CHILD POVERTY ACTION GROUP – WRITTEN EVIDENCE (EUC0075)

The economics of Universal Credit

About CPAG and our sources of evidence

Child Poverty Action Group works on behalf of the more than one in four children in the UK growing up in poverty. It doesn't have to be like this. We work to understand what causes poverty, the impact it has on children's lives, and how it can be prevented and solved – for good.

We have particular expertise in the functioning of the social security system, through our welfare rights, training and policy work. We author and publish The Welfare Rights Handbook (the annual authoritative guide to social security in the UK), and provide specialist advice to frontline advisors through a telephone and email service.

CPAG's Early Warning System (EWS) collects case study evidence from advisors across the UK on the impacts of welfare reform and has collected thousands of cases to date. We have also carried out original research into the impact of universal credit, through quantitative analysis and interviews with claimants and stakeholders. In putting together this submission we have drawn on all these sources of information.

How well has universal credit met its original objectives?

1. There is no authoritative list of the aims of universal credit, but documents from early in the programme's design suggest that it was expected to (i) reduce poverty by increasing levels of support, (ii) prepare people for work through design features intended to mirror the world of work (e.g. monthly payment in arrears and intense conditionality requirements on people to be 'in work to find work') (iii) ensure it always pays to work more hours by applying a single taper, and (iv) simplify the benefits system by combining multiple benefits into a single system. The following discussion takes each of these in turn.

2. It has also been argued that universal credit will have the benefit of increasing benefit take-up, and it is clear from the design of universal credit that priority was also given in the design to other policy aims including: recovering government debt through deductions (data sharing on money owed to government has clearly been prioritised to facilitate this, while data sharing on people's work capability assessment outcomes and legacy benefit entitlements still requires manual checks), new conditionality for certain

groups (e.g. disabled people awaiting assessment, carers of children aged 3-4), and monthly responsiveness to earnings.

Poverty reduction

3. Child poverty has been rising since 2012 and is projected to increase further in the future, to alarming highs. From 2010/11 to 2017/18 (the last year of available data), the number of children in poverty after housing costs rose from 3.6m to 4.1m.[1] Estimates suggest that this number will reach 4.8m by 2023/24.[2] The number of children in poverty before housing costs has also risen from 1.9m to 2.4m.

4. The principal reason for rising poverty is heavy cuts made this decade to social security. These include cuts to universal credit, cuts to legacy benefits and cuts which apply to both social security systems e.g. the four-year benefit freeze, two child limit and benefit cap. The OBR estimates that £36bn has been cut from social security since 2010.[3]

5. These policies are all significant drivers of child poverty, and are also making poverty deeper for those already below the poverty line. The two-child limit will mean that an additional 300,000 children are in poverty by 2023/24 as well as pushing a million children deeper into poverty, while the benefit freeze means that 200,000 extra children will be in poverty in 2023/24. The benefit cap only has a small effect on the number of children in poverty as most of these children would be below the poverty line anyway. However, it does mean that by 2023/24 an estimated 400,000 children will be deeper in poverty. While not specific to universal credit, universal credit is still a vehicle for these cuts.

6. Universal credit was initially expected to reduce child poverty by 350,000[4] but this quickly changed as cuts were brought in, and in recent years the government has refused to update this figure. Now following cuts, on average more households will lose out than will gain from the introduction of universal credit, comparing their entitlement to universal credit and legacy benefits.[5] Estimates which still anticipate that universal credit will reduce poverty rely on take-up increasing, as applying for any support leads to receiving all the elements of universal credit a household is entitled (whereas in the legacy system, a household might claim tax credits but not housing benefit, for example). However, CPAG is concerned that at the same time many people could be put off claiming, or miss out on parts of their entitlement, due to

[1] Department for Work and Pensions, Households Below Average Income: 1994/95 – 2017/18
[2] L. Gardiner, *The Shifting Shape of Social Security*, 2019
[3] Authors' calculation from Office of Budget Responsibility, *Policy Measures Database*, Mar 2019
[4] Department for Work and Pensions, *Welfare Reform Bill Universal Credit – Equality Impact Assessment*, Mar 2011
[5] M. Brewer, R. Joyce, T. Waters, J. Woods, *Universal Credit and its impact on household incomes: the long at the short of it*, IFS Briefing Note 248, 2018

unnecessary complexities in the design of universal credit and difficulties using the online system.[6]

