

<b>Title: Impact Assessment for Universal Credit</b>  <b>Lead department or agency:</b> Department for Work and Pensions  <b>Other departments or agencies:</b> Jobcentre Plus HMRC Local Authorities	<b>Impact Assessment (IA)</b>
	<b>IA No:</b>
	<b>Date: 16/11/2010</b>
	<b>Stage:</b> Final Proposal
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Other
	<b>Contact for enquiries:</b>

## Summary: Intervention and Options

### What is the problem 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 traps millions of individuals in poverty and a life of welfare dependency. For people reliant on benefits, the incentives to move into work or to increase earnings once in work can be very low. In nearly **1.5 million workless households, a person would currently lose more than 70% of their earnings if they move into work of 10 hours a week.** The incentives to increase hours once in work are also very weak. **At present around 0.7m households in low paid work would lose more than 80% of any increase in their earnings because of higher tax or withdrawn benefits.** The current system of benefits provides targeted support to meet specific needs, but the net effect is a complex array of benefits which interact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 perverse 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 the 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 as they move 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)

We set out five options in the consultation document 21<sup>st</sup> Century Welfare;

- 1) Universal Credit,
- 2) Single Unified Taper,
- 3) Mirrlees Model,
- 4) Single Working Age Benefit,
- 5) Single benefit/negative income tax model.

The assessment of the options and the principles used to evaluate them are set out in Annex 2 of the White Paper 'Universal Credit: Welfare that Works'. There was widespread agreement to the principles underpinning Universal Credit in the responses to 21<sup>st</sup> Century Welfare.

### When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

Review plan to be detailed in a subsequent edition of the Impact Assessment.

### Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

Monitoring arrangements to be detailed in a subsequent edition of the IA.

**Ministerial Sign-off** For final proposal stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.***

A handwritten signature in black ink, appearing to read "Chris Dumbleton". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Signed by the responsible:

Date: 16/11/2010

Price Base Year 10/11	PV Base Year 10/11	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate:
<b>COSTS (£m)</b>	<b>Total Transition</b> (Constant Price) Years		<b>Average Annual</b> (excl. Transition) (Constant Price)	<b>Total Cost</b> (Present Value)	
Low	Optional		Optional	<b>Optional</b>	
High	Optional		Optional	<b>Optional</b>	
Best Estimate					
<b>Description and scale of key monetised costs by 'main affected groups'</b>					
<b>Other key non-monetised costs by 'main affected groups'</b>					
The main costs of the reform include the following:					
1) Additional resource costs of implementation; 2) Costs to the Exchequer from increases in entitlement, higher take-up and cash protection to ensure that no-one experiences a cash loss due to Universal Credit; 3) Welfare impacts on individuals if future entitlements are lower than they otherwise would have been.					
Estimates of these costs are sensitive to the final design details of the policy and to the policy baseline. We will provide a fuller estimate of the economic costs in a subsequent edition of the Impact Assessment.					
<b>BENEFITS (£m)</b>	<b>Total Transition</b> (Constant Price) Years		<b>Average Annual</b> (excl. Transition) (Constant Price)	<b>Total Benefit</b> (Present Value)	
Low	Optional		Optional	<b>Optional</b>	
High	Optional		Optional	<b>Optional</b>	
Best Estimate					
<b>Description and scale of key monetised benefits by 'main affected groups'</b>					
<b>Other key non-monetised benefits by 'main affected groups'</b>					
The benefits of the reform include the following:					
1) Reduced costs of administering the system; 2) Savings to the Exchequer from reductions in fraud and error; 3) Welfare impacts on individuals whose future entitlements are higher than they would otherwise have been; 4) Welfare impacts of increases in incomes for individuals who move into work in response to the reformed benefits system.					
Estimates of these benefits are sensitive to the final design details of the policy and to the policy baseline. We will provide a fuller estimate of the economic benefits in a subsequent edition of the Impact Assessment.					
<b>Key assumptions/sensitivities/risks</b>			<b>Discount rate (%)</b>	3.5	

Impact on admin burden (AB) (£m):

Impact on policy cost savings (£m):

In scope

New AB:	AB savings:	Net:	Policy cost savings:	Yes/No
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## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?		United Kingdom			
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 <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> 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: NA		Benefits: NA	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	NA	NA	NA	NA	NA

## 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
<b>Statutory equality duties</b> <sup>1</sup> <a href="#">Statutory Equality Duties Impact Test guidance</a>	YES	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	NO	
Small firms <a href="#">Small Firms Impact Test guidance</a>	NO	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	NO	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	NO	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	NO	
Human rights <a href="#">Human Rights Impact Test guidance</a>	NO	
Justice system <a href="#">Justice Impact Test guidance</a>	NO	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	NO	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	NO	

<sup>1</sup> Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties 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

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### 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 - ( <a href="http://www.dwp.gov.uk/docs/21st-century-welfare.pdf">http://www.dwp.gov.uk/docs/21st-century-welfare.pdf</a> )
2	Universal Credit : Welfare that Works ( <a href="http://www.dwp.gov.uk/docs/universal-credit-full-document.pdf">http://www.dwp.gov.uk/docs/universal-credit-full-document.pdf</a> )
3	
4	

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# Evidence Base (for summary sheets)

## Introduction

The White Paper (“Universal Credit: welfare that works”) sets out the principles of the reform of the benefit system which the Government plans to undertake. The purpose of these changes is to remove or mitigate the many financial and administrative barriers to taking work which are inherent in the current system. This Interim Impact Assessment provides the Government’s initial assessment of the broad impacts of the Universal Credit based on the key components of the Universal Credit as outlined in the White Paper. A fuller analysis of the impacts will be provided in a subsequent edition of the Impact Assessment.

