Title: Universal Credit **Lead department or agency:** Department for Work and Pensions **Other departments or agencies:** Jobcentre Plus Local Authorities Her Majesty's Revenue and Customs	Impact Assessment (IA) **IA No:** **Date:** October 2011 **Stage :** Final Proposal **Source of intervention:** Domestic **Type of measure:** Primary Legislation **Contact for enquiries:**

Summary: Intervention and Options

What is the problem which is under consideration? Why is government intervention necessary?

There are two fundamental problems with the current welfare system: poor work incentives and complexity. As a result the current system hinders rather than helps millions of individuals who are in poverty and facing welfare dependency. For people often reliant on benefits, the incentives to move into work or to increase earnings once in work can be very low. In nearly **1.3 million workless households, a person would currently lose between 70 per cent and all of their earnings if they move into work of ten hours a week**. The incentives to increase hours once in work are also very weak. **Under the current system around 0.5 million individuals in low paid work would lose more than 80 per cent of an increase in their earnings because of higher tax or withdrawn benefits**[1]. The current system of benefits provides targeted support to meet specific needs, but the net effect is a complex array of benefits which interact in complicated ways, creating perverse incentives and penalties, confusion and administrative cost. This has the effect of preventing many in our society from seeing work as the best route out of poverty. It also increases the risk of error and the opportunities for fraud. Welfare dependency has become a significant problem in Britain with a huge social and economic cost.

What are the policy objectives and intended effects?

The policy will restructure the benefit system, to create one single income-replacement benefit for working-age adults which unifies the current system of means-tested out of work benefits, tax credits and support for housing. It will improve work incentives by allowing individuals to keep more of their income as they move into work, and by introducing a smoother and more transparent reduction of benefits when they increase their earnings. It will reduce the number of benefits and the number of agencies that people have to interact with and smooth the transition into work. This will make it easier for customers to understand their entitlements and easier to administer the system, thus leaving less scope for fraud and error. The effects of the policy will be to reduce the number of workless households by always ensuring that work pays.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Five options were set out in the consultation document 21st Century Welfare;
1) Universal Credit,
2) Single Unified Taper,
3) Mirrlees Model,
4) Single Working Age Benefit,
5) Single benefit/negative income tax model.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	From 2014-15
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	See Annex 3

[1] All work incentives analysis in this Impact Assessment excludes the impact of Council Tax Benefit in the current system and does not include council tax support as an element within Universal Credit.

Summary: Analysis and Evidence

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'. This modelling is based on the current policy design. Precise estimates of costs and numbers with higher or lower entitlements will not be available until all elements of the policy design are finalised.

1) Universal Credit is expected to be introduced in October 2013, and individuals will be migrated to Universal Credit over the subsequent four years. Costs and benefits over this transition period will depend upon the precise nature of the migration strategy and will need to take account of affordability constraints. This Impact Assessment provides an assessment of the costs and benefits once Universal Credit has been fully implemented and transitional protection has been exhausted.

2) Overall, it is estimated that benefit expenditure will be around £2bn higher once Universal Credit is fully implemented. There will be a cost to the Exchequer and the taxpayer of around £4bn as a result of entitlement changes and increased take-up. Offsetting this it is estimated that there will be savings of around £2bn due to reduced fraud, error and overpayments together with changes to the earnings disregards that currently exist in tax credits.

Other key non-monetised costs by 'main affected groups'

1) There will be resource costs for implementation of Universal Credit and transitioning the legacy caseload to the new scheme. In the longer run it is anticipated that the new system will reduce administration costs.

2) There will be fiscal costs associated with transitional protection for households against cash losses at the point of transition to Universal Credit. This will generate equivalent economic benefits for the households who receive the cash protection.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

1) Once fully implemented it is expected that overall individuals will benefit from Universal Credit by the equivalent benefit expenditure rise of around £2bn. Within this group some may have higher entitlements whilst others may have lower entitlements compared to the current system.

2) Around 2.8 million households will have higher entitlements under Universal Credit. The increase in benefit payments will generate welfare gains to households, with around 80 per cent of those with higher entitlements being in the bottom two quintiles.

3) Around two million households will have lower entitlements under Universal Credit. However it is important to recognise that a package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same.

Other key non-monetised benefits by 'main affected groups'
1) It is estimated that increased simplicity and improved work incentives under Universal Credit should lead to reduced worklessness. As a result, there will be positive welfare impacts due to increases in incomes for individuals who move into work in response to the reformed benefit system. In addition, there will be associated wider social benefits due to reduced crime and improved health outcomes. 2) Universal Credit will reduce the number of individuals in poverty. On reasonable assumptions, the combined impact of take-up and entitlements will lift around 900,000 individuals out of poverty, including more than 350,000 children and around 550,000 working-age adults. These poverty impacts exclude the positive impacts of more people moving into work. 3) The analysis presented in the Impact Assessment takes a conservative approach in capturing the fiscal impacts of improved work incentives. The costs and benefits are calculated using a static model and do not take into account the dynamic impacts of the policy, i.e. the increased number of people in work and resulting associated benefits. Therefore, Exchequer savings from moving people into employment have not been included in this Impact Assessment. Neither have the welfare impacts of moving individuals into work.

Key assumptions/sensitivities/risks	**Discount rate (%)**	3.5%
The costs/savings are calculated before taking account of any behavioural change associated with employment. Unless otherwise stated, the estimates of costs/savings are calculated from the Department's Policy Simulation Model (PSM). They compare Universal Credit with the benefit and tax credit system projected forwards to 2014/15. This takes account of projected changes in demography and economy. Clearly any estimates into the future will have an element of uncertainty; however, this analysis uses the best available data to provide a robust assessment of the likely pattern of impacts resulting from these changes. The costs and savings are calculated on a static basis, and so do not allow for benefits from the policy intention of moving more people into work.		

Impact on admin burden (AB) (£m):			**Impact on policy cost savings (£m):**	**In scope**
New AB:	**AB savings:**	**Net:**	**Policy cost savings:**	

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			Great Britain		
From what date will the policy be implemented?			October 2013		
Which organisation(s) will enforce the policy?			DWP		
What is the annual change in enforcement cost (£m)?			NA		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			NA		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**NA**	**NA**	
Does the proposal have an impact on competition?			NO		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**	**Benefits:**	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	N/A	N/A	N/A	N/A	N/A

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[2]	YES	Separate Publication
Economic impacts		
Competition	NO	
Small firms	NO	
Environmental impacts		
Greenhouse gas assessment	NO	
Wider environmental issues	NO	
Social impacts		
Health and well-being	NO	
Human rights	NO	
Justice system	NO	
Rural proofing	NO	
Sustainable development	NO	

[2] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded in 2011, once the Equality Bill comes into force. Statutory equality duties as part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	21st Century Welfare - (http://www.dwp.gov.uk/docs/21st-century-welfare.pdf)
2	Universal Credit: Welfare That Works (http://www.dwp.gov.uk/docs/universal-credit-full-document.pdf)
3	Impact Assessment Universal Credit : Welfare That Works (http://www.dwp.gov.uk/docs/universal-credit-ia-white-paper.pdf)
4	Welfare Reform Bill Impact Assessment Universal Credit (http://www.dwp.gov.uk/docs/universal-credit-wr2011-ia.pdf)
5	Universal Credit Policy Briefing Notes (http://www.dwp.gov.uk/policy/welfare%2Dreform/legislation%2Dand%2Dkey%2Ddocuments/welfare%2Dreform%2Dbill%2D2011/universal%2Dcredit%2Dbriefing/)

Summary

- Universal Credit will radically restructure the way in which benefits are calculated. The rationalisation of the benefit calculation rules will remove the more perverse features of the current system, and will substantially improve work incentives.

- As a result of the changes in benefit calculation, Universal Credit will restructure the pattern of entitlements; combined with increased take-up and the impact of greater simplicity, Universal Credit has an overall long-run cost to the exchequer of around £2bn in benefit expenditure[3]. This does not allow for the potential benefits from the dynamic impacts which are the policy intention. The £2bn consists of an increase of £4bn due to changes in entitlement rules and increased take-up, which is offset by an estimated £2bn of savings due to reduced fraud, error and overpayments together with changes to the current earnings disregards in tax credits. The net impact of Universal Credit will be to redistribute income to households with lower incomes.

- In the longer term, reduced complexity has the potential to lead to savings of more than £0.5bn a year in administrative costs.

- It is estimated that around 2.8 million households will have higher entitlements as a result of Universal Credit, with around 80 per cent of these households in the bottom two quintiles of the income distribution. Over 1.3 million households see an increase in entitlements of more than £25 a week.

- A package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same.

- In the longer-term approximately two million households will have notional lower entitlements than they otherwise would have done as a result of Universal Credit, although the majority of these will have a reduction of less than £25 per week.

- The greater simplicity of Universal Credit will lead to a substantial increase in the take-up of currently unclaimed benefits, with most of the impact being at the lower end of the income distribution. The changes to entitlement are estimated to increase average weekly net income in the bottom two income deciles by £3 and £4 per week respectively. After accounting for imperfect take-up in the current system and improved take-up under Universal Credit, the gain for the bottom two deciles increases to £11 and £10 per week respectively.

- Universal Credit will substantially improve the incentives to work. With regard to the participation tax rate (PTR), the number of households who lose between 70 per cent and all of their earnings through taxation and benefit withdrawal on moving into ten hours of work will fall by 1.2 million under Universal Credit.

- Universal Credit improves the incentives to increase hours of work for many; as a result of the single withdrawal rate, around 1.2 million individuals will see a reduction in their marginal deduction rate (MDR) and there will now be virtually no households with MDRs above 80 per cent. Although 2.1 million individuals will see an increase in their MDR the median MDR increase for these individuals will be just four percentage points. Individuals facing an increase in MDR tend to be households with higher incomes who would be in receipt of tax credits only in the current system, and are therefore better off financially than those currently facing the highest MDRs. These individuals will see a small increase in their MDR under Universal Credit. For some households the increase in MDR occurs because they become eligible for support through Universal Credit which they don't receive under the current system, and so this is associated with an improvement in their financial position.

[3] Unless otherwise stated, all expenditure refers to Great Britain not the United Kingdom.

Introduction

1. The White Paper, Universal Credit: Welfare that Works, sets out the principles of the reform of the benefit system which the Government is planning to undertake. The purpose of these changes is to remove or mitigate the many financial and administrative barriers to taking up work which are inherent in the current system. This Impact Assessment provides the Government's current assessment of the broad impacts of the Universal Credit based on the key components of the Universal Credit as outlined previously in the White Paper and taking into account recently announced policies as outlined in Annex 1[4]. Overall Universal Credit policy is still under development, so the Department will provide further iterations of this Assessment as the policy develops.

2. The policy rationale is to remove the financial and administrative barriers to work inherent in the current welfare system. The reform is designed to ensure that work always pays and to encourage more people to see work as the best route out of poverty. In the longer-term, it will reduce the economic costs of worklessness and reduce the number of children and adults living in poverty. On reasonable assumptions, the combined impact of take-up and entitlements will lift around 900,000 individuals out of poverty, including more than 350,000 children and around 550,000 working-age adults.

3. In the current benefit system, the financial returns to work can often be very weak. Many claimants would have most of any increase in earnings deducted from their benefits/tax credits, with some households facing deduction rates as high as 91 per cent[5]. These deductions often vary in unpredictable ways depending on the level of earnings and the combination of benefits and tax credits received.

4. Similarly, the incentives to move into work can be weak, particularly at low earnings or hours. Under the current system, if one person in a workless household moves into work then a very high proportion of their earnings is offset by reduced benefits and tax credits. For example around 1.3 million households face losing between 70 per cent and all of their earnings if they move into work of ten hours a week at the National Minimum Wage.

