HOUSE OF LORDS

Select Committee on Economic Affairs

Corrected oral evidence: The economics of Universal Credit

Tuesday 25 February 2020

4.45 pm

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Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Lord Burns; Viscount Chandos; Lord Fox; Baroness Harding of Winscombe; Lord Stern of Brentford; Lord Tugendhat.

Evidence Session No. 2 Heard in Public Questions 9 - 16

Witnesses

I: Tom Waters, Senior Research Economist, Institute for Fiscal Studies; Dr Katy Jones, Senior Research Associate, Manchester Metropolitan University.

Examination of witnesses

Tom Waters and Dr Katy Jones.

The Chair: Mr Waters and Dr Jones, I think you have been able to see some of the earlier evidence. We will try not to cover too much of the same ground, unless you have a different point of view. Lord Stern will ask the first question.

Q9 **Lord Stern of Brentford:** Thank you very much for coming. This is about the distinction between being in work and being out of work. Does universal credit work better as an in-work benefit or an out-of-work benefit, and how far is it possible to do both those things?

Tom Waters: One key thing about combining in and out-of-work benefits is that you have just one period for assessing eligibility to the benefit. Under the old system, tax credits were assessed over the course of your income over a whole year, whereas jobseeker's allowance was about how you were doing that week.

There is a bit of a trade-off; short assessment periods make the benefit system very flexible and quick to respond, so you can lose your job and then claim jobseeker's allowance almost immediately. The potential disadvantage is that it focuses the benefit system very much just on temporary poverty, so it gives money to those who are temporarily poor but who, over the longer run, might be somewhat better off. Related to that, longer assessment periods deal a bit better with fluctuating income. Under tax credits, for example, if you were a seasonal worker, that was okay, because the system would look at your income over the course of the whole year, whereas universal credit looks at it on a monthly basis, so it will appear to the universal credit system that your income is very high for some months and very low for other months.

Because UC combines benefits that historically had very short or much longer assessment periods, it splits the difference to some extent. It has a problem with fluctuating earnings and with the five-week wait because of having a monthly rather than a weekly assessment period. If you fall out of work, you have to wait a month before you can start claiming UC, whereas under the old system you could have started claiming jobseeker's allowance almost immediately. That is one of the key trade-offs.

One clear advantage of combining the systems is that it smooths the transition in and out of work. It is much easier to claim your whole entitlement. Under the old system, you might have been getting tax credits in work; if you lost your job, you needed to start claiming a new benefit, but under UC that process is smooth. On that side, there is a clear advantage.

Dr Katy Jones: I reiterate the point that it is desirable to do both and have an in and out-of-work benefit, precisely, as Tom says, for people who regularly move in and out of work. A key element of universal credit is the conditionality that underpins it, which was not explored too much in the previous session. That is where my research has focused, so I shall talk a little bit to that, if that is okay.

The welfare conditionality, sanctions, support and behaviour change study was a major UK-based study that followed universal credit claimants over a period of two years, from 2015 to 2017. I was a researcher on that project. We interviewed some of the first universal credit claimants and found that the conditionality that underpins universal credit was pretty much universally experienced negatively by both in and out-of-work claimants. The use of sanctions through the universal credit system, whether you are in or out of work, has not worked well for anybody, with disastrous consequences in some cases.

For those who are out of work, people found it very challenging to undertake job-seeking activities for 35 hours a week on average, both in terms of sustaining their motivation and well-being over that time and as regards the practical issues of trying to find work with lack of internet access and poor transport links. People in work struggle to meet the conditions of their claim, missing jobcentre appointments and facing a sanction because of that, because they conflict with variable work shifts and childcare arrangements. It is particularly challenging for those with variable hours.

It has not been experienced by a lot of people as a simpler system. As previous witnesses said, it is set up very much on the assumption that people will be paid on a monthly basis. A lot of workers, particularly at the bottom end of income distribution, are paid much more regularly than that. Numerous studies have shown that people struggle to understand universal credit and the conditions attached. The DWP user survey evidence perhaps presents a more positive picture of people's experiences of universal credit, but you have to question how open that is. As a researcher who speaks regularly to people on universal credit, I have to do a lot to reassure them that we are not feeding back their stories and information to the DWP.

