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Social Market Foundation

SINK OR SWIM?

The impact of the Universal Credit

Nigel Keohane and Ryan Shorthouse

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EXECUTIVE SUMMARY

The Government's Universal Credit reforms will be the most significant changes to the benefits system in a generation. The main aims of the reforms are to boost the personal responsibility of claimants, smooth the passage to work and prepare out-of-work claimants for their next job. The changes will affect around eight million households, many of them very vulnerable members of society. This report will assess the impact of the Universal Credit reforms on how low income households budget and sustain their financial resilience. The research finds that major changes are required if the system is to support rather than frustrate the stated aims of Government policy.

The challenge of financial resilience

The new Universal Credit system will go live from autumn 2013 following five years of economic stagnation and in the midst of the Government's fiscal consolidation drive.

The context into which Universal Credit is set to be launched could hardly be more sensitive. When the financial crisis and recession hit many households had insufficient savings set aside and were highly indebted. Low income households in particular were poorly placed to cope with the economic challenges.

- 10 million of those in low income households are in unsecured debt.[1]
- Three quarters of those in the lowest income quintile have no cash savings.[2]

1 Anna Ellison, Rob Forster, Paul Jones and Claire Whyley, *Briefing note on the potential impact of prices caps on low income credit users* (London: Policis, 2011); Department of Business, Innovation and Skills, *Over-indebtedness in Britain:* second follow-up report (London: HMSO, 2010), 14.

2 Anna Ellison, Claire Whyley, Rob Forster and Paul Jones, *Credit and low income consumers: a demand-side perspective on the issues for consumer protection* (Dorking: Friends Provident Foundation, 2011), 18.

In short, the resilience of low income households was low going into the economic crisis, and their vulnerability has only increased since then.

Universal Credit reforms and the policy challenge

Helping households – especially those on low incomes – to budget, and build and sustain their financial resilience is a prime motivation for the Universal Credit.

This research assesses six key aspects of the Universal Credit reforms, all of which have the potential to have a significant impact on the ability of households to manage their money effectively:

1. Integration of six core benefits and tax credits into a **single payment**. The claims processes for different benefits will be integrated and households will receive just one payment.
2. A shift away from a mix of weekly, fortnightly, four-weekly and monthly payments to a standard **monthly payment**.
3. A new **'fixed' monthly assessment** system that will replace the annual 'flexible' assessment period for tax credits, with payment monthly in arrears.
4. Payment of **Housing Benefit** to social tenants rather than direct to the social landlord.
5. Introduction of a **single recipient** model where the award is paid into one bank account.
6. Extension of the **capital allowance rule**, which currently applies to those on out-of-work benefits, to all Universal Credit recipients.

The focus of the research and the methodology

In assessing the impact of these reforms, this research seeks to answer three fundamental questions:

1. How are low income families coping with the current financial squeeze and managing their finances?
2. What are the likely implications of the Universal Credit payment reforms on household budgeting and financial resilience?
3. How can we design Universal Credit to promote personal responsibility and help low income households build their financial resilience?

To answer these questions, this research draws on 30 original in-depth interviews and three focus groups with low income families. These were designed to understand how households currently budget, their financial position and the implications of the Universal Credit reforms. The project also analysed lessons from secondary evidence to put the qualitative research into a wider context. In defining a low income household, the primary research uses the Department for Work and Pensions's standard definition, namely those households whose net income is below 60% of equivalised median household income.

RESEARCH FINDINGS

Financial circumstances of the thirty households

Unsurprisingly, our interviewees highlighted the fact that the downturn is having a real impact on their living standards. Our research sought to look at just how challenging the situation is for families on low incomes.

Chapter 3 shows that the financial situation of our thirty households varied, but many households were very vulnerable. Most of our households had seen their financial circumstances

deteriorate over the last five years. The most frequent cause of this decline stemmed from loss of employment by one or more members of the household. However, other factors included the impact of inflation and the costs of raising young children, and working fewer hours or facing lower wages. Most said that their finances were a source of worry, although the level of anxiety varied.

Most households struggled to balance their income and expenditure. To manage, many households had developed sophisticated budgeting methods. Households were relying on a range of sources of borrowing to see them through and the majority owed money either to formal or informal creditors. In particular, households were commonly drawing on financial support from their parents and other family members. However, this was not an opportunity available to all. Even for those that could get this support, many were also significantly indebted either to formal lenders such as banks, alternative credit providers, or to utility companies and landlords.

Many participants expressed strong aspiration to improve their circumstances. But the outlook for many was bleak in the short-term. Reasons cited included the lack of appropriate jobs, inflation, a reduction in working hours, the need to re-skill, the perception that they would be worse off in work, barriers in the benefit system and lack of affordable childcare options.

The impact of Universal Credit

In this challenging context, designing the Universal Credit to help rather than hinder low income households as they manage their tight finances will be fundamentally important.

Our findings – set out in Chapters 4 and 5 – indicate that some aspects of the Universal Credit are likely to prove unhelpful for a significant number of claimants. In particular the monthly payment

and the payment of Housing Benefit to social tenants will require behavioural change if the new system is not to cause serious problems for many.

The impact of each reform

Participants were predominantly in favour of a **single payment**, believing that this would make the process of claiming benefits simpler, and make it easier to understand how much income they would receive. In a minority of cases, interviewees registered concern that they currently hypothecated specific benefit payments to particular outgoings and that they would lose these reference points, making budgeting harder.

Most households in our sample opposed the idea of a **monthly payment**. This was the case for the majority of households, who tended to budget on a daily, weekly or fortnightly cycle. While many viewed it as a challenge that they could overcome, a significant minority were concerned that it would make their budgeting much more difficult and questioned their ability to cope.

Opposition to a monthly payment centred on:

- Concern about running out of money before the end of the month.
- Frequent payments under the existing benefits system acting as a psychological boost.
- More frequent benefit payments serving as a method to help households ration their income and restrain their spending.
- A large lump sum that participants feared they might spend too quickly given the competing demands on their low incomes.

Polling of benefit and tax credit claimants by the DWP suggests that the numbers of claimants adversely affected by the monthly payment could be large:

- Four in ten respondents said it would be harder to budget on a monthly payment.
- Of those who said it would be harder, eight in ten cited the fact that they might run out of money before the end of the month.

Analysis in this report also shows that households will not necessarily be better prepared for work by having a monthly payment – only half of all employees earning under £10,000 per year are paid monthly; four in ten of those in the lowest two income quintiles are paid weekly. These figures should be seen in the context of the comparatively low earnings that many receive on re-entering work.

There was general support for the shift to a **fixed monthly assessment** as a potential solution to the problems of tax credit overpayments and underpayments (the former having caused significant hardship for some families in the past). However, our research indicates that the policy could have some unintended consequences. For instance, under a fixed monthly payment made in arrears, individuals who leave work may have to wait a month before they receive their updated Universal Credit payment, leaving them financially exposed when facing a sudden drop in income. This risks exacerbating debt problems for those affected.

There was widespread opposition among our households to the planned changes to **Housing Benefit**, under which they would receive money in respect of their housing costs and be expected to manage payment to their landlords. Many expressed the fear that households would be unable to manage their finances effectively

and would overspend, leading to rental arrears, possible eviction and further indebtedness. The majority of this concern was raised by our interviewees on behalf of the wider claimant population but some also had reservations about their own ability to cope.

These findings should be seen in the context of a survey that found that 93% of social tenants would prefer their rental payment made direct to the landlord. Evidence from the Local Housing Allowance policy, through which tenants in the private-rented sector have received their housing benefit payment, also suggests that a significant minority are likely to struggle to manage their rental payments.

For most of our households, having a **single recipient** for Universal Credit, with all the cash going to one person in the household, was viewed with indifference. This was explained by close collaboration over finances in most households, and the fact that women participants generally elected themselves as the potential claimant under Universal Credit. However, in a small number of cases, considerable concern was registered. In these cases, participants referred to power imbalances within the household and the potential for the reform to lead to tension and to one partner struggling to get sufficient resources.

Views among our households were mixed on whether a **savings threshold** was fair in principle, but it appeared that the rule would be unlikely to affect the savings activities of very low income households, since savings levels were low or non-existent. However, SMF analysis of the Wealth and Assets Survey suggests that as many as 600,000 families currently receiving tax credits could lose all or part of their payment under the Universal Credit.

NEW 'NUDGE' PROPOSALS: A 'BUDGETING PORTAL'

The Government's aims of bolstering personal responsibility and financial capability are the right ones.

There is a danger, however, that without the requisite support or alternative provision many households will struggle to adapt to the payment structure planned in the reforms. These costs will fall not only on families themselves but also much more widely – for instance, on housing associations.

The Government is currently planning to help people who may struggle through an exceptions policy (a centralised system for identifying vulnerable individuals and putting them onto an alternative payment schedule), new financial products and through budgeting support. However, the significant number potentially affected and the difficulty in identifying struggling households suggests that this may be a socially and economically inefficient way of helping households. Some vulnerable people could be missed.

The reforms can be made to work with the grain of wider Government objectives, rather than against them, by drawing on behavioural insights. A single uniform monthly payment seeks to boost personal responsibility by forcing households to manage without the markers and aids that the current benefit system provides them with. Yet, past experience suggests that many, despite their best intentions, will struggle to budget effectively. By assisting families to manage their money, through the way that Universal Credit is paid, the new scheme can make household budgeting part of the solution.

There is a strong case for deploying a behavioural 'nudge' to help recipients budget and boost their financial resilience. This would

allow claimants to make the most of the budgeting mechanisms they have developed in the past and to trigger those who are less financially engaged to budget more effectively.

This report proposes a 'Budgeting Portal' that would sit alongside the normal claims process for Universal Credit. Claimants would by default receive their money monthly in a lump sum payment, but they would be able to opt into the Portal. Once individuals had made the active decision to opt in, the portal would allow them to make changes to the way their benefit money was transferred *before* it hit their bank account. The portal would not hold money, but individuals could make a series of structured decisions on how they receive their Universal Credit payment to help them budget and plan effectively, including:

- Identifying the different components of the payment, for example childcare;
- determining the frequency of the payment;
- directing payments such as housing rent or childcare fees to third parties;
- dividing up the payment between household members at source; and
- diverting cash into savings to prepare for lumpy expenditure.

While the Portal would be voluntary for most claimants, use of it could be required of families struggling with rent arrears, for example. Such a scheme would ensure that households engage with their finances and take active decisions on how they manage their money. It would also help them build the resilience to cope during the current economic downturn and financial shocks in the future.

The Government has articulated a number of laudable policy aims, including encouraging personal responsibility, boosting households' financial resilience, and simplifying the benefits and tax credits system. The introduction of the Universal Credit has the

potential to advance each of these goals, but on current plans it looks set to have a damaging effect in each area. The costs of that damage will fall not only on families themselves but on other service providers and wider society. Compared to these costs, the introduction of a Budgeting Portal would represent a wise investment.

It remains possible to develop the Universal Credit to assist with these aims by offering families on low incomes assistance with budgeting and planning. Behavioural insights and systems can help in this regard. But without them the new system risks harming rather than helping progress to some important goals of social policy.

CHAPTER 1: WHY THE RESEARCH?

CONVERGING PRESSURES ON LOW INCOME HOUSEHOLDS

> *The financial crisis is often talked about in abstract terms dealing with high finance, but when the financial crisis hits a family it has the real potential to jeopardise people's livelihoods and the freedom for them and their children to fulfil their potential.*[3]
>
> Mark Hoban MP, former Financial Secretary to the Treasury

Low income families have faced a series of converging pressures in recent years:

- Since the onset of recession in 2008, earnings growth has been stagnant, job insecurity high and unemployment has risen.[4]
- Those in receipt of in-work and out-of-work benefits and tax credits have been seeing their transfers reduced as part of the Government's fiscal consolidation. Families with children – and especially those on low incomes – are feeling the brunt of these reductions.[5] Measures include freezing Working Tax Credit and Child Benefit, and the uprating of benefits by the Consumer Prices Index (CPI) rather than the more generous Retail Prices Index (RPI).
- Many households have struggled with inflation, in part driven by an increase in VAT in January 2011. This has affected lower income households most severely: between 2008 and 2010, inflation for the poorest fifth of UK households averaged 4.3% against 2.7% for the richest fifth.[6]

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3 Mark Hoban, Speech to the Financial Education Body Conference, Cambridge, July 14, 2010, http://www.hm-treasury.gov.uk/press_26_10.htm.

4 Robert Joyce, *Household Incomes during the recession and austerity* (London: Institute for Fiscal Studies, 2012), http://www.ifs.org.uk/conferences/ids_incomes.pdf.

5 Fawcett Society and Institute for Fiscal Studies, *Single mothers: singled out – Summary: the impact of 2010-15 tax and benefit changes on women and men* (London: Fawcett Society, 2011), 5.

6 Peter Levelln and Zoe Oldfield, *The spending patterns and inflation experience of low income households over the past decade* (London: IFS, 2011).

Together these pressures are having a negative impact on children and their susceptibility to poverty. Research from the Institute for Fiscal Studies (IFS) shows that, although welfare reforms are expected to reduce relative poverty among children by approximately 300,000, this will be more than offset by the 'poverty-increasing impact of the government's other changes to personal taxes and state benefits.'[7]

The fiscal and macro-economic context means that few of these burdens are likely to ease quickly, if at all.[8] And, the introduction of many of these tax and benefits changes has been staggered over the course of the parliament. The only positive prospect is an apparent reduction in inflationary pressures over time.[9]

Many households are not well prepared to manage these difficult economic circumstances, as will be illustrated below.

FINANCIAL RESILIENCE

A household's financial resilience is its capacity to absorb shocks to its income. The consequences of fluctuating incomes or expenditure are much more severe when a household has no financial cushion to fall back on. Financial resilience can be characterised by low levels of debt and high levels of savings, alongside the capability to sustain this position, the latter which may include skills as well as wider resources (such as support from family and ability to access credit).

7 Mike Brewer, James Browne and Robert Joyce, *Child and working-wage poverty from 2010 to 2020: IFS commentary* C121 (London: IFS, 2011), 3.

8 Office for Budget Responsibility, *Fiscal sustainability report* (London: HMSO, 2011).

9 BBC News, "UK inflation rate falls to 2.4% in June", BBC News, 17 July, 2012, http://www.bbc.co.uk/news/business-18867248.

Poorer households are especially vulnerable to fluctuations in income and expenditure due to their lower levels of income. The sudden need to replace a white good or an accumulated bank charge can derail household budgeting, because the costs are high relative to household income. More significant trigger events such as redundancy, pregnancy, health problems or relationship break-downs can also lead to significant material disadvantage.[10]

For such reasons, reliance on borrowing is commonplace among low income households. Individuals tend to borrow for two core purposes: first, as a money-management tool to control their budget cycles in the short term; second, to smooth out lumpiness in income or expenditure on a longer-term basis.

However, debts can have serious negative implications for low income households. First, borrowing can often be expensive for low income households. Households may be excluded from mainstream credit and therefore have to rely on the alternative credit market. Such borrowing – including pay-day lending, pawnbrokers, home credit and retail credit – is characterised by high APRs.[11] Meanwhile, 'behaviour-related factors' – such as penalty fees for missed payments, failed direct debits or going over the limit on the overdraft – can significantly increase the initial APR costs of borrowing from mainstream providers.[12]

Second, research for the Financial Inclusion Taskforce has identified a 'high risk of being drawn into on-going cycles of borrowing from which people struggle to escape'.[13] In such circumstances, the consequences of debt can be severe, with

10 Barnardos, Below the breadline: a year in the life of families in poverty (London: Barnardos, 2009); Dalia Ben-Galim and Tess Lanning, Strength against shocks: low income families and debt (London: IPPR, 2010).

11 Financial Inclusion Taskforce, *Mainstreaming financial inclusion: planning for the future and coping with financial pressure – access to affordable credit* (London: HMSO, 2010), 7.

12 Ellison, Whyley, Forster and Jones, *Credit and low income consumers*), 8.

13 Claire Whyley, *HMT financial inclusion evidence review: the costs of credit exclusion and the benefits of access to affordable credit* (London: HMSO, 2010), 8.

households struggling further to make ends meet and having to forego essentials in order to service debt. Worst of all, households unable to access sub-prime credit may approach unlicensed lenders.

Third, over-indebtedness can cause depression and health problems. In certain instances, this can become a self-reinforcing factor.[14]

Conversely, the function of precautionary savings can be fundamentally important in helping households to cope with variations in income and expenditure without recourse to borrowing. Savings can be seen as particularly significant for those on lower incomes to help them to meet the costs of anticipated lumpy costs (such as the purchase of a school uniform) and unforeseen circumstances (such as a job loss, illness or a major car repair). Qualitative research from the Joseph Rowntree Foundation (JRF) suggests that even modest levels of precautionary savings can act as a buffer to assist in withstanding 'adverse shocks'.[15] Meanwhile, research from the Personal Finance Research Centre at Bristol University has shown that saving very moderate sums can help instil 'a sense of personal agency and control ("self-efficacy")'.[16] Finally, savings can improve psychological well-being due to the levels of assurance they can provide.[17]

Despite these clear benefits of building up a stock of saving, affordability is frequently cited as a concern for those on low incomes. As such, they are much less likely to save than those on higher incomes.

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14 John Gathergood, "Debt and depression: evidence on causal links and social stigma effects", Centre for Finance and Credit Markets, Working Paper 11/10, 2011.

15 Chris Dearden, Jackie Goode, Grahame Whitfield and Lynne Cox, *Credit and debt in low income families* (York: Joseph Rowntree Foundation, 2010), 27.

16 Andrea Finney and Sara Davies, *Towards a nation of savers. Understanding and overcoming the challenges to saving on a lower income* (Bristol: University of Bristol, 2011).

17 Man-Yee Kan, Heather Laurie, "Savings, investments, debts and psychological well-being in married and cohabiting couples", ISER Working Paper, 2010.

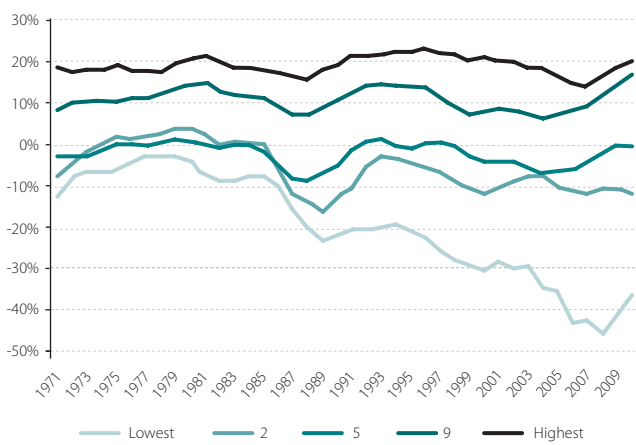
Low levels of financial resilience

Notwithstanding the clear dangers set out above, recent data suggests that UK households have very low resilience, especially low income households.

- 10 million of those in low income households are in unsecured debt, and lower-income households have higher debt-to-income ratios than higher income households.[18] In the decade leading up to the financial crisis, households in the lowest income decile increased their spending by 43% on the basis of only a 17% increase in income.[19]
- Three quarters of those in the lowest income quintile have no cash savings.[20]

Research by NIESR has demonstrated that the saving ratio among households in the lowest income decile has declined dramatically in the past 25 years (see Chart 1.1 below).