5. This problem is compounded by the administrative complexity of the system. There are separate systems for out-of-work and in-work support so a move into work entails a recalculation of entitlement and possible delays and gaps in payment. As a result, many people are not prepared to take the risk of moving into work.

6. The Universal Credit system will improve work incentives in three ways:

   - ensuring that support is reduced at a consistent and predictable rate, and that people generally keep a higher proportion of their earnings;

   - ensuring that any work pays and, in particular, low-hours work; and

   - reducing the complexity of the system, and removing the distinction between in-work and out-of-work support, thus making clear the potential gains to work and reducing the risks associated with moves into employment.

7. In addition, the Universal Credit will have a positive impact on child poverty; in the steady-state, taking into account improved take-up as well as entitlement changes, Universal Credit will lift more than 350,000 children out of poverty. This is due both to the re-focusing of entitlements on lower income in-work households, and because a simpler system should lead to a considerable increase in the take-up of Universal Credit compared to the current system of benefits and tax credits. In effect, there will be 'automatic passporting' for people who currently claim some, but not all, of the benefits or tax credits to which they are currently entitled. In addition, the simpler system will reduce the scope for fraud, error and

[4] The actual level of earnings disregards and the taper will be set closer to the date of implementation
[5] This is the highest MDR excluding Council Tax Benefit.

overpayments thus ensuring that the right benefit is paid to the right people at the right time.

Universal Credit Model and the Baseline

8. The White Paper, Universal Credit: Welfare that Works, sets out the Government's intended overall design for Universal Credit. This Impact Assessment presents analysis of the impacts of Universal Credit based on that design. It includes analysis of changes in entitlements, distributional impacts and changes to work incentives. The analysis compares Universal Credit to the current benefits and tax credits system, assuming the current system incorporates all of the changes announced up to and including the 2010 Spending Review.

9. This Impact Assessment has now been updated to take account of recently announced policy. The impacts will differ from the previous assessment to take account of announced policy changes to disability payments, council tax support, a childcare element within Universal Credit and the treatment of couples with one partner under and one over the qualifying age for Pension Credit, under Universal Credit. These policies are outlined in more detail in Annex 1.

10. Unless otherwise stated, the modelling in this Impact Assessment is based on the DWP Policy Simulation Model which draws on data from the 2008/09 Family Resources Survey. All costs and benefits are reported in 2011/12 prices. Unless otherwise stated, all impacts are provided in the steady-state; that is once Universal Credit is fully implemented and transitional protection has been fully exhausted. Analysis of changes in entitlement is presented on a Before Housing Costs (BHC) basis; that is before housing costs are deducted from household income.

Treatment of Council Tax support

11. Our distributional analysis assumes that individuals continue to receive 90 per cent of their current CTB award in our current system analysis and that they also receive 90 per of their current CTB alongside their Universal Credit award[6]. For the purpose of work incentives analysis council tax support has been excluded from both the current system and Universal Credit – this is a modelling assumption that is necessary in the absence of detailed information about the nature of local council tax support. The Government is currently consulting on the localisation of council tax support.

Fiscal Impacts

12. Once Universal Credit has been fully implemented and transitional protection has been exhausted it is estimated that benefit expenditure will be around £2bn higher. This includes an increase of £4bn due to changes in entitlement rules and increased take-up. Offsetting this it is estimated that there will be savings of around £2bn due to reduced fraud and error and changes to the de minimis rule and over-payments.

13. There will be three categories of fiscal costs during the transition period to Universal Credit:

[6] Decisions at the national and local level about how council tax support schemes are designed, and in particular whether any claimants should be protected, will affect overall council tax support.

- costs of implementing Universal Credit and transitioning cases to the new system;
- costs of paying transitional protection to ensure that there are no cash losers; and
- costs of higher entitlement and take-up as people move over to Universal Credit.

14. To fund transition to Universal Credit during the 2010 Spending Review period, £2bn has been set aside. This will include both the administrative costs and any increase in benefit expenditure. In the long-run, Universal Credit has the potential to lead to savings of more than £0.5bn a year in administrative costs.

15. The policy intention is to improve work incentives and so encourage more people to move into work and to progress in work. The estimates of the fiscal impacts do not include any savings from these dynamic impacts.

Benefit entitlement and take-up

16. Universal Credit changes the benefit entitlement rules and so generates fiscal costs and savings. In addition, because Universal Credit is a simpler system it is anticipated that there will be an increase in the proportion of people who take-up their benefit entitlement. In steady-state the net impact of the entitlement changes and increased take-up is to increase benefit expenditure by around £4bn. The drivers behind the direction and distribution of changes to entitlement are explored in more detail in a subsequent section.

Fraud, Error and Simplicity

17. The greater simplicity of the Universal Credit scheme will generate savings by reducing the scope for fraud and error and by making benefit payments sensitive to even small changes in income. In steady-state the Department anticipate the savings to be of the order of £2bn per annum. The savings fall into three categories:

- Universal Credit covers both in-work and out-of-work claimants, so there will no longer be errors due to the requirement of claimants to switch between in-work and out-of-work benefits as their working patterns change.
- Access to real time earnings data and better sharing of information will reduce the amount of fraud and error due to changes in circumstances which are reported late or not at all.
- When Universal Credit is introduced, tax credits will contain a de minimis rule (or disregard) for changes of earnings, whereby increases of up to £5,000 per annum and reductions of up to £2,500 do not have to be reported. Under Universal Credit the de minimis rule will be removed which will lead to a net reduction in expenditure.

Impact on Individual Welfare

Transitional Protection

18. Universal Credit will simplify the rules used to calculate entitlement by introducing a system of tailored earnings disregards and a single taper rate. As a result, some households will be entitled to more than under the current system, while others will be entitled to less. For those currently receiving benefits or tax credits there is a commitment to ensure that no one will experience a reduction in the benefit they are receiving as a result of the introduction of Universal Credit, where circumstances remain the same. A package of transitional protection is being developed in order to ensure that there will be no cash

losers as a direct result of the move to Universal Credit where circumstances remain the same.

19. At the point of transfer a comparison will be made between the household's total entitlement from current DWP benefits and tax credits and the amount of their Universal Credit entitlement. In the majority of cases, Universal Credit will provide a level of support that is at least as high as the current system so there will be no need for transitional protection. Under Universal Credit, in steady-state, around 2.7m households will see no change in their entitlement, 2.8 million households will receive higher entitlements and around two million households will receive notional lower entitlements. If the Universal Credit entitlement is less than that under the old system, the claimant will be awarded an amount of protection equivalent to the potential reduction in their income, where circumstances remain the same. As a result they will not be worse off in cash terms.

20. Over time the value of transitional protection will be eroded as people move off Universal Credit or their circumstances change. As a result, in steady-state, there will be some households whose income is notionally lower than it would have been under the old system. However, these households will not have experienced a cash reduction in benefit and in many cases will be able to increase their income because of the improved gains to work provided by Universal Credit.

Definition of the population pool

21. A population pool has been defined for the purposes of assessing whether Universal Credit has a differential impact on different groups. The population pool is defined as all households who would otherwise have been on the legacy benefits or tax credits[7] which are replaced by Universal Credit, and those who become newly entitled as a result of the Universal Credit payment rules. The announcement of policies since the last Impact Assessment has led to an update of the population pool to include couples with one partner under and one over the qualifying age for Pension Credit currently on Pension Credit or newly entitled to Universal Credit, alongside removing working age households who are on Council Tax Benefit only in the current system. Unless stated otherwise, the analysis in this Impact Assessment is consistent with this definition of the population pool.

Changes in household benefit entitlement

22. This section analyses the long-run impact of Universal Credit on the distribution of benefit entitlements. As it is a steady-state analysis it does not allow for transitional protection and will not be a full reflection of the impacts on existing claimants during the transition period.

23. Universal Credit is a fundamental reform of the current complex system of benefit rules and therefore leads to both increases and reductions in the level of entitlements. Table 1 segments the change in entitlements by the position of the household in the income distribution. It shows that around 2.8 million households have higher entitlements than they would have under the current benefit and tax credit system, while two million have lower entitlements. Analysis suggests that 2.7 million households, who are mostly workless, would experience no change.

24. The number of households with lower entitlements under Universal Credit has increased relative to the previous version of the Impact Assessment. This is primarily due to announced policy changes to disability payments and the treatment of couples with one partner under and one over the qualifying age for Pension Credit under Universal Credit, as outlined in Annex 1.

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[7] Includes Income Support, income-based Jobseekers Allowance; income-related Employment and Support Allowance; Housing Benefit; Working Tax Credit; Child Tax Credit; and Pension Credit for couples with one partner under and one over the qualifying age for Pension Credit.

25. Most of the increase in entitlement goes to households in the lowest two quintiles of the income distribution. As demonstrated in the income distribution and poverty section below, the changes in entitlement combine with higher take-up to have a progressive impact on the income distribution.

Table 1 – Changes in benefit entitlement by equivalised income (households)

	Higher Entitlement	No Change	Lower Entitlement
Bottom Quintile	1,100,000	1,700,000	600,000
2nd Quintile	1,200,000	700,000	800,000
3rd Quintile	400,000	100,000	500,000
4th Quintile	100,000	100,000	200,000
5th Quintile	*	*	*
Total	2,800,000	2,700,000	2,000,000

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15
*Fewer than 50,000 households
Figures may not sum due to rounding.

26. Table 2 shows that the majority of households who have a change in entitlement will have an income change of less than £25 a week. However, the wide ranging scope of the reform does mean that the range of potential changes in entitlement is large, as illustrated in table 2.

Table 2: Banded Changes in entitlement (pounds per week and households)

	Higher Entitlement	Lower Entitlement
More than £75	200,000	200,000
£50 to £75	200,000	200,000
£25 to £50	900,000	500,000
£10 to £25	900,000	500,000
Up to £10	600,000	600,000
Total	2,800,000	2,000,000

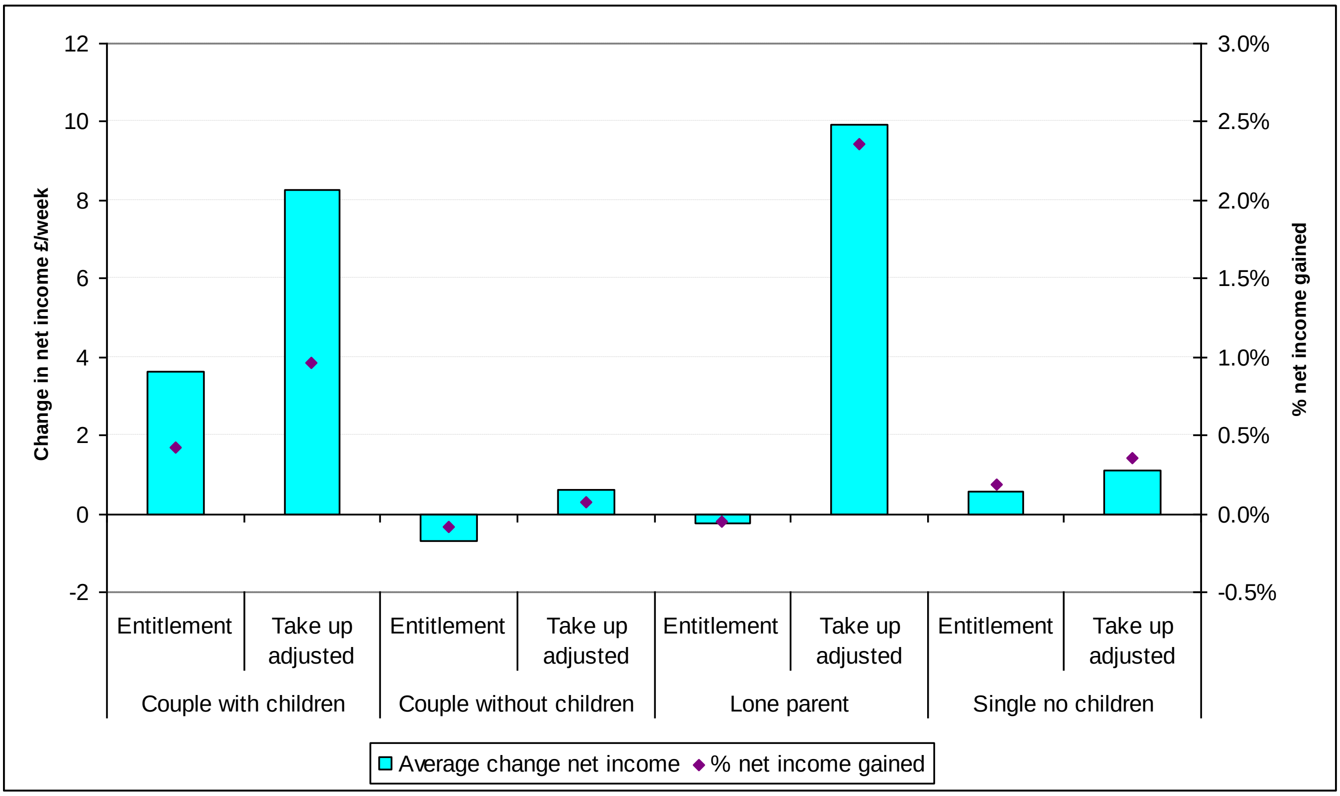
Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15

27. Chart 1 below shows the impact of changes in entitlement and increased take-up under Universal Credit on different family types, for all working age households. It shows the cash and percentage change in disposable income (before housing costs) in the steady-state.