Baroness Bowles of Berkhamsted: Can I pursue a question about the sanctions? If you miss appointments or you are unable to do something you are supposed to be doing, specifically because of the needs of working—you had to do such and such a shift or you had to have childcare, the very things that enable you to work—can you then recover from those sanctions, or is there no way back?

Dr Katy Jones: That depends very much on an individual basis. People should not be sanctioned when they are in work and they miss an appointment with good reason. As was brought up in the previous session, a lot of it is down to the discretion of your work coach and the decision-maker, who decides whether you are sanctioned or not. People are reliant on multiple systems of support, particularly when they are in low-wage work and have childcare responsibilities to juggle. If they are lucky, they have the help of family, friends and neighbours, but it is quite a complex patchwork that people have to manage.

Q10 **Lord Tugendhat:** As I recollect, the great argument for universal credit was that it made work pay. To what extent do you think that objective has been attained? In particular, do you think it has been successful in alleviating in-work poverty?

Tom Waters: On average, universal credit improves work incentives, both the incentive to be in work at all and the incentive to increase earnings for those already in work. That is mainly achieved by removing the very weakest work incentives. Under the old system, it could be the case that you could earn an extra pound and lose 96p in reduced benefits and increased taxes.

However, it depends quite a bit on your circumstances. For some people, work incentives are worse under UC. It is worth flagging that the goal of making work pay is to a pretty significant extent undermined by the fact that, around the same time, the Government localised council tax support, which is another means-tested benefit separate from UC. It is still the case that you can lose two benefits as you increase your earnings: your universal credit and your council tax support.

As for in-work poverty, the effect on in-work claimants differs substantially, so there are lots of people who gain a lot and lots of people who lose a lot. One key distinguishing feature is housing tenure. If you are a renter, you are much more likely to gain; if you are a home owner, you are much more likely to lose out. Similarly, if you are self-employed, you are much more likely to lose out.

One case that the Government might make, and there might be something to be said for it, is that UC might make it easier for people to take up their full entitlement. Under the old system, they may have been entitled to housing benefit and tax credits, but they took up only one of them, for whatever reason. Now, under UC, arguably it is easier to take up, which could help low-income people who are in work.

Dr Katy Jones: Universal credit has been introduced during a period of high employment but with a lot of people stuck in low-paid, low-quality jobs. The existing evidence we have shows that universal credit has not been effective in *supporting* people into work but, on the other hand, it has increased the pressure to work. That has sometimes resulted in people moving into jobs that are unsuitable and do not pay a sufficient income.

In-work poverty was increasing before the introduction of universal credit, but it has continued to increase since. Any in-work benefit will help to alleviate that to some extent, but it can be caused in the first place by people moving to inappropriate jobs, for example. To reiterate the take-up point, it is key that people actually take up the benefit, if it is to help to alleviate in-work poverty. We know that is the case for certain groups; for example, there are recent estimates that about half a million young people are entitled to take up benefits but do not do it, for various reasons, including the complications, and because of the stigma mentioned in the previous session.

Potentially, a move towards introducing in-work conditionality presents a real risk in encouraging people to sign off universal credit. I remember one woman I interviewed as part of the welfare conditionality project, who must have been in a trial area. She had three cleaning jobs, which took her to around a 25-hour working week. On top of that, she was managing the expectations put on her by her work coach at the jobcentre to try to find more work, alongside looking after her son and managing poor mental health. It was a longitudinal study, and we followed people over a two-year period. In the end, she actually signed off universal credit despite remaining eligible.

There are question marks over what in-work conditionality will look like at the moment, but, arguably, putting pressure on people in work and potentially sanctioning them is not the way to go. The Work and Pensions Select Committee has been quite clear about the need to not sanction people in work.

Lord Tugendhat: Given the fact that the nature of the economy varies somewhat between one region and another, would your responses apply differentially as between London and the south-east on the one hand and the north-west on the other?

Tom Waters: There is definitely a case for making the generosity of the benefit system dependent on local labour market conditions. There are countries that do that; the US does that. The main advantage you see there is that with giving more generous benefits, the main thing you are worried about is disincentivising work, but in a labour market that is very depressed there might not be much work, so you are not as worried about that effect.