Chart 1.1. Saving ratios across the income deciles



Source: Lucchino and Morelli, *Inequality, debt and growth*, 8.

18 Ellison, Forster, Jones and Whyley, *Briefing note on the potential impact of prices caps on low income credit users;* Department of Business, Innovation and Skills, *Over-indebtedness in Britain*, 14.

19 Paolo Lucchino and Salvatore Morelli, *Inequality, debt and growth* (London: Resolution Foundation, 2012), 9.

20 Ellison, Whyley, Forster and Jones, *Credit and low income consumers*, 18.

In the context of stagnant real wage growth, unemployment and cost pressures, the low levels of financial resilience represent a major public policy challenge.

WHAT CAN GOVERNMENT DO TO HELP?

The Government has an interest in financial resilience from both a fiscal and social perspective. As noted earlier, higher precautionary savings and the absence of over indebtedness can result in better well-being and psychological health for citizens. Low financial resilience also means that families are all the more reliant on taxpayers' help.

Governments have focused on a range of responses to help build the financial resilience of low income households, as shown in Table 1.1.

However, as this research will explore in depth, the Government can also act to build the resilience of households through the design of the benefits system. Previous research has demonstrated that the benefits system – for instance through overpayments and underpayments of tax credits – can introduce additional friction and difficulties into household finances. At worst, these can trigger further crises themselves. But, got right, the benefit system can help rather than hinder effective budgeting and household resilience. The administration of welfare policy is a crucial point of interaction that the state has with many of the most vulnerable people in society, especially in periods of upheaval when low income households' budgets are at their most fragile.

Table 1.1. Government activity to promote financial resilience in last decade	
Access to mainstream financial services	Successive initiatives to reduce the number of the unbanked, led by the Financial Inclusion Taskforce, have led to a halving of the number without a bank account between 2003 and 2010, thus allowing them access to banking products and associated benefits.
Availability of free debt advice	The Financial Inclusion Fund and other schemes funded charitable advice bodies to support the unbanked, those in debt and those who required financial support.
Provision of free or low cost credit	Additional regulation of non-mainstream credit. Targeting of unlicensed lenders. The Social Fund has provided interest-free loans to vulnerable households since 1988 (although this will change under Universal Credit). A DWP-backed Growth Fund provided capital to credit unions and Community Development Finance Institutions to enable them to provide instant loans to riskier lower-income individuals or those without a record of saving.
Incentives to save for low income households	The Savings Gateway and the Child Trust Fund were designed to encourage low income households to develop a savings habit.

Proposed government reforms: Universal Credit

The Government is undertaking what are widely regarded as the most significant reforms to the benefits system in a generation. The fundamental ambition of Universal Credit is to make the benefit system 'fairer, more affordable and better able to tackle

poverty, worklessness and welfare dependency'.[21] The specific aims are to make work pay, to help smooth the passage of claimants from out-of-work benefits to employment and to increase personal responsibility.

Box 1.1. Summary of goals behind Universal Credit[22]

- Make work pay by reducing the rate at which most claimants lose benefit support when entering work.
- Make the system more responsive to changes in earnings so that people feel the benefits of re-entering employment or working more hours immediately.
- Simplify the benefit system by integrating benefits and tax credits, meaning that individuals are better able to understand the advantages of taking on work, whilst reducing the risks of moving between benefits and work.
- Establish a series of strict conditions that any claimant will have to satisfy before receiving Universal Credit.
- Make significant long-term administrative efficiencies.

Reforms to the payment of benefits

Alongside reforms to benefit levels, the Government is changing the way that benefits are paid to individuals. This could have significant implications for the way that households manage money and their ability to build and sustain their financial resilience.[23]

Below is a detailed outline of each reform and the motivation that lies behind each.

21 Department for Work and Pensions, *Universal Credit white paper: welfare that works* (London: HMSO, 2010), 2.

22 Department for Work and Pensions, *Universal Credit White Paper.*

23 Although the Welfare Reform Act 2012 has passed into law, the reforms are currently captured in draft regulations to be approved by Parliament. They are also subject to consultation by the Social Security Advisory Committee and an enquiry by the House of Commons Work and Pensions Select Committee; the Government has stated that it is open to amendments to the way these changes are introduced.

1. Create a single payment

The Government will roll tax credits and core means-tested benefits into a single payment. This Universal Credit payment will bring together: income-based (means-tested) Job Seekers' Allowance; income-based Employment Support Allowance; Income Support; Housing Benefit; Child Tax Credit; and Working Tax Credit.[24] A number of transfers will continue to be made separately, including Child Benefit. However, the aim is to simplify the claims process and to allow claimants to see clearly the effect of their decisions about work on total household income, whilst encouraging claimants to take responsibility for budgeting.[25] The reform is also intended to reduce administration, inaccuracies and the extent of user engagement with different governmental authorities.[26]

2. Move to a uniform monthly schedule of payments

The frequency of benefit payments will be altered to a uniform monthly payment. Currently, tax credits and other benefits such as Income Support and Job Seekers Allowance are paid at different intervals including weekly, fortnightly, four-weekly and monthly. The Explanatory Memorandum for the draft regulations gives the following rationale for the change:

> *This approach reflects the world of work, where 75% of all employees receive wages monthly. Paying in this manner will help smooth the transition into monthly paid work, encourage claimants to take personal responsibility for their finances and to budget on a monthly basis which could save households money.*[27]

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24 The Disability Living Allowance will become the Personal Independence Payment, and will continue to be paid four-weekly (with exceptions).

25 Department for Work and Pensions, "Universal Credit Policy Briefing Note 2", http://www.dwp.gov.uk/docs/ucpbn-2-payment.pdf.

26 It might be noted that the Government is also localising aspects of the Social Fund, which acts against this simplifying instinct.

27 Department for Work and Pensions, "Explanatory Memorandum for the Social Security Advisory Committee", http://www.dwp.gov.uk/docs/uc-pip-claims-payments-draft-regs-2012-memorandum.pdf.

Alongside this, current flexibilities that allow households to select the frequency of in-work tax credit payments will be removed.

3. Move to a 'fixed' monthly assessment

Tax credits are currently assessed annually, although payments can be changed in-year if income fluctuations are reported. This 'flexible' annual assessment model will be replaced by a 'fixed' monthly assessment with calculations made automatically through Real Time Information on earnings and paid in arrears. The existing system suffers from the lack of any incentive for a household to report a rise in income (and thus trigger a reduction in their benefit entitlement). The Government disregards significant earnings increases (up to £10,000) made in-year. Even then, the current system results in over-payments (when the household reports changes in circumstances belatedly) and under-payments (when income falls go unreported).

4. Pay Housing Benefit to claimants

Universal Credit reforms will see Housing Benefit for social housing tenants paid to the claimant rather than direct to the social landlord in most cases. This will mirror changes that have already been introduced for most claimants who live in the private-rented sector and who receive Local Housing Allowance. Lord Freud, the Welfare Minister, has argued that direct payments to the landlord mean that 'people never learn to budget for their housing needs themselves. The way the system is set up encourages dependency.'[28]

5. Make the payment to a single recipient

Couple households will make a single joint claim for Universal Credit, and nominate one household member (or in practice one account) to receive the payment. This will alter the destination of a range of

28 Lord Freud, Speech to National Housing Federation, September 14, 2011. http://www.dwp.gov.uk/newsroom/ministers-speeches/2011/14-09-11.shtml.

benefits and tax credits. Benefits are currently distributed as follows: Child Tax Credit is paid to the 'main carer'; Working Tax Credit is paid to the full-time paid worker where there is only one, or to the nominated partner where both members of the couple are in work for 16 or more hours per week; income-based Job Seekers Allowance can be paid to either partner as nominated by the household. The Government has argued that it 'will be for the family to decide who receives the benefit and for them to decide how to budget that money on rent and the needs of the household.'[29]

6. Extend the capital allowance rule

Those on means-tested benefits are currently subject to a capital allowance of £16,000, above which they are not entitled to benefits. This rule is being extended to include those who receive tax credits. Capital under £6,000 will be disregarded, but those with anything over this threshold will start to lose benefits. The Government has argued that 'a typical working age household has only £300 in savings' and that people should draw on their own savings before being supported by the taxpayer.[30]

THE NEED FOR NEW ANALYSIS

Together these reforms will introduce significant changes to how low income households receive their income. The number of households affected will be large. The DWP has estimated that there will be eight million households entitled to make a claim under Universal Credit.[31] Although alterations have been made to payments in the past, these have been restricted to specific benefit payments and have been far more limited in scope. As the Government has acknowledged, the introduction of Universal Credit offers 'an important opportunity to consider how we can

29 Department for Work and Pensions, "Universal Credit Policy Briefing Note 2", http://www.dwp.gov.uk/docs/ucpbn-2-payment.pdf.

30 Department for Work and Pensions, "Universal Credit Policy Briefing Note 3", http://www.dwp.gov.uk/docs/ucpbn-3-capital.pdf.

31 House of Commons debates, Hansard, 9 May 2012, col 124.

help people to better manage their household finances.'[32] However, further analysis is needed to understand how the reforms will affect household budgeting and financial resilience.

Since the reforms were proposed, significant reservations have been raised from many quarters:

- Concerns were raised in the House of Lords at Committee Stage that these changes may encourage more individuals to take up high-cost loans such as pay-day loans. The House debated a revision to the regulation stipulating monthly payment, which would have allowed for a more frequent payment of Universal Credit, but the amendment moved by Baroness Lister was narrowly defeated.
- Organisations such as Save the Children have expressed unease that monthly payments will be out of sync with the rhythm of low income household budgeting who typically budget on shorter time cycles.[33]
- The Social Security Advisory Committee has voiced anxiety about 'the potential for claimants to get into debt as a result of the move to monthly benefit payments.'[34]
- Initial research by the DWP into the perceptions of Universal Credit has also revealed some concerns at changes to the frequency and destination of payments, concluding that the changes 'require unrealistic financial self-discipline, particularly from vulnerable groups'.[35]

Therefore, while the reform is predicated on significant behavioural change among low income households, it is uncertain whether

32 Department for Work and Pensions, *Social Justice: transforming lives* (London: HMSO, 2012), 58.

33 Save the Children, "White Paper on Universal Credit: written evidence submitted by Save the Children UK", http://www.publications.parliament.uk/pa/cm201011/cmselect/cmworpen/writev/whitepap/uc24.htm.

34 Social Security Advisory Committee, "SSAC response to the Universal Credit white paper", http://ssac.independent.gov.uk/pdf/universal-credit.pdf.

35 Monique Rotik and Luke Perry, *Perceptions of welfare reform and Universal Credit* (London, HMSO: 2011), 19.

behaviours will evolve as policymakers hope and expect. Previous reforms give some cause for concern. For instance, there have been great strides in increasing financial inclusion and in the availability and take-up of bank accounts. Take-up of accounts has increased and the number of the 'un-banked' has halved since 2003. However, many households have not used their bank accounts in the way that policymakers intended.[36] The newly-banked often do not use the full functionality of the service, a large number cycle in and out of banking and some have actually suffered a net loss (largely due to penalty charges).

The Government is seeking to put in place a series of safeguards and supports to help those who cannot cope with the standardised payment regime. This will include an exceptions policy that will identify those who should be provided with additional support or alternative payment arrangements. However, it is unclear how many individuals may need support and whether this is an efficient method of providing an alternative.

Given the vulnerability of the population at whom the reforms are directed, considerable care needs to be taken in the design of the Universal Credit to ensure that it does not contribute to financial instability among low income households. Indeed, failure could damage broader welfare goals by triggering indebtedness and undermining an individual's ability to remain within the labour market. More positively, if done well, these reforms could make big strides towards the Government's stated aim of assisting households to better manage their finances

36 Anna Ellison, Claire Whyley and Rob Forster, *Realising banking inclusion: the achievements and challenges* (London: HMSO, 2010).

FOCUS OF THIS RESEARCH

This research seeks to explore the impact that these proposed reforms will have on families on low incomes. In particular, this research assesses how money is paid to households, rather than the level of benefits paid, although the latter is obviously an important debate (including for instance the impact of the reductions to Council Tax benefits being devolved to local authorities). It seeks to answer the following questions:

1. How are low income households with children coping with the current financial squeeze and managing their finances?
2. What are the likely implications of the Universal Credit payment reforms on household budgeting and financial resilience?
3. How can we design Universal Credit to promote personal responsibility and help low income households build their financial resilience?

This research uses in-depth qualitative analysis with families on low incomes to answer these questions and is structured in four key phases:

- Section I sets out the research methodology and approach.
- Section II describes the financial circumstances of the low income households involved in our research.
- Section III assesses how these households manage their money and looks at the implications of the Universal Credit reforms.
- Section IV assesses how the benefit system should be reformed.

SECTION I:
RESEARCH METHODOLOGY

CHAPTER 2: THE METHODOLOGY

Understanding the financial circumstances of a household and its budgeting approaches requires careful interpretation. For these reasons, the SMF adopted an in-depth qualitative approach. In particular, this research sought to get detailed information on how and why households budget in the way they do, and how they think they would react to the Universal Credit reforms. This research seeks to build on and complement three assessments of Universal Credit carried out by the DWP which used qualitative and quantitative analysis to look at perceptions of the changes to benefit reforms.[37]

For public policy reasons, this research focuses on families with children on low incomes since these are the most vulnerable group of claimants. Households with children are much less likely to be keeping up with bills than those without.[38] Also, households with dependent children are feeling the impact of the fiscal retrenchment more acutely than other households. Finally, from a social justice perspective it is particularly important to understand the potential impact of benefit reforms on dependent children because they are reliant on others acting in their interests. Our research uses the DWP's definition of 'low income' as developed in its *Households Below Average Income* report – namely those whose net income is lower than 60% of the median household income, either Before Housing Costs or After Housing Costs.

37 Rotik and Perry, *Perceptions of welfare reform and Universal Credit*; Monique Rotik and Luke Perry, *Insight to support Universal Credit user-centred design* (London: HMSO, 2012); Trinh Tu and Steven Ginnis, *Work and the welfare system: a survey of benefits and tax credits recipients* (London: HMSO, 2012).

38 Department for Education, *A new approach to child poverty: tackling the causes of disadvantage and transforming families' lives* (London: HMSO, 2011), 32.

The methodology

The qualitative research was conducted in three parts:

- Extensive literature review and analysis of previous changes to the benefit system.
- Thirty in-depth interviews in three locations (Oldham, Brighton and London).
- Follow-up group discussions with five participants at each location. Participants had all already taken part in the interviews.

The fieldwork was carried out by Ipsos MORI.

Sampling

Rather than attempting to recruit a representative sample, qualitative sampling aims to reflect the diversity within the group. Therefore, the sampling aimed to capitalise on the household characteristics that may be associated with different money management approaches and different levels of financial resilience, as well as including recipients of specific benefits and tax credits that are to be changed under the Universal Credit.

The core criteria for selecting the households are set out in the table below.

Box 2.1. Research Sample

Sampling criteria					Research rationale
Income	Low income households (below 60 per cent of median disposable equivalised income) – Before Housing Costs (BHC) or After Housing Costs (AHC)				The research used DWP's 2011 *Households Below Average Income* report.[39] Each household recruited qualified under DWP's HBAI definition of low income either BHC or AHC (or both). AHC was used as well as BHC due to the distorting influence of high rents, especially in the capital.
Location	10 x Oldham (rural / suburban)		10 x Brighton (Urban / suburban)	10 x London (Urban)	Due to differences in experiences between those living in urban, suburban and rural areas, the research included some participants from each. Three locations were chosen because housing, transport and childcare costs (among others) vary greatly across the UK.
House-hold status	6 x one parent household with one child	7 x one parent household with two or more children	5 x two parent household with one child	12 x two parent household with two or more children	A significant proportion of household income is dedicated to supporting children and households with more than one child face a different set of challenges. Lone and dual parent households face different challenges. Lone parent households are more likely to experience poverty and face difficulties finding suitable work. They are also more likely to be in arrears with their bills, have lower net wealth than couples with children and have difficulty meeting housing costs.[40]
Work status	4 x Long-term in-work (longer than 12 months)	10 x Long-term out of work (longer than 12 months)	10 x In/out of work with one transition in last 12 months	6 x In/out of work with two or more transitions in the last 12 months.	The reforms will affect households who are both in- and out- of work: 14 of the 30 households were in work at the point of interview. In addition, SMF was keen to get insights from households who had been in transition and had experience of the interaction between out-of-work benefits and work. In a majority of our households, at least one individual had been in transition in or out of work during the last 12 months.

39 Department for Work and Pensions, *Households Below Average Income: An analysis of the income distribution 1994/95 – 2009/10* (London: HMSO, 2011).

40 Office for National Statistics, *Wealth in Great Britain: main results from the Wealth and Assets Survey 2006/08* (London: ONS, 2009), 37; Joseph Rowntree Foundation, Monitoring poverty and social exclusion (York: JRF, 2010), 50, 56.

In addition, the SMF used additional minimum quotas to ensure that specific constituencies of the low income population featured in the research.

Box 2.2. Additional recruitment quota

Sampling criteria		Research rationale
Receiving Housing Benefit or Local Housing Allowance	A number of recipients of Local Housing Allowance (LHA) and Housing Benefit (HB). 10 x LHA 12 x HB	Housing benefit consists of payments to those in the private-rented sector and those in the social rented sector. Those in the private-rented sector receive Local Housing Allowance (LHA). The Universal Credit will see all Housing Benefit claimants receiving their award. Most LHA claimants already have experience of this.
Other benefits received	A number of respondents each receiving specific transfers: - Tax Credits x28 - Jobseekers Allowance (JSA) x4 - Income Support (IS) x11 - Employment and Support Allowance (ESA) x4	The Universal Credit will bring together six welfare transfers: means-tested JSA, means-tested ESA, IS, Housing Benefit, Working Tax Credit and Child Tax Credit. It was important to include a range of people who received different benefits from the current system.
Ethnicity	Seven households with at least one adult from a minority ethnic group.	Research suggests that use of credit, interaction with the benefit system and intra-household distribution of income may differ on the basis of ethnicity.[41]
Confidence in managing finances	Minimum of ten who do not feel confident in managing finances.	Confidence in managing household finances can be a factor in influencing how households budget.
Use of credit	At least ten respondents who have used some form of credit within the last six months.	Use of credit is high across the population. In fact, a majority of low income households use credit.[42]

41 Zohra Moosa with Jessica Woodroffe, *Poverty pathways: ethnic minority women's livelihoods* (London: Fawcett Society, 2009).

42 Ellison, Whyley, Forster and Jones, *Credit and low income consumers*, 6.

The majority of the interviews were carried out with the designated household budgeter on their own, while some interviews were carried out as paired interviews to assess intra-household dynamics in an alternative way.

Recruitment

Recruitment was conducted face-to-face by professional recruiters using a screening questionnaire designed jointly by Ipsos MORI and the SMF. Ipsos MORI and SMF developed a table of equivalised incomes to qualify households under the DWP's criteria for low income households on a monthly and annualised basis. This served as an initial recruitment device. Once the household had been recruited a further screening took place during the interview as data was collected on net household income and housing costs. A number of households were removed at this stage as their net income was too high.

All families were offered a financial incentive to take part in the depth interviews and discussion groups.

