

Treasury Committee

Oral evidence: Cliff edges in the tax and benefits system, HC 1301

Tuesday 25 April 2023

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Members present: Harriett Baldwin (Chair); Rushanara Ali; Douglas Chapman; Dame Angela Eagle; Emma Hardy; Danny Kruger; Dame Andrea Leadsom; Siobhain McDonagh; Anne Marie Morris.

Work and Pensions Committee Members also present: Sir Stephen Timms (Chair); David Linden; Nigel Mills.

Questions 1 - 78

Witnesses

I: Fran Bennett, Associate Fellow, Department of Social Policy and Intervention, University of Oxford; Tom Clougherty, Head of Tax, Centre for Policy Studies; Deven Ghelani, Director, Policy in Practice; Helen Miller, Deputy Director, Institute for Fiscal Studies; Morgan Wild, Head of Policy, Citizens Advice.

Examination of Witnesses

Witnesses: Fran Bennett, Tom Clougherty, Deven Ghelani, Helen Miller and Morgan Wild.

Q1 **Chair:** Good morning, everyone, and welcome to this Treasury Committee evidence session, in which we are combining with the Work and Pensions Committee, looking at cliff edges. I am very grateful to all of you for coming in to give us evidence this morning. I would like to start by asking you to introduce yourselves.

Morgan Wild: It is really great to be here. My name is Morgan Wild. I am head of policy at Citizens Advice.

Helen Miller: I am Helen Miller, deputy director at the IFS. I run our tax work.

Tom Clougherty: I am Tom Clougherty, research director and head of tax at the Centre for Policy Studies.



HOUSE OF COMMONS

Fran Bennett: I am Fran Bennett, associate fellow at the Department of Social Policy and Intervention at the University of Oxford.

Deven Ghelani: I am Deven, director of Policy in Practice.

Q2 Chair: Thank you so much for coming in. We wanted to put our forces together as two Committees to look at this growing issue of cliff edges in the benefit and tax system. In terms of the range of different cliff edges that we have identified, the Treasury has income tax marginal rates, child benefit, tax-free childcare, VAT registration thresholds and tax credits. Work and Pensions has cost of living payments, universal credit, support for mortgage interest and mortgage interest run-on. Education has student loan repayments and free school meals. BEIS has the warm home discount scheme. Health has NHS prescriptions. We have agreement to look at all of those issues and an amazing panel of experts this morning to look at them with us.

I wanted to start with an open-ended question for all of you. With the Office of Tax Simplification being abolished at the Treasury and the list that I have just read through to you all, would you each like to highlight what you think are the worst cliff edges in our benefit and tax system?

Morgan Wild: We typically see people, particularly at the moment, at the worst ends of poverty, destitution and low income. Most people we are seeing are facing the brunt of the cost of living crisis. If somebody comes to us with an issue, one of the things that we do most often is to look at their benefit entitlements—the range of benefits that they might not know they are entitled to and could be claiming.

One general thing to say there is that, when people are in that situation, they are confronted with an enormous amount of complexity that goes across all of the benefits, and passported subsidies and benefits, that they have access to.

Q3 Chair: Which is the worst?

Morgan Wild: It is hard to pick one, but one thing that really comes out for us at the moment is about the cliff edges for cost of living payments. We are seeing about a quarter of advisers right now naming that cliff edge as something that they are seeing on a regular basis. People who are claiming universal credit, for one reason or another, perfectly legitimately, have a nil award in a month, which is the eligibility month for cost of living payments, and, therefore, do not receive an award.

Chair: You will have seen the report that our Committee put out on that.

Morgan Wild: Indeed.

Chair: Helen, Paul Johnson has recently described the tax system as “arbitrary, complex, inequitable and damaging”. What do you think is the worst cliff edge in our benefit and tax system?



HOUSE OF COMMONS

Helen Miller: I would draw a distinction between parts of the system that are merely increasing the marginal tax rate—you mentioned some of those, where things like student loans or the removal of child benefit lead to high marginal tax rates—and cliff edges where it is not just an increase in the marginal but a jump in the average tax rate. They are particularly damaging because they mean that, when you earn a bit more, not only do you pay more but you are worse off. I would distinguish that as a particularly bad feature of the tax system.

Of all of the things that we will talk about today, the cliff edges are the ones where a little change gives you a big drop—things like the removal of free school meals or of other benefits at £100,000. Losing access to childcare subsidies and VAT thresholds are other examples of those cliff edges. Although I am sure that we will talk about how higher marginal rates have damaging effects, we want to, as much as possible, avoid those very sharp cliff edges where you have these big jumps in marginal rates.

Q4 **Chair:** Would you agree with Morgan that the cost of living payment would be added to that list?

Helen Miller: Yes, that is an example of a cliff edge, because a small change in your income leads you to lose access to that entirely. That is a very sharp cliff edge.

Q5 **Chair:** Tom, what do you see as being the worst examples?

Tom Clougherty: I obviously have the greatest sympathy for people on very low incomes who are trapped in those situations because of the design of the tax and benefits system, so I do not want to sit here and say that we should really be concerned about people earning £100,000. But when you look at the scale of that £100,000 cliff edge with childcare subsidies—sorry, Helen, for stealing this IFS figure—a family with full-time childcare for two children in London would be better off earning less than £100,000 than they would earning nearly £150,000. That is an extraordinary distortion in the tax system and one that could have been easily avoided.

Fran Bennett: I do not want to repeat things that other people have said, but I would make the same distinction that Helen has made. In particular, I would make the distinction in terms of people losing all or a big part of their benefit. Sanctions are a cliff edge. You stare into the abyss when you get a sanction. Losing access to free school meals, particularly if you have several children, is another. In terms of having several children, that is often quite a big factor, so the two-child limit affects the benefit cap.

The one that is probably most absurd in terms of principles is the high-income child benefit charge. If people have children, they have lower taxable capacity, and we should help them with that at the time that they have children. If we think better-off people should pay more tax, all



HOUSE OF COMMONS

better-off people should pay more tax rather than just those who have children.

Q6 **Chair:** Is this the one that starts at £50,000?

Fran Bennett: Yes, and finishes at £60,000, by which time you have had all your child benefit withdrawn at a very high and increasing marginal tax rate if you have several children.

Deven Ghelani: I do not want to repeat what has already been said. I would draw your attention to two points. The first one is on cliff edges around cost of living payments. In a sense, this would increase cliff edges, but another challenge is people who do not take up support that would ensure that they got access to more. We have a report coming out at the end of this week on underclaiming of benefits. If more people were accessing universal credit, there would be more people getting those cost of living payments.

The second point that I want to draw your attention to is a cliff edge that is technically not a tax, a bit like sanctions. Even moving into work can feel like a cliff edge for people, because of the costs of going to work—hygiene, clothes and transport. One of the mechanisms that universal credit introduced to tackle those cliff edges was work allowances, so people got to keep all of their benefits as they took their first steps into work. They have been taken away from families without children or without disabilities.

Again, I completely agree with what others on the panel have said, but I would just try to draw your attention to perhaps some of those that you would not normally consider, because they are not really seen as part of the tax and benefits system.

Q7 **Chair:** My follow-up question is a simple yes/no. Do you agree that the Treasury should be abolishing the Office for Tax Simplification?

Morgan Wild: It is fine, yes, because that is not the problem.

Fran Bennett: No.

Tom Clougherty: No.

Helen Miller: No.

Deven Ghelani: I do not have a view.

Chair: I have three noes, one yes and an abstention.

Dame Angela Eagle: The noes have it.

Q8 **Sir Stephen Timms:** Chair, you and I served together on the Welfare Reform Bill Committee in 2011, I remember, and we talked then about how free school meals eligibility was going to be defined. We did not know what the answer was going to be at the time, although it was clear that there was a danger of a big new cliff edge, and one of the aims of



HOUSE OF COMMONS

universal credit was to get rid of cliff edges. Ministers told us at the time that it was all going to be sorted out.

The position now is that children of universal credit claimants are entitled to free schools meals if their household income is less than £7,400 a year, but not if it is more. I see from the IFS analysis that a lone parent with three children on free school meals earning just below the £7,400 threshold will be worse off with any pay rise less than £2,000 a year, which is a massive disincentive to getting a pay rise or increasing your hours a little bit. There were, of course, lots of perverse incentives in the old system, but I am not sure that any of them were quite as bad as that.

What I do not know is how serious a problem this is in practice. Helen, you have looked at this at the IFS. What is your impression of this at the moment?

Helen Miller: I can tell you a little bit about the numbers and then leave it to others to talk about the effect of it on the ground. We know that about 15% of children are eligible for means-tested free school meals. You can think of that group as having parents who are at risk of hitting this cliff edge. For all of them, their incentives are very clearly being affected, because, as you said, if they earned a bit more, they would lose that and be worse off. Even if you earn £10,000, that is not much of a return to work, because, after you have accounted for this, you are doing quite a bit more work and not getting much return.

To give you a sense of scale, you mentioned the IFS statistic where a single parent earning £7,399 is better off financially until they earn £9,400. That is the equivalent of turning down four extra hours of work at the national living wage. At this level of the income distribution, people are probably making these decisions. They are not making decisions about whether to work 40 or 50 hours a week, but about whether to work at all and, if they do, how many hours they work. It is a part of the distribution that we do worry about.

In terms of the 85% of children who are not getting free school meals currently, there will be a subset of those families who are on lower incomes and, therefore, losing their free school meals. If they worked a bit less and got them back, it would be affecting their decisions about how much to work. I cannot give you a concrete number of how many people are stopping work because of it, but it is part of the distribution where it will be affecting decisions. For families earning £7,500, £2,500 is a big number relative to your earnings, so it is one that should be looked at.

Q9 Sir Stephen Timms: Morgan, what is Citizens Advice's impression of this?

Morgan Wild: We see lots of people in this situation, particularly from a debt advice perspective, where we get real insight into their income and outgoings. One case that illustrates this, although it is a broader concern, is somebody we saw who was earning just over the threshold for free



HOUSE OF COMMONS

school meals. If they had been able to reduce their earnings by about £11 a month, they would then have been entitled to free school meals, which would have been worth about £40 a month. They would also have a slightly higher UC award, because of the taper rates.

For that person, the difference would have been massive. They were in what we call a negative budget, so they had more essential expenditure going out than they had income coming in—about £13 a month in the red. That makes the difference between being able to pay back your creditors and a situation where you are just falling further and further behind on your bills. That trap is something that we see quite a lot. That is one where there is a clear trap in place.

The overwhelmingly common case is somebody who is just really uncertain about what will happen if they make certain decisions about how much to earn. It may well be that, if you have proper advice on your situation, those concerns are unfounded, but it is rules like this where everybody knows somebody who this kind of thing has happened to, so it adds to the general cloud of uncertainty in making decisions.

Fran Bennett: Could I just add to that? I, with other colleagues, did a research project on universal credit and couples. I do not want to talk about that particularly, except to say that some families realised that they might lose free school meals if they changed their earnings.

My colleague Rita Griffiths, with Marsha Wood, is doing a new study looking at people's income month to month. A very good example from that shows that it is often the combination of losing different things that is important. One person was thinking about going into work as a second earner in a couple, and was one of their examples.

She said that they got several letters from the council. One said, "You will lose free school meals"; one said, "You will lose your help with council tax"; one said, "You will lose your uniform grant"; and another from, presumably, the NHS said, "You will lose Healthy Start vouchers". She was about to go into work, but she decided not to until her child started school, because she thought that they would be worse off as a family. That is one example.

We did qualitative research on universal credit and couples, so it is not quantitative, but there were parents who were worried about not just the taper rate, which, at that time, was 63%, not 55%, but also about losing passported benefits.

Q10 **Sir Stephen Timms:** Deven, we took evidence from you on the Welfare Reform Bill Committee in 2011, if I remember rightly, and I am sure that you will have thought about this at the time. Ideally, how would free school meals entitlement be established in universal credit?

Deven Ghelani: First, let me just emphasise the problem. The cost of free school meals is much lower than the amount that the parent would



HOUSE OF COMMONS

have to pay, because the parent has to pay for it from their post-tax, national insurance and universal credit withdrawal income. Something that currently costs the Government £550 a year to pay for school meals for one child is costing over £1,500 to £1,600 in gross income. If you have three children, that is £4,500, so these are really big differences that are salient to people and will make a massive difference to the living standards of the family and, of course, of the children living in them. It is a really serious problem.