## Policy Rationale

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.

In the current benefit system, the financial returns to work are often very weak. Many claimants have most of any increase in earnings deducted from their benefits/tax credits with some households facing deduction rates as high as 96%. These deductions often vary in unpredictable ways depending on the level of earnings and the combination of benefits and tax credits received.

Similarly, the incentives to move into work can be weak, particularly at low levels of 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 nearly 1.5m million households face losing more than 70% of their earnings if they move into work of 10 hours a week.

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.

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, work of only a few hours;
- 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 in the current system.

In addition, the Universal Credit will have positive impacts on child poverty, both by focusing entitlements to lower income in-work households, and because a simpler system will lead to a considerable increase in the take-up of Universal Credit compared to the current system of benefits and Tax Credits. The new system ensures that someone either claims everything (because they are eligible) or nothing (because they are ineligible). 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. Hence with this much simpler system, households will be more likely to claim their full entitlement. In addition, it will reduce the scope for fraud, error and overpayments thus ensuring that the right benefit is paid to the right people at the right time.

## Universal Credit Model and the Baseline

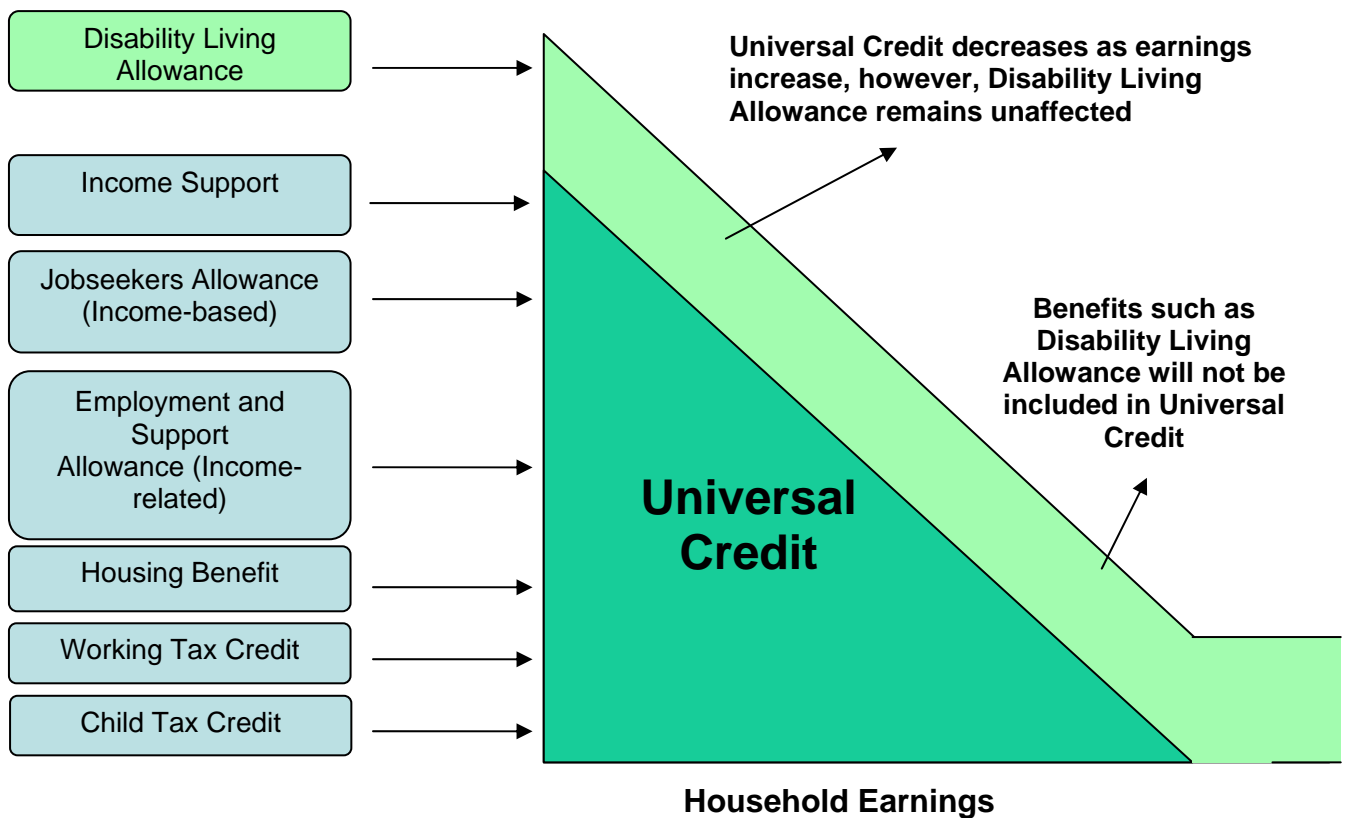
The White Paper has set out the Government's intended overall design for Universal Credit. This interim Impact Assessment presents initial analysis of the possible impacts of Universal Credit based on that design. It includes a provisional analysis of possible distributional impacts and changes to work incentives. The analysis compares Universal Credit to the current benefits and Tax Credit system, incorporating the changes set out in the June 2010 Budget. We have assessed the impact of Universal Credit on the basis of the pre-Spending Review position because Universal Credit was the centrepiece of welfare reform announced in that review. Some of the Spending Review measures will affect the detail of the impact shown here, as will future decisions on the details of the policy design.

