JRF JOSEPH ROWNTREE FOUNDATION

INSPIRING SOCIAL CHANGE

# DOES UNIVERSAL CREDIT ENABLE HOUSEHOLDS TO REACH A MINIMUM INCOME STANDARD?

The new Universal Credit (UC) benefit is designed to support households on low incomes and make work pay. This study looks at its effect on work incentives, and whether it enables households to reach the minimum income standard (MIS).

**Key points**

- When not in work, adults without children have only around 40 per cent of the income needed for MIS. Families with children have around 60 per cent.
- UC strengthens work incentives for some, but in many cases provides little or no incentive for additional work.
- By working part time and retaining some or all of UC, households can become significantly better off. However, they will remain well below MIS if their earnings are below average.
- Many families will have limited incentive to move from part-time to full-time work, especially if they require childcare. Disposable income 'plateaus' at as little as ten hours a week, as UC reduces sharply with additional earnings.
- For lone parents and second earners on the minimum wage, working 30 or more hours a week will *reduce* disposable income compared with working fewer hours. Above this level, working extra hours triggers higher childcare bills and reduced UC payments, and brings income into taxation.
- Couples without children can reach MIS by working full time on the minimum wage. At this wage level, other households fall at least 20 per cent short of what they need.
- Similar numbers of households are better and worse off under UC compared with tax credits. However, cuts before and after UC's introduction will leave many families significantly worse off overall.
- Proposals to improve childcare support in 2016 would significantly improve the adequacy of many full-time working families' incomes, and improve work incentives.

## The research

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# BACKGROUND

From 2013, Universal Credit (UC) is simplifying support for low-income families through a single payment to those in and out of work, and is intended to help 'make work pay'. In considering the new system's outcomes, this study looked at disposable household income for people working various hours on low wages, and examined how far UC makes work pay. Disposable income includes UC and Council Tax Support, and is net of taxes, childcare, rent and council tax. The study also compared disposable income to the minimum income standard (MIS), which is calculated from household budgets based on what items groups of members of the public say are necessary for a minimum acceptable standard of living.

## Income adequacy under UC

Universal Credit provides a baseline income for non-working households, equivalent to Income Support in the old system. This is well below an adequate income as defined by MIS: roughly 40 per cent of that required for households without children and 60 per cent for families with children.

For the first few hours households work each week, they can add earnings to their UC entitlement without losing any of it through reduced UC or income tax. This allows them to reduce the shortfall in adequate income as measured by MIS. Working one day a week on minimum wage, those without children can get above half of what they need; lone parents with a young child can get above two-thirds of an adequate income level.

However, improving income above this can be difficult on low wages, particularly for families with young children. As income rises, UC reduces sharply, income tax is applied, and longer working hours can increase childcare bills; Figure 1 shows how, particularly for lone parents on low wages, rising earnings create an 'income plateau', still well below MIS level. This reduces work incentives and makes it impossible for them to earn enough for a minimum acceptable living standard. While the plateau becomes less 'flat' with higher wages, such families working full time need to earn more than the median hourly wage of £11.26 to get above MIS.

**Figure 1: Disposable income by hours worked, for a lone parent with two children (primary and pre-school)**

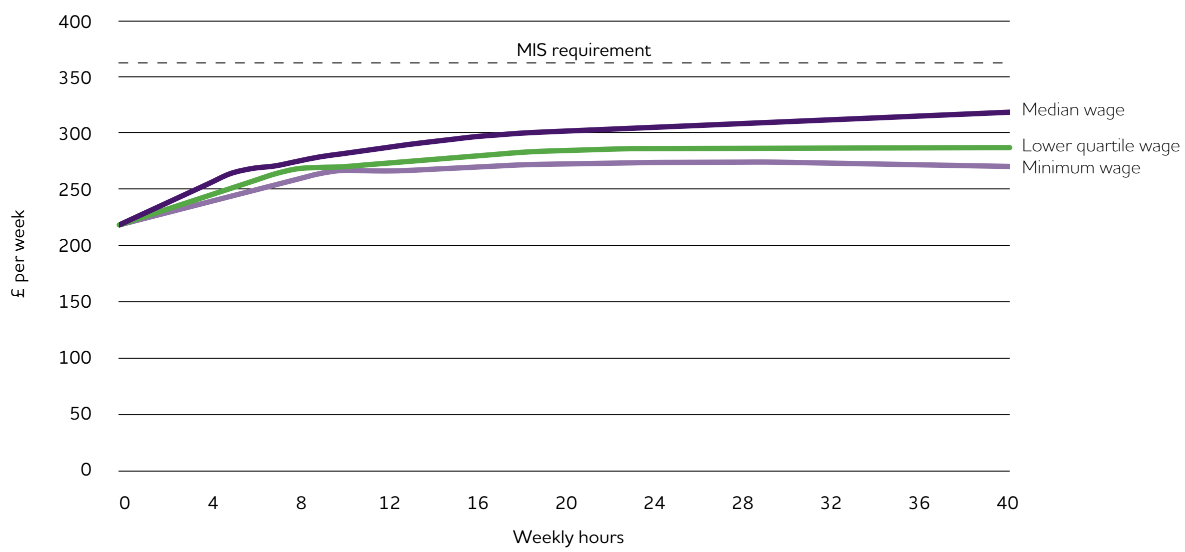
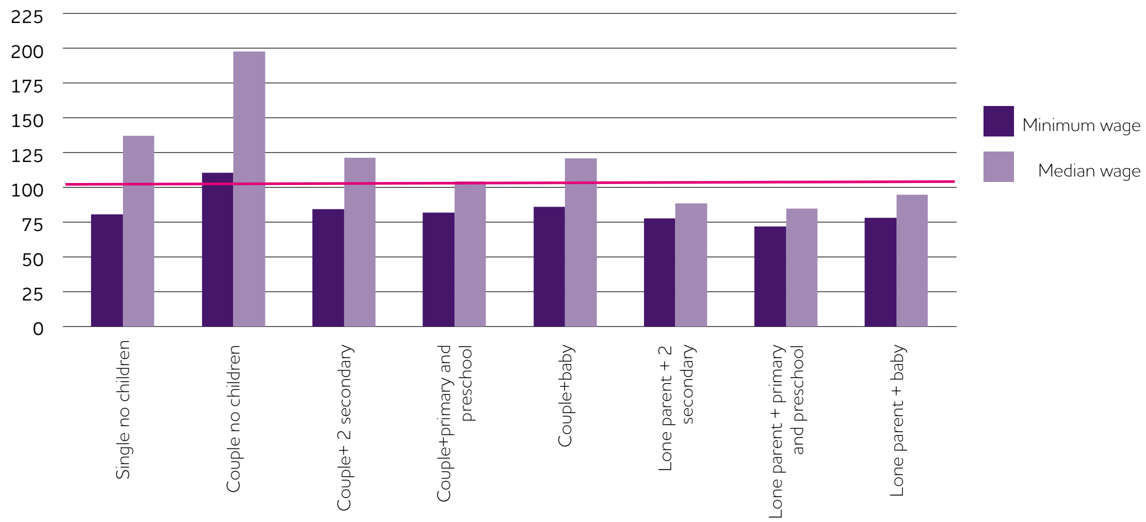