There are fundamentally three approaches, and I am leaning towards "the simpler the better" the further I get away from being a policy wonk working on universal credit in the weeds and the more I spend on the front line with practitioners who are using our software to try to understand what on earth is going on with the complexity of all of these interactions.

Of the three options, the first is making eligibility for free school meals universal for everyone on universal credit. That is because the cliff edge is much less when you come off universal credit. You are having to pay for it through just tax and national insurance being withdrawn.

The second option is something that is in place now as part of the transitional move to UC and is quite an elegant solution. If you are eligible for free school meals, you continue to receive it to the end of primary education or your current schooling. That massively reduces the impact of the cliff edge, because, if your earnings go up in year 2, you are not going to be affected by it until year 6.

Q11 Sir Stephen Timms: Is that the current arrangement?

Deven Ghelani: That is the current arrangement for people who are migrating on to universal credit. The current cliff edge is in place for new applicants to UC today, so you do have this difference in approach, which could be looked at in terms of what impact this is having.

The third approach is what we spoke about 10 years ago, where you can use the mechanism of the work allowance. If you give people a higher work allowance, you can take that away as they lose eligibility for free school meals. It is quite a technical approach. It does work, but it is not very salient, and, 10 years on, I am moving much more toward things that people can process.

Q12 Sir Stephen Timms: Why is the cliff edge less when you move off universal credit than it is under the current arrangement?

Deven Ghelani: Because the responsibility for paying for the free school meals shifts from the Government to the parent. When you are on universal credit, you have to pay for it after your universal credit has been withdrawn as well, so you are seeing income tax at, say, 20%. Assuming you are going from £7,000 to £10,000 or £12,000, you are above the tax threshold. Even if you are not, you are having 55% of your universal credit withdrawn, so you are already doubling the amount that



HOUSE OF COMMONS

you have to earn in order to have enough left over to pay for the school meal for your child.

Q13 Sir Stephen Timms: It would be possible to support children's food in low-income families in other ways, perhaps, to get over this problem. How effective do you think free school meals are in tackling child poverty?

Deven Ghelani: They are really important. I had free school meals growing up. It is just really important to education. Speaking with teachers and with people in schools, it is as much about education policy as it is about poverty in its broader sense. If you want children to be able to learn, you need to make sure that they are in a good environment to do so, and having a full stomach is one of those things. Sorry for just jumping straight in there.

Fran Bennett: Other countries providing universal school meals would see it as part of education, and part of socialisation of children as well, so that they are all eating together and so on.

I am in a local child poverty group that does a lot of work on child poverty in Oxford, and we did a study on the costs of education. One of the costs of education is clearly school meals, but we wanted to talk as well about things like stigma, discrimination and children feeling different because of their poverty, and how to create an inclusive school environment. How you deliver free school meals is part of creating that inclusive school environment.

I would want to argue that, if we continue with free school meals, it is only for people on low income. There is a strong argument to have universal free school meals, but, if we continue with that arrangement, we also need to be absolutely clear that we need to deliver them in an inclusive way. Poverty is not just lack of income, but also how you feel other people are treating you and how you feel in yourself.

Tom Clougherty: One interesting thing is that the logic of universal credit is that everything should be rolled into a cash payment, which is withdrawn at a simple and predictable rate. I do not think that universal credit was ever meant to stop at just integrating six benefits into one. It was meant to be something that would progress over the years. More and more things would be rolled into it, and you would get that greater simplification and get rid of the cliff edges.

Problems with the rollout diverted things off course, and I do not know if it is the solution for free school meals—it is not an area that I am particularly familiar with—but probably the first port of call when we think about addressing the very high marginal rates and the cliff edges is whether we can integrate other things into universal credit.

Helen Miller: I do not have these numbers in front of me, but I could send them to you afterwards. We do have some numbers on food



HOUSE OF COMMONS

insecurity for different groups, and it is much higher for lower-income households. There are children in these households who are not getting what they need in that sense. Free school meals are important in that sense, and I can send you some numbers after this.

Sir Stephen Timms: Thank you.

Helen Miller: Also, just to pick up on Tom's point, there are clearly lots of options here. Just to illustrate that, one option at the point of a current cliff edge, if that is when you want to start removing it, is to give parents a cash payment at that point equivalent and then taper that away. One trade-off that you would have to worry about is that it is a distribution away from children towards their parents. If you thought parents would then still go and buy those school meals, you would not worry. If you thought that that would not happen, then, to Fran's point, you would have to think about how the money is spent, so you might want to keep an element that is specifically targeted at those free school meals in order that there is a direct link between the money and the meals themselves.

Morgan Wild: That has to be right. The aim of the system should be geared towards simplicity and towards tapering support in the way that universal credit does, so that we can remove some of these cliff edges, but there are always going to be exceptions to that. One exception is that there are going to be particular types of payments that you at least want to assess differently, for very valid policy reasons. With things like energy support, because it is more volatile, it probably makes sense to bring it outside of the system.

With things like free school meals, you can make a compelling case, in the rare situation where an in-kind benefit is probably superior to a cash payment, that it makes sense to keep those out and to accept some degree of cliff edge. Either go with universal free school meals or move the cliff edge much higher up the distribution to something like the point where UC tapers out.

Q14 **Chair:** Fran and Deven, you said that the cost of providing free school meals is £550 a year and that, currently, those being transitioned on to universal credit are then supported until the end of primary education. Has anyone done any research as to whether those individuals have then done more work—because work incentives are very topical—and ended up paying much more in tax that helps to fund that? Are any of you aware of any research on that?

Deven Ghelani: No. I just thought of an experiment. Effectively, some people are protected and some are not. That would be an interesting thing to look at.

Fran Bennett: It is too recent, and people have not done that kind of research.

Chair: It would be interesting.



HOUSE OF COMMONS

Fran Bennett: I just wanted to echo a note of caution about absorbing everything into universal credit. There are good reasons not to, and there are some good reasons for taking some things out of universal credit, in my view, because it limits policy reforms that you might otherwise make.

Chair: It is a big topic. Thank you very much.

Q15 **Anne Marie Morris:** I am going to turn to cost of living support payments, which you all universally said was one of the worst cliff edges that exist, largely because it is one-off payment. If you are £1 on the wrong side, you simply miss out altogether. Did it also disincentivise work? How could we do it differently? This is rather different to some of the other benefits, in that this is about crisis management. It is something that we put in place when there is a crisis.

The defence from DWP was that it simply could not do it in any way other than a one-off lump sum payment; otherwise that would disrupt the rest of its standard DWP systems. I would be interested in your comments, Deven. Did this disincentivise work, particularly given that the period that was going to be relevant was set rather late, so you could not game the system?

Secondly, in your experience and looking at what other countries did, how would we design our system in such a way that we were better able, when we have these crises, to bring in these support mechanisms in a fairer and more realistic way?

Deven Ghelani: Firstly, it is the unfairness rather than work incentive effect that really stands out. You are right to say that people did not have much control over their eligibility. I did make a point in the introduction about take-up of universal credit as well. In a sense, it ought to encourage people to take up the wider support that they should.

Then there is a fundamental point around how you would do it better. We did do it better when we had the £20 uplift in universal credit. That was a much more effective way for those on universal credit to have access to that cost of living support. Even the legacy support was then administered through tax credit, so they found a way.

It is almost striking that they have not done that this time around, so there is very clearly a better way. With all of these cliff edges, there are very clearly better ways. Just going to my point about the Office of Tax Simplification, it is more that it needs some teeth. The solutions here are somewhat evident to certainly the five of us here, I am sure, and probably to you guys there. The whole purpose of universal credit and the biggest concern that I had was that it is there to simplify the system, but keeping it simple is a different story. That is probably one of the reasons why I continue to work in the field.

Q16 **Anne Marie Morris:** Fran, given what Deven has just said and what you said about universal credit, what can we bake into the system—although, as you said, not everything can be fixed by putting it into universal



HOUSE OF COMMONS

credit—to enable a flexible response at a time of crisis? Do we have any examples internationally of how this might have been done differently?

Fran Bennett: I do not know the answer to that, but the problem is that this is an example of the monthly assessment period of universal credit. If you do not get universal credit for some reason for that particular month, you would not have got the cost of living payment either, as I understand it.

The idea is that you have a monthly assessment period based on two things—a cash flow system of accounting in terms of the income that you get in that month, and a whole-month approach to changes of circumstances, which means that, no matter when they happen, it is treated as though they have happened for the whole month. Together, both are part of the automated formula for calculating universal credit, and it is very difficult to change that. That is the problem.

It is quite rigid, in that you have to have certain simple bright lines, as they were described in a court case, if you want to automate a system in the way that we have automated universal credit. Therefore, some of those ways in which you might want to make it more flexible, either for its own sake or for entitlement to other additions, are quite tricky to do, if not impossible.

Q17 **Anne Marie Morris:** Tom, what do you make of DWP's defence, effectively, that it could not possibly do this because it was going to disrupt all the other standard DWP payments? Does that sound and feel right, or do you think that it is more about "did not want to" rather than "could not"?

Tom Clougherty: I am not sure, honestly. One of the issues here, which you saw with the UC uplift, is that there was a huge political argument over whether the uplift would be maintained or whether it would be stripped out of UC. That probably has driven some of the decision making here to not put things into UC, because they do not want to set the precedent that UC is just higher forever going forward, even if and when the cost of living episode passes by.

Q18 **Anne Marie Morris:** That is helpful. Helen, have you and your team done any research into this? Are there any international examples of how you might do this differently?

Helen Miller: I echo what has been said. I can give you some numbers just to make some things concrete. There were the three instalment payments of around £300. We worked out that, in each of the relevant three months, there were around 825,000 people in a position whereby, had they reduced their income, they would have been better off. They could reduce their income to get into the universal credit and then get the payment. In practice, they would not have been able to do that, because they probably could not manipulate their income by just enough, but to give you a sense of scale, that is getting on for a million people who have been made worse off.



HOUSE OF COMMONS

To the work incentives point, there would have been people on the threshold who, had they worked, would have lost that payment, so work incentives are clearly being affected. To Deven's point, there is just a very straight horizontal equity point there. These are families who would have looked almost identical to other families who just made into universal credit and, therefore, got the payment and got close to £1,000 more for that year. Again, on that income level, that is quite a lot of money. Even aside from the work incentive, the pure horizontal equity point is one.

To Tom's point, this looks to me like a straight political choice. One could have increased universal credit payments in a way that they have been increased and then been tapered away. The system is quite well set up to do that—to, on a flexible, quite quick basis, increase payments and taper them away. These cost of living payments that come with a cliff edge and their temporary nature were not what UC was really designed for, so you can do it, but it was a straight political choice, as far as I can see, to do it that way rather than to do it through UC, and there are trade-offs to that.

Morgan Wild: I echo a lot of what has been said. It is straightforwardly an issue of fairness and equity, not work incentives. We see people who have been incredibly frustrated and confused as to why they have not been eligible for these payments. We have seen examples of people who had a backdated pay rise occur in that specific month, which just took them over the threshold, and they did not get the cost of living payment.

We have seen people with two payments in one month, because they are paid every four weeks. We have seen people to whom you might feel less sympathetic, in principle, such as those who were in receipt of a sanction in that specific period. Whatever your view on the sanction system, it does not seem right that people who happened to be receiving a sanction in that period were affected and others were not.

We also see a huge number of people through our benefits entitlement advice who are genuinely outside the system and feel the unfairness of being just outside threshold for genuine reasons and not receiving these cost of living payments. It would be better to do what we did with the £20 uplift, because that would have extended the base of people who were eligible for cost of living support as well.

It is just an ongoing source of unfairness for the people who we see, and that speaks to it being better to rule a larger number of people in than trying to means test as much as possible.

Q19 Anne Marie Morris: That is very helpful. I have one last question, which is for Deven. What you have all said is that there are better ways of doing it within the existing systems; therefore, it should not have been so hard and it looked rather like it was a political decision. That said, given that crises come and go, and you have to be fleet of foot, even existing systems take time to tweak. Is there anything that should be within the benefits system that can react more quickly to deal with crises as they



HOUSE OF COMMONS

happen in order to respond to a need that perhaps requires attention rather more quickly than the usual churn of sorting out how we deal with universal credit payments?

