

Memorandum submitted by Ferret Information Systems (WR 39)

Introduction

1. We have previously submitted to the Work and Pensions committee some modelling of the effects of the proposed changes (<http://bit.ly/fdPVDY>) but we are focussing in this note on two areas:
2. Work Incentives
3. Poverty Traps
4. The two are, sometimes, inter-related as will be seen.
5. In the examples used here, we have taken account of other benefit and tax credit changes announced in the Emergency Budget and the Comprehensive Spending Review. The effects that we examine are therefore cumulative and take account, year by year, of the changes that have been predicted.
6. We have used a real present value approach, as described in the methodology on page 11 and carried this forward into Universal Credit.
7. The largest impact over the period modelled is caused by the move from uprating benefits in line with RPI, and the Rossi Index, to uprating by the, usually lower, CPI. It is for this reason that we have used present values in the modelling.
8. The government said, in the White Paper, *“Within Universal Credit, the key mechanisms for making work pay will be a single taper to withdraw support as earnings rise and a new approach to earnings disregards.”*
9. We welcome a single taper but we question the emphasis on the new approach to earnings disregards.
10. The White Paper also says *“poor financial incentives to work are key factors in trapping people on out-of-work benefits”* and *“...we will allow some groups to earn significantly more before their benefit starts to be withdrawn. The level of these earnings disregards will reflect the needs of different families to ensure that work pays.”*
11. It seems to us that these aspirations, in themselves laudable, are more presentational than real.

Work Incentives

12. In table 1, below, we have shown the maximum, headline, earnings disregard for families with children, the ‘floor’ level or minimum earnings disregard and the housing costs which, because of the proposed deduction rule, would bring the disregard down to the ‘floor’ level. The results are disappointing.

Table 1

	Maximum	Floor	Housing Cost at Which Floor Reached
Couple	£57.69	£10.00	£31.79
+1 child	£109.62	£20.00	£59.74
+2 children	£109.62	£25.00	£56.41
+3 Children	£109.62	£30.00	£53.08

Lone Parent			
+1 child	£148.08	£40.00	£72.05
+2 children	£148.08	£45.00	£68.72
+3 Children	£148.08	£50.00	£65.38

13. The headline rates of disregard are generous but, for a couple, it only takes housing costs of less than £32 a week to reduce the disregard of almost £58 down to £10. This is exactly the same disregard they attract today although, if introduced at this rate, its value will be eroded by inflation.
14. It is difficult to look at the housing costs figure and see typical rents below these values. Our conclusion is that, for the vast majority of people with housing costs, the earnings disregard will be at the floor level. It is true that the floor level is, in many cases, higher than the current figures for equivalent circumstances in the current schemes but these values have been reduced in value considerably since their introduction because they have not been regularly updated. It is also the case that single people will lose the small disregard they currently have; hardly an incentive.
15. The advantages of the headline disregard will be felt only by those without housing costs, or with extremely low costs.
16. This may benefit those nearing retirement who may have paid-off their mortgages or those lucky enough to have inherited, or been given, their homes. For others, perhaps those still living at home with parents or sleeping on friends' floors, the disregard figures may prove a disincentive to establishing their own households. This may reduce pressure on the housing market but it would be strange to hide housing policy of this sort within a welfare reform measure.
17. It is also worth noting that the 2012 Income tax personal allowance increase, announced in last week's budget, will be worth £2.42 a week to those earning £115,000 a year but £0.48p to the poorest workers as the increase in net pay reduces their Housing Benefit and Council Tax Benefit.
18. This does not seem, to us, to demonstrate a commitment to improving incentives for the lower paid.

Work Incentives and the Poverty Trap

19. The single taper is intended to make it clear that work, and additional hours or pay, will provide an increase in net income. It should allow people to see for themselves the benefit of work and of working more.
20. Unfortunately the government has also announced its intention to cap benefits at the median earnings level. This proposal, in its current form, will create hardship and poverty traps.
21. The intention is that the cap will not apply where someone is receiving DLA, Working Tax Credit or War Widows Pension.
22. There are serious issues caused by the Working Tax Credit receipt exception as can be seen in the following table and chart.