**Figure 2: Disposable income relative to MIS (%), all adults working full time**




Lone parents and second earners in a couple hit a point where work incentives are reversed. If they work 30 hours or more a week on minimum wage, they are worse off than working 29 hours because they cross the income tax threshold, lose UC (withdrawn with additional earnings), and have extra childcare costs.

This pattern of disposable income relative to MIS varies by household type (Figure 2):

- On minimum wage, even working full time, most families are at least 20 per cent below MIS, except working couples without children, who can achieve an acceptable standard of living even on the minimum wage.
- Better pay can lift some households above MIS. Those without children, who rely less on in-work support, can raise their income comfortably above this level with average wages. Families with children, particularly those with high childcare requirements, are more likely to be trapped at a lower living standard.

## Comparison with tax credit system

Many features of UC, particularly the income plateau below MIS, are similar to the tax credit system. However, the change to UC will create winners and losers. The most significant winners will be people working a few hours a week, who do not qualify for tax credits; their income will rise significantly under UC. Significant losers include part-time second earners in couples with children; their earnings will trigger much more rapid withdrawal of UC compared with tax credits.

The differences primarily affect how far short of MIS families with very low earnings, working part time, will fall under the new and old systems. The difference will be less for families on full-time earnings, which are needed under both systems to reach MIS. However, couples with two children working full time on modest wages will be worse off under UC, in part because of the differing extent to which families benefit from higher tax allowances under the old and new systems. Additional income after tax triggers a reduction in UC. So when families receive more through higher allowances, those on UC lose two-thirds of it, because their net income is higher. This was not the case under tax credits, as entitlement was based on pre-tax income.

## Changes over time

The change from tax credits to UC is taking place while general state entitlements are being cut. Since 2010, the rate of support for childcare costs has been cut, and the rate of withdrawing tax credits with increasing income has risen, Child Benefit has been frozen, and below-inflation tax credit upratings have been introduced. This last policy will continue for the next two years under UC.

The combined result is illustrated for lone parents working full time. Lone parents with one child need £268 a week disposable income for an acceptable living standard. Had no cuts occurred since 2010, they would fall £25 (9 per cent) short of that threshold. Under conditions projected to 2015, this shortfall would double to £48 (17 per cent). However, this calculation does not take account of a further change, proposed for 2016: increasing the eligible percentage of childcare payable under UC from 70 to 85 per cent, where all adults in a family pay tax. For lone parents working full time, this would remove the effect of the cuts, restoring net income to 90 per cent of MIS. This would improve work incentives considerably.

## Conclusion

Universal Credit can provide some low-earning households with improved disposable incomes compared with the current system, particularly if they work only a few hours a week. However, for others, especially those working full time, it can mean a cut in disposable income. UC strengthens work incentives for some, but in many cases provides little or no incentive for additional work.

This mixed picture for work incentives is particularly problematic, because the income households can reach by working part time remains well below what they need. Even working full time, those on minimum wage are likely to fall at least 20 per cent below a minimum acceptable living standard as measured by MIS, through the combined effects of childcare costs, the UC taper and income tax.

Moreover, simplistic 'better or worse off' calculations based on the switchover to UC ignore the impact of other recent and projected entitlement cuts. These have often been more significant to households than gains or losses through the restructuring to UC itself. For some, these cuts' effects could be reversed by the proposed increase in childcare support in 2016. Such aspects of the UC system will determine whether it provides an effective route to adequate living standards.

## About the project

The team at the Centre for Research in Social Policy, Loughborough University, who conducted the initial MIS research calculated net income under various wage and employment scenarios for different family types.

## FOR FURTHER INFORMATION

This summary is part of JRF's research and development programme. The views are those of the authors and not necessarily those of JRF.

The full report, **Does Universal Credit enable households to reach a minimum income standard?** by Donald Hirsch and Yvette Hartfree, is published by the Joseph Rowntree Foundation. It is available as a free PDF at www.jrf.org.uk

To find out more about MIS and Universal Credit, visit www.jrf.org.uk/mis

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