Deven Ghelani: I am going to make two points. First, we saw how universal credit was able to do that for a much larger population. The £20 uplift was introduced incredibly rapidly as the pandemic struck, and that was much fairer than the cost of living payments, as I think the panel will all agree. We do have a more flexible benefits system when you are being more targeted and more universal about that support, as the cost of living payments are there for a large proportion of the population.

There is a second point. We have just put out a report on local welfare assistance, which is about targeted crisis support. We have found that that has been incredibly effective for those who have been able to find out about and get access to it. You can almost immediately feel the knock-on savings to other parts of the public sector, because you have prevented a subsequent homelessness crisis or another crisis that spills out elsewhere.

There is a worrying trend there. We have not talked too much about adequacy, because we are talking about cliff edges, but the worrying trend there is that we are seeing more and more people needing that crisis support due to inadequacy of the base level of benefits, which is pushing more and more people closer towards a crisis.

Where you need to get a lot of support to a lot of people, universal credit has shown itself capable of supporting many more people rapidly and amending the rules such that more people get support, and it is naturally fairer because of the way that the taper mechanism works, but let us not forget the wider point about helping people through a crisis. They need to be able to find out about it; they need to be able to access it; it needs to be properly funded; and it should be there for a crisis rather than the fact that, day to day and month to month, you cannot make ends meet.

Q20 Nigel Mills: The beauty of using UC for this is that you could have given the people with the least a higher amount than £900, and then there is the cliff edge of people just getting a few pounds a week of UC and not getting very much cost of living payment. You would have taken that tension out of just missing it, I suspect.

You all seem to be saying that UC is a solution to that. Is it working as well as we all thought it would? I remember the big slogan for UC was “making sure work always pays” and everyone always knew that, if they took another hour’s work, they would be a bit better off. Is that the experience of people claiming UC? Fran, you have done some work on this.

Fran Bennett: We did research on universal credit and couples, which I mentioned before. This was a University of Bath-led project, which was



HOUSE OF COMMONS

ESRC-funded. We had two sets of interviews in qualitative research. As I said before, this is not quantitative.

We had some couples with two earners, some with one and some with none. The big finding was just that, although, as I said before, the taper at 63% was quite high and quite demotivating for some people, what was probably more important for lots of our participants was the volatility of income with universal credit. It was the fluctuations of income and the unpredictability, from their point of view, of income that discouraged them from changing their situations.

For one thing, stability is incredibly important, particularly for people with children. Lots of our families had children, so stability, security and reliability of income are very important. Child benefit was a lifesaver, for example, for some of them from that point of view. Some of them preferred annual assessment rather than monthly, because, under working tax credit, despite the overpayments that they had had to pay back, they had a foundation to build on rather than changing every month.

The volatility of their income led some second earners to either stop work or reduce their hours, I am afraid. It was the taper and the loss of passported benefits that we were talking about earlier, but, in particular, it was that they were not certain what the income was going to do over the future. I can go on, but that was a particular finding.

Morgan Wild: That would be the key thing that we see every day as well. Universal credit has a lot of fans among our advisers, particularly compared to aspects of the legacy system. It is working pretty well if you are the normal case that it is designed for, which is, roughly, unemployed and moving into full-time, regular, paid work. As long as you are not too complicated, that journey is relatively straightforward. It is the uncertainty from the volatility of payments. It is the fact that, if you do not fit into one of the boxes that universal credit has for you, there may well be easements in the system that your work coach can put in as a form of discretion.

We often see self-employed people who are trying to understand why a minimum income floor, or an assumed level of income, has been placed on them after a year of being self-employed. For lots of people, that is as their business is becoming a going concern. Some people who are disabled cannot really work with a standard employer and consider small amounts of self-employment, and are being caught by that issue too.

In general, it is working reasonably well, but there are so many edge and half cases that add to the uncertainty Fran speaks about, which a lot of claimants face.

Q21 **Nigel Mills:** How do we balance having a conditional system and having one where we incentivise you? On the second of those, you can say that having a withdrawal rate of 55% plus 32% in taxes that kick in means



HOUSE OF COMMONS

that, if you earn an extra hour, you are never going to get that high a proportion of it. The flipside argument would be that, if you are fit, healthy and available to work for an extra six hours a week, you should lose the benefit anyway. You are going to keep all your wages and you do not have to factor in the 55% withdrawal, because we are just going to withdraw it, whether you work or not.

It seems that, one week, we have a system where we incentivise someone and say, "You will be far better off if you work," and, the next week, we are trying to say, "We will just take your benefit away, so you are definitely better off if you work, because you will not have it, regardless." What is the right way of handling this situation?

Fran Bennett: We err on the side of greater conditionality in the UK. We also err on the side of low-pay and poor-quality work, which the Government would say makes the in-work progression also more difficult.

I would say two things on that. One is that the Institute for Fiscal Studies has looked at how people are moved into low-paid work, but that tends to be dead end. I will not say any more about that, because Helen might want to.

The other is that the study of in-work progression for the DWP by RAND Europe has just been made public by a freedom of information request. That is where I am saying that we do have a problem with moving people up from low-paid and often poor-quality work.

Talking about conditionality, the other thing that we need to recognise, and which we found in our in our work with universal credit and couples, is that a lot of people do not have control over their working hours. For example, they may ask for an hour or two extra in order to try to escape universal credit altogether—escaping was how some of our participants saw it—but they may be offered only a whole shift rather than one or two extra hours a week. They do not necessarily have the control over the in-work progression that they might wish to have.

Helen Miller: The big picture trade-off here is between redistribution and work incentives. You want to redistribute to the low end, but you want to maintain work incentives. It is worth unpacking that there are different types of work incentives being effected for different types of people.

To give you just two examples of that, one is that the system can incentivise you to take a job, but not necessarily to be full time. It offers incentives to work a part-time job, but not so much to increase hours. Picking up on what Fran was alluding to, there is more evidence, from IFS but also within economics, that part-time work does not have the same kind of long-run payoffs as full-time work, not just in a snapshot of how much you are paid today, but part-time work does not lead to the human capital accumulation that goes on to let you progress and have higher income in future. That is not to say that we should not like part-time work. There are benefits to it, but we should think at least about the



HOUSE OF COMMONS

kinds of work that people are doing, and people cannot always flexibly pick any hours that they want.

Another dimension of the trade-off that I would highlight is that you can do things that make work pay more. You could increase work allowances or reduce the taper, so you get more if you go into work and you get to keep more. One effect that that has is to move further up the income distribution. You have strengthened the incentives for those people who are around the decisions, "Do I get a job? Do I work a little bit more?" but weakened the incentive for those people who are further up the distribution.

There is no silver bullet whereby you could have it all. You are often trading off not just redistribution versus work incentives, but work incentives for different types of people at different margins, so there is a tricky balancing act to be made with all those moving parts.

Q22 Nigel Mills: One of the flip sides of having a household income approach is that we are not very generous to second earners. Is it a disincentive that the second earner does not get a work allowance, and then it starts fluctuating and makes the whole thing harder to manage? Are we accidentally putting a disincentive in place for someone to go back to work?

Fran Bennett: That was shown in a qualitative sense in our research. Some people asked for a second work allowance for second earners. Of course, work allowances were put in, as Deven suggested, for children and for disability to be recognised. Another thing, which, for example, France does in its benefits system, is to have a bonus for every additional earner that you get into work. That is another potential way of recognising that.

Deven Ghelani: There are a couple of points there that I just want to come in on. Work allowances were originally introduced, going back to the origins of UC, for all households, which was the point I made at the start. Staying with those origins of universal credit, there is a lot to be said for positive conditionality or positive approaches to work incentives, support and training. If you are out of work, you probably do need some kind of backstop. Certainly in this country, we lean toward conditionality and to encouraging or expecting people to look for work.

When you are already in work, it becomes highly problematic to ask, or place expectations on, people to look for work. The positive side of it is to be encouraged, but the stick approach becomes very problematic, and there are a couple of reasons for that.

When we looked at this back in 2009 to 2012, we wanted to encourage people with fluctuating health conditions and other kinds of challenges to take those steps into work, if they could. It is up to them to determine whether they can take an extra shift or a couple of extra hours. That is not really a work coach call or responsibility.



HOUSE OF COMMONS

This budget also introduced something that I found somewhat problematic, whereby it is not really the household earnings threshold but the potential for a work coach to say to a second earner, "We expect you to look for work," even though the first earner is earning sufficiently. You would just be slightly wary of overreach, because, again, the question is whether it is about, "Work harder. Crack the whip. We need to grow the economy and pay off our debts," or about creating an environment where people are able to fulfil their potential, take those steps into work and be rewarded for that, and then having positive expectations. It is really about the framing of the system as much as anything else.

- Q23 **Dame Angela Eagle:** Fran, you talked about sanctions. Do you just want to say how this affects our inquiry, which is about cliff edges? There is a lot that can be said about sanctions, but what is the effect on cliff edges? Could you just tell us how many people who appeal their sanctions win the appeal?

Fran Bennett: I do not know the answer to that last one, but other colleagues may. The report that the Department for Work and Pensions published just now, which it had not published for quite some time since it did the research, and which the Work and Pensions Committee probably encouraged it to publish, showed the financial and personal impact of sanctions on people, which was deleterious, not surprisingly.

There are two messages coming through from me. One is that it is not just cliff edges that are important, but peaks and troughs, if we want to get a geographical image, in terms of the volatility of people's incomes. The other is staring into the abyss, which is probably how it feels when you have been sanctioned, particularly for the maximum length of time at the highest level at the moment.

- Q24 **Dame Angela Eagle:** Could you just tell us what that is for people who might be listening?

Fran Bennett: You lose your benefit for six months maximum. It used to be three years maximum, and it is great that it has come down from three years. Some of the sanctions continue, even when you have started fulfilling the conditionality requirements, until the end of the fixed period rather than just when you start behaving as you are meant to.

- Q25 **Dame Angela Eagle:** Morgan, do you have any figures on how many people who appeal win?

Morgan Wild: Not to hand, but we have seen a big uptick in the number of people coming to us.

- Q26 **Dame Angela Eagle:** From my advice surgeries, quite a lot of people who appeal their sanctions win, but it takes 12 to 18 months before you even get a hearing.

Morgan Wild: There can be discretion in the system but, again, it depends on your experience at your local jobcentre. The big challenge is



HOUSE OF COMMONS

that there is not enough distinction between minor infractions, like missing an appointment because your train was late and you could not make it, and more major infractions. There could be much more use of things like using a yellow card system, so that, if you have made minor breaches of your claim commitments, which can often be quite complex and lengthy, you are not facing the full force of losing a significant fraction of your income.

Q27 Dame Angela Eagle: Deven, you were talking about overreach there in extended conditionality. We know that the Government want to extend conditionality on universal credit to persuade people to look for more work, which might, in isolation, be a good thing in itself, but, given that cliff edges can arise, it might be the situation that you are incentivised by conditionality to look for more work and, if you get it, you will be worse off.

Deven Ghelani: Yes, exactly. You need to be very careful here. Again, I will probably give DWP some credit here and say that I have not seen examples of it being abused, used egregiously or anything like that, yet it is, to a large degree, down to work coach discretion as to how this is applied. Hopefully, they apply it sensibly.

Applying it in the context of, "Maybe look at this training scheme. Maybe look at how you can develop your skills. Maybe think about other transport options that you have not considered to allow you to look further afield for wider work opportunities", I do not think that anyone would have a problem with those kinds of positive support elements.

When you are saying to two earners in a couple, "We expect both of you to look for work," that feels like a decision for the household. When you are saying to someone who has caring responsibilities either for children or for other adults, and who has a job that works for them around that, "Do more hours" or "Go look for another job", that affects their ability to do that well.

Another issue is with employers. What are you trying to achieve? If an employer has someone in a role, are they being pushed away from that role? Increasing your hours is fine, but one of the best things that you can do if you want to increase your earnings is to get another job. That is one of the striking things that we found when we looked at this.

Just to round off the point, if the work incentives are strong enough, we did not see a major issue. If you feel that it is appropriate for you to do one less shift and you take the income hit for that, that is a choice that probably all of us are around the table would make. You are all MPs and work very hard, and perhaps you do not have that option, but, in principle, I do not think that there is a major issue with that.