Timing

The interviews and focus groups were carried out between March and April 2012.

Interview and discussion groups

The two phases of primary research were designed sequentially so that outcomes from the depth interviews could inform the focus of the discussion groups. Discussion group participants had already been interviewed because it was felt that participants would be better-placed to comment on what were complex and sensitive issues.

Each interview took place at the interviewee's home and lasted an hour. The discussion groups were held at a central location and lasted 1 ½ to 2 hours.

SMF and Ipsos MORI jointly authored the interview questionnaires which provided the framework for the interviews and focus groups. A version of each can be found on SMF's website.[43] These included broad questions on the financial position of the household. Detailed information about income and outgoings was also collected consistently through the use of a showcard listing potential sources of income and expenditure. Interviewees were then asked in detail about the Universal Credit proposals and their likely response to the changes.

Research analysis

The data gathered in the interviews was analysed in the following ways. First, SMF participated in a feedback session with primary researchers at Ipsos MORI and, second, SMF read the data. From this, SMF sought to identify any emerging patterns, relationships and categories. This allowed SMF to develop codes that referred to specific characteristics and responses from the interviews, such as budgeting approaches, views on benefit reforms and budgeting cycles. Throughout the report, SMF supports its analysis with verbatim evidence from participants as these represent the views and perspectives of those who participated in the research, as well as case studies of specific households.

43 www.smf.co.uk.

SECTION II:
HOW HOUSEHOLDS ARE COPING

CHAPTER 3: THE IMPACT OF THE SQUEEZE

This chapter explores the financial circumstances of the households in our sample and asks: how are low income households coping with the current financial squeeze? It describes the key issues faced by the thirty participant households and explores the financial pressures they are facing and the opportunities open to them to better their circumstances.

Worsening circumstances and declining income

Most of our households had experienced deterioration in their financial position over the last five years. This had been driven by two major factors. First, a number had lost jobs. Second, some households had moved to reduced hours of work and / or wage levels after changing employment.

Only a small number of participants pointed towards improved financial circumstances over the last five years. In the few instances where they did, these were due to accessing a wider set of benefits or no longer having to pay full housing costs, for a variety of reasons.[44]

Across our group, a distinction emerged between those who had experienced a significant deterioration in their financial situation recently and those who had been on out-of-work benefits for a longer period. The latter were more likely to describe their financial condition as more stable. Meanwhile, those who had lost work were often struggling to adjust, even though in some cases the reduction in income had occurred years before. Some were carrying large debts that had been built up when they had been on higher earnings and consuming more.

44 These included having a friendly landlord who accepted a low rent and those in temporary or emergency accommodation.

The decline in household income and work status affected individuals markedly. As one research participant put it,

> *I think if you've always been on benefits and you've never done any different you can probably manage it better than somebody like me can.*
>
> Dual parent household, recently transitioned out of work, Oldham

The Government's cuts to benefits featured infrequently and only a few participants referred to specific reductions or cuts. Where a household was seeing loss of benefit income, this was usually due to the ending of entitlement, such as a child's eligibility to Child Benefit expiring or the end of maternity leave. The absence of criticism was striking despite benefit and tax credit income featuring as a principal and often primary component in the household income.

Box 3.1. The impact of benefit cuts

Participants rarely referred to cuts in benefits. This can be explained by several factors. First, out-of-work benefits have risen with inflation whilst wages have stagnated in real terms, making out-of-work claimants relatively better off last year.[45] Second, benefits are now rising by the Consumer Prices Index rather than the typically higher Retail Prices Index. This will have a large cumulative impact on benefit generosity in the coming years, but the initial impact has been modest.[46] Finally, in referring to the effects of inflation, participants may have implicitly been identifying freezes to Working Tax Credit and Child Benefit.

Notwithstanding the lack of specific reference to recent benefit cuts, there was a widespread belief that the Government did not understand the conditions that low income households faced.

45 Robert Joyce, *Household incomes during the recession and austerity* (London: IFS, 2012).

46 Robert Joyce and Peter Levell, *The impact in 2012-13 of the change to indexation policy* (London: IFS, 2011).

Struggling with costs

Apart from depressed incomes, the most commonly-cited causes of budgeting pressure stemmed from increases in food prices, the costs of fuel and the costs of bringing up children.

Concern about inflation was widespread. There was a widely-held view that the major supermarkets had increased their prices over the last 12-18 months and many families described how they had tried to compromise and find savings in this area by buying cheaper, value, items, by visiting discount stores, using the internet and shopping ahead of time for deals.

> *I always go for bargains… Buy clothes on sales. Shop about using the internet, to buy stuff like birthday presents coming up.*
>
> Lone parent household, long-term out of work, Brighton

Increases in the costs of petrol and domestic fuel were also cited by participants as limiting disposable income. In the context of the significant inflation in food prices and fuel in recent years these comments are not surprising. Inflationary pressures for those on lower incomes have been comparatively more severe due to the fact that a typical basket of goods for these households has increased faster than general inflation.[47]

A significant number of our participants pointed to the costs of school activities and trips, which caused specific difficulties. For instance, trips often represented outlays of lump sums that could not easily be budgeted for. This reflects previous research that has identified raising children as a period of straitened circumstances, especially in the earliest years.[48]

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47 Donald Hirsch, James Plunkett and Jacqueline Beckhelling, *Priced Out: The new inflation and its impact on living standards* (London: Resolution Foundation, 2011).

48 LV=, "Cost of a child: from cradle to college", http://www.lv.com/upload/lv-rebrand-2009/pdfs/other/11665_LV_COAC.PDF.

Families were keen to emphasise that the needs of their children came before their own needs.

> *I couldn't tell you when I last bought clothes, you know it all goes on the children first and foremost.*
>
> Lone parent household, long-term out-of-work, London

Indeed, the prioritisation of expenditure on children was a common theme across almost all our households. Participants often referenced their inability to go out for family activities or meals. Many felt that presents at birthdays and Christmas were exceptional costs that had to be met whatever the consequences. In part this could be explained as being motivated by the desire to be regarded as a good parent notwithstanding the testing circumstances. However, existing research has shown that parents on low incomes seek to provide the child with the wherewithal to interact with their peers on a par and avoid standing out, and to shield the child from the difficult financial circumstances experienced by the household.[49]

> *I worry about…making sure we've got enough money to just get by and give the children what other children have as well.*
>
> Dual parent household, recently transitioned into work, Brighton

Anxiety about finances

Levels of anxiety varied across the sample. In some cases, households were finding their financial situation the source of anxiety, and, as in the case study (Box 3.2) below extremely stressful.

The convergence of cost pressures and squeezed income was leading some households to sacrifice one need to meet another. In such instances, the first items of expenditure that households

49 Tess Ridge, *Living with poverty: A review of the literature on children's and families' experiences of poverty* (London: HMSO, 2009), 4, 67.

sacrificed tended to be adult leisure and social activities, and family days and holidays. Less frequently households were also sacrificing television, smoking, cars, healthy food, home insurance policies, adult clothing, and household repairs. In a small number of cases – often when the family had many children, competing priorities and high bills – participants spoke about having to sacrifice food and heating.

Box 3.2. Case study of a household: Striking the right balance?

Finding the balance between a series of costs was causing extreme stress and creating severe difficulties for one particular household. The couple had three children and had been in and out of work in the last twelve months. Despite the husband working full time, the couple were finding themselves unable to meet necessary household expenditure. As the mother noted, 'more and more, it's which [item's] a need and which one's a want and all of the wants went out of the window…'

It was clear that the family were sacrificing core household items.[50] The ambition to provide their children with the necessary support had led them to pay out £27 a week on extra maths and science tuition for one of their children. Managing on a low income, whilst meeting the costs of this tuition, was leading them to sacrifice expenditure on heating: 'we were bloody cold this winter weren't we?'; 'Winter was horrendous'. The upshot was that the family was foregoing home insurance, heating and food.

Unsurprisingly, the situation was leading to significant pressure: 'It's ridiculous, absolutely ridiculous. I'm constantly stressed out', the mother noted.

A number appeared to be more phlegmatic about their financial situation despite the difficulties.

50 For the latest assessment for core household items see Donald Hirsch, *Minimum income standard 2012* (York: JRF, 2012).

> *I used to worry a lot. But, I can't. It would take thousands of pounds to make my life better so there's no point in stressing myself about it … Fortunately, I [have] got a very good landlady who'll let me delay things if I need.*
>
> Lone parent household, long-term out of work, London

This materialised for a range of reasons. As the above quote suggests, some households had sources of support or relief (in the above case an understanding landlady) that reduced the pressure on them. Others felt it would be hard to expect different circumstances or sought to deliberately suppress anxiety because of its potential negative consequences:

> *I try not to [worry], 'cause it just will take over. … 'cause I've had periods of time like that and it just isn't beneficial at all 'cause family suffer.*
>
> Lone parent household, recently transitioned into work, London

Others could see some cause for optimism in the future, often stemming from their children entering school and childcare no-longer being a constraint, or hopes for new employment.

The 'bank of mum and dad'

Many drew on informal credit, the most notable feature of which was the prevalence of informal pecuniary support being provided by parents. This assistance comprised: loans for housing costs that were being paid off over time; one-off grants for capital costs or repairs; and regular monthly contributions for specific bills such as mobile phones, petrol or costs associated with children. For most of our households, informal support from parents was the first source of assistance that was sought out and provided when cash was short. It appeared to take place even when the person in the older generation was on benefits. Where parental support was not available, households sometimes turned to grandparents or siblings.

Informal support was valued highly by those who received it, but three very important points should be noted. First, not everyone had access to informal support from parents, other family members or friends. Indeed, some who did not have familial support believed that they were disadvantaged as a result.

> *We do have a lot of friends who get a lot of hand outs from family and that. They get their shopping bought for them weekly and, you know, their roof over their heads paid for and things. They're lucky.*
>
> Dual parent household, recently transitioned into work, Brighton

Therefore, from a public policy perspective, such forms of credit cannot be relied on. Second, although those who could bank on familial support appreciated the reassurance it gave them, many still remained very anxious about their financial situation and indebted in other ways as well. Third, some were reluctant to ask parents for support, feeling guilty at the prospect.

Wider use of credit and savings

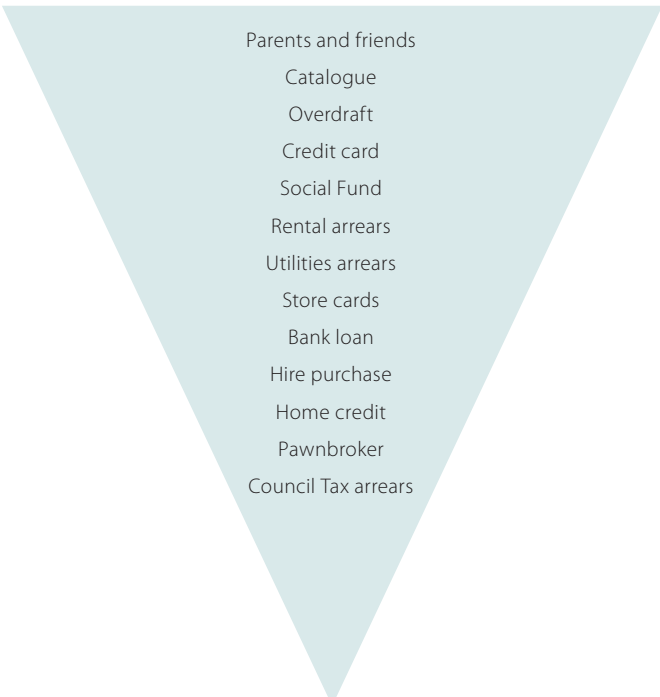
There was a widespread stated aversion to going into debt and an ambition to be free of it in the future, but this sat alongside evidence of high continued use of credit. A small number had extremely high unsecured debts that exceeded more than 50% of their annual household income. Such households obviously had to make major repayments, which were drastically limiting their disposable income.

Aside of familial support, the most common forms of borrowing across our households are set out in Figure 3.1.

The differences in borrowing behaviour stemmed from a number of factors. First, attitudes to what constituted borrowing

varied. Not all forms of borrowing were perceived as formal credit use, and different types of borrowing were viewed differently depending on their role in the budgeting cycle. For instance, some participants who used catalogues did not appear to conceptualise it as a form of borrowing in the same way as other forms of debt.[51]

Figure 3.1. Hierarchy of credit usage among the group



Second, one group had built up significant debt in previous years – often during periods when they had been in comparatively well-paid employment and had borrowed to finance consumption. Having lost their jobs or finding themselves in different circumstances, these families had found themselves in very difficult situations with extremely high repayments.

51 This bears out research that people who use retail credit or mail order credit had low levels of awareness of the costs they were paying for the credit: Whyley, *HMT Financial Inclusion evidence review*, 6.

> *These were all debts that I'd got before I was on benefits. Loans and credit cards and I was confident of being able to pay them until I lost my job.*
>
> Lone parent household, long-term out of work, London

A small number, including the household above, had taken more drastic steps such as filing for bankruptcy or consolidating their loans. Bad experiences with debt in the past had also caused one household to manage its finances without recourse to borrowing:

> *We could get a credit card. Yeah, of course we could but you've still got to pay the blooming thing back, haven't you? And that's just something I'm not going to go down again, no.*
>
> Dual parent household, long-term in work, Brighton

Third, although some pointed to previous consumption, many others noted different factors. Simply the cost of everyday living was cited frequently as a factor. Others included: costs of domestic items and repairs; Christmas and birthdays; bank charges; and reductions in benefits leading to arrears. Previous research undertaken during the 2008-09 recession found that the picture was not one of 'widespread profligate use of credit to acquire a high materialistic standard of living, but more typically the use of credit and the acquisition of debt as a function of persistent low levels of income.'[52]

52 Dearden, Goode, Whitfield and Cox, *Credit and debt in low income families*, 44.

Box 3.3. Use of credit across low income households in recent years

Research suggests that there is a high level of crossover between low income users of mainstream credit (lending from banks) and non-mainstream credit (other regulated lending), with six in ten who use the latter also using the former. The leading sources of borrowing are overdrafts, credit cards and personal bank loans, followed by home credit, catalogue credit and storecards. Many households in SMF's sample were also multiple users of credit.[53]

A survey in 2011 found that more than a third in the lowest income quintile said that they had been trying to avoid borrowing in the last two years; almost a third have been focused on paying down their debt.[54] This reflects a shift across the whole population to reduce unsecured debt.[55]

Alongside indebtedness, very few households had any savings set aside. This is hardly surprising: the DWP's research has found a persistently high proportion of low income households without savings.[56] Even those who had savings usually only had very small sums, as will be discussed further in Chapter 4.

Aspirations

Many households were taking a range of measures to improve their prospects and to find suitable work. A number were doing voluntary work to build up their requisite skills and develop up-to-date work experience; others were planning to re-train or were in education; a small number were at an early stage of moving towards self-employment.

53 Ellison, Whyley, Forster and Jones, *Credit and low income consumers*, 28.

54 Ibid., 17.

55 Department for Business, Innovation and Skills, *Credit, debt and financial difficulty in Britain, 2011* (London: HMSO, 2012), 5.

56 Department for Work and Pensions, *Households below average income: an analysis of the income distribution 1994/95 – 2010/11.*

However, despite this ambition, many did not expect their immediate prospects to improve principally because of a lack of appropriate jobs, the difficulty of developing necessary skills, the challenge of finding affordable and flexible childcare support, and the structure of the benefit system.[57] One lone parent conceived it,

> *I would have to pay childcare, you know, all the other things. To kind of cover that and everything else you would need to have an income of probably £40,000 minimum and since that wouldn't be part time that's completely unlikely.*
>
> Lone parent household, recently transitioned out of work, Brighton

Especially for those with young children, there was a feeling that the prospects might improve when their children reached school age, often because they would no longer have to secure and pay for suitable childcare.

Some people that had been out of work for long periods identified hurdles and expressed a lack of optimism and a sense of hopelessness about changing their situation. Barriers included the view that they would be worse off entering work (because of low wages, the benefits they would lose and the high costs of childcare); and the rigidity and complexity of the benefit system that acted as a disincentive to work (especially for temporary jobs).[58]

> *If we worked we'd get less than we do when we don't. So we're stuck.*
>
> Dual parent household, long-term out of work, Brighton

Generally, households expressed a desire to receive a little bit more money – and that this would help them enormously, for example

57 This bears out recent SMF research that showed the growing affordability problems in childcare. Ian Mulheirn and Ryan Shorthouse, *The parent Trap: Illustrating the growing costs of childcare* (London: Social Market Foundation, 2011).

58 The latter is discussed in more detail in Chapter 5, Reform 1.

to allow them to take their children on holiday, offering a rare family treat and something that they could seldom afford.

Conclusions

Our research underscores the fact that the economic downturn has had a significant negative impact on the financial position of low income households. Some have seen their circumstances deteriorate dramatically following redundancy. Many have seen their finances stretched by inflation.

Their financial positions remain fragile. Like the majority of the low income population, balancing income and expenditure is difficult. This has been exacerbated by considerable use of credit. For some this has stemmed from periods of greater consumption when they were in better jobs. Such households are therefore left seeking to adjust to significantly more straitened circumstances whilst having to service high levels of debt. For others it has been the result of trying to make ends meet persistently on a low income. As a number of households in our sample testify, not all families have the requisite resources. Very few have any buffer in the form of savings.

Despite significant aspiration across many of the sample to improve their circumstances, re-entering the labour market and improving their financial position was proving difficult.

Designing a method of payment that can best aid households as they manage their tight finances will be fundamentally important. The Universal Credit is a key opportunity to help vulnerable households build their financial resilience during a period of economic turmoil. But if the policy is designed poorly it may lead to more negative and serious implications for households.

The following chapters explore how households budget and relate to the benefit system.

SECTION III: HOUSEHOLD BUDGETING AND THE UNIVERSAL CREDIT

CHAPTER 4: HOW LOW INCOME HOUSEHOLDS MANAGE THEIR FINANCES

The last chapter described the financial situation of our research participants and showed that many are in a vulnerable position, often seeking to balance extremely tight budgets. This chapter explores in depth how households budget and plan financially, since this will help inform how they are likely to respond to the proposed changes in the Universal Credit. As such it seeks to answer:

- How do low income households budget and manage their finances and what budgeting challenges do they face?
- What explains the similarities and differences that characterise different budgeting techniques and habits?

BUDGETING CHALLENGES

Our low income households faced three overriding challenges in managing their money, each of which could have detrimental consequences.

- *Limited income* meant that households had to carefully balance the need to make regular payments across a range of essentials such as food, housing costs, heating and children's clothing. Many ran out of money before the end of the budgeting cycle thus pushing them into debt, and some rationalised their borrowing on this basis.[59] Once in debt, repayments became an additional drain on disposable income.
- *Anticipated* lumpier costs or dips in income that occur

59 This reflects DWP research which shows that 37% of families in the lowest income quintile run out of money 'always' or 'most often' at the end of the week or the month. Natalie Maplethorpe, Jenny Chanfreau, Dan Philo and Clare Tait, *Families with children in Britain: findings from the 2008 Families and Children Study* (London: HMSO, 2008), 193.

intermittently presented a second challenge, interrupting the steady flow of budgeting. Christmas, birthdays and school expenses featured frequently across our households as anticipated but additional costs. Households also had to meet the costs of repairs, maintenance and replacement of household goods. Some of these costs appeared to fall outside what households considered to be the regular budgeting cycle and were considered extraordinary costs that would *necessarily* have to be met through borrowing or financial assistance.