The main disadvantage is that it could incentivise people to move to areas that are more depressed to get higher benefits. There is also a certain way in which it could reinforce the problem. If benefits are higher in a particular area, employers might find it more difficult to get people into work so would be less inclined to post vacancies in those areas, and that would reinforce the depressed conditions. There is certainly a case to be made. We would need quite a bit more analysis and evidence.

Lord Burns: With "making work pay" and the way the system works from the point of view of people in work, what changes would you make? Would changes to taper rates, the work allowance or other characteristics of universal credit make it more effective? What would be the costs of doing that?

Tom Waters: Reducing the taper rate slows the speed at which universal credit is removed, as you increase your earnings. If you increase the work allowance, you move up the point at which you begin to remove it. Both those policies would incentivise families to have at least one member in work; there are some circumstances where it could actually disincentivise them to have two members in work.

More generally, it is a bit difficult to rank them, because precisely who sees their incentives improved is quite different between the two. When you change the taper rate, the incentive to earn a bit more is strengthened for anyone who is on that taper, where it is being removed slowly, whereas when you change the work allowance it affects a rather different group. It is not possible to say ex ante which of the two would be more effective for getting people into work; there is a careful balance of trade-offs.

Lord Burns: Is it an area of any priority? If you were going to make tweaks to the system, is it an area you would focus on, or would you focus on other aspects of the way it works?

Tom Waters: In a way, the area is not specific to universal credit. There would have been exactly the same questions under the old system. I see it as one of the very key, fundamental trade-offs in any benefit system. If you withdraw benefits more slowly, you improve incentives for people who are on benefits to earn a bit more, but you also make the system more costly, for that reason, and you also bring more people into means testing, because you expand the number of people who can get something, so for them you potentially worsen their incentives. I do not have a professional view on what the Government should do there; it is part of the fundamental bedrock trade-off that all Governments face in designing benefits.

The Chair: The effect of the marginal rate of tax is 67%, or something of that order.

Tom Waters: It depends exactly where you are. For universal credit, it is at 63%.

The Chair: How high can it get if you take into account local authority council tax benefit?

Tom Waters: Even if you are not getting council tax support, you might be paying income tax and national insurance, and then it can be in the high seventies, as I recall. Once you take account of council tax support, it depends exactly which local authority you are in, because they all have their own systems.

The Chair: What is the range?

Tom Waters: There are cases where it goes up to more than 100%.

The Chair: Have you done some work on that? Could you provide us with some information?

Tom Waters: We have not done any work on it yet, but it is something we hope to look into soon.

The Chair: For a Government who, quite rightly in my view, argue that you must not set very high marginal rates of income tax because that disincentivises people, and you could not possibly increase the rate of income tax above 45%, it seems rather perverse that at the same time we are able to argue that there is an incentive to work when people are paying 60%, 70% or 80%. Why does that not apply to benefits?

Tom Waters: I think the argument that could be given there is that, when people are on very low incomes, their incentive to have a higher after-tax income is quite strong in the sense that, if your income is £100 a week, the difference between £100 and £150 a week would make a very big difference to your life that £50 might not if you had a considerably higher income. The basic incentive to work a bit more might already be stronger for people on lower incomes. That is the general argument that the Government could give, whereas, for people on very high incomes, an extra small amount would not mean very much.

The Chair: I think even you are finding it hard to pursue that argument. Sorry, Lord Burns, I interrupted you.

Q11 **Lord Burns:** I was going to move on to the results and the whole question of what the value of moving to universal credit would be. There is the figure of £34 billion over 10 years, which I have seen, but people also question the reality of that. Is there anything in those numbers? Are they just a shot in the dark, or are they based on optimistic assumptions? Do you have any view of what the value or the disbenefit in aggregate has been of the move to universal credit?

Dr Katy Jones: I defer to my IFS colleague on the calculations, how they were made and whether they are robust. I stress that those projections do not take into account the additional costs borne by lots of other services, which were highlighted in the last session.

Lord Burns: This is basically supposed to be a government figure, is it not? It is supposed to be how public finances are going to be improved by this change.

Dr Katy Jones: True, but I am talking about some of the services that it knocks on to, such as the National Health Service, when people have to attend appointments.