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.

## Current Benefit System and Universal Credit

Universal Credit will streamline a number of existing benefits and Tax Credits into one unified payment. The chart below shows the existing benefits and Tax Credits which will be replaced by Universal Credit. It also shows benefits such as Disability Living Allowance will not be affected by the introduction of Universal Credit.

**Chart 1: The Current Benefits and Universal Credit**



**Other benefits not included:** Council Tax Benefit, Jobseekers Allowance (Contributory), Employment Support Allowance (Contributory)<sup>2</sup>, Child Benefit, bereavement benefits, Statutory Sick Pay, Statutory Maternity Pay, Maternity Allowance and Industrial Injuries Disablement Benefit<sup>3</sup>.

## Overall Financial Impacts

The introduction of Universal Credit will enable the Government to increase and better target the support that is provided through the benefit system in order to ensure that work always pays and that the most vulnerable are protected.

The increased support comes from greater generosity for in-work households with low earnings and more consistent support as households increase their earnings. In addition, the simplification of the system will lead to significant improvements in the take-up of entitlements within this group. Alongside this, there will be substantial reductions in fraud, error and overpayments.

The costs of Universal Credit will build-up over a number of years. The Spending Review set aside £2bn to fund the implementation of Universal Credit up to 2014/15. In the longer term, the Universal Credit will lead to savings of more than £0.5bn a year in administrative costs. In addition, we anticipate that there will be fiscal savings and economic benefits as a result of the dynamic labour market effects.

## The Distributional Impact and Poverty

Under the simplified Universal Credit, some households will be entitled to higher payments than they would have been had in the current benefit and Tax Credit system. Although, some households will be entitled to lower amounts than currently, no one will experience a reduction in the benefit they are receiving as a result of the introduction of Universal Credit. At the point of transition onto the new system, those households whose circumstances remain unchanged and who would otherwise experience a reduction in income will receive cash protection

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. Universal Credit is also expected to reduce the level of fraud and error and overpayments in the benefit system. In addition, the interaction of Universal Credit with real-time earnings will also reduce the level of over-payments due to the operation of the current de-minimis rule within the Tax Credit system.

Chart 2, illustrates the potential distributional impacts of Universal Credit. It shows the average change in income for the Universal Credit caseload in each ten percent band (decile) of the income distribution. The chart shows that the bottom two deciles of the income distribution will see increases in entitlement of around £2.40 and £3.60 a week. For the bottom decile the increase equates to around 1.5% of weekly income. The higher income deciles see very small reductions in net income, with the typical reductions being less than 50p a week. No households will experience a reduction in benefit as a result of the introduction of Universal Credit. At the point of transition to the new system, those households whose circumstances remain unchanged and who would otherwise experience a cash loss will receive cash protection.

The most substantial reductions in entitlement are in the 7<sup>th</sup> decile. The reason for this is that this decile has the highest proportion of households in receipt of the Working Tax Credit under the current system. More specific reasons for changes in entitlements are set out in a subsequent section.