Q28 Dame Angela Eagle: The Prime Minister's tax release showed that he pays 22% tax on his multimillion-pound income. What is the largest marginal tax rate in the benefits system? If this is available, can you then



HOUSE OF COMMONS

add in the extra cost of loss of passported benefits?

Fran Bennett: I was going to look at IFS for the answer to that question.

Helen Miller: I am not claiming this is the highest, and I am sure that you can find some higher ones, but I can tell you that, if you have three children, the removal of child benefit between £50,000 and £60,000 gets you a marginal rate of towards 70%. Maybe we will come back to this, but the completely bizarre way in which we have now frozen both of the thresholds, the £50,000 and the £60,000—

Q29 **Dame Angela Eagle:** I was going to ask you about that. The frozen income tax thresholds mean that the child benefit hit is going to be dragged down.

Helen Miller: There are two things that are particularly silly about it. We have frozen the £50,000 and the £60,000, so when you start tapering and when you finish tapering. That means that, just because it is frozen, more people will be brought into this system. Also, child benefit is going up in nominal terms, which means that, in order to reduce child benefit across that range, you have higher and higher marginal rates. We are not there yet, but, if you continue in that system, you could easily get to marginal rates of above 100%, because you are moving the marginal rates down and compressing the range over which it is drawn in real terms.

Dame Angela Eagle: There has been very little chat about what is happening with the child benefit means tests at that level.

Helen Miller: I am sure that we could find some even higher marginal rates somewhere along the line in odd cases, but, clearly, 70% is high.

Deven Ghelani: I would like to make a couple of points. The standard withdrawal rate for people in work on universal credit gets up to 70% once you are above the income tax and national insurance threshold. That is the marginal rate that people on UC face generally.

The second point is that you are above 100%, because there are higher rate taxpayers on universal credit. You can access it if you have savings below £16,000. It does not take much if you rent in a high-cost area and have one or two children. We estimate that there are around 300,000 people who are high-rate taxpayers and eligible for universal credit.

Q30 **Dame Angela Eagle:** That is going to go up with the frozen thresholds.

Deven Ghelani: Yes, exactly. When you factor in UC withdrawal, you are above 100% with the high-income child benefit charge at the same time. We have a report here with a table. You are at 100% above £50,000 to £60,000. It is incredibly high at the £100,000 threshold too. That is the cliff edge point. It is when you are worse off.

Q31 **Dame Angela Eagle:** There is a cliff edge and then there is a great big ditch or hole that you jump down into.



Deven Ghelani: Yes, you fall into it.

Dame Angela Eagle: You are below the ground.

Deven Ghelani: It is a real problem. We have clients who have people coming to them saying, "How do I not earn more? This is going to be a problem for me". As we were looking at in this report, it is a genuine problem.

Q32 **Dame Angela Eagle:** Fran, I just wanted to ask about incentives to save, work conditionality, and the £16,000 savings above which you do not qualify for universal credit. What effect does that have, particularly for women?

Fran Bennett: I think that it is right to say that it has not been raised since 1990, so it is another of those frozen thresholds that the IFS has written so clearly about, which are really counterproductive. The particular thing in terms of women is that there was some research done by the Welfare at a (Social) Distance team during the pandemic, which was looking at people who were claiming universal credit. It also looked at take-up rate, but it looked at people who were trying to claim universal credit, many of whom succeeded, but some of whom did not. One of the reasons they did not was that a couple was being assessed together. There is a joint means test for universal credit. It jointly assesses not just your income but also your savings.

Let us say there are two people who are wanting to live together and buy a property together, and they are both saving for a deposit. If you put them together, they are very likely to go over the £16,000 limit for universal credit. There is already a taper between certain limits for means tested benefits, where you are assumed to earn a certain amount in interest these days.

Q33 **Dame Angela Eagle:** That happened all the way through virtually zero interest rates as well.

Fran Bennett: Exactly, yes. Not only is there a savings tariff; there is also this absolute limit, which I believe is different for pension credit.

Morgan Wild: It is.

Fran Bennett: It is more generous for pensioners. The point I was making is that means-testing people jointly is increasingly problematic, particularly for young people, who may well want to be financially independent. They are forced into a relationship where they have to depend on the other person rather than getting benefit. Of course, that is exacerbated by the fact that the non-means tested benefits have been neglected in our system. Therefore, they may not get those themselves because the conditions for getting them are more difficult and indeed, if they do get them, they may stop after a year, which is another cliff edge, as the contributory version of employment and support allowance does for people who are not in the support group.



Morgan Wild: Just on that point, we saw this a lot in the pandemic. In particular, we saw young people encountering rules in the benefits system like the living as a married couple test or the savings limit, and not understanding why that would affect their entitlement to benefits and why they were being assessed on the basis of what their partner earned or had in savings, whether or not they lived together, when they viewed themselves as completely financially independent. The idea that they would rely on their partner if they did not have a job was not how they thought of their relationship.

Deven Ghelani: We made the point about cost of living payments earlier. You lose eligibility for all of those. There is a quote in here. "If we were not saving for a deposit, we could get universal credit at £700 a month". These are significant sums that are really causing a degree of unfairness. As Fran said, you have tariff income. There is a mechanism to taper away support much more fairly than the savings limit. Again, the extent of that cliff edge is becoming greater and greater, particularly as the cost of living keeps going up and up. It is certainly worth looking at that.

Q34 **David Linden:** The Work and Pensions Committee has produced a report showing that claimants found that having to pay for their childcare up front was problematic for them. The Government, it is fair to say, have sought to fix that. Also in the Budget was this desire to tackle economic inactivity. Can I ask you a fairly broad question to start with about the feeling you have as to whether the incentives to work have been improved as a result of this for women?

Fran Bennett: Just to take the childcare point, the Budget measures are very welcome. The upfront payment of childcare costs was absolutely a real problem in our universal credit couples' research—very much so. Hardly anybody used paid childcare. All but one of the ones who did had problems using it. Several had given up using it by our second interview. It was a real problem.

I should say that it was not just the upfront costs. It was also the administrative burden of having to manage that way of dealing with childcare costs, which was different from the way in which it was dealt with under tax credits. The administrative burden, which often fell on the woman in the couple, was also quite high.

Just to come back to the upfront childcare costs, the fact that the Budget has removed that from universal credit, as well as the other childcare reforms, is very welcome. However, they have done it via the flexible support fund. The flexible support fund is not currently very well known so we hope there will be a publicity campaign. It is discretionary; it is cash-limited; it covers things other than just childcare costs because it covers other short-term help in terms of helping people get into work. It is hard to get information on how it is spent, and apparently it has been underspent recently.



HOUSE OF COMMONS

There are issues with solving the problem in the way the Government did. As you know from the Government's response to your report, they have said you can ignore the amount that is given by the flexible support fund to the childcare provider when you have your first payment of universal credit. It is as though you have not ever had that help. That is great, but it does also have those disadvantages in terms of how to deal with that issue.

It is also only for those people who are going into work or who are increasing their hours to an extent. I personally do not yet know what the Government mean by that.

Q35 David Linden: Before I ask Morgan about some of the administrative burdens, can you speak a little more to how the changes around childcare impact single-parent families in particular?

Fran Bennett: Do you mean the administrative burden of dealing with childcare costs? It is in having to show how much you have spent on childcare before you can claim at the end of the month. You have to ask the childcare provider to provide that evidence. Sometimes it gets lost or the childcare provider is away. There are issues that occur. Just the regular burden of having to deal with that as well as the universal credit claim itself is quite a burden for people, including single parents.

Q36 David Linden: Am I right in thinking that the childcare cap has been increased for the first time since 2006, but it does not increase with inflation? Would you consider that to be part of the cliff edge?

Fran Bennett: We should say that we do not know what the Government are going to do in the future. They have increased it significantly after not increasing it at all for quite some time. The other thing we must remember is that that is up to 85% of childcare costs with certain maxima. The 15% you still have to meet. The 15% you still have to meet if you need another extra hour of childcare because you have increased your work by an extra hour a week. We need to factor that into our thinking about effective marginal tax rates as well, in a way.

Q37 David Linden: Morgan, if I can come to you on some of the administrative burdens, can you speak a little more to that as well? Is it fair to say that the Budget makes the administrative burden easier?

Morgan Wild: That is fair to say. If you speak to the parents who come to Citizens Advice, the upfront cost of childcare is the No. 1 issue they raise. North of 90% of the parents who come to us for advice who are on UC cannot meet that cost up front. As Fran says, you could use the flexible support fund for the first month under the existing system, but that was no use for helping you with the second month of childcare cost. You just moved the problem one month further.

This should help. Again, I share the concern that the flexible support fund is not well known. It will be very useful for people who know enough to engage with guidance or who know enough to come to Citizens Advice for



HOUSE OF COMMONS

support. Ideally, we would design a system for this that did not require any expert input at all and just worked smoothly. We will have to wait and see, but I worry that it will still be perceived as a barrier even if, technically speaking, it is not. I would share the concerns about how the support reaches nursery providers.

Lastly, it is welcome to see that childcare cap. I am also borrowing an IFS statistic, but there was an indication that that was not necessarily the biggest issue. It was roughly £300 a month for many parents. I suspect it will be more outside than that suggests just because most of the people we see are making a jump from no work to thinking about full-time work, and you would expect people making that jump to be most affected by the level of the cap.

Q38 David Linden: Just on the nuts and bolts of childcare, my understanding is that school holidays are still not covered by wraparound care. They remain part of that childcare cap. Can you just speak a bit more to that?

Morgan Wild: Fran may know better than I do. Is it 37 weeks?

Fran Bennett: It is 38 weeks a year in England. That also applies to the free childcare, of course. You have conditionality for increasing numbers of parents at the same time as childcare provision and wraparound childcare provision only being provided in school terms.

Q39 David Linden: I am glad that you come on to some of the aspects around conditionality. Gingerbread, in response to the Budget, said, "The expansion of free childcare provision, which may appear on the surface to be a win, is so steeped in conditionality and excludes those in training or not working 'sufficient' hours, that it reduces parental choices and further embeds inequality". Is that right?

Fran Bennett: One issue is when the conditionality that is increasing for lead carers starts versus when the additional hours of free childcare are going to be provided. As I understand it, the additional hours of free childcare are not going to be provided immediately whereas the conditionality is coming in shortly.

The other issue is what you do about school holidays, as we were just talking about. I know some childcare providers average their free hours over the whole year, but that does not cope with the point about conditionality for lead carers.

However, the other thing I would just say—it does not answer Gingerbread's point, which was talking about single parents—is that our universal credit couples were also not that happy with the idea of a lead carer whose conditionality, even under the new system, would be less than the other person in the couple, for whom no responsibilities of parenthood are taken into account at all in terms of conditionality.

The lead carer still has some leeway, under what you are suggesting, until their child is 12 at least, in terms of the hours of work or work



HOUSE OF COMMONS

search they have to perform, but the other person has no allowance for the fact they are a parent at all. Our couples found that very peculiar. They did not necessarily always choose the woman to be the one at home and the man to be the one in the labour market either. It just does not fit with the development of family life, really.

Q40 David Linden: Just finally, respecting time for the rest of my colleagues, I have a simple yes/no question. We have spoken about conditionality and sanctions this morning. Do sanctions work?

Deven Ghelani: No, not really.

Fran Bennett: No.

Tom Clougherty: I think so, sometimes.

Helen Miller: I do not know enough to say.

Morgan Wild: No.

David Linden: Three out of five say that sanctions do not work.

Q41 Dame Andrea Leadsom: Good morning. I would like to start with a yes/no question as well, please. There is a lot of talk about the fairness of those working and those not working, and the changes in working arrangements. Could you all just say yes or no? Should people, on balance, work when they can or should it be a choice? Should they work when they can?

Deven Ghelani: Yes, broadly. It is good for them. It is good for everyone.

Fran Bennett: Yes.

Tom Clougherty: Yes.

Helen Miller: Yes.

Morgan Wild: Yes.

Q42 Dame Andrea Leadsom: Okay, thank you. I also want to talk about childcare a bit. I personally have a concern that, with free childcare and in the—totally understandably and sensibly—independent financial position of each in a couple, we now have a position where we are trying to say, “Everyone is back to work, then, and the state will look after your children”, and there will be all sorts of conditionality and that will be difficult.

Further to what you have just said, with which I totally agree, would you further agree that there is a complexity where children are concerned and that there is an argument for saying, “In fact, my contribution is that I am going to raise my children”? Would you say yes or no to that, Deven?



