Half-measures

The Chancellor's options for Universal Credit in the Budget

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The Government has still to decide on whether to continue the £20 per week uplift to Universal Credit (UC) and Working Tax Credit (WTC), due to expire in just 45 days. There are suggestions the Chancellor will opt for a halfway house of keeping the uplift for six months. Compared to the pencilled-in default of letting the uplift expire, this would cost the Treasury £3 billion, and provide up to £500 to around 6 million low-income families.

There were two aims behind the original uplift: to reduce the size of the income hit from the Covid-19 crisis, and to strengthen the UK's safety net. A six-month extension fails to achieve these. It means less support for people who become unemployed when the labour market is likely still to be struggling and, rather than strengthening the safety net, stopping the uplift in October 2021 would weaken it when it is still greatly needed. Compared to a full year's extension of the current regime, it would mean a cut in annual incomes of 3.8 per cent for households receiving UC or tax credits.

The Chancellor must also not forget that the need to extend the £20 per week uplift derives from the very low levels of unemployment benefit rates. Without the uplift, benefits for the unemployed would be at their lowest real-terms level since the early 1990s. There is, therefore, a strong case for the uplift to be made permanent. This would likely mean higher taxes in the years to come, but it would reverse only a fraction of the welfare cuts since 2010, and would be an essential step towards a functioning social security safety net.

The Government acted swfitly to improve benefit generosity at the outset of the crisis, and under current plans is set to undo this just as quickly

The Government's initial policy to protect family incomes when the pandemic hit had three-prongs: the Coronavirus Job Retention Scheme, the Self-Employment Income Support Scheme and the emergency £20 a week uplift to Universal Credit (UC) and the Working Tax Credit (WTC) (along with increases in Local Housing Allowance). The £20 per week boost has set the monthly basic rate for UC in 2020-21 at £410 for a single adult, and £594 for a couple, rather than £323 and £507 respectively (adults aged 24 or younger receive reduced rates, and additions for children, health conditions and caring have remained unchanged). A similar increase was made to WTC rates.

The stated rationale mentioned two closely-related goals: "to strengthen the safety net and protect people's incomes". And this measure can be seen as successful, in so far as incomes in 2020-21 are projected to have increased rather than fallen at the bottom of the income distribution.

Although the Government recognises the need to continue to support people while the effects of the pandemic are ongoing, the default position, as set out by the Chancellor in the Spending Review, is that the £20 per week uplift will expire in 40 days.[1] The Treasury is no doubt concerned about the impact on the public finances of making the £20 a week uplift permanent, and this may explain why a final decision is being taken so late, despite the problems with cutting support in April 2021 having being obvious for months. So, a variety of alternatives have also been discussed within Government, including one off payments (a terrible idea), a one-year extension, and packages that tweak the extra support so it is focused towards children. The latest proposal is a sub-optimal halfway house of keeping the uplift for six months.

