

The introduction of the Universal Credit

1. Background

The Universal Credit is widely acknowledged as the most significant reform to the benefit system in a generation and is a flagship policy of the Coalition Government. 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'.

The scheme officially goes live on Monday 29 April with a "Pathfinder" scheme in one area in the north of England. Subsequent Pathfinders will launch later in the year, with the scheme due to be rolled out nationwide in October 2013.

This short briefing explores the changes that Universal Credit will bring about, examines some of the potential pitfalls in UC's design, and considers what unresolved issues remain for the Government in simplifying and integrating the benefits system.

2. What is changing and what does the Government hope to achieve through Universal Credit?

The Universal Credit will see the integration of six core benefits – Job Seekers Allowance, Income Support, Employment Support Allowance, Housing Benefit, Child Tax Credit and Working Tax Credit – into one single benefit.

The Government's stated intentions in introducing the Universal Credit are to:¹

- **Make work pay** by reducing the rate at which most claimants lose benefit support when entering work.
- Establish **strict conditions** that any claimant will have to satisfy before receiving Universal Credit as part of a 'Claimant Commitment'. These will include requirements for those who are in part-time work and could be expected to work more hours a week, known as 'in-work conditionality'.
- Move away from a mix of weekly, fortnightly, four-weekly and monthly payments to a **standard monthly payment**, with the intention of benefits mirroring a monthly salary from work. Each household will have to nominate one individual to receive this payment.
- Make the system **more responsive to changes in earnings** so that people feel the benefits of re-entering employment or working more hours immediately and to stop over-payments and under-payments which have

¹ DWP, *Universal Credit White Paper*.

affected millions of households under the tax credits regime. It will seek to do this by introducing a new 'fixed' monthly assessment system that will replace the annual 'flexible' assessment period for tax credits, with payment monthly in arrears.

- **Pay Housing Benefit to social tenants** rather than direct to the social landlord, with the intention of boosting the personal responsibility of claimants.

3. What is happening on 29 April?

From 29 April 2013, Universal Credit will be launched in one location in the northwest of England – Ashton-under-Lyne – where the jobcentre will start accepting claims. The aim of the Pathfinder is to assess whether the processes of Universal Credit are effective.

There are a number of core components to Universal Credit that it is important are tested: the Universal Credit online interface and website; the claimant commitment; the new UC payments thresholds and taper rates; the Real-time information computer system that will get up-to-date information from employers on earnings and match this with DWP and HMRC data; and the payment methods (such as monthly payment). The Pathfinder will test the first two of these components. However, it is unclear whether it will test the latter three components, which are fundamental to the success of UC: the UC taper rates and thresholds will determine whether the new policy is effective in getting more people into work, and the real-time computer system underpins the whole operational effectiveness of UC.

The Pathfinder will be a live test and claimants will be expected to make their claim online at www.gov.uk/universalcredit. The Pathfinder will only apply to a limited number of the simplest claims. For instance, it will only apply to single people with no dependent children and there are ten other limiting criteria.² These factors mean that the numbers of people entering the scheme at this early stage is likely to be very low. For instance, there were only 498 new JSA claims in March 2013 in this Job Centre area.

Under the original timetable, the Government was due to roll out UC in four Pathfinder areas of the northwest in April 2013. It was estimated this would include 1,500 new benefit claimants per month.³ However, the three other locations (Wigan, Oldham and Warrington) will only start accepting claims in July 2013. Therefore, the numbers involved in the Pathfinder test will be much smaller than originally intended.

² DWP, *Making your Universal Credit claim from April 2013* (March 2013)

³ <https://www.gov.uk/government/news/ian-duncan-smith-early-roll-out-of-universal-credit-to-go-live-in-manchester-and-cheshire>



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Universal Credit will be rolled out across the whole country to new claimants from October 2013.

4. What to look out for when Universal Credit goes live

Much media attention has focused on whether or not the real-time computer system will work, and whether HMRC and DWP will be able to update claimant's Universal Credit payments each month in line with the latest PAYE data on their earnings. This remains a significant delivery risk for the DWP and HMRC. However, SMF's research publication *Sink or Swim: the impact of the Universal Credit* showed that, even if the IT system does work, many vulnerable households are likely to struggle. Key areas of concern include the following:

a) Payment of benefits monthly

Most households in SMF's research opposed the move from weekly or fortnightly to a monthly benefits payment, citing fears that they would run out of money before the end of the month. The DWP's own evidence shows that four in ten claimants (equating to about 3 million people) would find it harder to budget under a monthly payment.⁴ 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. Subsequently, the House of Commons Work and Pensions Select Committee recommended that the Government specifically look out for how claimants in the Pathfinder areas cope with monthly payments.⁵

b) Payment monthly in arrears

Under a fixed monthly payment made in arrears, individuals who leave work may have to wait up to 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. The DWP will provide Budgeting Advances and Short-term Advances to some claimants, but these will be loans that the claimant will have to repay.

c) Housing Benefit payments and rental arrears

The SMF's research revealed strong opposition amongst low income households to the proposal that social tenants should have to manage their rental payments, instead of the money going direct to their social landlord. Interviewees were concerned that it would land households in even more debt, and increase the risk of rental arrears and eviction.