HOUSE OF COMMONS

Deven Ghelani: Parents who want to raise their children should certainly have the choice to do so.

Q43 **Dame Andrea Leadsom:** Yes, that is not quite the same. If I am working and I am earning, let us say, £100,000 a year, and I have a child and I want to raise that child, is it right that I should be supported by the state to be able to do so?

Deven Ghelani: You should have that choice.

Dame Andrea Leadsom: Fran, what do you think?

Fran Bennett: You cannot generalise like that. Your child might be 16, for example.

Dame Andrea Leadsom: No, this would be a baby.

Fran Bennett: I think what you might be suggesting—though it might not be—is to pay a low level of state benefit to people who look after their young children, meaning under-threes, at home without any link to employment rights or going back to work. There is international evidence to show that that tends to result—there is a Finnish study that has just been published, for example—in both short and long-term exit from the labour market for mothers in particular. It is also not necessarily conducive to the best child development either.

You talked about the state bringing up your children. I would not see it as that. You raise your children whether your children are in childcare or not. A lot of other countries see the right to childcare as a right of the child. It depends on the age, but we can help people to look after their very young children, which is what you are concerned about, by making improvements to maternity, paternity and parental leave, which would also include the right to go back to employment.

There is a very good network called the International Network on Leave Policies and Research, which does regular reports every year on different countries, including the UK. It says that the important issue is the gap between well-paid parental leave, whether it is maternity or paternity, and the beginning of affordable childcare. That is what we ought to be looking at as a policy issue. We do not necessarily have a good record on adequately paid parental leave for mothers or fathers.

Q44 **Dame Andrea Leadsom:** Fran, you are saying there is a cliff edge when you come off parental leave and go back to work in terms of the childcare that is then available.

Fran Bennett: There is currently. We would currently be one of the not good examples that the International Network on Leave Policies and Research has of the gap between adequately paid parental leave and affordable childcare. They will not yet have taken into account the Budget matters, of course.

Q45 **Dame Andrea Leadsom:** Tom, going back to the original question, is it



HOUSE OF COMMONS

a valid decision to say, "I am giving up my £100,000 a year job and going to raise my baby"? Is that something the state should be willing to subsidise and pay for, even though I could perfectly well go back to my £100,000 a year job?

Tom Clougherty: I agree with you, basically. I will not often say that we should think less about GDP, but it is weird that we do not count the economic value of a parent staying home and looking after their children, while we do count someone being paid to provide the same service. We have skewed the playing field. It is not level because the Government are funding free childcare in many cases, but we are not allowing transferable tax allowances. We tax solely on an individual basis. That is problematic.

It is not up to me to say that everyone should work or everyone should stay at home and look after their children. It should be a choice, and it should be a choice made on a level playing field.

Helen Miller: This is a thorny issue. There are two big-picture principles to help people unpack where they stand on it. It depends a bit on whether you think of childcare as a consumption good. I chose to come to work today. My baby is at home. I wanted to come and be helpful. In that sense, maybe I should not get any help with my childcare. On the other hand, it is a cost of going to work. I had to pay a nursery to look after my baby, and therefore there is a cost. It does depend a bit on how you think of it. It is going to differ for different kinds of people. There is a bit of a thorny issue there.

The other big picture principle to help us navigate this is that there are different things you might want to be doing with childcare. There are three in particular. First, you might want to be directly getting women back into work and thinking about labour supply choices. We should think about this level playing field argument. We are not trying to push people into making decisions they would not otherwise make, ideally, because it is a perfectly valid thing to want to stay at home and look after your baby. If we want to think about the labour supply, that is one thing you might do through childcare.

The other is all about child education and welfare. This is another reason for the provision of childcare in the early years. It has nothing to do with labour supply at all; it is about making sure those children get access to education, including social and emotional education. That would lead to different policy outcomes than just labour supply.

The third thing is that families with children have higher costs. As a Government, you might want to help people with higher costs. Therefore, helping to provide childcare is one way to do that.

Which of those three things you want to do with the childcare system—it could possibly be one, none or all three—will affect how you design your childcare system in terms of both how much you spend on it and how much you can do through cash versus through universal provision. The



HOUSE OF COMMONS

problem with our system at the moment is that it jumbles all of those things up. It does some bits in some cases and not in others.

Before we think about whether the current system is doing a good job, we should think about what it is trying to do. That is not entirely clear at the moment.

Q46 Dame Andrea Leadsom: I totally agree with you. In a way, my thesis is that the childcare system is different to any other benefit. This is not about survival and whether there is food on the table. It is about how you want to raise your family. As you rightly say, babies and very young children do need that development. They might be better off getting it at home or in a nursery, depending on their home circumstances, parental choices and so on. It is rather different to the whole benefits system. "Is there food on the table? Do I have enough money in the bank?" What do you think, Morgan?

Morgan Wild: It makes sense to support families to make the choices that best work for them. In a sense, I answer yes to your question.

This is my worry. The direction of travel in the Budget is very welcome in lots of ways. We are supporting families with more childcare and we are making changes to payments in arrears for low-income households, but it is also a step in the direction of the state taking a more micromanaging approach to families' decisions through changes to things like the administrative earning thresholds, as Deven was saying earlier.

That practically means the DWP is taking a view on not just how much a couple should earn but how much the individuals within that couple should earn. That changes their incentives in a way that, in effect, is steering them to making particular decisions, which they are best placed to make.

Q47 Dame Andrea Leadsom: Yes. It is interesting that you raise that, because this is my next question. Is there evidence that suggests people do only make economically rational decisions or are there other factors at play? If I am on £100,000 and I decide to look after my baby, there is no benefit in the world that is going to make me financially better off. This is an emotional choice, is it not?

Is there research that says I will do only what is economically rational for me? If I have a cliff edge, I just will not work those extra hours. Do people make those decisions for other reasons? Do we have a handle on that?

Helen Miller: We know that people are always weighing up lots of different factors. Nobody is ever looking purely at the money in their bank account. To give you an example, there is evidence that a lot of people on universal credit are not taking up their full entitlement. When you ask them, it is not purely about money; they also have preferences about whether they want to look after their own child. Clearly, that matters.



HOUSE OF COMMONS

It is also the case that, if you give somebody on £100,000 some support, in whatever dimension you choose, you are making them better off and therefore possibly more able to pay for the other things they need, such as wraparound care for school. It can still affect, at the margins, somebody's decision to go to work or to go back to work full time, part time or reduce their hours.

It is not fair to say that anything is ever driven entirely by one or the other. Of course, people are weighing up their preferences, their circumstances and things like whether they can access a job where they can match the hours they can work and the childcare provision they can access. You might not be able to get those things to match up. Can they get the wraparound care that allows them to get to work, get back and pick up their children? There are all those other kinds of things.

It is also fair to say that, where there are financial incentives, they matter. They matter as to whether it is worth you taking on work and whether you can even afford to do it, if you want to. Childcare costs are high. Can you even afford to pay them once you have been paid? The cost of childcare, after taking account of anything the Government do, obviously affects the choices people make about how they work.

Q48 Dame Andrea Leadsom: Is there an argument for allowing families to opt to be taxed as a family? Is there a case for that?

Fran Bennett: Just quickly on the previous question, I absolutely agree that there are lots of issues that people take into account as well as financial incentives. One of the issues we ought to look at is whether some people are more susceptible to financial incentives than others. We know that is the case from research. Lone parents and second earners in couples are more sensitive to incentives. Therefore, perhaps we should think about—this is quite difficult under universal credit—giving different kinds of incentives to different people, if we want to do that.

The other thing was just to agree with you that there are lots of things that are very important to people. I said one of them. Stability and security for families is absolutely crucial. People also do not like working so many hours in order to get off universal credit that they never see their children. That absolutely came out of our universal credit couples research. I would not want to give any impression that did not include that, so I would very much agree with that.

Taxation is a different issue. Do people want to get on to that?

Chair: It may come up in later sections, and I want to move on to student loans.

Q49 Danny Kruger: I will come straight on to student loans in a second. Thank you so much. This has been the most interesting conversation. I really appreciate the more philosophical dilemmas we have been exploring about the fundamental incentives or purpose of our benefits



HOUSE OF COMMONS

system.

Fran, I am sorry. You keep being asked the same question in different ways. I want to try again.

Fran Bennett: Oh dear, I am obviously not answering it.

Danny Kruger: You are answering very well. I maybe have one for Morgan as well, which is this question about joint assessment. Morgan, maybe I will start with you. I was interested in your point about the living like a married couple test. A lot of people just do not understand why that applies. Do you see any positive benefits from it?

You were suggesting that there is a challenge—either you or Fran said this—for some individuals because they find themselves, as it were, forced into a relationship or forced to act as if they are in a relationship when they want to be independent. Do you see the positive benefit of supporting couples to stay together through the way we assess people jointly? The alternative is encouraging people to live apart, as it were. We get it in casework. People are being told, “The best thing for you is not to be in a relationship”. How do you see the trade-off there?

Morgan Wild: Yes, it is a really good question. Throughout different benefits, taxes and supports for things like energy bills, there is this tension between assessment as an individual and assessment as a household. Lots of the ways in which we fail to design schemes well touch on that issue.

The living as a married couple test can be extraordinarily complex. The definition has not been updated in decades. The current guidance as to whether you count as a married couple is about 15 pages long and heavily reliant on case law. What we have seen is more focused on the value shift among younger generations, who often want to be treated as financially independent when they enter into a couple. That has been present in all generations to a greater or lesser extent.

The general principle that you should not be worse off for making the decision to move in together or to live apart is a good one. To the extent that the system is not doing that, it is failing.

Fran Bennett: Let me just play devil’s advocate. The rationale for doing it is the economies of sharing a household. Sometimes that has been got round by reformers suggesting that you should have a household addition to your means-tested benefit rather than having less for two people than for one. A household addition would be given to the household as a whole.

There is some research about this. My colleague Rita Griffiths did her PhD on lone parents and the means test. She found that lone parents, because they had their own independent income and they quite wanted to keep that, made decisions about their relationships and cohabitation with a new partner on that basis. They were reluctant to form a



committed couple household because they did not want to lose their independent income, which they had got used to.

Secondly, there was some research by another colleague, Jane Lewis, that found—this is above benefit level—that people wanted some measure of financial independence before they committed to a long-term couple relationship. That seemed to be what people thought. My own view is that the best way to cope with this issue is to try to put the emphasis on non-means tested benefits where you can, which are now individually based rather than household-based. The more you do that, the less of a problem you have with the jointly assessed means-tested benefit.

Q50 Danny Kruger: That is fascinating. Fran, if it is possible to answer this question, would you say we have more people living apart together, people in relationships who are acting as independent people, versus people who are being locked into a household against their will?

Fran Bennett: I do not know the answer to that, but I do know a man who does. John Haskey does a lot of research on couples living apart together. There has been quite a bit of research on it.

Danny Kruger: I would love to get the research you just mentioned about single mothers who declined to join relationships. If you could let me know about that separately, I would be very grateful.

Fran Bennett: Of course, yes. I can always write to you.

Q51 Danny Kruger: Okay, I will now do what you asked me, Chair, and talk about student loans. This comes back to the same issue, which is about what the purpose of the system is. I do not know who the best person to ask so please jump in, any of you.

We are dealing with the interaction between universal credit, child benefits and student loan repayments. Is it the issue that the interaction is too complex? It does seem to me that, when you add in student loan repayments, we are talking about almost 100% withdrawal rates. Is there a problem with the interaction or is it something else?

Deven Ghelani: It is something else. It is the broader message we are sending out to young people, particularly as they get older, and younger families. A combination of the things we have talked about today is saying, "Do not save because you will lose eligibility for universal credit and cost of living payments". It is saying, "Do not save for a house or a deposit because fundamentally you cannot".

This goes back to that same point about the threshold and the cut-off. In the student loans system, you are effectively repaying something you have borrowed, but the interest rates are much higher than they were historically. Firstly, the amount you are borrowing is much higher, but the interest rates you are paying back at are also much higher than they were in my day. That is the first time I have said that; I am clearly



hitting a threshold.

Helen Miller: People do not start repaying their student loans until they are earning £25,000 to £27,000, depending on the year. They are usually, though not always, going to be people who are outside the universal credit system. Those systems are usually not going to interact all that often.

