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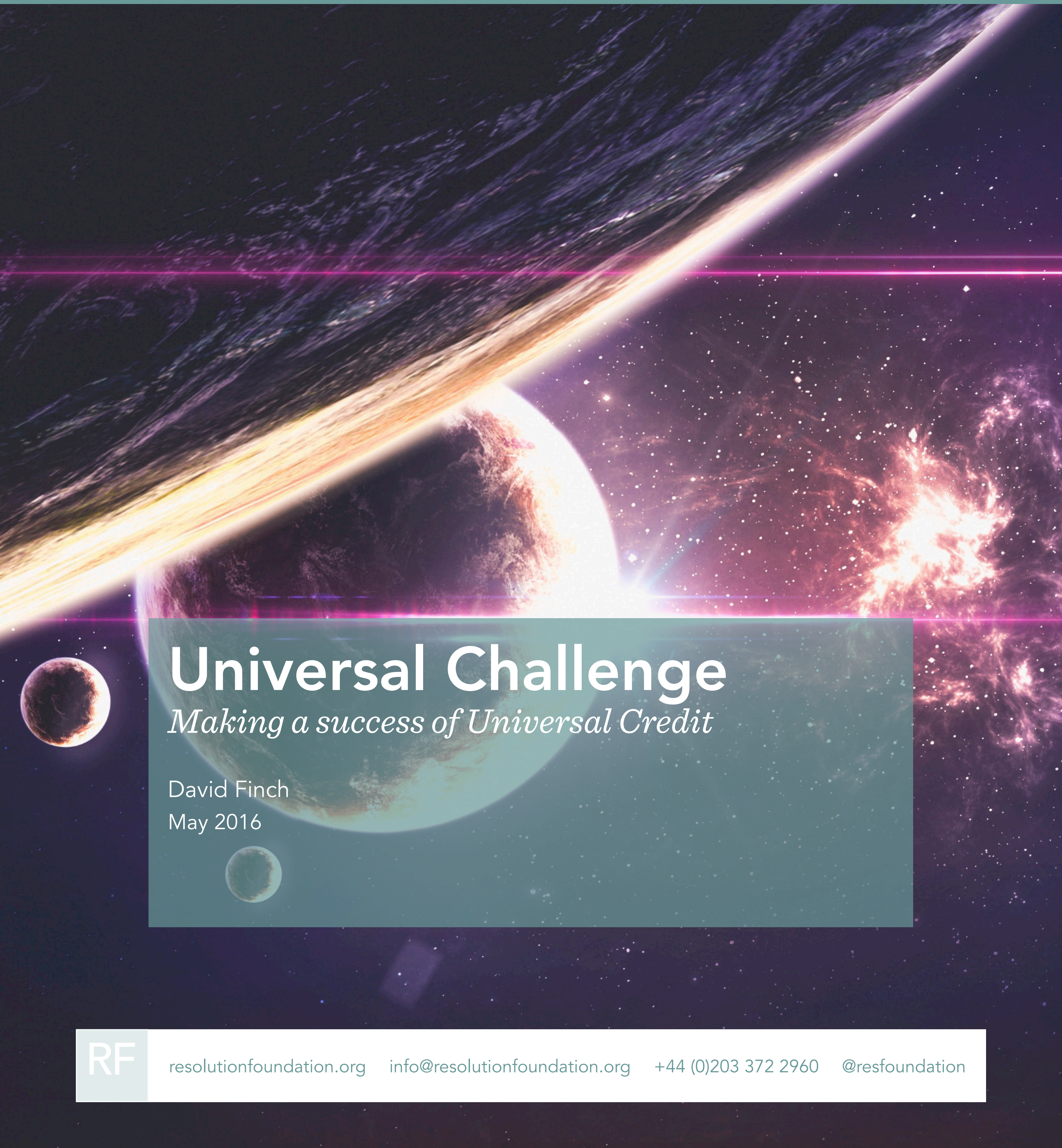

Universal Challenge

Making a success of Universal Credit

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Contents

Executive Summary

In his first speech as the new Secretary of State at the Department for Work and Pensions (DWP), Stephen Crabb was quick to emphasise his commitment to continuing the roll-out of Universal Credit (UC), describing it as having the "potential to be the most important public sector change project for decades". In the face of budget cuts, criticisms over implementation delays and the exit of its architect-in-chief, Iain Duncan Smith, such reassurance is welcome.

Once in place, almost half of all families with children will be entitled to UC at any given point in time – more still will interact with it at some point over the course of their lifetime. In total, UC – rolling six benefits into one – will account for £53 billion of welfare spend by 2020-21. That's roughly a quarter of total welfare spend, making it the second biggest component after the State Pension. Getting it right is important.

Setting aside some of its practical problems, UC is a reform programme with genuine potential. The principle behind it enjoys cross-party support and could deliver gains in relation to simplicity, work incentives and earnings progression. The new Secretary of State is presented with a double opportunity to realise these potential gains from both his stated commitment to deliver UC and by bringing a fresh approach that can make the necessary changes to renew and reinvigorate the reform.

It's certainly true that **the UC of today (and the near future) looks very different from its original inception**. In part, that's due to the inevitable compromises made when converting a policy proposal into a workable reality. But it is also much changed as a result of the increasingly tight financial restraints placed on it over recent years. These have involved more than just a reduction in the money available under UC, they have also altered the very structure of the policy – changing the composition of winners and losers and fundamentally damaging its ability to deliver against its purported aims.

Crucially, **the latest series of cuts – announced at last year's Summer Budget – risk leaving UC as little more than a vehicle for rationalising benefit administration and cutting costs to the Exchequer**. Any ambition for supporting and rewarding work and progression looks very hard to achieve under the revised proposals. Indeed, even some of the welcome progress made over the last 15 years under the tax credit system in reducing worklessness – particularly among single parents – is at risk of being dismantled. Improving financial incentives to start work alongside gradual labour market reform over the last two decades have underpinned the strength of recent employment performance.

The urgency of tackling this issue is growing, with the introduction of a new 'full service' version of UC from May. The limited roll-out undertaken to date has covered relatively simple cases – those who are childless and unemployed and who would otherwise be entitled to Jobseekers' Allowance (JSA). Evaluations of those so far affected imply some improvement in employment outcomes, though it is unclear whether this has been driven by the changes that the UC system brings – and whether that's due to different incentives, simplicity or practical support – or by 'pilot effects' that tend to occur in the early stages of trialling a new system. Further roll-out – particularly the addition of more complex cases – will inevitably prove a sterner test.

And it's not just a new IT system being put into place. UC brings with it a new, untried and untested system of in-work conditionality, aiming to boost earnings of those entering the labour market – but no further than a full-time job at the wage floor.

UC therefore rests on a knife's edge. On one side lies a path to a scheme that has had its original aims watered down significantly, almost to the point that the gains it would still bring risk being outweighed by the likely pain of implementation over the coming months and years. The alternative path is one of opportunity – taking the chance in the wake of recent turmoil to improve UC and ensure that it is fit for purpose in the labour market of the next decade.

This report sets out a **three point plan** for the new Secretary of State, designed to both ensure that UC will provide the support needed for families moving into and progressing in work in the future and to make implementation as simple as possible. We argue that Stephen Crabb should **restate and reclaim the role of UC in supporting more people into work and then boosting earnings**, rather than being a source of savings for the Treasury to meet fiscal targets, by:

» **Ensuring that the incentives UC creates are focused on those most likely to respond to and be in most need of support**. With the employment picture vastly improved over recent years and levels of worklessness in households dropping dramatically, UC must be refocused to meet the living standards challenge of the future rather than the past.

» **Embracing the challenge of tackling low pay and progression**. Despite the welcome strides taken forward with the implementation of the National Living Wage, in-work poverty and low pay look set to remain key challenges in the coming years – UC must be ready to meet them.

» **Taking the chance to reassess the way in which the UC system itself functions and the processes people must go through when making their claim.** As currently designed UC piles extra burdens on recipients - these could be eased. Making people's lives more difficult may make them resistant to the change UC brings. Requiring recipients to provide complex information so the system can calculate entitlements risks creating errors and mistakes that could cause implementation to stumble.

UC has the potential to significantly improve on the current system and help boost living standards

When first unveiled, UC promised three key improvements relative to the current system, each associated with labour market outcomes:

» By combining six in- and out-of-work benefits it was expected to **simplify the claims process for people moving into work**, raising take-up of benefits (and therefore incomes) and removing the barriers created by a complex system that recipients struggle to navigate;

» By introducing a new 'work allowance' – which allows recipients to retain their out-of-work benefits even as they enter work up to a specified amount – it offered **improved financial incentives to enter work**; and

» By replacing a range of benefit withdrawal rates with a 'single taper' beyond the work allowance, it was intended to allow recipients to keep more of each extra pound earned and therefore **boost progression incentives**.

The mechanics underpinning UC mean that the first of these promises remains on course to be met – though the new system will inevitably remain complex. However, the other two risk going unmet, driven both by UC's failure to adapt to a changing labour market backdrop and – most especially – by a series of cuts in the generosity of the system which have undermined the basic tenets of its structure.

But it needs to adjust to a changing labour market with new challenges

A key stated aim of UC is to focus work incentives on ensuring that at least one person in a household works. Tackling such household 'worklessness' was once an important part of lowering poverty and raising self-sufficiency. But rates have been falling for some time and, **even at UC's inception, worklessness had ceased to be the problem it once was**. With employment performing beyond all expectations in recent years, the number of workless households has fallen still further.

If the government wants to make further inroads in this area, then it must focus its attention on those furthest from the labour market, including single parents with very young children and disabled households. Given the nature of the barriers to work faced by such families, this is likely to require a very different approach – one that potentially goes beyond what UC can hope to achieve. A forthcoming Resolution Foundation report focuses on helping disabled people to remain in touch with the labour market.

Where UC *can* make a difference however, is in dealing with the growing issue of 'in-work poverty'. Almost two-thirds of poor children live in working families, often where one parent works and one doesn't. **UC should build on the successes of the tax credit system** to ensure that those who have been supported into work in recent years remain incentivised to do so. And it should provide new encouragement for second earners in couples.

And after almost a decade of falling real pay and ongoing productivity stagnation, **boosting pay growth for UC recipients looks ever more important**. By significantly raising the wage floor for those aged 25 and over, the National Living Wage represents a welcome step forward but it will not on its own deal with the UK's low pay problem. And, to the extent that it might lead to wage compression – with the National Living Wage becoming a 'going rate' in some firms and industries – UC must rise to a potentially more complex progression challenge.

Even as UC is implemented in a time of new fiscal constraints

Just as the problems that UC needs to tackle have shifted and become more complex, so have the improved incentives it was set to introduce been undermined by repeated cuts in its budget. This has **culminated in reductions at last year's Summer Budget amounting to** £3 billion by 2020 which now make UC **overall less generous than the current system and raise serious questions over UC's ability to deliver improved incentives for recipients**.

As initially designed, UC gave broad parity with the current tax credit system – though simplifications inevitably meant that some households lost and some gained relative to the status quo. **Now, UC will on balance be less generous than the tax credit system for working families**. Even when considered alongside policies designed to boost incomes, including the introduction of the National Living Wage and income tax cuts, relative to the current system without those measures in place, the latest version of UC implies:

» 1.3 million working families entitled to support in the tax credit system will no longer be entitled to *any* in-work support, leaving them £42 a week worse off on average;

» A further 1.2 million are set to receive UC, but be an average of £41 a week worse off;

» 1.7 million still in receipt of UC will be better off by an average of £38 a week, in part due to the more generous treatment of housing costs; and

» Only around 200,000 families – a mix of those without children and couple parents – who are no are longer entitled to UC at all will be overall better off following cuts to in-work support and boosts to income from the National Living Wage and income tax cuts.

Overall, **the reductions associated with the UC cuts planned for this parliament mean that the majority of working families with in-work support will be detrimentally affected**. And if we included wider cuts to working-age benefits which affect both systems – such as the four year freeze to increasing their value and limiting support for new families and to two children – and compared to a system without those cuts the picture would look worse still, with some families worse off by up to £3,400 a year in 2020.

Transitional protection will offer limited support at best. Such protection only applies to families moved directly from the current system to UC who are not considered to either be new claims or to have experienced a significant change in their circumstances (with the definition of this remaining unclear).

By 2020-21, following the £3 billion cut to its in-work support, UC will now be less generous than the current system by £1.5 billion when just considering entitlements (a further £1.6 billion is saved through process improvements such as reducing fraud and error), yet just £0.5 billion of transitional protection is expected to be paid out (with only £0.2 billion of this coming as a direct result of the further cuts to in-work support announced at the 2015 Summer Budget). This suggests that of those moved to UC by 2020-21 up to 300,000 working families will receive transitional protection – just one-in-three of the working families expected to have a lower entitlement than in the tax credit system in that year.

These cuts don't just affect incomes, they also undermine the scheme's incentives structure

One of UC's key advantages over tax credits is the introduction of an incentive to enter work at a short number of hours. While individuals currently face losing entitlement to out-of-work benefits once they start working on a pound-for-pound basis (until they reach a certain number of hours' work and so qualify for tax credits), the introduction of work allowances in UC mean that individuals can work at lower hours without facing any withdrawal in their entitlement. This is expected to be of particular benefit to people who face barriers to working more than a few hours – including some disabled people and parents with very young children.

This advantage remains in place, but it has been significantly watered down over time. Returns to entering work are much lower than anticipated under the earlier design of UC. Compared to the tax credit system, incentives to enter part-time work for single parents are slightly improved – though the extra support provided is focused at low levels of earnings. At full-time hours, 70 per cent of single parents entering work at full time hours would be better off by no more than 40 per cent of their total earnings – a similar picture to the one faced in the current system. Likewise, 50 per cent of second earners looking to move into part-time work while children are young would be better off by no more than 40 per cent of their total earnings.

Crucially, **the much-reduced scale of the work allowances available to different families risks lowering the 'sweet spot' for working** faced by many – particularly single parents who have shown themselves to be responsive to such incentives. The hours rule in tax credits incentivises work of 16 hours a week and is reflected in significant numbers of single parents working precisely that many. But UC risks encouraging the trading of fewer hours for a relatively small drop in income.

