Resolution Foundation
BRIEFING

Taper cut

Analysis of the Autumn Budget changes to Universal Credit

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Summary

Last week's Budget saw surprisingly large giveaways from the Chancellor (in response to an improved fiscal outlook). He left the most significant policy change for low-income families until the end of his speech – reducing the Universal Credit (UC) taper rate from 63 per cent to 55 per cent, and increasing work allowances by £500 a year. This represents a significant, permanent increase in the generosity of one part of the welfare state, with the £3 billion per year increase in spending required for these reforms standing in stark contrast to the welfare cuts that have characterised the past decade. These Budget changes will benefit 2.2 million families in 2022-23, who – on average – will be £1,000 per year better off.

The fact that this giveaway was announced just weeks after the temporary £20-per-week boost to UC expired is not coincidental: this change is designed to mute the impact of that cut for some households. Absent the Budget announcements, all 4.4 million UC families would have seen their Universal Credit entitlement fall by £1,000 per year (perhaps the biggest overnight cut to benefits ever). Now, the change to their incomes is more complex. Higher-earning UC families will be better-off – in some cases by as much £1,800 per year; lower-earning UC families will still lose out but by less than previously feared; but out-of-work UC families (the majority) will still see the full impact of the £1,000 per year cut. For a family with children and not renting, the tipping point is at annual earnings of £18,800. The net result of the removal of the £20-per-week boost and the Budget changes are that, in 2022-23, 27 per cent (1.3 million) of the families in receipt of UC will be better-off, and 73 per cent (3.6 million) will see their incomes fall.

The pattern of more support for some working households and big falls in incomes for those not in work shape the wider impact of the package on poverty, work incentives and the overall role of the welfare state. Ahead of the Budget, the Government would have been all too aware that poverty was set to rise over this parliament as a result of the roll-out of previously announced cuts to social security such as the two-child limit. The taper rate and work allowance changes alone will mean 590,000 fewer people in relative poverty in 2022-23 (after housing costs). But considered in combination with the removal of the £20 uplift, only 40,000 fewer people will be in in-work poverty, and 160,000 more people will be in out-of-work poverty.

The choice to change the taper rate fits with the Government's priority to improve work incentives. In-work families on UC now face marginal effective tax rates (when they pay income tax and national insurance contributions) of 70 per cent – returning to rates last seen in 2010-11 and much lower than the 75 per cent rate put in place with the introduction of UC. Allowing UC recipients to keep more of their earnings necessarily means that UC entitlement extends further up the earnings distribution: the Budget

changes make an additional 330,000 families entitled to UC (compared to the situation with the £20 a week uplift in place). For a family with two children and not renting, the Budget changes extend entitlement to those with earnings up to £37,700, rather than £35,300 with the £20 a week uplift, or £32,800 without, but still lower than the situation in 2010 (which was £40,500 in today's prices). These new claimants will see their incomes rise, but their incentives to earn more weaken slightly.

The decision to focus all increased support on working families leaves the UK with a weak welfare safety net: workers may have higher incomes today, but they have less insurance against the risk of unemployment tomorrow. The basic rate of unemployment benefit now stands at its lowest level in real-terms since 1991, at just 14 per cent of average weekly earnings (down from 32 per cent in 1965). If it wants a welfare system that is fully prepared for the decade of economic change ahead, the Government must address this gap in support for families facing the economic shocks to come.

A significantly lower taper rate and a higher work allowance means Universal Credit is withdrawn more slowly as earnings rise

The Autumn 2021 Budget, saw the Government announce that – from December this year – the work allowance for Universal Credit (UC) will rise by £500 a year (for those with responsibility for a child or limited capability for work),[1] and the taper rate will fall from 63 per cent to 55 per cent (for all).[2] The work allowance determines how much a claimant can earn before their entitlement to UC is reduced, and the taper rate determines how quickly the UC entitlement is reduced as earnings rise above that point. Both changes in effect allow working UC recipients to keep more of their earnings. This is a significant package that will cost £2.2 billion in 2022-23, rising to £3 billion by 2026-27.[3] These Budget changes will benefit 2.2 million families in 2022-23, who – on average – will be £1,000 per year better off.

