

Anticipating the Arrival of Universal Credit

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Slides are available at: users.ox.ac.uk/~sedm1375/UniversalCreditPresentation.pdf

Universal credit fundamentally flawed, say whistleblowers

- WHAT IS UNIVERSAL CREDIT?
- CAN IT BE A FORCE FOR GOOD?

Tory welfare revolt after minister says families will lose out

Universal Credit thrown into chaos

Threat of revolt forces rethink of 'catastrophic' universal credit

- **HOMO ECONOMICUS**

- Classical Welfare Economics

- **HOMO PSYCHOLOGICUS**

- Behavioural Economics
- Psychology of Scarcity

- **HOMO POLITICUS**

- Next Generation Proposals - Central Government
- Patches - Local Government

Normative Criteria for Desirability of a Tax/Benefit System

1 Efficiency

- Incentives / Distortions
- Simplicity / Ease of Administration

2 Equity

- **Horizontal Equity** - Treat similar households equally (irrelevant differences - e.g. race, religion), compensate for household needs (relevant differences - e.g. age, disability).
- **Vertical Equity** - Treat households with different income/wealth levels differently.

3 Autonomy

- Fundamental purpose of the welfare state is to enhance the autonomy of citizens. [Raz, 1986]

4 Beneficence

5 Justice

6 Non-Maleficence

- Reforms should seek to avoid to harm any existing recipients.

There is often a tension / trade-off!

Historical Origins of the UK Welfare State

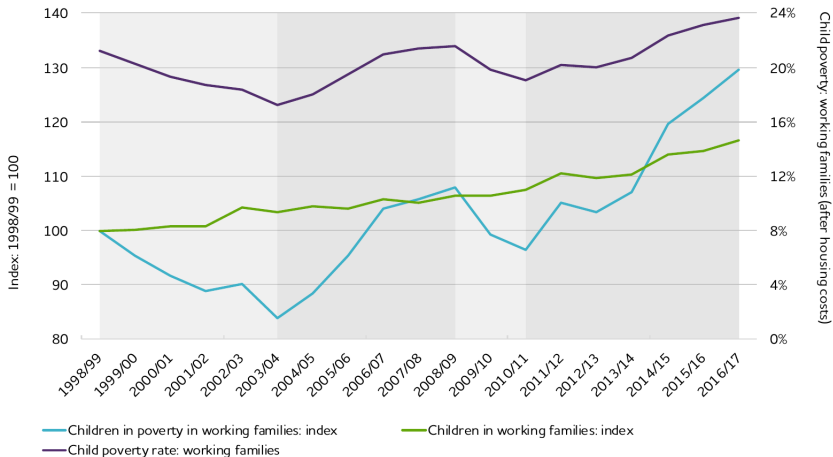
- **Elizabethan Poor Law** (1601) - Decentralised; individual parishes responsible; “postcode lottery”
- **Speenhamland System** (1795) - “Topped-up wages” of unemployed workers relative to the price of bread; but still decentralised and patchy; came under a lot of pressure with increased mobility during industrial revolution
- **Victorian Poor Law** (1834) - Punitive, autonomy-destroying, based on “just world” fallacy
- **Lloyd George** (1911) - Pensions, free school meals, sickness and unemployment benefits
- **Beveridge, Attlee Government** (1945) - Comprehensive national social insurance system
- **Wilson/Callaghan Government** (1975) - Income-related national insurance contributions introduced - more progressive
- **Thatcher Government** (1986) - Family credit introduced
- **Blair/Brown Government** (1997) - Tax credit systems reformed and massively expanded

A Brief History of Universal Credit

- **Universal Credit** is the latest incarnation in the United Kingdom of the **negative income tax** concept, generally favoured by economists over traditional means-tested benefits due to potentially reduced disincentive effects for recipients.
- **Earned Income Tax Credits** were pioneered in the United States, initially introduced in a limited form in 1975, but then substantially expanded by the *Tax Reform Act* of 1986 and the *Omnibus Budget Reconciliation Act* of 1993.
- The UK New Labour government, with Gordon Brown as Chancellor, introduced the **Working Families Tax Credit** in 1999, designed along similar lines to the US policy. This evolved into the **Working Tax Credit** and **Child Tax Credit** (designed to work in tandem) in the 2002 *Tax Credits Act*.
- Although (at first) successful in reducing poverty, the fact that these benefits continued to interact perversely with a complex series of other benefits maintained a desire to consolidate and simplify the system.