9 Children Mortgage £100,000, 4.5% Interest £86.54 interest pw

Table 2

Gross Earnings	Net Weekly Income		Current		UC		
	2011	2012	2013	2014	2014	2015	
£10,000.00	£841.75	£850.97	£836.71	£824.60	£846.96	£809.73	£832.94
£15,000.00	£866.75	£872.40	£858.38	£846.21	£865.49	£831.19	£851.32
£20,000.00	£887.52	£893.17	£806.97	£806.97	£806.97	£806.97	£806.97
£25,000.00	£908.29	£913.94	£872.35	£872.35	£872.35	£872.35	£872.35
£30,000.00	£929.06	£934.71	£922.25	£910.07	£920.12	£895.05	£905.95
£35,000.00	£949.83	£956.81	£944.94	£932.83	£939.80	£917.97	£925.79

23. It can be seen in Table 2 above, and graphically on Figure 1 below, that increasing earnings does not always lead to increased income. In 2013 earnings of £10,000 produce a weekly income almost £30 higher than earnings of £20,000; twice the amount.
24. This is because, even though the benefits in payment are over the cap limit at £10,000 and £15,000, there is no cap because WTC is in payment. At £20,000 there is no entitlement to WTC and the cap is applied.

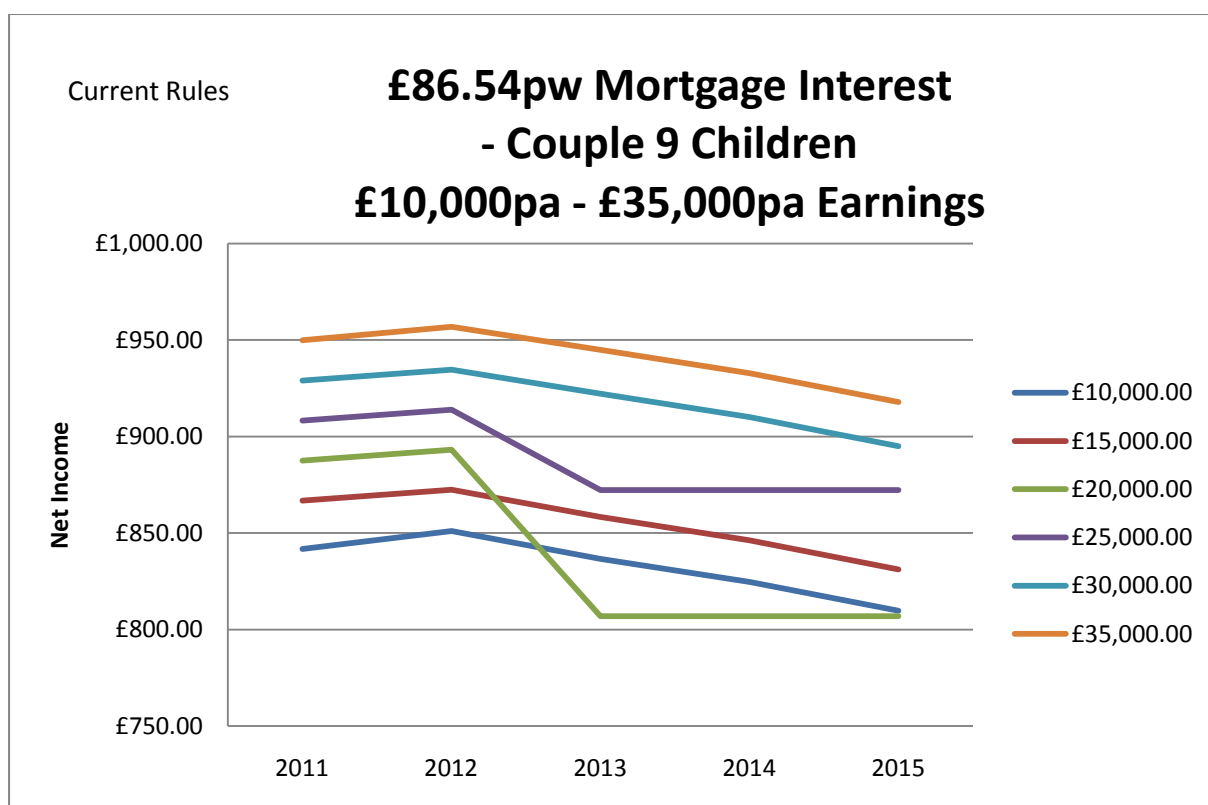


Figure 1

25. We have used calculations based on large numbers of children to emphasise the effect but, even if these were outliers, this fundamentally challenges the incentive oriented policy of the reforms.
26. Some other examples of this effect are shown below.
27. For Universal Credit we have assessed whether WTC would be payable at the real levels in 2014 and 2015 and not considered capping if it would be.