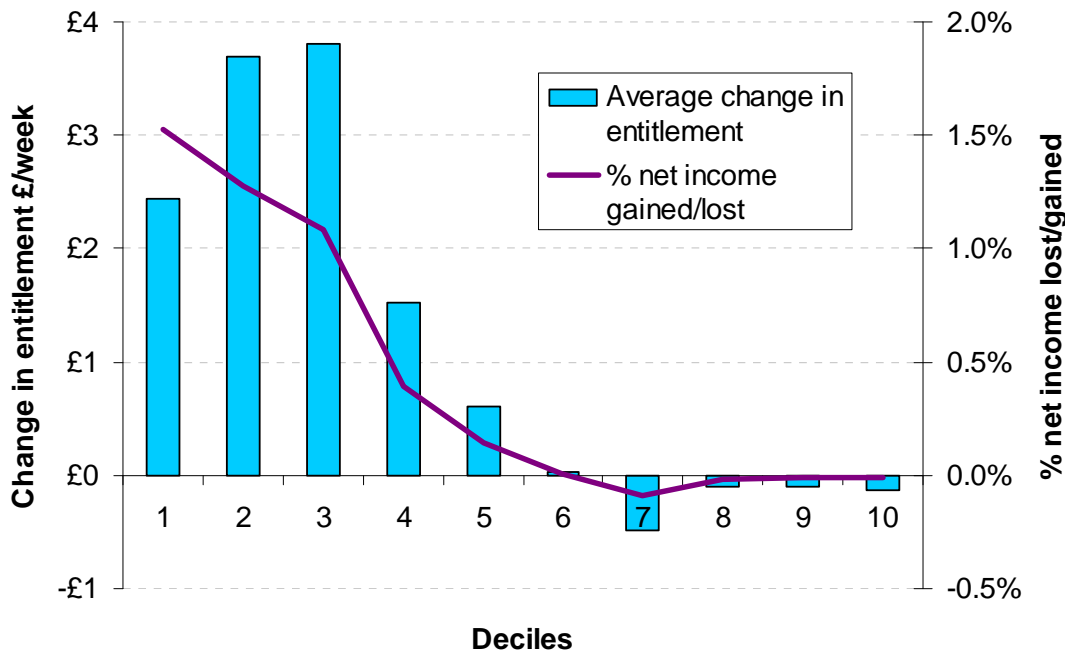
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<sup>2</sup> Contributory Jobseekers Allowance and Employment and Support Allowance will remain in their present form but will be administered through the same system as Universal Credit. Under the new system, they would retain an insurance element but will have the same earnings rules (such as disregards and tapered withdrawal) as Universal Credit. For ESA claimants in the assessment and work-related activity groups, the contributory element will be time-limited to one year, after which they may be entitled to Universal Credit instead.

<sup>3</sup> We are currently considering whether a number of other benefits are suitable for inclusion within the Universal Credit, for example, Carer's Allowance and the treatment of help with Council Tax Bills.



**Chart 2 - Distributional Impact - Gainers / losers by income decile**



Changes in modelled entitlements suggest a substantial impact on poverty in steady-state - lifting approximately 150,000 children and 300,000 working age adults out of poverty. In addition, the increased take-up of unclaimed entitlements will reinforce the positive impact on poverty. On reasonable assumptions, the combined impact of take-up and entitlements might lift around 850,000 individuals out of poverty, including as many as 350,000 children and 500,000 working-age adults. These poverty impacts do not take any account of any positive impacts of more people moving into work.

## Work Incentives

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

- It will increase 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 ensure that support is reduced at a consistent rate, and that people generally keep a higher proportion of their earnings than under the current system – this is measured through the **marginal deduction rates (MDRs)**;
- 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.

## Earnings incentives – Marginal Deduction Rates

As the earnings of a household increase, their benefits and tax credits are withdrawn. In addition, above a certain level of earnings, the increase in their wages will be offset by income tax and national insurance. The rate at which earnings are withdrawn is called the marginal deduction rate (MDR). This is calculated as the proportion of an increase in earnings which is lost in lower benefits/tax credits and/or higher income tax and national insurance payments.

Under the current system, the pattern of MDRs reduces work incentives in two ways. Firstly, MDRs are 100% for many people working while on IS/ESA/JSA. For people simultaneously in receipt of Housing Benefit, Council Tax Benefit and Tax Credits, MDRs can be as high as 96%.

By replacing the multiplicity of tapers for in-work support with a consistent taper of around 65%, and removing the 100% taper for out of work benefits, the Universal Credit will reduce the overall level of MDRs. This is illustrated in tables 1 and 2 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 in-work households should face an MDR of above 80% under the new Universal Credit system.

**Table 1: MDRs<sup>4</sup> for those in work (working age only), earning below the tax threshold**

<b>MDR for non-taxpaying earners</b>	<b>Current System millions</b>	<b>Universal Credit millions</b>	<b>Difference millions</b>
Up to 60%	0.3	0.1	-0.3
60%-70%	0.0	0.5	0.5
70%-80%	0.0	0.0	0.0
80%-90%	0.1	0.0	-0.1
Over 90%	0.1	0.0	-0.1

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15<sup>5</sup>.

Figures may not sum due to rounding

**Table 2: MDRs<sup>6</sup> for those in work (working age only), earning above the tax threshold**

<b>MDR for taxpaying benefit recipients</b>	<b>Current System millions</b>	<b>Universal Credit Millions</b>	<b>Difference millions</b>
Up to 60%	0.9	0.8	0.0
60%-70%	0.2	0.4	0.2
70%-80%	1.7	2.0	0.3
80%-90%	0.4	0.0	-0.4
Over 90%	0.1	*	-0.1

Source: DWP Policy Simulation Model (based on FRS 2008/9), 2014/15<sup>7</sup>.