Tom Waters: It is not the effect on the public finances, in the sense of the amount of money that the Government are going to save; universal credit will actually cost the Government a small amount of money overall. This is the DWP’s assessment of the economic value to society. Any number of that kind will be extremely imprecise. That is not to say that it is an unreasonable figure, but it is definitely going to be imprecise.

The DWP gets the figure from two key inputs. The first is that it expects 200,000 more people to be in work, and it puts some value on that. If there is a big increase in take-up, which we have mentioned already, it makes universal credit look progressive, in the sense that lower-income people end up with more money than they would have had otherwise. In the DWP analysis, that increases the economic value, because a pound to a poorer person is worth more than a pound to a richer person.

Both those assessments have a lot of uncertainty attached. The employment effect is not totally unreasonable, but it is very uncertain. As to whether UC will lead to a big increase in take-up, there are ways that you can certainly see that as being true, but, again, it is quite uncertain.

Lord Burns: What about fraud and error?

Tom Waters: The Office for Budget Responsibility expects the Government to save £1 billion or £2 billion from reductions in fraud and error. Part of what is going on there is that because UC does not have any hours rules, and you do not have to prove that you are working 16 hours a week or whatever, it is potentially an area where there could be more fraud, so getting rid of that removes an area of potential fraud. As I understand it, the OBR assessment is just a forecast; there is not much data yet on that.

Lord Burns: Is it a piece of work that is at all useful, or is it window dressing?

Tom Waters: It is useful for Governments to try to assess the effects and values of policies, even when there is a high degree of uncertainty around it. That said, giving some sense to the uncertainty is also very valuable, and I do not think that there are any published figures on how uncertain the Government are about that figure of £34 billion.

Lord Stern of Brentford: It looks to me as if it is just 200,000 times a rough idea of a wage of about £15,000 a year, which would give you a ballpark of £30 billion. That sounds to me like licking a finger and putting it up in the air, particularly because you would normally take into account the disutility of the work. If somebody is on the margin of working or not working, the rewards for the work just about balance the cost of the work to that individual. It sounds pretty dubious to me. You do not have to agree.

Tom Waters: There are quite a few things that the £34 billion figure does not include. You mentioned one, and other things such as temporary hardship through the five-week wait are not included. I certainly agree that the disutility of work is, conventionally, one of the key things that we would want to include.

Lord Fox: Dr Jones, you mentioned additional costs that have gone on to other agencies. Do either of you have any sense of the scale of those additional costs? Clearly, whether or not we believe the £34 billion, there are other costs, as you indicated. What order of magnitude are we talking about? Is it a 10th, or equal, or what? How does it look?

Dr Katy Jones: It is hard to quantify. For example, housing associations have highlighted rent arrears, but there is also the additional resource that a lot have put in with debt advice and making sure that there is help to claim.

My doctoral research focused on homelessness agencies and their educational provision, and I have spoken to a lot of third-sector agencies.

Since 2010, they have all noticed a significant shift away from those services. They do not provide literacy or employment support any more; they are just trying to deal with the consequences of someone literally having no money (as a result of sanctions or other benefits-related issues).

Lord Fox: It is an opportunity cost in a sense, in that you are missing the chance to do things because you have to concentrate on the here and now.

Q12 **Baroness Harding of Winscombe:** How have employers reacted to universal credit?

Dr Katy Jones: We do not know enough about what employers think about universal credit, or how they have reacted. They have tended not to be involved in research or even policy debates, which is surprising and a mistake, given that universal credit is now extending to those in work.

I recently led on a small project where we spoke to employers; we focused specifically on the in-work conditionality elements of universal credit that are in development. As part of that, we asked a bit more generally about what they understood about universal credit. It was not much. Some had tried to find out, and some had even tried to go to the jobcentre to ask what the deal was with the benefit and how they could support their employees. The response was that jobcentres could not advise because it is administered on a very individual basis and takes into account lots of different things, so they gave up trying to figure out what was going on.

Some had picked up the policy aims about simplification but also that it was a stricter benefit regime. Although, admittedly, they were not that well informed, they were quite welcoming of the removal of the 16-hour rule. Overall, there was a sense, albeit in the small sample of employers that I spoke to, that there was a need to engage with them and explore how universal credit would impact on their businesses and their workers.