For **second earners in couples the situation may be worse still, with increasing numbers potentially deciding not to enter work at all**. Without a work allowance this group will see anything that they earn reduce their benefit income through the taper. A parent earning £5,000 a year would see their income increase by only £1,750 – and that is before accounting for any associated childcare costs.

To ensure that the introduction of UC supports working families to boost their incomes, **financial incentives should be focused on those most likely to respond. Rebalancing support towards single parents and second earners could help UC surpass the current system in its ability to help people into work**. But with in-work support already stripped back this will require reinvestment – via a reversal of the Summer Budget cuts to work allowances.

With progression opportunities looking increasingly difficult, in-work conditionality takes on new importance

Beyond the work allowance, UC recipients become subject to a single benefit taper – that is, the rate at which UC is withdrawn as earnings increase. **Despite initial ambitions and a capping of the very worst incentives to progress in the current system, this taper offers little improvement over the incentive to progress beyond the 'sweet spot' for many recipients – and is worse for some**. A taxpayer in UC will keep only 24p of an additional pound earned compared to 27p in the current tax credit system (though this improves on the 9p kept when housing benefit is in the mix). In reality more people will face a slightly worse incentive to progress than will have their very highest rates capped.

In-work conditionality was always intended as something of a 'backstop' measure in reserve to stop people reducing their earnings due to the removal of the hours rules in the current system. In effect around 1 million people deemed not to be earning enough – currently set at a target of full-time hours at the wage floor; lower for primary carers of children and the long-term ill or disabled – will be expected to find more or higher paid work.

With cuts to work allowances significantly shifting recipients' 'sweet spots' down, it is now more vital than ever that in-work conditionality works. The success of UC rests on its shoulders. Yet as currently designed in-work conditionality does little more than replicate the current out-of-work conditionality regime. **A narrow focus on moving people into work at a level of a full-time at the wage floor does nothing to support progression out of low pay**: it simply helps secure a job in low pay.

In tackling this now more urgent problem, the new Secretary of State should also take the opportunity to raise the ambition of the policy. To **truly tackle progression more radical thinking and new methods will need to be developed**. The UC system itself provides an opportunity to engage with individuals who have been stuck in low pay and offer them support. It is an opportunity that should be taken and not squandered.

Implementing such a regime is likely to be hard, particularly when there is little evidence either in the UK or internationally of how to run such a scheme. The current system of out-of-work conditionality took a couple of decades to get right – this time round the DWP do not have so long. With **the introduction of the National Living Wage bringing with it potential compression of paybands in mostly low paying sectors, developing effective practical support to help people progress is more important than ever**. Tackling the issue now is crucial.

And ensuring that the new system is easy to use and runs smoothly remains a key challenge

While criticised for being slow, the approach taken towards the roll-out of UC – namely, not acting until the proper systems are in place and have been piloted – is a sensible one. Nevertheless, **the new Secretary of State should take the opportunity to review a number of practical issues which the government has not yet addressed**, but which could benefit from new thinking. In particular, we have previously called for:

- **Dealing with long delays before initial claims are processed and then paid**. Potential new recipients have to wait a week before making a claim, and then a further month before they receive their first UC payment. For someone with little other income and a final weekly pay packet life will be tough.

- **Make it easier to pay housing costs direct to landlords**. Maintaining a default payment to recipients until housing bills go unpaid and debts mount up when it is clear they will run into difficulties is not sensible.

- **Allowing the self-employed to report incomes annually rather than monthly**. By applying the Minimum Income Floor in the same way, so that it supports poorly performing enterprises rather than hitting those that do well but have variable monthly income streams, the new system can better match the particular needs of the self-employed.

More widely, **reviewing how UC will interact with other parts of government support** – which, as with the labour market backdrop, has also in some instances moved on from where it was when UC was first announced – would make sense. In particular:

- **Amalgamating Council Tax Support with UC** would represent a radical step, but would significantly simplify claims for recipients and could help deal with the regressivity of many existing local schemes.

- **Reconsidering the requirements for reporting childcare support** for the around 500,000 families expected to claim would help UC better mirror the world of work by replacing its complex and restrictive monthly reporting requirements with more relaxed ones, similar to those proposed under Tax-Free Childcare.

- Tackling the difficult question of how **entitlements to Free School Meals** will be determined under UC – with around 600,000 families currently eligible in England – is necessary to stop undermining financial incentives further.

Revisiting these important practical issues and sweeping away unnecessary complexity will improve claimant interactions with UC and ensure the system lands more effectively. Failing to do so risks another wave of negative publicity.

The challenge is tough, but it is one worth rising to

The administrative prizes of UC – a simpler, single benefit system – may just be realised for the vast majority by the end of this decade. The arrival of a new Secretary of State brings commitment and a renewed vigour to deliver the major reform programme, while its roll-out has likely been given a further spur by the fact that UC is now set to deliver savings to the Exchequer rather than costs.

However, **it would be a mistake to simply assume existing plans optimise potential gains**. The laudable goals of UC have been undermined by successive paring back of its ambition and capacity to support claimants in a rapidly changing labour market. Recent welfare U-turns have been driven in part by unease from the government's own supporters, hinting at a recognition that the deal between the state and low-income working families needs reviewing.

Welfare reform is always difficult to implement – especially during a period of fiscal consolidation. But **refocusing work incentives on those most likely to respond, tackling low pay and progression head on and sweeping away unnecessary burdens on recipients can all ease the passage of UC's implementation**. The new Secretary of State faces a difficult task, but one that offers significant reward.

Section 1

Introduction – refocusing UC

Universal Credit (UC – which merges six working age benefits into one) was billed as a "once in a generation reform".[1] *Yet continued delay in its roll-out means that the generation referred to may end up relating to the duration of its implementation. Moving beyond the obvious embarrassment associated with such delay, this prolonged process raises a new challenge – namely the extent of change in the political and economic backdrop that has occurred over this period. Simply put, UC needs refocusing.*

The most profound change relates to the balance of support for this rethink of welfare from government departments. When first conceived UC was expected to raise the working age welfare bill, extending support at lower hours of work, reducing the rate at which entitlements are clawed back and boosting take-up via a single point of claim. Championed by its chief architect Iain Duncan Smith, sentiment within the Treasury was inevitably less favourable.

But, following a series of cuts in generosity undertaken as part of the government's fiscal consolidation, UC is now expected to actually create savings when it is introduced. Indeed, having reversed the cuts to in-work support from tax credits in last year's Autumn Statement, the Chancellor's fiscal plans now rest on the transition to UC sticking to schedule.

In contrast, the various cuts announced at the Summer Budget have spelled bad news for the scheme's designers in DWP. It will be significantly harder to deliver a system that supports low and middle income workers, with support focused on those either most likely to need it, or most likely to respond to financial incentives, without further disturbing the balance of winners and losers from the move to the new scheme.

Delivering a major reform that is behind schedule, poorly understood and – now – less generous on average than what came before looks like an unenviable task for the new Secretary of State at the DWP, Stephen Crabb. However, it could represent a vital opportunity to review the ambition and structure of UC – dealing not just with new fiscal realities but with a changed problem statement too.

UC was initially designed to deliver three key objectives: to simplify the benefit system, to ease entry into work and to increase earnings and living standards by allowing families to keep more of each additional pound earned. Noble and worthy goals, but budget cutbacks and rapid developments in the labour market raise questions over UC's ability to meet the challenge of the second and third aims.

By incentivising short hours working and concentrating resources on first earners rather than dual earners, UC has been set up to tackle workless households. Yet the number of households in which nobody works is already at an historic low.[2] Further improvements will require dealing with groups with far greater barriers to work and with question marks over whether work is the most desirable outcome – disabled people and single parents with very young children.

[1] DWP (2013) Press release: Universal Credit progress

[2] P Gregg & D Finch (2016) *Employing new tactics: the changing distribution of work across British households,* Resolution Foundation

Today's living standards challenge is centred on in-work poverty – with almost two-thirds of children in poverty living in a working household. Supporting progression for low paid parents already in work and second earners in one earner couples to at least half of a full-time job are essential aims to boost incomes. Refocusing limited resources to support such aims more effectively is made so much tougher, yet more important than ever, given the cuts to in-work support in place in the UC system – reducing both the available spend and lowering incomes of working families.

At the same time the challenge of raising earnings appears to have become harder. High withdrawal rates will remain in the system, with taxpayers keeping as little as 24p of each additional pound earned. While this caps the very highest rates faced in the current system for working housing benefit recipients, most will see their returns from additional earnings get slightly worse (much worse for many second earners).

The National Living Wage is a very welcome boost to low pay but its introduction risks greater earnings compression in predominantly low paid sectors. In this light there is a need to review just how progression can be supported and disentangle attempts to boost earnings from the new system of in-work conditionality which is aimed at finding sustainable employment but on the wage floor.

Beyond incentives the system itself can be made easier for people to use. Many of the processes people have to undertake increase reporting burdens for recipients, making their lives harder, not simpler. Reviewing how people are expected to deal with the system would help ease implementation, reducing the kind of high profile errors that could dog implementation and create negative public perceptions of the new scheme.

This report builds on Resolution Foundation's major review of UC published in May 2015 to reflect on what changes the new Secretary of State should consider as UC continues to roll-out. To ensure UC remains a vehicle of reform with a clear focus on new challenges in the labour market and to boost living standards, rather than a means of cutting the benefits bill we set out a three point plan to:

- Refocus resources to ensure work incentives are improved for those most likely to respond and in need of support;
- Reconsider how UC meets the growing future challenge of boosting earnings in what appears to be an era in which it is harder to progress; and
- Continue with what now appears to be a more realistic roll-out plan but one that also deals with the unnecessary practical complexities built into the scheme that make people's lives harder, not simpler.

UC's reach into the lives of almost half of all families with children means it is important to get it right for the long term. It should not be undermined and constrained by much narrower short-term fiscal goals. A simpler, easier to understand and interact with welfare system remains a big prize that could still be grasped.

This remainder of this report is split into six further sections:

- Section 2 deals with the necessary refocus of UC to no longer be a vehicle for fiscal savings and reflects on the impact the coming cuts to in-work support will have on people's incomes;
- Section 3 sets out the impact UC will have on financial incentives to work, highlighting where support can be better focused to maximise it on those most likely to respond;
- Section 4 deals with the challenge of tackling low pay and aiding earnings progression while reducing reliance on an untried and untested scheme of in-work conditionality;

- Section 5 provides the latest information on UC roll-out, transitional protection and ways to make the system itself easier to interact with to ease implementation;
- Section 6 provides a summary of key findings and recommendations to ensure that the roll-out of UC is a success.
- Finally, Annex A gives a more detailed account of analysis relating to how incentives to enter work compare between the current system and UC.

Section 2

Reclaiming UC in a 'low tax, low welfare, high pay' world

Following a pattern set in the last parliament, the government has announced a wave of cuts to the working-age welfare budget over the course of this parliament – totalling £13 billion by 2020. At the same time, it is delivering a series of cuts in income tax and a sizeable lifting of the wage floor via the introduction of a new National Living Wage.

While primarily focused on deficit reduction, these changes are described as a deliberate attempt to shift towards a low tax, low welfare, high pay society. Yet the distribution of low paid workers across households and the nature of income tax cuts means the announced boosts are primarily skewed towards middle and higher income households. While at the same time cuts in working-age benefits are set to lower incomes at the bottom end of the distribution. This mismatch between the winners and losers raises serious questions over the extent to which the selected approach can achieve favourable outcomes.

The balance of the latest set of cuts – and in particular the decision to reverse planned tax credit reductions – mean that, for the first time, the introduction of UC is set to save the Exchequer money when it is introduced. The suspicion is that UC has shifted from being a vehicle of genuine reform designed to improve jobs and earnings prospects for lower income workers to a simple exercise in cost cutting. Any such shift must be reversed.

Lifting the wage floor and cutting income tax

The introduction of the National Living Wage, expected to increase the wage floor to £9 in April 2020 for those aged 25 and over, provides an important boost for the lowest paid. At the same time delivering on the pledge to increase the personal allowance for income tax to £12,500 by 2020 will mean that many part-time workers and those paid at the minimum wage will no longer pay any tax on their earnings (though they will still pay National Insurance if earning more than £8,475 a year).

However, neither policy is tightly focused on working families with low incomes. Many second earners with higher earning partners benefit from the National Living Wage. Further cuts to income tax disproportionately benefit the top half of the income distribution because they boost incomes of all working families, not just the poorest and many of the lowest earners no longer pay any tax. The additional pledge to lift the Higher Rate Threshold to £50,000 will specifically benefit the highest earners in the UK.[3]

Reducing welfare spend

At the same time, and building over the parliament, significant cuts are being made to working age welfare with a total of £13 billion a year expected to be saved in 2020-21. The largest single contribution to these savings is a four year freeze to most benefits from April 2016 (£4 billion)

[3] M Whittaker (2016) *Budget 2016 response*, Resolution Foundation

with cuts to support for families with children[4] (£2 billion) and in-work support through UC (£3 billion) the next largest.

Cuts to the in-work support in UC (through reductions in work allowances) will have a similar scale of impact on working families as the cuts to tax credits originally set for April 2016 (and subsequently reversed) were expected to have, though the shape – precisely who is affected and by how much – differs.

It is these cuts we focus on here – unique as they are to the new welfare system. Crucially, the balance has tipped following the latest wave of cuts. Before the Summer Budget the introduction of UC represented a cost to the exchequer relative to the current system; now the Treasury stands to save money as UC is rolled out – with obvious implications for family budgets. In total UC is expected to save the Exchequer £3.1 billion a year in 2020-21 relative to benefits it replaces in the current system – with £1.5 billion of this due to lower entitlements compared to the tax credit system.[5] But this aggregate figure masks a range of varying outcomes for different family types, some will be better off than in the current system, and others will be worse off.

Impact on incomes

The analysis in this section compares entitlements between two scenarios. In the first scenario the tax credit system is fully in place but without the announced reductions this parliament in income tax or the introduction of the National Living Wage. In the second scenario UC is fully in place along with announced cuts to income tax and the National Living Wage. As such, our analysis considers the impact not just of UC cuts, but a fuller 'package' of reform.

It does not account for the pace of transition between the two schemes or the transitional protection in place for those moving between the two (discussed in greater detail in Section 5). However, it is worth bearing in mind that in 2020 UC entitlements are expected to be £1.5 billion a year less generous than the current system, but with only £0.5 billion of transitional protection being paid.[6]

Our analysis shows that compared to entitlement in the tax credit system, even accounting for gains from income tax cuts and the National Living Wage we expect the majority of working families (2.5 million of 4.5 million entitled in either or both systems) to be worse off, with an overall average loss of entitlement of £41 a week for losers.

