

To: 1. Secretary of State
2. Minister for Welfare Delivery



Department
for Work &
Pensions

NR
NR Finance: NR UC Policy
NR UC Policy
Date: XX July 2020

Universal Credit Budget Options

Summary

-
1. Following advice that you have received on DWP strategic budget priorities from Strategic Finance (PFER) this submission provides further detail on options specific to Universal Credit.

Timing

-
2. Routine
-

Recommendation

-
- That you consider the following UC budget advice in conjunction with your broader strategic thinking for budget;
 - That you consider our advice for potentially scoping a review of the benefit cap levels and provide a steer (Paragraph 26).
-

Key Information

-
3. The upcoming Budget provides an opportunity to bid for one or more measures to support the strategic objectives set out by Finance colleagues in the submission of 16 July. The Objectives set out were as follows:
 - *Incentivising work and supporting labour market recovery;*
 - *Addressing poverty and overall benefit sufficiency;*
 - *Improving financial resilience; and*
 - *Boosting consumption and providing economic stimulus.*
 4. This submission sets out in more detail some of the potential measures (with detail of the costs set out in the table in Annex A). A high level steer on your preferences would allow us to focus our work on your preferred options. We will

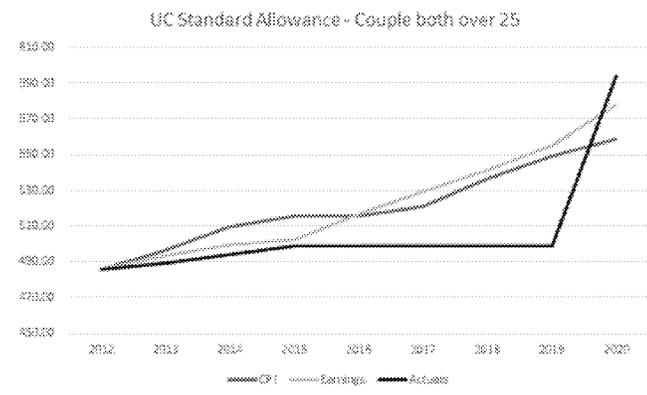
also need to make sure that we consider any increase in rates of UC in the wider context of uprating other benefits.

MAIN OPTIONS:

Maintaining the £20 increase in the UC Standard Allowance

5. The SA increase comes to an end in April 2021 and we can expect significant external pressure to maintain the increase. There is an obvious and very significant downside – the costs are significant at £5.2bn by 2024/25. Of course the costs could be lowered if the increase was only partially reversed, however, even then it is likely that Treasury would need some persuading.
6. The strongest argument for maintaining it is that the Standard Allowance is that it is one of, if not the Government’s most direct and effective fiscal stimulus. It has a very strong multiplier effect as for every £ spent, lower income recipients are more likely to themselves spend a significant proportion – or likely all of it on goods and services leading to job creation. Of course the flipside of this means that reversing it would mean taking demand out of the economy and leading to fewer jobs being available. Such a counter cyclical move is likely to be strongly criticised not only by charities and those supporting the interests of low income groups, but also by economic commentators.
7. We have also seen that the increase has significantly eased the number of people living in severe poverty. Maintaining the £20pw increase would lead to 200,000 fewer children in absolute poverty, after housing costs, compared to reverting to previous benefit levels. If the increase was reversed there would be a high negative reputational impact for DWP which could reverse the gains made by DWP and UC in the handling of the Covid-19 outbreak.
8. There might be a concern that a higher out of work benefit rate may reduce the incentive to enter work. However, even with the increase, benefit rates remain low in comparison to earnings in historical terms. As Chart 1 shows earnings have grown much faster than benefit rates since 2012. Maintaining the £20pw increase would seem them return to an earnings ratio seen around the turn of the century, when unemployment was around 5-6%.