It is important to note that the Taylor review of modern working practices did not look at universal credit, so there is scope for commissioning something to review that specific issue, because there is a real gap at the moment. I can say more about in-work conditionality and their response to that, but I think that might be for another question that is coming up.

Q13 **Lord Fox:** The Taylor report comment takes us to the effects that universal credit has or may not have on low-paid and particularly part-time work. What effect is it having, and how do the national living wage and universal credit interact and affect each other? Overall, has universal credit enhanced or inhibited the flexibility of the labour market?

Tom Waters: To take the first part first, UC in one sense is obviously literally a subsidy for low-paid work, in the sense that that is precisely the group it is targeted at. There is often concern that when we supply in-work benefits it allows employers to cut wages, so some fraction of the gain from the benefit goes to the employer rather than the claimant. For

UC specifically, I do not think we have any evidence on that. There is some evidence for the tax credits system, which suggested that about 30% of the value of increased tax credits went to the employer via lower wages.

Lord Fox: Does universal credit reduce that?

Tom Waters: I do not think we can say exactly. My expectation would be that it would not change it one way or the other, but we cannot say at the moment because we do not have any evidence on it. The time period when research was done on tax credits was back in the early 2000s, when modern tax credits were introduced, so you would expect things to be different.

There is some research showing that, when UC is fully rolled out, about 20% of people on the minimum wage or the living wage will be subject to in-work conditionality, which struck me as quite a high fraction. Broadly speaking, the rollout of UC means that when the living wage goes up, the amount that living wage workers will keep is slightly higher, but it is broadly unchanged.

Lord Fox: And on flexibility?

Tom Waters: It seems as though UC should make the labour market more flexible in so far as it makes it easier to move in and out of work, because you do not have to start new claims. On the other hand, because UC is very rigidly on monthly assessment, if your employer pays monthly, it works quite nicely; but if you are thinking about moving to an employer who would pay you four-weekly, it can cause a lot of problems under UC, because once a year you have two payments in the same month and UC will think you have had a big pay rise and you will get much less or perhaps nothing. You can imagine that discouraging people from moving. It is hard to say overall, but you can imagine effects in both directions.

Lord Fox: But there is no study or evidence.

Tom Waters: Not that I am aware of.

Q14 **Viscount Chandos:** What impact does universal credit have on different groups over the short run and the long run? We have already explored that a bit in the earlier session, but we would like your view.

Tom Waters: Overall, UC has a bigger negative impact on the entitlements of the temporarily poor than the persistently poor, because some groups under UC are hit especially hard for relatively short periods of time. The big ones there are people with significant financial assets, who do badly under UC, as do the low income self-employed and what the Government call mixed-age couples, with one person above state pension age and one person below it. They all do very badly out of UC. It turns out that quite a few of those people are, on average, likely to be only temporarily poor or temporarily in that situation, so that gives the result that UC is a bigger takeaway for the temporarily poor than for the persistently poor.

That said, one of the biggest issues with UC has been the five-week wait, which is by its nature a temporary issue. In that sense, it clearly has a much bigger effect in the short run than in the long run.

Q15 **Baroness Bowles of Berkhamsted:** Has there been any analysis to show what effect the universal credit programme has had on productivity?

Tom Waters: I am not aware of any. Productivity is conventionally defined as output per hour worked. I would not expect UC to have much effect on aggregate productivity across the whole economy.

Dr Katy Jones: The DWP has said that universal credit will help businesses to grow and that it will improve productivity, but there is no clarity on the mechanisms through which that is going to be achieved. Lots of different factors play into productivity in the UK labour market, including skills and well-being, as well as the nature of work and the workplace. As it focuses on individual workers and emphasises work intensity, by moving people into work and then into simply getting more hours, while neglecting to consider the demand-side issues such as quality of work and poor management practices, which we know are core to the UK's productivity problem, I find it hard to see how universal credit will improve productivity.

I know you have other questions about well-being and the nature of the workplace, so I shall just say one thing about skills, which are a key part of our productivity issues. Since 2015, I have been interviewing claimants on universal credit and the earlier legacy systems, and I have asked them about the support that they have received, including training. The only things that they have been able to tell me about, if they have been able to tell me about anything at all, are the CSCS, or construction health and safety card, or the SIA badge, which is a security qualification. They might have been able to get some ESOL, whether or not they needed it, although not recently. That is completely at odds with the skills needs in our UK economy.