Again, in terms of these big broad principles, it is worth thinking about two types of graduates. The majority of people in the £22,000 system do not expect to pay back all of their student loans. If you do not expect to pay the loan back, changing the student loan system to give you these higher tax rates does just feel like a tax rise. What it is doing is affecting how much you will pay back overall. A higher marginal rate, however it occurs, means you are going to pay back more of your loan. It is more like a tax rise that will affect work incentives in a similar way.

For those graduates who do expect to pay back their loans in their entirety, this is different to a regular marginal tax rate issue. A higher tax rate is going to affect how quickly you pay back your loan. It is not going to affect how much you pay overall. For those kinds of graduates, the effects are not really about the labour supply. It is really a timing issue. The system is going to change this year in a few ways, but it will change more towards people who are going to pay back more of their loans. For those people, the changes in marginal tax rates are less about labour supply and more about how quickly you pay back your loan.

The interest rate is also coming down. There are situations where people are paying back their loans over long periods and paying back very large sums. This will mitigate that to some extent because we are only going to charge inflation. There is no real interest. The system has been shaped in such a way that the marginal tax rate element of it will be less damaging. There are still people who are not going to pay it back, for whom these high rates are basically tax rates. That is not to say that will not happen, but the system is changing.

Of course, there is something different about the student loans system compared to a marginal tax rate: people have chosen to go into it in the first place. One reason you want to have some link between making that choice and the repayment is that you want people to make that choice if they think it is good for them after taking everything into account, both how much they are going to enjoy university and whether they think it is going to increase their earnings. If you completely delink those two things and say that the Government will pay for university for everyone, you change the decision as to whether you get a loan in the first place.

Q52 **Danny Kruger:** Tom, can I ask you to follow on from that? Where do you see the incentives in the system? Are we disincentivising people from taking on higher-paid work, if they are a graduate? What is the effect of that? Are people disinclined to go to university in the first place because of the loan?

Tom Clougherty: Possibly, and in certain cases they might be wise to be



HOUSE OF COMMONS

disinclined, when you look at the economic returns on certain courses. I agree strongly with Helen's last point. Nothing I am about to say is suggesting a free-for-all or that Government pay for everything. At the same time, you have to factor in the influence of student loans on the effective marginal tax rate people face—these are basically average earners—when you are thinking about how much more tax you can get from ordinary workers.

You have your 20% basic rate of income tax; you have your 12% national insurance. If you factor in the employer side, that pushes the effective marginal rate up just over 40%. If you add in student loans, you are at 50%. People will also be making their auto-enrolment pension contributions. Again, that is a good thing and to be welcomed, but that still takes the overall tax wedge to something like 55% on an ordinary graduate not earning a vast sum of money.

The reason it is useful to bear that in mind is that, if you look at the burdens that an ageing population is going to place on the dwindling workforce, it is hard to avoid the long-run conclusion that VAT or basic rate income tax is going to have to go up to pay for some of this stuff unless we change policies. Surely, these people are taxed enough already. When less than half of the total cost to the employer is going to the employee as the return on their labour, that is a really difficult situation to be in. It is one that clearly must have an impact on work incentives.

It is not going to stop a young graduate going to work or looking for a better job, but it does feed into an economic malaise and a sense that it does not really matter what you do because you cannot get ahead anyway, especially if you factor in housing issues, the cost of childcare and everything else. We have created quite an unfortunate dynamic for ourselves.

Danny Kruger: Thank you, Tom. That was well put.

Q53 Anthony Browne: This morning we have been discussing quite a bit high marginal tax rates, the interaction with universal credit and the child benefit charge. I am going to ask about the higher end of the income scale, those earning over £100,000. Because of the withdrawal of the personal allowance, they have marginal rates of taxation over 60%. If you include national insurance, it gets to over 65%. That is in England and Wales. Northern Ireland and Scotland have a different regime. They have high marginal tax rates of over 60% between £48,600 and £60,000.

First, how much does having these high marginal rates of taxation, 60% or 65%, disincentivise higher earners from working more hours? Is there any effect? I can understand why they do not like it, but does it actually affect their behaviour? I am going to ask Helen from the IFS first, but I suspect others might have some views.

Helen Miller: Yes, there are a couple things to say. First, you have to distinguish between these higher marginal rates and cliff edges. If you



think about something like the additional rate of—

Anthony Browne: How steep does it have to be to be a cliff? 65% is quite steep.

Helen Miller: I would say a cliff edge is where you have a jump in your average tax rate. A high marginal rate might mean you lose 90%, but you are still better off. A cliff edge is where, no, you are worse off. Take the £100,000 cliff edge. The taper of the personal allowance means you earn more. You have a high marginal rate, but you are still better off. In contrast, the removal of tax-free childcare, for example, means you are actually worse off.

To give you the sense of that, if you are a parent with a couple of children, you can be better off earning £99,000 than all the way up to £130,000. You could take a pay rise anywhere between £99,000 and £130,000 and not just have a higher tax rate but be worse off. That is inexcusable. Why do we have a £30,000 range?

Anthony Browne: We all agree that marginal rates over 100% are completely mad.

Helen Miller: Yes, exactly.

Q54 **Anthony Browne:** It is really the lower rates, where two thirds of your income goes. Does that have an effect?

Helen Miller: The other thing we know is that people at the top of the income distribution are pretty responsive to high marginal rates, but they are not necessarily responsive in their labour supply.

Anthony Browne: What do you mean by “responsive”?

Helen Miller: If you put tax rates up, people reduce their income, but there are at least two way they can do that without working less. One easy one is to put more money into your pension. If you are near the £100,000 cliff edge and you want to work more but not be hit by this, you should put money into a pension instead, if you can, subject to all the other constraints.

The other thing that some people can do—this is more at the top—is work through self-employment. If you are already self-employed or you own a company, you can pay yourself in dividends or capital gains. That is not a cliff edge in the sense we have talked about today, but there is a big cliff edge between paying yourself in capital gains, which was a question earlier, and paying yourself in salary.

People at the top are very responsive to taxes. Their incomes will come down when you tax them more, but it is not always or even predominantly because they are working less. It is because they are doing something like putting income into a pension or changing how they get their income.



HOUSE OF COMMONS

What would happen if we removed those silly bits of the system? As a thought experiment, imagine we taxed people in the same way whether they got their income through capital gains, dividends or salary, and imagine you could not just put money in a pension to escape these high marginal rates, but you had to face this expense. We do not know so much for different people in the distribution about how much less they would work. It would have some effect.

At the moment, the big responses are not coming through the labour supply; they are coming through income shifting.

- Q55 **Anthony Browne:** Before I come to the others, the question is then about the extent to which that change in behaviour or in how you categorise your income is a loss for the Treasury. They are only doing it to pay less tax, in a totally legal way. Presumably these high marginal rates raise less than you would expect them to raise on a straightforward basis.

Helen Miller: Yes. The pension one is a bit more complicated. If you put money into a pension, it will be subject to some tax in the future, so there is some money back. When people are shifting from salary to capital gains, that is a straightforward loss for the Treasury.

To give you an example, take company owner-managers—people who run their own companies. We have very clear evidence, using HMRC tax records, saying that a lot of them do save large amounts of their money in a company rather than taking it out in salary in the year. A lot of that goes to capital gains. That is a straight loss, in that sense.

- Q56 **Anthony Browne:** What is the scale of that loss? Are we at the peak of the Laffer curve at 65%?

Helen Miller: It is difficult to say. We have an old number from a few years ago, which I can dig out for you. I do not have it off the top of my head. The OBR has put a number on how much we have lost through income shifting, as more people have moved to self-employment and owner managers. It is not an “enough to pay for the NHS” type number, but we are talking low billions. That is a figure to have as a ballpark.

Of course, that income shifting also has other effects. In terms of the Laffer curve, if we increased the additional rate of income tax, the current expectation based on HMRC estimates is that it would not raise very much money. That is because of the design of the system. We are near peak Laffer curve if we keep the design of our system the same. If we moved to a system where there was greater alignment in taxes between labour and capital gains, we could raise more.

Anthony Browne: You would reduce the chances to avoid it.

Helen Miller: In some ways, there is not one peak of the Laffer curve. It very much depends on the design of the system. In the way our system is designed, we are close to it.



HOUSE OF COMMONS

Anthony Browne: There are alternatives. I suspect lots of you have views on this.

Deven Ghelani: I would make the argument that increasing the headline rate of tax would improve labour supply. That is because the decisions people make relate to cliff edges and not nearly as much to marginal rates.

At £50,000, I am going to lose my child benefit. I want to work three days a week instead of four or five. At £100,000, I am going to lose all of my childcare. My personal tax allowance is going to be withdrawn. It is barely worth it to go from £100,000 to £106,000. These are high earners who could be making these changes that would increase tax. Because of these cliff edges, you are introducing a decision point that, in a normal progressive taxation system, should not exist. If you increased the additional rate of tax by 5p or the higher rate of tax by 1p or 2p, you could pay for and remove all of these distortions.

Going back to my point about the Office of Tax Simplification, all of these distortions that we are talking about have pretty much been introduced while the Office of Tax Simplification has been around. These are not hugely complicated.

Q57 **Anthony Browne:** I agree with the point about distortions elsewhere in the system. All of these distortions have been brought in to raise money. In and of itself, would those high marginal rates reduce or, in your view, increase labour supply?

Deven Ghelani: Clearly, you want to shift taxes away from work altogether, if you want to increase labour supply. I am saying that these distortions do far more damage than marginal rates. We need to find a way to remove these distortions.

Anthony Browne: Yes, but it does not matter where the money comes from.

Deven Ghelani: Yes, absolutely. I agree.

Tom Clougherty: The thing you are specifically asking about is the withdrawal of the personal allowance at £100,000. It is a particularly nasty policy because those people in the £100,000 to £125,000 bracket are not the internationally mobile super-rich. You can get away with taxing them at much higher marginal rates and still raise a lot of money in a way that you could not do if it was just raising the additional rate of tax to 60%.

If you raised the additional rate, which is currently at 45p, to 60p, you would probably lose money. I am not sure you would gain much at all by going to 50p. On the other hand, you have this captive audience earning just over £100,000, who are not going to move to Switzerland, the Emirates or whatever. You can get away with taxing them more and still raise revenue.



Of course, that is not to say you should. It is a very problematic policy. It makes no sense for marginal rates to be structured in that way, to suddenly spike at £100,000 and then drop down. This is quite a good illustration of the way these problems enter our tax system and become durable. Over time they become more significant and, curiously, harder to get rid of as well.

When Alistair Darling announced that the personal allowance would be withdrawn, we had a relatively low personal allowance. It affected a relatively small number of people. Why did he do it? Well, it was the financial crisis era so they needed to raise a bit more money.

The way these things often sneak into the tax system is through this weird annual or twice-yearly system of Budgets that we have. The Chancellor wants to pull some rabbits out of the hat. People have to work out what we are going to do to offset some of the fiscal costs to make the numbers add up. The Chancellor will do a small tweak and introduce a cliff edge or a higher marginal rate here or there. It does not affect many people, and they are not a politically salient constituency anyway. Then the personal allowance grows and it affects more and more people.

Equally, though, getting rid of it is now going to cost about £5.5 billion. Everyone would say, "Why are you targeting a £5.5 billion tax cut at people earning over £100,000?" Look at the distributional analysis. It will be flat, and then have a huge spike in the 10th decile.

In a way this is just a tale of despair because I am saying I do not know what to do about it. Politically speaking, the answer is not to get into this situation in the first place. That requires the Treasury to be a little more responsible about the things it introduces in the first place with regard to the long-run effects.

Anthony Browne: It seemed like a good idea at the time.

Fran Bennett: Just briefly, this is not really my area. I would want to say, however, that we ought to think about the incentives for people to stay here in particular, which are to do with public services and the kind of country we are, and not just individual tax rates. We should not forget that. That may be an issue.

I also wanted to say that lower-income people in general cannot use the kinds of mechanisms to avoid these cliff edge situations that we have been talking about, as richer people can do. That is worth remembering.

Q58 **Anthony Browne:** Can I ask one last question on Tom's point? Could there ever be an economic rationale for having higher marginal rates of taxation between £100,000 and £125,000, and then lowering them afterwards? That is what we have almost by accident, it seems.