A recent survey also demonstrated this concern, showing that 86% of social tenants believe "strongly" that it is better for

⁴ Nigel Keohane and Ryan Shorthouse, *Sink or Swim: the impact of the Universal Credit* (SMF, 2012)

⁵ House of Commons Work and Pensions Select Committee, *Universal Credit implementation: meeting the needs of vulnerable claimants* (2012)



Housing Benefit to be paid direct to the landlord, whilst more than a third of claimants are not confident that they can keep up rental payments if they have to manage benefits paid in respect of their rent.⁶

Experience in the private rented sector and trials in the social rented sector have borne out these concerns

- Based on a pilot, the NHF has estimated that arrears for housing associations would increase by about £320m.⁷
- These concerns have been reinforced by on-going Universal Credit 'Direct Payment Demonstration Projects' in six local areas. Pilot areas have seen significant increases in rent arrears and increased costs of rent collection. Overall rent arrears of 8% suggest that the NHF's figure of £320m will not be an underestimate.⁸
- Payment of housing benefit to tenants in the private-rented sector under the Local Housing Allowance has seen many struggle, and one fifth of claimants have been switched over to alternative payment plans because they have gone into or are at risk of going into arrears.⁹ Those in the social rented sector are generally more vulnerable and therefore arrears could be at the higher end of that experienced in the private rented sector.

The Government is proposing a centrally-planned 'exceptions policy' under which vulnerable claimants will be put onto alternative payment plans. However, claimants will not be allowed to opt into this scheme, and the scheme is likely to be costly to administer because of the large number of claimants who will require an alternative payment structure.

Overall, it is unclear whether the government can achieve its goals of boosting personal responsibility, if such large numbers are going to have to be moved back to a centrally-administered system.

d) Problems for those without access to the internet

Applications to Universal Credit will have to be made online. However, although a DWP survey showed that 78% of the relevant population go online, there remains an aptitude challenge, with 45% believing they will need help in making a claim online.¹⁰

e) Winners and losers

⁶ Policis, *Optimising welfare reform outcomes for social tenants* (2012)

⁷ National Housing Federation, *Briefing on Welfare Reform Bill* (2011)

⁸ DWP, *Direct Payment Demonstration Project: Payment figures* (December 2012)

⁹ Department for Work and Pensions, *Two year review of the Local Housing Allowance* (London: HMSO, 2011), 11-12.

¹⁰ Trinh Tu and Steven Ginnis, *Work and the welfare system: a survey of benefits and tax credits recipients* (DWP, 2012)



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The numbers of winners and losers under Universal Credit is quite even, though understanding which parts of the claimant population will win or lose is extremely complex. The latest DWP Impact Assessment estimated that:¹¹

- 3.1 million households will have higher entitlement under Universal Credit, with an average increase of £168 per month.
- 2.8 million households will have lower entitlement with an average reduction of £137 per month.

Since the average working age loss due to Council Tax Benefit cuts will be in excess of £11 per month (see below for more detail), the overall picture is one of winners and losers broadly offsetting each other.

f) Incentives to work

There are two types of work incentive: the incentive to enter employment, and the incentive to progress in employment. Very often these goals are in tension with one another. The Universal Credit will have a number of important effects on both:

- **Incentives to enter employment.** On the whole UC will improve the financial incentive to move into work. First earners in a workless household entering work will be able to keep significantly more of their earnings than under the current system. For those working 10 hours or under, while 800,000 previously lost 90% of their gross earnings withdrawn in tax and benefit reductions, none will lose more than 60% under UC. This will come at the expense of a lower gain to work for some people working 16 hours. In general, second earners will see only very marginal improvements to their incentive to enter work.
- **Incentives to progress in employment.** Incentives to progress in work will deteriorate for slightly more people (2.1 million) than will see an improvement (1.5 million). A small number of claimants who previously faced very high effective tax rates or 'Marginal Deduction Rates' (MDRs) will see a significant decrease in this rate, meaning that they can keep more of their earnings as they increase the number of hours they work. But, a larger number will see a small rise in their effective tax rate.

A typical working family with children on UC will see a rise in their effective tax rate from 73% currently to 76.2% under UC.

Overall, therefore, the Universal Credit will shift the emphasis onto getting people into work no matter how few hours per week, rather than encouraging people to progress in work (increasing the number of hours worked a week).

¹¹ DWP, *Universal Credit: Impact assessment* (December 2012).



5. Universal Credit: Unfinished business

In addition to the problems set out above, there are a number of major design questions about UC that remain unaddressed. These will have to be resolved before the Universal Credit is rolled out fully in October 2013.

a) 'In-work conditionality'

As claimants will be entitled to in-work support immediately on entering work, rather than at the point of working 16 hours per week as at present, the UC contains strong incentives for people to take up low-hours jobs. But, at the same time, incentives to work more hours have been weakened. This will create an incentive for part-time employees to reduce their hours, potentially resulting in more 'mini jobs'.