- *Unanticipated* events or shocks could dramatically upset a household budget. The case therefore for building up a stock of precautionary savings was patent, though the ability to do so was less evident.

COMMONALITIES

Across all the households there were a number of budgeting perceptions and methods that were commonplace. First, stability and certainty of income were valued highly. One lone parent was currently going through the process of applying for benefits, where both income instability and uncertainty were high, leading to considerable anxiety.

Second, as indicated above, on-going use of formal or informal credit was commonplace, and this was not symptomatic of ineffective budgeting.

Third, it was clear that most of our households had developed their own tailored techniques to manage the flow of money in and out. This bears out previous research by the Financial Services Authority that has demonstrated that poorer households manage

their finances at least as well as, and often more closely than, wealthier families.[60]

Many in our sample had developed techniques to control expenditure though their methods varied. In one case of a couple with high dependence on alcohol, this involved delegating the budgeting responsibility to a parent. There were few signs of dependency across our sample and many had developed positive strategies for coping in response to their circumstances, bearing out research by Professor Ruth Lister and others.[61]

BUDGETING DIMENSIONS AND TYPOLOGY

Aside some similarities outlined above, households had adopted very different approaches to managing their money. These can be separated across three dimensions, each of which is explained in detail below:

1. Length of budgeting cycles.
2. Level of formalised household budgeting methods.
3. Length of planning horizons.

Depending on where households were situated across these dimensions, our analysis found that households comprised three broad types: 'Planners', 'Tacticians' and 'Ad hoc budgeters'. This typology is summarised in Figure 4.1, which sets out some of the characteristics and budgeting techniques adopted by different types. Each dimension is then described in detail below. As will be discussed in Chapter 5, the characteristics and attitudes displayed by these different types of budgeters, and their situation across these dimensions, is likely to have implications for how they could adapt and respond to the Universal Credit reforms.

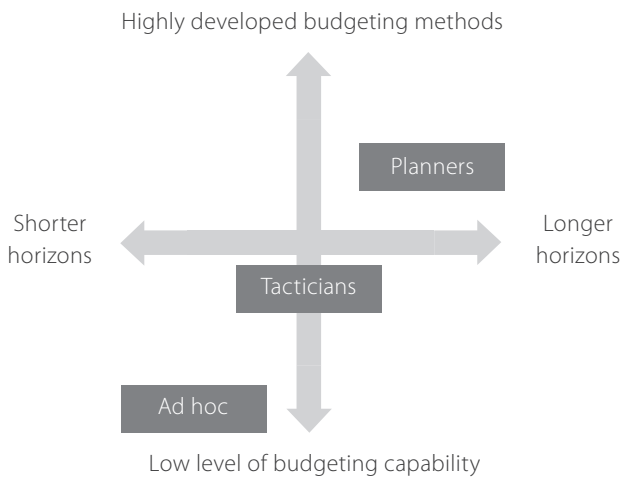
60 Financial Services Authority, *Financial Capability in the UK: Establishing a Baseline* (London: FSA, 2006); Barnardos, *Below the breadline.*

61 Ruth Lister, Poverty (Cambridge: Polity, 2004), 129.

Figure 4.1. Characteristics associated with budgeting approaches across the continuum

As indicated in Figure 4.2 and described below, the two key determinants for understanding how a household managed its finances were the level and type of formalised household budgeting methods and the length of planning horizons. The length of the budgeting cycle did not of itself determine the overall budgeting approach. Despite monthly budgeters being more likely to be 'planners', those on shorter budgeting cycles could also be defined as being in this group. Meanwhile, longer budgeting cycles did not necessarily mean that the household had sophisticated budgeting methods. There were similar proportions of active savers across weekly, fortnightly and monthly budgeting cycles. Given the level of variation, this typology is best thought of as a spectrum (see Figure 4.2).

Figure 4.2. Spectrum of budgeting types



The three key dimensions across which households varied are set out below.

Dimension 1: Periodicity of budgeting cycles

'Budgeting' is the act of balancing income against expenditure, and a 'budgeting cycle' is the period over which an individual typically conceptualises their core income and expenditure and seeks to match the two. At times it was clear that households operated more than one budgeting cycle (as when households sought to meet the costs of irregular expenditure such as Christmas). However, during the interviews individuals were asked about their approach to managing their money and budgeting including the length of time over which they typically managed their money.

Budgeting cycles varied in their length across the sample. As Table 4.1 indicates, these differed between daily, weekly, fortnightly and monthly budgeting cycles.

Table 4.1. Work status, transition status and budgeting periods

Types of budgeters	**Total**	**Long-term out of work**	**Transition out of work**	**Transition in work**	**Long-term in work**
Daily	**3**		3		
Weekly	**14**	7	1	6	
Fortnightly	**3**	2	1		
Monthly/ weekly	**1**			1	
Monthly	**9**	1	1	3	4

This broadly reflects the distribution of budgeting across the benefit and tax credit population: 9% budget daily, 39% weekly, 17% fortnightly, 29% monthly and 4% less frequently.[62]

No overriding factors determined the length of budgeting cycles across our sample, although some associations were notable. Payment frequency appeared to influence the periodicity

62 Tu and Ginnis, *Work and the welfare system*, 55.

of the budgeting cycle for some (see case study below). For instance, most of our households who were out of work budgeted and managed their money on a daily or weekly basis. Only two budgeted on a monthly cycle. Conversely, for those in work, most budgeted on a monthly cycle. In part, at least, this was because some were paid monthly. However, payment frequency was only one factor. Other research has suggested that payment frequency alone does not determine the length of the budgeting cycle: low incomes are likely to determine shorter budgeting cycles as an independent factor.[63]

Box 4.1. Case study of a household: frequency of income and budgeting cycles

Sometimes, the frequency of income receipt appeared to affect the period over which a household budgeted. In the example of a couple with a child, the household received a range of benefits including Tax Credits, Disability Living Allowance, Child Benefit, Local Housing Allowance and Income Support, at different intervals across the month. The budgeting cycle was influenced by the largest payment (Income Support), which was paid fortnightly, and the majority of payments were then made fortnightly with a minority of payments made either weekly or monthly (see Figure 4.3). This budgeting pattern may also have been affected by the fact that the LHA rent payment was made direct to the landlord rather than to the household. The household also received a regular monthly contribution from one of their parents to cover a mobile phone bill.

The couple had high levels of financial engagement with very careful use of credit. In terms of future payment of Universal Credit, the woman interviewee was against the idea of shifting to a monthly payment, preferring a weekly single payment. She was also against managing Housing Benefit payments, though she was confident she and her husband could adapt.

63 Elaine Kempson and Claire Whyley, *Payment of pensions and benefits* (London: HMSO, 2001).

Figure 4.3. Income and expenditure calendar – frequency of income

	Mon	Tues	Weds	Thur	Fri	Sat	Sun	Mon	Tues	Weds	Thur	Fri	Sat	Sun	Mon	Tues	Weds	Thur	Fri	Sat	Sun	Mon	Tues
Monthly Income																							
Tax credits					57							57							57				
Income Support			257							257													
DLA		160																					
Child benefit	20							20							20								
LHA (Paid direct to landlord)					*648*																		
Monthly Expenditure																							
Food							120														120		
Toiletries							20														20		
Water							20														20		
Tobacco							32														32		
Rent (Paid direct to landlord)							320														320		
Gas and electricity				18						18								18					
TV bills				7						7								7					
Mobile phone 1																	30						
Mobile phone 2																	30						
Transport																							
Parents																	30						

It should be noted also that incomes were often staggered through the month, meaning that even when payments were received monthly or four-weekly, households received other forms of income at different points in the month. For instance, a household in work may receive a monthly salary, and Child Benefit and Child Tax Credits every four weeks but can expect these payments to come at three different times in the month.[64]

Dimension 2: Level of formalised household budgeting method

a) Budgeting oversight and management

Many of our households went to great lengths to oversee their bill payments and expenditure, with some looking at their online accounts every day. Almost all the interviewees – most of whom were women – displayed a clear understanding of the household income and outgoings to the point where they were able to talk comfortably about them in the interviews. Only in a small number of cases did households ignore their finances. This was associated with extremely difficult financial situations (though it was not clear that it was always a direct cause).

However, not only did the level of oversight vary, but some households actively managed their money, whereas others were more laissez-faire. Regular oversight of household finances online was no indication that payments were made online, or that households were effective budgeters.

b) Rationing and apportioning

Households adopted a range of techniques to manage their finances. The most confident budgeters tended to use online payment with major payments set up as direct debits. In the

64 Ironically, in such a scenario the Universal Credit will mean households not in work will receive fewer payments, while those in work may receive the same number (i.e. a wage, a Universal Credit payment and a child benefit payment).

most advanced cases, multiple accounts were used to divide and apportion income. Sometimes, however, multiple accounts were as much a product of a couple-dynamic or accident as of a deliberate decision to compartmentalise spending pots and saving. Therefore, having multiple accounts did not necessarily indicate that a household was using the accounts to structure their income and expenditure. Households also used a range of methods to ration or apportion income and expenditure. In some instances, this included deliberately shopping for certain items or paying bills at particular points of the week or month. Other examples included using meters and other devices such as pay-as-you-go phones to enforce regular contributions to on-going costs and to smooth the expenditure over time (even though they cost more).

> *My electric's a pre-paid meter. Now everyone else would be happy being on a bill but I can't run myself up like that. I'm already in too much debt anyway.*
>
> Lone parent household, long-term out of work, London

There were marked differences across the households in terms of whether and how they deployed benefit payments as a framing device for rationing and apportioning income. A significant minority of households used the benefit system to help them apportion their income. The case study below gives an insight into how this operated in some instances. Methods of allocation included:

- diverting Child Benefit to a savings account for their children;
- spending Child Benefit on clothes and other durables for their children;
- using payments made into different household members' accounts to pay for specific outcomes;
- directing Child Tax Credits to a specific account to cover expenses for a child;
- hypothecating specific benefits or tax credits to utility costs or other expenditures.

Box 4.2. Case Study: Use of the benefit system as a framing device

Ms J. sought to apportion her Child Tax Credit (CTC) specifically for a number of core priority payments, namely the electricity meter and the rent service charge (see Figure 4.4). She budgeted on a weekly cycle and most of her payments were made weekly except her rent service charge (fortnightly), catalogue repayments and TV licence (monthly). Her weekly income (£140 from Child Benefit (CB) and CTC) out-weighed her fortnightly income – though it is not clear that this was the principal factor behind her budgeting methods.

Ms J. had developed a number of tactics to help her cope. First, while she was frequently in arrears on bills (at the time of the interview she was two weeks in rent arrears), she was able to juggle different informal creditors to delay bill payment, and thus keep a floating informal loan. Second, she had a positive preference for using cash rather than bank facilities. This was due to the fear of bank charges. Third, Ms J. valued the electricity payment meter facility which served as a rationing device.

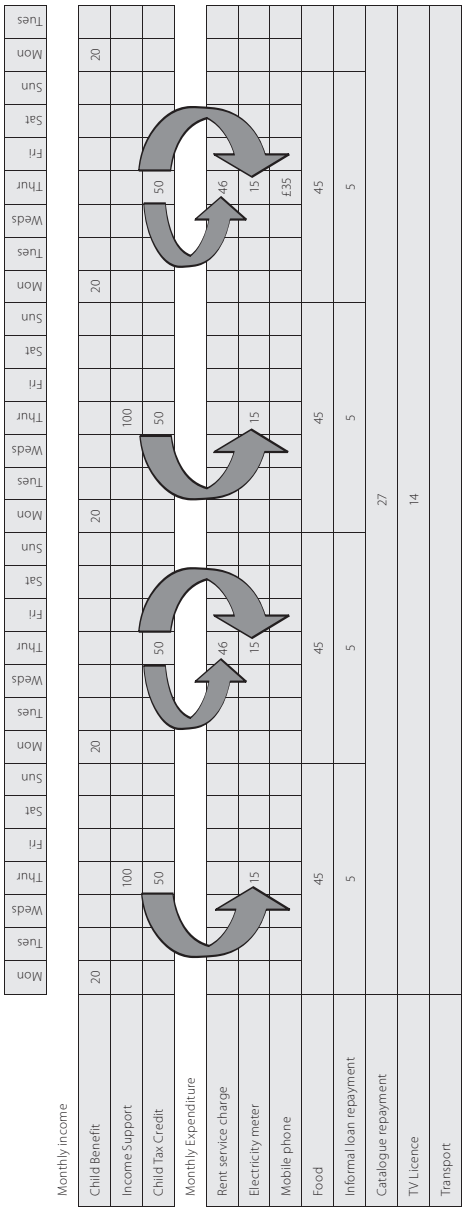
Perhaps unsurprisingly, Ms J. was against the idea of a single monthly benefits and tax credit payment; and she felt that she would struggle to adapt. In fact, she wanted her fortnightly Income Support payments to be paid weekly. As a social housing tenant, she was also against the idea of receiving her Housing Benefit (HB).

Many used regular payments as a rationing device, providing them with security and control, but others replicated this by their use of cash.

c) Use of financial products and cash

Virtually all benefit claimants now receive their benefits in an electronic account. Households in our sample managed their money to a lesser or greater extent through the use of mainstream financial products. A large majority had a bank account, while a small number relied on the limited capabilities of the Post Office Card Account. However, despite nearly almost all households having a bank account, many did not use its full functionality. This

Figure 4.4. Income and expenditure calendar – use of benefit system as framing device



is symptomatic of a resistance amongst some groups – such as the newly banked – to rely on mainstream financial services.

About half the group used cash entirely or to a significant degree to pay bills or buy food. Most commonly this was a deliberate decision. In an extreme instance, one household withdrew money and stored cash under the bed to pay for the rent.

The decision to deal in cash stemmed from a number of core motivations. First, some households were afraid that, if they relied on direct debits and other card payments, they would run out of money and incur bank charges. Some who cited this reason had previously had their fingers burnt, for instance with overdraft charges.[65] These unexpected lump sums could disrupt the budgeting flow significantly. Second, using cash made it easier for the household to keep a tab on their spending and understand how much money they had left over. The advantage, as one interviewee put it, was that:

> *What you've got is what you've got, it's in your hand…*
>
> Dual parent household, recently transitioned out of work, Oldham

Third, cash offered greater flexibility than automated debit deductions in terms of when bills were paid, because while the latter went out for fixed amounts on fixed dates, cash payments could be juggled more easily, being brought forward, delayed or reduced. Fourth, drawing out cash periodically could help act as a rationing device with a household making cash last until the next regular withdrawal.

65 This reflects the fact that some four million users of banks incur regular bank charges. Andy Burrows, *Credit where credit's due* (London: Consumer Finance, 2012), 4.

Dimension 3: Length of planning horizons and consumption smoothing

Finally, households varied according to the length of their planning horizons and whether they limited their financial planning to the budget cycle or whether they smoothed their consumption across months and/or years. A small number of households in our sample had savings set aside, typically modest amounts. Approximately a third described themselves as actively saving in one form or another.

Previous research from the Personal Finance Research Centre at Bristol University has demonstrated two purposes behind formal saving for those on a lower income:[66]

- Saving or smoothing consumption for a particular, often short-term purpose or anticipated expense.
- Precautionary saving to provide a financial safety net.

The most common purpose behind saving amongst participants was to help the household meet anticipated costs within the year, so that they did not have to cut back on other expenditure when the cost arose. Such costs typically included: Christmas and birthdays; children's durables such as shoes and other items such as school uniforms. A smaller number were setting resources aside for car insurance premiums or upcoming tax liabilities.

> *I'll either rob something one week and when I know [renewing the tax disc] is approaching I'll start putting bits away.*
>
> Dual parent household, long-term out of work, Oldham

Much of this consumption smoothing was within year, although one household was setting aside money for their child's longer-term future.

66 Elaine Kempson and Andrea Finney, *Saving in lower-income households: A review of the evidence* (Bristol: University of Bristol, 2009).

> *Clothes occasionally and obviously birthdays and Christmas, I have to start budgeting a year at a time for them.*
>
> Lone parent household, long-term out of work, Oldham

Meanwhile, precautionary saving was very rare. The difference in numbers between those smoothing their consumption for anticipated costs versus the small number building up precautionary saving bears out previous research that precautionary saving is often viewed as an optional activity.[67] This demonstrates how challenging the Government's goal is to build resilience among those on a low income.

Box 4.3. Reasons for not saving

Previous research has set out a range of reasons why low income households may not save. The most commonly self-reported reason is that households have insufficient income to afford to save. This is undoubtedly an important factor. However, more recent research by the Personal Finance Research Centre has demonstrated that attitudes to saving can also be very significant in determining regular saving.[68] Research identified that among lower income households, 40% could be categorised as 'savings inclined' rather than 'active savers'. Partly for these reasons, there is growing interest in innovative mechanisms to promote saving among low income households, such as matched saving schemes and prize-related savings.[69]

Households were using a wide range of methods for setting resources aside, most frequently for anticipated expenditure:

- saving for their child / children into specific accounts / trusts;
- use of bank savings accounts;

67 Tony Dolphin, *Saving and asset building in low income households* (London: IPPR, 2009), 4.

68 Finney and Davies, *Towards a nation of savers*, 49.

69 Jeff Masters and Emily Farchy, *Savings on a Shoestring* (London: Social Market Foundation, 2011).

- saving through their parents;
- accumulating a surplus in their current account;
- building up vouchers that could be redeemed at supermarkets;
- advance buying of Christmas products well ahead of the season (this was both a consumption smoothing device and a means to get a 'deal');
- advance payment of quarterly bills to 'get ahead' with repayment for services;
- and purchasing of insurance for domestic products that effectively meant that the item would not have to be replaced for five years.

Interestingly, there was no current usage of credit unions in our sample, although a number had used them in the past.[70]

As discussed in the earlier chapter, households drew on a range of credit options. Different types of budgeters tended to use different alternatives. Some who were proactive but had short time horizons used informal credit and tested the tolerance of providers by running up arrears. This was described by one as 'robbing Peter to pay Paul' and could provide a household with an on-going floating loan.

Conclusions

Many of our households possessed particular – and at times very advanced – methods for managing on a low income. Money management techniques varied by the length of the budgeting cycle; the methods and extent of financial management (including, the level of anchoring around the benefit system); and the level of future planning involved. Many demonstrated significant agency and capability. It is through the methods set out above that the households build and sustain their financial resilience despite tight incomes.

70 Recent research suggests that awareness of credit unions is low, with less than a quarter of those on low incomes able to identify the main purpose of a credit union. Burrows, *Credit where credit's due*, 10.

The following chapter analyses in depth how the Universal Credit changes are likely to affect the ability of households to manage their finances effectively and whether they are likely to bolster or undermine the financial resilience of low income households.

CHAPTER 5: UNIVERSAL CREDIT REFORMS AND THE IMPACT ON FINANCIAL RESILIENCE

Informed by the analysis of household budgeting in the last chapter, Chapter 5 explores the potential impact of the Universal Credit reforms on our low income households and draws on wider evidence to assess their likely implications. This analysis assesses six major planned reforms that make up the core of the reform plan:

1. The change to a single payment and claim for most benefits;
2. The shift to monthly payments;
3. The adoption of a 'fixed' monthly assessment;
4. Changes to the flow of Housing Benefit money;
5. The move to a single household recipient; and
6. Tighter capital restrictions on in-work claimants.