Development of Child Poverty 1998-2017

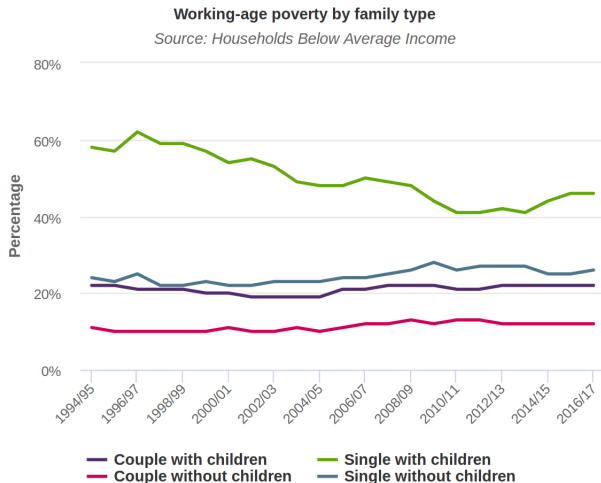
Children in working families: poverty rates and levels



Source: Households Below Average Income (JRF analysis)

Source: Joseph Rowntree Foundation [Joseph Rowntree Foundation, 2018]

Development of Working-Age Poverty 1994-2017



Source: Joseph Rowntree Foundation [Joseph Rowntree Foundation, 2018]

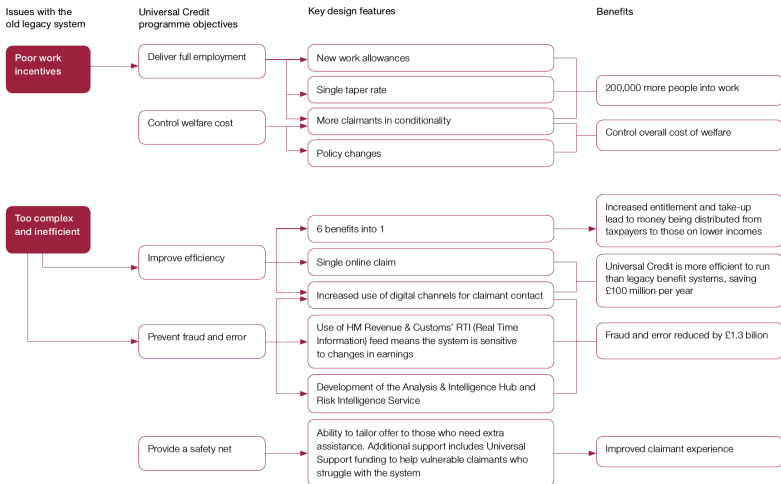
How Universal Credit Works

- **Universal Credit** has been gradually introduced since 2010.
 - Up to Jan 2019, **1.6 million** people in receipt, of whom **34%** in employment. Average household payment: **£650** per month.
 - Starting in 2019, accelerating in 2020, the government plans to move all welfare claimants to the new system, with the process completed by 2023 [Turn2US, 2018].
 - According to Paul Johnson of the Institute for Fiscal Studies [Johnson, 2018], it will eventually pay out more than **£60 billion** a year (which is more than the UK spends on the armed forces and police combined) and about **7 million** families will receive it (around **one third** of all working age households).
- **Universal Credit** unifies together six different benefits into a single negative income tax system:
 - 1 **Jobseeker's Allowance**
 - 2 **Employment and Support Allowance**
 - 3 **Income Support**
 - 4 **Working Tax Credit**
 - 5 **Child Tax Credit**
 - 6 **Housing Benefit**

Government Objectives

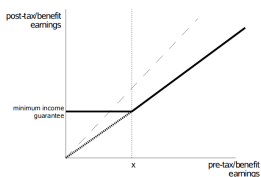
Universal Credit's objectives

Universal Credit is designed to address the issues of poor work incentives and complexity within the current welfare system



Source: National Audit Office analysis of Universal Credit White Paper and business cases