9 Children £86.54pw Rent

Universal Credit	2011	2012	2013	2014	2015	
£10,000.00	£0.00	£0.00	£181.92	£178.49	£163.39	Amount of benefit above £500 but not capped as WTC would be in payment
£15,000.00	£0.00	£0.00	£162.17	£131.63	£116.38	Amount of benefit above £500 but not capped as WTC would be in payment
£20,000.00	£0.00	£0.00	£119.00	£84.46	£69.20	Amount capped
£25,000.00	£0.00	£0.00	£58.03	£37.29	£22.03	Amount capped
£30,000.00	£0.00	£0.00	£0.00	£0.00	£0.00	Benefit below £500
£35,000.00	£0.00	£0.00	£0.00	£0.00	£0.00	Benefit below £500

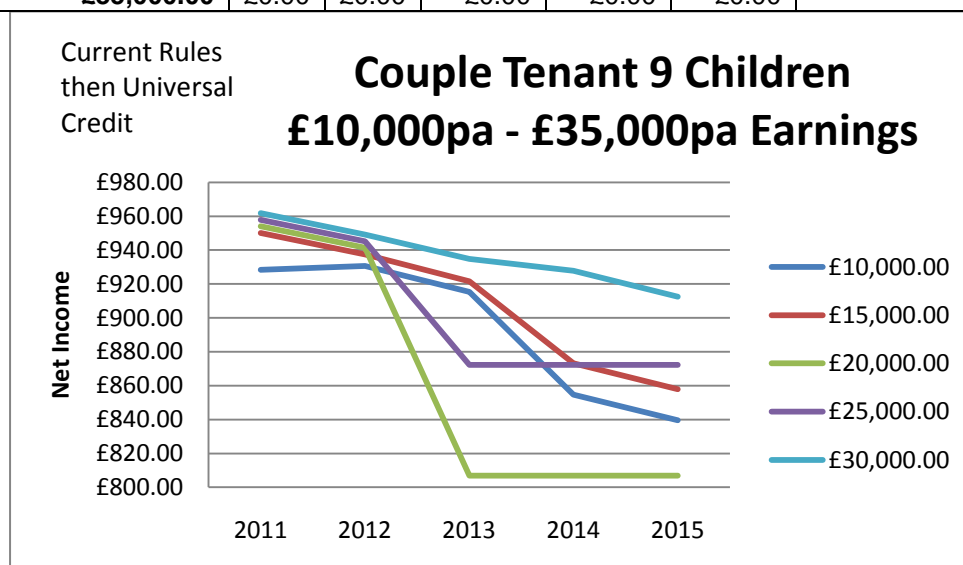


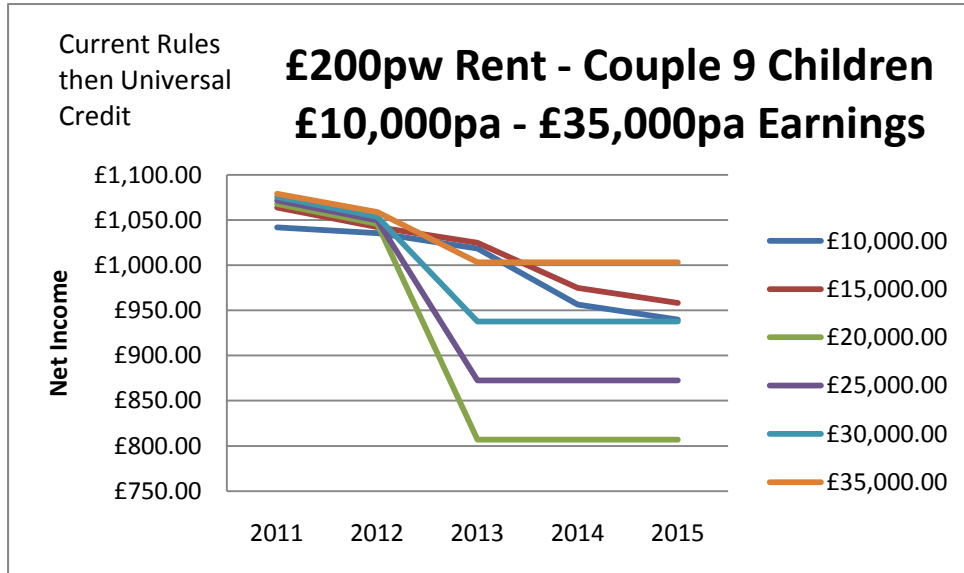
Figure 2

28. The tables and charts above show some of the effects that can be caused by this policy.
29. At £10,00 and £15,000pa WTC is in payment so no capping applies although benefits exceed £500pw
30. At £20,000pa and £25,000 capping is applied while at £30,000pa benefits have fallen below £500pw and no capping takes place.
31. The combination of the cap and net earnings creates a poverty trap where someone, in these circumstances, earning £20,000 a year may be over £100 a week worse off in net income than if they earned £5,000 a year less.

9 Children £200pw Rent

Gross Earnings	Net Weekly Income		Current		UC		UC	
	2011	2012	2013	2014	2014	2015	2015	
£10,000.00	£1,041.75	£1,035.29	£1,018.45	£1,003.80	£956.34	£986.42	£939.82	
£15,000.00	£1,063.62	£1,042.00	£1,024.66	£1,009.68	£974.87	£991.59	£958.20	
£20,000.00	£1,067.51	£1,045.89	£806.97	£806.97	£806.97	£806.97	£806.97	
£25,000.00	£1,071.40	£1,049.79	£872.35	£872.35	£872.35	£872.35	£872.35	
£30,000.00	£1,075.30	£1,053.68	£937.74	£937.74	£937.74	£937.74	£937.74	