28. When looking at the pattern of changes in entitlement, couples with children see the biggest increase in both cash and percentage terms, gaining an average of around £3.60 per week (around 0.4 per cent of their net income). Couples without children see the largest, albeit small, reduction in entitlement both in cash and percentage terms. Some of the heaviest notional losses for couples without children are in cases where one member is of working-age and one is currently eligible for Pension Credit. As outlined in Annex 1, under the reform they will be eligible for Universal Credit as opposed to the more generous Pension Credit. Lone parents also see a very small reduction in their average disposable income on an entitlement basis. Changes to the policies on disability support, council tax and childcare all reduce the average gain for lone parents by a small amount on an entitlement basis leading to a very small overall average loss. A package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same.

29. Although couples with children and lone parents see a reduction in average weekly entitlement, chart 1 shows that when the analysis is adjusted for improvements in take-up, all family types will see an increase in their average net income.

Chart 1: Average change in net income by family type (all households)



Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15

30. Table 3 develops this point by showing the distribution of changes in entitlement by family type and household tenure, for all households in the population pool. In all family types there are significant numbers of households with higher or lower entitlements than under the current system. This largely reflects the fact that Universal Credit introduces a system of benefit entitlements which removes the unnecessary complexities of the current system. Therefore, the pattern of changes in entitlements is driven as much by the simplification to the calculation rules as by the membership of a particular demographic group. However, there are some policy changes, such as moving couples with one partner under and one over the qualifying age for Pension Credit onto Universal Credit, which specifically affect a certain demographic group.

31. Table 3 shows that 67 per cent of renting couples with children have higher entitlements as a result of Universal Credit, with only 12 per cent seeing a reduction. The reason for this is that this group benefits from the combination of more generous disregards and a reduced benefit withdrawal rate which creates the more substantial increases in entitlement. Universal Credit takes the first steps to address the couple penalty by rewarding families, especially those with children. There is also further investment in support for childcare and a number of additional families with children also benefit from provision to cover the costs of childcare below 16 hours, as detailed in Annex 1.

Table 3: Changes in entitlement by family type and household tenure type (row percentages in brackets)

	Higher Entitlement	No change	Lower Entitlement
Under 25 No Children	400,000 *(49%)*	400,000 *(50%)*	*
Single No Children	500,000 *(28%)*	1,100,000 *(54%)*	500,000 *(24%)*
Couple No Children	300,000 *(34%)*	200,000 *(18%)*	400,000 *(48%)*
Lone Parent - Renting	400,000 *(29%)*	700,000 *(55%)*	200,000 *(17%)*
Lone Parent - No Rent	300,000 *(43%)*	100,000 *(17%)*	300,000 *(40%)*
Couple with Children - Renting	600,000 *(67%)*	200,000 *(21%)*	100,000 *(12%)*
Couple with Children - No Rent	500,000 *(47%)*	100,000 *(5%)*	500,000 *(48%)*
All	2,800,000 *(38%)*	2,700,000 *(35%)*	2,000,000 *(27%)*

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15
Amounts are weekly, given in 2011/12 prices
*Fewer than 50,000 households
Figures may not sum due to rounding

Why do entitlements change under Universal Credit?

32. To understand the drivers behind changes in entitlement it is important to consider the structure of Universal Credit:

- A tailored system of earnings disregards which are generally higher than under the current system. This allows people to keep more of their earnings, thus improving work incentives. This Impact Assessment includes proposed changes to disregards as set out in Annex 1. Different amounts will be disregarded from earnings before the taper applies in order to reflect the needs of different families and ensure that work pays for those who need the most support. There will be considerably higher disregards for lone parents and couples with children, and lower disregards for single people without children.

- Claimants in receipt of large amounts of housing support will have a higher award of Universal Credit than those with low or no housing costs. In order to address this and target resources fairly, we intend to allow those claimants who receive little or no support with their housing costs to keep more of their earnings. We intend to do this by setting higher earnings disregards in these circumstances.

- A single withdrawal rate of 65 per cent, which can be higher or lower than the current withdrawal rate depending on the combination of benefits/tax credits currently received by the household, but which eradicates the very high withdrawal rates currently faced by many.

- Removal of Working Tax Credit (WTC) which tends to have higher amounts in payment for people working 16 and 30 hours.

- Childless 18-24 year olds (who are not disabled) can not claim in-work tax credits under the current rules, but will be able to claim Universal Credit.

- Applying a capital limit for people with capital of more than £16,000. There is a capital limit in the current out of work benefits and Housing Benefit which is set at £16,000 but tax credits currently treat capital differently. Under tax credits there is no limit on eligibility as a result of capital but the investment income from capital is taken into account after a small annual disregard.

- Support for childcare will be extended to below 16 hours of work. As outlined in Annex 1, this will provide an important financial incentive to those taking their first steps into paid employment.

33. Entitlements are also affected by the recently announced policy changes described in Annex 1. As a result changes in entitlements presented here differ to those in previous Impact Assessments.

34. Universal Credit has very simple rules for calculating entitlements, but the move away from the complexities of the current system means that some of the changes in entitlement will be driven by interactions between the different changes. This can be illustrated by two examples:

- Lone parents are more likely to see higher entitlements due to higher disregards, whereas the removal of the 16 and 30 hour premiums will reduce some entitlements. However the Universal Credit provides a system which rewards each hour of work and will give lone parents greater flexibility to choose the hours most appropriate for them.

- Households who are towards the upper end of the income distribution may benefit from a higher earnings disregard (depending on the household circumstances) under Universal Credit but may also have a higher withdrawal rate applied to their earnings compared with current rules (this would be the case if they were entitled to tax credits only in the current system).

35. Table 4 segments the changes in entitlement by employment status and type of eligibility under the current system. The table illustrates the point that there is no straightforward mapping between current eligibility and changes in entitlement. A package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same.

Table 4: Changes in entitlement by work status and Tax Credit eligibility (for households entitled to state support under the current system or Universal Credit)

	Higher Entitlement	No change	Lower Entitlement
Workless	200,000	2,700,000	600,000
Under 25 (or disabled and under 16)	300,000	-	-
Not Eligible for WTC because working too few hours	400,000	*	100,000
Working part-time[8] and Receiving Tax Credits plus Other Benefits	300,000	*	100,000
Working part-time and receiving Tax Credits, but no other benefits	100,000	-	100,000
Working full-time and receiving Tax Credits and other benefits	600,000	-	200,000
Working full time and only Receiving Tax Credits	600,000	*	1,100,000
Not Eligible for Tax Credits: Too much Income	200,000	-	*
All	2,800,000	2,700,000	2,000,000

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15
Amounts are weekly, given in 2011/12 prices
* Fewer than 50,000 households
- Indicates no sample cases

36. In many cases workless households experience no change in their entitlement in static financial terms. This is because they do not benefit from the earnings disregard, and their

[8] Part-time is defined as working less then 16 hours.

basic benefit rates are as in the current benefit and tax credit system. However, some workless households in receipt of disability premiums, or couples with one under and one over the qualifying age for Pension Credit are affected as set out in Annex 1. Workless households experiencing higher entitlements will do so as a result of changes to the disability premiums and rates, which target support to the most severely disabled.

37. Claimants under 25, who are childless and not disabled, are currently unable to claim WTC when they are in work and are therefore likely to benefit from the removal of this exclusion within Universal Credit. Likewise households who are working part-time and who receive tax credits and other benefits, will gain from the fact that they will have a lower withdrawal rate than under the current system and because they are likely to have a higher earnings disregard.

38. Working households not currently receiving WTC but receiving other benefits will tend to have higher entitlements under Universal Credit. They benefit from the fact that the Universal Credit taper is likely to be lower than the combined taper on their current suite of benefits, but they do not experience an offsetting reduction due to the removal of WTC.

39. If households are working less than 16 hours, and are either disabled or have children, then they benefit from the fact that their earnings disregards are generally higher than under the current system. Because they are working below 16 hours they are not currently entitled to WTC, and so will not be affected by the fact that for some households the generosity of WTC is not replicated in Universal Credit.

40. If households are in receipt of Housing Benefit and tax credits then they will have a lower withdrawal rate under Universal Credit and so are more likely to receive higher entitlements.

41. The households with lower entitlements, as a result of the design of the system, will tend to be claimants who fall in to one or more of the following categories:

- those currently in receipt of a large amount of WTC;
- those who do not currently receive HB;
- mainly in work households with substantial amounts of capital; and
- higher earners on tax credits only.

42. Many people who currently receive a large amount of support through WTC, for example those who receive the 16/30 hour premiums, will generally have lower entitlements under Universal Credit because the specific generosity of their WTC entitlement at certain hours is not replicated under Universal Credit, however the Universal Credit provides a system which rewards each hour of work and will give people greater flexibility to choose the hours most appropriate for them.. For some households the impact of this change will be offset by the impact of the higher disregards and a lower withdrawal rate.

43. As a proportion of those with lower entitlements around 55 per cent fall into a group with all of the three following characteristics:

- working more than 30 hours; and
- receiving WTC; and
- not in receipt of HB.

44. Working households who are currently only in receipt of tax credits will have a higher withdrawal rate under Universal Credit. These households currently face a 41 per cent taper rate on gross income or a 73 per cent MDR after tax and NI. However, under Universal Credit the taper rate will increase to 65 percent on net income or a 76 percent MDR after tax and NI. Therefore, these households are more likely to have a lower

entitlement where this effect is not offset by the impact of the higher disregards under Universal Credit.

45. Of the households eligible for Universal Credit or the current benefits that it will replace, households with children are more likely to be affected by the reform than those without children. Of households with children, 44 per cent have higher entitlements and 28 per cent have lower entitlements, whereas 25 per cent of households without children have higher entitlements and 21 per cent have lower entitlements. This is largely due to the fact that households with children are more likely to be in work and eligible for Universal Credit where changes to entitlements occur. They will also be affected by the reform of childcare support which is incorporated into these estimates (see Annex 1 for more detail).

46. A number of households will also be affected by recently announced reforms including changes to disability support and including couples with one partner under and one over the qualifying age for Pension Credit on Universal Credit.

Entitlement changes and transitional protection

47. As outlined above, the move to a simpler system will mean that some households will be entitled to more than under the current system, while some will be entitled to less.