Table 1 shows that the number of families gaining or losing is broadly even across single parents and couple parents, with an extra 100,000 couples and single parents with lower entitlements. Families without children are more likely to have lower entitlement with 300,000 more losing than gaining, however the aggregate hides important underlying detail:

» Overall couple parents are net losers, but by only £3 a week. However, the 800,000 couple parents expected to gain have an average weekly gain of £46 a week, while the 900,000 couple parents with lower entitlement lose an average of £46 a week. Around 400,000 losing couples will no longer receive any UC, while around 100,000 gainers would not receive entitlement in the current system.

» The biggest overall losers are single parents losing overall an average of £15 a week, with 100,000 extra families who lose no longer receiving UC. The vast majority of working single

[4] Limiting support from the child element to two children (worth up to £2,780 per child in 2016-17) for new claims or births and the removal of the family element (£545) for new claims from April 2017.

[5] OBR (2016) *Economic and Fiscal Outlook*, March 2016. This figure includes the impact of changes to entitlements and other factors such as improved fraud and error measures and higher take-up.

[6] ibid

parents remain entitled to UC.

» Families without children comprise the greatest number of losers and, although losses appear a little smaller, these are large relative to their average UC entitlement. However, some caution is required in interpreting changes in entitlement for this group as they are least likely to take up their entitlement.[7]

Table 1: Average loss of income for working families entitled to either UC or the current system, 2020-21

Millions of families, £ per week (2016-17 CPI terms)

	Couple parents	Single parents	Non-parents	All
Change in generosity for population entitled in either the current system or UC				
Gainers	0.8 m	0.4 m	0.8 m	2.0 m
of which:				
receive UC	0.7 m	0.4 m	0.6 m	1.7 m
do not receive UC	0.1 m	*	0.2 m	0.2 m
Losers	0.9 m	0.5 m	1.1 m	2.5 m
of which:				
receive UC	0.5 m	0.4 m	0.3 m	1.2 m
do not receive UC	0.4 m	0.1 m	0.8 m	1.3 m
Total population entitled to UC	1.3 m	0.8 m	0.9 m	3.0 m
Change in entitlement				
Mean Gain	£46	£25	£27	£34
of which:				
receive UC	£49	£25	£32	£38
do not receive UC	£10	*	£8	£9
Mean Loss	-£46	-£43	-£37	-£41
of which:				
receive UC	-£44	-£41	-£36	-£41
do not receive UC	-£48	-£50	-£38	-£42
Net change in income	-£3	-£15	-£10	-£8

Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Table includes all families entitled to either UC or the current tax credit system or both assuming full take-up of benefit entitlements in two scenarios where UC (with tax cuts and the National Living Wage) or the current system (without tax cuts and the National Living Wage) are fully in place in April 2020, as are cuts to the child element for new claims/families. Analysis uses OBR economic assumptions from Budget 2016 and the Family Resources Survey, 2013-14. * Denotes where sample size is too small to report an estimate.

In total we estimate that 1.5 million working families will no longer be entitled to UC due to the reduction in its generosity – mostly families without children (who tend to have less entitlement in the first place)[8] and couples with children (usually with both parents in work or a relatively higher single earner). Around 0.3 million of these families are net gainers from the combination of UC cuts, income tax cuts and the boost to pay from the National Living Wage.

Overall we estimate that once in steady state around 3 million working families will be entitled to UC. The actual number that claim is likely to be lower because not all people with entitlement claim – this may be for a variety of reasons such as having only very low entitlements. Therefore we would expect the actual number of working families claiming UC to be around 2.7 million once fully in place, compared to 3.2 million in the current system.[9]

[7] An artefact of our modelling process, the actual number of families without children in receipt is likely to be in the region of two-thirds to three-quarters of the population shown in the table. For families with children we would expect the reported entitled populations to be broadly in line with the actual numbers in receipt.

[8] As noted previously some caution is required in interpreting changes in entitlement for this latter group as they are least likely to take up their award.

[9] HMRC (2016) *Child and Working Tax Credit statistics April 2016*

Mitigating measures?

The position of single parents as being more likely to remain entitled to UC post-cuts, but with lower levels of generosity, reflects their propensity to work in part-time and low paid roles. This profile implies that they will have fewer opportunities to ameliorate the impact of cuts to in-work support by raising their hours or their rate of pay.

At the same time, cuts to income tax do little to offset losses among these working families. In part, that's because of a limited overlap between low paid losers of UC and the beneficiaries of tax cuts. But it also reflects the fact that UC entitlements are assessed on incomes after tax is taken into account (unlike in the current tax credit system). This means that for every £1 of tax cut received by a family, their UC entitlement will fall by up to 65p, leaving them only 35p better off.

One lesson is that if the government wants tax cuts intended for low paid workers to be received by low income working families it will need to adjust work allowances in UC to account for the tax cut.[10]

In a similar way, the National Living Wage does little to offset losses because up to 76 per cent of the gross income gain is withdrawn in tax and in UC entitlement.

An additional free 15 hours of childcare for three and four year olds in families in which all parents work, announced at the Summer Budget, has often been advanced as a potential offset to wider losses – one that is not included in the analysis above. While this may be true for some families, the policy clearly offers no help to those without a child aged three or four. Indeed, only around 260,000 families with a child under the age of five are expected to claim for support with childcare costs through UC – and not all of these will have a child aged three or four.[11] And with 85 per cent of childcare costs already covered we would expect these families to gain only around £10 a week on average – significantly less than the average loss for families with children with lower entitlements reported in Table 1 above.

Taken as a package we would still expect the majority of working families on UC to be worse off over the period; that is the cuts to benefits reduce income by a greater amount than the combined boost associated with the National Living Wage, income tax cuts and additional childcare support.

Ending the merry-go-round

The aim of a low tax, low welfare, high pay society is clearly attractive. But it falls foul of both the widespread issue of low pay in the UK – where the National Living Wage alone is not enough to cover the cost of raising children through pay – and the individualised nature of the tax system compared to the family-based structure of the benefit system.

The losses faced by families in the coming years are not simply a product of UC itself, but of repeated reductions in the generosity of the system since it was first announced as a policy. As a result of these cuts, UC is at risk of no longer effectively meeting the labour market and living standards challenge that it was initially purported to tackle. Cuts to the generosity of UC should be reversed so that it remains on a par with the current system.

In reviewing its focus and role the Secretary of State should clearly restate the purpose of UC in improving the lives of low income working families. This means reclaiming it from the Treasury and ensuring it is more than just a vehicle for extracting savings to meet wider fiscal targets.

Alongside a direct impact on incomes the cuts to UC have also diminished the improved financial incentives to work that were core to its introduction. In the following section we turn to the impact on work incentives from the switch to UC for different family types.

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

[11] HMRC (2016) *Child and Working Tax Credits Statistics April 2016*

Section 3

Improving incentives to get into and get on at work

Any welfare reform will bring a trade-off between generosity, incentives and total spend – the 'iron triangle' of welfare reform. The original concept of UC boosted the generosity of financial incentives to both start work and progress in work. In the longer term improved incentives were meant to lead to better work outcomes and, therefore, reduced spend.

However, initial financial constraints significantly reduced the ability to deliver incentives to progress. Successive budget reductions, culminating in the large cuts to work allowances which took effect this April have overall reduced the generosity of UC for those in work compared to the current system.

With a now stripped back scheme in constrained fiscal times it is important to ensure that incentives are focused where they can be of greatest help and on those most likely to respond. Perhaps more fundamentally it is also important that progress made in supporting people into work over the last two decades is not lost.

Incentives and the Tax Credit regime

Incentives matter to labour market outcomes – but evidence suggests they matter more for some than others. Under the current tax credit regime, benefit recipients are encouraged to enter work via 'hours rules'. These provide a boost to income when a minimum number of hours are worked (16 for a single parent, 24 between couple parents).

Work less than the specific hours threshold and you face potentially punitive benefit withdrawal rates (with out-of-work benefits withdrawn pound-for-pound), work more and the withdrawal of tax credits and imposition of income tax mean that workers keep as little as 27p – falling to 9p if also receiving Housing Benefit.

The result is a powerful incentive to work a specific number of hours, and that's precisely what occurred for some[12] – most notably among single parents where a fifth of those in employment work exactly 16 hours and employment rates have risen strongly. In contrast, among second earners in the tax credit system, where incentives to start work at all are weak, only a quarter are in work.

For others such incentives are less important. Main earners in couples with children, usually men, tend to work full-time regardless of incentives – the large and historically constant proportion of fathers working full time bears this out. For others without significant barriers to work – such as individuals without children, disability or caring responsibilities – the expectation is generally that they can work full-time and tend to 'jump' to those hours avoiding poor incentives at low part-time hours.

[12] M Brewer, et al (2005) *Did Working Families' Tax Credit work? The final evaluation of the impact of in-work support on parents' labour supply and take-up behaviour in the UK*

A new set of incentives

UC sought to deal with one of the big drawbacks of tax credits – mainly that it offered very little to those who can only work short hours – through a 'work allowance'. Work allowances are effectively an earnings disregard where families can earn up to the level of the allowance without having any benefits withdrawn. In comparison to the current system this provides a strong incentive to start work at a small number of hours.

Such incentives should be of help to the remaining households in which nobody works who are largely either disabled people or single parents with pre-school aged children who may struggle to meet the hours requirements in the tax credit system.[13] But financial incentives alone are unlikely to be enough given the barriers such groups face. We set out a full approach in the final report of our almost year long investigation into setting a path for government to reach full employment.[14]

Beyond the work allowance a new 'single taper' on benefit income applies – the rate at which UC is withdrawn as earnings increase. For every pound earned after tax and National Insurance are paid, UC is reduced by 65p. This means that a worker will be 35p better off for each pound earned, falling to 24p once earning enough to pay tax. Compared to the current system this is lower for those with housing costs, but slightly higher for those without.

Failing to significantly lower the taper rate means there is little improvement (and in fact for many a worsening) of the incentive to progress. To build and improve on the tax credit system the greatest challenge to boost living standards is to tackle low pay and the resulting levels of in-work poverty – almost two thirds of children in poverty live in working households. In addition the introduction of the National Living Wage creates an additional potential barrier to progression, through a compression of the earnings distribution around the new wage floor (see Section 4 for more). The financial incentives provided by UC do not go far enough in meeting these challenges.

Reducing the value of work allowances

As with the tax credit system, the new regime creates a 'sweet spot' which maximises earnings and benefit income. The difference now will be that rather than being hours based the 'sweet spot' will vary across claimants depending on whether they rent, have children or disabilities and on their hourly rate of pay – work allowances relate to an earnings level rather than hours.

But UC runs the risk of significantly lowering the hours most incentivised. The 2015 Summer Budget reshaped work allowances. They had already deteriorated in value, but are now significantly less generous than previously expected. By 2020, for a renter the work allowance will be exceeded when working only 5 hours a week at the National Living Wage, rising to 10 hours a week for a non-renter (see Table 2). These are significant reductions, particularly for non-renters, and alter the basic premise of UC.

[13] P Gregg & D Finch (2016) *Employing new tactics: the changing distribution of work across British households*, Resolution Foundation

[14] P Gregg & L Gardiner (2016) *The road to full employment: what the journey looks like and how to make it progress*, Resolution Foundation

Table 2: Work allowances in 2020 compared to wage floors

	Pre-Summer Budget			Post-Summer Budget		
	Annual limit	Weekly hours at NMW	Weekly hours at NLW	Annual limit	Weekly hours at NMW	Weekly hours at NLW
Higher work allowance - without housing costs						
Single parent	£9,300	23	20	£4,900	12	10
Couple with children	£6,800	17	15	£4,900	12	10
No dependent children	£1,400	3	3	£0	0	0
Limited capability for work	£8,200	20	18	£4,900	12	10
Lower work allowance - with housing costs						
Single parent	£3,300	8	7	£2,400	6	5
Couple with children	£2,800	7	6	£2,400	6	5
No dependent children	£1,400	3	3	£0	0	0
Limited capability for work	£2,400	6	5	£2,400	6	5

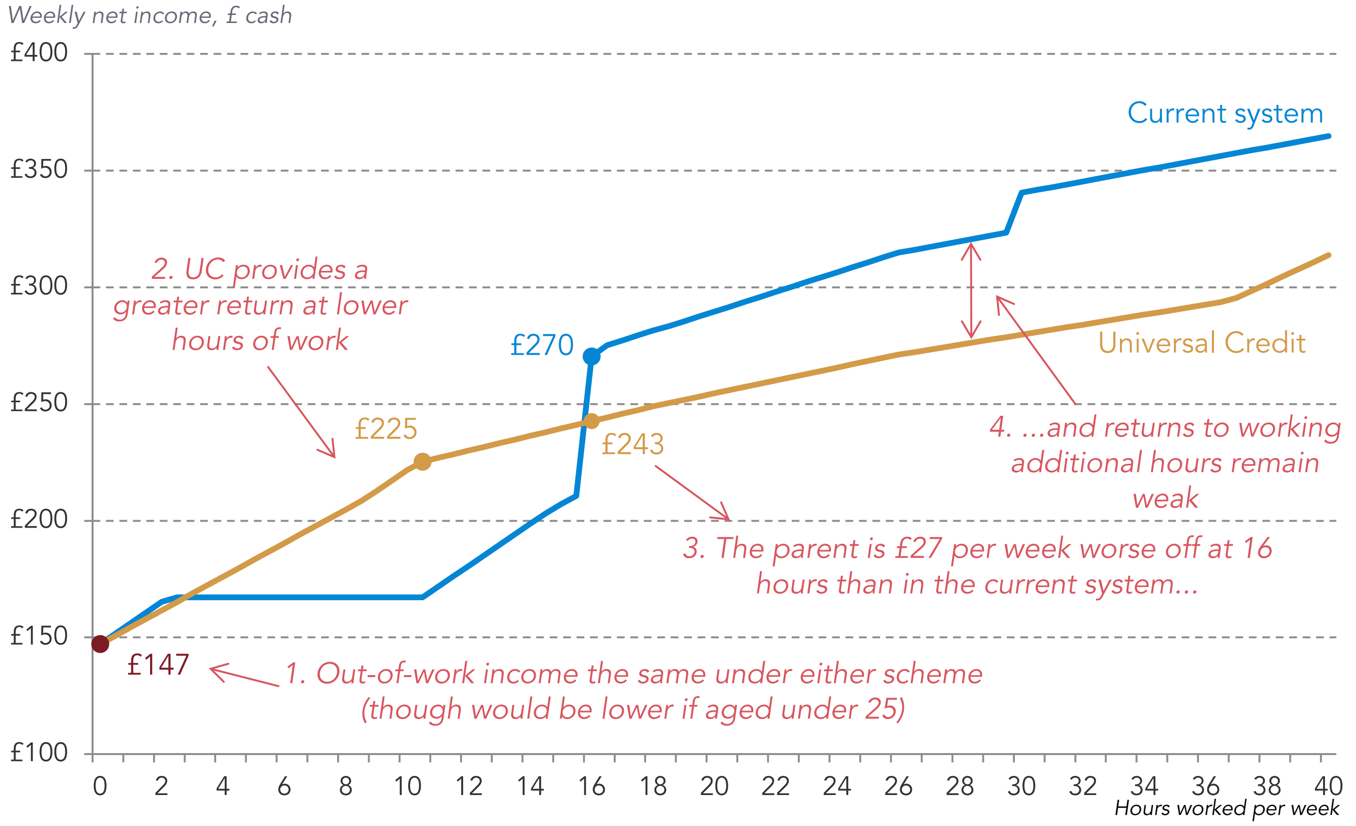
Source: Resolution Foundation analysis using DWP Benefit R ates for 2016-17 & OBR economic assumptions at Budget 2016