Figures may not sum due to rounding

\*\* denotes fewer than 50,000 people

The impact of the new system on MDRs can also be illustrated through an individual example. Chart 3 shows the profile of MDRs for a lone parent with two children. She is assumed to pay £80 a week in rent and £15 in council tax and she receives Income Support when she is out of work. As she moves into a few hours of work she has the first £20 of her earnings disregarded but then has an MDR of 100% applied until her Income Support is extinguished<sup>8</sup>. Between 25 and 30 hours a week she currently experiences an MDR of above 95% - the combined effect of the interaction of the tax and National Insurance system with Housing Benefit, Council Tax Benefit and tax credit tapers.

Under Universal Credit, the MDR is lower at all levels of hours worked with the exception of the 16 hour and 30 hour thresholds (where the current system provides step increases in benefit entitlement). Universal Credit also withdraws in-work support at a much more predictable rate as MDRs only vary when earnings pass the tax and/or NI thresholds, or when entitlement to Universal Credit is exhausted.

<sup>4</sup> 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.

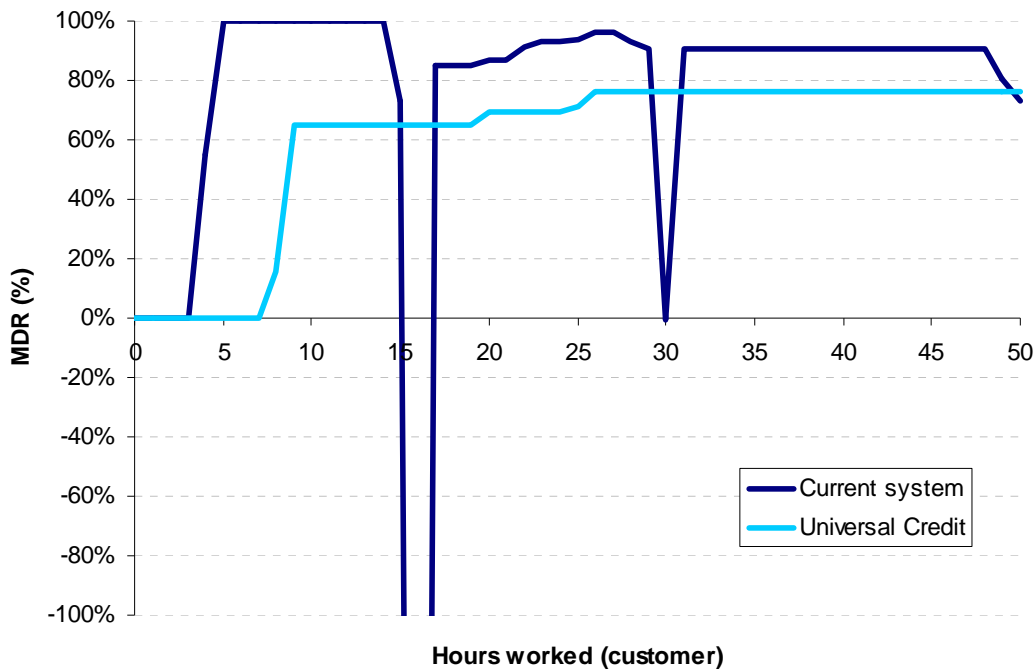
<sup>5</sup> Modelling is based on entitlement changes only.

<sup>6</sup> 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.

<sup>7</sup> Modelling is based on entitlement changes only.

<sup>8</sup> This example assumes that the customer is paid at the national minimum wage

**Chart 3 – Marginal Deduction rates under current system and Universal Credit for a Lone Parent with Two Children (Rent £80, CT £15)**



### Employment incentives - Participation Tax Rates

A key aim of Universal Credit is to encourage people currently out of work to take their first steps into the world of employment. Consequently, a key part of the design of earnings disregards and benefit tapers is aimed at radically improving the incentive to work a few hours per week. Table 3 below, illustrates the change in PTRs facing people considering a move into 10 hours per week of work. The number of households facing PTRs of over 70% falls by around 1.3 million under Universal Credit.

**Table 3: PTRs for the first earner in a workless household if they were to enter work at 10 hours per week (working age only)**

<b>PTR for first earners</b>	<b>Current System millions</b>	<b>Universal Credit millions</b>	<b>Difference Millions</b>
Up to 60%	1.2	3.0	1.8
60%-70%	1.5	1.0	-0.5
70%-80%	0.2	0.2	-0.1
80%-90%	0.6	*	-0.6
Over 90%	0.6	*	-0.6