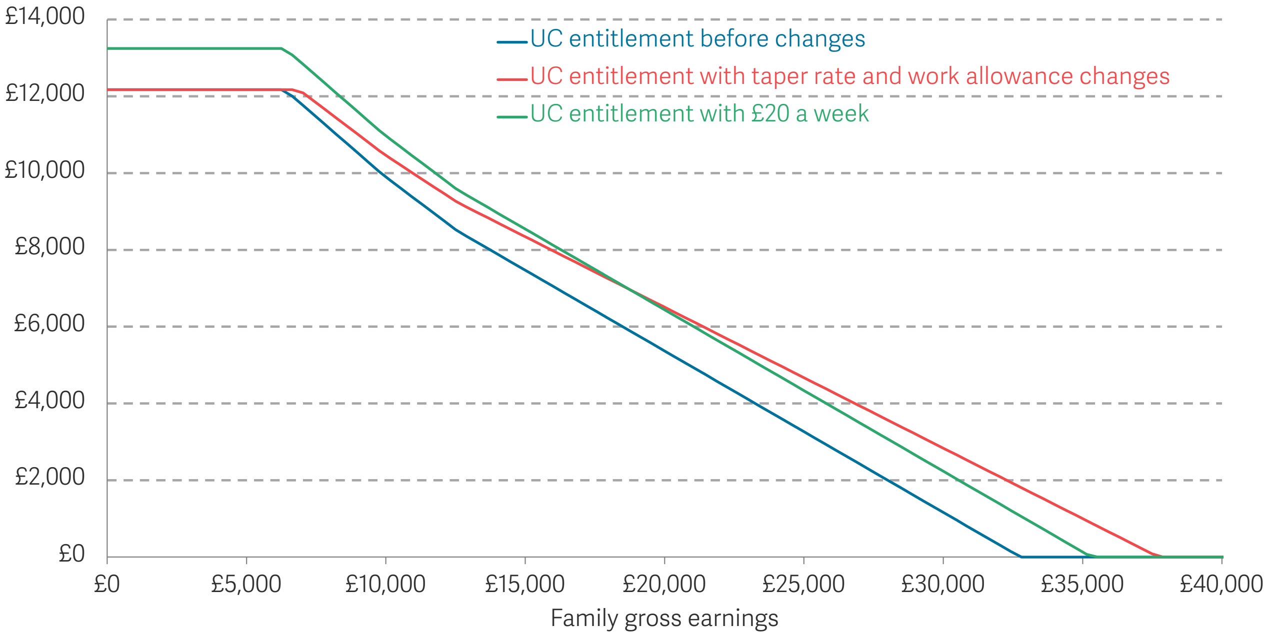
The Autumn 2021 Budget changes come just weeks after the Government ended the £20-per-week uplift to Universal Credit introduced when the pandemic hit, a decision that has saved it around £7 billion a year in the long-run (i.e. in the steady state when UC is fully rolled out).[4] So how do all these changes net out? Figure 1 shows how the UC entitlement of a couple with two children varies as their earnings increase under three policy regimes: the pre-pandemic system; when the £20-per-week uplift was in place;

1 See: https://www.gov.uk/government/publications/universal-credit-work-allowances/universal-credit-work-allowances, accessed 3 November 2021, for further details on the work allowance.
2 See: T Bell et al, The Boris Budget: Resolution Foundation analysis of Autumn Budget and Spending Review 2021, Resolution Foundation, October 2021 for further details.
3 OBR, Autumn Budget and Spending Review 2021: Policy Costings, October 2021.
4 In March 2021, the OBR forecast there would be 6.55 million benefit units claiming either UC or (in a small number of cases) a legacy benefit in 2025-26. The cost of increasing the base award of UC in steady state by a fixed £20 per week is therefore 6.55 million multiplied by £20 and by 52 weeks, or £6.8 billion per year. On top of this there will be a small number of newly eligible claims with awards of less than £20 per week. See: OBR, Welfare Trends Report, March 2021.

and the new post-Budget scheme. Comparing first to the pre-pandemic system, the Budget changes increase UC entitlement for any family earning more than the existing work allowance (for this family that is £6,180 per year, but would have been £3,516 per year if their claim included support for housing costs). The biggest gains – of £1,800 a year – accrue to families who were just at the end of the taper before the reform (i.e. they previously earned just too much to be entitled to any UC: for this family type, that was £32,800 a year). Allowing UC recipients to keep more of their earnings automatically means that UC entitlement will extend further up the earnings distribution, and so there are also gains for some families with earnings above £37,900 a year who are now entitled to UC for the first time.[5]

