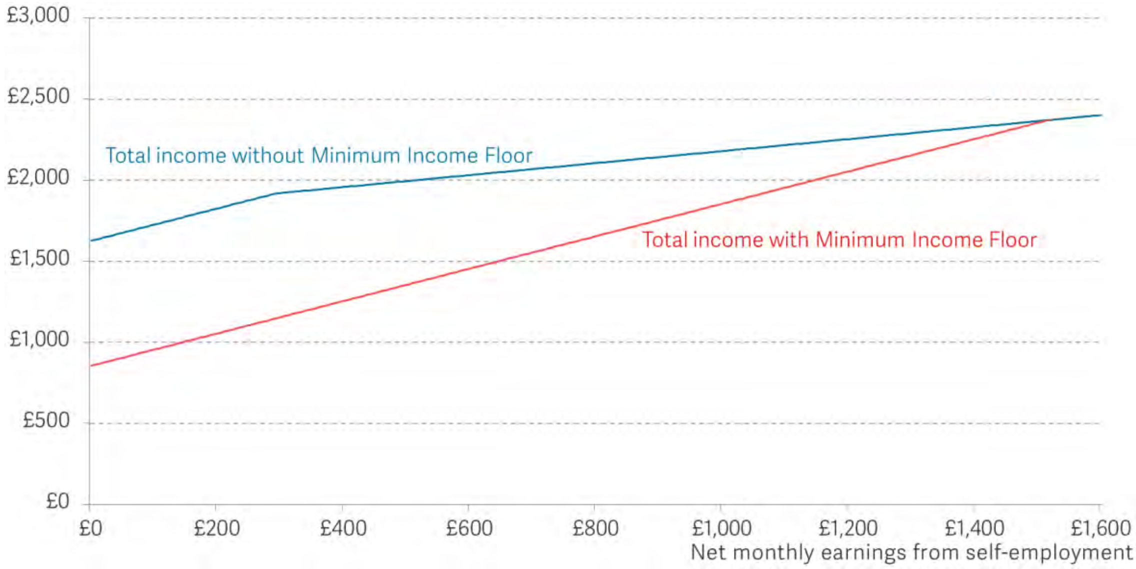
The Minimum Income Floor (MIF) in UC was designed to prevent UC from supporting very low productivity self-employed jobs. It does this by assuming that all self-employed claimants earn at least as much as they would in a minimum wage position (although new self-employed claimants have always been allowed a start-up period of 12 months when the MIF does not apply). Figure 4 shows how the policy acts to reduce monthly income compared to a world without such a rule.

When the crisis hit, the Government rightly suspended the MIF so that self-employed workers whose businesses had stopped completely, or who had to stop work because of ill-health, self-isolation or shielding, could receive the full level of UC, just as employed workers could who had lost their job or were otherwise away from work.

There is a very strong case to continue the suspension of the Minimum Income Floor for self-employed UC claimants during the uncertain economic climate. Maintaining the policy punishes self-employed business owners who are optimistic about their earnings in the coming months, and for some will reward those who close their business and become unemployed. Avoiding support for unproductive businesses is a worthy policy aim, but at present the Minimum Income Floor fails to distinguish between unproductive work and temporary lower demand.

Figure 4 **A self-employed single parent could be £770 a month worse off due to the Minimum Income Floor**

Combined monthly earnings and Universal Credit income for a single parent with two children living in three-bedroom private rented housing, who is expected to work for 40 hours per week: 2020-21



Notes: Depending on the ages of the children, the expected number of hours may be reduced, lessening the effect on the Minimum Income Floor. Housing costs of £161 per week, no childcare costs.
Source: RF calculations.

