



Institute for
Fiscal Studies

Universal credit and work incentives

Stuart Adam

Launch of OECD report ‘Connecting people with jobs:
activation policies in the UK’

The Work Foundation, London, 15 July 2014

Main thrust of OECD recommendations on UC

Scale back in-work support by considering, for certain groups (particularly those expected to work full-time):

- Applying conditionality up to individual hours threshold, not just family earnings threshold
- Time-limiting UC for part-time workers
- Increasing withdrawal rate from 65% towards 100%

‘The 100% rate dissuades people from taking up part-time work while claiming benefits, and out-of-work benefit conditionality ensures that they choose full-time work rather than zero work.’

Identifying the target

- Some of the criticism (and praise) is of specific features new to UC
 - e.g. removal of hours rules; new conditionality regime
- Much of the criticism applies to extensive in-work support in general
 - A feature of UK system both before and after UC
 - Not clear move to UC creates/worsens many of the problems identified
 - Case for benefit integration remains intact

Two kinds of financial work incentives

1. Incentive for those in work to increase their earnings
 - Marginal effective tax rate (METR): proportion of an extra £1 of earnings taken in tax and withdrawn benefits
2. Incentive to be in paid work at all
 - Participation tax rate (PTR): proportion of total earnings taken in tax and withdrawn benefits
- In-work support strengthens latter at expense of former
- Modern optimal tax literature emphasises incentive to work at all
 - Evidence that employment more responsive than earnings
- OECD recommendations reverse this
 - Argue that conditionality can remove no-work option
- Joint assessment for couples puts a different slant on the trade-off
 - Incentive to have one earner rather than two or none

Effect of UC on work incentives

UC gets rid of many of the very weakest work incentives:

- reduces number of people with METRs >85% by more than 90% (0.5m)
- reduces number of people with PTRs >75% by half (1.5m)

Effect on average work incentives:

	Percentage point change in average:	
	METR	PTR
Single, no children		
Lone parent		
Partner not working, no children		
Partner not working, children		
Partner working, no children		
Partner working, children		
All		

Source: Adam & Browne (2013), *Do the UK government's welfare reforms make work pay?*



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All	-0.1	

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Effect on average work incentives:

	Percentage point change in average:	
	METR	PTR
Single, no children	+0.7	
Lone parent	-5.2	
Partner not working, no children	-0.4	
Partner not working, children	+1.2	
Partner working, no children	-0.3	
Partner working, children	+0.0	
All	-0.1	

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All	-0.1	-0.7

Effect of UC on work incentives

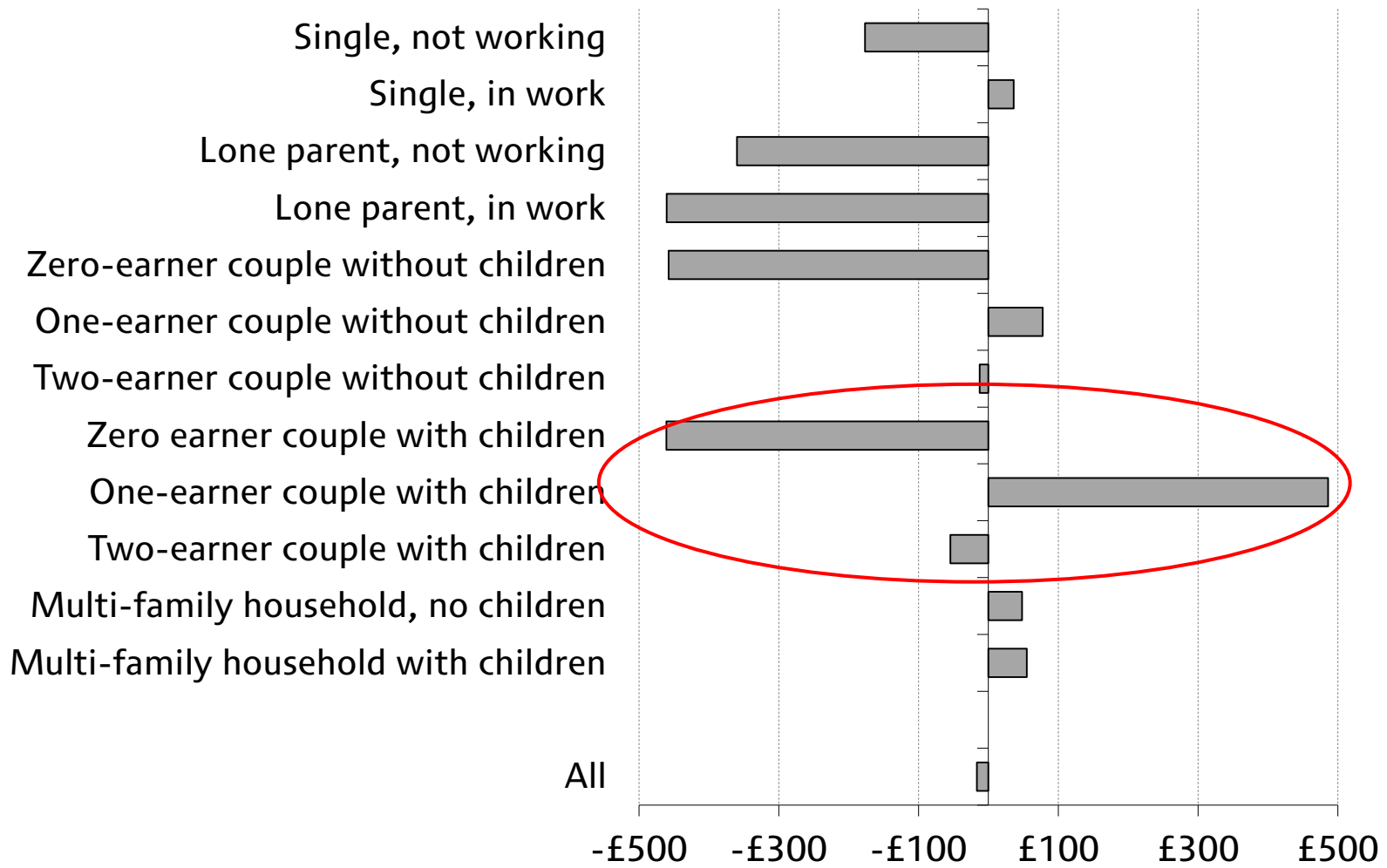
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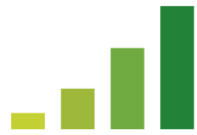
	Percentage point change in average:	
	METR	PTR
Single, no children	+0.7	-1.5
Lone parent	-5.2	+3.6
Partner not working, no children	-0.4	-3.4
Partner not working, children	+1.2	-10.7
Partner working, no children	-0.3	+0.1
Partner working, children	+0.0	+2.5
All	-0.1	-0.7

Distributional impact of universal credit



Assessing the OECD recommendations on UC

- Scaling back in-work support has considerable appeal
 - Reduce scope of means-testing
 - Encourage full-time rather than part-time work
 - Strengthen incentives for couples to have both partners in work
- Involves multiple trade-offs
 - Weakens incentives to have someone in work at all
 - Reduces support for those for whom low-earning work appropriate
- Needs care in identifying which groups to target
- Relies heavily on out-of-work conditionality to avoid worklessness



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