48. For those currently receiving benefits or tax credits there is a commitment to ensure that no one will experience a reduction in the benefit they are receiving as a result of the introduction of Universal Credit, where circumstances remain the same. A package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same.

49. At the point of transfer a comparison will be made between the household's total entitlement from current benefits and tax credits and the amount of their Universal Credit entitlement. As already demonstrated, for a majority of households Universal Credit will provide a level of support that is similar to or higher than that in the current system so there will be no need for transitional protection. A package of transitional protection is being developed in order to ensure that there will be no cash losers as a direct result of the move to Universal Credit where circumstances remain the same. As a result they will not be worse off in cash terms.

Impacts on Income Distribution and Poverty

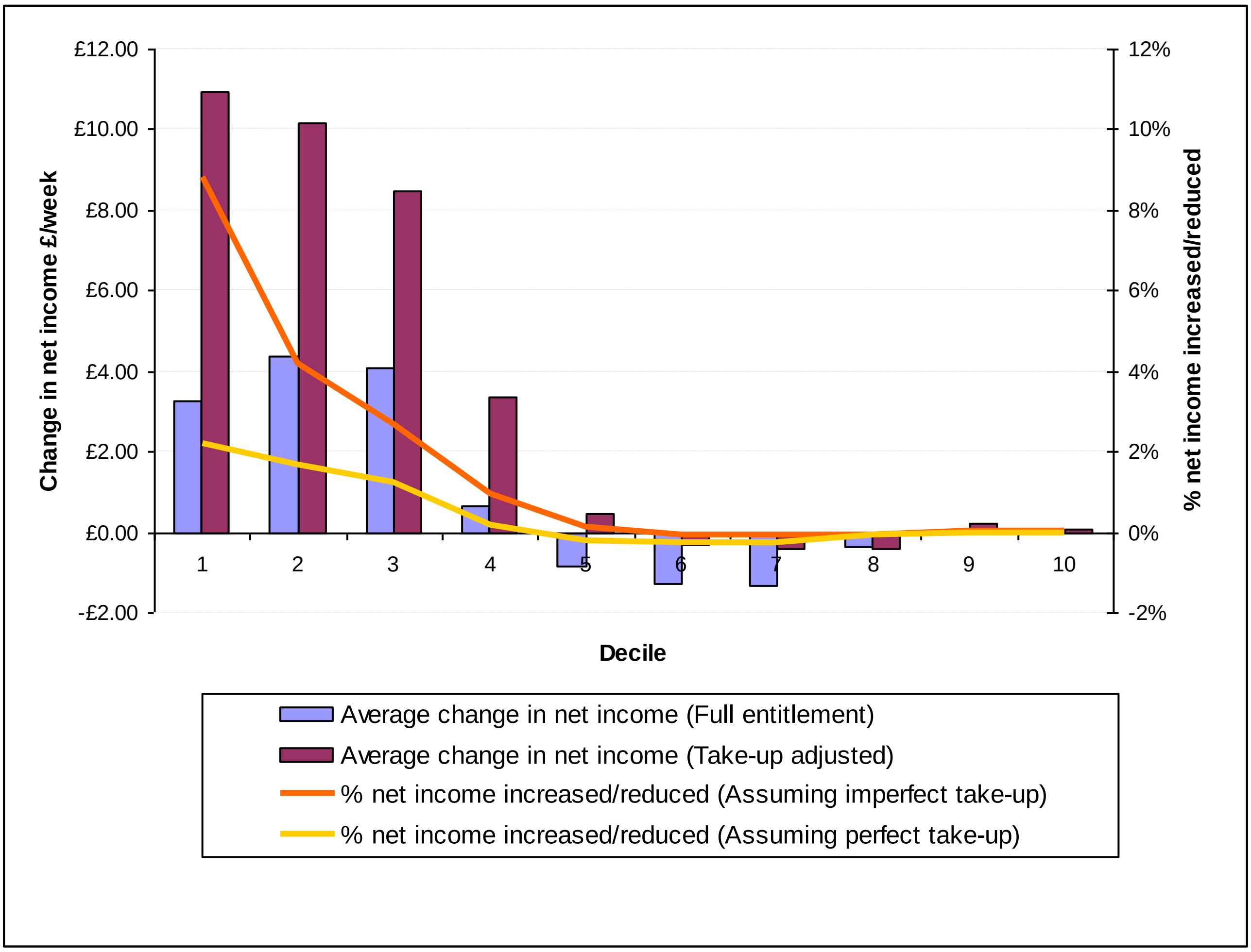
50. Universal Credit removes many of the complexities and inconsistencies of the current benefit and tax credit system and replaces it with increased support for low-income families and consistency in support as income rises. However, this simplification will mean that, in the long term, some households will be entitled to less under Universal Credit than they would have been had the current benefit and tax credit system continued. It is important to note that the design of the current system creates greater incentives to work at a particular number of hours, particularly 16 and 30. These might not be the optimum choice for people if the support was more evenly distributed.

51. Under Universal Credit, all hours of work are rewarded not just a few particular points. The aim is to improve work incentives and to support progression in work. It is reasonable to expect some individuals to adjust their hours as the incentives change so this analysis may be overstating the actual number of households with lower entitlements in the long run. These notional losses will arise gradually over time, as new claimants take up Universal Credit and the circumstances of current benefit and tax credit claimants change. Chart 2 below illustrates this long-term impact after transitional protection has been fully eroded, showing the average change in income for the working age population (all households) in each ten per cent band (decile) of the equivalised income distribution.

52. The chart shows that Universal Credit will benefit low-income families, with those with the lowest incomes gaining the most as a proportion of their income. The bottom two deciles of the income distribution will see increases in entitlement of around £3 and £4 a week. For these deciles this equates to an increase of about two per cent of average weekly income. Those higher up the income distribution see smaller gains. Chart 2 also shows that when the analysis adjusts for improvements in take-up the gains to the bottom of the income distribution are even greater. The bottom two deciles gain around £11 and £10 a week respectively when accounting for imperfect take-up in the current system and improved take-up under Universal Credit. For the bottom decile this represents a nine per cent increase in weekly income.

53. The most substantial reductions in entitlement are in the sixth and seventh decile, where households lose an average of around £1.30 a week. One of the reasons is that those in the sixth and seventh decile are most likely to be in receipt of Working Tax Credit and no other elements of the current system; they will tend to have lower entitlements as outlined above. Furthermore, announced policy changes to disability premiums, detailed in Annex 1, will impact more severely on the middle of the income distribution.

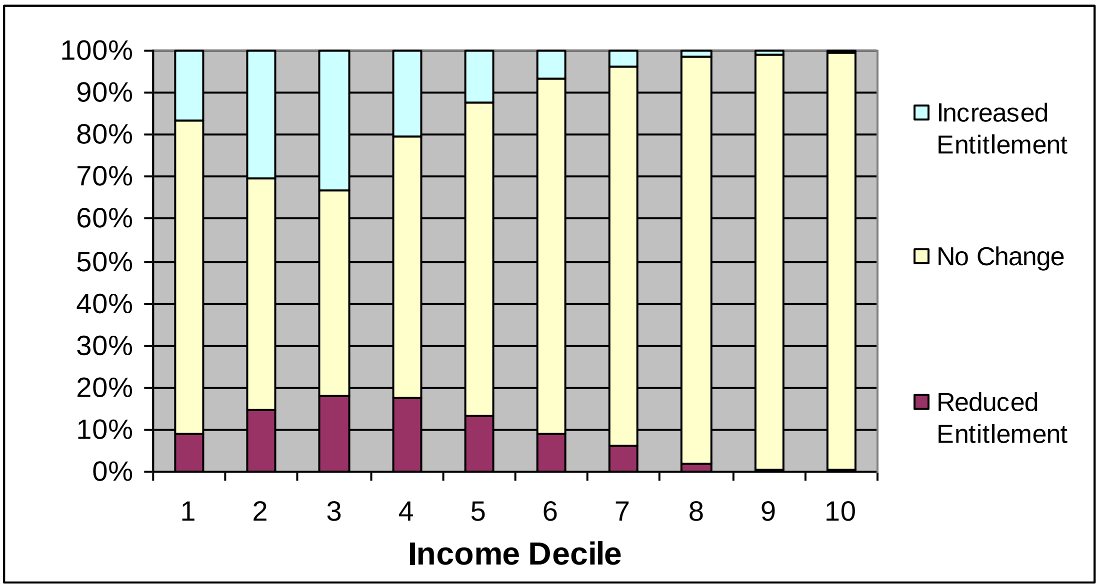
Chart 2: Long term Distributional Impact – Average entitlement changes by income decile (all households)



Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15
Weekly change in net income presented in 2011/12 prices.

54. Chart 3 below shows the distribution of changes in entitlement by income decile, for all working age households. In the first four decile groups there are more households with higher entitlements than lower entitlements. As outlined above, households in the middle of the income distribution will be impacted by the removal of Working Tax Credit and the announced changes to disability premiums (see Annex 1), which is why a slightly higher proportion have reduced entitlements compared to increased entitlements. Households in the top half of the income distribution are less likely to be affected by the introduction of Universal Credit. This is because they are currently not entitled to means-tested benefits and are therefore unlikely to be affected by the changes.

Chart 3: Entitlement changes by income decile (all households)



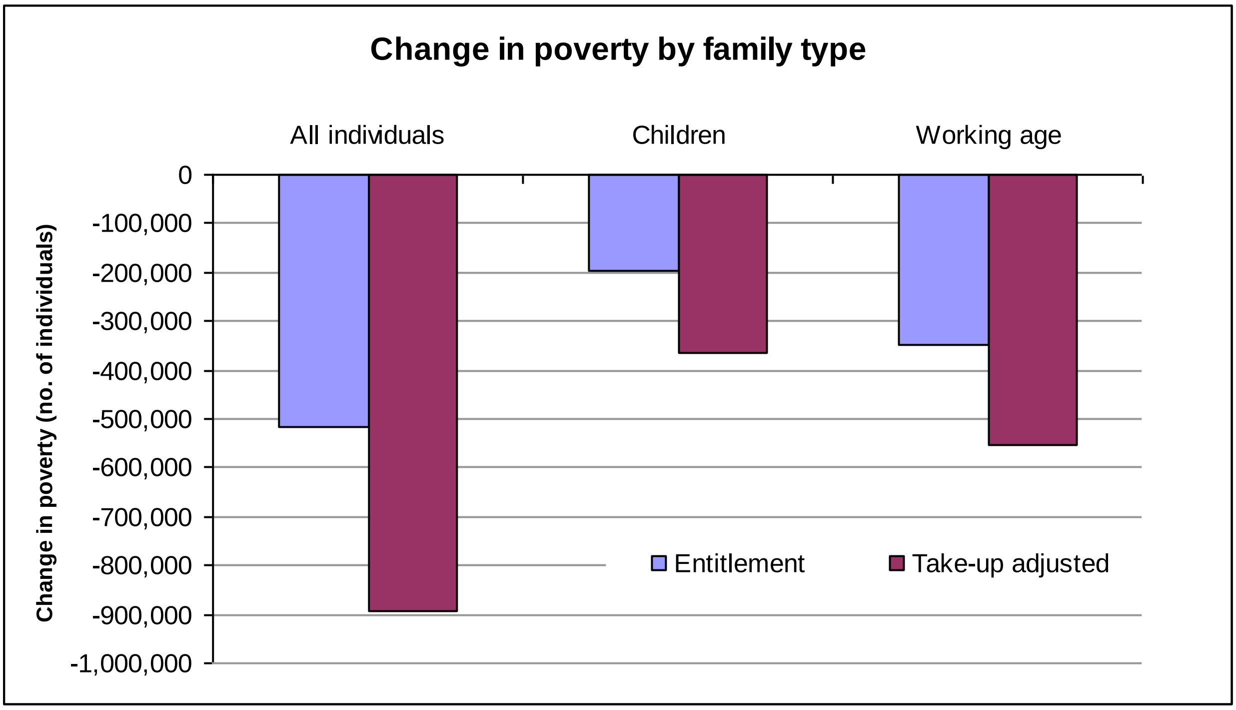
Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15

Poverty

55. Chart 4 shows the effect of Universal Credit on poverty by family type. Poverty is defined as living below 60 per cent of equivalised medium income. Changes in modelled entitlements suggest a substantial impact on poverty in steady-state, lifting approximately 200,000 children and 350,000 working age adults out of poverty. In addition, the increased take-up of currently unclaimed entitlements will strongly reinforce the positive impact on poverty. On reasonable assumptions, the combined impact of take-up and entitlements will lift around 900,000 individuals out of poverty, including more than 350,000 children and around 550,000 working-age adults. These poverty impacts exclude the positive impacts of more people moving into work.