REFORM 1: SINGLE PAYMENT

What is changing?

The aggregation of most in-work and out-of-work benefits and tax credits into one Universal Credit award will mean that a household receives a larger, single cash transfer from government through a single recipient. The introduction of this single payment is intended to reduce complexity for both claimant and government. The aim is to remove unnecessary error, reduce cost and harmonise taper rates. This is different from the Single Recipient (which refers to who in the household receives the money, and which is discussed below under Reform 5).

Summary of impact

Interviewees in our sample were generally positive about having to deal with fewer government agencies and simpler claims' process and in favour of receiving a bigger, lump-sum payment. A Single Payment would help many households by providing a less complicated income stream. However, those who tactically rely on the benefit system to help

them ration or apportion their income are likely to see their methods for financial management disrupted. Without careful attention, policy makers will also lose the ability to shape spending priorities through the positive effects from labelling benefits.

The case for simplicity

The logic of a single payment is that it will increase take-up by making benefits simpler for claimants to understand and by auto-enrolling a claimant on the full suite of benefits to which they are entitled, whilst reducing administrative costs. The Government has forecast that it will reduce administrative costs by £500m a year through reduction of duplication and greater efficiency.[71] However, it should be noted that, in boosting take-up of benefits, the single payment will also generate additional costs to the Exchequer.[72]

Interviewees who were positive about the introduction of a single payment (and most in the sample were) believed it would reduce time on exhausting and complex form-filling as well as interaction with different government departments. They welcomed this change especially as many felt that they were constantly passed around different departments and that staff were insensitive and impersonal. In discussion groups, participants criticised the current system for being 'unorganised', 'sporadic', 'confusing', and 'under-resourced'.

> *It's just a nightmare, nothing's simple and the forms are so big and long it's almost as though you feel everybody's trying to catch you out.*
>
> Dual parent household, recently transitioned out of work, Oldham

71 Department for Work and Pensions, *Universal Credit white paper*, 60.

72 Department for Work and Pensions, *Universal Credit Impact Assessment* (London, October 2011) 6.

In this sense, participants felt that simplification could mean being passed around the system less.

The complexity in the current system imposed a significant additional burden on those whose work status or family circumstances had changed, but it also dis-incentivised households from moving from benefits to work due to the burden of re-applying for, and the risk of losing, benefits. In other cases, a lack of transparency and information meant the benefit system at times appeared arbitrary – such as the level of repayments for Social Fund loans. In general, this meant the system did not appear responsive and often required multiple form-filling to be entitled to benefits.

> *You would work a couple of months and then you would lose it and you would have to go through the whole system again and it's just such a difficult process.*
>
> Lone parent household, long-term out of work, London

Singly good? – Rationing and apportioning

Beneath the initial reaction of our households lay a more nuanced picture, with implications for the different budgeting types (identified in Chapter 4). A few interviewees mentioned that a larger lump-sum would help their budgeting, including paying for larger outgoings, such as being able to afford a big shop. For these households, different awards under the current system often meant payments arriving at different points in time, unsettling those who appreciated larger, simpler income streams:

> *It really annoys me that everything is paid on a different day ... It drives me mad.*
>
> Dual parent household, recently transitioned out of work, Oldham

These views existed across all three budgeting types.

However, for those who framed their budgeting and household finances around the benefit system, the reform is likely to be more disruptive, although generally there was confidence that the household could successfully adapt. This is likely to be more of a challenge for 'Planners and 'Tacticians' than for 'Ad hoc' budgeters, as the latter tended to have quite reactive and un-structured approaches to managing money. 'Planners' sometimes diverted income into specific pots from particular income streams. For instance, one household was directing its Child Benefit payment into a savings account for their children. And, some 'tacticians' framed their budget around different regular income streams to help them ration and apportion money.

> *I've got my Child Benefit still paid… but I know that's coming … I pay [my children's] clubs with that money.*
>
> Discussion group, Brighton

Another noted concern about the single payment on the basis that:

> *One [benefit payment] is assigned to the bills and because it's split during the week you know it kind of like manages me more.*
>
> Dual parent household, long-term out of work, Oldham

Others were using the structure of the benefit payments to help them apportion and ration income, such as directing both Child Benefit and Child Tax Credit into a separate account that helped fund items for the child.

From a public policy perspective, this evidence together with secondary literature suggests that a move towards a single payment with no breakdown of the different components reduces the potential for the positive effect of labelling. Professor Richard Thaler's research has shown that 'people make decisions piecemeal,

influenced by the context of the choice'.[73] Some campaign groups and academics have expressed concern that money may be diverted away from carers and children to other household expenditure. Evidence shows that the labelling of benefits can lead to positive behavioural responses. For example, analysis by the IFS has revealed that the labelling of Winter Fuel Payment led to a significant expenditure on fuel from that cash transfer. Households spent an average of 41% of the Winter Fuel Payment on household fuel; if the payment had been treated by households as any other form of transfer, households would be expected to spend only about 3% of the payment on fuel.[74] In addition, research from the Netherlands suggests that increased child benefit led to a corresponding increase in expenditure on child-related goods.[75]

Due to this reliance on the existing payment schedule, the research suggests that the Single Payment may be disruptive to some households. Its negative impact is likely to be mitigated in part by the fact that Child Benefit was the transfer our interviewees most commonly hypothecated, and this will remain outside the Universal Credit. However, this does not mean that the Government should abandon considering how it can 'nudge' households towards socially-desirable expenditure and help them apportion by providing information on the components of their benefit payment, as will be discussed in Chapter 6.

73 Richard Thaler, "Mental accounting matters", *Journal of Behavioral Decision Making*, 12: 3, (1999): 186.

74 Timothy K.M. Beatty et al, *Cash by any other name? Evidence on labeling from the UK Winter Fuel Payment* (London: IFS, 2011), 3-4.

75 Peter Kooreman, "The labeling effect of a child benefit system", *American Economic Review*, 90:3, (2000): 571-583.

REFORM 2: MONTHLY PAYMENTS

What is changing?

The draft Universal Credit regulations will establish a single frequency of benefit payment. This will be monthly, instead of the current mix of weekly, fortnightly, four-weekly and monthly transfers.[76] Benefits such as JSA and IS are currently paid fortnightly in arrears. Tax credit claimants can decide whether they receive their payment weekly or 4-weekly.[77]

Summary of impact

The proposed move to a uniform monthly payment elicited predominantly negative responses from our households. This was especially the case for most of households who budget on shorter budgeting cycles. The consequences identified were an increased likelihood of running out of money before the end of the month and the risk of relying more heavily on formal or informal credit. While many respondents indicated that they may be able to adjust given the right types of support, the reform is likely to be problematic for those who have less assured methods of managing their finances. This could have significant implications for third party organisations. The scale of the problem has important implications for the Government's 'Exceptions' policy (see Chapter 6 for further discussion of this).

Headline views on the monthly payment

Most of our households responded negatively to the proposal that payments would be made monthly. Those who viewed the change negatively included those who considered it an inconvenience right through to those who felt they would be unable to cope. Almost all those who were budgeting on a weekly or fortnightly cycle (the majority of the sample) were against the idea of a

76 Department for Work and Pensions, *Explanatory memorandum for the Social Security Advisory Committee*, http://www.dwp.gov.uk/docs/uc-pip-claims-payments-draft-regs-2012-memorandum.pdf.

77 Fran Bennett, "Welfare Reform Bill 2011 – Universal Credit payment issues: briefing from Women's Budget Group (WBG) (September 2011)", http://wbg.org.uk/pdfs/Universal-Credit-payment-issues-Sept-2011-revised.pdf.

monthly payment. Conversely, those who budgeted on a monthly cycle were more likely to view the change positively.

Box 5.2. Benefit claimant views towards a monthly payment

Generally, this finding underscores previous qualitative and quantitative research carried out by the DWP which indicated that households would view monthly payments negatively. Research published in 1999 found that there was 'little support for lengthening of benefit payment periods' and that those paid weekly believed the change 'would make budgeting much more difficult for them'.[78] A DWP survey in 2000 of those on working age benefits found that only 2% said they would 'prefer larger amounts less often'. This research suggested also that people tend to choose to have their benefits paid by the method that fits most closely with their budgeting cycle.[79] Finally, DWP's research on claimant perceptions of Universal Credit published in late 2011 noted that monthly payments were 'highly contentious'.[80]

Based on our sample, this research sets out below in depth how households are likely to respond to a shift to monthly payments.

Smoothing the passage to work?

The proposed reforms did elicit some positive responses from our participants. A number referred to the additional simplicity of monthly payments. Most of those in favour of the switch already budgeted on a monthly cycle – as such, the less frequent payment of benefits and tax credits would synchronise with the rhythm of their existing habits. Others noted the additional certainty that could come from a single payment and the fact that the current

78 Andrew Thomas and Nick Pettigrew, *Attitudes towards methods of paying benefits* (London: HMSO, 1999), 4.

79 Kempson and Whyley, *Payment of pensions and benefits*, 80. This was carried out prior to changes to the frequency of JSA payments.

80 Rotik and Perry, *Perceptions of welfare reform and Universal Credit*, 15.

payments came in at different types of the calendar month, thus upsetting payments on specific monthly dates.

> *I'd know more exactly what's gone in and what's gone out. Sometimes with different dates you can get a little bit in a mess. It would be better if it all got paid together.*
>
> Lone parent household, long-term in work, Oldham

Some referred to the fact that it might prompt them to take a more organised approach towards managing their money, including greater use of direct debits. A small number thought that a single payment each month would make it easier for them to understand the amount of money that could be set aside for savings each month.

However, the promotion of a monthly benefit as a means to smooth the transition to work was neither widely supported nor persuasive for our participants. Coping on a monthly wage packet was seen as very different from managing on a monthly benefit payment because the latter would be much smaller:

> *When you're working … it's totally different, the margins of the money that you're' getting. But when you're getting such a smaller amount, you can't be going for a whole month, stretching that out.*
>
> Discussion group, London

These views illustrate experiences of living on a low benefit income versus a higher income when in work.

However, figures also suggest that monthly wage payment is not typical for those on lower earnings. Although three quarters of those in work are paid monthly, the reforms are targeted at a specific part of the population in which far fewer receive their earnings on a monthly basis: 42% of those in the lowest two

quintiles are paid weekly;[81] and only 51% of those earning under £10,000 a year receive their earnings monthly.[82] The average income levels of the benefit population when they move into work indicates that monthly payments are anything but certain. DWP research shows the following average incomes on re-entering employment from different benefits: £13,800 per year for JSA claimants; £8,550 for those previously on Income Support; £12,350 for those on Employment Support Allowance.[83]

Therefore, although DWP research has suggested that transition from weekly benefit payments to a monthly wage could be 'difficult to get accustomed to',[84] it is unclear that a standard monthly payment is the right answer.

Frequency and rationing

Households referred to the advantages of more frequent payment of incomes which were staggered over shorter time periods, thus rationing expenditure and allowing households to control outgoings on a more frequent basis. Weekly payments were seen by some as a positive method of restraining expenditure and a method of retaining control. This had two dimensions. First, under a monthly payment households would be more likely to run out of money, because stretching the income over 30 days would be more challenging than stretching the money over 7 days. Second, if they were struggling they felt more comfortable managing until the next weekly payment date. Conversely, under a monthly payment, there would be a danger of spending a longer period of time on limited or no funds.

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81 Thanks to Professor Elaine Kempson for permission to cite this figure from her presentation at the Department for Work and Pensions on 2 July 2012.

82 Department for Work and Pensions, "Universal Credit Policy Briefing Note 2", http://www.dwp.gov.uk/docs/ucpbn-2-payment.pdf.

83 Lorna Adams, Katie Oldfield, Catherine Riley and Andrew Skone James, *Destinations of Jobseeker's Allowance, Income Support and Employment and Support Allowance Leavers 2011* (London: HMSO, 2012). It should be noted that the nature of the work is also likely to affect how often employees are paid, though this is difficult to quantify.

84 Christopher Farrell and William O'Connor, *Low income families and household spending* (London: HMSO, 2003), 28.

> *And then that last week you'd have nothing; no money left.*
>
> Discussion group, Oldham

Monthly payments, conversely, would remove this assistance and increase the risk that households would overspend during the month or run out of money earlier in the budgeting cycle leading to further debt or a crisis situation. A number referred to the increased difficulty of managing competing demands on their income when they had a big lump sum sitting in their bank account. In particular, this should be seen in the context of parents' desire to promote the well-being of their children described in Chapter 3. Levels of confidence of coping with this pressure varied markedly.

> *People just, you know, they work on a weekly basis when they're on such low incomes…. You know sometimes it's daily. So I mean that's going to be an absolute nightmare. It's going to cause more debt.*
>
> Lone parent household, recently transitioned into work, London

One interviewee suggested an analogy for what would be required of those who currently budgeted weekly and then received a monthly payment:

> *It's almost the same as saying okay, we're going to give you your lump sum of pay all in one … instead of just getting it monthly, you now get your annual salary paid to you directly and ... you're supposed to manage on that. People will be broke within a few months.*
>
> Discussion group, London

For some against a monthly payment, fear also rested on a belief that a monthly payment would present the opportunity early in the month to spend a significant amount which would then be followed by lengthy periods when the household had minimal resources.

> *Well [at the beginning of the month] you'd think you've got more money than what you've actually got.*
>
> Lone parent household, long-term out of work, Oldham

This was expressed as a concern both for the individual answering the questions as well as the wider benefit population. Consumerist pressures and demands from children were of particular concern:

> *That's the temptation and the kids of today are I want this and I want that and going here and going there, it's a pressure anyway keeping up with [the] Jones's. I try to bring Jones's to my level but it don't work.*
>
> Discussion group, Oldham

This change should not be underestimated. As demonstrated in Chapter 4, the benefit system can help individuals ration expenditure. In addition, households may depend on constraints on their income to help them interpret what constitutes necessary expenditure. Households typically rejected the idea that a shift to monthly payments would make it easier for them to set aside savings. In fact, some felt strongly that it may mean that they were more likely to run out of money and go into additional debt.

Making a difficult job harder

In straitened circumstances, regular benefit income streams were also felt to make a positive psychological contribution, acting as points of reference and events that individuals could look forward to.

> *You do all constantly feel really poor. At least when you're being paid on a weekly basis that feeling of being skint [is shorter] before you get a bit of money again.*
>
> Dual parent household, recently transitioned into work, London

For many, budgeting was a sufficiently difficult and testing exercise already for low income households without additional complications and changes exacerbating the situation and making the process even more stressful and stretched. As will be seen later, many preferred their weekly Housing Benefit going direct to the landlord and budgeting with their housing costs already deducted.

Indeed, contrary to the direction of the Government's planned policy destination, a number of households actually volunteered that they would like more frequent payments.

The implications: prepared, adaptors, exposed and hopers

From our sample, four groups of the claimant population were identified who are likely to respond to monthly payments in different ways and face different risks:

1. those who are already *Prepared*;
2. *Adaptors* for whom monthly payments would be a challenge but who could respond confidently;
3. the *Exposed* who felt they would be unable to cope and at risk of running out of money and taking on additional debt;
4. *Hopers* who viewed the reform positively, but whose response may not be appropriate to the challenge.

Figure 5.1 Typology of responses to the monthly payment and the characteristics of each group

Prepared

- Budget monthly
- Receive fewer benefit payments
- Mainly in favour of change

Adaptors

- Budget weekly or fortnightly
- Robust planners
- Strong budgeting systems
- Experience of successful adjustment

Exposed

- Largely ad hoc budgeters but some tacticians
- Heavy reliance on benefits to frame aspects of budgeting
- Major worries about coping and running out of money

Hopers

- Catalyst for improvement and more strategic budgeting
- Positive towards the reform
- Low budgeting capability

1. Prepared

These were households who welcomed the change to a monthly payment and were more likely to be budgeting monthly at the moment. The structure of their budgeting – with fewer and larger income streams – meant that the reform should assist them in managing their money. As one interviewee argued,

> *I pay everything else monthly. So it would just make it a lot easier to budget and see clearly what money I had in the way that in fact everybody else in the world does.*
>
> Lone parent household, recently transitioned out of work, Brighton

2. Adaptors

'Adaptors' represented the largest group in our research sample. Some of the adaptors viewed the reform negatively, referring to the inconvenience and the challenge of the transition. However, their characteristics, experiences and budgeting habits positioned them well to adapt to the change. In terms of budgeting traits, this group consisted largely of 'planners' and 'tacticians' who had confidence in their financial capabilities and budgeting. Experience was an important determinant of the confidence of a household to adapt effectively to change. Most of them budgeted on a weekly time-scale. Some referred to previous changes in the benefit systems that they had had to overcome.

Many disliked the reforms but recognised that they would have to respond proactively.

> *Whether it's weekly, monthly, you just have to adapt to whatever… whatever situation it was that I was in, if it means moving direct debit dates then you do.*
>
> Discussion group, Brighton

Box 5.3. Re-inventing the structure of benefit payments

Techniques for adapting differed, and households registered a number of responses:

- Rationing their income on weekly basis by setting the monthly payment aside and drawing down a virtual weekly payment.
- Apportioning money for specific purposes, such as food, through separate accounts and making greater use of online banking.
- Relying more heavily on direct debits, and restructuring and aligning regular bills and debt repayments to the new structure, with major payments timed to go out early in the month.
- Preserving the current structure of benefit payments by withdrawing cash fortnightly from the post office.

3. Exposed

Those who would be exposed to significant risks by the monthly payment represented a significant minority of households. The group comprised both 'ad hoc' budgeters and 'tacticians'. Typically, households in this group were opposed to the change, had lower levels of confidence that they would be able to adapt, were less financially engaged, and made more use of cash and less of bank services. Some – especially ad hoc budgeters – had less effective budgeting strategies. Tacticians who framed their money management fundamentally around the benefit system were vulnerable to the removal of many of the reference points around which they structured their household finances.

> *I'd just be worried that we wouldn't be able to cope week to week… At least if it's weekly we know that week to week if we can't do anything else at least we can eat or do the main important things.*
>
> Dual parent household, recently transitioned into work, Brighton

In addition, the lack of confidence in altering a budget technique could stem from individuals' internalised sense of their inability to budget. Other research has suggested that an internalising of the sense of 'otherness' and self-failure can create barriers to accessing

credit.[85] The same may apply to those who felt they would struggle with the change in payments. This may only be exacerbated if they are treated as 'exceptions'.

4. Hopers

While most of those who were positive towards the reforms already received monthly income, there were a number of households whose responses did not relate intuitively to their current budgeting period. There were a small number who saw the reforms as a potential catalyst for change, to improve their financial circumstances. However, some of these appeared to have comparatively poor budgeting skills and capabilities, and little suggested that, in these cases, the change would have the effect desired by the household in question. For instance, one mother who admitted that she did not know how much income was coming in from different sources, said that the change would be good:

> *Because I think I'd be a bit more organised and hopefully if I was a bit more organised I might be able to save a little bit more or put a little bit more or budget a little bit better.*
>
> Dual parent household, recently transitioned out of work, Oldham

THE NUMBERS AFFECTED

Quantitative evidence shows that a significant proportion of benefit and tax credit recipients believe that a monthly payment would make it harder to budget. A recent DWP survey asked benefit and tax credit recipients the following question: 'If payments of benefits and tax credits are made monthly, would you find it easier or harder to budget, or would it make no difference at all?'[86]

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85 John Flint, *Coping strategies? Agencies, budgeting and self-esteem amongst low income households* (Sheffield: Centre for Regional Economic and Social Research, 2010), 8.