A half-year extension is only half a solution

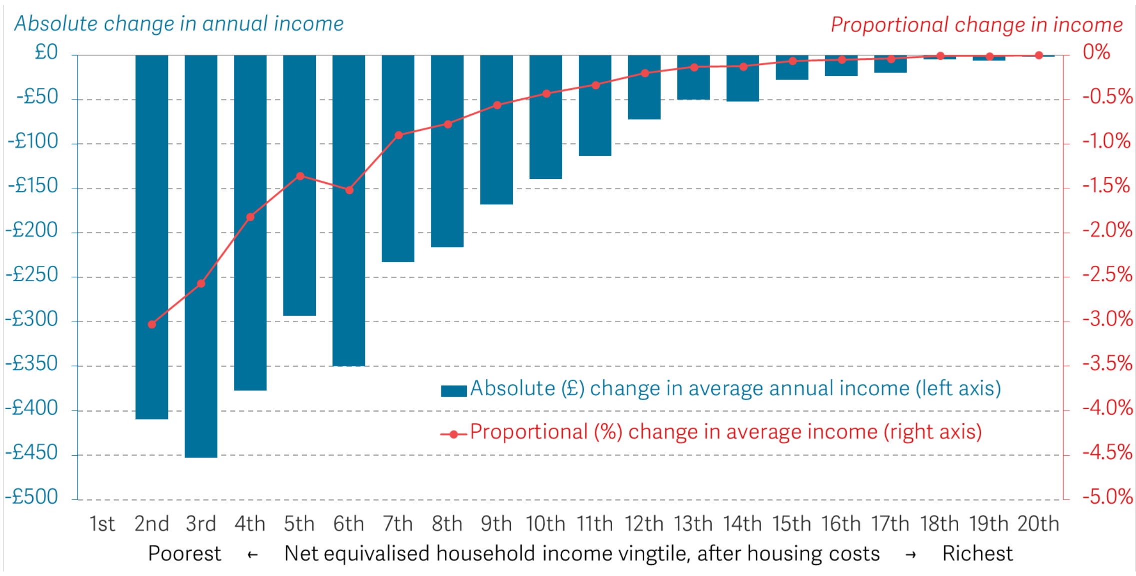
The halfway house option under discussion would see the £20 per week boost to Universal Credit continued until the end of September 2021, with an equivalent one-off bonus of £520 for families in receipt of Working Tax Credit. Paying the extra entitlement to WTC as a lump-sum is necessary, as it operates on an annual basis, meaning it is not possible to increase entitlements only for the first 6 months of the year. The problems with a one-off lump sum payment to UC recipients do not apply to WTC recipients, principally because WTC is being phased out, and so no new claims are possible. [2]

Compared to stopping the uplift in April (the default policy assumed in the fiscal forecasts made in the 2020 Spending Review), the cost of a six-month extension would be around £3 billion, about half that (unsurprisingly) of continuing with the uplift for the full year.[3] And, again compared to stopping the uplift in April, this would provide up to £520 to around 6 million low-income families (there were 3.9 million families in receipt of UC in August 2020, and 1.7 million families receiving WTC in April 2020; there will likely be more UC recipients than this in in 2021-22, but fewer tax credit recipients, as no new claims can be made for WTC).[4] And this is to be welcomed in the light of recent research that estimated that one-in-five UC recipients had fallen behind on essential bills during the pandemic, and three-in-ten had said that their level of debt had increased since February 2020. The various restrictions on economic activity and social interactions during the Covid-19 crisis, as well as the pressure of home-schooling, have also combined to make life more expensive for those on a low income.

But a six-month extension is less than many organisations have called for. Figure 1 shows the impact on household incomes, assessed over 2021-22 as a whole, of proceeding with a six-month extension rather than an extension for the full financial year. As this makes clear, the poorest fifth of households would be £350 worse off across 2021-22, on average, compared with an extension for the full financial year. A loss of this size represents an average of 3.8 per cent of the annual income of households receiving UC or tax credits.

Figure 1 **Removing the £20 per week boost after six months will mean the poorest households will be £350 worse off over the whole of 2021-22**

Estimated impact on annual household income of continuing the £20 a week UC and WTC uplift for six rather than twelve months, by income vingtile: UK, 2021-22



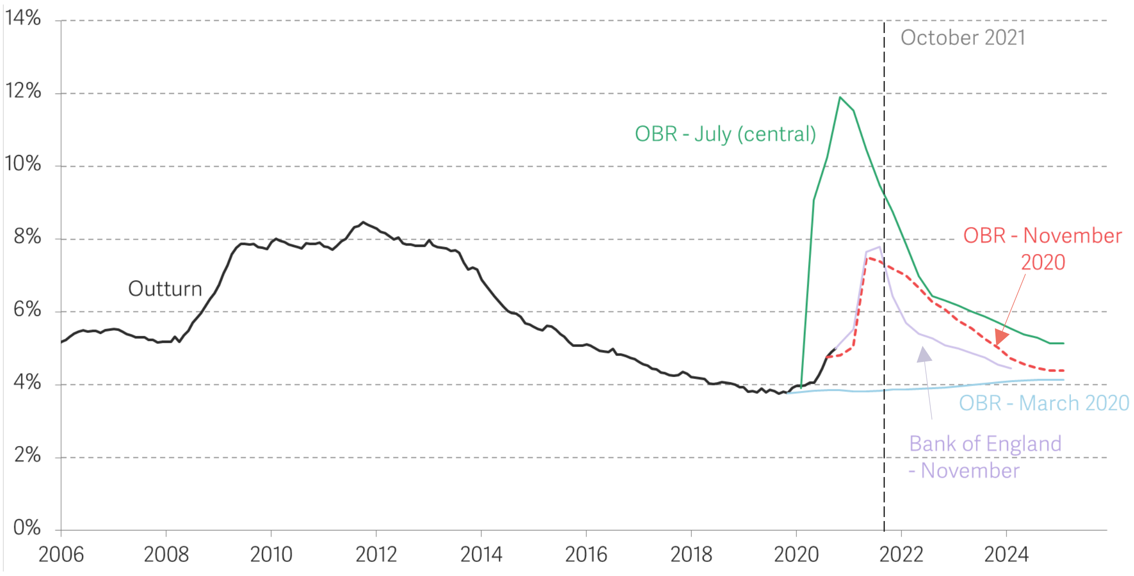
Notes: We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.
Source: RF analysis of DWP, Households Below Average Income; and RF forecast (for more details, see M Brewer et al., Living Standards Outlook 2021, Resolution Foundation, January 2021).