Comparison of Welfare Benefit Systems



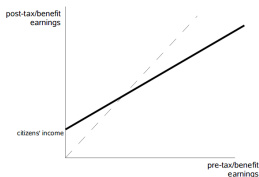
M. I. Guarantee

Advantages:

Well-targeted

Disadvantages:

Massive disincentives
Poverty/benefits trap



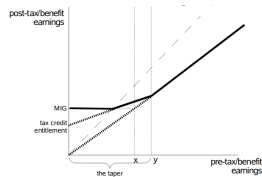
Univ. Basic Income (Citizen's Income)

Advantages:

Simplicity
Social cohesion
Stable benefit income

Disadvantages:

Poorly targeted
Give-away to rich
"Reverse Robin Hood"



Tax Credit System

Advantages:

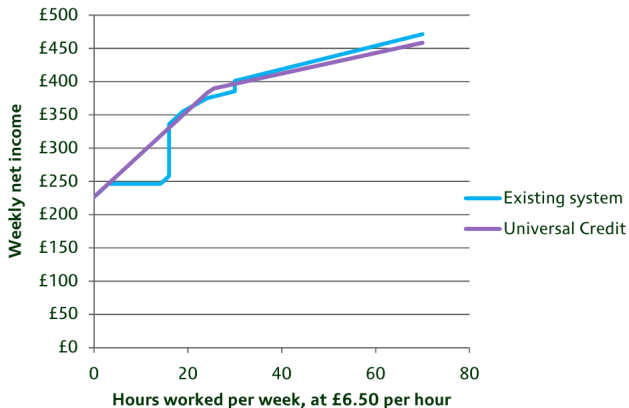
Compromise
Best of both worlds?

Disadvantages:

Complexity

Budget Constraints Before and After Universal Credit

Figure 3.2a. Budget constraint under Universal Credit for an example lone parent with two children

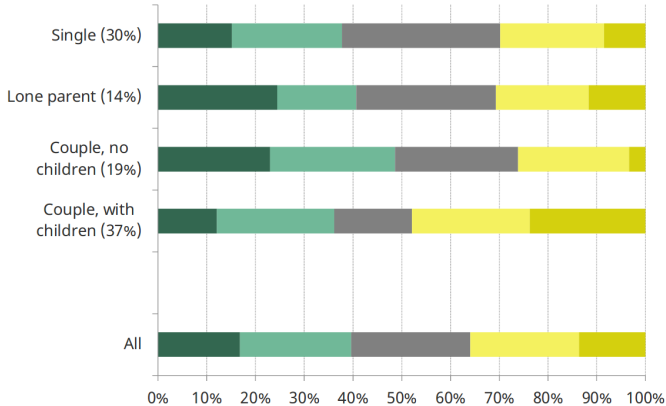


Source: Institute for Fiscal Studies [Brewer et al., 2012]

Winners and Losers from Universal Credit

Figure 3. Impact of UC on adults in households entitled to means-tested benefits, by family type (share of all entitled adults in brackets)

■ Lose > £1,000 ■ Lose £100 – £1,000 ■ Gain or lose < £100 ■ Gain £100 – £1,000 ■ Gain > £1,000



Source: Institute for Fiscal Studies [Brewer et al., 2019]

- **Marginal Effective Tax Rate (METR)** - Key analytic concept in public economics capturing incentives.
 - Incorporates impact of tax and benefit system on the incentive of an individual to earn an additional £1.
 - For example, for someone on the legacy child tax credit system but earning more than the personal income tax allowance, the METR will be 41 % (tax credit taper) + 20 % (income tax) + 12 % (national insurance) = 73 %.
- Economists argue that lowering the METR is good for efficiency and that it is generally better for the METR to be fairly equal across the income distribution.
- However, if a welfare reform increases the real income of a recipient and simultaneously lowers METR then economic theory is *ambiguous* as to whether they work more!
 - **Substitution effect** - Higher opportunity cost of taking leisure induces more work.
 - **Income effect** - Higher real income means more leisure can be “purchased” hence inducing less work.