The welfare system appears to operate in complete isolation from our skills system, and that would be a fundamental thing to highlight in improving universal credit, if it is to deliver on the productivity objectives.

Baroness Bowles of Berkhamsted: You have mentioned well-being a few times. Would you say that universal credit has reduced well-being?

Dr Katy Jones: Yes, I would. As part of our welfare conditionality project, we spoke specifically to people who had been claiming universal credit. The threat of a sanction, whether or not people experienced it, led to profound levels of stress and anxiety. When people experienced sanctions, it worsened their situation. It put them into debt and led to alcohol abuse and adverse mental health. More generally, looking at the evidence base in the UK and internationally, conditional social security payments have been shown to have that adverse impact.

Together with colleagues, we took a sample of 207 people in our welfare conditionality project who indicated having a mental health impairment at the start of the two-year study. These were people on universal credit but also on JSA and ESA. We found that not only was conditionality ineffective in moving people into or closer to work, but it triggered negative health outcomes, making future employment less likely. The poor experience of the social security system for people with mental health impairments has also been demonstrated in follow-up work that we have done specifically with veterans, funded by the Forces in Mind Trust.

Baroness Bowles of Berkhamsted: So, as well as there not being particularly good outcomes for individuals, there would be more costs downstream because of there being more mental health issues and people not being able to work because of them. It is a false economy to have sanctions.

Dr Katy Jones: Yes. As researchers we try to present research at lots of different events, and, speaking anecdotally, you can see it in the make-up of who is coming to those events. In the early days, they were welfare rights advisers and debt advice agencies, but now it is much more of a mixed bag, and there are a lot of health professionals. Particularly with the Forces in Mind-funded work that we have done, the health services have helped us to highlight the additional costs involved in supporting people through a system that is not working well for them.

Baroness Bowles of Berkhamsted: So there is a cost downstream, but it is not on the DWP; it is on the NHS.

The Chair: We have time for one quick last question.

Q16 **Lord Stern of Brentford:** Universal credit came in at a time of austerity or fiscal entrenchment, or pressures on the public finances, however you describe it. If you have more money, you can do more, which I guess is a fairly banal statement. Do you feel that the timing of the arrival of universal credit in relation to the pressures on public finances made a big difference to its ability to deliver its objectives?

Tom Waters: There are two ways in which it made it potentially trickier. First, the nature of radical reforms such as UC is that you create a lot of winners and losers, and that is true with UC. There are plenty of people who have seen a substantial increase in entitlements and plenty who have seen substantial decreases. You can avoid that and have many fewer losers if you are prepared to plough a lot more money into the system at the same time. In so far as UC has run into a lot of problems politically, part of that is probably because it creates a lot of losers. Had the Government had more money to increase the total value of the system, they could have had far fewer losers.

Relatedly, one of the key objectives of UC is to make work pay. Again, that is something you can do more effectively if you have a lot of money to throw at the problem; you can withdraw UC more slowly to improve people's incentives. That said, obviously, if you are going to pay for that by increasing taxes, you will be weakening other people's work incentives. Those are two ways in which fiscal retrenchment has made it potentially trickier.

Dr Katy Jones: Some of the choices that have been made about universal credit, in part to reduce government spending, such as the two-child limit and the five-week wait, undermine the ability to deliver its objectives. The budget cuts that have accompanied the rollout of universal credit have seen jobcentres get fewer resources to deliver an effective service. It is unclear what additional resources will be available to support the development of an in-work service, but it is estimated that about 1 million people will come into that in-work regime, so that will be a key thing. Employers we spoke to are very sceptical about whether it can deliver in the fiscal climate we are operating in.

The Chair: On that slightly depressing note, thank you very much indeed for coming to give evidence to us. You have certainly given us a lot to think about this afternoon. Tom, have you done any work on that point about the cost to the Government of improving the incentives?

Tom Waters: The cost of reducing the taper rate, and that sort of thing?

The Chair: Yes.

Tom Waters: We have not done so recently, but it is something we could do.

The Chair: If you could provide us with some evidence, that would be very much appreciated by the Committee. Thank you very much indeed.