7. None of these estimates consider the amount of deductions that universal credit claimants are commonly subject to. In August 2019, seven per cent of overall universal credit entitlement was not paid to claimants because of deductions.[7]

Preparing people for the world of work

8. Universal credit was designed to 'mirror the world of work' to prepare people for the labour market, by providing a single monthly payment in arrears and intensifying conditionality. However a single monthly payment per household is not a true mirror of the world of many people in work. 72 per cent of new universal credit claimants (34 per cent of all jobs) in 2016/17 were paid non-monthly.[8] In addition, there are several million dual-worker households who receive two pay checks as well as income from other sources such as child benefit.

9. Monthly payment in arrears means that low income households have to wait 5 weeks for their first payment. The majority of households in poverty have no savings, pushing households into debt and the risk of falling deeper into poverty. The switch to a single monthly payment in arrears also disrupts careful budgeting systems which many low-income households have developed. It is notable than in the managed migration pilot claimants are being carefully supported to choose the timing of their universal credit application with this in mind, but for people needing to claim outside this small pilot, this is not an option.

10. It is also false to assume that people who are unemployed need to be 'prepared' for work. Most people receiving jobseeker's allowance are unemployed for a matter of months only, between jobs, thanks to insecurity in the labour market – not because of any lack of preparedness. Others face difficulty overcoming health barriers or finding childcare that fits with available jobs.

11. With very high employment rates, and most poverty now seen among working families, it is also questionable whether designing a benefit primarily around unemployed claimants was the right approach. This focus may have led to the benefit being poorly designed for working claimants (for example the rigid monthly assessment periods and complex rules for claiming back

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[6] See Points 18-20 for more detail
[7] https://www.theyworkforyou.com/wrans/?id=2020-01-31.10759.h&s=speaker%3A25306#g10759.q0
[8] D. Finch, *Time to make Universal Credit fit for purpose in 21st century Britain*, 2017

childcare costs). Furthermore many claimants are out of the labour market and not looking for work for reasons other than unemployment (e.g. carers, disabled people).

12. Universal credit also promised to get people into work by providing personalised employment support. This is a worthy goal, but CPAG research in Tower Hamlets found that employment support from Jobcentre Plus was too often of limited use, especially for parents who were already working but were asked to look for more hours.[9] Claimants largely felt that there was little or no connection between universal credit and finding better paid work or more hours.

Ensuring it always pays to work more

13. Universal credit has removed many of the inconsistencies in the legacy system's effective marginal tax rates, where working additional hours could mean anything from a 0% to 100% taper rate depending on individual circumstances. However, there is still a very high basic taper rate of 63%, and the effective marginal tax rate is even higher for people who work enough to reach the NICs or income tax threshold.

14. Also some cliff edges still remain in the system. This means that people who increase their earnings can in fact become worse off, if they cross the threshold for entitlement to certain forms of additional support, e.g. the cap on childcare costs, free school meals threshold and free prescriptions threshold. For instance if a lone parent with two children on universal credit working 17 hours a week at national minimum wage wanted to work more hours, their children would lose their free school meals entitlement, at a total cost of nearly £1,000 a year. The monthly cap on childcare support means it is not always worth parents working full time, especially in parts of the country with high childcare costs such as London.

15. Monthly means-testing also leads to an immediate 'poverty trap' which is apparent to claimants every month. In a month where a claimant earns more (e.g. by taking on extra hours) they will immediately see a reduction in their next universal credit payment. We have heard from claimants that this makes them feel that it is not worth working extra, particularly if they also have to cover childcare costs (of which only 85% are paid by universal credit) or transport costs to work. This is very different from the situation in tax credits, where payments would only change in response to a sustained increase in earnings (because assessment was annual and there were generous disregards for in year increases in earnings), so for the most part extra earnings within the year were kept in their entirety.

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[9] A. Woudhusyen, *WORSE OFF: The impact of universal credit on families in Tower Hamlets*, 2019

16. The minimum income floor and surplus earnings rules are also unnecessarily complicated, and penalise self-employed workers with lumpy income, and seasonal workers, compared with employees with a standard monthly wage. Yet many self-employed roles do not offer a regular monthly income, for example farming.