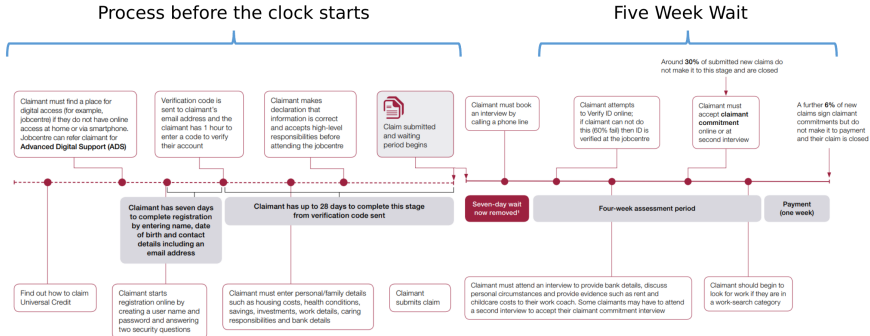
Labour Market Participation

- Less controversial that labour market participation is a good thing, *ceteris paribus*, in that it would be better for a given number of work hours to be shared more evenly among the potential workforce.
- However, must be balanced against other important objectives!
- For example, compare the UK and France.
 - Very similar levels of real GDP per capita but lower average work hours in France (thus around 20% higher productivity).
 - Fairly similar levels of (post-tax/benefit) income inequality. (UK slightly higher.)
 - But lower labour market participation in France also - greater problems of youth unemployment and unemployment among ethnic minorities contributing to social exclusion.
 - Similar-sized foreign-born populations but unemployment rate of 5% in UK versus 15% in France [OECD, 2019].
 - So, debatable which country has the superior political economy (neither optimal - Nordic countries better).

Changes to Welfare System Since 2010

- It is important to understand that most of the changes to benefits since 2010 which have had an impact are not directly due to Universal Credit, but to reductions in the generosity of the existing tax credit system.
- In his April 2011 budget, Chancellor George Osborne increased the taper rate for **Child Tax Credit** and **Working Tax Credit** from **39%** to **41%** (out of *gross income*).
- A number of entitlement elements were also frozen in nominal terms (therefore falling in real terms) for 3 years from 2011.
- A second currently-ongoing nominal freeze was implemented in 2016. From 2015-19 the real value of benefits has fallen by **6.5%** [Barnard, 2019].
- The replacement of **Disability Living Allowance** with **Personal Independence Payments** from 2013 onwards has also been hugely controversial, but that is beyond the scope of this talk.

Universal Credit Process



Next Generation Policy Proposals

- The Universal Credit **taper rate** is currently **63%** out of *net income*, approximately equivalent to **43%** out of gross income for a basic rate taxpayer - slightly higher than the 41% under old system. (Full jump from 41% to 63% for lowest earners.)
- The Universal Credit **work allowance** (income at which tapering commences) is **£287** for a family with children receiving housing support and **£503** otherwise. [DWP, 2019]
- Cut in taper rate would move in direction of Universal Basic Income. However, raising work allowances is more progressive.
- A 1% decrease in the taper rate or a 20% increase in work allowances would each cost approximately £1 billion per year.
- The Joseph Rowntree Foundation argues that:

*“The OBR estimates it will cost **£1.4 billion** to raise the Personal Tax Allowance (PTA) to **£12,500** and the Higher Rate Threshold to **£50,000** in 2020. This money would be better spent helping to pay the lion’s share of increased work allowances.”*

[Joseph Rowntree Foundation, 2018].

The Psychology of Scarcity




20 rounds

“Rich”: 50 sec / rnd (1000 sec total)

“Poor”: 15 sec / rnd (300 sec total)

No borrowing vs. High Interest Borrowing

How about giving this one a try?

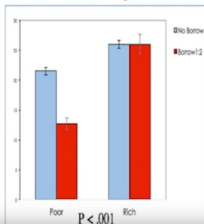


- (1)
- (2)
- (3)
- (4)
- (5)

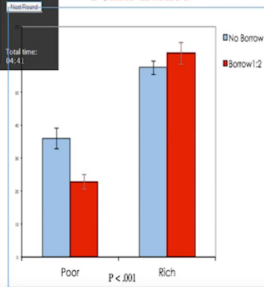
Name a specific item that you have on the patio...

