



# Universal Credit needs to adapt to the modern labour market

Citizens Advice helps people find a way forward. We advocate for our clients and consumers on the issues that matter to them.

## Summary

- By 2022, an estimated 7.2 million families in the UK will receive Universal Credit (UC) - 3.9 million of which will be in work.
- Citizens Advice supports the principles of Universal Credit, to help people move into and progress in work, provide low-income families with financial security and simplify the benefits system.
- We have helped people with over 200,000 UC issues since the roll out of the new benefit began in 2013.
- Our new analysis finds that UC risks leaving some workers' financial stability hanging in the balance, and diminishes some people's incentive to work or increase their hours.
- 2.1 million low income families will lose an average of £1,600 per year when they move to UC from the old benefit system. Our research shows that 1 in 4 workers receiving in-work benefits think they would not be able to increase their income through employment, even though they might need to. 1 in 3 (33%) of this group gave the reason that they work full-time already.
- The way UC is designed means that people who are not paid once a month could face unexpected income shocks. In addition, self-employed people could be left facing financial losses. Our new analysis gives an example of a self-employed worker receiving UC who is worse off by £630 a year compared to an employee on the benefit, even though their annual earnings are identical.

## Recommendation

- To achieve the Government's ambition to incentivise people to move into and progress in work, and provide low-income families with financial security, they need to look again at the lowered work allowance, the Minimum Income Floor for the self employed, the flexibility of UC's monthly assessment period and the budgeting support available to UC claimants.

## What is the current situation?

### Working people now rely on Universal Credit to make ends meet

By 2022, an estimated 7.2 million families in the UK will receive UC - 3.9 million of which will be in work.<sup>1</sup> With UC replacing the current system of tax credits, these working families will rely on UC to top up low wages and pay for essentials like food, rent and heating.

However, changes to the design of UC - as well as the way it is delivered - create new challenges for some people in work. A reduction in the amount of hours you can work before your benefit is cut - known as the 'work allowance' - will lead to significant benefit reductions for millions. The way that UC is calculated could also make things more difficult for people whose incomes changes month by month, or for those not paid monthly.

As more and more working people move onto UC, these issues need to be addressed as a matter of urgency. Citizens Advice is committed to working with the Government and other organisations to ensure UC works for people in the modern labour market.

## **The way many people work has changed**

UC was designed almost a decade ago, but the labour market has changed significantly since then. We've seen record levels of employment, but many people are not following the traditional model of work in which they have a full time, permanent job.

Our analysis suggests around 4.5 million people in the UK are in some form of insecure work (holding jobs with some variability in hours or earnings), around 8.5 million work part-time, and 4.8 million people are self-employed.<sup>2</sup> Many of these people's hours and earnings vary throughout the year - and UC could make life more difficult for them.

## **Why is change needed?**

### **Some workers moving to Universal Credit stand to gain:**

**1.8 million low income families** - Some working families will benefit from moving to UC. They stand to receive more financial support under Universal Credit. There are many reasons why this may be the case, including that people who work less than 16 hours a week may be better off as they get more financial support on UC. One-earner couples with children are more likely to be better off compared to the old system.<sup>3</sup>

**Workers who have struggled with tax credit overpayments** - UC reduces the risk of big benefit overpayments, which was a recurring problem under the tax credit system, and pushed many people further into debt. This is because payments under UC are

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<sup>1</sup> Citizens Advice, [Delivering on Universal Credit](#), 2017, 9.

<sup>2</sup> Citizens Advice, [The Importance of Income Security](#), 2016; ONS, [Trends in Self-Employment](#), 2018; ONS, [UK Labour Market](#) 2017.

<sup>3</sup> IFS, [Green Budget](#), 2016, 232.

adjusted to reflect earnings each month, rather than annually as they were with tax credits.

## **But many are more likely to lose out when compared to the old benefits system:**

**2.1 million low income families** - Some working families will lose out as they move to UC. According to the Institute for Fiscal Studies, they will lose an average of £1,600 per year on UC compared to the old benefit system.<sup>4</sup> This is because of the series of cuts to the benefit announced by the Government in 2015. One of the biggest cuts was to the work allowance, resulting in workers seeing a reduction in the amount of hours they can work before their UC payment starts to decrease. Lone parents and two-earner couples are likely to lose out the most from this change.

Citizens Advice asked a representative sample of people receiving in-work benefits how they would cope with a £100 drop in their monthly income, roughly the average amount affected households stand to lose from the reduced work allowance:

- 1 in 4 workers (26%) said they would not be able to increase their income through employment even though they might need to, with 1 in 3 (33%) of those saying they work full-time already.
- Caring responsibilities (23%) and having a disability (18%) were other reasons workers gave for not being able to make up the £100 shortfall through work.<sup>5</sup>

**Self employed workers** - Our new analysis gives an example of a self employed worker receiving Universal Credit who is worse off by £630 a year compared to an employee on the benefit, even if their annual earnings are identical.<sup>6</sup> This is due to issues with the Minimum Income Floor, a rule that assumes everyone claiming UC who has been self-employed for a year or more is earning the National Minimum Wage (NMW). If they earn less than the NMW one month, their UC payment won't make up the difference. But if the next month their earnings go over the NMW, their benefit payment will be reduced accordingly. This design flaw is unfair and risks causing financial hardship as self-employed workers often earn different amounts from one month to the next.

**Workers who are not paid once a month** - These people could face unexpected changes to their monthly income and some will also have to re-claim UC at multiple points throughout the year. This is because UC payments are assessed each month and adjusted to ensure households have the financial support they need every month. In theory this is a good idea, but if people aren't paid monthly the UC monthly assessment period is inflexible and causes people difficulty.

For example, if a person is paid every four weeks, they could at some points during the year have two pay packets recorded in a single monthly assessment period. This could take their recorded earnings over the eligibility threshold for UC, which could lead to a

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<sup>4</sup> Ibid.

<sup>5</sup> Citizens Advice, Universal Credit and Modern Employment: Work Incentives, 2018, 9.

<sup>6</sup> Citizens Advice, Universal Credit and Modern Employment: Non-traditional work, 2018, 8.

significant reduction in their income for that month - even though the amount they are earning through work has not changed. In this example, the person would have to re-claim the benefit the following month, and may only notice this when a direct debit is unpaid because they hadn't received their UC payment.

This household will therefore face significant and often unexpected changes to their monthly income at numerous points through the year presenting a big budgeting challenge. Our clients' evidence suggests more than half of claimants are not paid monthly, and so may have to manage these financial shocks.

## **What change is needed?**

### **To make UC fit for purpose in the modern labour market the Government should:**

1. Reassess the work allowance to make sure it is supporting the Government's ambition of improving work incentives and encouraging UC claimants who are able to, to enter the workforce or increase their income from work.
2. Review the impact of the Minimum Income Floor to ensure self-employed people are not disadvantaged financially compared to people working for an employer.
3. Introduce greater flexibility around the monthly assessment period for UC to give people not paid a regular wage per month a more stable income.
4. Ensure budgeting support and information is available to anyone receiving UC at any stage in their claim. Improving the amount of information claimants get in their online journal and provision of extra support when needed will help them manage their finances by adapting to the significant changes the new benefit brings.

### **Case study**

One family helped by Citizens Advice had to visit a food bank as a result of having less money to pay their bills because of the Minimum Income Floor. In order to boost their UC payment, the father was forced to give up his computing business and stop work altogether, while the mother cut short her maternity leave to return to work.

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