Tom Clougherty: Helen might be able to speak to that. If you go into academic optimal tax theory, it does not really look like a progressive tax rate. It says, "You tax the people who are not going to move more, and



HOUSE OF COMMONS

you tax people at the lower end nothing". They might say, "You tax the people at the top end nothing because you want to attract as many of them into the country to create wealth as possible".

Anthony Browne: That is very regressive.

Tom Clougherty: That is academic theory. That is not really what anyone is going to accept as a practical tax system.

Helen Miller: Yes, you can get into lots of very fine optimal tax models that might, in principle, allow you to justify wiggly schedules. By "wiggly" I mean it goes up and down.

Anthony Browne: We do not like wiggly schedules.

Helen Miller: Given what our income distribution looks like, we do not need those kinds of schedules to achieve our goals. We have a progressive tax system because we have decided collectively that we want to raise more from the top than we do from the bottom. A broad system with a personal allowance and two or three rates allows you to do that really quite successfully without having to have other structures. You do not need a flat structure with just one rate, but you also do not need 10 rates.

The problems we are highlighting are where you have deviations from that broad two-rate structure, where you have these humps of child benefit.

Anthony Browne: We need to go back to the Lawsonian system.

Q59 **Siobhain McDonagh:** I would like to look at rising levels of inactivity and people with disabilities. The UK has seen the largest drop in employment out of any G7 country since the start of the pandemic. That has happened partly because of an increase in the number of people who are too sick to work, which is up 350,000 to 2.5 million.

That is a record number of people who are economically inactive due to ill health, allegedly costing £150 billion a year, which is the equivalent to what we spend on the NHS, more than we spend on our school system and three times what we spend on defence.

Andy Haldane, former chief economist at the Bank of England, is quoted as saying, "For perhaps the first time since the industrial revolution, health factors are acting as a serious headwind to UK economic growth". Does that have anything to do with NHS waiting lists having soared to 7 million, it taking three weeks to get a GP appointment and it being almost impossible to get physiotherapy on the NHS?

Helen Miller: I can tell you a few things. IFS has dug into the numbers, which are interesting. You mentioned those net changes. In the big picture, what has happened recently is that there were people who were out of work anyway before the pandemic, but those people have got sicker. The change is not really about people who are well and healthy



HOUSE OF COMMONS

becoming sick and dropping out of work. It was people who were out of work and unwell who have now got more ill. They are more likely to say they are staying out of work because they are ill.

It is a change—more people are ill—but it is not necessarily driving them to be out of work. They were out of work already. If you are thinking about getting them back into work, the challenge might be harder now because they are sicker, but they were not in work.

There is also a group of older workers who are leaving the labour market. This looks more like a choice. When Covid hit, they reassessed their choices about how much they wanted to work. They assessed their financial position and how able they are to work and, weighing all those things up, they decided to leave the labour force.

It is completely right that health is important here, but it is not that health is dragging people out of the labour market. They were already out. That is a subtle distinction when we are thinking about how we get people in and out of the labour market.

On the point about waiting lists, I do not have evidence on the exact link between access to health services and work, but it stands to reason that there must be some link. If you cannot get your condition fixed and therefore you cannot go back to work, there is going to be a link there. We do not know how many of these are people with long-term chronic conditions who would not be able to get back into work if they had access to healthcare—although we want them to be able to access health services so they are better off—versus people with conditions that could be somehow fixed by access to healthcare and who could then get back into work. We do not know a great deal about the people in those different camps.

Morgan Wild: Just to add to that, the No. 1 reason people come to Citizens Advice for advice at the moment is that they are having issues with personal independence payments, whether that is assessments, appeals or whatever else. We have also seen a huge increase in the number of people coming to us for advice on work capability assessment. Those twin things account for a lot of our advice to disabled people and people with long-term health conditions. We do not have direct evidence that that is related to NHS crunches or pandemic-related inactivity, but it seems like a reasonable hypothesis.

The big issue in terms of labour market participation, which the Budget will hopefully have partly addressed in future, is people who have received a positive work capability assessment that found they were now capable to work and have been outside the labour market for a few years. When they think about whether they might be able to work again, they are terrified at the scale of the financial cliff edge they would face if they decided to experiment with work, realised it was not going to work for them and then lost all of their disability benefits. That should hopefully—the devil is in the detail—be partly addressed by the measures



HOUSE OF COMMONS

in the Budget that move towards a single health element for universal credit, but it is the biggest source of anxiety we see.

One area where there is also a role for people with real health expertise, which is underserved at the moment, is occupational health. We see people who are accessing some kind of health benefit. It is like night and day for our advisers, whether people have received occupational health support or not. The chances of it being a positive experience are so much higher if they have been able to access some kind of occupational health, of which there is very limited supply unless you happen to be attached to an employer.

Tom Clougherty: There is clearly a problem with labour market activity. The NHS waiting list must be feeding into it to some degree. I would just highlight a couple of interesting findings from CPS's research on this issue.

First, as Helen has already alluded to, it does seem like for the older cohorts being financially comfortable and being a homeowner is much more associated with the decision to leave the labour market since Covid than worsening health. You should probably just say well done to those people, if they are in the situation where they can happily retire.

We do not have a good explanation for this, but across all age groups there are more women in work now than before the pandemic. The entire fall is accounted for by men. Maybe that is a weird statistical thing; maybe it will endure in the data and we will have to try and work out what is going on there. There is definitely stuff around labour market inactivity that does not fit a lot of the usual narratives.

Q60 **Siobhain McDonagh:** In *The Times* yesterday there was an article headed, "Long NHS waits take private healthcare from boardroom to building site". The idea behind this article was that, rather than private health insurance being a perk for somebody at the top of the company, it was being provided further down the company because of employers' concerns about being able to get physiotherapy, if you had a back problem and you were a builder, or access to NHS GPs. If it is £48 a time privately, that is a lot less than you are going to pay somebody to be off work sick.

Will we begin to see more of that differential? Will companies take it into their hands to keep their workers going? The most significant factor in the article was access to mental health services and counselling.

Helen Miller: I do not know. It stands to reason. Why do employers give their employees benefits of any type? It is because they think it benefits them more than it costs them. Employers can provide healthcare at a lower rate. If it costs them less than it benefits their employees, it stands to reason that they will do that. If employees increasingly want these services because they cannot access their GP, it all stands to reason.

We do not know the scale of that and how many people will be in that



HOUSE OF COMMONS

situation. Similarly, will more employers want to take part in occupational health schemes and offer their employees occupational health packages in order to help them through any short-term mental health problems, for example? That stands to reason.

We have no evidence, other than anecdotes, on exactly how big a trend that will be, but I would not be surprised if people do more of that, as well as doing more personally. Individuals can also pay private GPs. I expect more people will, in some cases, turn to that, or to dentists or whatever it happens to be, if they have acute issues.

Q61 Siobhain McDonagh: My feeling about the whole system is that nothing works. Nothing in Government Departments or local authorities works. You have to be so tenacious and fight your way through it. It does not matter what good initiative any Government comes up with, if you do not believe they can do it.

Going back to your point, Morgan, in the Budget the Government announced they would abolish the work capability assessment and replace it with the health assessment that currently exists for the personal independence payment. The hope is that, because it is a non-means-tested benefit, people can rely on having more money if they go into work. As I said, that sounds great, but are the Government capable of assessing those claims?

As of December 2022, there were 25,103 outstanding access to work applications, which is a year-on-year increase of more than 10,000. If people do not believe you can do the assessments, are the initiatives going to work?

Morgan Wild: You have posed the central challenge for the Government's new plans for disability benefits. They have a lot of attractive properties from a policy perspective, and a lot of attractive properties from the perspective of claimants only having to go through one assessment rather than two. The increase in the number of people coming to us for advice on personal independence payments has been overwhelmingly driven by that increased backlog. It is right to push on that backlog as a big delivery problem for personal independence payments.

While personal independence payment is our number one issue at the moment, if you look to the graph of our issues over time, ever since its inception personal independence payment has been a big problem that people come to us with. While typically that would have been things like appeals and mandatory reconsideration, it is only now that we are really adding a huge backlog element as well. That would be my key concern.

Q62 Siobhain McDonagh: Is this all too little too late? To your point, Helen, we know the number of people not in work was increasing prior to the pandemic. The Office for National Statistics says that the issue of long-term sickness predated the pandemic to 2018. The proposals in the Budget are going to be rolled out only in a very small form in 2026-27. Is



HOUSE OF COMMONS

there really anything out there that is going to turn any of this around?

Helen Miller: To be slightly cheerier, if you look internationally, even with the recent changes, labour force participation in the UK does not look shockingly low. We are in the middle of the table. We do not have people participating at the rates of Germany or Scandinavia, but we are better than places like the US and some other countries. In the broader big picture sense, we are not a big international outlier in relation to how many of our people are in the labour force.

Of course, as you have identified, there are these acute issues around illness and there are these really rather shocking trends towards increased illness, including mental health illness, that mean people do not feel able to work. We have to do something about that. As you said, PIP is not new. We have had it a long time. There is more work to do. I do not know whether we should have done something a bit sooner or how quickly we can turn these things around, but it still needs work.

Q63 **Rushanara Ali:** Good afternoon. I have a couple of follow-up questions from earlier on, and then I will go on to pension contributions and incentives to work. Deven, you were talking about in-crisis support and how that is going up and up. Do you have the figures on what the trend is and how much it has gone up by?

Deven Ghelani: We have just published a report on it, but I do not have them immediately off the top of my head. I will happily send that on. What did come out of that report, from the feedback from those on the frontline who are dealing with the applications, was that a growing number of those were coming from those not really in crisis but just facing a day-to-day inability to make ends meet.

Rushanara Ali: It would be really helpful if you could give us the numbers and the trends.

Deven Ghelani: I will send you the report.

Q64 **Rushanara Ali:** Yes, thank you. Morgan, you were talking about the uncertainty and volatility of payments and the impact of that. Overall, what is the macro trend in terms of that? How does it affect participation in the labour market and so on? What might be the two or three things Government could do to improve that experience and help make the transition to work run more smoothly? Then on sanctions, if they create such negatives, what is the value of them?

Morgan Wild: I can perhaps leave the macro picture to others, but, in terms of the level of uncertainty in the system, it is worth saying that universal credit seems to have more positive labour market outcomes than the proceeding legacy system. That is a benefit.

When we talk to people, they value their absolute level of income, but they also value the security of that income just as much. If they are faced with a system where they have fluctuating incomes, and they are



on a rollercoaster ride where they consistently do not know what support is going to come in next month, that strikes us as a big problem.

The thing you would do to address that is to give different types of workers more choice and flexibility about the period over which they are paid. Universal credit is very centred on a monthly assessment period. Future reviews of the system should look at that.

Q65 Rushanara Ali: It is symptomatic of middle-class people being used to getting paid in that way—there is almost a class prejudice—and not understanding the experience of people who have those sorts of ways of working.

Morgan Wild: There is certainly something to it being designed with a particular type of worker in mind and therefore not as well designed for other types of workers.

Just to take up your point on sanctions, the case clearly needs proving. The evidence we saw from the FOI'd reports indicates that there are questions to answer about the existing sanctions regime. Certainly, we see lots of evidence of it being applied inconsistently or wrongly for people who are coming to us.

Fran Bennett: I just wanted to add a point in terms of sources. One is Andy Haldane, who has been mentioned already. He has talked about how insecurity of income is stopping people applying for higher-grade jobs. He must have written about that as well. We invited him to Oxford talk about it.

Secondly, the Joseph Rowntree Foundation put out a call in autumn for some research to be done on income going up and down, so fluctuations in income. In the future, we will hopefully be able to see some more general work on that compared to what we have been talking about.

On sanctions, one of the worries is that they are increasing or at least they have increased more recently. It was not quite so much of an issue in the pandemic. The person who writes about this regularly is David Webster of the University of Glasgow. He sends regular bulletins about sanctions. They contain a huge amount of information.

There has always been some conditionality in the system. In an insurance system, it was about not throwing yourself on the fund, but there were sanctions in the means-tested system as well. It has become increasingly punitive and widespread. More and more people are being treated as unemployed rather than in other—

Q66 Rushanara Ali: You must be aware of evidence about the differential use of sanctions. Across our society, there are different levels of discrimination towards certain groups and different treatments. Who are the big losers in terms of differential impacts? Are there particular groups that are more heavily sanctioned, such as those with learning disabilities, versus others?