Simplifying the benefits system

17. It is our experience that while the system set out to be 'simple', for claimants the experience of claiming universal credit is often far from simple for a multitude of reasons.

18. There are inherent design flaws with universal credit that make it difficult to manage for some claimants. Fifteen per cent of all universal credit claimants do not have access to the internet at home, meaning they cannot claim or manage their account without going to a library, jobcentre, or other location – which could be some distance away, may not be open at convenient times or may be difficult for people with health conditions to get to. [10] In a study CPAG carried out in Tower Hamlets, we found that many claimants lacked the English language and digital skills required to make and manage their claims and some had to rely on their children or support workers for help.[11] Evidence from our early warning system also shows that people with certain illnesses or cognitive impairments may find the system difficult or impossible to use.

19. Strict monthly assessment periods combined with variable work hours - a feature of many jobs at the bottom of the labour market today - can mean that working claimants often do not know what their universal credit entitlement will be every month.[12] When these are combined with universal credit deductions, monthly thresholds for entitlement to passported benefits, complex rules for reclaiming childcare costs, and additional adjustments which may be made for the benefit cap, minimum income floor or surplus earnings rules, the system becomes fiendish indeed. Not only does this volatility make life very difficult for claimants, it also undermines the goal of having a simple relationship between hours worked and total income which can be easily understood by claimants, thus incentivising work.

20. The information that is currently provided to claimants about their universal credit payment calculation, and how to challenge a decision if

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[10] See https://www.gov.uk/government/publications/dwp-claimant-service-and-experience-survey-2017-to-2018
[11] See https://cpag.org.uk/sites/default/files/files/policypost/WORSE%20OFF%20report%20final_0.pdf page 4
[12] See https://cpag.org.uk/policy-and-campaigns/report/rough-justice-problems-monthly-assessment-pay-and-circumstances

they think a mistake has been made is inadequate and, in some instances, unlawful. The government's own survey of universal credit claimants found that nearly a quarter (23 per cent) felt that a decision about their universal credit claim had either not been explained at all, or had not been explained clearly. This situation is particularly worrying because of the high number of reported cases where universal credit payments have been incorrectly calculated. [13]

Were these objectives right and how should they change?

21. *Reducing poverty*. A key objective of any social security system, and universal credit should provide a minimum level of support which recipients can live on (*after* deductions). Currently too many universal credit recipients and their children live in poverty.

22. *Preparing people for work*. In today's world, with high employment but high in-work poverty, it would be better for universal credit to be refocused around supporting claimants who are working or unable to work due to ill health or caring responsibilities. Of course it should also support claimants to achieve their career goals and to overcome barriers to work where these exist. This is best done through supportive coaching, effective help with childcare costs and support for people with health needs and caring roles, rather than through intense conditionality (which tends to drive compliance with the rules rather than genuine career development, and which can be detrimental to claimants' mental health).

23. *Ensuring it always pays to work more*. It is right that a social security system allows people to benefit from working and does not create perverse incentives. However, today's very high taper rate and the shortfall in childcare cost provision (only 85% of costs, up to a cap), means that it does not currently pay a great deal to work more hours. More generous disregards, a lower taper rate and full payment of childcare costs would assist with this. There is also currently limited incentive for second earners in a household to start work, as they have no work allowance and all earnings are subject to the taper. A second work allowance could greatly improve this.

24. *Simplifying the benefit system*. This is a desirable objective, if by this we mean making the system simple for claimants to use and understand. However in our view it is a mistake to think that merging six benefits into one is necessarily making the system simpler. Each legacy benefit had its own set of rules, for good reason - recognising the variation in claimants' circumstances and the particular purpose of each benefit. Merging these into one system has resulted in increased complexity because there is still a need

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[13] See https://cpag.org.uk/sites/default/files/files/policypost/Computer%20says%20%27no%21%27%20Stage%20one%20-%20information%20provision.pdf page 4

to cater to people in a very wide range of situations (often through add-ons and workarounds added to a system which was designed in too much of a 'one-size fits all' fashion), and a huge burden on the staff running universal credit in terms of the volume of law and guidance which they have to master and apply.

What have been the positive and negative economic effects of universal credit?