Figure 1 below maps the net income of a single parent non-renter with one child as they move into work and up to full-time hours earning at the wage floor, in both the current tax credit system and UC. Four points stand out:

- Income is the same when out-of-work in either the current system or UC (although single parents aged 18 to 24 are £15 a week worse off);
- The work allowance in UC is more generous , providing a boost to income at low hours of work – although benefits are tapered once 10 hours are worked;
- Beyond 15 hours UC becomes less generous than the current system with someone working 16 hours a week having a £27 per week drop in income;
- There are relatively low marginal returns from additional hours worked in either system but in UC this point starts much earlier – once the work allowance ends – than in the current system (in this example once 30 hours are worked).

It would follow that we expect to see single parents moving towards their optimum point – or 'sweet spot' – of 10 hours for non-renters and 5 hours for renters, the point at which work allowances end.

Figure 1: Income schedule for a single parent with 1 child entering work under the current system and UC, 2020



Source: Resolution Foundation micro-simulation model

The shape of incentives is also likely to be an issue for second earners. As noted above, such changes to incentives are perhaps less of a problem for main earners in a couple with children who tend to be unresponsive to changes in financial incentives at the margin. But because work allowances apply to a household, and with their low value are generally met by the first earner, the taper of 65 per cent applies to all of the second earner's pay: earning £5,000 would only boost income by £1,750. Responsive to incentives, there is a risk that second earners choose not to work at all, especially if additional costs like childcare are taken into account. Indeed the DWP Impact Assessment on UC expected that fewer second earners would work due to the incentives created.[15]

Measuring incentives to enter work

By measuring the change in the distribution of work incentives for the members of different family types we are able to better understand where issues arise and consider how likely members of that group are to react. Below we set out in detail the impact on the distribution of incentives to start work for couple parents who are currently out of work (Figure 2), and summarise the impact for members of other family types (Figure 3). Annex A sets out the full detail, with many more family types.

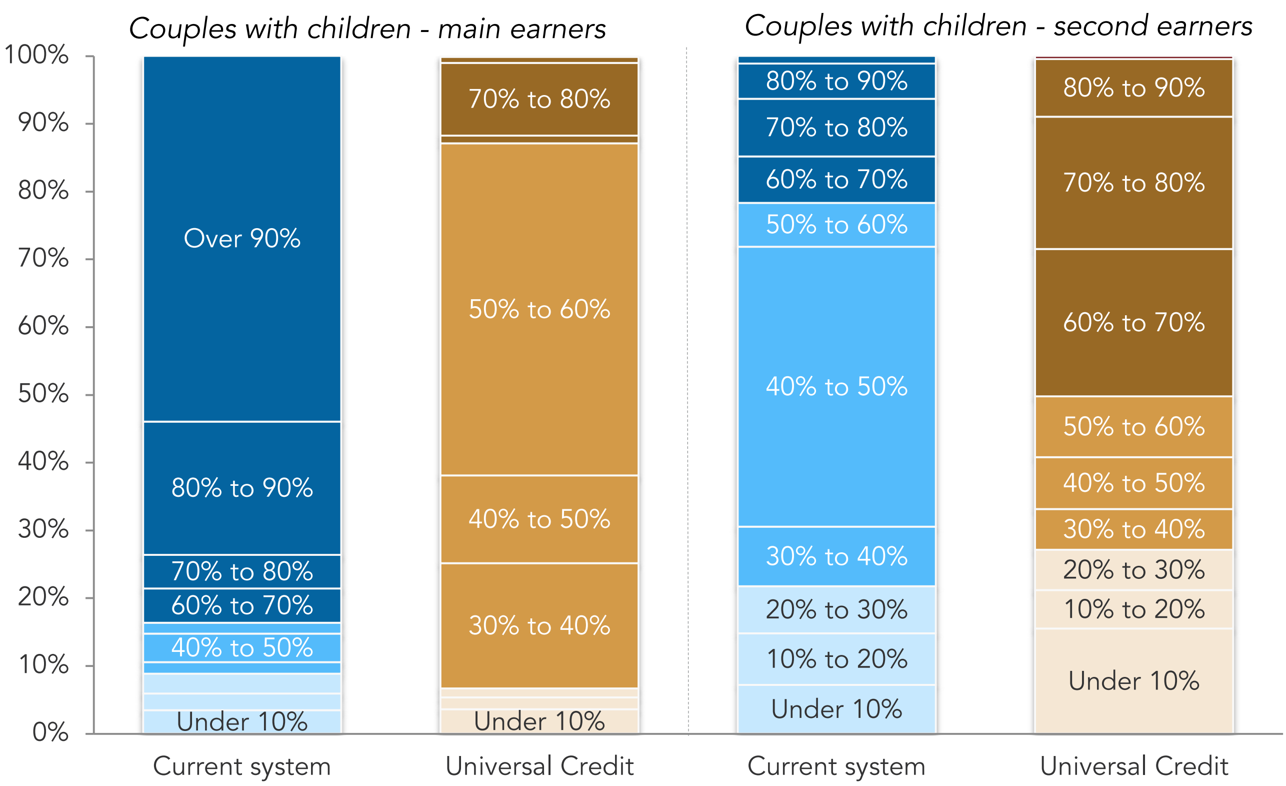
We focus on the Participation Tax Rate (PTR) – the proportion of earnings an individual is left with when entering work once tax payments and benefit withdrawals are accounted for – is calculated to measure the financial return from starting work. And we consider entrance at either 20 hours (part-time) or 40 hours (full-time) a week – in all instances using the wage floor as the appropriate level of hourly pay.

[15] DWP (2012) *Universal Credit Impact Assessment*, December 2012

Figure 2 relates to couples with children and shows that, for a parent entering part-time work on the wage floor:[16]

- If they are the potential main earner (mostly in households with disability or ill-health and who rent- most other couples with children already have someone in work) the incentive to enter work at part-time hours is significantly improved relative to the current system. This is driven by the work allowance, which reduces the amount of their out-of-work award that is withdrawn when working 20 hours. Over half of the group in the current system would face a PTR of over 90 per cent – meaning they are better off in work by only 10 per cent of their earnings after tax and benefits are deducted. Under UC, the very highest PTRs are capped and more than four-fifths will keep up to 60 per cent of what they earn.
- If they are the potential second earner (ie with a working partner) the incentive to start work at part-time hours is significantly worse than in the current system. Half of second earners will be better off by no more than 40 per cent of what they earn – a PTR of 60 per cent or more – compared to around one-fifth in this position in the current system. This reduced incentive occurs largely because the 65 per cent taper in UC applies to all of a second earner's income (that is, the mitigating effect of the work allowance that applies to the first earner in the first example does not apply because it has already been exhausted), leaving them with a higher withdrawal rate than the 41 per cent taper that applies in the tax credit system.

Figure 2: Participation tax rate distribution for person starting work at the wage floor for 20 hours a week



Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Out-of-work individuals are assumed to enter work at the appropriate wage floor (the National Living Wage for over 24 year olds) and at the given number of hours. The population is restricted to those expected to be entitled to Universal Credit in 2020.

[16] The 'First earner' is the head of a couple in which nobody works, the 'second earner' is the non-working partner in a couple in which one person is already in work.

These shifts in incentives are important. We have already discussed what the new shape of incentives might mean for a single parent. For couple parents the improved incentive to work part-time hours (and indeed hours much lower than 20 as modelled) due to the work allowance provides an improved chance that people unable to meet the hours requirements of the current system start work. At the same time it would seem unlikely that those currently working full-time (the vast majority of the group) would adjust their earnings down given that historically they are unresponsive to such changes in financial incentives. This shows an improvement on the current system.

However, second earners – who will find it much less worthwhile to start work at part-time hours – are more likely to be responsive to such incentives. We would expect – and government estimates have previously shown – that fewer will choose to work at all under UC. This response is likely to be stronger still for those needing to pay for childcare support to work, even with 85 per cent of childcare costs covered by UC, the further 15 per cent that must be paid can leave little financial return from starting work. This shows a worsening of incentives compared to the current system (where they were already weak).

Figure 3 summarises the impact at part-time and full-time hours for the members of different family types. Across the board the very worst incentives to work are capped – because the very high benefit withdrawal rates at very low hours of work or when in work and receiving Housing Benefit have been removed by the work allowance and single taper rate respectively. Beyond that:

- For couple parents entering work at full-time hours, the incentive to enter work is relatively unchanged.
- For single parents entering work at part-time hours, work is now more attractive – although those incentives are stronger at lower hours. At full-time hours the incentive to enter work remains weak, with almost three-quarters of the group better off by no more than 30 to 40 per cent of their earnings.
- The balance of incentives for people without children has been improved, which should help support those with barriers to work (like disability) into short hours of work and to some extent reduce the risk of simpler cases being incentivised to cut their hours. However, at both part-time and full-time hours, half of the group will be better off by only 30 to 40 per cent of their earnings.

Figure 3: Changing incentives to start work, the current system v Universal Credit

	Couple parent - 1st earner	Couple parent - 2nd earner	Single parent	Family with no children
Full-time, entering work at 40 hours on the wage floor	Very highest PTRs capped ✓ But overall remain high: - 60 per cent of group are better off by no more than 40 per cent of what they earn ✗	Broadly unchanged: - a fifth are better off by no more than 30 per cent of what they earn Driven by lower generosity moving dual earners off UC sooner	Very highest PTRs capped ✓ But overall remain high: - 70 per cent of group are better off by no more than 40 per cent of what they earn ✗	Very highest PTRs capped ✓ PTRs, overall still remain high: 50 per cent better off by no more than 40 per cent of what they earn
Part-time, entering work at 20 hours on the wage floor	Very highest PTRs capped ✓ High PTRs now lower: - half now better off by up to 50 per cent of their earnings, conpared to only 10 per cent of earnings now	Incentives signifcanlty worse: ✗ - Half of group keep no more than 40 per cent of their earnings	Very highest PTRs capped. ✓ While half keep up to 50 per cent of what they earn, incentives are weighted to lower hours ✗	Very highest PTRs capped ✓ But overall remain high: - 50 per cent of group are better off by no more than 40 per cent of what they earn ✗

Source: Summary of Resolution Foundation analysis using the IPPR tax-benefit model set out in Annex A.

Overall, the incentives to enter work created by UC do little to greatly improve on the current system, other than at very low hours and by capping the very worst incentives (the effect of which is greater among those still not in work because they are more likely to live in rented accommodation). Compared to the earlier, more generous, work allowances that were set to apply incentives are improved by far less. Indeed the very shape of the new incentives is set to place greater downward pressure on the earnings of those finding themselves trapped on UC with little incentive to earn more.

This is a complex picture with some significant improvements in incentives for certain groups at particular hours but marginal improvements for others, while there is a worsening picture for others In particular the very worst returns for all groups have been capped, but their rates remain relatively high – particularly for those entering full-time work. Where incentives are improved it is mostly at part-time hours, a pattern that for many does not support a goal of increasing earnings to improve living standards. For those most likely to respond to financial incentives - such as single parents and second earners in couples with children - this represents a lost opportunity. Given the importance of boosting employment within such groups as a means of supporting living standards and reducing levels of poverty, this focus appears to be misplaced.

Theory in practice?

Although DWP has published initial evidence on the impact of UC on the likelihood of claimants entering work, it is difficult to broadly apply these lessons to the bulk of the UC caseload. The evidence to date is based on simple cases without children and importantly relate to a more generous incentive design (see Box 1 for further detail). It will be important to assess the impact again when more Jobcentres have UC in place (reducing the likelihood of 'pilot' effects in the initial areas) and when people more likely to respond to changed incentives (like single parents) are part of the scheme.

Restoring and reshaping incentives to enter work

Financial work incentives have been inevitably damaged by the significant reduction in funds announced at Summer Budget. In our major review of UC which reported last year, we argued for a better targeting of resources in constrained times – targeting support on those most likely to respond and who need it most. But the latest cuts take us beyond this, removing work allowances for those with the least barriers to working (as we recommended) but not recycling savings to those most likely to respond. Instead incentives have been cut across the board.

It is imperative for the success of UC that the new Secretary of State makes efforts to raise the available budget in order to make work allowances – a fundamental plank of UC – worthwhile. The welcome improvement to incentivise working short hours for those who wish to do so, or can do no more, must be achieved without destroying the incentive to work beyond that point. Failing to fix incentives risks trapping many – particularly single parents or single earning families with young children – in low pay and low income.

Looking beyond work allowances leads to a consideration of progression and the role of the single taper. The next section delves into the progression incentives UC provides and the potential role of practical support and in-work conditionality.

i Box 1: Research to date on the impact of UC for actual UC claimants

DWP has published research reports relating to the employment and earnings impacts of UC on claimants using administrative data relating to 8,000 single unemployed cases between July 2013 and September 2014 in initial 'pathfinder' areas where UC was tested.