56. The introduction of Universal Credit will significantly improve the take-up of unclaimed entitlements, a powerful tool in tackling poverty. This is partly because it will be easier for people to understand the level of benefit to which they are entitled. In addition, there will be an 'automatic passporting' effect for people who currently claim some, but not all, of the benefits or tax credits to which they are entitled; a claim for Universal Credit will automatically ensure that claimants receive amounts associated with their children and their housing costs.

Chart 4: The impact of Universal Credit on poverty by family type (all households)



Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15

Note: A small number of pensioners are affected by the reforms and are included in the total poverty impact on individuals. However the impact on pensioner poverty is insignificant and therefore not presented separately.

Impact on Work Incentives

57. Universal Credit will substantially improve incentives to work in three key ways:

- It will increase the incentive to start work by increasing the proportion of earnings which people keep when they move into work – this is measured through changes in the **participation tax rate (PTRs).**
- It will increase the incentive to increase hours of work and progress through the labour market by reducing the proportion of any increase in earnings which is lost due to tax or reduced benefit payments – this is measured through the **marginal deduction rates (MDRs).** This will be balanced against the incentive for some to move to lower hours as there will no longer be 16/30 hour rules under Universal Credit.
- It will be a simpler system which removes some of the risks associated with moves into work and makes much clearer the actual financial gain from working.

58. The current system mainly rewards those working 16 or 30 hours, although conditionality ends for most people once their earnings reach a certain level which can be as low as £70 a week (equivalent to less than 12 hours work at National Minimum Wage for a claimant over 21). Under Universal Credit, all hours of work will be rewarded and conditionality will be extended so as to incentivise Universal Credit claimants who are earning over £70 a week to work more and reduce their dependency on benefits.

59. The higher earnings disregards and lower taper-rate means that many households will be able to keep a higher proportion of their earnings. In particular, Universal Credit provides strong incentives for workless households to take up mini jobs. Mini jobs could be important in helping individuals who have spent long periods in unemployment take steps into the labour market, particularly those on ESA (Work Related Activity Group) and individuals on IS.

Modelling work incentives

60. For the purpose of work incentives analysis, childcare support is excluded from the baseline and Universal Credit model[9].

61. To reflect the fact that council tax support will be localised it has been excluded from both the current system and Universal Credit. For this analysis no assumptions are made about how council tax support will be provided by local authorities.

62. The work incentives outlined in this Impact Assessment differ from those in previous iterations as a result of announced policy changes and the removal of council tax support from the analysis. There is also a larger population defined as working-age as a result of the policy to bring couples with one partner under and one over the qualifying age for Pension Credit (see Annex 1) onto Universal Credit.

Impact on Employment incentives - Participation Tax Rates

63. The participation tax rate (PTR) measures the incentive for someone to enter work at all. At a given level of gross earnings it tells you how much will be withdrawn in tax/national insurance contributions and reduced benefit payments. The lower the PTR faced by an individual at a particular level of earnings, the more incentive they have to move into work at those earnings. A key aim of Universal Credit is to encourage people currently out of work to take their first steps into employment. Consequently, a key part of the design of earnings disregards and benefit tapers is aimed at radically improving the incentive to take-up work of a few hours per week.

64. PTRs are obviously important for individuals considering the decision to enter work. However, for Universal Credit to have the desired effect it will also be important that individuals understand the system and can see the gain to work. Therefore the greater transparency of the new system will be an important component in maximising the benefits of improved PTRs.

65. Table 5 below illustrates the change in PTRs for first earners in workless households at different points of hours worked. It is assumed that those entering work do so at the National Minimum Wage (NMW) of around £6.00 per hour[10]. It shows that under Universal Credit there is a large reduction in the number of households facing PTRs of over 70 per cent. For example, for those who go into ten hours of work, the number of households facing PTRs between 70 and 100 per cent falls by around 1.2 million under Universal Credit.[11] For those entering 16 hours of work, the number of households who face PTRs in this range falls by over 800,000.

[9] As opposed to analysis of changes in entitlements, work incentives analysis requires an assumption to be made about the increased cost of childcare associated with an increase in hours worked or a movement into work. As this cost will vary significantly according to individual circumstances, it is difficult to capture this accurately in the modelling of work incentives at a population-wide level.

[10] In 2011/12

[11] Departmental analysis estimates that there are approximately 400,000 workless households with PTRs in excess of 100 per cent under the current system and 100,000 with PTRs over 100 per cent under Universal Credit. The vast majority of these cases are households in receipt of contributory ESA, whose incomes at ten hours of work are not fully captured as modelling does not include Permitted Work.

Table 5: PTRs[12] for first earners in a workless household at various hours (millions, individuals)

First earner PTRs	10 hours		16 hours		25 hours		37 hours	
	Current System	Universal Credit	Current System	Universal Credit	Current System	Universal Credit	Current System	Universal Credit
Under 60%	1.4	4.1	2.7	4.0	3.2	4.0	3.4	3.6
60% to 70%	1.3	0.1	0.5	0.2	0.5	0.3	0.6	0.7
70% to 80%	0.1	*	0.2	0.1	0.5	0.1	0.3	0.1
80% to 90%	0.6	*	0.5	0.1	0.2	*	0.1	*
Over 90%	0.6	*	0.3	*	0.1	*	*	*

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[13].
Figures may not sum due to rounding.
* Rounds to less than 50,000
The small number of individuals with PTRs in excess of 80 per cent at 16 hours reflects the current working assumption to withdraw Support for Mortgage Interest at this point.

66. These reductions occur for two reasons:

- Universal Credit provides higher earnings disregards for many more people than the current system does; and

- for those households earning above their disregard, the single taper-rate is lower than the 100 per cent taper which they face under current out of work benefits, or the very high withdrawal rate if they face the simultaneous tapers for Housing Benefit and tax credits.

67. Note that changes in the incentives to enter work have occurred due to the redesign of earnings disregards, reflecting the removal of council tax support. Single adults without children or a disability, who in the previous Impact Assessment were not awarded an earnings disregard, and consequently often faced PTRs in the range of 60 per cent to 70 per cent, will now receive an annual earnings disregard of £700 as set out in Annex 1. This ensures that the vast majority of households have a PTR below 60 per cent before council tax support is taken into account.

68. Table 6 below shows the PTRs for potential second earners in a household, where one partner is already in work. The second earner is assumed to enter work at the NMW. In general, second earners face higher PTRs because the earnings disregard is exhausted by the earnings of the main earner. Furthermore, two earner households are likely to have a higher income and therefore are less likely to face simultaneous tapers in the current system on more than one benefit or tax credit. For this reason second earners do not benefit as much from the reduced taper under Universal Credit. .

69. More broadly, as the Universal Credit delivers a more progressive tax and benefit system, a couple with two earners who have a higher income tend to lose slightly more in terms of state support.

70. Although the number of workless households will reduce, it is possible that in some families, second earners may choose to reduce or rebalance their hours or leave work. In these cases, the improved ability of the main earner to support his or her family will increase the options available for families to strike their preferred work/life balance. The

[12] PTRs calculated on a pre Council Tax basis in the current system and under Universal Credit – meaning that these are somewhat lower than are currently the case.
[13] Modelling is based on entitlement changes only.

Universal Credit policy is gender neutral. Where men and women are in the same circumstances they are treated equally under Universal Credit.

71. Table 6 illustrates this point, highlighting that Universal Credit has less effect on second earner PTRs. However it is also important to note that the highest PTRs for second earners in the current system are virtually eliminated under Universal Credit providing additional support for potential second earners with the highest financial barriers to entering work. In some instances there is an increase in PTRs for the second earner, primarily for those households who are currently in receipt of Tax Credits but no other benefits; this is primarily because their current MDR of 73 per cent is lower than the 76.2 per cent[14] which will apply under Universal Credit.

Table 6: PTRs for potential second earners at various hours (millions, individuals)

	10 hours		**16 hours**		**25 hours**		**37 hours**	
	Current System	Universal Credit	Current System	Universal Credit	Current System	Universal Credit	Current System	Universal Credit
Under 60%	2.0	2.2	2.0	2.2	2.0	2.3	2.0	2.3
60% to 70%	0.4	0.5	0.4	0.5	0.4	0.5	0.4	0.5
70% to 80%	0.3	0.1	0.3	0.1	0.3	0.1	0.3	0.1
80% to 90%	0.1	*	0.1	*	0.1	*	0.1	*
Over 90%	0.1	*	0.1	*	0.1	*	0.1	*

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[15].
Figures may not sum due to rounding
* Rounds to less than 50,000

Employment incentives by Family Type

72. Table 7 shows that the Universal Credit dramatically reduces the highest PTRs (above 70 per cent) making it much more worthwhile for all family types to consider work at ten hours a week. Single adults without children are most likely to face the highest PTRs under the current system. In the current system they have a very small earnings disregard (£5 a week unless they have a disability in which case it is £20) and then face a pound for pound taper on their ESA/IS/JSA.

Table 7: PTRs for the first earner in a workless household if they were to enter work at 10 hours per week (working age only) by family type (millions, individuals)

PTR for first earners	**Couple with children**		**Couple without children**		**Lone parent**		**Single without children**	
	Current system	Universal Credit	Current system	Universal Credit	Current system	Universal Credit	Current system	Universal Credit
Below 60%	0.1	0.3	0.4	0.7	0.1	0.9	0.9	2.3
60% to 70%	0.1	-	0.1	*	0.5	*	0.6	0.1
70% to 80%	*	*	*	*	*	*	0.1	*
80% to 90%	0.1	-	0.1	*	0.1	*	0.2	*
0ver 90%	*	*	*	*	*	*	0.5	*

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[16].
Figures may not sum due to rounding
* Rounds to less than 50,000
- Denotes no sample cases

[14] This is the combined effect of the withdrawal of Universal Credit, tax and NI.
[15] Modelling is based on entitlement changes only.
[16] Modelling is based on entitlement changes only.

Impact on Earnings incentives – Marginal Deduction Rates

73. Marginal deduction rates (MDRs) measure the incentive for someone to increase their hours of work. As the earnings of a household increase, means-tested benefits and tax credits start to be withdrawn. In addition, above a certain level of earnings, the increase in their wages will also be partially offset by income tax and national insurance contributions. The MDR is calculated as the proportion of a small increase in earnings which is lost in lower benefits/tax credits and/or higher income tax and national insurance payments.

74. Under the current system, many households have very high MDRs which substantially damage their incentive to increase their hours of work. There are two particularly notable circumstances in which very high MDRs occur:

- firstly, MDRs are 100 per cent for anyone working while in receipt of income-related benefits and whose earnings are above the disregard level; and

- people who have exhausted their IS/ESA/JSA but are simultaneously in receipt of Housing Benefit and tax credits can have MDRs as high as 91 per cent[17].