Of course, analysing incomes over the whole of 2021-22 papers over the distinctive aspect of this proposal, which is that it would cut UC by £20 a week midway through the year. The lived experience of this proposal is that those people receiving UC in the first half of 2021-22 would see no fall in benefit income, but those receiving UC in the second half of 2021-22 would see a fall to their monthly income that was twice as large, in proportionate terms, as those shown in Figure 1. It would also mean that someone who loses their job in October will get £20 a week less in UC than someone who loses their job now.

Families will likely still face significant economic headwinds in October 2021

A six-month extension to the £20 per week uplift simply shifts today's policy dilemma six months into the future, and it would put us back in the position of imposing a large benefit cut on about 6 million families at the end of September. But this autumn looks unlikely to be the right time to cut back support for the unemployed and low-income working families. The most recent Bank of England forecasts have unemployment at 7.9 per cent in July to September, and 6.6 per cent from October to December 2021 (see Figure 2) – both considerably higher than the current level of 5 per cent, and a firm indication that the UK's labour market will still be feeling the economic effects of the Covid-19 crisis. Rather than reinforcing the safety net when the greatest number of families will need it, ending the uplift in October 2021 would be doing the opposite, going directly against the Chancellor's original rationale for introducing it.

Figure 2 **Unemployment is set to rise through 2021 even as the economy grows**
16+ unemployment rate, outturn and successive OBR projections and Bank of England forecast: UK



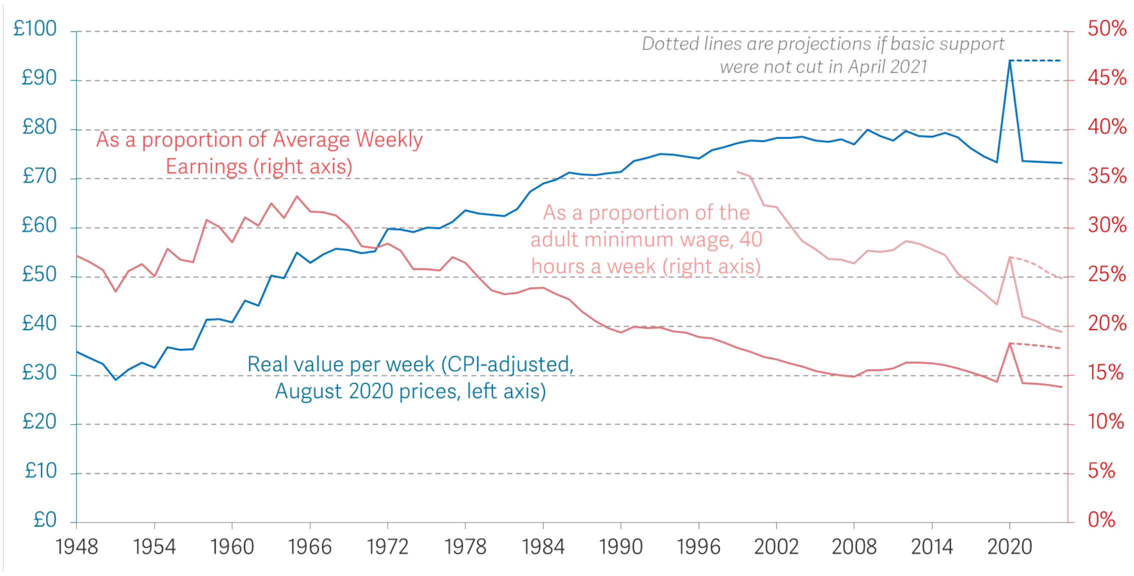
Source: OBR, Economic and Fiscal Outlook, various; OBR, Fiscal Sustainability Report, July 2020; Bank of England, Monetary Policy Report, November 2020.