The two key findings from that research are that for people on UC compared to similar cases in the current Jobseekers Allowance regime:

- 8 per cent more people were in work for a period of time in the first nine months of a claim; and
- Around 3 per cent more people were actually in work nine months after a claim has started.

The difference between the two findings is that the higher figure relates to being in work *at some point* during the nine months the lower to *actually being in work* nine months later. This suggests that the difference is due to UC claimants being more likely to be undertaking temporary work.

The research also finds that those on UC earned more in total over the period than people on JSA. However, the extra earnings were small and together with the additional time spent in work would suggest that on average the extra work was for lower pay.

The study is unable to show what has driven these different outcomes – was it the different work incentives, using a simpler, single system or a different approach from Jobcentres staff. Understanding which has played the pivotal role is important if the government wish to replicate those outcomes elsewhere.

It is also important to note that some of the impact may be due to 'pilot effects' where resource beyond the norm is dedicated to those areas where UC was initially put in place to ensure the test was as smooth as possible. As UC is rolled out more widely it will be interesting to note whether resource becomes diluted.

Further research which explores the claim experience with 900 UC and 901 JSA claimants found that:

- 71 per cent did not know they would be 35p better off for every pound they earned; two-thirds knew they would be better off working an additional hour; 95 per cent knew they would have to spend 35 hours a week looking for work;
- The average number of jobs applied for in the week before interview was similar whether claiming UC or JSA – 18 or 19 a week respectively – but hours spent searching for work was reported as 30 in UC and 20 under JSA. However, it is not clear whether JSA and UC claimants had the same level of work search required of them by JCP advisors; and
- Claimants that had moved into work were more likely to be looking for extra hours or ways to increase income if they claimed UC. However, the evidence suggests that those on UC came back for an interview with JCP about working more once they had found a job.

Sources: DWP (2015) Estimating the Early Labour Market Impacts of Universal Credit: Updated analysis, December 2015; (2015) Universal Credit Extended Gateway Evaluation: Findings from research with Extended Gateway claimants, December 2015

Section 4

Progression and the ongoing low pay challenge

Not only was UC intended to help people move into work, it was also conceived as a system with far greater incentives for workers to progress to higher levels of pay. The introduction of a 'single taper' that withdraws benefits at the same rate as earnings rise – rather than the multiple overlapping rates in the current tax credit system – was key to this ambition.

However, two factors mean that this was never realised. First, the aim of significantly reducing the taper rate to 55 per cent[17] *(instead of what now hits a maximum of 81 per cent) was ruled out as too expensive early in the last parliament. Second, interactions with Council Tax Support (which has been left outside the UC system) and the income tax and NI systems mean that a 'single' taper rate is not a reality. Put simply, implementation realities scuppered the ambition of the design.*

More recently the introduction of the National Living Wage – which, while welcome brings it potential compression of the pay scale in certain low paying sectors and firms – presents a further and immediate challenge, elevating the issue of progression still higher.

Financial incentives to progress

The proportion of earnings that a person keeps in their pocket once accounting for the withdrawal of benefits and payment of tax can be measured through the 'Marginal Effective Tax Rate' (METR). The lower the METR, the more of their earnings a person gets to keep.

Figure 4 compares the distribution of METRS across working recipients under the latest version of UC and the existing tax credit regime. As in Section 3 this analysis compares outcomes in 2020 in two scenarios – one in which the tax credit regime is fully in place and another in which UC is fully in place. It shows that:

» Overall, UC limits the very highest METRs – of over 85 per cent – faced by some in the current tax credit system. The single taper rate removes the very high withdrawal rates created by the interaction of Housing Benefit, tax credits and income tax.

» Despite this, UC will result in a significantly higher proportion (over two-thirds) facing METRs in excess of 75 per cent than the tax credit system (just under half). Under UC, roughly one-third of working claimants will have METRs of 76 per cent (due to interaction between the tax system and UC) and one-third will have METRs of 81 per cent (due to the addition of Council Tax Support).[18]

» Those workers (mostly second earners or single parents) who do not earn enough to pay tax will also face higher METRs under UC. Rather than the 41 per cent (rising to 53 per cent if also receiving Council Tax Support) taper that applies in the tax credit regime, claimants would

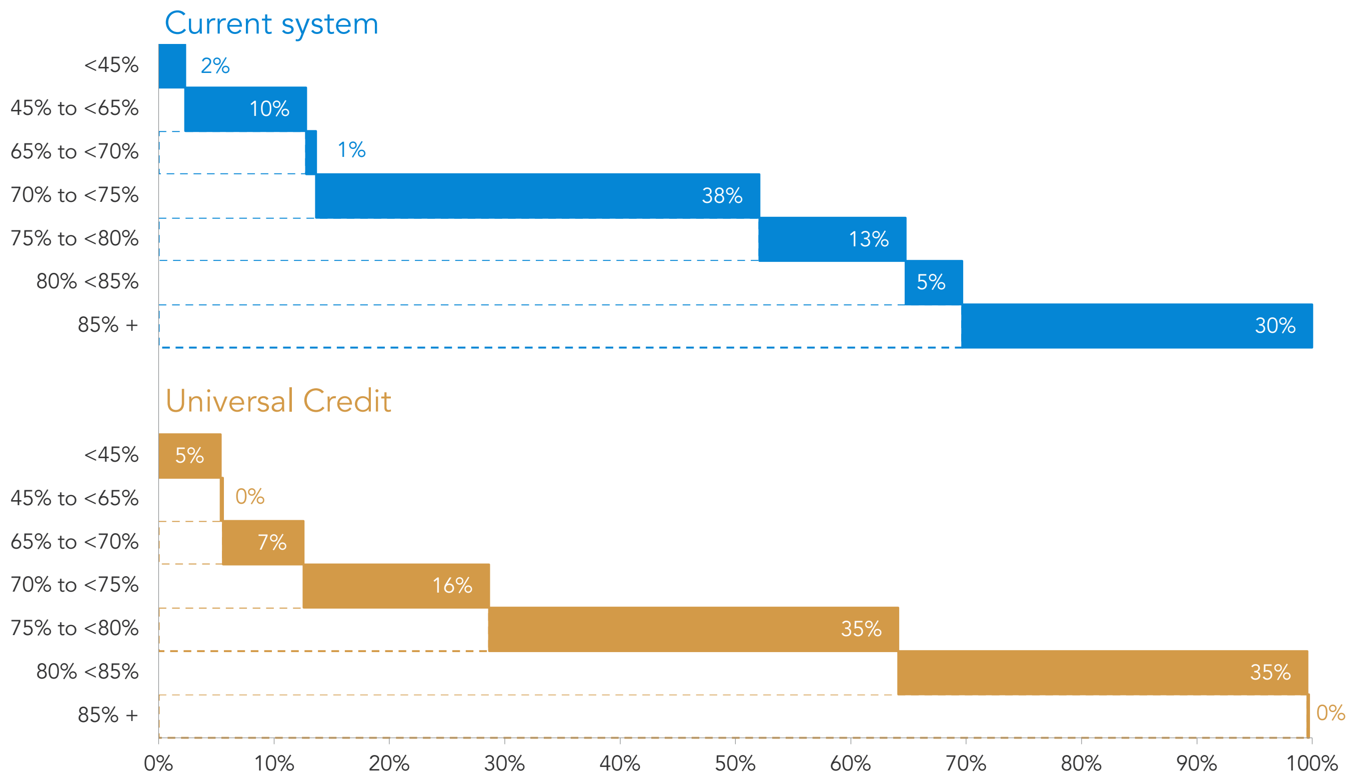
[17] Instead of a combined taper of 79 per cent where tax credits and housing benefit are withdrawn together, but only 41 per cent where only tax credits are withdrawn.

[18] Our modelling assumes that a single scheme of CTS with A 20 per cent taper rate applies to all UC households. In reality the parameters of each scheme in operation vary by local authority.

face an METR of 65 per cent (72 per cent if also receiving Council Tax Support).

Figure 4: Distribution of Marginal Effective Tax Rates for workers in UC and current system

Marginal effective tax rate band for percentage of population



Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Chart shows selected METR ranges to capture the key areas of interest for the in-work support regimes. Key METRs for UC recipients are: 65 per cent if not paying tax or National Insurance (72 per cent if also receiving CTS); 76 per cent if paying tax and National Insurance (81 per cent if also receiving CTS). Key METRs for tax credit recipients are: 41 per cent if not paying tax or National Insurance (53 per cent if also receiving CTS); 73 per cent if paying tax and National Insurance (78 per cent if also receiving CTS); 79 per cent if receiving HB and 92 per cent if receiving HB and also paying tax and National Insurance.

In addition to the 2.7 million working families we expect to receive UC, we anticipate that over 1 million families who were entitled under the tax credit system will no longer receive in-work support. These families – around half with children and half without – will inevitably have a lower METR – usually of around 32 per cent because they will only pay income tax and National Insurance.

For some this is a consequence of aligning the rules between the in- and out-of-work benefit systems;[19] for others, it is due to the reduced generosity of UC work allowances. Families without children and no or low rental costs are likely to be better off overall once accounting for the introduction of the National Living Wage and income tax cuts. This is not the case however, for couples with children who form the other group most likely to no longer receive UC. Their lower METR is more likely to come at the price of a lower income.

However, it is single parents who are perhaps worst affected by these cuts. Because not only will most have lower incomes they are also still subject to the high METRs that remain part of the system – so will find it much harder to earn more to offset their losses. To improve net income (after tax and benefits) by £1, a taxpayer on UC would need to earn over £4. If not on UC (and

[19] For example, capital rules that limit entitlement to out-of-work benefits for those with savings of more than £16,000 will be applied to working families, whereas currently only income from savings is taken into account.

just paying income tax and NI) the equivalent additional earnings needed to secure £1 would be just £1.28. Accounting for the cost of childcare support as a person works towards full-time hours would make the situation worse, pushing METRs towards 100 per cent in some instances.

The level of earnings at which different family types would leave the UC system altogether (and therefore no longer be subject to high METRs) differs depending upon the number of children and the size of any housing costs. Table 2 sets this out using a typical rent cost by way of illustration. In most cases families without children (unless they have high housing costs) will leave UC once they work full-time – a sensible position for those with few barriers to entering work. Among couple parents it is possible that once both work full-time they will no longer be entitled to UC, and if they do not rent this point would come much sooner. However, most couples in UC have younger children and one working partner. The incentive to move into a part-time job (as discussed in Section 3) for second earners are weak, and this is often the first step on the eventual route back to full-time work.

Single parents with one child (whether they pay rent or not) will need to earn almost £300 a week on their own – compared to the £356 a week shared between couple parents to leave UC. – Single parents will struggle to earn their way out of UC entitlement. Importantly, the picture would change if childcare costs were included, the additional support paid to families with children within UC would push their exit point to a potentially much higher level of earnings – a parent reporting £300 a week of childcare costs needing to earn an extra £730 a week.

Table 2: Earnings levels to leave UC by family type, 2020 cash

	Single	Couple	Couple parents		Single parent	
			One child	Two children	One child	Two children
Without housing costs						
Maximum UC award	£73	£115	£169	£222	£127	£180
Earnings to leave UC	£113	£177	£356	£438	£292	£374
Hours at NLW	12 hrs	19 hrs	39 hrs	48 hrs	32 hrs	41 hrs
With housing costs						
Maximum UC award	£143	£194	£281	£390	£239	£348
Earnings to leave UC	£221	£298	£478	£647	£414	£583
Hours at NLW	24 hrs	33 hrs	52 hrs	71 hrs	45 hrs	64 hrs

Source: Resolution Foundation analysis using latest OBR economic assumptions and announced benefit rates for April 2016-17

Notes: Assumes that families have made new claims, therefore the family element is not paid to families with children, and transitional protection does not apply.

Overall UC will do little to improve financial incentives to progress, beyond capping the very highest withdrawal rates faced in the current system and moving some people out of entitlement altogether at the price of a lower income.

The role of in-work conditionality

Alongside the progression 'carrot' provided by financial incentives, UC also introduces an apparent new 'stick' in the form of in-work conditionality (IWC). Conditionality – a well-established feature of the out-of-work benefit system – has played a fundamental part in the success of the UK labour market. Applied as a requirement to undertake job seeking or job preparation activity, an appropriate balance alongside practical support, financial incentives and compliance (although here the extent to which sanctions applied since the downturn has appeared to be excessive) is key.

Starting to apply such a regime to working individuals or families (with requirements placed on around 1 million people once UC is full in place[20]) is a radical shift in focus for Jobcentre Plus and likely to take time to get right. The current conditionality regime has developed slowly over

[20] Oral evidence to Work and Pensions Select Committee, 7 March 2016

decades and despite attempts since 2008 is still not effective for disabled people and the long term sick. DWP are rightly taking time and trialling the scheme as UC is rolled out over the next two years (a series of trials are being conducted involving up to 15,000 low earning UC recipients, with varying levels of 'work search' intensity to find higher levels of pay).[21] But it is vital that what the scheme is trying to achieve is clear both so that it is successful and does not disappoint.

The parameters of IWC have been set to at most move individuals to earn the equivalent of working full-time (35 hours a week) at the wage floor. While these requirements are reduced for people with caring responsibilities, and for couples they can be met through their combined household earnings,[22] they are effectively aimed at achieving sustained employment outcomes. By definition this aim will not tackle progression and move people out of low pay.

In effect IWC will largely mirror the outcomes expected of people in the current benefit system through the hours rules of the tax credit system (a minimum of 16 hours for a single parent) or standard work patterns – where most people without barriers to working – such as caring responsibilities or disability – work full-time. It was seen as a necessary 'backstop' in the system to account for the removal of the hours rules mentioned above. Where it differs and creates particular difficulties for implementation, many of which will interact with each other, are:

- Requirements will be greater for single parents with children of secondary school age who will be expected to work full-time hours. Similar expectations will apply to the second earner in a couple where previously none applied. For both finding available or affordable childcare may be a barrier to finding more work, while for many the lack of well-paid part-time roles will mean it is hours rather than pay they have to target.
- Bringing people into conditionality who will previously have thought of themselves as 'doing the right thing' or indeed escaping such treatment by being in work is likely to provoke difficult conversations. This may particularly be the case where individuals have little expectation or experience of such interaction or the threat of sanctions.
- People already in work are likely to have different needs and availability when finding further work or seeking a higher paid role. Jobcentres currently focus on encouraging individuals to look for a job not alter careers or move between roles.
- The required earnings levels are set by relatively loose guidance, meaning that the earnings requirement placed on an individual can vary on a case-by-case basis. Therefore it is likely that similar cases will end up with different requirements either across or within Jobcentres leading to potential unfairness or simply poor application of the rules.