86 Tu and Ginnis, *Work and the welfare system*, 56.

- Four in ten replied it would be harder, only one in ten said it would be easier, whilst four in ten said it would make no difference.
- Over half of those on JSA and six in ten of those on IS said it would be harder.
- Of those who said it would be harder, eight in ten cited the fact that they might run out of money before the end of the month.

These figures imply that a significant number may be adversely affected by the monthly payment. However, as our qualitative research indicated, opposition to the monthly payment did not necessarily mean that a household would be unable to adapt to the change and all those who said they would find it harder would not necessarily be unable to adapt.

REFORM 3: 'FIXED' MONTHLY ASSESSMENT AND PAYMENT IN ARREARS

What is changing?

Universal Credit will operate a fixed monthly assessment instead of the current annual assessment. The assessment period will be a month in length and the payment will, on current plans, be made seven days after the end of the assessment period. Awards will be fixed, unlike the current flexible tax credit awards. This means that financial support will not respond to changes in income or circumstances within the month.

Summary of impact

The reform should help automatically stabilise the incomes of those whose earnings fluctuate dramatically during the year and help rectify problems of overpayments and underpayments in the current system. However, the introduction of monthly payment in arrears could have a number of unintended consequences. First, because benefit income will fluctuate month-to-month to counterbalance rises and falls in earnings this may make it harder for those who hypothecate their tax credit income to specific outgoings. Second, the fluctuating payments

may serve to depress enthusiasm to work longer hours because of the immediacy of the loss of benefit income. Third, individuals who leave work may have to wait significant periods before they receive their updated Universal Credit payment, leaving them financially exposed. In addition, concern has been registered elsewhere as to whether the HMRC's Real Time Information (RTI) on earnings, on which the new assessment is predicated, is likely to work.[87]

Income stability or predictable benefits?

There was scepticism among some participants that a new fixed monthly assessment could accurately calculate their benefit levels. This stemmed from experiences with the current benefit system together with concerns about the complexity of the new system.

> *They're going to adjust your benefits according to how much you earn that particular month? They can't get it right at the moment with the tax credits…*
>
> Discussion group, London

However, aside from those views relating to the administrative feasibility of the system, responses were very nuanced. Views varied on the fluctuating Universal Credit income. While some recognised the advantages of a more responsive benefit assessment that could automatically adjust their entitlement month-to-month according to their income, for others the fluctuation inserted additional unwanted uncertainty into their budgeting:

> *So you can't tell whether next month you're going to pay all four bills or just three bills because you've earned an extra bit of overtime …You're constantly going to be on the back foot.*
>
> Discussion group, Brighton

87 Jamie Black, *All-Party Parliamentary Taxation Group: PAYE at the Crossroads* (London: House of Commons, 2012).

Box 5.4. 'Fixed' versus 'flexible' tax credit awards

In-work financial support systems differ between those in which the payment is fixed for a set period following an assessment period, and those in which the payment is flexible and can be adjusted during the payment period in response to fluctuations in income or changing recipient circumstances. Both have advantages and disadvantages.

Under Working Family Tax Credits (WFTC), which was operational between 1999 and 2003, awards were fixed for six months once they had initially been calculated. Any changes in circumstances or family income during the subsequent six months had no impact on the award, making life difficult for families who suffer unemployment or reduce their hours. Claimants increasing their earnings, on the other hand, would see no reduction in their award until the next assessment.

In contrast, Child and Working Tax Credits – introduced in 2003 – use a flexible award approach. Under this, the amount that a claimant receives within the assessment period (of one year) can change in response to variations in income and circumstances. Although this flexible approach is theoretically responsive to households' changing needs, it is reliant on claimants promptly reporting any changes and many do not. The result has been higher than expected levels of overpayments and underpayments of tax credits.

To mitigate these, the last Government was forced to introduce very generous income disregards for increases in earnings. These effectively made the system 'downward flexible' and' upward fixed': in other words, people facing a drop in income could have their tax credits increased, while those moving into work would have their tax credit payments unchanged until the following year. This solution strengthened work incentives but raised the cost of the scheme substantially.

The Universal Credit will revert to a fully fixed system, but will seek to overcome the lack of responsiveness under WFTC by shortening the award period from six months to one month. This approach aims to offer the solution to the debate about the merits of fixed and flexible systems. Making it work without introducing a huge bureaucracy relies on a new and risky innovation: linking up the tax and benefits system so that fixed monthly assessments can be done automatically (through real time information on earnings). But the gains from making the system work could be significant.

Research led by Professor John Hills demonstrated that household income for those on tax credits ranged from predictable and stable to highly irregular and unstable patterns across the year. LSE's longitudinal research categorised about four in ten of the families studied as having 'highly stable' or 'stable' incomes.[88] As the case study in Box 5.5 demonstrates, the lack of stability of income could be extremely disruptive for a household.

Box 5.5. Case Study of a household: Universal Credit and fluctuating incomes

Mrs A. has been working as a pre-school assistant for about eight years. She receives £498 per month in earnings when working, £535 in tax credits, £88 in child benefit and £360 in LHA payments. Mrs A. does not get paid in the school holidays. Therefore, her income plummets during the summer holidays: her benefits remain the same whilst her earnings evaporate.

The impact was severe: 'Less shopping. We can't go out as much. It's a struggle. It's a panic … I dread the holidays.' She prepared for the drop in income by trying to save in the period leading up to the holidays. However, she often ended up in more debt at the end of the holidays and noted that it took six months for her finances to recover from the summer holidays.

After further discussion, Mrs A. recognised that the new system could help smooth her income over the year and resolve the problem in the summer holidays. However, she valued certainty of income from benefits even more highly. She set aside her WTC and CTC into an account as a savings device and to make specific purchases for her child. She concluded that overall she would prefer the current system.

Getting the right amount

There was greater consensus among our participants on the advantages of the new system in resolving the problems of

88 John Hills, Rachel Smithies and Abigail McKnight, *Tracking income: how working families' incomes vary through the year* (London: ESRC Centre for Analysis of Social Exclusion, 2006).

overpayments of tax credits. Previous research shows that overpayments can be the source of considerable distress for those affected and severely undermine their financial resilience, triggering anxiety, debt and even family break-up.[89] A number of our households had been affected by overpayments or had friends who had experienced them:

> *It's good in one way that you're never going to get in debt with them, because obviously I've been in that situation where it has happened with me.*
>
> Dual parent household, long-term in work, Oldham

This suggests that moving to a shorter assessment period may be attractive but the corollary is a fixed rather than flexible award.

Improving work incentives

Despite the Government's clear desire to make work pay, behavioural responses to the new incentives to work following the introduction of the fixed monthly assessment and payment monthly in arrears may differ from the intentions of policymakers.

While the taper rates under Universal Credit will mean that the majority of individuals are better off in work than on benefits, the rolling assessment on which the principle relies may act as a disincentive for individuals to work more hours. Research interviewees noted potential pitfalls with the new system and incentives to work. This represented only a minority of views, but it indicates that some participants felt that the fixed monthly assessment and fluctuating payment would act as a disincentive for doing overtime.

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89 House of Commons Public Accounts Committee, *Tax credits and PAYE: eight report of the session 2007-08* (London: House of Commons, 2008), 7; Sophia Parker, *Just coping: a new perspective on low income families* (Maidstone: Social Innovation Lab for Kent, 2009), 36.

> *I don't think I'd bother trying to put more overtime in. I just think it would be disheartening … even if you say that if you had a good month you would be left with a bit more, I still don't think I'd put that extra effort in.*
>
> Discussion group, Brighton

This may be due to 'loss aversion' and the attachment of greater value to the benefits 'lost' than the earnings 'gained'. This bears out concern expressed by claimants in a recent DWP testing exercise which found that even when audiences were presented with a 'better-off calculator', 'in-work audiences were still not convinced that they would be demonstrably better off in going beyond their current "sweet spot" in terms of hours'.[90]

Smoothing the transition phase

Delayed welfare payments can cause financial distress as people move in and out of work.[91]

Universal Credit is a clear opportunity for the benefit system to become more responsive. However, the payment of benefits monthly in arrears alongside a fixed monthly assessment may mean that an individual has to get by without any income or very low income for a significant period of time.

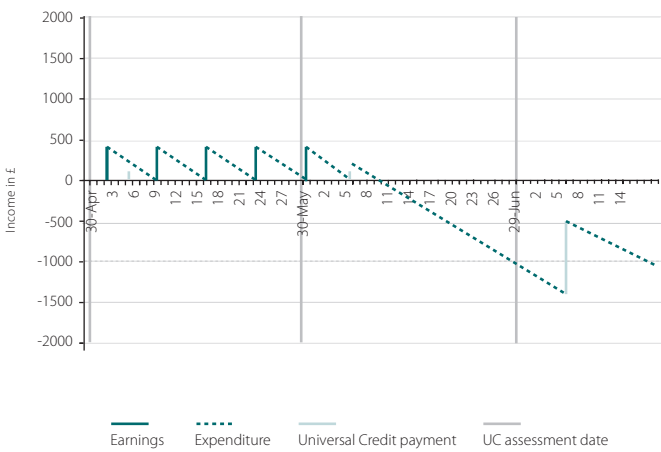
90 Rotik and Perry, *Insight to support Universal Credit user-centred design*, 6-7.

91 Centre for Social Justice, *Dynamic Benefits: Towards welfare that works* (London: Centre for Social Justice, 2009), 142-3.

Box 5.6. Assessment periods and payment times

The draft regulations state that the assessment period will run from the 'effective date of claim and each subsequent assessment period will begin on the same date of the month'.[92] The assessment period will run for a month to ensure that the DWP receives at least one update on earnings information for each working member of a household. Claimants will then be paid seven calendar days after the end of their initial assessment period and on the same calendar day in subsequent months.

Figure 5.2: Simulated scenario: Assessment and payment as in draft regulations



Simulated analysis indicates that the new structure could also potentially pose problems where a worker on a weekly income loses a job. For instance, a claimant's assessment period starts on 30th of each month, and the correct Universal Credit payment is made seven days later on the 6th of each month thereafter.

92 Department for Work and Pensions, "Explanatory memorandum for the Social Security Advisory Committee: Claims and payment regulations", http://www.dwp.gov.uk/docs/uc-pip-claims-payments-draft-regs-2012-memorandum.pdf.

As Figure 5.2 shows, even in the most optimistic playing out of this scenario, a person earning a weekly wage would have to get by for a month without any substantive income. It is far from inconceivable that it will take longer than seven days from assessment to payment. In 2007, the average time for a claimant to become established with the right rate of Income Support benefit was between 12 and 16 working days.[93] Shelter and Crisis have found significant delays to Housing Benefit that may face new claimants and those amending their claims.[94] The draft regulations imply it may take longer in certain circumstances.[95] In such cases, the household would be pushed further into debt.

There is no provision in the draft regulations to shorten the assessment period (except for those reaching the qualifying age for Pension Credit).[96] Instead, the Government is looking to support those in transition through 'Short-term Advances' and 'Budgeting Advances'.[97] It will be important to ensure that all individuals who are potentially disadvantaged by the monthly payment in arrears can access interim sources of support, whether they be loans or grants.

93 David Freud, *Reducing dependency, increasing opportunity: options for the future of welfare to work* (London: HMSO, 2007), 100.

94 Shelter submission, in House of Commons Work and Pensions Select Committee, *White Paper on Universal Credit: oral and written evidence* (London: House of Commons, 2011), Ev123, http://www.publications.parliament.uk/pa/cm201011/cmselect/cmworpen/743/743.pdf.

95 DWP, *The Universal Credit, Personal Independence Payment and Working-age Benefits (Claims and Payments)* Regulations 2012, Section 40 (2).

96 Department for Work and Pensions, "Explanatory memorandum for the Social Security Advisory Committee, Decision making and appeals regulations for Universal Credit", http://www.dwp.gov.uk/docs/uc-pip-decisions-appeals-draft-regs-2012-memorandum.pdf, 12.

97 Department for Work and Pensions, "Information sheet on short-term advances and budgeting advances", http://www.dwp.gov.uk/local-authority-staff/social-fund-reform/. Short-term Advances will replace Interim Payments and Social Fund Crisis Loan alignment payments. Budgeting Advances will replace Social Fund Budgeting Loans.

REFORM 4: HOUSING BENEFIT PAYMENT

What is changing?

Rather than seeing their Housing Benefit paid direct to their landlords, claimants in social housing will receive the benefit themselves and will be responsible for paying rent under the new system. This is currently the case for most recipients of Local Housing Allowance who live in the private rented sector. A number of housing demonstration projects are currently underway to test ways of introducing payment via the tenant without causing a large increase in arrears.

Summary of impact

The households in our research were strongly opposed to receiving their rental payments, even many of those currently receiving LHA money. Many expressed the fear that households would be unable to manage their finances effectively and would overspend, leading to rental arrears and possible eviction. Most of this concern was raised by our interviewees on behalf of the wider claimant population but some also had reservations about their own ability to cope.

The impact on our households

The Housing Benefit reform was opposed by most participants in the interviews and discussion groups. Broadly this reflects quantitative research carried out by Policis that indicates that nine in ten social tenants believe that it would be better for Housing Benefit to be paid direct to the landlord.[98]

The fact that housing costs are currently 'taken care' of and set aside was regarded by most of our households as a positive aspect of the current system, which helps families to budget more effectively. Many preferred to budget after housing costs had been made as it was easier to manage and less risky. Some Housing

98 Wendy Wilson, *Paying Housing Benefit direct to tenants in social rented housing* (London: House of Commons Library, 2012), 5.

Benefit recipients had a very distant relationship with the housing money that would be coming their way.

> *I just think, it's not your money is it? So why does it have to pass through your hands if it's not your money? You haven't earned it, you haven't done anything for it.'*
>
> Dual parent household, recently transitioned out of work, Oldham

The main reason for participants objecting was the prediction that a significant number of claimants would spend their housing money on other things, leading to rent arrears and debt, which would in turn mean families being evicted and additional social problems.

> *Everyone is going to be in arrears. It is just going to end up costing them [the Government] more money.*
>
> Dual parent household, recently transitioned out of work, Oldham

For some, this was of direct consequence to them; for others it was a wider social concern for other claimants. More generally, the proposal was met with considerable surprise and many were unable to understand what would motivate such a change.

A minority of our households registered considerable concern that the payments would be difficult for them. As with concerns about the monthly payments, apprehension stemmed in part from the perception that the housing payment would be hard to set aside for rent given the other demands on their income and that this could lead them into debt.

> *Because I would spend it. … I do need my roof over my head but if my kids are walking around in shoes with holes in you put them first.*
>
> Dual parent household, recently transitioned out of work, Oldham

How would households adapt?

Most in this research who might be affected by this change expected they would be able to adjust and would control the risk. In part this was because households identified rent payments as a particular priority.

> *No, you'd be messing about with your home in a way basically by not paying your landlord.*
>
> Dual parent household, recently into work, London

However, participants felt strongly that tenants would be unable to pay their housing costs and would go into arrears. In almost all instances, participants struggled to identify any positive aspects of the proposal, although one interviewee mentioned that the reform might remove some of the stigma attached to living in social housing as the landlord would not know where the money was coming from.[99]

Some participants interpreted the change in terms of the Government wanting to transfer more responsibility to benefits recipients. But, this was seen mostly in terms of government trying to avoid the administrative work involved in processing payments rather than being driven by any wider benefits of increasing personal awareness and responsibility. On the rare occasions this latter argument was acknowledged it was rejected; families felt that they already had a great deal of responsibility in managing their tight budgets and that increasing this would represent a greater burden and an obstacle to financial resilience. Moreover, families dismissed the idea that people could be obliged to assume greater responsibility simply by forcing it on them, and that even if this did happen in a few cases, the advantages would be far outweighed by the disadvantages of many families entering hardship and debt.

99 It is unclear that this would actually be the case.

You can't force people to budget. You can only educate them.

Discussion group, London

Parallel lessons from the Local Housing Allowance

These insights bear out events that have taken place with Local Housing Allowance (LHA) claimants who live in the private-rented sector and are receiving their rent payments. The LHA experience indicates that such payments are likely to lead to significant problems for social landlords and for social housing tenants, the latter who are comparatively more vulnerable than LHA recipients.

Under LHA, the National Landlords Association found that more than half of private landlords said they would not rent out their properties to benefit tenants due to fears of rent arrears.[100] A pilot run by L&Q Housing Association in 2004 found that when tenants were moved over to receiving their payments the rate of arrears increased from 3% to 7%.

DWP evaluations of the LHA policy have shown significant problems for a minority of tenants. The report concluded that 'evidence on financial management of tenants was mixed', with some taking responsibility for paying their rent seriously but a significant minority failing to manage the income effectively.[101] Those who were struggling with the payments included those with multiple debts, those who depleted their rent payments on other purchases, vulnerable people and financial inexperienced claimants. The proportion of tenants who were shifted back onto direct payments to the landlord in light of problems with arrears was 8%; a further 11% had been put onto direct payments due to safeguards around being "unlikely to pay" or having "difficulty paying".

100 Shelter, "Local Housing Allowance and direct payments-giving claimants a choice", http://england.shelter.org.uk/__data/assets/pdf_file/0007/221659/LHA_directpayment_briefing.pdf.

101 Department for Work and Pensions, *Two year review of the Local Housing Allowance* (London: HMSO, 2011), 11-12.

Payment to tenants and potential inefficiencies

There are likely to be fiscal implications as the risk of rent arrears increases. Moody's, the leading ratings agency, has noted that direct payment to the landlord is a 'credit strength' and that payments via the tenants and the increases to social landlords of rent arrears and voids would be 'credit negative'.[102] The result would be that housing associations would have to pay more to borrow money, with knock-on implications for the building of affordable housing and new dwellings. The Government has explicitly recognised 'the importance of stable rental income for social landlords to support the delivery of new homes and will develop Universal Credit in a way that protects their financial position.'[103] To this end, the Government is currently carrying out a number of demonstration projects to assess how these risks could be managed. However, this research and the experiences of the LHA suggest that it will be extremely hard to make the existing Universal Credit proposal work.

102 Isabel Hardman, '"Direct payments would harm credit ratings", *Inside Housing*, March 22, 2011; Moody's Investors Services, "Report on Circle Housing", November 17, 2011.

103 Department for Work and Pensions, *Universal Credit white paper*, 20.

REFORM 5: SINGLE RECIPIENT

What is changing?

When households receive their Universal Credit award, it will go to one bank account, which has to be nominated and approved by both members of a couple. This is a change from the current system, where different benefits and tax credits can be split between the main earner and the main carer. In 80% of cases, the Child Tax Credit (typically the largest state transfer families receive) is paid to the mother, for example.[104]

Summary of impact

For most of our households, the single recipient was viewed with indifference; this was because of the collaboration over finances in most households, and the fact that most of our interviews were with women, who generally elected themselves as the potential claimant under Universal Credit. However, in a minority of cases, the research suggests that the reforms could undermine the financial independence and resilience of a household member where power was unbalanced within the relationship. In addition, the secondary literature suggests the reforms could have unforeseen impacts such as lowering the level of resources directed at children.