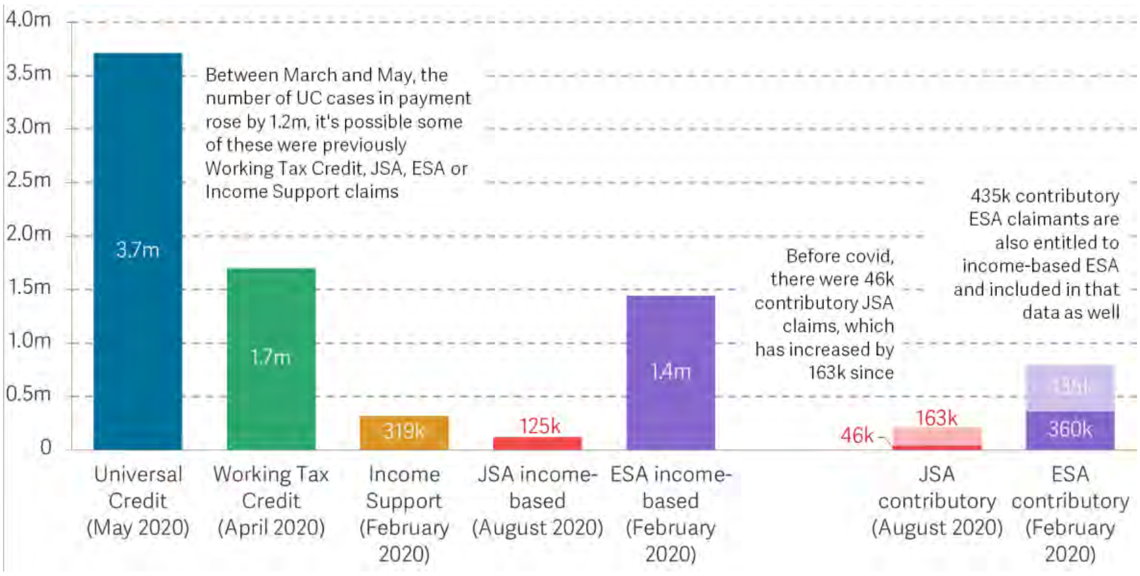
4. The £20/wk increase to Universal Credit was never reflected in the old "legacy" benefits

There are still over 3 million claims of the legacy benefits (according to the latest statistics) that UC has been slowly replacing since 2013. These include income-based Jobseeker's Allowance (JSA), income-based Employment and Support Allowance (ESA), Income Support (IS) and Working Tax Credit (WTC) (all of which could be claimed exclusively of one another), in addition to Housing Benefit and Child Tax Credit, which could be claimed in their own right. On top of that, there are also contributory-based JSA and ESA claims, which will not be replaced by UC – as set out in Figure 5.

Other than WTC, none of these other benefits were increased when the Government added £20 a week to UC, creating differences in generosity between what are ostensibly the same benefits serving similar client groups. (It is possible to overcome this gap in generosity by actively claiming and switching to UC, but some of those with ill-health or disabilities are rightfully wary of moving to UC, as this could mean going through a new work capability assessment process and a 13-week period with reduced benefit.)

Figure 5 **The transition to Universal Credit makes for a complex benefit landscape**

Working age income-related and contributory benefits cases in payment: 2020, GB



Notes: JSA=Jobseeker's Allowance; ESA = Employment and Support Allowance. Latest data shown for each benefit, as data is published separately it is not possible to know the extent of any double counting between benefits, for example if a Working Tax Credit claim closed in April and started a new Universal Credit claim. Jobseeker's Allowance data includes a small number of claims not in payment. We assume all JSA cases over six months duration are income-based claims, which closed to new claims in 2019, and all those under six months are contributory as it is time-limited to six months. Housing Benefit and Child Tax credit cases not shown as the majority of (but not all) claims are in combination with one of the other benefits.
Source: DWP, Stat Xplore; ONS, Nomis.

The Government's rationale was that, since no new claims to these legacy benefits have been allowed since early 2019, then recipients will not have recently been in work. However, there were recipients of UC who in March 2020 were not working, and there were others with long-term health-related conditions who are in effect identical to some ESA claimants. On this basis, it seems arbitrary and unfair to have increased UC and not income-based ESA or JSA. If the £20 per week increase to UC is made permanent, the Government should, in the interests of fairness, consider increasing legacy benefits. We estimate this would cost between £1.5 and £2 billion per year, a cost that would fall significantly over the next few years as UC completes its roll out.