FIGURE 1: **A couple with two children earning over £18,700 will have a higher income with the taper rate and work allowance changes than with the £20-per-week boost**

Universal Credit entitlement for a single-earner couple with two children under actual and hypothetical rules, by family gross earnings: UK, 2022-23



NOTES: Other parts of tax and benefit system are set to April 2022 values. Family assumed to be home-owners.
SOURCE: RF Case Study Model.

Compared to a system that retained the £20-per-week uplift, UC recipients on the lowest income lose out from the Budget changes

To allow us to see the combined impact of removing the £20-per-week uplift and reducing the taper and increasing work allowances, Figure 1 also shows the UC schedule

5 Maximum gains from the Budget changes would be higher for families with additional entitlements to UC, such as for additional children, a disability or health condition, who care for a severely disabled person, or to help with housing costs.

had the £20 uplift been retained but the Budget changes not made. It shows that non-working and low-earning UC recipients are worse off after the Budget changes compared to a system that retains the £20-per-week uplift, but higher-earning UC recipients (as well as those who previously earned just too much to be entitled to UC) are better off with the Budget changes than they would have been with a £20 uplift.

For our example one-earner couple with two children (and no housing costs or other elements), the 'tipping point' above which a family is a net winner is £18,800 a year.[6] (For families with a lower work allowance – because they have housing costs included in their UC award – the tipping point is £14,600, and for families with no work allowance – for adults without children – the tipping point is £14,300 per year.) With earnings of £30,000 per year, our example family would be £600 per year better off compared to the £20-per-week uplift system (receiving £2,800 in UC compared to £2,200).

Figure 2 shows the combined impact of the two changes on UC families in 2022-23, according to where they are in the household income distribution.[7] Considered together, we estimate that about 3.6 million UC families will be worse off, and 1.3 million UC families better off, in 2022-23.[8] In addition, the Budget changes mean that 330,000 families will become newly eligible for UC and so better off if they were to claim. All those in non-working UC families are worse off, and among working UC families, those with the highest earnings are more likely to be better off.

This is a clear reminder that designing a welfare system means making constant trade-offs. For example: is it better to provide more support to all those on UC? Or to provide stronger financial gains to working and earning more, something which then benefits those who already have the most?

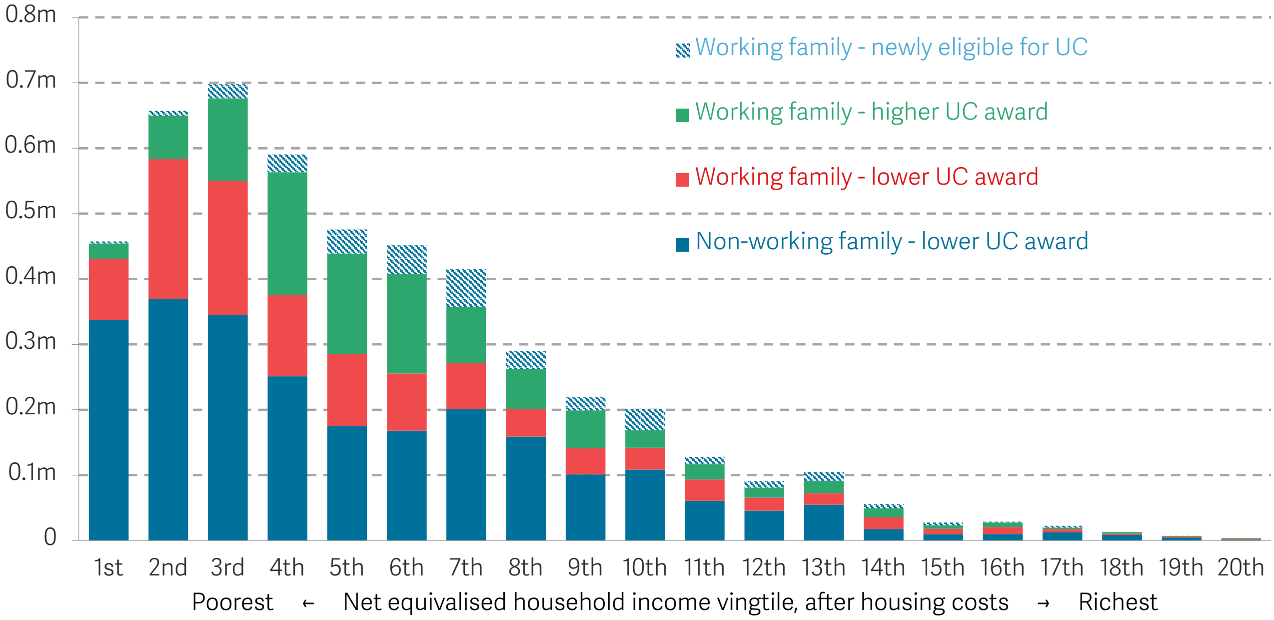
6 The position of the tipping point is determined by the work allowance, and so is the same for all families with a work allowance without housing costs. It is lower for families with housing costs, and lower still for UC families without a work allowance.