£35,000.00	£1,079.19	£1,058.90	£1,003.12	£1,003.12	£1,003.12	£1,003.12	£1,003.12
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32. If the rent is increased to £200pw, a more realistic level for the large house needed for the family size, the effect is even clearer

Universal Credit	2011	2012	2013	2014	2015	
£10,000.00	£0.00	£0.00	£285.02	£280.15	£263.62	Amount of benefit above £500 but not capped as WTC in payment
£15,000.00	£0.00	£0.00	£265.27	£233.29	£216.61	Amount of benefit above £500 but not capped as WTC in payment
£20,000.00	£0.00	£0.00	£222.10	£186.12	£169.44	Amount capped
£25,000.00	£0.00	£0.00	£161.13	£138.94	£122.27	Amount capped
£30,000.00	£0.00	£0.00	£100.16	£91.77	£75.09	Amount capped
£35,000.00	£0.00	£0.00	£40.59	£46.07	£29.54	Amount capped

- 33. At £10,00 and £15,000pa WTC is in payment so no capping applies although benefits substantially exceed £500pw
- 34. From £20,000pa to £35,000 capping is applied .The combination of the cap and net earnings creates a poverty trap where someone, in these circumstances, earning £20,000 a year may be over £200 a week worse off in net income than if they earned half that amount.
- 35. At £40,000pa benefits have fallen just below £500pw and no capping takes place.
- 36. In 2013/2014 this couple, with one person earning £10,000pa, will have total net current value income of £1,018.45 a week and will be over £210 a week better off than if they earned £20,000 a year. If they were to become better off in real terms they would need to earn almost £40,000 a year which would give them £1,052.80 a week, an income increase of almost £35 a week.
- 37. We find it difficult to see a solution which will not introduce more complexity into a move to a simpler system.