75. Universal Credit replaces the multiplicity of tapers for in-work support with a consistent proposed taper of 65 per cent on net income, and removes the 100 per cent taper for out of work benefits; as a result Universal Credit will reduce the highest MDRs, as illustrated in tables 8 and 9 which compare the distribution of MDRs under the current and the new system. The tables illustrate the fact that, to all intents and purposes, no-one in work will face an MDR of above 76.2 per cent under the new Universal Credit system. Tables 8 and 9 combined show that one of the key impacts of Universal Credit is that around 500,000 people, who currently have MDRs above 80 per cent, will see their MDR reduced to 76.2 per cent or lower.

76. As Universal Credit policy is developed, the government will have the scope to balance affordability constraints with the taper rate to further increase work incentives.

77. It is important to note that MDRs are partially driven by the generosity of the benefit system. There is a trade off between increasing entitlements and reducing MDRs. It is possible to reduce MDRs by reducing entitlements. However, under Universal Credit 2.8 million households will receive higher entitlements and some of these households will see their MDRs increase as a result. For example, some households become entitled to state support for the first time under Universal Credit; as a result the Universal Credit taper will be combined with tax/NI thus increasing their MDR. Therefore, for these households, the increase in MDRs is associated with an increase in their income.

78. As with PTRs, MDRs differ from those reported in the previous impact assessments due to the incorporation of policies announced since the last publication (see Annex 1) and reflecting the removal of council tax support from the analysis of both the current system and Universal Credit[18].

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[17] Basic rate tax and National Insurance together take 32 pence from each pound earned; tax credits then take an additional 41 pence from each pound earned therefore 73 pence in total is taken from each pound leaving 27 pence. Housing benefit then tapers at 65 percent of income net of tax and tax credits – taking 65 percent of the 27 pence which is left is around 18 pence. Added together this is a reduction of 91 pence (73 pence plus 18 pence) for each pound earned while these benefits are being simultaneously withdrawn.

[18] Removing Council Tax Benefit (CTB) from the current system causes a reduction in the numbers facing the highest MDRs in the current system. As an example, a person who was previously entitled to Council Tax Benefit and Housing Benefit (but not tax credits) would have had a taper of 85 per cent on net income (an MDR of 85 per cent without tax and national insurance deductions and 91 per cent afterwards). When Council Tax Benefit is excluded from the analysis the same household now faces a taper of 65 per cent on net income (an MDR of 65 per cent before tax and national insurance deductions and 76 per cent afterwards). In previous analysis this individual would have seen their MDR reduce as a result of the move to Universal Credit but now their MDR will be the same under both systems. For this reason, compared to the previous Impact Assessment, there is a fall in the number of people who have a lower MDR under Universal Credit than under the current system

79. Alongside financial work incentives it is also important to remember that there will be a system of conditionality helping to encourage and support as many people into work as possible. Additionally, the effectiveness of reducing MDRs on work incentives will be supported by the greater simplicity and transparency of the new system.

Table 8: MDRs[19] for those in work (working age only), earning below the tax threshold

MDR for non-taxpaying earners	**Current System** (millions)	**Universal Credit** (millions)	**Difference** (millions)
Up to 60%	0.7	0.2	-0.5
60%-70%	0.3	0.9	0.6
70%-80%	0.1	0.1	*
80%-90%	*	-	*
Over 90%	0.1	*	-0.1

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[20]
Figures may not sum due to rounding
* Rounds to less than 50,000
- Denotes no sample cases

Table 9: MDRs[21] for those in work (working age only), earning above the tax threshold

MDR for taxpaying earners	**Current System** (millions)	**Universal Credit** (millions)	**Difference** (millions)
Up to 60%	0.4	0.6[22]	0.1
60%-70%	0.1	*	*
70%-80%	1.6	1.8	0.2
80%-90%	0.3	*	-0.3
Over 90%	0.1	*	-0.1

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[23].
Figures may not sum due to rounding
* Rounds to less than 50,000

Distribution of Changes in MDRs

80. Table 10 summarises the impact of Universal Credit on the distribution of MDRs, and segments them into first and second earners in the household. Some 2.1 million individuals will have higher MDRs under Universal Credit but the median increase will be comparatively small, at around four percentage points. Many of these cases will be households with above-average income for Universal Credit claimants, and who move from an MDR of 73 to 76.2 per cent.

81. Around 1.2 million individuals will have lower MDRs under Universal Credit with a median reduction of 27 percentage points; this reflects the virtual elimination of the highest MDRs under Universal Credit and the move to a maximum MDR of 76.2 per cent.

82. Around 300,000 second earners will face higher MDRs under Universal Credit and around 100,000 second earners will experience reduced MDRs. The median increase is higher for this group than for first earners, reflecting the fact that second earners already tend to have

[19] MDRs for those receiving income related benefits or tax credits in the current system or receiving the new Universal Credit. Self employed and students are excluded.
[20] Modelling is based on entitlement changes only.
[21] MDRs for those receiving income related benefits or Tax Credits in the current system or receiving the new Universal Credit. Self employed and students are excluded.
[22] Individuals with MDRs below 60 per cent under Universal Credit will be those no longer entitled to state support on transition to UC.
[23] Modelling is based on entitlement changes only.

lower MDRs. A second earner who does not earn enough to pay income tax or national insurance (in 2011/12 an individual would start paying NI at £139 a week (approx £7250 a year) and tax at £7475 a year), but whose household income is sufficiently high to place them on the tax credit taper would have an MDR under the current system of 41 per cent. This would increase to 65 per cent under the new system, which explains the median increase of 24 percentage points.

83. In some cases an increase in MDR would occur because the reduced taper of Universal Credit means that a household would still be in receipt of some of the benefit at a point where under the current system their benefits/tax credits would have tapered away completely. In this case, the increase in the MDR is associated with an increase in their net income. Individuals facing an increase in MDR tend to be those who become newly entitled to state support for the first time under Universal Credit, and households with higher incomes who would be in receipt of tax credits only in the current system.

Table 10: Changes in MDRs

	MDR increases (millions)	MDR decreases (millions)	Mean increase	Mean decrease	Median increase	Median decrease
First earners	1.8	1.0	0.22	-0.31	0.04	-0.23
Second earners	0.3	0.1	0.24	-0.34	0.24	-0.41
Total	2.1	1.2	0.22	-0.31	0.04	-0.27

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[24].
Figures may not sum due to rounding

Earnings Incentives by Family Type

84. Table 11 segments the banded MDRs by family type, while table 12 shows the increases and decreases. Table 11 shows that for all household types only a small number of people are left on the highest MDRs. In absolute terms, families with children are the greater beneficiaries from this change because they are more likely to have a high MDR in the first place.

85. Couples with children are slightly more likely than other family types to see an increase in their MDRs. The median increase is comparatively small (4 percentage points) which reflects the fact that they are more likely to have incomes which place them in the group, described above, whose MDRs move from 73 per cent to 76.2 per cent as a result of Universal Credit[25].

Table 11: MDRs[26] for those in work (working age only) by family type

MDR for benefit recipients	**Couple with children (**millions)		**Couple without children (**millions)		**Lone parent (**millions)		**Single without children (**millions)	
	Current	UC	Current	UC	Current	UC	Current	UC
Below 60%	0.5	0.3	0.2	0.1	-	-	0.4	0.2
60% to 70%	0.1	0.3	*	0.1	0.1	0.1	0.1	0.4
70% to 80%	0.9	1.0	0.1	0.2	0.5	0.6	0.2	0.1
80% to 90%	0.2	*	*	*	0.1	-	*	-
0ver 90%	0.1	*	*	*	*	*	*	*

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[27].
Figures may not sum due to rounding
* Rounds to less than 50,000 people
- Denotes no sample cases

24 Modelling is based on entitlement changes only.
25 Where someone pays contracted out NI, the increase would be four percentage points.
26 MDRs for those receiving income related benefits or Tax Credits in the current system or receiving the new Universal Credit. Self employed and students are excluded.
27 Modelling is based on entitlement changes only.

Table 12: MDRs average changes

	Couple with children	Couple without children	Lone parent	Single without children	All
MDR increases (millions)	1.1m	0.2m	0.5m	0.3m	2.1m
MDR decreases (millions)	0.5m	0.2m	0.3m	0.2m	1.2m
Mean increase (ppt)	17	34	7	51	22
Mean decrease (ppt)	-28	-41	-27	-39	-31
Median increase (ppt)	4	44	4	65	4
Median decrease (ppt)	-19	-41	-14	-41	-27

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15[28].
Figures may not sum due to rounding

86. For those people for whom MDRs fall, the reductions are substantial across all of the family types, but especially families without children. The median reduction of 41 percentage points is typical of a family who would be entitled to tax credits in the current system but would not be entitled to Universal Credit. The increases are more variable, with families without children experiencing the largest average increase. The numbers affected by these larger increases will be comparatively small, and some of them will be people who become newly entitled to support as a result of Universal Credit, and so experience an increase in their net income at the same time.

Work incentives – Impacts on transparency and simplicity of the benefit system

87. Universal Credit will considerably ease the movement into work by reducing the uncertainty people will experience around the return to work. Under the current system, someone moving into work needs to have their benefits and tax credits reassessed and may have to deal with three government agencies in the process. This creates considerable uncertainty around the value of their in-work support and about when they will start to receive it. A number of changes have been made to the current system to address this, for example through having a 'run-on' period in Housing Benefit. However these are only partial solutions.

88. Under Universal Credit, the complexity of dealing with many agencies is reduced. Many of the changes in circumstances which affect benefit entitlements, such as changes in hours, will be handled automatically. The simpler system will make the financial implications of changes in circumstance much more transparent to customers, who will also be able to check on-line calculations to estimate the benefit of working at any number of hours. Support for council tax will remain outside Universal Credit, to be administered by local authorities as part of the council tax system.

Dynamic Effects of Universal Credit

89. Universal Credit represents a fundamental and structural change to the welfare system. As a result, it is not possible to reach definitive conclusions about the likely scale of the labour supply impacts of the measure using analysis and evidence in the current system. Traditional labour supply modelling is helpful in understanding the impact of small changes in financial incentives within the confines of the existing tax and benefit system, but cannot account for many of the other factors associated with this reform that are likely to elicit a dynamic response. For example:

- increased transparency of work incentives;

[28] Modelling is based on entitlement changes only.

- reduced administrative complexity associated with a move into work and, related to this, reduced risks of interruptions in benefit payments;
- reinforcement of the conditionality regime; and
- in the long-run the reinforcement of pro-work social norms.

90. In the previous version of the Impact Assessment it was estimated that there would be a reduction in the region of 300,000 workless households. The government will make a further assessment of the likely impact in future, including taking account of the shape of local support for council tax once more detail becomes clear.

Conditionality

91. Under current benefit rules, claimants of some out of work benefits, most notably Jobseeker's Allowance (JSA), have to meet various conditions in return for benefit payments. Although JSA is an unemployment benefit, a number of claimants who receive it are engaged in some paid work. This can only be for a few hours a week and the JSA regime rightly requires these claimants to look for and take up more substantive employment rather than continuing to rely on support from the state.

92. Entitlement to JSA ends as soon as a claimant's income reaches a certain level, which can be as little as £70 a week. After that point, the individual may be able to claim in work benefits, such as tax credits, as well as other financial support from the State, such as Housing Benefit, with no work-related conditions attached.

93. Under Universal Credit, the separation between in work and out of work benefits will be removed, and conditionality extended so as to encourage Universal Credit claimants who are earning over £70 a week to work more and reduce their dependency on benefits.

94. To achieve this an earnings threshold within Universal Credit will be set which will be personalised to reflect a claimant's circumstances. Any claimant earning above that level would fall into the no conditionality group, while claimants earning below that level could be subject to all work-related requirements.

95. As a default the maximum threshold for a single claimant will be set at the level of earnings that would be accrued by working full-time (35 hours) at the National Minimum Wage. At current rates this equates to £212.80 a week. For claimants not expected to work full-time, such as lone parents with young children, the conditionality threshold will be set at the earnings that they would accrue working at the National Minimum Wage for the number of hours they are expected to be available for work as set out in their Claimant Commitment.