Round: 3
Score: 0
Round time left: 00:08
Next Round
Total time: 04:41

Rounds Completed



Points Earned



Shah, Mullainathan, & Shafir, *Science*, 2012

The Psychology of Scarcity

- **Bounded Rationality** - Rational behaviour changes under conditions of scarcity due to limited **mental bandwidth**.
- Evidence suggests differences when people's cognition is affected by such scarcity can be as much as **13 IQ points**, equivalent to the difference between average intelligence and highly gifted. [Shah et al., 2012]
- Behaviour that appears irrational is usually not so once context is understood.
 - **Example:** single mother who spends weekly benefit payment on expensive designer sneakers for her child. This money would likely be quickly spent on other things (given to other family members, friends) whereas trainer purchase creates a durable asset that stores value quite well (in context of cash scarcity) as well as psychological satisfaction of treating child.
 - Middle class professionals often have difficulty empathising. Considering lived experience of *time scarcity* leading to irrational behaviours such as not spending enough quality time with family is useful here.

Bounded Rationality Implications - Mediated Autonomy

- Predictable irrationality due to psychological biases have important implications for optimal public policy.
- **Raise individual awareness** - Can be helpful but often not able to remove biases.
- **Retraining** - Try to “reprogram” harmful impulses.
- **Leveraging** - Assume biases will continue and exploit them to maximise individual and social welfare.
 - Example: When encouraging people to lose weight or give up smoking, focus on short term benefits of feeling healthier, saving money since long term health benefits are difficult to act upon due to bounded rationality (myopia).
- Policy interventions can still be conceptualised as targeting or maximising autonomy through the tool of *mediated autonomy*.

Insights from Psychology for Policy Proposals

- Freeing up **mental bandwidth** [Shah et al., 2012] is essential to autonomy-enhancing role of welfare system.
- Yet overly “respecting” people’s economic rationality can harm them (e.g. unregulated and freely-available payday loans).
- People budget better with money coming in a regularly as possible - ideally weekly.
- **PATCH** - Reduce time lag in Universal Credit transfer and ameliorate impact. Help people to budget weekly.
- “Hostile environment” in benefit offices requiring people to prove they are not lazy/criminal undermines the autonomy-enhancing normative purpose of the benefit system.

- **Frank Field**

- One key factor in the flaws with the design and conception of Universal Credit is the fact that it has been designed by middle class people without any meaningful input from poor people.
- Universal Credit claimant [Cheetham et al., 2019]:
 - *"It's like insidious brutality, this Universal Credit thing. I don't know who dreamed it up, because on paper I can see some bits of it could be really good. Maybe it's just the way it's being implemented."*



Summary of Flaws in Universal Credit System

- 5 week delay in first payment, pushing recipients into debt.
- Monthly rather than weekly payments, greater fluctuations.
- Reduced payments for some (not all) claimants, but especially the most vulnerable: lone parents and the disabled.
 - ‘Severe Disability Premium’ no longer available.
[Cheetham et al., 2019]
- “Hostile environment” - punitive and inflexible conditionality.
- Online application system, automated call centre, little help or guidance available. Particularly problematic for older claimants or those with learning difficulties. Stressful for almost all claimants compared to the old system with more human advisors available, which makes sense in light of psychology of scarcity. [Cheetham et al., 2019]
 - Susceptible to fraud? (Recent case - seems connected.)
- Rent payments now generally made to claimants rather than direct to landlord.

Impact on Third Parties and Local Government

- **Social Housing/Rent**

Tricky autonomy issues here. Rent component of Universal Credit can be arranged to be paid directly to landlord at the request of the recipient under certain circumstances (e.g. in rent arrears). Government thinks it desirable for recipients to take individual responsibility wherever possible. Misguided?

- **Council Tax** - Increase in change in circumstances notices.

- **Food Banks** - Increased use.

- **Homelessness** - Likely to cause further increase.

- **School Meals** - More likely to affect breakfast club demand.

- **Libraries**

- **Mental Health Services** - Greater pressures.

- **Public Health** - Recent BMJ study [Cheetham et al., 2019] suggests risks to physical and mental health of claimants if Universal Credit is rolled out further without reform:

- Stress, substance abuse
- Suicide
- Insufficient food and heating

Policy Patch Role of Local Government?