Implications of the single recipient

Most of those interviewed felt that the move towards a single recipient would not be problematic. This was due to two principal reasons. First, many of the women interviewed nominated themselves as the likely recipient. Second, even when this was not the case, participants often expressed high levels of trust, sharing and communication with their partners over household budget management.

104 Chris Warburton Brown, "Should mum get the credit? The impact of paying tax credits directly to mothers", University of Glasgow presentation, http://www.social-policy.org.uk/lincoln2011/Warburton-Borwn%20P5.pdf.

> *I mean, I guess Dan puts the money in, and he's the one who, kind of, checks and makes sure, and I double check to make sure its ok. It's, kind of, the two of us really.*
>
> Female in a dual parent household, recently transitioned into work, London

Therefore, most of our households felt that they would adjust to the reforms with only a marginal restructuring of the way the household managed its money.

> *I don't think it would affect us a great deal. Obviously we would have to juggle things around as to who pays what.*
>
> Female in a dual parent household, recently transitioned into work, Brighton

> *It wouldn't affect us. I would just give the [Post Office] card to H.*
>
> Male in a dual parent household, long-term out of work, Brighton

However, these findings have to be interpreted with care, not least because the evidence from other benefits for workless couples suggests the man is the likely claimant: currently almost two thirds of Income Support claims are made by men.[105] First, the majority of our interviews were carried out with only one member of the household, typically the woman, and the interviewee had identified themselves as the principal budgeter in the household. Second, the research involved a number of paired interviews. This did not bring different underlying tensions to the surface but, even in paired interviews, research suggests that when asked about their arrangements, couples may put on a united front to convey

105 Department for Work and Pensions, *Equality Impact Assessment – Universal Credit: welfare that works* (London: HMSO, 2011), 10.

togetherness.[106] To get right to the bottom of any inconsistencies in how members of the households report how they will manage money under the Universal Credit, more interviews with women and men independently and together may help.

A small number of women interviewees also believed that some benefits should go to the member of the household who was 'entitled' to it, because they saw it as income replacement. For example, it was argued that, if a man had just been made redundant, it was fair that he should receive the Jobseekers' Allowance:

> *I just think if it was his Job Seekers money, it should go to him. I just feel that that's the right way.*
>
> Female in discussion group, Brighton

Some interviewees did express secondary concern for other households – that, in a troubled relationship, for example where there was a power imbalance or a controlling partner, it may be problematic for one partner to have no independent source of income.

> *You're basically giving the power to people to control other people.*
>
> Male in discussion group, London

Though interdependence and collaboration with partners was most common for our interviewees, in a small minority of cases the idea of a single recipient was extremely troubling. This concern stemmed from:

- financial affairs being separately managed within the household, with little sharing of information on income and expenditure;

106 J. Stocks, C. Diaz, C. and B. Hallerod (eds), *Modern couples sharing money, sharing life* (New York: Palgrave Macmillan, 2007).

- a lack of certainty about who would end up wanting or being able to lead the household finances and budgeting process;
- distrust of the man's ability to spend money in the interests of the whole household;
- concern that the single recipient could be used to exert power and control within the household.

One woman said that she would have to nominate herself as '*I don't trust my partner*'. She also noted that it would cause significant tensions in the household,

> *Because a man… if something like that happens, a lot of men, the majority of men would think, "Well, I'm the man, it's me who should be controlling it".*
>
> Female in a dual parent household, recently transitioned out of work, London

Although reluctant to manage the household finances completely herself, another woman noted,

> *I think if he had it, he'd probably get on like some kind of power trip and like "no, it's his money", "here's your £10 pocket money" and stuff like that. I don't think it would be good for us if that was the case.*
>
> Female in a dual parent household, recently transitioned into work, Oldham

Therefore, it is clear that a single recipient could have significant consequences for such households. Under the provisions of the Welfare Reform Bill, both members of a couple have to sign the Universal Credit claim. Additionally, the Secretary of State has powers to decide which partner should receive a payment, for example where the Secretary of State considers that the benefit

money could be mis-spent.[107] This power will be useful in cases of criminal abuse, but less compelling in instances of power imbalances and financial abuse within the household.

Wider implications

Our research suggested two broad categories of people: those who will manage well with a single recipient and those where it could be extremely problematic because of financial abuse. But the secondary literature suggests there are wider, more subtle implications which may mean there are less tangible implications of which households may be less aware.

First, some households may not be abusive, but the man does control financial arrangements. The academic literature reveals that the power dynamic over finances in some households can be unbalanced, and can be particularly unfavourable for the woman.[108] Several studies show that in these types of households, men often consume more items from the common 'house-keeping' purse.[109] Additionally, secondary analysis of the 2005 Financial Services Authority baseline survey of financial capability shows that 46% of households have a joint bank or building society account;[110] but a joint bank account does not necessarily mean joint ownership of the management of the money. The Government has confirmed that 'particularly in low income households … men sometimes benefit at the expense of women from shared household income'.[111]

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107 Department for Work and Pensions, *Explanatory memorandum for the Social Security Advisory Committee*, http://www.dwp.gov.uk/docs/uc-draft-regs-2012-memorandum.pdf, 7.

108 The Women's Budget Group, *Women's and children's poverty: making the links* (London: The Women's Budget Group, 2005), 6.

109 Chris Warburton Brown, "Should mum get the credit? The impact of paying tax credits directly to mothers", University of Glasgow presentation, http://www.social-policy.org.uk/lincoln2011/Warburton-Borwn%20P5.pdf.

110 Adele Atkinson, Stephen McKay, Elaine Kempson and Sharon Collard, *Levels of financial capability in the UK: results of a baseline survey* (Bristol: University of Bristol, 2006).

111 House of Commons, Hansard, Written Answer, 14 March 2011, c126W.

Second, there is a wealth of evidence from the UK and abroad to suggest that when women receive benefits this is more likely to lead to higher expenditure on children. When child benefit was transferred to women from men in the late 1970s, there was a significant increase in expenditure on women's and children's clothing.[112] In Brazil, Canada and France, there has been econometric testing showing that men and women have different spending patterns, with women tending to spend more on children.[113]

Third, other literature suggests a single recipient could have wider gender implications, of which claimants may be less aware:

- One member of the couple could be deprived of the opportunity to manage finances on a regular basis. Making more people dependent on their partner for financial affairs – as 19% of people currently are[114] – could have negative long-term effects, particularly in later years if a relationship ends because of separation or bereavement.
- One member of the couple may not be able to access a bank account in the future. To open a bank account, you need proof of income – which is difficult if you are not paying utilities or bills.
- It could lead to a couple penalty. Those forming new relationships are more likely to have a separate bank account: 58% of cohabiting couples did not set up a joint account when they first moved in with each other, for instance.[115] But the risk of losing control over income when a partner moves into the household could deter couples from living together.[116]

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112 Shelly J.Lundberg, Robert A.Pollak, Terence J.Wales, "Do husbands and wives pool their resources? Evidence from the United Kingdom Child Benefit", *The Journal of Human Resources,* XXXII, (1996), 479.

113 John Hoddinott and Lawrence Haddad, "Does female income share influence household expenditures?", *Oxford Bulletin of Economic and Statistics,* 57:1 (1995), 78.

114 Atkinson, McKay, Kempson and Collard, *Levels of financial capability in the UK: results of a baseline survey.*

115 Myra Butterworth, "Four out of five couples do not share joint bank account", *The Daily Telegraph*, May 9, 2011. A further 21% only set up a joint account for bill payments.

116 Fran Bennett, "Universal Credit: payment to joint claimants", http://wbg.org.uk/pdfs/Universal-credit-payment-to-joint-claimants-Nov-2011-Clause-97.pdf, 6-7.

The secondary literature suggests there are more nuanced gender implications. So, in addition to the powers residing with the Secretary of State, there may be a case for claimants to be given a choice to split payments if they feel this would help their budgeting and financial arrangements.

REFORM 6: SAVINGS PENALTIES

What is changing?

Currently, those families with over £16,000 in savings are ineligible for out-of-work benefits, but treatment of savings for tax credit recipients is much more generous, allowing them to claim in-work support. Under the planned reforms, the tighter capital restrictions will be applied to all Universal Credit claimants.[117] Savings of over £16,000 will disqualify a household from receiving any support at all. Those with savings between £6,000 and £16,000 will be eligible for reduced Universal Credit benefits.[118]

Summary of impact

Views among our households were mixed on whether the threshold was fair in principle, but it appears the rule is unlikely to affect savings activities among the very lowest income families. Since few do any saving now, low income households are not the constituency that will be principally affected by these reforms. For working families, particularly those on middle incomes, the savings disincentive could bite harder. The new rules will likely have important consequences for working families relying on childcare support.

117 House of Commons Library Note, Research Paper 11/48, 12. Capital in excess of £6,000 will be treated as yielding an income (known as "tariff income") of £1 per week for each complete £250 over this £6,000 floor. Capital under £6,000 will be disregarded.

118 Department for Work and Pensions, "Universal Credit Policy Briefing Note 3", http://www.dwp.gov.uk/docs/ucpbn-3-capital.pdf.

The Government's analysis suggests that there will be up to 100,000 households on tax credits with savings over £16,000 who could be affected by the capital rules in universal credit.[119] However, SMF analysis using the ONS's Wealth and Assets Survey has shown that around 400,000 families with children currently receiving tax credits will lose their entire eligibility for financial support under the Universal Credit, whilst a further 200,000 (with savings of between £6,000 and £16,000) would lose part of their benefit.[120]

Due to the very low levels of savings across our households, and the low number of active savers, it was difficult to engage participants in this issue. Therefore this reform was only discussed with a minority of households. When this issue was discussed, responses took two principal forms. Some felt that the cap was so high as to have a negligible impact on them.

> *I don't think I would set aside money for the future to tell you the truth. I don't think it would have any impact for me.*
>
> Dual parent household, long-term out of work, Oldham

Others considered the rule unfair and contradictory in policy terms, even though their savings levels were well below the cap. These households were regular savers.

> *I think it's a bit unfair that people who actually are sensible with money rather than squander it get punished for it. I think that's a bit mean.*
>
> Dual parent household, recently transitioned into work, Brighton

119 Steven Kennedy, "House of Commons, Welfare Reform Bill 2010-12: Commons Report Stage and Third Reading", House of Commons Library, 2011, 7-8.

120 Cited in House of Commons Library, "Welfare Reform Bill: Universal Credit provisions Bill No 154 of Session 2010-11". House of Commons Library, 2011), 25.

However, it was not clear whether the policy would change households' desire or ability to save.

> *It wouldn't affect us, I don't think we save that much.*
>
> Dual parent household, recently transitioned into work, Brighton

This research suggests that the cap is likely to have little impact on the motivation to save among low income households. However, it is quite possible that the cap may act as a disincentive for those further up the income spectrum. Those in receipt of Universal Credit solely for childcare support and young families seeking to build up a deposit for a house are among those likely to feel the impact.

Conclusions

The benefit system would benefit from simplification. However, our fieldwork together with insights from previous reforms and other evidence indicates that the proposed reforms are unlikely to help build and sustain financial resilience across all of the low income population. Chapter 4 described the patterns that characterise low income households and how they manage their money. Chapter 5's analysis and findings suggest that the Universal Credit reforms are likely to run counter to many of the budgeting strategies developed by low income households.

The research indicates that the monthly payment and the payment of Housing Benefit to claimants will require significant behavioural change amongst the claimant population. Our research suggests that most are likely to be able to adapt, though some will require support and time to adjust effectively. However, a minority of households registered real concern about their ability to cope with the proposed changes. In these cases, there is a danger that households run out of money before their next benefit payment arrives, thus increasing the reliance on formal and informal debt. In these instances and others, the reforms are unlikely to help the

Government make progress towards its goal of building financial resilience across the claimant population. In the next chapter the research assesses in detail the proposed measures to safeguard vulnerable individuals alongside potential alternatives.

SECTION IV: NEW IDEAS TO BUILD FINANCIAL RESILIENCE

CHAPTER 6: POLICY AND PROPOSALS

Chapter Five demonstrated that, as currently planned, the Universal Credit reforms have the potential to undermine the financial resilience of many low income households by removing budgeting markers and aids, damaging incentives to save for those in work and providing assistance to those leaving work only after a considerable time lag. The DWP recognises some of these issues and has expressed a desire to find a solution that supports vulnerable households, increases financial capability and helps individuals exercise their personal responsibility, whilst achieving its efficiency aims.

The reforms can be made to work with the grain of wider government objectives, rather than against them, by drawing on behavioural insights. A single uniform monthly payment seeks to boost personal responsibility by effectively throwing recipients in at the budgeting deep-end. Claimants will have to take close control over a tight budget and manage it themselves without the markers and aids that the current benefit system provides them with and around which many have structured their budgeting approaches. Yet for anyone but rational economic man this is easier said than done, and past experience suggests that many, despite their best intentions, will struggle to budget effectively.

By entirely devolving responsibility for how claimant families manage their money, the new system risks creating problems not only for families but also for those organisations and individuals that families will effectively come to rely on for credit. Rather than solving it, such a laissez-faire approach will effectively shift the problem and its associated economic costs around. But, by assisting families to manage their money, through the way that Universal Credit is paid, the new scheme can make household budgeting part of the solution.

This chapter suggests how this goal could be achieved by developing an active approach to the personal responsibility agenda and helping people to help themselves.

THE GOVERNMENT'S PROPOSALS

The Government has committed itself to supporting claimants who need more help. It is doing this through a combination of three policies: promoting more appropriate financial products; providing financial advice and budgeting support; and shifting vulnerable individuals on to an alternative payment structure ('Exceptions'), though this is planned to be only temporary.

Financial products

Widening the availability of affordable and more functional financial services is likely to be a valuable solution for a section of the claimant population. The Financial Inclusion Taskforce has argued the case for more appropriate bank accounts for low income households and the unbanked population.[121] Jam Jar Accounts (accounts which automatically apportion income to rent and other expenditure) could help those our research has identified as 'Planners'. Such accounts could assist them in developing their budgeting capability further and help some 'Tacticians' transition to the monthly payments and Housing Benefit payment, including greater use of direct debits. However, the service is unlikely to suit many 'Tacticians' and 'Ad Hoc budgeters' who avoid financial services and deliberately use cash rather than automated payments.[122]

121 Financial Inclusion Taskforce, *Banking services and poorer households* (London: HMSO, 2010). See also the report commissioned by the taskforce, authored by Social Finance.

122 See debate in the House of Commons led by Damian Hinds MP, *Hansard*, February 28, 2012: Column 56WH.

Box 6.1. Jam Jar Accounts

Jam Jar Accounts allow customers to put their money in different jars for spending, saving and bill payment. They can improve budgeting through low balance alerts and automated transfers between jars.[123] Currently, it is estimated that 150,000 consumers take advantage of such accounts, and pay fixed fees of £12.50 to £14.50 per month for them.[124] However, there are still large numbers of people without even a simple transactional bank account.

Our focus group research uncovered very mixed perspectives towards jam jar-style accounts. Some participants were positive about how this would help them manage their money especially in the context of the Universal Credit changes. However, the opposite view was put forward more frequently. Criticisms included: the reduced level of flexibility that direct debits would entail; concerns that banks would 'set off' the income in their account against outstanding bills; the fact that it would replicate the budgeting activity they were doing in their home already; and the costs to the consumer (which even those in favour of the service said they would be unhappy to pay). As the evidence on budgeting approaches indicated, many choose to budget in cash to exert control on their finances, even though they may have bank accounts.[125]

As Social Finance has argued, therefore, jam jars could be very beneficial products. But, they have only partial applicability across the claimant population. Alongside deficiencies on the demand-side, it is also unclear whether providers would be able to offer

123 Keith Cooper, "Report tries to allay direct payment fears", *Inside housing*, May 13, 2011.

124 Louise Savell et al, *A new approach to banking: Extending the use of jam jar accounts in the UK* (London, Social Finance, 2011).

125 It should be noted that social tenants are more likely to be unbanked. Financial Inclusion *Taskforce, Banking services and poorer households*, 5.

jam jar accounts free of charge or at very low cost.[126] This opens up questions as to where the subsidy would come from to make them into a solution.

Our research suggests a strong resistance to financial products amongst a significant part of the claimant population.[127] In addition, the DWP's recent research has indicated that the provision of interactive budgeting tools and other initiatives through the online system could help some claimants but 'are unlikely to themselves be enough to resolve the issues as it may be that those at greatest risk make the least use of the new provisions.'[128] Only about one in two of the unbanked show an appetite to make use of financial services – and given the high level of churn of the newly banked, it is likely that many of these would leak away over time.[129] As noted earlier, a large number end up net losers from entering financial services due to charges.

Advice and budgeting support

Financial advice – whether upfront budgeting support or debt advice – could play an important role. Research has demonstrated that debt advice can have a very positive effect on the levels of indebtedness in a household, on financial management and on well-being.[130] Other research has also indicated that there can be a financial business case for social landlords to invest in debt advice to help their tenants and reduce rental arrears.[131]

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126 Research by Social Finance suggests that accounts would have to be subsidised. On a case by case basis this subsidy could come from a number of sources such as social landlords – see Tom Lloyd, "Landlord urges tenants to use 'jam jar' accounts", Inside Housing, August 15, 2012.

127 Elaine Kempson and Sharon Collard, *Developing a vision for financial inclusion* (London: Friends Provident Foundation, 2012), 27.

128 Rotik and Perry, Insight to support *Universal Credit user-centred design*, 28-31.

129 Financial Inclusion Taskforce, *Banking services and poorer households* (London: HMSO, 2010).

130 Michael Orton, *The Long-term impact of debt advice on low income households* (London: Friends Provident Financial, 2010).

131 Gareth Evans and Mick McAteer, *Does debt advice pay?* (London Friends Provident Financial, 2012), 2-3.

However, advice remains very resource-intensive and support is likely to have to be narrow in scope rather than universal. First, advice has to be highly targeted to be effective. Second, there is a stronger financial business case to target advice where the intervention is clearly likely to reduce financial harm to a third party (such as a social landlord) than where this case is less obvious. Third, demand for advice may be low: DWP's research suggests that only 10% of those who said they would struggle with the change in payment structure felt they would be helped by advice; 55% could not identify anything that could help them.[132]

Fourth, there are significant on-going reductions to financial support services. Central grant to local authorities is being cut by over a quarter during the course of the spending review.[133] While it is unclear who the Government expects to provide advice and whether there will be specific funding available, these cuts are squeezing the local charities that step into the gap.[134] This reduction of the supply of advice needs to be set against increasing demand due to higher levels of unemployment.[135] These dynamics are likely to make advice services even more stretched unless significant additional resources are made available.[136] As such, financial advice alone will be unable to provide universal coverage.

Budgeting and debt advice will have a fundamental role to play in helping specific individuals transition to the new payment

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132 Tu and Ginnis, *Work and the welfare system*, 56.