7 We assume 86 per cent take-up of Universal Credit (except for the newly-eligible families), and that the rollout to UC in terms of benefit caseloads is 62 per cent complete. We have also scaled the total number of UC families in our modelling to match the OBR March forecast for the policy scenario without the £20 per week boost or the change to the taper rate, some 4.4 million families. See: OBR, Welfare Trends Report, March 2021. Vingtiles contain a mixture of winners and losers because: the tipping point varies by family composition; households can contain multiple benefit units; and because Figure 2 ranks families by their equivalised household income.

8 We estimate there will be about 4.9 million families on UC in 2022-23: this is slightly higher than the OBR's March 2021 forecast of 4.4m families, but that forecast assumed that the £20 uplift would expire.

FIGURE 2: **Lower-income UC recipients are more likely to be losers as a result of the loss of the £20-per-week uplift and Budget 2021 changes**

Number of families with higher or lower Universal Credit award due to combination of removal of £20-per-week boost and reduction in taper rate and higher work allowances: UK, 2022-23



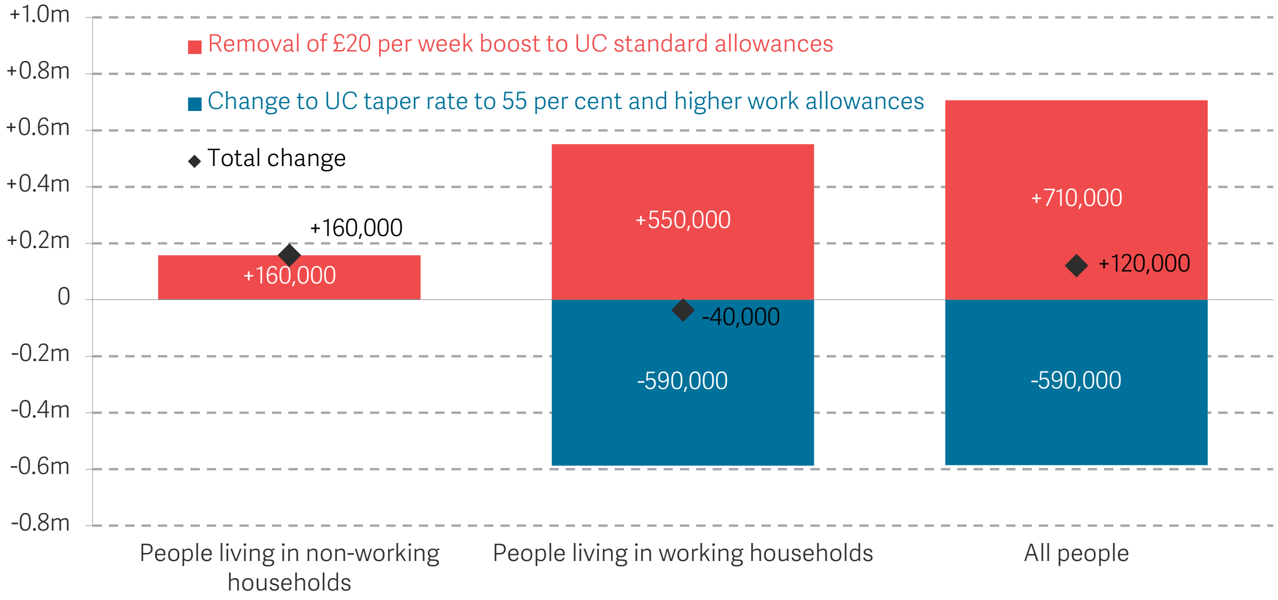
NOTES: UC and work status analysed at a benefit unit level. Estimate of newly eligible does not allow for incomplete take-up.
SOURCE: RF analysis of DWP, Households Below Average Income using the IPPR Tax Benefit Model.