Chart 1: Benefit rates since 2012 under different uprating assumptions



9. If you were minded to bid for maintaining the increase in the Standard Allowance, then the question arises whether to apply this in UC only, or in UC and legacy benefits. Applying the changes in UC only could have significant advantages in encouraging claimants to move onto UC from legacy benefits. UC is designed to create stronger work incentives and keep claimants closer to the labour market than the legacy system. Encouraging claimants onto UC therefore, could help move more people towards work as the economy recovers and economic demand increases.
10. The uplift to UC rates has meant that there are many more “winners” on UC now compared to legacy benefits than before. Pre COVID nearly half of benefit units had a higher entitlement on UC than they would have had on legacy. However, the post COVID policy changes have resulted in around 70% having a higher entitlement on UC than they would have had on legacy: primarily because the £20pw increase was not replicated in JSA, IS or ESA.
11. If the proposed measures were applied in UC only, this would increase the number with a higher entitlement. If more claimants chose to move over to UC voluntarily, this could reduce the numbers that would need to be migrated as part of Move to UC.
12. If the numbers in Move to UC were substantially reduced, this might enable us to revisit some of the policy around transitional protection in due course. This would also mitigate against some of the legal risks associated with Move to UC (which is relatively novel in social security law – there are likely to be legal challenges on the way in which we operate the system and calculate transitional protection). You will receive further advice from UC policy on managed migration and transitional protection in due course.

Increasing the child element

13. An increase in the Child Element in UC would obviously also reduce child poverty and would stimulate the economy – although the stimulant effect would be less than the SA increase if the overall expenditure was lower. For example, an increase in the Child Element of £10 achieve an estimated reduction in absolute child poverty of 200,000 in 2021/22 (400,000 if replicated in Tax Credits), but would cost £2bn by 2024/25 and therefore have a much lower stimulating effect than the SA increase.
14. It would also have a less significant impact in reducing severe low income as claimants in this category are less likely to have children. It is also not well targeted at the new UC claimant intake, who are more likely to be young or male and less likely to be a lone parent compared to the pre-Covid-19 caseload.
15. An increase in the Child Element in UC has the same potential to attract claimants on legacy benefits to UC – although of course it would only apply to households with children and the detail would depend on the generosity of the increase (for example a £10 increase in the child element only provides half the fiscal incentive that a £20 increase in the Standard Allowance provides).

16. One option could be to maintain the SA increase in UC only (or only reverse it partly) and combine this with an increase in the Child Element.

Measures to improve work incentives

17. The two main ways of improving work incentives in UC are to increase work allowances or reduce the taper. Although there is no specific evaluation evidence from UC, academic evidence would suggest there may be a modest positive impact on labour supply, with lone parents likely to be most responsive. Within this an increase in work allowances would be more likely to incentivise participation in the labour market and a change in the taper rate would be more likely to support progression.
18. However, work incentives are only effective if there are actually jobs available. There has been a significant rise in those out of work and claiming Universal Credit and there is the potential for further rises with the withdrawal of the furlough scheme. Vacancies dropped by 58.1% in the 3 months to June, compared to the 3 months to March, and are the lowest on record since ONS data began in 2001.
19. Scenario modelling suggests that economic recovery and employment demand may well pick up from next year so measures to incentivise work may become more attractive after that. You may wish to consider this as your Budget bid develops and we gain a greater understanding of the likely path of economic recovery.
20. Even in the absence of financial incentives driving behavioural change, taper and work allowance changes will reduce in-work poverty and boost incomes. Reducing the taper to 55% would equal a reduction in absolute child poverty 2021/22 of 200,000, a 50% taper would increase that to 300,000. We would expect similar poverty impacts for a change to work allowance.
21. Work allowance increases would provide more support to claimants at the lower end of the income distribution compared to the taper rate and can also target families with children. A taper change would be better targeted at younger claimants who have been significantly impacted by the economic and labour market conditions. Neither work allowance or taper changes would help the poorest claimants, the vast majority of which are not in work. **Annex B** sets out a comparison on the effect on incomes.

Increasing the lower rate of the Disabled Child Addition (DCA) in line with legacy benefits

1. UC has two Disabled Child Additions – a lower rate addition and a higher rate. Originally the lower rate was set at the same level as the lower Limited Capability for Work rate (LCW) rate for adults. The rationale being to smooth the transition

from childhood to adulthood. In 2015 the lower rate DCA was frozen but the legacy equivalents were not. The lower rate addition in UC for adults was also removed for new claims from 2017. This has created a large disparity between the UC lower DCA and its legacy equivalent and reduced the link with the adult rate and transitions.

22. As with the SA and the Child Element, this measure would boost demand, and while still expensive at £400m per year by the end of the forecast period it is significantly less expensive than some of the measures above.
23. The measure would also significantly help with some of the issues we will encounter with Move to UC. We need to conduct further analysis to quantify but we would expect claimants receiving this rate in legacy are likely to represent a significant portion of the claimants who would be worse off in UC. There is a legal challenge now in this area, and the measure would mitigate the risks. One possible outcome from the case could be the requirement to increase the rate retrospectively, whereas changing the policy now may limit the increase to prospective cases only, reducing the cost and administrative complexity.