The Benefits Cap and Rents

38. Much has been written already about the effect of the benefits cap on London and the potential 'social engineering' effects that may be seen because of the higher housing costs in the area.
39. The following tables show the amount of benefit available to pay rent and council tax after a £500 per week cap is applied. The tables use current benefits figures for unemployed working age families with no disabilities. The median income earnings after tax for working households is currently £479 per week (Family Resources Survey) so, if applied on that basis, the available income for Housing Benefit and Council Tax Benefit would be £21 a week less.
40. The stark result is that nowhere in England (we haven't yet modelled elsewhere in the UK) will Housing Benefit and Council Tax Benefit be enough to pay for rent at the LHA level and Council tax at the Band A level.
41. The lowest LHA figure for a 4 bedroom house in England is in the BRMA of Bradford and South Vales and is (for February 2011) £137.31. Council Tax in Bradford, for the cheapest Band A property, without any parish precept, is £851.49 (£16.37 a week). If it were possible to find a Band A, four bedroom house, at the LHA level in Bradford, the total cost of rent and council tax would be £153.68.
42. On current rates of benefit therefore, shown in the tables below, a single parent with 5 children living in the cheapest LHA level house in England on the lowest council tax band would have its Housing Benefit capped by exactly £25.00 a week. If the cap were to use the current median income figure the HB would be capped by £46.
43. A couple with 6 children, in the same house, would find a shortfall of £120 a week or £141 on the current median earnings figure.
44. In the most expensive areas, taking the £400 per week LHA limit to be introduced in April 2011, there will be a shortfall of from £271.32 to £366.31, without taking any account of council tax. There are currently 8 areas with 4 bed LHA levels of over £400 a week. Table 3 shows the maximum benefit available for rent and council tax; for couples and larger numbers of children the amount is lower.

Table 3

Single parent with 5 children Income based	£65.45
JSA / Income Support / ESA -Adult(s)	
Child Tax Credit	£231.97
Child Benefit	£73.90
Other benefits (including Carer's Allowance and Industrial Injuries Disablement Benefit)	£0.00
Maximum benefit available for Housing & Council Tax	£128.68 max

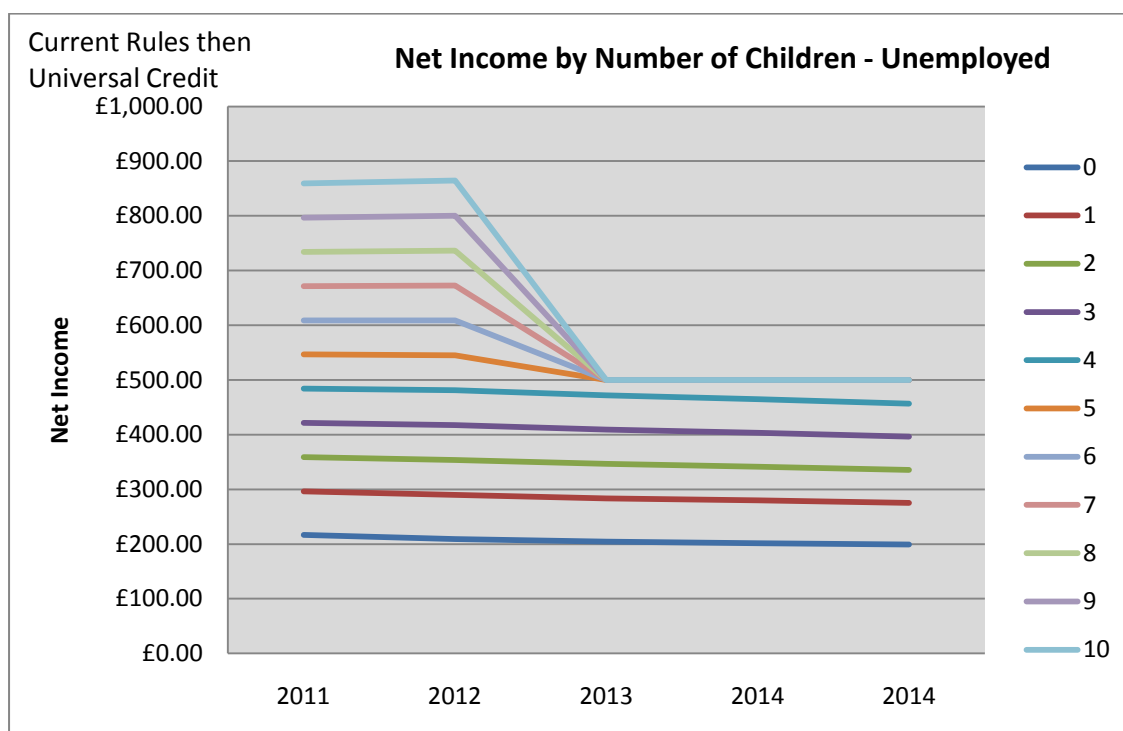
45. It's not just London.