As Figure 3 makes clear, taken alone the effect of the Budget change in the taper rate and work allowances will mean 590,000 fewer people in poverty in 2022-23. But the Budget changes to UC alongside £20-per-week cut will lead to 40,000 fewer people in in-work families in relative poverty (after housing costs) in the same year, but 120,000 more people in out-of-work families in relative poverty. (It should be noted that this calculation does not account for the fact that these reforms would increase median income and so would also move the poverty line upwards).[9]

9 This means that the taper rate and work allowance change have nearly as much impact on relative poverty as the £20-per-week uplift, despite costing less than half as much. This is because the beneficiaries from the Autumn Budget 2021 changes are more likely to be found around the poverty line, whereas many of the beneficiaries from the £20 uplift are far below the poverty line even after the uplift; had we considered the impact of the two reforms on measures like the poverty gap, then the (more expensive) £20 uplift would have been considerably more effective.

FIGURE 3: **The cut in taper rate and higher work allowances only partially offset the higher relative poverty caused by the £20-per-week reduction in UC**

Change in number of people in poverty due to recent UC changes, by household work status: UK, 2022-23



NOTES: Assumes that newly eligible families take-up UC at the same rate as the already-eligible, but this should have little impact as most are already above the poverty line before the change to the taper rate. Labels rounded to the nearest 10,000.
SOURCE: RF analysis of DWP, Households Below Average Income using the IPPR Tax Benefit Model.

The Autumn 2021 Budget reforms reverse, but do not undo entirely, Osborne-era changes affecting moderate earners

As we showed in Figure 1, the implication of reducing the rate at which UC is withdrawn as earnings rise is that UC entitlement extends further up the distribution of earnings. We estimate that an additional 330,000 more families will be eligible for UC in 2022-23 as a result of the reform.

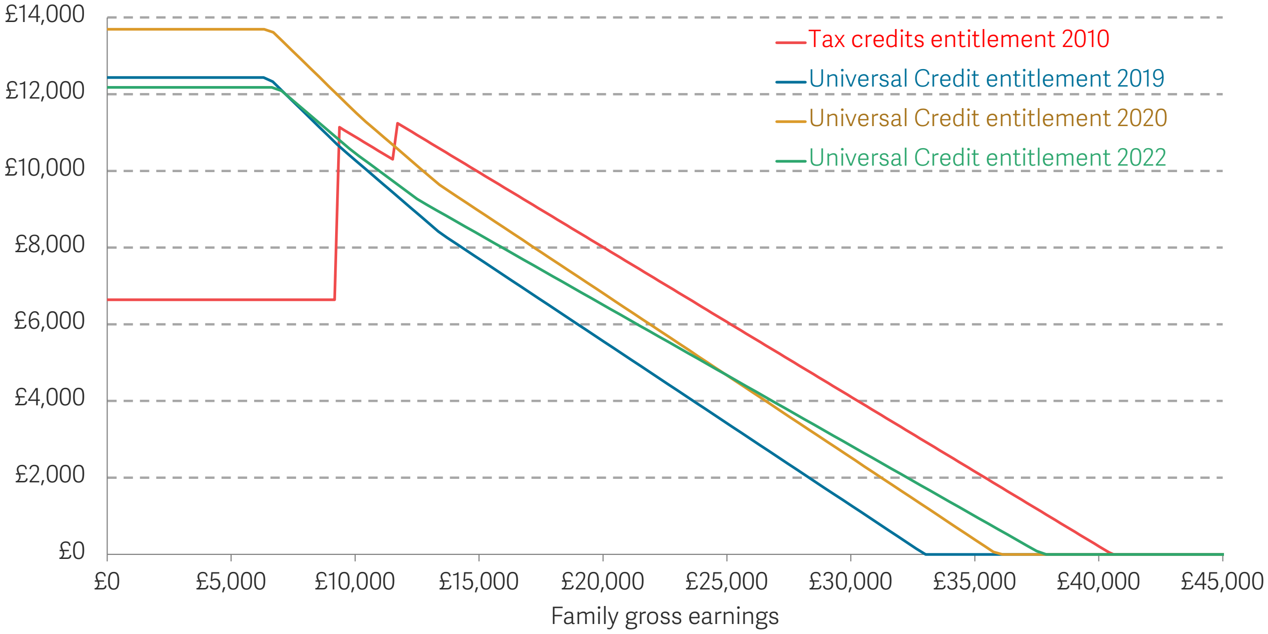
This change goes firmly against the spirit of reforms announced by George Osborne during his time as Chancellor, who argued that "We also need to focus Tax Credits, and Universal Credit, on those on lower incomes, if we are going to keep the whole system affordable and able to support those most in need", and took steps to remove tax credits from middle-income families.[10] However, as Figure 4 shows, the 2021 Autumn Budget does not entirely undo the impact of the Osborne-era reforms. In 2010, for a couple with two children, entitlement to tax credits (other than the family element of the child tax credit) would have run out with pre-tax earnings of £40,500 (in today's prices). Under the pre-pandemic 2019 system of UC, this had fallen to £32,800. It would have been £35,300