Difficult those these issues are, what's clear is that the need for an effective IWC system is likely to be greater now than when UC was first designed due to both the weakening of financial incentives associated with budget cuts and the introduction of the National Living Wage..

Despite the introduction of the National Living Wage, low pay is likely to remain a key living standards challenge into the next decade. Almost a decade of lost pay growth has squeezed incomes, and with rapid employment growth over the same period there is little room left for incomes to be boosted by increasing numbers in work. The National Living Wage may act as a spur for productivity and will provide a limited boost to incomes, but on its own will not go far enough.

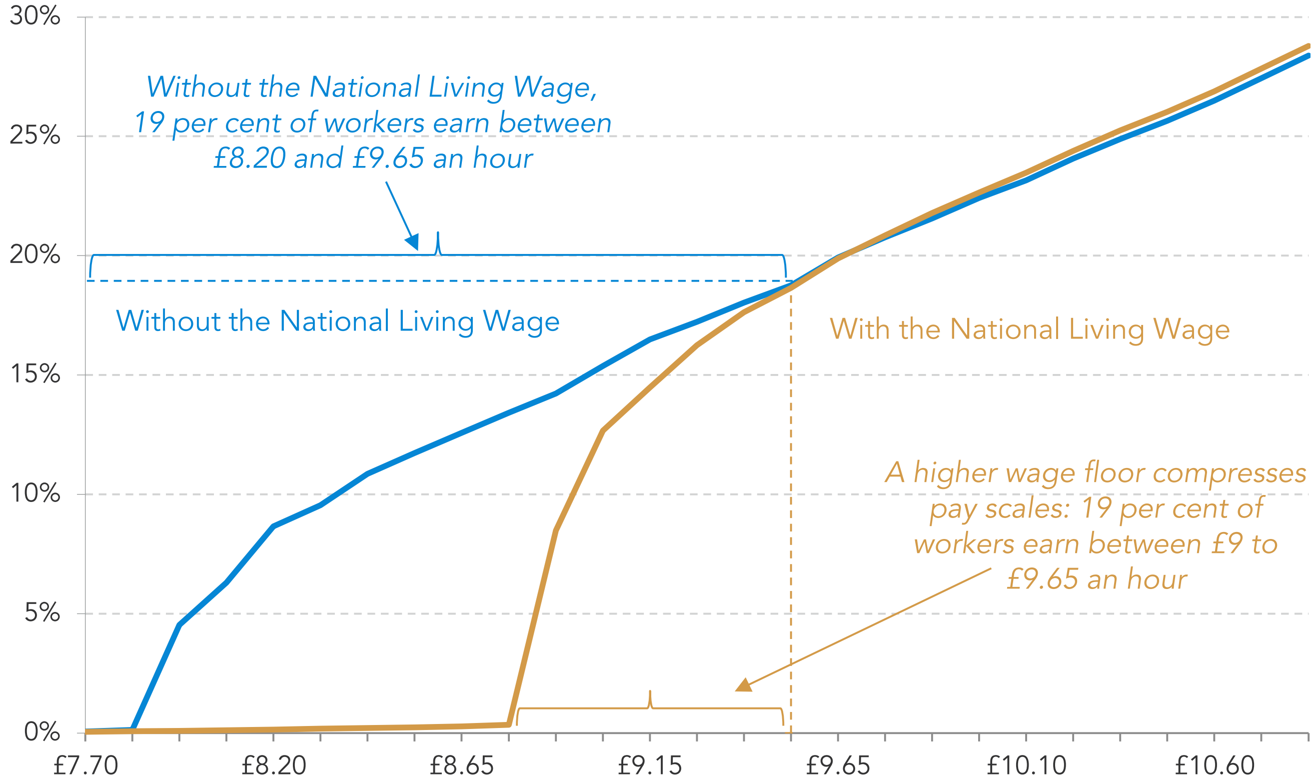
One challenge the National Living Wage brings is the risk of wage compression – particularly in low paid sectors where UC recipients are likely to work or be looking for roles. Figure 5 shows the impact of the National Living Wage on the wage distribution as a proportion of the median wage for over-25s. Lifting the wage floor is likely to mean a greater bunching of workers paid at or near that rate. How firms cope and the extent to which firms maintain current wage differentials is yet to be seen.

[21] Evidence supplied to the Work and Pensions Select Committee, April 2016

[22] Expected hours of work are reduced to within the school day for the parent of a 5 to 11 year old, none for a parent of a 0 to 2 year old.

Figure 5: Impact of the National Living Wage on the lower part of the wage distribution

Proportion of employees aged 25 plus by hourly rate of pay



Source: Resolution Foundation analysis using ASHE data and OBR economic assumptions from Budget 2016

Notes: This work contains statistical data from the ONS which is Crown Copyright. The use of the ONS statistical data in this work does not imply the endorsement of the ONS in relation to the interpretation or analysis of the statistical data. This work uses research datasets which may not exactly reproduce National Statistics aggregates.

However, while across all industries 23 per cent of workers will be affected by the National Living Wage, in typically lower paying sectors the proportion is much higher. It reaches 51 per cent in residential care, 48 per cent in hospitality and 46 per cent in retail. With practically half of the workforce at or near the same pay rate, clear routes to progress will be needed to further boost earnings. In this sense IWC is far too limited in its scope. Nor is it enough to simply extend the approach to higher levels of earnings.

As things stand, the government's plans for IWC create a potentially toxic mix of a new complex conditionality regime reliant on individual decision makers, imposed on a group who currently have little – if anything – to do with DWP, with financial incentives that do not support that goal and a prolonged and tricky implementation of IT.

To make so many changes at once is not sensible – particularly when it is not clear how effective each element of reform will actually be. The potential role of conditionality and in-work progression in UC was explored in some depth in our expert panel review of UC – and details can be found in the final report of that review[23] – but the following key guiding principles can help ease implementation:

» Strengthening financial incentives by reversing cuts to work allowances and testing the effect of a lower taper rate to make it more worthwhile for people to first find sustained employment and then earn more;

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

» Keeping to current hours rules and expectations to first simplify earnings requirements and reduce the need for individual decision making, and secondly to allow the system to bed in and understand the implications of UC incentives before making significant alterations;

» That a system to truly boost earnings progression and move people out of low pay should be separated from conditionality and requires a very different approach to the traditional role of Jobcentre Plus. But such an approach should be trialled and developed as a matter of priority; and

» Finally, that an element of consideration of future progression and career path be brought into work seeking activity with an option to delay a return to work to undertake training with a clear route to higher paid opportunities.

We have since gone further, as part of our work on the path to full employment[24], considering the role that a 'public employment service' might play. Primarily this is in relation to those with the greatest barriers to working. But it would also be important for such a service to maximise the earnings potential of future workers and operate effectively alongside UC.

An appropriate blend of carrots, sticks and support

Tackling low pay and supporting progression is by no means straightforward. And it is likely to get harder given the weakening of financial incentives associated with UC budget cuts and the wage compression that is likely to result from the introduction of the National Living Wage. Implementing an untried and untested form of conditionality to push people to reach a minimum earnings requirement is also a big ask. But it is important that the Secretary of State ensures that the new system supports the progression challenge rather than impedes it.

UC offers an opportunity to identify those stuck in low pay or a low pay-no pay cycle and offer them appropriate support. Doing so requires a more radical step than the proposed IWC provides. Instead new forms of practical support should be developed to help boost earnings progression and unlock untapped potential among those who currently receive little support from the state. Clearly, such support will take time to develop but this is a tough new challenge that should be grasped now rather than later.

UC will be introduced gradually in the coming years with families moved to UC at different times depending on how they are formed and where. Introducing significant welfare reform at any time can be tricky but we are yet to see just how tough this might be when on balance more families will be worse off than better off in UC. The next section considers the pace of transition, what this will mean for the families affected and highlights ways to ease the introduction of the new scheme.

[24] P Gregg & L Gardiner (2016) *The road to full employment: what the journey looks like and how to make it progress*, Resolution Foundation

Section 5

Road to full implementation

Despite the significant structural changes discussed in earlier sections. The majority of headlines generated by UC to date relate to its much delayed implementation. In common with other major government reforms and IT programmes, the new system has regularly missed deadlines. According to plans from 2013, roughly five million families were expected to be in receipt of UC today: instead the number is just over 225,000[25].

Whether the latest timetable will be adhered to is yet to be seen, but the project now stands at a critical juncture – with a 'full service' of UC (that can finally be used by all eligible family types) set to come into operation. In previous reports we have always been clear that it is better to get the system right than to adhere to a strict schedule. Nevertheless, implementation matters – not least for public confidence in the system.

In this section we consider the pace and shape of the rollout of the 'full service' UC system, and the role of transitional protection. We also take a view on practical elements of the design of UC, highlighting where people may find it difficult to interact with and use the system – vital to ease the path of implementation.

Implementation of UC

Until now UC has largely covered simple cases equivalent to JSA which tend not to encompass the mass of complex characteristics and changing circumstances that are a feature of other types of working age support. It is these latter cases that present such a design challenge from an IT perspective. Although it should be noted that some of those simple cases may become complicated as life happens. This in itself generates a risk of poor public perception of UC if these cases prove difficult to process through the old IT system.

DWP is about to embark on the gradual implementation of a new 'full service' that has been quietly (and slowly) developed in the background. From May 2016 this new system will go live in only around five Jobcentres a month[26] – which seems a sensibly incremental approach to something that has so far been so hard to get right. The lack of clear published milestones and timetables may be frustrating to those trying to assure the project,[27] but taking as much political pressure out of what have so far been large, visible and ultimately unachievable aims has merit.

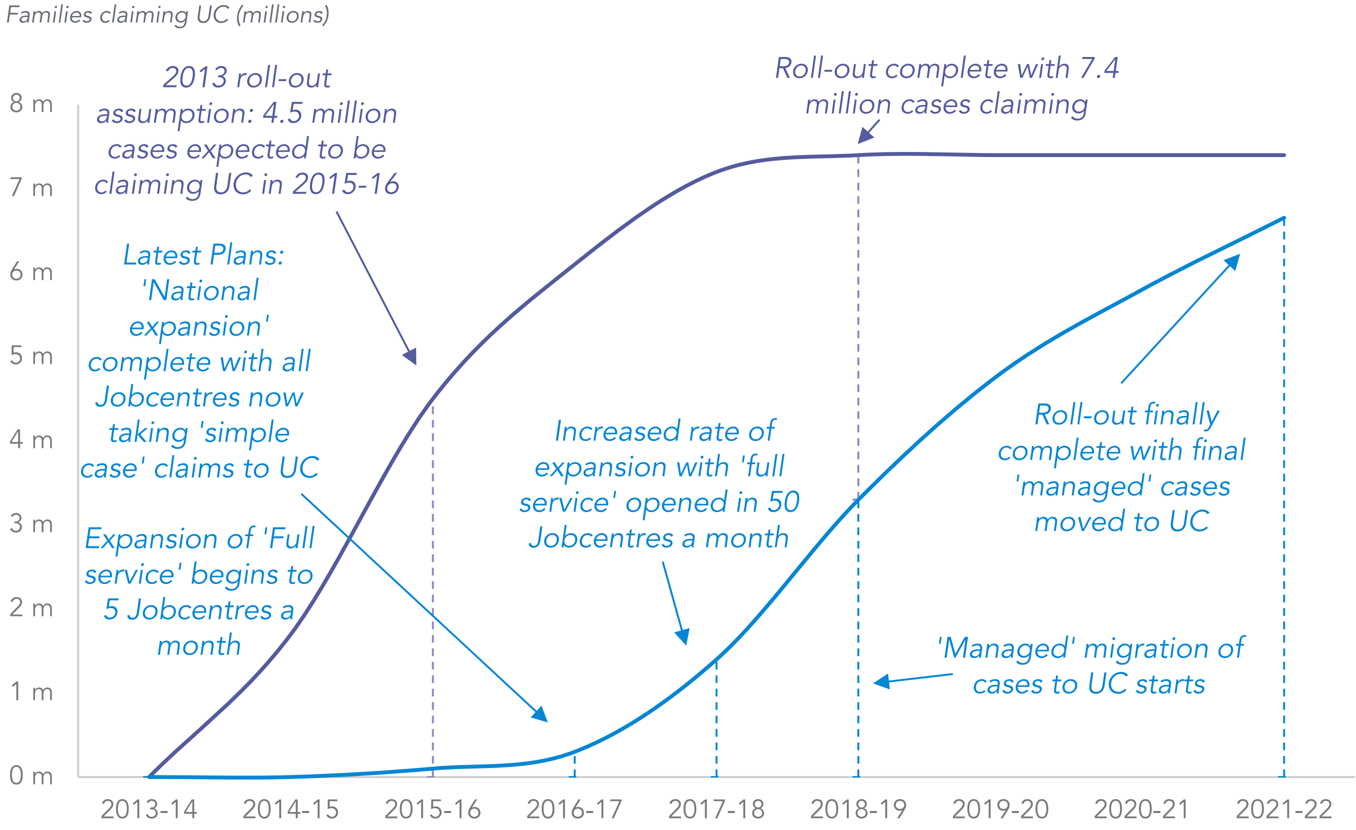
If this initial roll out goes to plan then UC will be put into place in 50 Jobcentres a month from around May 2017. As UC comes into operation, claims will no longer be taken to existing schemes. As such, by June 2018, UC should be operational across the UK and claims to the current system of out-of-work benefits should stop altogether (see Figure 6 for a comparison of the current roll-out plans relative to those from 2013).