5. Contributory benefits have returned to the spotlight during this crisis, and are now less generous than UC

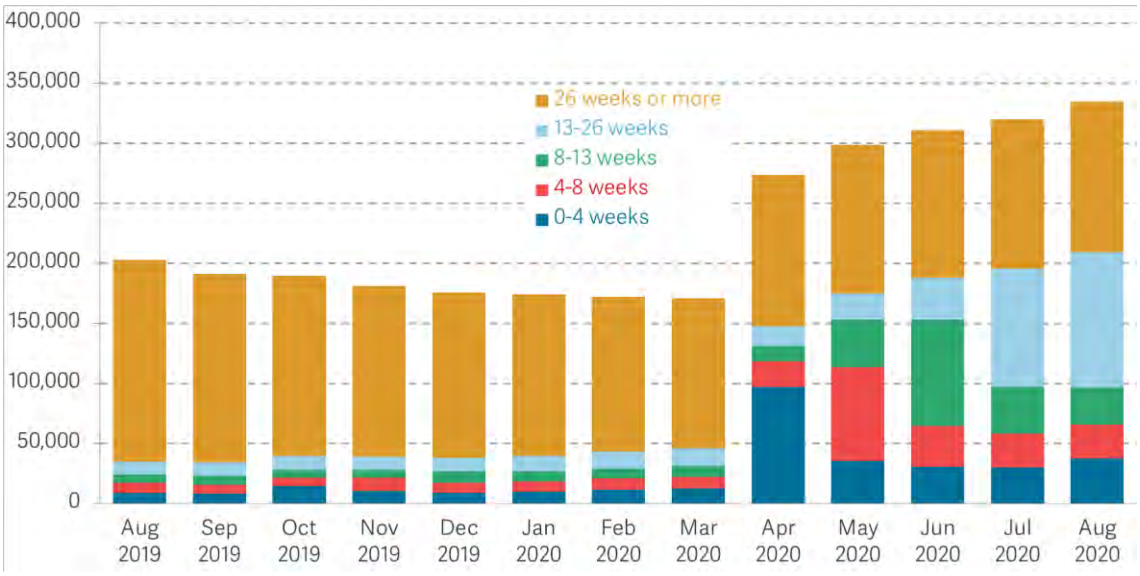
Since the introduction of UC, there has been little policy discussion or political attention given to the main contributory benefits for those of working age, Jobseeker's Allowance (JSA) for the unemployed and Employment and Support Allowance (ESA) for those who cannot work through ill-health or disability, Importantly, these are *not* set to be merged into UC alongside the other income-contingent benefits.

The key distinguishing feature of these benefits from UC and other income-based benefits is that entitlement does not take into account the earnings of any partner or the amount of savings a family has. Instead, the claimant must have been in work over the last two years and paid sufficient national insurance contributions to qualify. Crucially, contributory JSA claims are time limited to six months, and some ESA claims are time limited to 12 months (the more serious health condition claims are not time limited).

Figure 6 sets out the number of active JSA claims each month by the duration of each claim. This allows us to distinguish between those who must be new-style contributory JSA claims – those who have claimed for less than six months – and the remaining 'legacy' income-based cases who have been unable to claim JSA since 2019 (and must now claim UC instead) and therefore must have been claiming for more than six months. There has been an increase of 164,000 JSA cases since March, and, as detailed by the duration breakdown, many of these claimants are now coming to the end of the six month time-limited claim period. Although these claimants are likely to have other sources of income or wealth to live on, the time-limited nature of JSA is inconsistent with the current economic climate. If we compare two individuals, one who was furloughed and the other who was not and claimed JSA instead, the difference in outcomes is stark indeed: the former receives 80 per cent of previous wages and the latter gets just £74 a week.

Figure 6 **Claims to contributory Jobseeker's Allowance have nearly doubled since March**

Jobseeker's Allowance claimants by duration of claim: UK



Source: Nomis, ONS.

When the crisis has passed, there is a very good case for reviewing the balance between contributory and means-tested benefits. Making a fundamental change will take years, but the Government should consider bridging the gap between a what was a generous furlough scheme and what is a very limited form of unemployment insurance provided by JSA. Such a system could provide a more flexible welfare system that would enable more targeted economic support for families during a future recession, and provide higher income replacement rates for those who lose their jobs.

The government can also make changes to UC today that will benefit contributory JSA claimants finding their six-month entitlement coming to an end. The £16,000 capital rule test has led to 6,300 claims ineligible for support through UC – which in part explains the increase in claims for JSA. As we have argued before, the UC capital rule test is unfair for many would-be claimants in the current crisis, easing the UC capital rule would enable more newly unemployed families with no earnings to access support during the remainder of this crisis.

