

Changes to the Working Tax Credit may not always make work pay and raise serious questions about fairness

Mar 20 2012

Kate Bell and **Mike Brewer** evaluate the government's changes to Working Tax Credit, arguing that challenges remain to ensure that "work always pays".

Campaigning by the shopworkers union USDAW and **parliamentary questions** from the Labour MP Anne Coffey have highlighted the fact that an estimated 212,000 families will lose their entitlement to Working Tax Credit (WTC) from 6 April unless they are able to increase their working hours



A change in the tax credit rules, announced in the 2010 Spending Review, means that a couple claiming WTC will now be eligible only if at least one of them works 24 or more hours a week, rather than, as used to be the case, if at least one of them works 16 hours or more a week. Some of the couples affected by the change will find that, if they are unable to increase their hours (and 78 per cent of those affected families surveyed by USDAW said that **they would not** be able to find the additional hours), then they will hardly any better off in work – and, in some cases, actually worse off – than they would if they were not working and instead receiving benefits.



Some will support this move, arguing that it is unfair to other taxpayers that the government supports adults in a couple who are doing just 16 hours paid work a week between them; setting the hours limit at 24 would take us back to the situation that existed before 1992. On the other hand, the change does go against the government's expressed intention to make work pay. But the government's main motivation is, almost certainly, to save money. Working families are also being affected by a freeze in the working tax credit, an increase in the withdrawal rate of tax credits, and cuts to childcare subsidies.

New **IFS analysis** finds families with children to be losing more than other groups from recent changes to taxes and benefits. We assume the government is not actively trying to weaken work incentives; instead, such an outcome is an inevitable consequence of the choice to reduce spending on subsidies for working families.

But the debate about this change highlights not only the challenges of ensuring that "work always pays", but the challenge of defining what exactly should count as "work". The changes are one of the consequences of so-called "hours rules", which inevitably have to classify working families into those working hard enough to receive support, and those which are not. The government can point out that Universal Credit, enabled by the recent passage of the Welfare Reform Bill and due to begin in 2013, will not suffer from these problems as it will be paid to all families with a low income, whether working or not, with no need for hours rules to distinguish between the two.

The current system, with separate "out of work benefits" and tax credits for workers, sets the initial bar for work at 16 hours, meaning that families working fewer than 16 hours see only minimal gains to employment. In contrast, Universal Credit should help to provide clear incentives for those who not in work to get some form of paid employment, particularly for those wanting to work for less than 16 hours a week, or who might find themselves moving in and out of temporary jobs. These features are to be welcomed. Indeed, we have in the past argued that the way that the benefit and tax system discourages some from working a small number of hours a week is unhelpful and unjustified, and we called for **stronger incentives** for lone parents to work in so-called "mini-jobs".

So Universal Credit should encourage people to move into work (now defined as work of any hours). But [analysis](#) by one of us with researchers from the IFS found that the way that Universal Credit will affect the incentives for those in work to work more hours, or to earn more, is much less straightforward, and the outcome may not always be welcome. For example, Universal Credit will mean that no-one in work should face a combined tax-and-benefit withdrawal rate above 76.2 per cent, but it will increase the number of individuals with a combined tax-and-benefit withdrawal rate higher than 73 per cent, and increase the number with a combined tax-and-benefit withdrawal rate of 65 per cent or more (a combined tax-and-benefit withdrawal rate measures what fraction of a small rise in earnings is lost to income tax, national insurance, and reduced payments of benefits or tax credits).

This is particularly the case for potential second earners in couples, usually women, who look set to face significantly weaker incentives to work, because Universal Credit will be withdrawn more quickly as their earnings rise than is currently the case for tax credits.

However, the government believes that it can encourage people to work longer hours or increase their earning with a new tool: the so-called “in-work conditionality”. At present, people who claim Jobseekers Allowance are required to look for full-time work (part-time if a lone parent) as a condition of receiving benefits. The government has proposed that a similar principle will apply to claimants of Universal Credit, but that the rule which will apply to couples will be substantially more demanding than that which currently applies.

Under Universal Credit, adults in a couple who are not yet working full-time, and whose joint earnings are [less than £425.60](#) (the equivalent of two people working 35 hours a week at the national minimum wage) will be required to look for better-paid (either longer hours or higher wage) jobs. Although there will be exceptions for couples with young children, this introduces conditionality to an entirely new group: partners of adults working full-time but at low hourly wages.

This change raises issues of fairness – is it right that a partner of a low-paid adult is required to look for work when a partner of a better-paid adult is not? – and efficiency – there is good evidence that the Jobseekers Allowance regime may have [reduced claimants’ earnings](#) in the medium-run, even if it got them to leave JSA quicker. The [evidence](#) on the effectiveness of sanctions themselves on promoting sustained employment is mixed. And it is arguable that the policy reflects confusion in the government over what combination of carrots and sticks is the most effective way to encourage people to work at all, and to increase their hours.

The government appears to believe that increasing financial incentives is essential to encourage first earners to work, but that more coercion is needed for second earners. Initially, the government was keen to stress that Universal Credit would represent an enhanced carrot for the workless; it now looks increasingly like the stick will be larger too.

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Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics.

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