133 HMT, *Spending Review 2010* (London: TSO, 2010).

134 For instance, Citizen's Advice reported that in the first year of the budget cuts it had been forced to reduce the number of people who came to the organisation for debt advice by 7%; Citizens Advice Bureau, "Cuts in CAB funding leave thousands with nowhere to turn for help", http://www.citizensadvice.org.uk/press_index/press_20110906.htm.

135 Ivan Mathers and Neera Sharma, *A vicious cycle: the heavy burden of credit on low income families* (London: Barnardos, 2011).

136 Orton, *The long-term impact of debt advice on low income households*, 25-6. Although people were very positive towards the advice they received, they noted that it was difficult to access services, especially face-to-face advisors.

environment, but the charitable sector would be better directed to helping the most vulnerable with tailored support rather than mass-producing generic support.

An exceptions policy

The Government is seeking also to develop an exceptions policy.[137] The draft regulations stipulate the Government's commitment to supporting vulnerable individuals who, once identified, would be channelled into exceptional safeguarding arrangements. This might include intense budgeting support or an alternative to the standard benefit payment structure, which could involve more frequent payments or payments to third parties to assist in financial management.

Exceptions policies are methods of ensuring that those who cannot cope with a standard service are accommodated. Such a method was deployed in the roll-out of LHA. But an exceptions policy also has limitations. While it relies on the ability to identify vulnerable individuals, the capacity of a low income household to adapt effectively to the policy change is determined by many factors, some more clearly identifiable than others.

Figure 6.1 below sets out some of the characteristics of different individuals that may make them more capable of adapting to the changes in Universal Credit. This is developed from analysis in Chapters 4 and 5 above. In particular it draws out the characteristics of the different types of responses to the monthly payment (see Figure 5.1), alongside proxies of high or low financial resilience (such as savings, arrears and debt levels).

137 Department for Work and Pensions, *Explanatory memorandum for the Social Security Advisory Committee Claims and Payment regulations*, http://www.dwp.gov.uk/docs/uc-pip-claims-payments-draft-regs-2012-memorandum.pdf, 13.

Figure 6.1. Characteristics associated with ability to adapt

While the state may be able to identify some (such as ex-prisoners and those with mental health conditions), and may be able to make use of credit reference agencies to supply further data, it is far harder to track many others who are likely to struggle. Evidence from the LHA supports this case, as shown in Box 6.2.

Box 6.2. Lessons from other exceptions policies

The exceptions policy that was developed for the LHA offers some lessons for the design and viability of an exceptions policy. Under LHA, local authorities were responsible for identifying those who would be eligible for exceptional conditions. Three rules were applied to identify those who should be supported under the safeguarding policy: tenants who were eight weeks or more in arrears; those who were "unlikely to pay"; and those who had "difficulty paying". However, 'advisers often had difficulty obtaining supporting evidence for the "unlikely to pay" or "difficulty paying" safeguards' and the criteria were insufficiently broad to capture the range of claimants who needed support.[138] This suggests that, rather than preventing negative repercussions, the policy picked up the vulnerable often only after they had already been allowed to fall into arrears.

138 Department for Work and Pensions, *Two year review of the Local Housing Allowance* (London: HMSO, 2011), 12, 73, Chapter 4.

An exceptions policy is open to three principal risks. First, it may be too selective and exclude many vulnerable households that require help (and this research suggests that a significant number could need help). Alternatively, it may be too late and identify the vulnerable households but only at the crisis point when significant damage has already been inflicted to the household's resilience (see Box 6.2.). Finally, it may be too generous and pick up not only those who are vulnerable but also many who could cope, pushing up the administrative costs necessary to identify exceptional cases and rendering the exception the rule.

AN ALTERNATIVE: A 'BUDGETING PORTAL'

A role for flexibility?

The Government has thus far been reluctant to offer claimants flexibility in the way that they receive their benefits. However, in our focus groups, participants volunteered (unprompted in two of the groups) the idea of flexibility and choice over payments. The idea met with widespread, almost universal, approval.

Box 6.3. Participants' views on flexibility in method of benefit payment

Participants were almost universally in favour of the idea of flexibility to select how payments were made. This was especially the case for the monthly payment.

> *But [if] they gave you the option to say well if you really can't cope with monthly, we can negotiate and we can probably do it bi-weekly, then yes I agree with them.*
>
> Discussion group, London

If they're going to bring this in, they should give you an option of when you get it.

Discussion group, Brighton

Choice is always good.

Discussion group, London

There probably wouldn't be so much of a panic as well if they give people that choice. One little word and it means a lot doesn't it?

Discussion group, Oldham

This linked closely with the desire among our research participants for a more interactive and responsive benefit system. The DWP's own research identified 'overarching guiding principles' for the Universal Credit, the most significant of which was 'personalisation'.[139]

As well as capturing the support of the claimant population, a more flexible system would recognise the high levels of agency already demonstrated by low income households in their money management. The personal responsibility agenda can better be furthered by harnessing the motivation and skills of claimants, rather than forcing a one-size fits all approach on them. Using behavioural insights, a system can be designed to boost personal responsibility by encouraging households to take active responsibility to determine how they received and use their benefit payments.

139 Rotik and Perry, *Insight to support Universal Credit user-centred design*, 6-7.

Behavioural nudge?

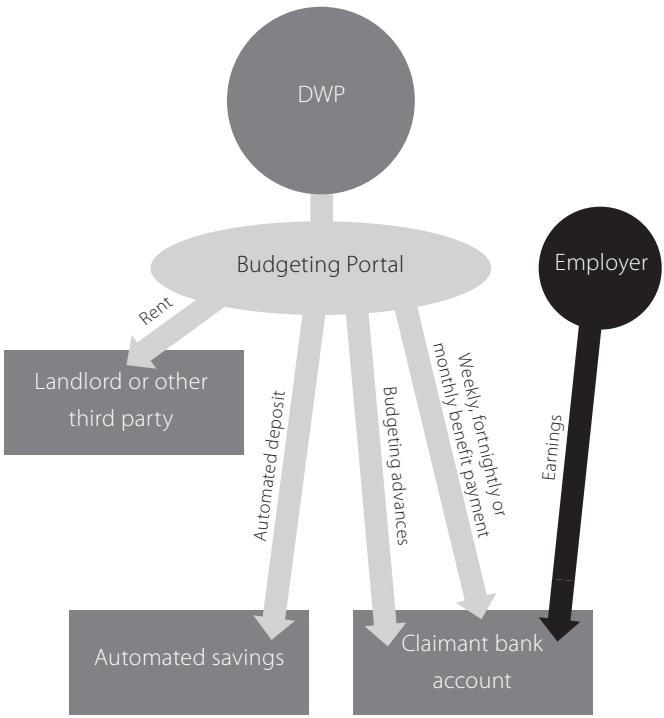
As in other areas of reform, such as pension auto-enrolment, behavioural prompts can be used to achieve public policy aims and help people to achieve goals they want for themselves but find it difficult to achieve. For similar reasons to those that lie behind the challenge of getting people to save for a pension, low income families – like anyone else – can find effective budgeting difficult. Myopia about the future and the complexity of life frustrate the best of intentions. But by changing the 'choice architecture' around budgeting, people can be helped to manage their money better in their own interests and those of others.

Just such a system could be effectively deployed alongside the Universal Credit. Claimants would by default receive their money monthly in a lump sum payment, but they would be able to opt into a 'Budgeting Portal'. Once claimants had made the active decision to opt in to the Portal, they would be able to make changes to the way their benefit money was directed before it hit their bank account. In addition, for those who continue to receive the default lump-sum payment, the DWP could offer claimants the chance to opt into the scheme at regular intervals (such as every year).[140] This would ensure that households were actively engaged in how they budgeted by one means or another.

140 The idea of successive opt-outs is being considered for pension auto-enrolment, by which employees would be triggered more than once to consider whether they wish to be part of the default scheme.

How a budgeting portal could work

Figure 6.2: A Budgeting Portal



The default position would be for claimants to receive their monthly Universal Credit lump sum direct into their bank account as planned. However, under these proposals, individuals could choose instead to opt in to a 'Budgeting Portal'. The portal would be an offshoot of the main Universal Credit website and claims channel.

The Portal would not be a bank account, but would allow claimants to structure their benefit payments before the money was transferred to them. Claimants could, therefore, tailor their payments to help them manage their money more effectively.

The Portal could offer claimants the chance to structure major elements of spending before they receive the money. It would allow them to:

- Access personalised information on how the monthly payment translates into weekly amounts or payments for different categories of expenditure (such as rent). This could go even further than the current labelling, for instance with detail on childcare payments.
- Decide the frequency of payments into their bank account.
- Determine the destination of Housing Benefit payments (and potentially other third party payments, such as childcare fees), so that the cash is effectively ring-fenced by the claimant for the specific purpose.
- Divide up the payment between the claimant and their partner, or other household members, at source.
- To opt into an automated savings account to help households manage predictable lumpy expenditure or unanticipated events without going into debt.
- To trigger signposting and access routes through to support services such as budgeting advice.

This could be administered centrally or by an arm's-length nondepartmental public body and offer services being developed by the Government for its exceptions policy. It would be important that the delivery organisation possessed or could build the trust of consumers. As such, there may be a case for managing this system under the brand of the Post Office or other trusted intermediary if the DWP brand was not used.[141] Although the portal could be administered centrally, specific services could be provided externally.

141 Consumer Focus, Credit where credit's due – The provision of credit union services through post offices (London: 2012).

The principal channel would be online, but as with other aspects of the Universal Credit, these facilities in the online portal could also be initiated over the phone or by post, for those who do not have access to online services. For the sake of administrative efficiency and ease for claimants, the portal should be accessible via the main Universal Credit claims website.

Any costs associated with administering third party payments – such as Housing Benefit payments – could be sourced from the third parties themselves (such as social landlords) through a transaction fee. This is the arrangement that the Government intends to pursue for Support for Mortgage Interest which is set to be paid direct to the lender with the lender paying the administrative cost.[142]Such an approach would minimise any administrative costs to the government as well as being cost effective for third parties, especially when set against the costs of rental arrears and DWP advances that would be required otherwise.

Additional features could include nudging recipients to divide their benefit payments between household members at source. This would help to ensure that financial power in the household is a matter for both partners rather than being the preserve of the main claimant by default.

The research in Chapter 5 suggested that many households have strong views on the frequency of payment. However, in addition to households opting into the Budgeting Portal, there may be a case for allowing third parties such as banks or social landlords to suggest that those with low budgeting capability make use of the service.

142 Department for Work and Pensions, *Explanatory memorandum for the Social Security Advisory Committee Claims and Payment regulations*, http://www.dwp.gov.uk/docs/uc-pip-claims-payments-draft-regs-2012-memorandum.pdf, Schedule 4.

Advantages of a Personal Budgeting Portal

Such a scheme would have significant benefits:

1. **Flexibility.** It would allow households to build and sustain their financial resilience by selecting the frequency of payment that best suited their budgeting approaches and circumstances. The research has demonstrated that budgeting on a weekly frequency is not an implicit indication of a lack of financial capability, but often an outcome of living on a low income. Neither, as this research has explained, would it be incompatible with a move into work, as monthly earnings cannot be characterised as the norm amongst lower earning groups.

2. **Efficiency.** There are several reasons to believe that the portal could be a more efficient method than the Government's proposals. First, an effective exceptions policy is likely to be expensive, given the difficulty of administration and the high numbers of individuals that may ultimately be channelled into it. A system based on self-referral would reduce this administrative task enormously, whilst there would still be scope for third parties or the Government itself to channel claimants with a clear need through the portal.

Second, a more effective solution that seeks to limit exposure could reduce externalities. This would have positive implications for informal credit providers such as housing associations, who will otherwise find themselves required to pay higher rates to borrow money due to the reduced certainty of their income. Consequently, the costs of building new housing and the Housing Benefit bill can be restrained. Based on previous trials, the cost imposed by additional arrears has been estimated at £320m. This would be a loan that social landlords would have to make in perpetuity. In addition, extra transactional costs have been estimated at £100m.[143]

143 National Housing Federation, 'Briefing on Welfare Reform Bill', http://www.housing.org.uk/idoc.ashx?docid=2e7b74ab-5d2f-4921-96ac-e59a24b54ac1&version=-1.

The costs to social landlords are only the most immediate inefficiencies created and a flexible system could serve to reduce the costs to the Exchequer of 'Short-term Advances' and 'Budgeting Advances' that are funded by Central Government, and any discretionary loans offered by local authorities. It would also reduce the reliance on the advice sector.

Third, in the Universal Credit legislation's Committee Stage of the House of Lords, the Government stated that the standard monthly payments reforms were not being pursued on cost grounds. In fact, Lord Freud noted: 'we can make universal credit payable more frequently. … [There] is a small cost to doing it fortnightly rather than monthly but it is very small; it is about a penny'.[144] If additional funding were needed to build added functionality (such as diverting income direct to third parties), then the Government could look to levy third parties to recoup the cost from those who have most to gain from the significant savings the system could produce.

As such, SMF assumes that the low costs associated with establishing and running the portal will lead to significant savings in the future compared to the inefficiencies generated by its absence.

3. **Savings.** A benefit portal could help low income households build up levels of precautionary savings. Previous research from the Personal Finance Research Centre has indicated interest among lower income households for 'a routine *automated* deposit into savings'.[145]

Our focus group research also suggests that such a product would be attractive to some low income households: while there was resistance in the Brighton discussion group on the basis of

144 Speech by Lord Freud, *Hansard*, House of Lords debates, 12 December 2011, Column 1020.

145 Finney and Davies, *Towards a nation of savers*, 49.

affordability, in the Oldham discussion group the idea emerged unprompted. It was received positively as a route to save for anticipated and unanticipated needs, as a method to prevent families going into debt and a way of saving without noticing the loss of disposable income.

Box 6.5. Participants' views on how to save (Discussion group, Oldham)

F: *I suppose if they took it out of my money before they even give it me, I've got no choice then.*

F: *That'd work for me too.*

F: *Even if it were £5 a week.*

F: *Just take £10, £15, or whatever and just took it straight out.*

F: *Because I do know people that, if they've got in debt and something, they've done like an attachment on the things and they've took it out before they even get their money and after a bit they don't even realise they're doing it.*

Currently, claimants repaying advances and loans to DWP often have their repayments deducted at source. There may be opportunities for claimants to pre-commit to divert a small amount of their money to savings or even re-commit to diverting money at the point of DWP debt repayments ending.

4. **Credit.** The portal could also be designed to stimulate demand for credit unions. A recent DWP report on credit union expansion noted that a market exists for savings deposits, banking services and loans delivered by trusted providers. However, 'the challenge to credit union expansion is one of credit union awareness'.[146] An automated savings vehicle could provide a route to build up the customer base of credit unions, with savings accounts directed

146 Department for Work and Pensions, *Credit Union expansion project: feasibility study report* (London: HMSO, 2012), 4, 9.

through to Credit Unions as preferred providers. The Portal would build families' relationships with financial services providers and increase the number of families who could build up a savings record, allowing them to access low-cost loans from credit unions.

5. **Advice.** The interactive structure could be designed to give signposts to additional financial support such as budgeting advice, debt advice and other sources. This could be triggered automatically or selected by claimants.

The reforms set out above would represent a way by which the Government could promote its personal responsibility agenda whilst safeguarding vulnerable households and promoting their financial resilience and independence. The difference is that by altering the 'choice architecture' around the Universal Credit payments, the SMF proposal would help families to help themselves. Active personal responsibility would cut costs for government and private organisations, as well as helping to build families' financial resilience.

ADDITIONAL MEASURES TO BUILD FINANCIAL RESILIENCE

Whether or not the proposals above are adopted or the Universal Credit regulations are approved as drafted, a number of other reforms could help in the transition from the current benefit payment structure to the Universal Credit.

1. As noted above, there is a strong case to **promote Jam Jar accounts**, even if the population they can serve effectively is likely to be limited. The price and quality of these accounts would have to be effectively regulated and it is likely they would have to subsidised.
2. The Government is seeking to give individuals a breakdown of how the tax they pay goes to specific outcomes through public

services and national security. Lessons could be adopted for the Universal Credit. With the introduction of a Single Recipient and Single Payment, there is a strong case for **retaining an element of labelling in the payment structure** so that socially-desirable outcomes can be achieved whilst households can retain an anchor on which to manage their expenditure. This could comprise a break-down of the different benefit components and how much income derives from each. This could help households apportion their spending especially in the transition period.

3. With the advent of a single monthly payment, many of the cues on which many 'tacticians' and 'ad hoc' budgeters rely to ration their expenditure would disappear. The Government should consider providing a '**Weekly Breakdown**', which would provide information on what the monthly payment translates into per week to help them ration their expenditure.
4. The payment of Universal Credit monthly in arrears could be a significant problem for those transitioning from work on to out-of-work benefits, with claimants facing up to a month without income even under optimistic assumptions about the operation of the Real Time Information system. Under the reforms, claimants will rely on two forms of support: 'Short-term Advances' and 'Budgeting Advances'. However, it remains unclear how households would be supported through these transitions and periods without any income. Eligibility to Budgeting Advances appears to be limited to Universal Credit recipients,[147] and eligibility to council support may vary.

In designing Universal Credit, further consideration needs to be given to potential implications of the new monthly fixed assessment. First, it is unclear whether everyone would be eligible for an advance from DWP – including those not previously in receipt of Universal Credit who have lost their

147 Department for Work and Pensions, *Impact assessment: amendments to payments on account provision (Budgeting Advances)*, http://www.dwp.gov.uk/docs/budgeting-advances-wr2011-ia.pdf.

job. Second, DWP advances are loans that have to be repaid (typically over three months). This may mean that when someone loses their job they incur a debt. It is unclear whether the benefit system will allow them to recover this money and thus stabilise their financial circumstances.

There should be a clear commitment to guarantee individuals – at what are very vulnerable periods in their lives – **adequate loans or grants**.

5. It is clear that structural barriers such as the high cost of childcare are acting as a constraint on the work ambitions of those on benefits. The SMF has recently proposed that government offer **income contingent childcare loans** to help parents better manage and afford childcare costs, and to allow parents to re-enter the labour market whilst their children benefit from high quality childcare.[148]

CONCLUSIONS

The Government's stated aims about building financial resilience and personal responsibility are the right ones. Many Universal Credit reforms are to be welcomed. But, on current plans, the scheme risks undermining its own goals by taking a sink or swim approach to the challenge. For those families that sink, the consequences for them will be severe and the costs for others significant. With behavioural adaptations, the Universal Credit can be made to work with the grain of Government policy, and to help people to help themselves.

148 Ryan Shorthouse, Ian Mulheirn and Jeff Masters, *A better beginning: easing the cost of childcare* (London, Social Market Foundation, 2012).

The Universal Credit is heading for trouble. The Government's reforms will be the most significant changes to the benefits system in a generation, affecting around eight million households, including some of the most vulnerable in society. In changing the way that benefits are paid, the policy aims to prepare people for work, boost personal responsibility and strengthen financial resilience. However, this research finds that on current plans, the scheme risks undermining its own goals by taking a sink or swim approach to the challenge.

Based on in-depth interviews and discussion groups with low income families with children, the research shows that the changes - including monthly payment and Housing Benefit paid to claimants in the social rented sector - will leave many households struggling to cope. That risks imposing costs on third parties and undermining the Government's policy aims. The report makes new recommendations so that the Universal Credit can be made to work with the grain of Government policy, and to help people to help themselves.

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