“Technical” options

24. At each fiscal event there are a number of UC measures that are of a more “technical” nature – i.e. that we need to make in order to keep the system running or in order to comply with legal judgments. We will provide separate advice on these.

OTHER CONSIDERATIONS

Benefit Cap

25. The Benefit Cap is applied to both UC and legacy benefits - the latter by way of reducing Housing Benefit (HB) awards. Following the UC (and HB) uplifts more people have been brought into scope of the Cap and those already in scope have not benefited from those increases. Maintaining the current benefit cap levels brings legal risks and making the Standard Allowance increase permanent and/or increasing other rates (especially the Child element) without reviewing the levels of the benefit cap would exacerbate the risks.
26. The risks of not undertaking a review relatively soon, i.e. this year, could be mitigated with an announcement of when a review might take place. **If you were minded to consider any of the options that increase UC rates set out above we would recommend that we commence scoping work to identify parameters and a process for a review of the benefit cap levels. Do you agree?**

Financial Implications

27. This submission provides Ministers with contextual advice that they will need to consider alongside the notes.

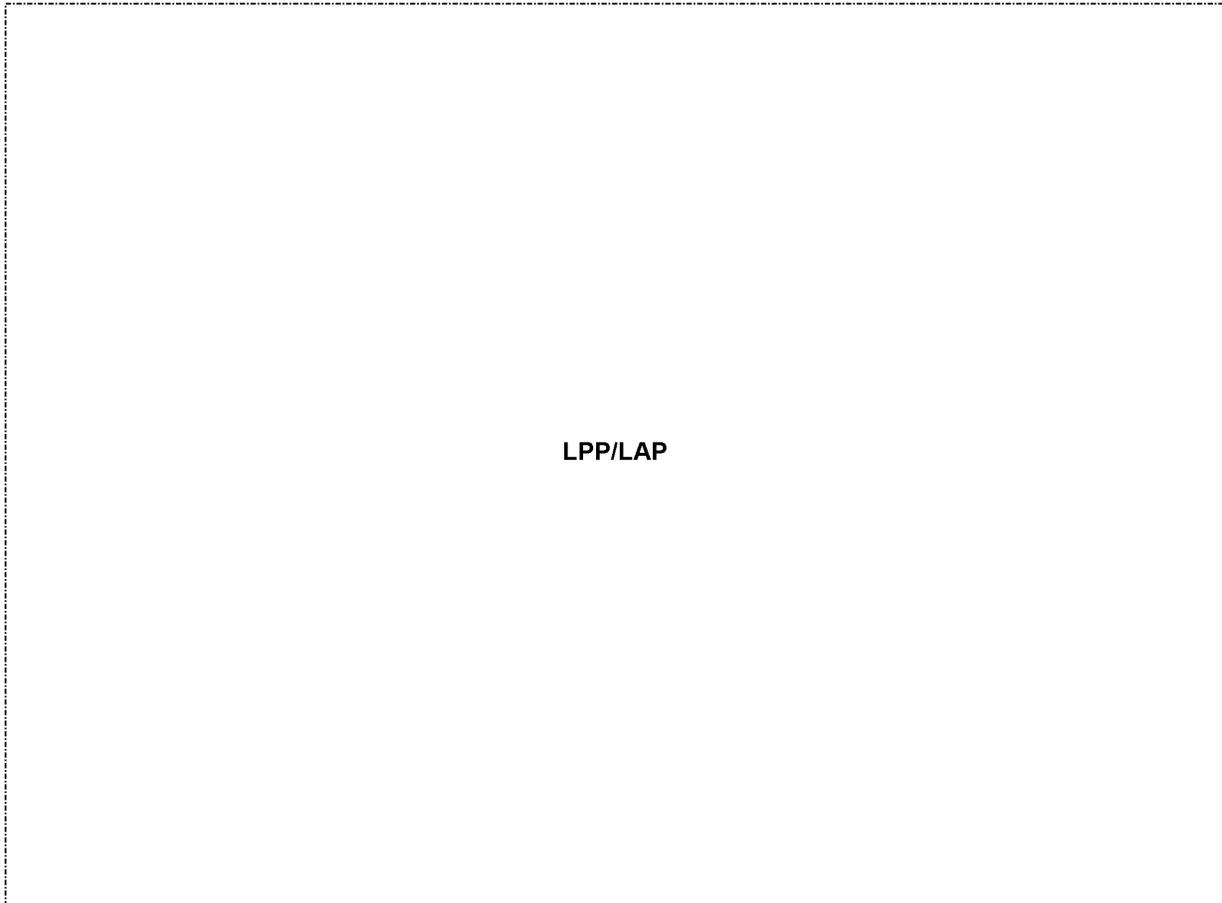
Handing Considerations

28. There are no handling considerations at this time.

Service Delivery Implications

29. The service delivery implications are covered in earlier sections of this submission.

Legal Considerations



Public Sector Equality Duty

33. At this stage PSED is not engaged. As we narrow down options a full Equality Analysis will be completed for each option.

Devolution Implications

34. As these matters are reserved we would inform the Scottish and Welsh Governments of any proposed changes at the appropriate time. It should be noted that from the beginning of next year both UC and legacy benefits will be topped up by Scottish Government's new Scottish Child Payment for families with children under 6 (this will be rolled out to older children in due course). The net poverty and work incentive effects may therefore be different in Scotland.
35. Although social security is a transferred matter in Northern Ireland, we have a statutory duty under the Northern Ireland Act 1998 to consult with them on any proposed changes to the social security system in the rest of the UK. Therefore, we will need to discuss any changes with the Department for Communities in order for them to consider replicating our changes to maintain parity.