10 See: https://www.gov.uk/government/speeches/chancellor-george-osbornes-summer-budget-2015-speech, accessed 4 November 2021 for more details.

had the £20-per-week uplift been extended, and it will be £37,700 after the cut in the taper rate.

FIGURE 4: **Post-2010 changes to tax credits removed in-work benefits from moderate earners, a reform which the taper rate cut and higher work allowance partially undoes**

Tax Credit and Universal Credit entitlement for a single-earner couple with two children, in 2022 prices, by family gross earnings: UK, 2022-23



NOTES: Tax Credit award subject to hours rules, single earner assumed to earn the national living or minimum wage for each relevant year. Other tax assumptions set for the relevant year.
SOURCE: RF Case Study Model.

The cut to the taper rate reduces marginal effective tax rates paid by UC recipients, except for some newly-entitled families

The cut in the taper rate to 55 per cent is actually the second time that the taper rate in UC has been reduced: it was 65 per cent when it was first introduced, and then was cut to 63 per cent from April 2017 (although there were very few UC recipients before this date).[11] The taper in UC applies to a family's net earnings (i.e. after income tax and national insurance have been deducted). This means that the overall marginal effective tax rate faced by a worker on UC who is also liable to (basic rate) income tax and National Insurance contributions will be 75 per cent in October 2021, falling to 69 per cent

11 55 per cent was also the rate initially suggested by the Centre for Social Justice, whose work acted as blueprint for UC. See: The Centre for Social Justice, Dynamic benefits: towards welfare that works, September 2009 for more details.

in December 2021, before rising to 70 per cent in April 2022 when rates of National Insurance rise.[12]

This is the same rate as that faced by a worker receiving tax credits – but no housing benefit – and paying (basic rate) income tax and National Insurance contributions from 2003-04 to 2010-11, but lower than the 73 per cent marginal effective tax rate for tax credit claimants after 2011-12. Overall, all those on UC will see their marginal effective tax rates fall as a result of this reform, but those 330,000 newly eligible families will see marginal effective tax rates rise if they claim (although they will also be better off if they do claim), a reminder that it is very difficult to reform welfare benefits in a way that unambiguously strengthens incentives to work.