Is the safety net sufficient?

But we should not lose sight of why we are having this conversation in the first place. According to OECD data, the UK had one of the lowest benefit replacement rates for unemployment before the crisis (48 per cent compared to an OECD average of 67 per cent for a single adult earning two-thirds of the median wage). As Figure 3 plainly shows, the basic level of unemployment benefit has fallen in recent years because of the four-year benefit freeze (from 2015 to 2019).[5] But it is also clear that it has completely failed to keep pace with growth in the economy for decades. If the £20 per week uplift to UC is removed next fiscal year, then the real-terms value of unemployment benefit will fall to its lowest level since 1991, a period over which the size of the economy (per capita) has grown by 50 per cent in real-terms. Relative to earnings, unemployment support would fall to its lowest level ever, and would be less than one-fifth of the earnings from a full-time minimum wage job by the end of this Parliament, compared to around one-third in 2001.

Figure 3 **The real-terms value of unemployment benefit is set to fall to their lowest level since 1991**

Value of the main rate of unemployment-related benefit over time for a single adult, with projections: UK, 1948 to 2024

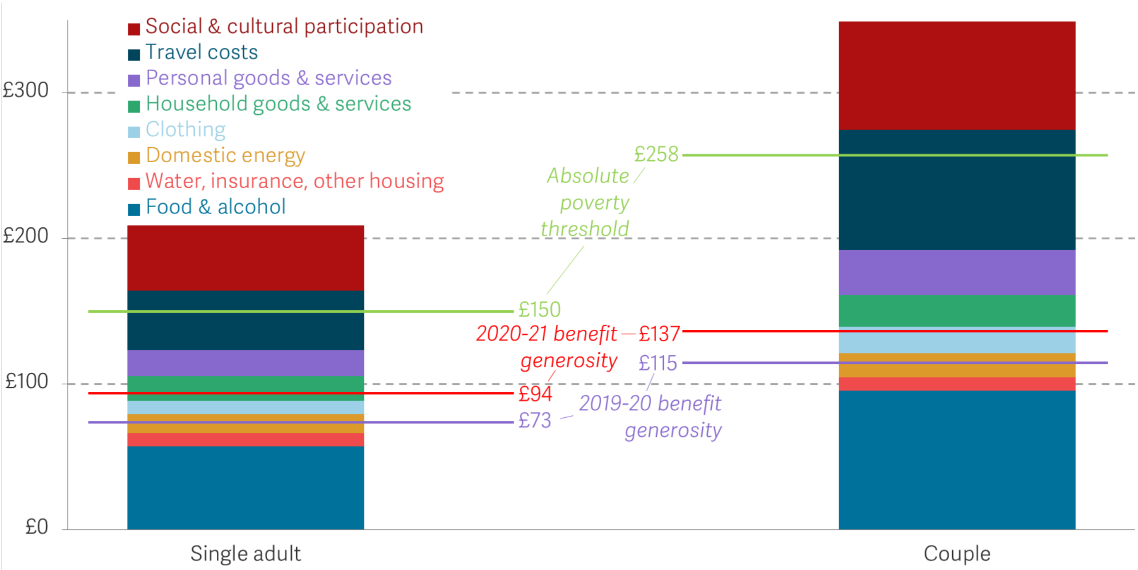


Notes: Minimum wage is National Minimum Wage until introduction of National Living Wage thereafter. National Living Wage forecast is based on OBR, Economic and Fiscal Outlook, November 2020.
Source: RF analysis of IFS Fiscal Facts; ONS; Bank of England; and OBR.