Children and the Benefits Cap

46. The effect of the benefits cap on families with differing numbers of children, but otherwise identical circumstances, is easy to show, as can be seen below.

Couple – Tenants, Unemployed – Varied by Children

Children Unemployed	Net Weekly Income		Current		UC		UC	
	2011	2012	2013	2014	2014	2015	2015	
0	£216.53	£209.08	£204.18	£201.80	£201.80	£199.01	£199.01	
1	£296.44	£289.98	£283.68	£279.88	£279.88	£275.35	£275.35	
2	£358.98	£353.79	£346.45	£341.59	£341.59	£335.74	£335.74	
3	£421.51	£417.61	£409.23	£403.30	£403.30	£396.13	£396.13	
4	£484.05	£481.42	£472.01	£465.01	£465.01	£456.52	£456.52	
5	£546.58	£545.24	£500.00	£500.00	£500.00	£500.00	£500.00	
6	£609.12	£609.05	£500.00	£500.00	£500.00	£500.00	£500.00	
7	£671.65	£672.87	£500.00	£500.00	£500.00	£500.00	£500.00	
8	£734.19	£736.69	£500.00	£500.00	£500.00	£500.00	£500.00	
9	£796.72	£800.50	£500.00	£500.00	£500.00	£500.00	£500.00	
10	£859.26	£864.32	£500.00	£500.00	£500.00	£500.00	£500.00	

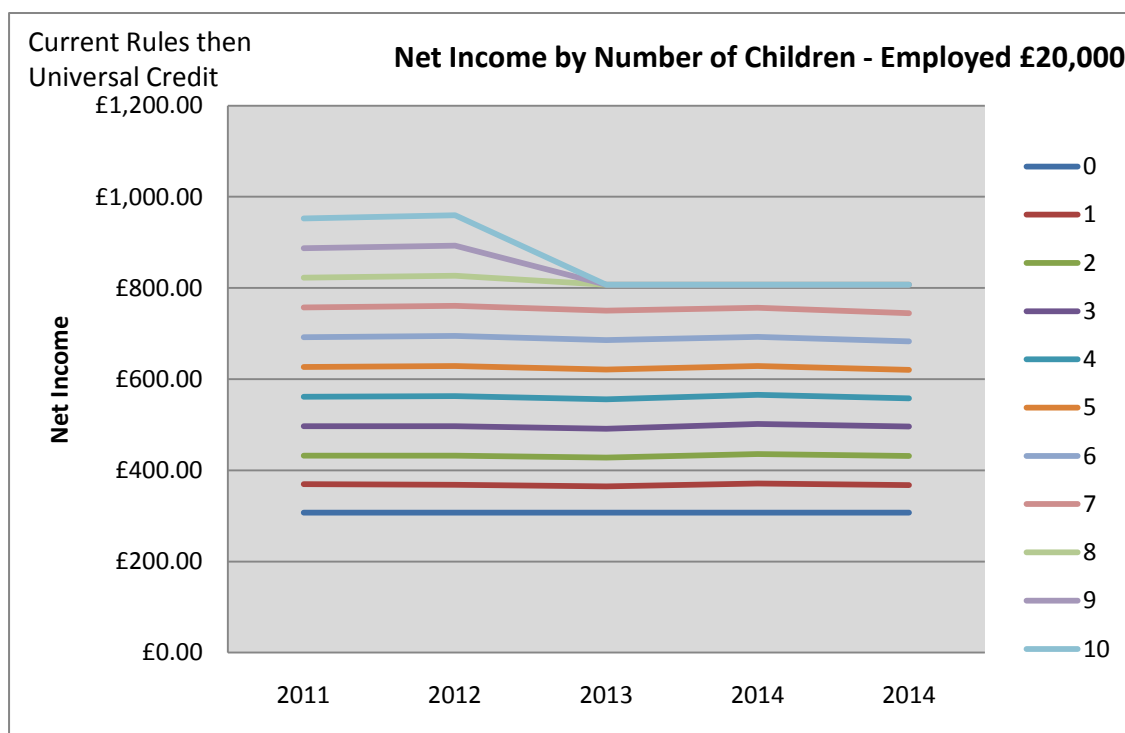


47. Capping starts with 5 children. With 10 children the benefit will be capped by almost £350 a week in 2013 in today's values. Universal Credit figures are shown as capped at the same rate.