36. We have started the process to hand back the temporary powers DWP hold to amend certain social security legislation on behalf of the NI Assembly. Should any proposed changes result in legislation before this is completed, DWP will need to take this forward in Westminster.

37. **Annex A - to complete** The Department is in the process of producing medium term volume forecast to reflect the Covid scenarios, indicative costs have been provided for the standard allowance costs but poverty numbers are subject to revision and will be adjusted to take account of changes to the poverty measures

<u>Pre- COVID volumes</u>	Costs (rounded to nearest £0.1bn)				
<u>Current projections based on additional volumes caused by COVID</u>					
Measure	20/21	21/22	22/23	23/24	24/25
£20pw standard allowance in Universal Credit	£3.0bn (£4.9bn)	£3.6bn (£5.6bn)	£4.1bn (£5.2bn)	£4.6bn (£5.0bn)	£5.2bn
<i>Additional cost if replicated in WTC</i>	£1.8bn	£1.6bn	£1.3bn	£1bn	£0.7bn
Total	£4.8bn (£6.7bn)	£5.2bn (£7.2bn)	£5.4bn (£6.5bn)	£5.6bn (£6.0bn)	£5.9bn
Increase child element £10pw (UC)	n/a	£1.4bn	£1.7bn	£1.9bn	£2.2bn
Increase child element £10pw (UC, CTC and HB)	n/a	£3.3bn	£3.2bn	£3.1bn	£3.0bn
UC taper rate to 55%	n/a	£1.6bn	£1.9bn	£2.1bn	£2.4bn
UC taper rate to 50%	n/a	£3.0bn	£3.4bn	£3.8bn	£4.3bn

[INSERT SECURITY CLASSIFICATION]

[INSERT SECURITY CLASSIFICATION]

Annex B – comparison of a change in net incomes between taper rate and work allowance

Impact for a single earner renting household with children

Gross Annual Earnings	£10,000			£20,000		
Taper rate	Change in net income	Participation Tax Rate	Effective Marginal Tax Rate	Change in net income	Participation Tax Rate	Effective Marginal Tax Rate
Current (63%)	-	41%	67%	-	57%	75%
55%	£515	36%	60%	£1,099	52%	69%
50%	£837	33%	56%	£1,786	48%	66%
63% + increase work allowance by £150pm	£1,134	30%	67%	£1,134	51%	75%

Participation tax rate – proportion of total earnings deducted through tax, NI benefit withdrawal

Marginal tax rate – proportion of an additional hour's earnings deducted through tax, NI and benefit withdrawal

- As shown above, a taper rate change will improve the incentive to progress (marginal tax rate) whereas an increase in the work allowance may not do this.
- The work allowance provides a greater incentive to enter work as all eligible families (earning above the work allowance) benefit by the same cash amount whilst those with greater earnings benefit more from a taper rate reduction
- Households without children or a disabled adult would only benefit from the taper change