[25] DWP (2016) Universal Credit: 29 Apr 2013 to 7 Apr 2016, April 2016

[26] The first being in the Bath, Newcastle Cathedral Square, Rugby, Bridgwater and Lowestoft Jobcentres, see: DWP (2016) *Transition Rollout Schedule – Phases 1 and 2: May to December 2016*

[27] Public Accounts Committee (2016) *Universal Credit: progress update*

Figure 6: The roll-out timetable for Universal Credit in 2013 and latest assumptions



Sources: OBR (2016) Economic and Fiscal Outlook; PAC written evidence from DWP, Resolution Foundation calculations based on OBR tax credit savings estimates & analysis of the IPPR tax-benefit model, DWP administrative benefit data & Impact Assessment for Welfare Reform and Work Bill.

As the caseload builds to what is now expected to be a final caseload of approaching a total 7 million families (almost 1 million less than previously expected due to cuts in generosity), which includes the 2.7 million working families we expect to claim and discussed in Section 2, there are three ways in which families can move onto the system:

- 'New claims': These are people who currently receive no benefits but a change in their circumstances, for example losing a job or having a child, means they are now eligible for support. These are most likely to be from people who would otherwise flow onto Income Support, Jobseekers Allowance or Employment Support Allowance. The JSA equivalent caseload will build fastest because claims from these case types can already be taken in all Jobcentres across the UK.
- 'Natural change': These are families already entitled to some form of support whose circumstances change to a great enough extent that their current entitlements could be affected and they make a claim for other benefit entitlements. This includes losing a job, having a first child or moving into rented accommodation. These are most likely to be working families and will include people who are currently out-of-work in either UC or the current system who move into work.
- 'Managed change': These families already claim support in the current system but following no significant change in circumstances, are actively moved by the government onto UC. Such families will receive 'transitional protection' – effectively a cash top-up to reflect any reduction in entitlement if this is lower when moved to UC compared to in the current system. This protection is time limited and will end earlier if there is a significant change in circumstance that affects their entitlement. These cases are most likely to be working families or ESA cases.

These types of move are important to understand if we want to shed light on who is moving onto the new system and how their incomes might be affected.

'New claims' are most likely to be from people who are not in work. They will, very broadly, have a similar award in either system with the big exception being single parents aged under 25 who have had the component of UC equivalent to their Income Support cut by £15 a week. Working families will also form part of the 'new claims' but a smaller proportion initially. This is largely because the areas they can claim in are limited to those in which the new 'full service' is rolled out to, and because flows of working families onto tax credits are smaller than flows for out-of-work families.

'Natural change' cases are more likely to capture an overlapping mix of working families, families with children and/or newly formed families. This will include single parent families moving from Income Support in the current system when their youngest child reaches age five (falling to age three in UC). Working families are more likely to have a different entitlement in UC to what they would receive in the current system, with more now likely to be worse off – as covered in more detail in Section 2. Significant numbers are not likely to start claiming UC until the summer of 2017 when the pace at which the new 'full service' is rolled out increases to around 50 Jobcentres a month, and therefore capturing more 'new claim' and 'natural change' cases.

'Managed change' cases – the final tranche – are most likely to be working families and ESA cases, both of which types are less likely to experience significant changes in circumstance. These cases receive transitional protection (see Box 2) but are not expected to be moved across to UC at large scale until the start of 2019.[28] By the end of the decade somewhere in the region of 400,000 tax credit and 165,000 ESA cases[29] – a relatively small portion of all cases – are likely to still require a managed move onto UC.

[28] OBR assumptions delay the managed migration by six months from the middle of 2018.

[29] NAO (2014) *Universal Credit: progress update*, November 2014 showed DWP estimates of this number of cases awaiting a managed move in December 2019. Since then DWP have delayed the timetable by six months with an additional six months delay assumed by the OBR.

Box 2: Transitional protection

Transitional protection is intended to "ensure, there will be no cash losers directly as a result of the migration to UC where circumstances remain the same".[1] It works by providing a cash top-up equivalent to the difference between their current system entitlement and a lower UC award. If the UC award increases, this transitional protection is reduced to keep income on a par with the point of leaving the current system. If circumstances change the transitional protection ends.

The DWP list the following key changes in circumstances when transitional protection may apply:

- A partner leaving/joining the household
- A sustained (three month) earnings drop beneath the level of work that is expected of them according to their claimant commitment
- The UC award ending
- One (or both) members of the household stopping work

However, these are not the same circumstances that will trigger a 'natural change' – those are likely to happen more frequently and relate to the point at which in the current system a person claims a different benefit (such as a move from JSA to Working Tax Credit). Reasons this may occur include moving in or out of work, having a first child or moving into rented accommodation.[2]

The speed at which the overall UC caseload increases, timing of the managed migration and overall spend on transitional protection suggests that relatively few in the period to 2020 will have their entitlement protected – or at least have it protected for a prolonged period of time.

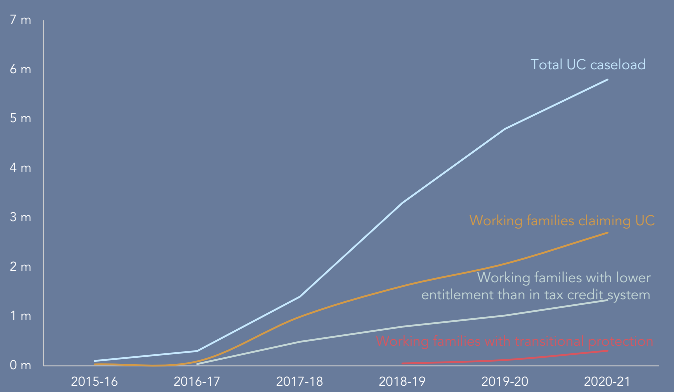
In 2020-21, for example, UC will be £1.5 billion less generous due to lower entitlements but only £0.5 billion of transitional protection will be paid.[3] Of that offsetting spend, £0.2bn is a direct result of the £3 billion of cuts to in-work support announced at the Summer Budget 2015, and the subsequent reversal of tax credit cuts in the following Autumn Statement.[4]

Applying the proportion of aggregate losses we expect transitional protection to offset for working families suggests that by the middle of the 2020-21 financial year only around 300,000 of the one million working families on UC, with lower entitlements than in the current system, will have transitional protection in place.

Figure 7 sets out our best estimate of the path of UC roll-out for working families, when those with lower entitlements move to the new scheme and how many are protected by transitional protection to the end of the 2020 financial year. OBR forecasts do not extend beyond the 2020-21 financial year but further cases are expected to move to UC in the following year, including more who are part of the managed migration – which will increase the level of spend on transitional protection – and bring the total caseload to close to 7 million working families.

Figure 7: Migration of working families onto UC

Families claiming UC (millions)



Sources: OBR (2016) Economic and Fiscal Outlook; PAC written evidence from DWP, Resolution Foundation calculations based on OBR tax credit savings estimates & analysis of the IPPR tax-benefit model, DWP administrative benefit data & Impact Assessment for Welfare Reform and Work Bill.

[1] DWP (2012) *Universal Credit Policy Briefing Note: Transitional Protection and Universal Credit*

[2] Child Poverty Action Group (2016) Welfare Benefits and Tax Credits Handbook 2016-17

[3] OBR (2016) *Economic and Fiscal Outlook - March 2016*

[4] OBR (2015) *Supplementary forecast information release: Tax credits costings – November 2015*

Perverse incentives?

With a change in circumstances triggering a reduction in entitlement for some (and an increase for others), perverse incentives could be created for families to try and slow down (or speed up) their migration to UC.

Those trying to maximise their entitlements may: first, try to claim in the current system before UC is introduced in their area; secondly, try to stay on the current system for as long as possible by not changing their circumstances; and finally, if moved to UC as part of a managed migration try not to change their circumstances for as long as possible.

However, real life rarely happens so neatly and the size of a financial loss or gain may be difficult to quantify. Take, for example, two people deciding to form a new couple and trying to understand whether they would be better off financially as well as other less readily quantifiable benefits that stem from living together. One alternative to trying not to change specific circumstances may be a reluctance to report them.

An increase in compliance and error issues are likely when it is unclear precisely what counts as a change in circumstances and people may wish to delay, or simply not bother, reporting such changes in fear of ending up with a lower income. To add to the confusion some people may be better off in UC than in the tax credit system so clear and accurate advice on how and when changes in circumstances matter is vital.

With the limited information available from government setting out what counts as a change in circumstances for either a 'natural change', or triggering the end of transitional protection, it is tricky to understand precisely how and when people will be affected. A problem that is clearly far greater for those who may be about to experience these changes.

Implementing a new system that has already developed a poor reputation will be difficult. But doing so when the people you want to use that system are resistant to the change for fear of being made worse off could work to undermine the very principles of simplicity and transparency UC is meant to create.

Easing implementation

Even with a plan to go slow until the full service is working effectively, there are still significant risks to implementation, posed by inevitable practical complexities. A key lesson from the introduction of the tax credit system was the sheer volume of changes in circumstance reported by recipients in the initial stages. The government responded by reducing the extent to which such changes needed to be reported, but UC tackles these head on by requiring monthly compliance.

This approach is designed to place the burden of complexity on the individual rather than the system. It is also justified as mirroring the monthly budgeting associated with work. Yet it appears inappropriate for some claimants, adding potentially prohibitive practical difficulties. At the very least the system needs reviewing to consider how damaging this might be and whether flexibility can be provided where appropriate.

Our previous wide ranging-review of UC identified a series of measures that would make UC easier to use. The myriad of different issues do not bear repeating here in full. The recommendations of the previous report – relating to how UC interacts with the wider benefit system and the extent to which the system itself will be easy to use – remain relevant.

A system that better matches user needs

Focusing here specifically on easing initial implementation (rather than policy decisions which lead to inequitable outcomes), there are some easy quick wins that relate to payment patterns:

» Reducing waiting times before a UC claim can be made would provide a better bridge for incomes in the space between leaving a job and starting to look for a new one.

- Providing more frequent payment of awards, rather than default monthly payments in arrears, would help ensure that people with short term financial pressures do not encounter budgeting problems – a particular issue early on in a claim or when falling out of work that can be paid weekly rather than monthly.
- Allowing rent to be paid direct to landlords through the expansion of the 'Trusted Partner Status' scheme, which allows landlords to request an 'Alternative Payment Arrangement' for at risk tenants.
- Allowing the self-employed to report their incomes on an annual basis, in line with the current tax regime, and similarly switching the Minimum Income Floor (a monthly cap on UC entitlement for the self-employed) to an annual footing to better support struggling enterprises.

A better fit with wider support for working-age families

Implementation may also be undermined by problems associated with links between UC and other forms of state support. These must be considered in the round, to ensure interactions between various entitlements are as straightforward as possible. Again considered more fully in our review of UC, key issues include:

- Reporting requirements for childcare costs, where strict monthly reporting may not fit with the pattern of childcare use. The government's complex workaround to allocate reported childcare costs to the period of childcare use appears open to user and systems error. Relaxing requirements to match those of the proposed Tax-Free Childcare scheme – the system intended for the bulk of working families – would help. Failing to do so risks claims of a two-tier system, with low and middle income recipients facing greater barriers than exist for higher income families.
- The administration of Council Tax Support at a local level. Incorporating this within UC would simplify the administration of working age benefits, placing the remaining large scale support for working age families within the single scheme. The potential operational savings from centralising administration could be used to offset the cost of reversing the usually regressive cuts to support made when Council Tax Support was localised.
- Determining eligibility to Free School Meals (and other 'passported' benefits). Perhaps the greatest ticking time-bomb in how UC interacts with other entitlements, a solution for determining eligibility is yet to be stated. But with cuts to work allowances, the earnings thresholds most recently on the government's agenda are likely to further dent incentives to work – even if the number of families entitled is maintained.

A simpler, more transparent system

It has taken a long time to get to the stage at which a UC system that can be put into place at scale and for all potentially entitled family types is set to be implemented. DWP still has some way to go to ensure the system it has developed functions successfully, but the new Secretary of State must bear in mind that implementing policy as it stands is not the only challenge.

Introducing the new 'full service' gradually and disentangling political risk as far as possible can only be a sensible approach, but the implementation process could be eased in a number of ways. Chief among these would be to restore some of the lost generosity so that UC no longer results in overall lower incomes for recipients. Greater clarity of the potential impact of transitional protection and on who will be affected when will also help families better understand the implications of UC roll-out.

At the same time the opportunity should be taken to sweep away some of the unnecessary reporting burdens and payment mechanisms that may make people's lives harder rather than simpler as it rolls out. Taking time to wrestle with some of the important practical issues that risk undermining the smoothness of the transition to the new scheme, and how that scheme fits with wider support available to working age families, could pay dividends though improved public confidence in the new scheme and a simpler more effective welfare system. Rather than a rigid, prickly system that is tough to engage with, the goal should be a more flexible, open system that is simpler to use.

Section 6

Conclusion

A radical reform of the working age welfare system, UC is undoubtedly a big deal. It provides a huge opportunity to shape the future of state support for low and middle income families in a way that best matches the labour market and living standards challenges of the next decade and beyond.

However, with implementation of UC dragging and a succession of cuts to its generosity biting, the world into which UC will be introduced, and the type of support UC will offer has fundamentally changed since its inception.

No longer should the focus be on reducing worklessness. Rates had fallen significantly even when UC was first mooted, and have since reached record lows. Instead UC should focus on supporting people into work and progression out of low pay. Welcome though the introduction of the National Living Wage is, too many families look set to remain stuck at low levels of earnings in the coming years. Rather than using the arrival of the National Living Wage as a backdrop for withdrawing state support, the government should ensure that the two policies complement each other.

A number of steps can be taken, some straightforward and quick to implement, others likely to lead to running battles with the Treasury or simply take time to deliver. But too large a prize is at stake to accept business as usual. Our extensive review of UC, published in May 2015, offered a blueprint to ensure UC would be fit for purpose in the next decade.

Those lessons still apply with UC in its infancy. Indeed, the review and reclamation of UC has become even more urgent following the announcement of further budget cuts. In this light, the change in political leadership at DWP – coming just as the proper roll-out of UC is about to start offers an important opportunity.

We have encouraged the new Secretary of State to reclaim UC from the Treasury, refocusing on what made it a bold reform with the potential to match the future living standards challenge. Rooting UC back in its ambition to support better life chances for low and middle income families, rather than a vehicle for meeting fiscal goals, is an important first step.