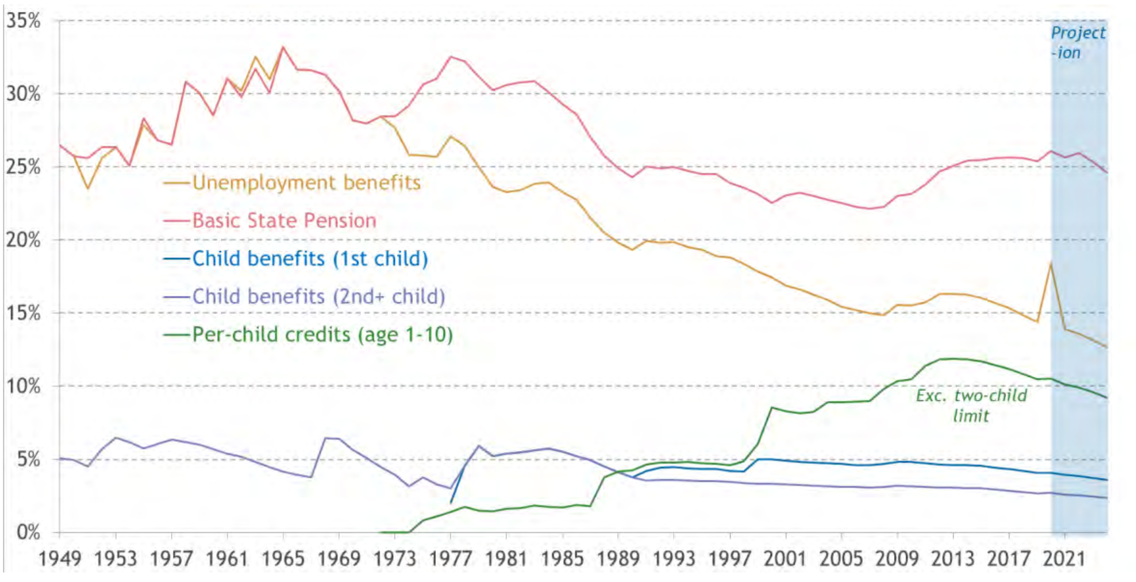
6. The design of the State Pension triple-lock risks further inequity during the crisis

The rachet effect of the triple lock of inflation, earnings and 2.5 per cent, will continue to ensure that the State Pension increases during the crisis. During this particularly volatile period, we estimate that the triple lock will mean that State Pension increases by 7.6 per cent over the next two years, compared to 1.5 per cent earnings growth and 2.5 per cent price growth.

There is an important debate to be had about the right level for the State Pension. However the juxtaposition of the triple lock and major cuts to working-age benefits has been problematic, especially given the much stronger growth in pensioner than working-age incomes over the past two decades. And the mechanism itself is a messy way of achieving the objective of a higher State Pension, providing an upwards ratchet that is dependent on not just the general pace of growth in prices and wages, but their volatility too.

Figure 7 **The State Pension will continue to outpace earnings and leave other benefits behind**

Selected major benefits as a proportion of average weekly earnings



Notes: 'Unemployment benefits' captures the main rate of Universal Credit from 2013 onwards, rather than the contributory ('new style') Jobseeker's Allowance benefit that continues alongside it (which did not benefit from the temporary uplift in April 2020).
Source: RF analysis of IFS, Fiscal Facts; ONS; BoE; OBR; HMT.

As Figure 7 shows, the £20 per week increase to UC goes some way to reversing the falling generosity of working-age benefits over time, although it remains almost £40 per week below the State Pension. The £2.1 billion per year potential savings from moving to a 'smoothed earnings link' could be put towards making the £20 per week UC increase permanent, doing much to restore equity in the benefits system. If the Government is particularly worried about pensioner poverty, then it has the option to uprate Pension Credit – the benefit for low-income pensioners – by more than earnings or prices, should it choose, but at a much lower cost compared to the triple lock (only 1.5 million pensioners claim pension credit compared to 12.5 million in receipt of the State Pension).

There are tough longer-term decisions to make about taxes, spending and borrowing as a result of this crisis. But in the midst of this crisis, the Government should consider its options carefully. With rising unemployment, doing what it can to prevent millions of households falling into a living standards crisis today will surely provide a sounder social and economic foothold for the future.

---

1 Taking an example single parent aged 21, with two young children, privately renting a two-bedroom property in Reading at the 30th percentile of local rents (£219 per week). They would currently be entitled to an underlying UC award equal to £406 per week and £35 per week in Child Benefit, but the Benefit Cap would reduce that by £57 to £384 per week. After housing costs, that equates to 26 per cent lower income at £165 per week (instead of £222).