But inflation and economic growth are not the only benchmarks against which to measure benefit adequacy. Figure 4 shows levels of benefit with and without the £20 per week boost compared to a Minimum Income Standard (an estimated budget deemed adequate to meet material needs and participate in society).[6] The previous benefit level of £73 per week for a single adult over the age of 25 was around one-third of a Minimum Income Standard, and less than half of the Government's own measure of absolute poverty (set at 60 per cent of the median income in 2010-11, adjusted for inflation since). Even excluding all social and travel activities, with the £20 per week boost, the basic levels of benefit fall short. Perhaps then it is unsurprising that, for the first time since 2001, the 2019 British Social Attitudes survey found that more people thought the level of unemployment benefit was too low and causing hardship than thought the benefit was too high and discouraging work.

Figure 4 **The £20 per week uplift implicitly recognised that benefits fell well short of a minimum income standard or the absolute poverty threshold**

2020 Minimum Income Standard (excluding rent and Council Tax); 2019-20 absolute poverty threshold; and basic benefit levels – per week



Notes: The absolute poverty threshold is measured after housing costs and taxes.
Source: RF; Centre for Research in Social Policy, Loughborough University; DWP, Households Below Average Income.

Keeping the uplift for the long-term has a price tag, but would go some way to mending the UK's frayed safety net

Cutting support for the unemployed – for whom UC is the main form of support – when so many families are dependent on it makes little sense if the Government's objectives are to protect family incomes, and would act as a drag on growth at a time when the hoped-for economic recovery is still at an early stage.

If the only reason for the emergency uplift was to support the economy and family finances through the pandemic, then it should be continued until the labour market is back to normal, and jobseekers have realistic chances of finding work, an argument that would support an extension to the uplift of at least another year. But in reality, the increase was also needed because the welfare safety net we had in the run-in to the Covid-19 crisis was insufficient for families, contributing to the years of poor pre-pandemic income growth for low-income households. For this reason, there is a strong case for the uplift to be made permanent. The Chancellor will have to recognise that this would impose a permanent pressure on the public finances that, on balance, will likely mean higher taxes in the years to come. But it would reverse only a fraction of the benefit cuts since 2010; be a step towards levelling-up for low-income families over the rest of this Parliament; and is an essential if we are to have a functioning safety net that provides income protection when families are hit by crises.

1 Local Housing Allowance rates will be frozen at their new higher level (meaning that the maximum entitlement to housing support will, once again, become detached from local housing costs), and the Minimum Income Floor (which reduces the amount of UC that low-paid self-employed workers are eligible for) is set to be reintroduced in May 2021.

2 Just as in April 2020, there are no proposals to increase (beyond the cost of living increase) any of DWP's main 'legacy' income support benefits, including Jobseeker's Allowance, Employment and Support Allowance and Income Support. This distinction is extremely hard to justify, and ends up creating a two-tier benefit system: these legacy benefits remain an integral part of our social security safety net, along with UC, and all their recipients will have been experiencing the same pressure on living costs through the Covid-19 crisis. One explanation for this difference is that UC and WTC can have their rates changed almost instantaneously, whereas the others require several months of notice, due to older IT systems. But it is more than unfortunate that a decision was not been taken early enough to allow for equity across the different benefits.

3 This is consistent with RF modelling using the IPPR tax-benefit model; forecasts for the number of UC recipients published by the Department for Work and Pensions; tax credit forecasts published by the Office for Budget Responsibility, and in line with other estimates (for example, see: C Emmerson, R Joyce, T Waters, The temporary benefit uplift: extension, permanence, or a one-off bonus?, Institute for Fiscal Studies, Jan 2021).

4 This is the latest data available on how many people are actually being paid some UC, rather than those who have a live claim open but may not be getting paid anything currently due to, for example, having sufficiently high earnings.

5 This chart was first shown in: M Brewer et al., The Living Standards Audit 2020, Resolution Foundation, July 2020.

6 For a longer discussion, see: M Brewer et al., The Living Standards Audit 2020, Resolution Foundation, July 2020.