The Budget changes show the Government is thinking seriously about welfare system design

We said earlier this year that:

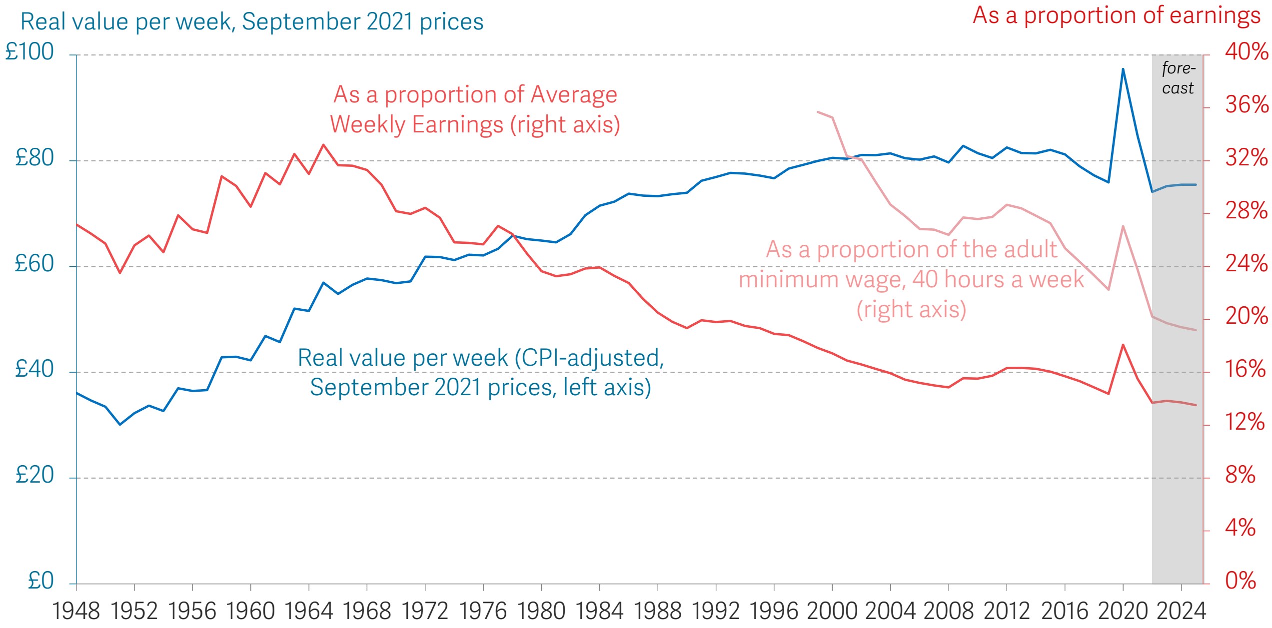
> *"There are very few upsides to what has happened over the past year but one of them is that it has reminded us of the extent to which purposeful public policy can ensure greater economic security for families. Putting this lesson into practice as we return to more normal times will mean devoting more money to the social security system."*[13]

So, after a decade where much of the narrative behind changes to welfare benefits was about the need to curtail costs, it is very welcome that the Government has introduced a significant discretionary increase in spending on UC and sought to reduce the very high effective marginal rates of tax on low-income families. However, the act of removing the £20-per-week uplift puts the basic level of unemployment benefit back to its lowest real-terms value since 1991 (see Figure 5) and at just 14 per cent of average weekly earnings (down from 32 per cent in 1965). This suggests that the Government has not learned the lessons from the pandemic about ensuring a basic level of adequacy for all.

12 On additional earnings of £10 in April 2022, a person will lose £2 to income tax, £1.32 to the higher rate of NI, and then lose 55 per cent of what is left (i.e. £3.67 of £6.68) to the UC taper.
13 M. Brewer, K. Handscomb & K. Shah, In need of support?: Lessons from the Covid-19 crisis for our social security system, Resolution Foundation, April 2021.

FIGURE 5: **Unemployment benefit will stand at its lowest level as share of earnings in real-terms since 1990**

Value of unemployment benefit in real-terms, as a proportion of average weekly earnings and full-time minimum wage earnings: UK



SOURCE: RF calculations of: ONS, Average Weekly Earnings; OBR, Economic and Fiscal Outlook, October 2021; DWP, Abstract of DWP benefit rate statistics.

To conclude, it is welcome that the Government articulated its aim behind the Budget changes – to allow workers on UC to keep more of their earnings, and thereby strengthening the financial reward to work. But we should also look critically at other aspects of our welfare system as we emerge from the pandemic to make sure that it is aligned closely to our economic strategy, and well-equipped to serve households and the economy in a forthcoming decade of unprecedented change. We will be providing our contribution to that debate in the next few months, as part of the Economy 2030 Inquiry.[14]

14 See: The Economy 2030 Inquiry: https://economy2030.resolutionfoundation.org/.

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