96. For couples, the conditionality threshold will be defined as the sum of what would be their two individual thresholds. Couples earning below their conditionality threshold would then both be subject to conditionality, in line with their personal circumstances and capabilities. Couples with combined earnings above their conditionality threshold would both be out of scope of conditionality, regardless of the composition of their earnings.

97. Claimants who are subject to all work-related requirements should be spending as much time as possible looking for work – until claimants find employment this should be their job. Regulations will specify that claimants must, as a minimum, be engaged in work search for at least the number of hours expected of them to be available for work. For many claimants this will be the equivalent of a full time job but for others it may be lower to reflect, for example, their caring responsibilities. Claimants must also undertake work search action that gives them the best prospects of securing work.

Annex 1: Policy updates

1. This Annex outlines the policies which have been announced since the publication of the Universal Credit Impact Assessment in February 2011. These impacts have now been incorporated into this latest assessment of the impact of the Universal Credit reform. The announcements include: further detail about the benefit rates for those with limited capability for work; localisation of council tax support; changes to the treatment of couples with one partner under and one over the qualifying age for Pension Credit; and childcare support within Universal Credit. The detail and impact of each policy is set out below.

Benefit Rates for Those with Limited Capability for Work

2. The current benefit system includes a range of payments for disabled people (for example Employment Support Allowance and its components, disability premium in income-related benefits, additional severe and enhanced disability premiums and disability elements within tax credits). The Government has published a policy briefing note[29] outlining how these payments can be simplified under Universal Credit with support focused on those who are most severely disabled.

3. For adults, the policy is to replace existing provision with two elements to reflect the extra costs of longer durations on Universal Credit. These elements will be based on limited capability for work (and also for limited capability for work-related activity), reflecting the current ESA components. Resources released from abolishing the current premiums will be re-invested into the support component equivalent, raising it in stages as resources become available to around £77[30]. This would widen the current differential between that component and the work-related activity component.

4. For disabled children, the policy is to mirror the two elements for adults. The higher rate (at around £77) would be based on the child being eligible for the highest rate of the DLA care component (and widened to include children who are registered blind). The lower rate would be based on the child being eligible for the other rates of DLA and would be less than now (£26.75 instead of £53.84) so as to mirror the limited capability for work element for adults. During the period when the rate for severely disabled adults is being raised to £77, the higher rate for severely disabled children will not be less than the Child Tax Credit equivalent[31].

5. The Government is also removing the current rule which allows an individual to simultaneously claim both a disability and a carer premium for themselves. This ‘overlap’ will not occur in Universal Credit as the individual would receive only one element even if they are eligible for both the carer element and one of the limited capability for work elements.

6. As outlined in the policy briefing note, the Government believes that the existing structure of overlapping disability payments causes confusion, and thus for adults, simplification is justified as a means of removing unnecessary complexity and cliff-edges in levels of benefit entitlement in order to ensure that, where possible, disabled people can benefit from improved work incentives and a smoother transition into work. The improved earnings disregard under Universal Credit allows disabled adults to retain more of this entitlement as they move into work.

7. For children the change is intended to equalise elements for disabled children with those of adults, including increased support for the most severely disabled children. The Government believes that the payments for disabled children and adults need to be aligned as between 2003 and 2010 the uprating of child payments increased at a faster rate than those of adults. In addition the Government believes that the higher rate of the element for disabled children and adults is the most

[29] http://www.dwp.gov.uk/docs/ucpbn-1-additions.pdf; and revised version published 12 September 2011
[30] 2011/12 benefit rates
[31] Revised version of policy briefing note published 12 September 2011

appropriate target for support within Universal Credit (with extra disability costs being supported through DLA).

Council Tax Support

8. It was announced at the Spending Review that support for council tax will be localised and will not form an element of the Universal Credit. Council Tax Benefit will be abolished and local authorities will develop their own local discount schemes, determining the amount of support the most vulnerable need to meet their council tax bills.

9. To reflect the decision that council tax support will remain outside Universal Credit, the Government has decided to make some changes to the parameters set out in the White Paper and accompanying Impact Assessment. This will support some of the positive impacts of Universal Credit on poverty, income redistribution and work incentives, while not increasing the cost of the reform.

10. Specifically, this Impact Assessment sets out higher earnings disregards than were set out in the White Paper. This would allow a reduction in the risk of dual tapering (council tax support and UC being withdrawn simultaneously) ensuring that support can be directed to those who could otherwise be affected by the exclusion of council tax support from UC.

11. To achieve this, additions to the original earnings disregards have been proposed[32] including:
    i. An additional earnings disregard to couples with children of £250;
    ii. Increasing the child element in the earnings disregard from £2,700 to £4,000, and;
    iii. An increase in the disregard floor per adult of £700, including for single claimants.

Couples with One Partner Under and One Over the Qualifying Age For Pension Credit

12. The previous Impact Assessment and Equality Impact Assessment, published in February 2011, did not take account of the transfer of some pensioner couples from Pension Credit to Universal Credit in cases where one member of the couple is under and one over the qualifying age for Pension Credit. Any household containing a pensioner was treated as eligible to Pension Credit, as in the current system, and not Universal Credit.

13. This Impact Assessment reflects the Government's decision that households where one member of a couple is a pensioner and the other member is of working-age, will be entitled to Universal Credit. The Government believes that all people of working age who can work should be expected to do so and that it is not right to continue the current position where Pension Credit can go to households which contain a person of working age without that person having to meet any work-related requirements. Requiring such couples to claim Universal Credit will ensure that working age people have the right support and incentives to move into work.

Support with Childcare Costs

14. The Government has announced that Universal Credit will include an element for childcare costs to help working families as it fully recognises that for many parents childcare is essential to support their return to, and/or their progression in work. The basic structure of paying a percentage to a maximum limit of childcare costs will be retained as the best way to provide childcare support in Universal Credit. This support will be subject to the Universal Credit taper.

15. In recognition of the Government’s commitment to helping parents with the costs of childcare the Government has committed to investing an additional £300 million into childcare support- this is

[32] The actual disregard levels will be set closer to the date of implementation.

on top of the £2bn already spent on childcare support within the current tax credit system and Housing Benefit/ Council Tax Benefit disregards.

16. Support for the costs of childcare within Universal Credit will be available to all lone parents and couples, where both members are in work, regardless of the number of hours they work. Removing the current requirement to work 16 hours will provide an important financial incentive to those taking their first steps into paid employment.

17. Families will be able to recover childcare costs in line with the current arrangements: 70 per cent of up to £175 for one child or £300 for two or more children per week

Annex 2: Examples of impacts on work incentives

1. Annex 2 looks at work incentives for four hypothetical family types, comparing their budget constraint under the current system and Universal Credit. Throughout the analysis no council tax support is included in either the current system or as part of Universal Credit. The budget constraints show how net income changes as earnings increase. The level of the budget constraint shows the net income received at particular levels of earnings, while the slope is an indication of the MDR faced by the households.

2. Charts 1 to 4 assume the household pays £80 rent and earns the National Minimum Wage. The charts illustrate the simple structure of Universal Credit and the improvement in work incentives:

    - Under Universal Credit support is withdrawn at a consistent rate of 65 per cent which is reflected in the stable slope of the budget constraint. The budget constraint under the current system is considerably more complex.
    - In general, the individual faces a lower MDR under Universal Credit than the current system. Under Universal Credit the gain from working more is predictable and the MDR does not rise above 76.2 per cent.
    - At most levels of earnings the individual is financially better off under Universal Credit.
    - Under Universal credit there is an opportunity to work much more flexibly, where all hours of work pay not just 16 or 30 hours.
    - There are much higher gains to working at low earnings levels under Universal Credit, in particular for first earners in a household.

Chart 1: Budget Constraint for a single person (excluding council tax support)

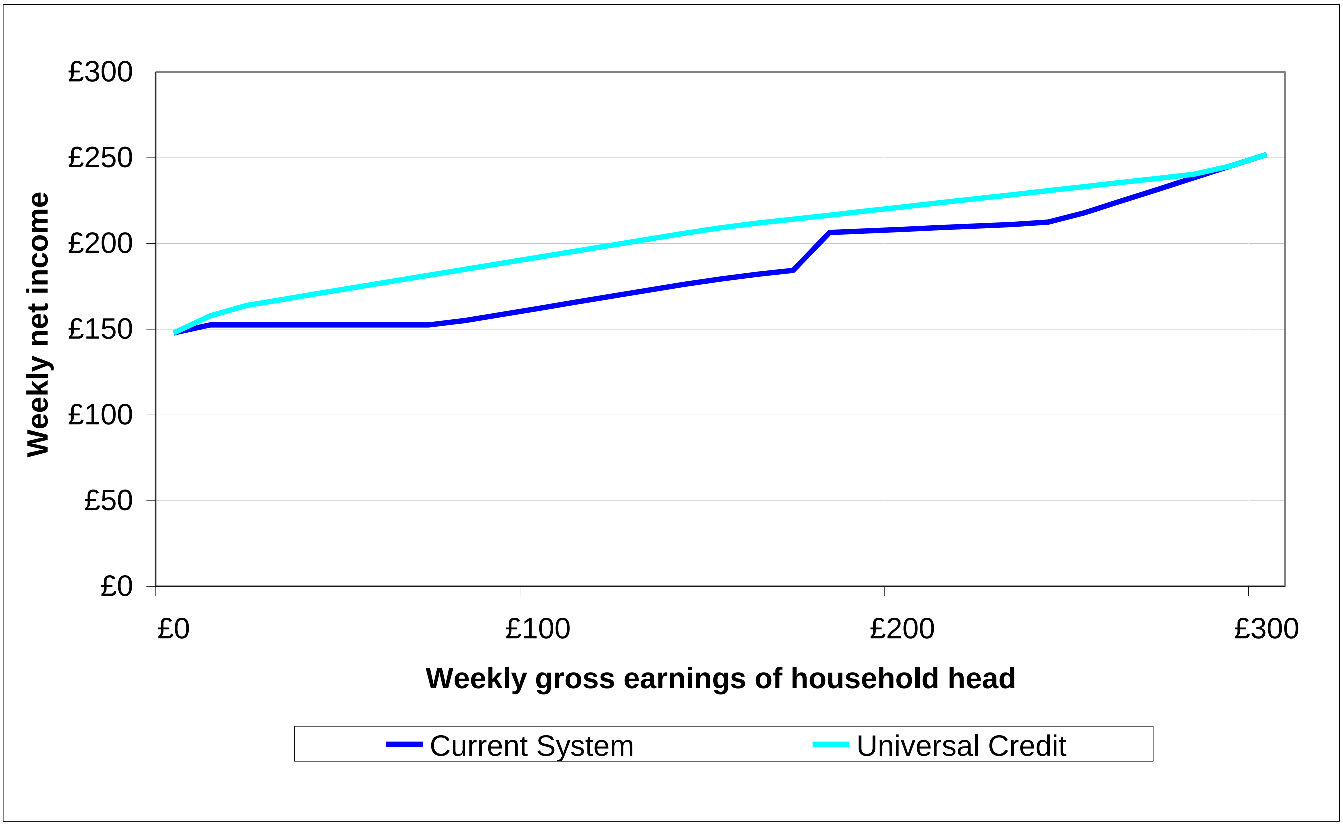


Chart 2: Budget Constraint for a couple with two children (excluding council tax support)