To offset this incentive to reduce hours, the Government is introducing 'in-work conditionality', which will seek to push people to work longer hours. All claimants who earn less than the equivalent of a 35-hour week at the national minimum wage rate will have to seek more income from earnings through more hours at the same job, an additional part-time job or higher hourly wages. This will affect an estimated 1.2m people, who will be threatened with sanctions (such as losing part of their UC payment) if they do not comply.¹² However, the details of how this will be achieved are unclear and the policy is beset with challenges. These include the danger of creating a second tier workforce, and of producing a scheme that is extremely complex and expensive to deliver. Moreover, the relationship between the Work Programme and 'in-work conditionality' remains unclear.

b) Free School Meals

Free School Meals (FSMs) are worth about £10 every week, or around £370 per year, per child. Families with children at school are entitled to FSMs if they are on out-of-work benefits, or if their income is under £16,190 and they work under 16 hours a week (24 hours for a couple) and are therefore ineligible for Working Tax Credit.¹³

Because Working Tax Credit is being integrated into Universal Credit, the Government needs to establish new criteria on which to distribute FSMs. However, this is very problematic. In the current system, parents who increase their working hours beyond 16 hours per week lose their entitlement to FSMs immediately, but this is currently compensated for by a simultaneous gain in entitlement to Working Tax Credit.¹⁴

Under Universal Credit, if entitlement to FSMs is taken away when earnings reach a specific point a serious "cliff edge"

¹² Resolution Foundation, *Conditions Uncertain* (2012)

¹³ http://www.childrenssociety.org.uk/sites/default/files/tcs/fair_and_square_policy_report_final.pdf

¹⁴ Social Security Advisory Committee, *Universal Credit: the impact on passported benefits* (2012)



would arise, whereby people just over the threshold would see their income fall as a result of the sudden withdrawal of FSMs. For example, if the threshold were £7,800 pa, this would mean that as family earnings from employment cross the £150 per week mark, household income would actually decrease by an average of £14 per week because of the loss of FSMs.¹⁵

The Government has not set out how it intends to deal with the issue of FSMs under Universal Credit. However, the risk is that the policy contradicts the underlying basis for the UC reform by creating a significant disincentive for families with children to increase their hours.

c) Council tax benefit

Under the welfare reforms, the Government abolished Council Tax Benefit (CTB) from 1 April 2013. Responsibility has been handed to local authorities who each have their own locally designed 'Council Tax Support Scheme'. In distributing this support, councils have been given 10% less than was previously given out in CTB. In addition, current levels of support for pensioners have to be maintained, with the consequence that reductions to the funding for Council Tax Cuts to support for the working-age population was estimated by the Government to be approximately 16%. There are three implications of these reductions:

- *Impact on households.* Evidence suggests that nearly three quarters of councils are requiring all households to pay at least some council tax.¹⁶ The Government estimated that households that previously claimed CTB will lose an average of £137 per year.¹⁷
- *Impact on work incentives.* The localisation of CTB significantly undermines the principal intention of the UC, namely to markedly improve and simplify the work incentives. Localising the scheme also means that there may be very different work incentives in neighbouring local authority areas.
- *Impact on local authority budgets.* This reform also comes with administrative costs as councils will have to devise and administer their own support schemes, and collect large numbers of small sums from these households.¹⁸ As Council Tax Support for working-age households is not ring-fenced, councils may decide to reduce the rebate further as they respond to the next Spending Review, thus worsening work incentives further.

¹⁵ Citizen's Advice et al, *Submission to the SSAC independent review of Passported Benefits under Universal Credit*

¹⁶ JRF, *The Impact of Localising Council Tax Benefit* (March 2013)

¹⁷ DCLG, *Local Government Finance Bill: Localising support for council tax – Impact assessment* (2011)

¹⁸ JRF, *The Impact of Localising Council Tax Benefit* (March 2013)



6. Conclusions

There is common consent that the goals of simplifying the benefit system and improving work incentives are desirable. As such, the ambitions behind the Universal Credit are to be applauded. However, trade-offs are unavoidable.

- UC will shift the balance of policy towards incentivising any work and slightly away from encouraging progression in work.
- There will be slightly more winners than losers from the transition to UC, although this needs to be seen in the context of cuts that have been made to benefits both before UC's introduction (freezes to WTC, for example) and in benefits that remain outside UC (CTB cuts).
- There are huge challenges facing the scheme in terms of how the Universal Credit is implemented and the impact that changes – such as monthly payments and Housing Benefit payments – will have on many of the most vulnerable in society.

If the technology works, UC will represent an important simplification and modernisation of the benefit system. But the system will also require claimants and employers to be engaged in new ways, and failure to achieve that could cause problems. There are also major policy dilemmas that are unsolved, especially on Free School Meals, Council Tax Benefit and In-Work Conditionality. Whilst these problems remain, the viability of Universal Credit to achieve its own aims – of simplification and stronger incentives to work – is hugely questionable.



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