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

Figures may not sum due to rounding

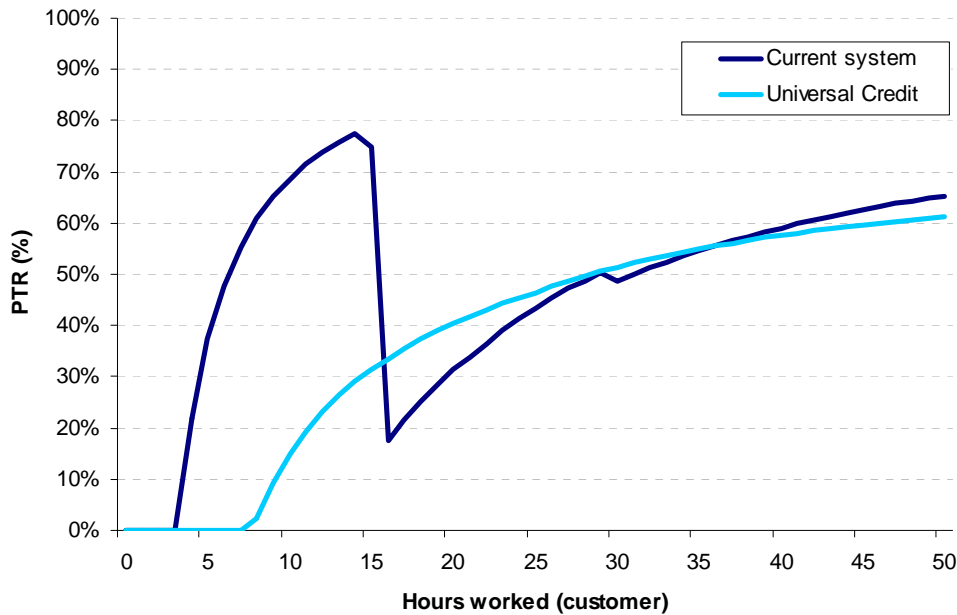
\*\* denotes fewer than 50,000 people

These reductions occur because of higher earnings disregards and lower benefit tapers under Universal Credit. For example, under the current system, households claiming IS, ESA and JSA can face PTRs of over 80%-90% because, above a small earnings disregard, these benefits are withdrawn pound for pound until the individual's benefit entitlement has been extinguished. Under Universal Credit, the taper rate reduces the number of households facing very high PTRs

<sup>9</sup> Modelling is based on entitlement changes only.

The impact of Universal Credit on the profile of PTRs is shown in Chart 4 for an illustrative family type. The PTR is considerably lower under Universal Credit at lower levels of hours and then increases more smoothly as earnings increase.

**Chart 4: Participation Tax Rates for a lone parent with two children<sup>10</sup>**



## Work incentives – A Simpler System

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 that have been made to the current system address this, for example through having a ‘run-on’ period in Housing Benefit. However these are only partial solutions.

We have illustrated the impact of the complexity of the current system by outlining the various interactions between government agencies and a hypothetical lone parent as she moves from out of work benefits into work.

### Under the current system

Under the current system Ms C claims Income Support from Jobcentre Plus, Housing Benefit and Council Tax Benefit from the local authority and Child Tax Credit from HM Revenue & Customs.

If Ms C moves into work of 10 hours a week she will inform Jobcentre Plus about her change in circumstances. Jobcentre Plus will then recalculate the Income Support entitlement. In the event of Income Support being extinguished Ms C would have to contact the local authority, who will recalculate the Housing Benefit and Council Tax Benefit entitlement.

If the customer subsequently decides to work 16 hours a week she will have to contact Jobcentre Plus who will terminate the Income Support claim. Ms C will now be entitled to Working Tax Credit which she will need to claim through HM Revenue & Customs. In addition the Local Authority will need to carry out a reassessment of the Council Tax Benefit and Housing Benefit entitlement, amongst other things to take Working Tax Credit into account as income.

<sup>10</sup> Earning national minimum wage. Paying rent of £100 per week and council tax of £15.

## Under Universal Credit

- While out of work, Ms C claims and receives a Universal Credit payment. This includes a personal allowance, a housing addition and additions for her children. She also receives Child Benefit from HM Revenue & Customs.
- Ms C gets a job working 10 hours a week, her benefit entitlement will be automatically updated using a real-time payment system.
- The same happens when she increases her hours to 16 or more.

Under Universal Credit, the complexity of dealing with many agencies is removed. Many of the changes in circumstances which affect her benefit entitlement, 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.

### ***Financial Impacts (Exchequer Costs)***

£2bn was set aside to fund the implementation of Universal Credit as part of the Department for Work and Pensions Spending Review settlement. We will set out a more detailed assessment of the steady state costs of Universal Credit in a subsequent edition of the Impact Assessment.

## Impact on individual welfare

We will provide a more a more detailed assessment of the economic costs and benefits of Universal Credit in a subsequent edition of the Impact Assessment.

## Dynamic Effects of Universal Credit

Universal Credit represents a fundamental and structural change to the welfare system in the UK. 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
- Reduced administrative complexity associated with a move into work and, related to this, reduced risks of interruptions in benefit payments occurring
- Reinforcement of the conditionality regime
- In the long-run the reinforcement of pro-work social norms.

As it cannot properly account for all these factors, traditional labour supply modelling is likely to significantly understate the impact of this reform. We have therefore taken a different approach to estimating the combined impact of all these factors, together with the improved financial incentives under Universal Credit. Using the evidence available, **a plausible estimate is that the reform will lead to a reduction of 300,000 in the number of workless households**. This impact is driven by three different groups - people moving from worklessness into part-time work, people moving from worklessness into full-time work, and people who leave work. Our estimate of the reduction in the number of workless households is based on a series of assumptions and judgements that are set out below.