25. It is very difficult to measure the economic effects of universal credit, especially as the partial roll-out means that currently only claimants who have naturally migrated (through a new claim rather than through managed migration) are on universal credit. This is a selective group of people and as such it is hard to isolate the effect of universal credit from other factors.

26. DWP estimated that Universal Credit would have benefits of £8bn a year from 2024-25 onwards (after full roll-out), of which over £5bn comes from increased employment.[14] However, as DWP themselves admit, it is impossible to isolate the effect of Universal Credit from other economic factors in increasing employment. The National Audit Office believes that the DWP have vastly overestimated the amount that will be saved through reduced fraud and error.[15]

27. Local authorities are spending a lot of time and money supporting people on universal credit. Feedback from workshops we have attended with many local authorities, and our research in Tower Hamlets, indicates that they have more casework than ever despite having fewer staff due to large cuts to local government funding and that universal credit is creating some particular difficulties. It thus appears that there has been significant cost shifting on to local government and it is not clear whether this is being assessed.

Which claimants have benefited from the universal credit reforms and which have lost out?

28. The biggest losers from universal credit, in terms of financial losses, are parents aged under-25 (who receive a lower rate than in legacy benefits), those with financial assets (some who would have qualified for tax credits, will not qualify for universal credit), the low-earning self-employed (who are penalised by the minimum income floor), couples where one member is above the state pension age and the other below (who must now apply for universal credit not pension credit, which is often worth much less), and some claimants of disability benefits.[16] The biggest winners are in-work

[14] National Audit Office, *Rolling out Universal Credit*, 2018
[15] Ibid
[16] M. Brewer, R. Joyce, T. Waters, J. Woods, *Universal Credit and its impact on household incomes: the long and the short of it*, IFS Briefing Note 248, 2018

renting households. On average however, on an entitlement basis (ignoring effects on take-up, which in our view could go in either direction), people will get worse off.

29. There are also some groups who will lose out not because of the level of entitlement but because of the design of the system. As discussed above, people who are paid non-monthly or work variable hours may find the system difficult to use, as will people with limited digital skills/literacy/internet access.

How has the world of work changed since the introduction of universal credit? Does universal credit's design adequately reflect the reality of low-paid work?

30. The world of work has not changed dramatically since the introduction of universal credit, although there have been some notable trends over the past decade. The most striking feature of the labour market over the past decade is the lack of growth in real wages. The real median wage is below its 2010 value, and even post-recession the growth in real wages has been far below the historical trend.[17] The employment rate has risen slightly from 73% in the 2000s to 76% in 2019,[18] while the percentages of people saying that they would like more hours, and of part-time workers who are involuntarily part-time, have both risen.[19]

31. Universal credit does not adequately reflect the reality of low-paid work today. The slow growth in wages combined with the very high effective marginal tax rate means that just seeking to move people into work is not an adequate strategy for reducing poverty – 70 per cent of children in poverty today live in a working family. And for those in work, the strict system of monthly assessment in universal credit deals poorly with earnings volatility due to flexible work hours and non-monthly payment schedules, which are key issues in today's labour market. Rather than giving people in insecure work a stable floor of income which they can rely on, universal credit is often unpredictable (including whether people will receive any help with childcare costs in a given month) and is immediately reduced by any increase in earnings.

Recommendations

32. Universal credit needs to be reformed both in terms of the level of entitlement and the way it is delivered. To put the brakes on rising child poverty, CPAG recommends an immediate package of reinvestment:

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[17] R. Costa, S. Machin, The Labour Market CEP Election Analysis, 2019
[18] Ibid
[19] Ibid

scrapping the two-child limit and benefit cap, and restoring the value of the child element and increasing child benefit by £5 per child. This would mean 700,000 fewer children in poverty in 2023/24.

33. We also recommend a range of design changes, including shorter assessment periods, permitting averaging of wages, upfront payment of childcare costs and the abolition of complex rules like the minimum income floor and surplus earnings rules. For more discussion of our recommendations for both reinvestment and design changes to universal credit, please see our report 'Universal credit: what needs to change to reduce child poverty and make it fit for families'.[20]

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[20] See https://cpag.org.uk/policy-and-campaigns/report/universal-credit-what-needs-change