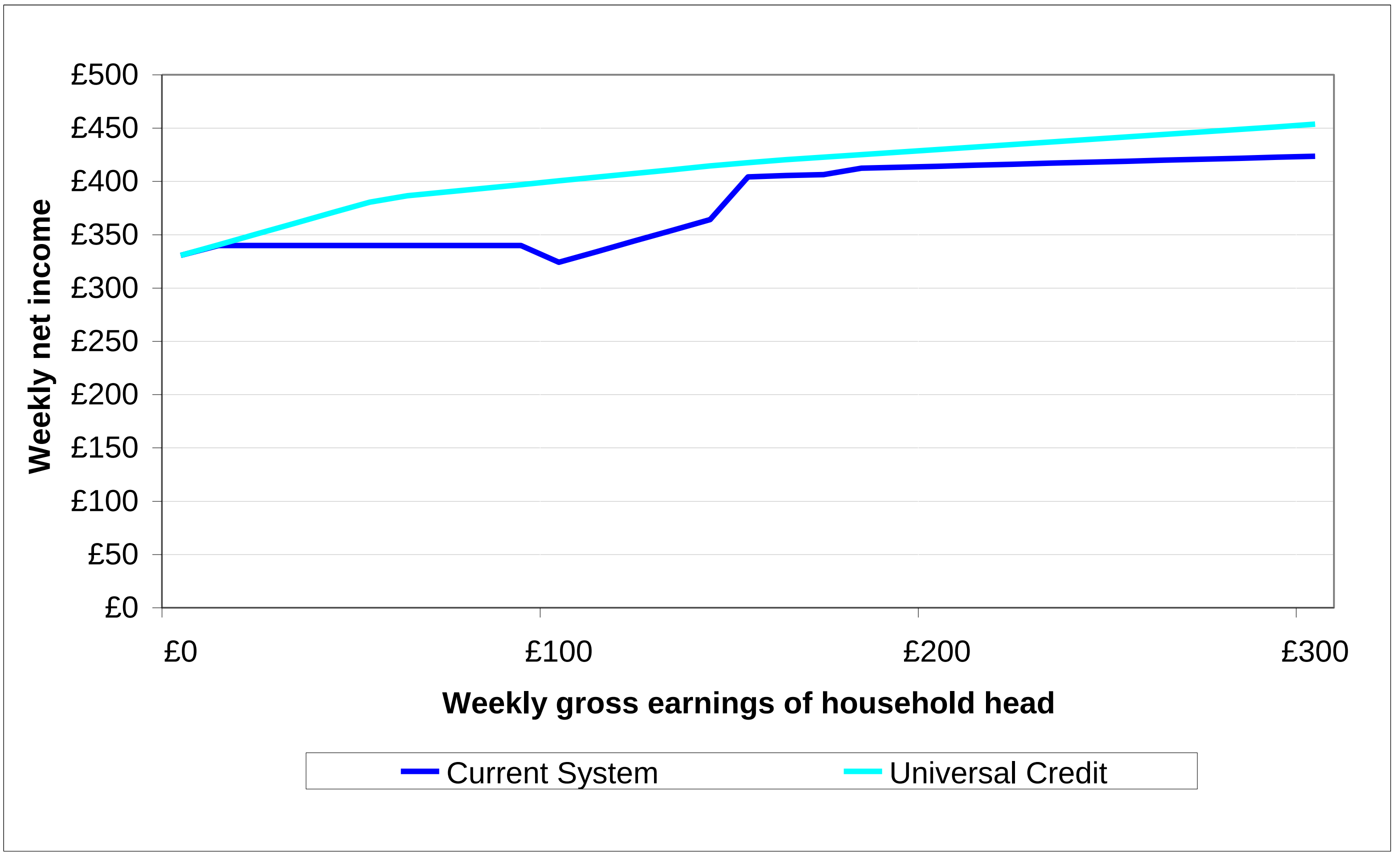


Chart 3: Budget Constraint for a lone parent with two children (excluding council tax support)

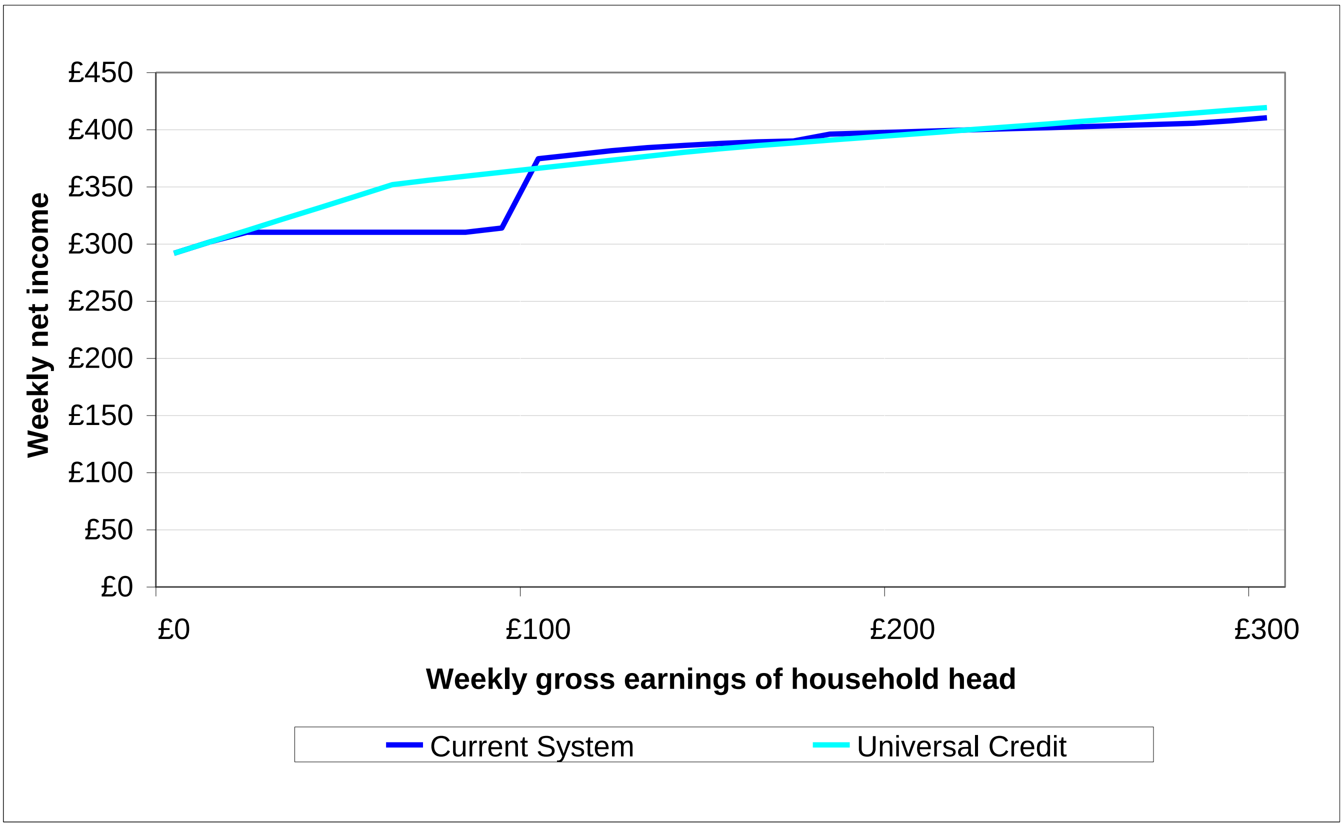
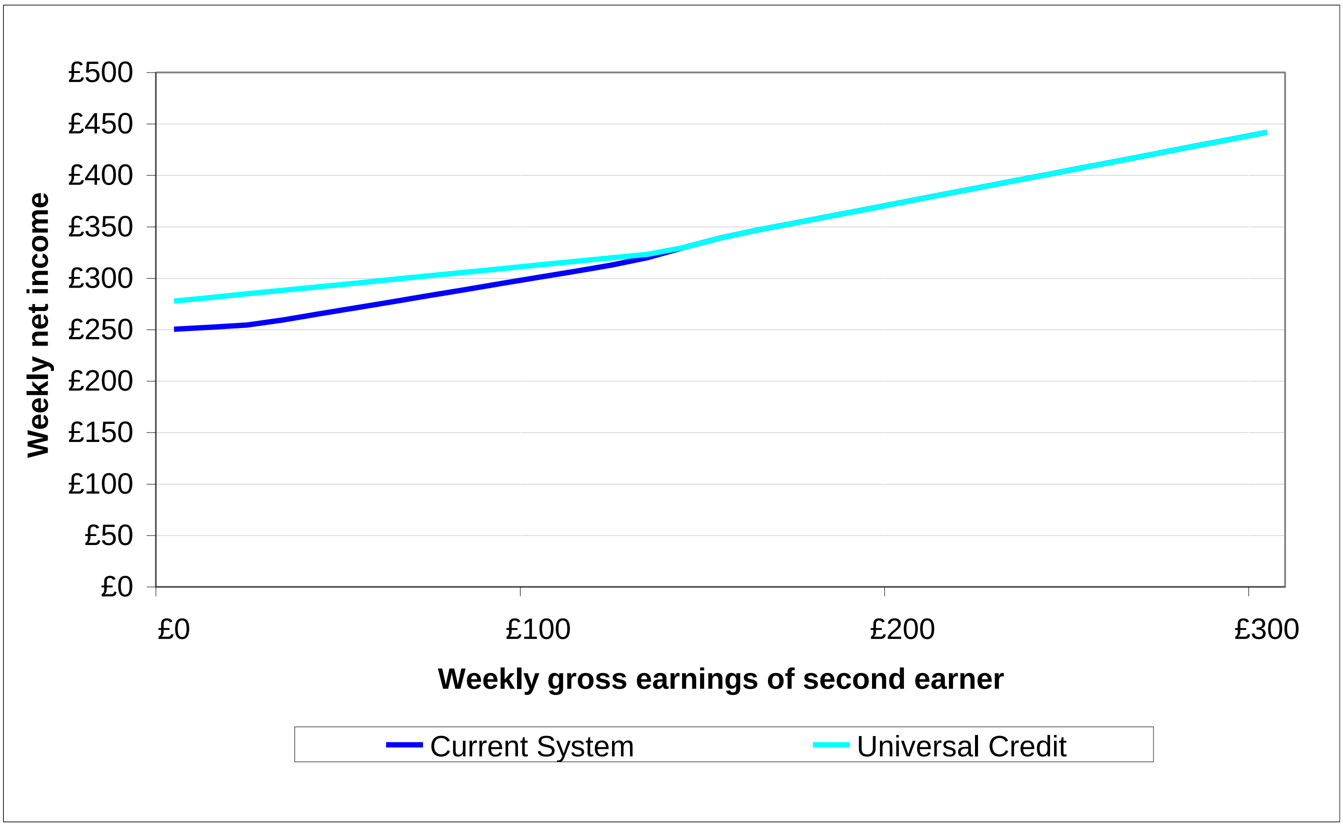


Chart 4: Budget Constraint for a second earner (excluding council tax support)



Annex 3: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: The impact of the policy changes will be reviewed and monitored as roll out takes place. All analysis in the review will be subject to the ongoing availability of the required underlying administrative and survey data.
Review objective: To assess whether the Universal Credit meets the broad objectives set out in the Impact Assessment.
Review approach and rationale: A mixture of approaches will be used including: 1) Analysis of internal administrative datasets, 2) Analysis of survey data such as Family Resources Survey, 3) Other bespoke analysis to cover questions not addressed by the other approaches. The review will use a mixture of approaches, reflecting the fact that a range of datasets and methodologies are required to assess all of potential impacts of the policy and the interactions with other welfare reform policies.
Baseline: Projected trends in caseload, expenditure and other key variables under the current benefit and tax credit system in the absence of the change.
Success criteria: Criteria will include indicators such as total benefit expenditure, caseload trends on the main out of work benefits, work incentives, movements into work, duration of unemployment, as well as some of the wider impacts outlined in this document.
Monitoring information arrangements: The review will assess impacts based on Departmental administrative data and survey data such as the Family Resources Survey and will collect other information as required through appropriate means.
Reasons for not planning a PIR: Not applicable