While this will not be easy given the fiscal backdrop, we offer a three point plan for change:

- Refocus support for working families on those most likely to respond to incentives and who need the support most. Boosting the work incentives of single parents and second earners will ensure the former are not trapped at low levels of earnings. Yet to do so, recent cuts to the generosity of in-work support will need to be restored – and then reshaped.
- Establish a more effective blend of financial incentives and practical support in order to solve the progression conundrum – made trickier by potential compression of wage differentials with the introduction of the National Living Wage. Rowing back on in-work conditionality, while exploring new methods of practical support for progression would give a more positive approach.
- Ensure a successful implementation. A gradual approach should be commended but so would taking the opportunity to review and then sweep away unnecessary complexity faced by people using the system. And ensuring the system fits with wider support for working age families is

essential. All will help land UC more successfully, as will providing greater clarity and when and how different families will be effected as they move onto the new system.

UC is about to come of age. It is therefore perhaps appropriate that its original architect has moved on. However, the new system isn't yet ready to go it alone and the man at the helm has an important job at hand. It will not be easy. And goes beyond a simple administrative exercise in project management – some elements of the system need rethinking altogether. But the rewards of getting it right are sizable.

Annex A: Measuring incentives to enter work

In Section 3 we discussed the incentives to enter work at full- and part-time hours for a selection of families under both UC and the existing tax credit system. We spent some time setting out the example of a couple with children, distinguishing between the main earner and the second earner. In this Annex we present three alternative examples, all of which were summarised in Figure 3.

Calculating the Participation Tax Rate (PTR) – the proportion of earnings an individual is left with when entering work once tax payments and benefit withdrawals are accounted for – provides a measure of the financial return from starting work. The figures below show how PTRs will differ for different members of family types at part-time and full-time hours among the current population of individuals who are out-of-work and entitled to UC.

Incentives at part-time hours

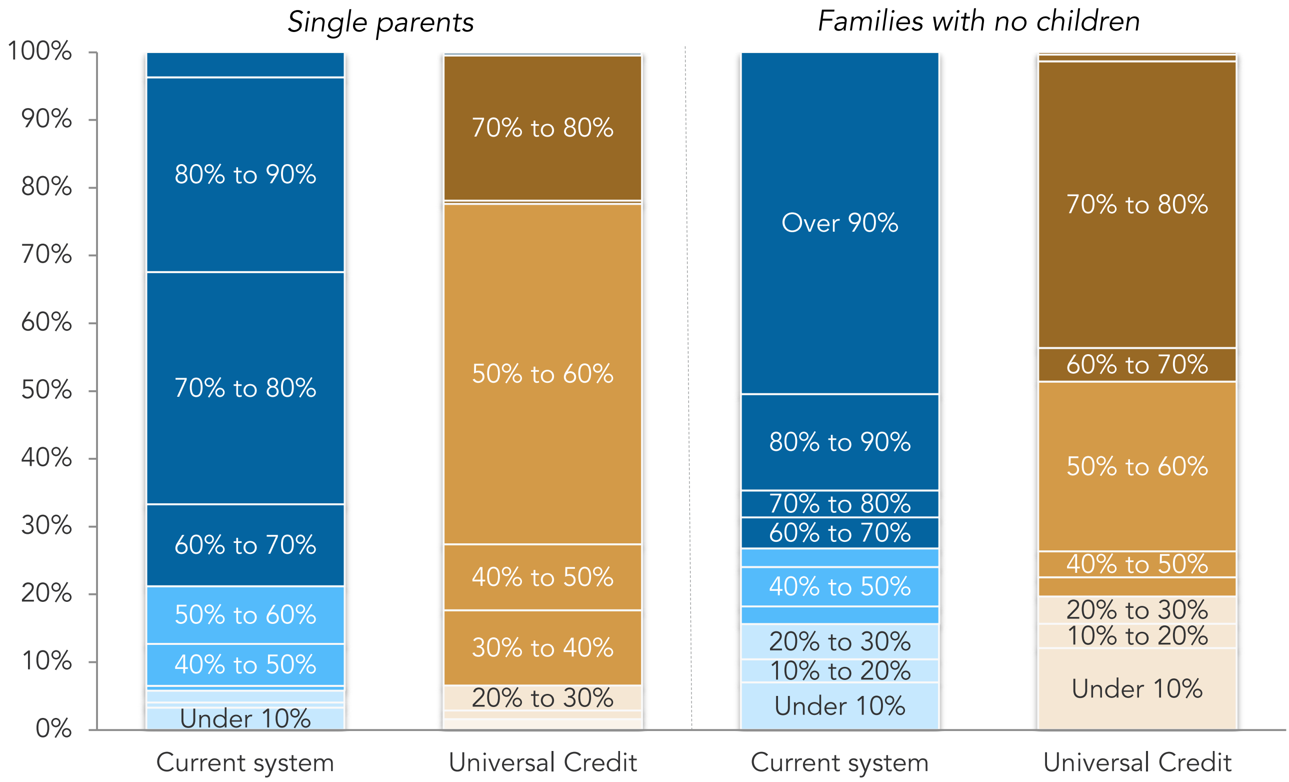
Figure 8 shows that for single parents and households without children (mainly singles) entering part-time work at 20 hours a week on the wage floor:

» For **single parents the incentive to work part-time hours is improved** because of the introduction of the work allowance. Only a fifth will have a PTR of at least 70 per cent under UC, compared to almost two-thirds under the current tax credit system. However this outcome **is far less of an improvement than before cuts to work allowances were made** and the low work allowances mean that **incentives are strongest at lower hours of work**.

» Among families without children the **very worst incentives to start part-time work in the current system are reduced** (because the 65 per cent taper now applies instead of pound-for pound withdrawal of benefits) – almost half will have a PTR of 60 to 80 per cent in UC compared to half having a PTR of over 90 per cent in the current system.

Figure 8: Participation tax rate distribution for single parents and individuals without children starting part-time work of 20 hours a week at the wage floor

Proportion of people out-of-work



Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Out-of-work individuals are assumed to enter work at the appropriate wage floor (the National Living Wage for over 24 year olds) and at the given number of hours. The population is restricted to those expected to be entitled to Universal Credit in 2020.

Incentives at Full-time hours

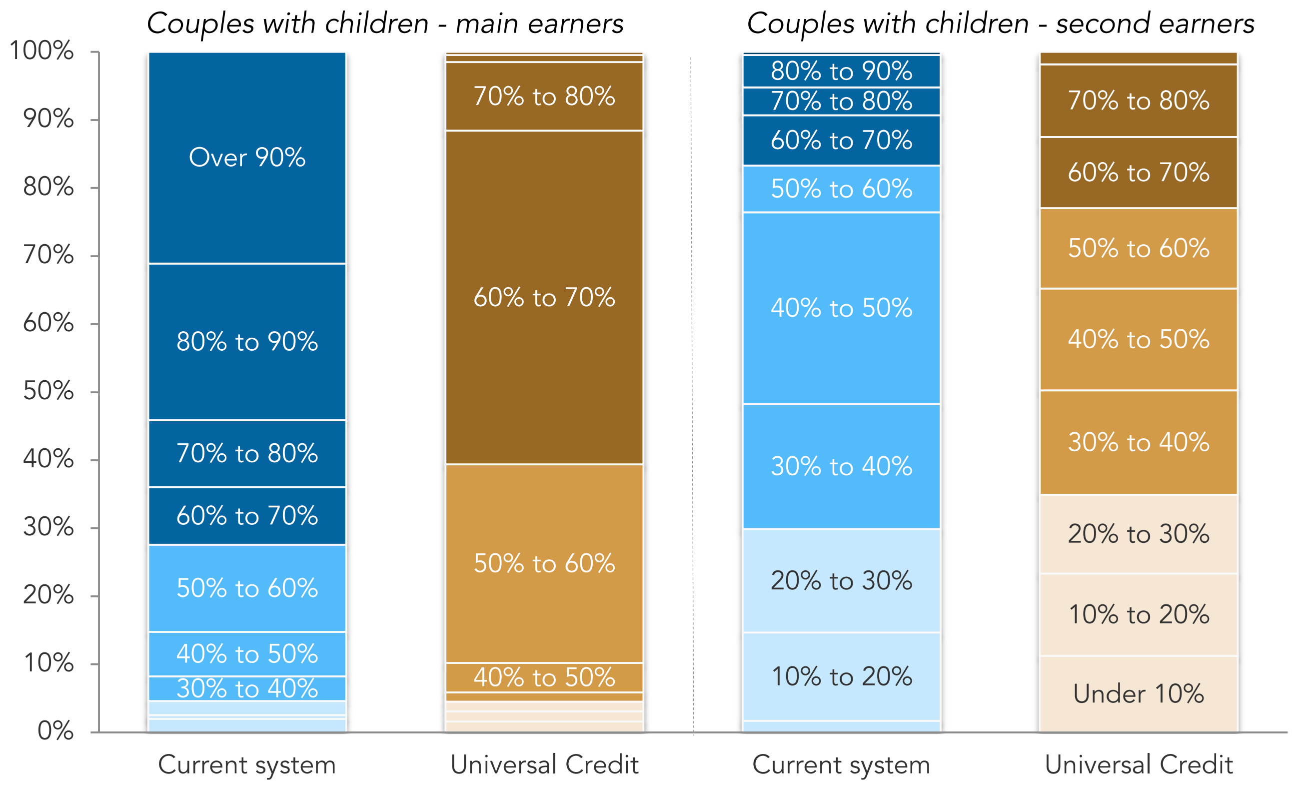
Figure 9 shows that within couples with children, for a parent entering full-time work at 40 hours a week on the wage floor:

» If the potential **main earner the very worst incentives to enter work at full-time hours are capped, but most still face relatively high PTRs once in work**. Over 70 per cent in the current system would face a PTR of over 60 per cent, compared to over 60 per cent of main earners in UC.

» If the **second earner the incentives that exist in the current system to start full-time work remain broadly unchanged**. There is a slight increase with an extra 8 per cent of second earners with high PTRs of 60 per cent or more. Incentives are stronger than before cuts to work allowances in the Summer Budget because with the system less generous couples are more likely to have no UC entitlement at all, and only pay tax and NI, when both parents work full-time.

Figure 9: Participation tax rate distribution for person starting work at the wage floor for 40 hours a week

Proportion of people out-of-work



Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Out-of-work individuals are assumed to enter work at the appropriate wage floor (the National Living Wage for over 24 year olds) and at the given number of hours. The population is restricted to those expected to be entitled to Universal Credit in 2020.

Figure 10 shows that for single parents and families without children (mainly singles) entering full-time work at 40 hours a week on the wage floor:

- **Incentives to start full-time work for single parents remain weak** with over 70 per cent facing a PTR of over 60 per cent in either the current system or UC. The very highest PTRs of 80 per cent or higher have been capped. This improvement is driven by the lower taper applied to in-work support for those with housing costs.
- Among families without children a significant proportion (50 per cent) still have high PTRs of 60 per cent and over but importantly the very worst PTRs of over 90 per cent no longer apply.

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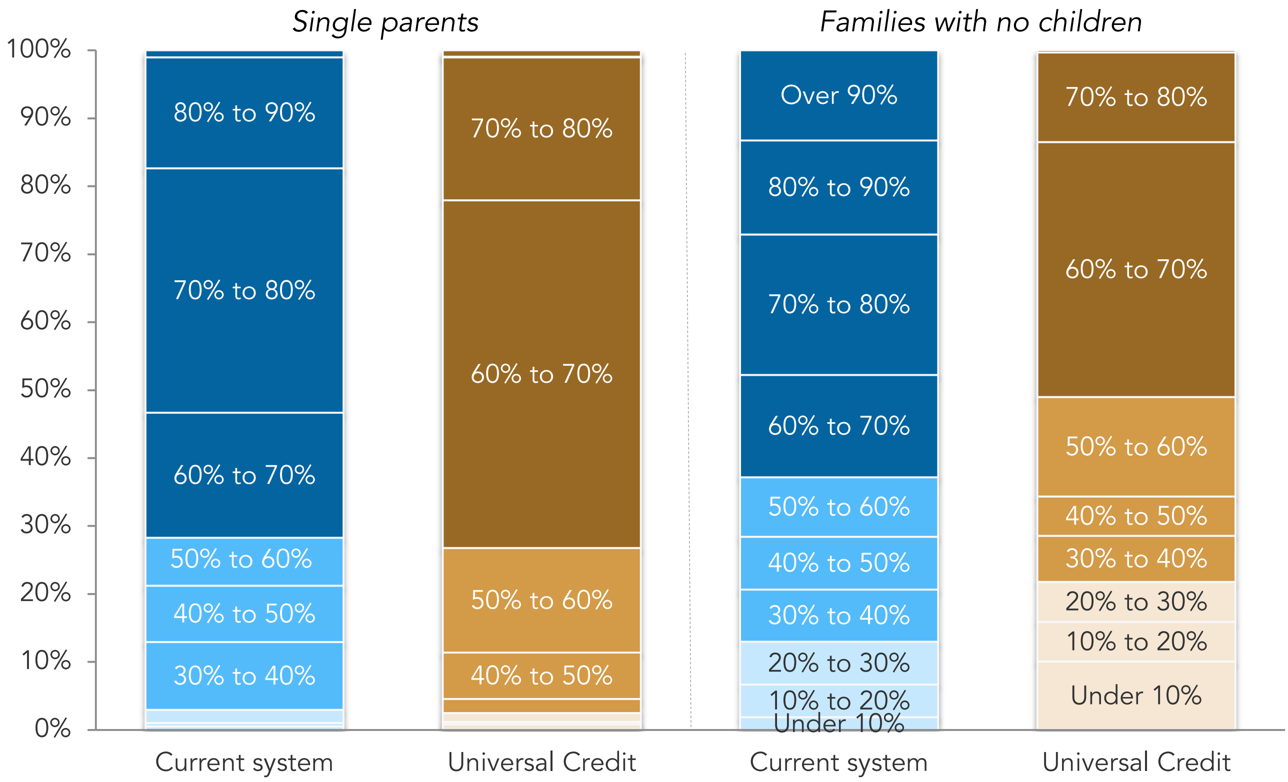

Source: Resolution Foundation analysis using the IPPR tax-benefit model

Notes: Out-of-work individuals are assumed to enter work at the appropriate wage floor (the National Living Wage for over 24 year olds) and at the given number of hours. The population is restricted to those expected to be entitled to Universal Credit in 2020.

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:

- *undertaking research and economic analysis to understand the challenges facing people on a low to middle income;*
- *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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