48. But, again, work incentives and a poverty trap are impacted by the cap. Working Tax Credit will run out before Child tax Credit and, often, other benefits. In the example below of an owner earning £20,000 a year, larger numbers of children lead to the cap being applied. In this case there is no clear incentive to earn at this level.

No. of Children	2013	2014	2015
8	£7.97	£13.09	£0.27
9	£72.70	£76.73	£62.56
10	£137.44	£140.37	£124.85

Capping amount



Conclusion

49. The work incentive of high earnings disregards is largely confined to those without housing costs.
50. The effect of the benefits cap is to introduce nationwide difficulties for those with numbers of children or high housing costs. These effects are not limited to London or other areas with particularly high housing costs.
51. Large poverty traps can occur as a consequence of the crude operation of the cap, as currently described.

Methodology

52. The examples in this document consolidate the changes to tax and benefits rules announced in the Emergency Budget of June 2010 and the Comprehensive Spending Review October 2010. This document includes modelling for the effects of reductions in real values of benefits caused by government changes to up-rating methods.
53. Assessments start with the current values, rules and rates in force on uprating in April 2011 and progress from those.
54. Values used are based on starting figures and then adjusted in 3 ways:
55. Earnings, other incomes, tax bands etc. use current values.
56. Benefits which are to be up-rated by CPI in future have their current values reduced by the cumulative year by year difference between RPI and CPI
57. Benefits, and elements of benefits, which have been frozen have their current values reduced by the cumulative RPI.
58. This, crudely, allows comparison of the real future values of income to be compared with starting values.
59. The CPI and RPI forecast figures used are those produced by the Office for Budget Responsibility.
60. Universal Credit assessment has been modelled by using forecast benefit values together with the tapers and disregards proposed in the White Paper, *Universal Credit: welfare that works* Cm 7957.
61. For LHA, because of the individual transition, the assumption has been made that the 30th percentile reduction does not apply in 2011/2012. In 2012/2013 the VOA current and 30th percentile national figures have been averaged and the reduction applied to rental figures. Those figures have then been treated in the same way using the CPI reduction in following years when the LHA figures will be up-rated by CPI.
- 62. Changes in Council Tax Benefit, outlined in the CSR and white paper have not been included as no detail is yet available, instead the current rules are used with a 10% reduction from the proposed date.**
63. Most of these examples are based on the situation of a couple with two children.
64. They are both aged 45 and have 2 children aged 8 and 10. They do not have any childcare costs and make no pension contributions.
65. They pay rent of £86.54 per week which is exactly the Local Housing Allowance (LHA) for their home (the figure is chosen to match the mortgage interest payable in the examples for home owners with a mortgage of £100,000 at an interest rate of 4.5%)
66. They pay council tax of £1250 per annum.

Ferret Information Systems

67. Ferret is the world's leading company specialising in the application of technology to advanced advice and information for the individual. We focus on areas linked to social welfare, assessment and support.
68. In 30 years of innovation Ferret has grown out of a Citizens Advice Bureaux project, into a multi-award winning company whose world's first's include the world's first large scale roll-out of mobile technology in government and the world's first Web based benefits assessment system – in 1995.
69. Ferret specialises in modelling holistic assessment of financial circumstances, coupled with a software development methodology which offers a high level of flexibility and rapid updating to reflect rule changes.
70. Ferret works in partnership with many companies and organisations using our expertise, and that of our partners, to develop effective products and services. For example our work with the Council of Mortgage Lenders in developing Fintal, the ground breaking tool for advice and compliance needs in lifetime mortgages, quickly established itself as the industry standard for this essential task.