HOUSE OF COMMONS

Deven Ghelani: There are probably three broad points. The first thing you have to look at is discrimination on almost a postcode-by-postcode basis, based on who your work coach is and where your jobcentre is. It would be really interesting to see how that differs area by area. There could be some economic drivers for that, but it is probably more to do with the discretionary approach.

The second point is about who is hit hardest. A lot of single people seem able to work but fundamentally have some serious issues. I do not really feel as though the support for them is there. That is definitely the one that stands out. We talk, as we should, about families with children, older people and all of these groups, but single people, often single men, living on their own with a very limited support network are often some of the hardest hit, especially in terms of the proportion of their income.

Thirdly, we are talking about cliff edges. There are certain things that can happen that mean you avoid sanctions and conditionality. The work capability assessment is one. There are others. Returning to a system where you face that level of conditionality and the risk of sanction is definitely seen as a risk by people. It is definitely a risk that they do not feel comfortable taking and that is in itself a cliff edge in the same way I said at the start.

You mentioned that sanctions themselves can be a cliff edge; so can moving into work. It is not a traditional tax and benefits cliff edge, but, in some ways, if you are trying to support those the people at that end, it can be as big or bigger.

Q67 **Rushanara Ali:** Turning to pension contributions, the Chancellor told this Committee that the abolition of lifetime pension allowance in the spring Budget constituted a significant simplification of the tax system. He is also going to scrap the Office of Tax Simplification, which this Committee is not happy about. Do you agree with the statement he has made? Will it increase incentive to work?

Tom Clougherty: On the specific narrow point about whether getting rid of the lifetime allowance helps work incentives, in certain cases, yes, particularly around highly paid older NHS staff. There is no doubt that there is an issue there. I am sure there are similar cases in the private sector as well.

More broadly, scrapping the lifetime allowance is not solely a work incentives policy. The lifetime allowance was just a bad way of controlling pension contributions and their fiscal cost. It really does not make any sense at all. For defined contribution pensions, where you already have annual limits, it is very hard for people to predict or control how well their investments are going to do. That makes planning difficult.

It applies very differently between defined benefit and defined contribution pensions, such that you can get hit by the lifetime allowance with a much smaller defined contribution pension than you would be with



HOUSE OF COMMONS

a DB one. There were all sorts of reasons for getting rid of the lifetime allowance, so I welcome it.

Q68 **Rushanara Ali:** The Resolution Foundation would disagree with you. They argued it would enable people to retire even earlier because of the amount—

Tom Clougherty: Yes, because they would be better off.

Q69 **Rushanara Ali:** Yes, that is right. Helen, did you want to add anything?

Helen Miller: There are two offsetting effects. First, people might reach their savings goals earlier and therefore retire earlier. At the margin, they have a stronger incentive to save, but there are offsetting effects. The OBR thought that, if you weighed those two things up, you might get 15,000 more people into work. That is a very small effect, given our labour supply.

Rushanara Ali: Yes, and it will cost £80,000 per person.

Helen Miller: You mentioned the principle behind the lifetime cap. It does cause problems because people cannot always exactly manage how much they have in their pension pots once you consider the investment returns. You could change the cap to a cap on contributions rather than a cap on the total amount.

Q70 **Rushanara Ali:** Is this an effective policy? It is regressive, is it not? We are going to pay people who have very large pension pots. Yet there is scepticism about whether it would keep people, even doctors, in employment for longer. Is it a waste of money?

Helen Miller: If you are trying to do it purely for the labour supply effects, yes, this is the wrong way to go about it. You are getting a relatively small effect for a big change in policy. There are other problems with the lifetime cap. It makes it harder for people to manage—

Q71 **Rushanara Ali:** Should there be some conditionality on rich people? We are going to give them £1.2 billion because we want them in work. We have been talking a lot about conditionality and sanctions on some of the poorest in society, but yet the Government are quite happy to dish out hundreds of thousands of pounds without necessarily any guarantee they will stay in work.

Helen Miller: What they could have and should have done is cap the tax benefits. We could have a reasonable debate—and people have different opinions—about how much we should let people save in a pension as a vehicle. It becomes much harder to say, “If you have already £1 million, we will give you additional tax advantages”.

They did put a cap in place on the 25% lump sum. That is capped at the current lifetime allowance so you will not be able to get more than 25% of that. That is still £250,000, so quite a lot of money. The other tax benefits, including the large national insurance benefits, because you



HOUSE OF COMMONS

often do not pay on the way in or the way out, and the benefit that pensions are free of inheritance tax entirely, remain in place.

Those benefits are now going to the group who can save more in a pension. Even if, as Tom said, there are genuine concerns about the lifetime allowance that are completely independent of labour supply effects, you want to have something that caps the tax advantage.

The simplest thing to do is to move to a cap on contributions rather than the total pot. That would be very straightforward and would remove some of the investment uncertainty. You could go further and create other caps to tax benefits, of the variety of capping the lump sum, which you could do in very many different ways, capping other benefits or removing them wholesale. If we have an inheritance tax, pensions should be brought within that, for example.

There is a whole range of things you could do that target rich people having pensions but are directly to do with the tax benefits rather than the amount of savings per se.

Q72 Rushanara Ali: One final thing is about the aspects of pension taxation. Which ones should be changed to increase the incentive to work, say for lower-income groups? Just very briefly, do you have any thoughts on that?

Helen Miller: One of the problems with the 25% lump sum being tax free at the moment is that it is more generous to people who are higher-rate taxpayers in retirement and does nothing for non-taxpayers. You could keep something that looked like that but reform it so that, for example, nothing changed for basic rate payers, higher-rate taxpayers got less and non-taxpayers got more. You could reform that part of the tax benefit to sway incentives towards those who do not pay tax in retirement, who are the lower earners. That is one of many examples where you can change the incentives in the pension tax system.

Q73 Douglas Chapman: We move to the exciting world of VAT tax thresholds. We have very little time left, but I have four questions, which I will move through quite quickly. We are told by the Government that one of their main aims is to improve growth in the economy. Secondly, we are constantly being told that the SME sector is the backbone of the British economy. Is there any evidence to suggest that the current £85,000 tax threshold in terms of VAT is a disincentive for business growth?

Tom Clougherty: Yes, absolutely. If you look at the chart of corporations by turnover, there is a huge pile-up of companies just under the threshold. You assume that there are a lot of people who do not want to earn that little bit more and have to register for VAT. That is a problem.

Helen Miller: Tom is completely right. There is this large bunching around the threshold. While that is an issue per se because there might



HOUSE OF COMMONS

be people who would have earned a little bit more, the bigger and much more important point that this bunching teaches us is not just that there are some people who have not grown in order to overcome it, but that the VAT system is distortionary. Those distortions do not just hold at the threshold; they hold much above the threshold.

The big issue with VAT is compliance. Those compliance costs are part of what stops businesses wanting to get into the VAT system. Those compliance costs do not stop above a threshold. Said differently, if we completely removed the threshold, those compliance costs would still exist.

In this case, I am trying to point your attention towards not so much the threshold per se, although that has some specific issues, but how we are learning that the VAT system has lots of compliance costs. They are bad for growth for all businesses. We should turn our attention to those. That is the big issue with VAT, rather than the threshold per se.

Tom Clougherty: If it were easy to comply with, people would not worry about crossing the threshold.

Helen Miller: There are marginal businesses that would have been at £90,000 turnover but are actually at £75,000. We would rather they were at £90,000 than £75,000, but that is a relatively small issue compared to our third largest tax putting big compliance burdens on all firms. A lot of that is about the design of the VAT system, the various zero rates and exemptions. In terms of big problems to fix, I would turn our attention towards the compliance costs of the VAT system in general for all firms and not just the precise threshold. We should not get too hung up on the threshold per se.

Q74 **Douglas Chapman:** Just on thresholds, if you look at that, other people are focused on that part. If you look at the OECD, for example, we have the highest thresholds of all the OECD countries. The EU average tends to be closer, more or less, to the equivalent of £30,000.

Is there a better way of doing this to incentivise business to grow and make that leap over the barrier beyond £85,000? Is there something else we should be doing to maintain that level of income for the Treasury and incentivise businesses at the same time?

Helen Miller: I would come back to the point about the compliance costs. If we reduced the compliance costs within the VAT system, crossing the threshold would be less problematic because there would not be such a big cost to complying. The big trade-off around where you put the threshold is that, if you have a higher threshold, fewer businesses have to comply with the VAT system. That makes those businesses better off, but you lose revenue.

You could move it lower. You could think of things like putting in more of a flat-rate system lower down. People could be in the VAT system and you would get some revenue, but there would not be a cliff edge and you



HOUSE OF COMMONS

would not have to have the full compliance burden of the full whack of VAT. There are things you could do to ease the problem.

Q75 Douglas Chapman: Are there any international examples we could point to and say, "This is a better standard or a gold standard of doing this"?

Helen Miller: Most countries have a lower VAT threshold. In that sense, we do stand out. We do also have more zero rates and more exemptions than most other countries. We have a VAT system that is much more complicated than other countries. Again, if you want to pull more people into your VAT system, that is harder to do when you have a more complicated system to start with. The simpler your system, the easier it is to say, "We will put it down to more businesses" because it is not as complex.

The gold standard would be the textbook VAT, where we get rid of as many of the zero rates and exemptions as possible, and ideally all of them. Businesses would not have to, for example, work out which of their inputs were inputs to produce a zero-rated good or an exempt good. That is what makes VAT hard to comply with for a firm.

Q76 Douglas Chapman: The Chancellor has also said that the £85,000 threshold will remain in place until 2026. Is that a particular problem? Should he be trying to adjust that at the moment to account for the fact that we have relatively high inflation and a lot more companies are likely to be caught in that VAT net when they really do not have to be?

Tom Clougherty: I suspect there is a primarily political calculation here.

Douglas Chapman: It is beyond the next election.

Tom Clougherty: It is beyond the next election, but the Treasury knows that the VAT threshold is higher than ideally it would be if they were starting from scratch. That causes distortions because you get the bunching up of companies just under the threshold. They know it would be politically incredibly toxic to reduce the threshold, and indeed that would have some serious unintended consequences because the VAT system is difficult to comply with, complicated and everything else.

What they are saying is, "We are going to fix it in nominal terms". It will get lower in real terms. That is sort of the policy objective, but no one wants to say so out loud, to be a bit cynical about it.

Q77 Douglas Chapman: Helen, you have given quite good answers in terms of the things you would want to do. Tom, or any other member of the panel, if you were invited into No. 11 just before the next Budget and told, "We need to fix this VAT threshold problem", what other solutions would you suggest to the Chancellor?

Tom Clougherty: Sadly even I would say, "Do not touch it before an election". That is probably foremost in their mind.



Realistically, yes, you want to simplify VAT and have a broader base. Your main rate, which probably should be lower, should apply to as many things as possible. It should be simplified as much as it can be. We should make complying with it, reporting it and everything as simple as we can. We could learn from those other countries. New Zealand is often considered a paragon of simplicity when it comes to its goods and services tax.

This is really complicated stuff with political pitfalls all around. You can easily see why the system has been like it is for so long and no one has wanted to touch it.

Q78 Douglas Chapman: Should there be more regular reviews? Should it be index-linked in some way? Is that possible?

Tom Clougherty: Yes. If we reformed and simplified the VAT system and we had a more internationally standard threshold, that clearly should be linked to inflation so businesses of a certain size stay out of the net in the long term rather than randomly being dragged into it.

Douglas Chapman: I told you VAT was exciting.

Chair: Thank you very much, Douglas. What we have learned today has been amazing. I want to thank our colleagues from the Work and Pensions Committee for coming along. It has highlighted just what an incredible web of complexity we have created in our benefits and tax systems.

The particular takeaways for me were the fact there is now an over 100% tax rate for people on high incomes with children and particularly the fact that you have to be making well over £200,000 a year before you are just paying a straightforward 45p tax rate, effectively. That is really what I learned this morning.

You are now our Office of Tax Simplification. The Government are progressing with abolishing it. Could I ask you to follow up with some homework? Regardless of how you answered my first question on the Office of Tax Simplification, could you write in with your views on its work and your solutions for the problems that have been so expertly highlighted by you today? Could you pick three changes you would like to see to the benefits and tax system to simplify the cliff edges we have learned about today? That is your homework.

I want to thank you all very much for your fascinating evidence and declare that this session is over. Thank you.