### **1-People moving into part-time work**

To calculate the number of people currently in workless households who begin working part-time (less than 16 hours a week) we start by identifying those groups of workless households claiming benefits who are most likely to respond to the introduction of Universal Credit. We use research evidence and

assumptions about the level of conditionality and support, to identify those groups who are most likely to respond. This approach will exclude, for example, people in receipt of DLA.

We have made an assumption that a plausible reservation wage is £5 an hour after tax and benefit withdrawal, and we have used the Department's Policy Simulation Model to identify those whose net gain from working (10 hours a week at minimum wage) increases above this reservation wage under the Universal Credit system. Finally we have assumed that half of this sub-group respond to this financial incentive, which gives an estimate of the reduction in the number of workless households as a result of people moving into mini jobs of around 250,000.

## 2-People moving from worklessness to full-time work

We have made estimates of the impact of simplification, and the smoothing of transitions, on the number of people currently in workless households who move into full-time work (16 hours or more a week). This estimate is based on evaluations of previous initiatives which have worked to improve the transparency of the system and to reduce the (perceived) risks of transitions between work and benefits.

For example we have examined evidence for provision of 'better off calculations' to lone parents through mandatory Work Focused Interviews, as well as the provision of an In Work Credit to lone parents. The evidence suggests that a substantial part of the impacts of these measures can be attributed to smoothing and transparency effects. Therefore we have used 50% of their estimated impact as an illustrative example of the potential impacts of improving these dimensions of the benefit system

These assumptions are then applied to those groups who, the research evidence suggests, are most likely to be affected by these particular issues i.e. parents in workless households and those in receipt of Housing Benefit. This suggests that we could achieve an additional reduction of up to 100,000 in the number of workless households.

## 3-People moving out of work

For some people the incentives to work maybe reduced under Universal Credit. To identify what impact this will have, we have used a similar approach to the part-time work estimate set out above. We have focussed on those segments of the working population most likely to respond to changed financial incentives, and looked at those whose gains to work fall below the same reservation wage. Our judgement is that this effect will result in a very small offsetting increase in the number of workless households.

Putting together these three effects suggests a reduction in the number of workless households of around **300,000** (rounded to the nearest 100,000). **We believe this is a plausible estimate, although we acknowledge that the true impact is highly uncertain.** We believe that there is no reason why this increase should not be brought about within two to three years of implementation.

## Analysis of changes in entitlements

This radical restructuring of the benefits and Tax Credits system is strongly progressive. It enables the Government to focus support more heavily and more consistently on those at the lower end of the income distribution.

Many households will receive more under Universal Credit than under the current system. These higher entitlements arise primarily for three broad groups of working households with low earnings:

- households not entitled to Working Tax Credit under the current system, for example, because they are childless and aged under 25, who gain entitlement to in-work support under Universal Credit;
- households receiving Housing Benefit and Council Tax Benefit under the current system who benefit from a significant reduction in the rate at which their benefit is withdrawn as earnings increase; and

- other households who benefit from the higher earnings disregards and, for most people, the lower withdrawal rate the Government is building into Universal Credit.

No-one will experience a reduction in the benefit they are receiving as a result of the introduction of Universal Credit. At the point of transition onto the new system, those households whose circumstances remain unchanged and who would otherwise experience a reduction in income will receive cash protection.

Universal Credit will remove the complexities and inconsistent support available in the current benefits and Tax Credits system and replace it with increased support for low-income families and consistency in support as income rises. This simplification means that, in the long term, some households will be entitled to less under Universal Credit than they would have been had the current benefits and Tax Credits system continued. These distributional losses will also arise gradually over time, as new people come into the system and the circumstances of existing cases change. Chart 2 shows this long-term impact. We expect to see average net incomes reduce in the long term in only deciles 7 to 10, and even there the average reduction will be small – less than 15 pence per week in deciles 8 to 10.

## Conditionality

Chapter 3 of the White Paper sets out the policies we will introduce in order to ensure that people claiming benefits do everything that can reasonably be expected of them to find work or prepare for work in the future. This section provides a high level assessment of the costs and benefits of those changes. Values are indicative and have not been included in the costs and benefit section at the front of the Impact Assessment.

The measures considered here are all intended to either raise conditionality or improve compliance with existing conditions of entitlement. Where this results in additional time in employment there will be fiscal, as well as wider economic and social benefits. Benefits to the exchequer include reduced expenditure on out-of-work benefits, housing benefit and council tax benefit (eventually Universal Credit payments), as well as indirect benefits such as increases in tax receipts and National Insurance Contributions (partly offset by tax credit payments). Claimants who are supported in finding work also benefit, through increased income from wages (although this will be partly off-set by a reduction in benefits and increases in taxes paid). There will also be less tangible benefits such as improved health status associated with being in work. Improving flows into work benefits the economy as a whole, and there are also wider social benefits such as reductions in crime.<sup>11</sup> Increases in parental employment will also reduce the number of children living in poverty.