● Resource constraints

- Local government spending per person has been cut by around 30% in real terms since 2010, so no money for ameliorative policies?
- Yet psychology and economics both suggest that policy design is important as well as amount spent.

● Incentives

- The benefits from good policy in one local authority might primarily accrue to the central government budget. (E.g. when local authorities spend on adult social care a lot of the gains go to the central NHS budget.) This is perverse.
- Yet there would plausibly be “bankable” gains at local level from policies that corrected for flaws in universal credit:
 - Local tax receipts
 - Children better fed and equipped for school, better attendance
 - Less antisocial behaviour

THANK YOU

QUESTIONS?

Discussion Activities

In order to motivate further discussion, we would like to split yourselves into small groups (these could be based on professional linkages, or random, entirely up to you) in order to:

- 1 Try to generate an improved and more appropriate set of **Objectives** and **Metrics** for Universal Credit and for welfare reform more generally.
- 2 Generate suggestions for local **policy patches** to ameliorate impact of Universal Credit.

We would also like to receive individual evaluation/feedback.

Group Activity 1 - Objectives and Metrics

- An **Objective** should be general enough to apply to local and central government yet concrete enough to be measurable by a small number of key **Metrics**.
- An **Objective** should be something central to the normative purpose of the welfare benefit system. (See normative criteria.)
- A **Metric** should be:
 - ① Well-connected with appropriate Objective
 - ② Fairly easily observed / calculated
 - ③ Reasonably robust to “massaging” / distortion
- Each group should produce 3 suggestions for Objectives and a small number (1-3) of suggested Metrics for each Objective. We will then vote on which of these to include. (Duplicate objectives may well occur.)

Improved Objectives

With thanks to Wessex Public Health Network CPD Event Participants.

1 Poverty

- **Metric** (relative poverty): Minimise child poverty (proportion of children in families with equivalised income below 60% of median).
- **Metric** (absolute poverty): Minimise households with insufficient real income to meet basic needs: food, shelter, social participation.

2 Humane treatment of the disabled and vulnerable

- **Metric**: Minimise proportion of claim decisions overturned at appeal (assuming decent recourse to legal review of decisions).

3 Debt

- **Metric**: Minimise households with no bank account or <£500 savings.

4 Housing

- **Metric**: Minimise proportion of households with insecure rented tenure.
- **Metric**: Minimise proportion of inadequate properties.

5 Simplicity and Coherency of Administration

- **Metric**: Weekly payments, minimise payment fluctuations (therefore at most only periodic review of benefit levels and gradual adjustment)
- **Metric**: Single clear unified and accountable delivery agency.

6 Desperation

- **Metric**: Minimise composite desperation index which includes homelessness, use of short term loans, food banks, fuel poverty, default on energy bills, kids in care, infant mortality, "cost of vice".

Group Activity 2 - Local Policy Patches / Interventions

- Although next generation reforms to transform Universal Credit are needed, we should consider our role as *homo politicus* in local decision-making.
- We would like each group to report on 1 or more impacts of Universal Credit that they have experienced.
- We would like each group to suggest 1 or more local government policy patches that might help to ameliorate the impact of Universal Credit. These will need to be:
 - ① Affordable
 - ② Practical
 - ③ Consistent with insights from psychology and economics (hopefully!)
- We also have a role as *homo politicus* in family and friendship groups or voluntary organisations, so these are not excluded!

- **Induction Package**

- Provide information
- Help with I.T. Skills - Libraries, Job Centre Computer Stations or Internet Cafés with advisers on hand.

- **Personal Budgeting Apps**

- Nudge to help people to budget weekly: “Mediated autonomy”.

- **Social Prescribers**

- Training to deal with psychology of scarcity issues, in general and specific to Universal Credit.

- **Local Credit Unions**

- Provide low interest or subsidised loans with long repayment schedules to ameliorate impact of delay in payments.
- (Bridging loans supplied by central government have been likened to “loan sharks” due to rapidly required repayment and therefore high amounts deducted from monthly benefits during repayment.) [Cheetham et al., 2019]

- Anything surprising?
- How might you apply this material?
- Anything else you would like to know?
(Please include email address!)

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