### Conditionality-increases for lone parents with youngest child aged five and six

This policy is expected to affect around 75,000 lone parents per year. There will be an increase in costs associated with transferring lone parents onto the more intensive JSA and ESA regimes and additional Work Focussed Interviews prior to transfer. The increase in costs will be in the range of £150 to £190 million over the Spending Review period to March 2015. The policy could lead to a net reduction of around 30,000 to 40,000 in the number of lone parents on out of work benefits. This reflects reductions in the number of lone parents on IS, and increases in the number of lone parents on JSA and ESA. It is estimated that the number of lone parents in paid work would increase by 20,000 to 25,000, which could result in 11,000 to 15,000 fewer children in poverty over the longer run. The fiscal savings would be £200 to £300 million over the Spending Review period and the total economic impacts in the range £400 to £550 million.

### Conditionality-increases for partners of benefit claimants

This policy is expected to affect around 45,000 partners of JSA claimants per year. There will be a cost associated with putting partners through the more intensive JSA regime. However we anticipate that these changes will have a positive impact on the employment prospects for the families affected. We are working on the estimates for this policy and are unable to be more specific at this stage.

<sup>11</sup> Note that where a benefit recipient loses or gains income it is reasonable to assume that the welfare impact is greater than the impact to the exchequer. This is because benefit recipients are at a lower income level than the average taxpayer, and their marginal utility of income will be correspondingly higher.

## **Conditionality-targeted increases for jobseekers**

Targeted increases in conditionality for jobseekers will be implemented using the resources already available to Jobcentre Plus (although there is an opportunity cost in terms of Jobcentre Plus staff time). Jobcentre Plus will have greater flexibility than currently to maximise the chances of jobseekers finding employment. We anticipate that these changes will have a positive impact on the employment prospects for claimants. The intention of these measures is to increase engagement among a group who are not effectively responding to the existing regime.

## **Conditionality-increases for those in the ESA Work Related Activity Group**

Work Related Activity might be required for a particular claimant either by Jobcentre Plus or as part of the Work Programme. Where Work Related Activity is mandated by Jobcentre Plus there would be an administrative cost to DWP, and provision would be commissioned and paid for through the Flexible Support Fund. Where a Work Programme provider requires a claimant to undertake work related activity the costs will be absorbed as part of the contracted provision. We are not currently able to estimate the employment or off-flow effects of this measure.

## **Conditionality-introduction of the claimant commitment**

We anticipate that introducing clarity with respect to the requirements on each individual will encourage greater compliance with the conditions of entitlement for each group. For jobseekers in particular this will facilitate work-search and movements into work. It will also ensure that claimants are fully aware of the results of non-compliance, further increasing the incentive to comply with the regime. We are not currently able to estimate the size of the employment impact from this measure.

## **Conditionality-changes to the sanctions regime**

A financial sanction results in partial or total withdrawal of benefits for a particular claimant over a period. This results in a saving to the exchequer (partly offset by hardship payments in some cases), and a loss to the sanctioned claimant. The proposed changes could increase the average duration of sanctions. For a given volume of sanctions and disentitlements this would result in a saving to the exchequer and a cost to sanctioned claimants.

A tighter sanctions regime will also provide a greater incentive to comply with the jobseeking requirements. This should increase the amount of productive jobsearch and could also reduce the number of sanctions and disentitlements. As a result of these behavioural changes we would expect some claimants to find work earlier than they otherwise would have done.

We anticipate only a small number of claimants would ever be subject to a three-year sanction, mitigated to an extent by the existence of a hardship regime.

## **Conditionality-the introduction of the Mandatory Work Activity**

Mandatory Work Activity will only be required for a very small proportion of those who are actively seeking work. The intention is for Mandatory Work Activity to help claimants to develop the discipline required for full time employment. This should facilitate those who participate in finding and maintaining work in future. Some claimants may respond to such activity by attempting to disengage with the system; while this would result in a fiscal saving it could also lead to social costs – that is why the sanctions regime exists. Jobcentre Plus advisers will have the flexibility to use Mandatory Work Activity, where they feel this is appropriate to ensure customers receive the personalised, responsive support that they need to find employment.

Customers will be required to continue to meet the conditionality requirements and attend Fortnightly Jobsearch Reviews in order to ensure that they remain engaged with the labour market.



## Options for Reform

There were five broad options for reform set out in '21<sup>st</sup> Century Welfare'. These options were evaluated against seven principles used to guide reform. An assessment of how each of these responses performed against the principles is set out in the annex two of 'Universal Credit: welfare that works'.

## Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

### Annex 1: 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.

<p><b>Basis of the review:</b> [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; We will provide details of the Post-Implementation Review Plan in a subsequent edition of the Impact Assessment.</p>
<p><b>Review objective:</b> [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p>
<p><b>Review approach and rationale:</b> [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p>
<p><b>Baseline:</b> [The current (baseline) position against which the change introduced by the legislation can be measured]</p>
<p><b>Success criteria:</b> [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p>
<p><b>Monitoring information arrangements:</b> [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]</p>
<p><b>Reasons for not planning a PIR:</b> [If there is no plan to do a PIR please provide reasons here]</p>