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Institute for Fiscal Studies

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Pascale Bourquin
Tom Waters

The temporary benefit increases beyond 2020–21

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Nuffield Foundation

8. The temporary benefit increases beyond 2020–21

Pascale Bourquin and Tom Waters (IFS)[1]

Key findings

1 The **number of families claiming universal credit (UC) has increased from 2.6 million in February 2020 to 4.2 million in May 2020**. Claimants are receiving higher entitlements than they were before – due to both the changes in their circumstances and the temporary increase in generosity of working-age benefits. Consequently, **spending on working-age benefits is now forecast to be 7% of national income in 2020–21**. This is 2% of national income higher than it was last year and the highest it has been since records began in 1978–79.

2 The temporary, £1,000-a-year increase in the UC standard allowance is due to expire in April 2021. If the number of UC claimants is the same in March 2021 as it was in May 2020, **this would see 4 million families lose an average of 13% of their benefits overnight**. Some families would be hit even harder: for

[1] We are grateful to Robert Joyce for helpful comments on this chapter and to Isaac Delestre for his assistance in calculating the employment income distribution using the Survey of Personal Incomes (SPI). We are thankful for co-funding through the UK Research and Innovation (UKRI), grant number ES/V00381X/1.

example, a single, childless homeowner who is out of paid work would see their UC entitlement cut by 21%.

3 Choosing instead to **make the increase in the standard allowance permanent would, in the long run, cost the government £6.6 billion per year (in today's prices), adding roughly 10% to the annual cost of UC**, though undoing only a fraction of the cuts to benefits implemented since 2010. This would represent a **bigger increase to the entitlements of out-of-work claimants without children than has been seen over the whole of the past 45 years.** Nonetheless, the UK's system of support for out-of-work claimants would remain very thin by international standards.

4 The minimum income floor (MIF) in the UC system caps UC entitlements among the low-income self-employed at the same level as for full-time minimum-wage employees. The MIF has been temporarily suspended; permanently abolishing it **would cost £1.4 billion in the long run and would create some big winners,** with around 450,000 self-employed households gaining an average £3,200 per year. Most of these households are in the bottom fifth of the income distribution.

5 **The MIF has sensible aims**: combating fraud and avoiding subsidising non-viable self-employment. But there is room for improvement in its design; it penalises self-employed workers with fluctuating or seasonal incomes, compared with those whose incomes are more stable. **Instead of abolishing it, the government should consider adopting a cap based on a 12-month rolling average of earnings.** While there is a concern that the MIF chokes off otherwise viable businesses in their first few years of operation, **we find that – even before the introduction of the MIF – self-employed workers on means-tested benefits did not, on average, see significant increases in earnings over time**. In fact, two-thirds of those who remained in self-employment still earned below the MIF three years after becoming self-employed.

6 Prior to the pandemic, the link between local rents and the amount of housing support for low-income private renters had broken down; bizarrely, maximum support related to local rents in 2011. This meant that – rather arbitrarily – **families in some high-rent areas were eligible for less support than those in low-rent ones**. The government has temporarily re-established the link, by setting the maximum housing support level so it covers the rent of 30% of local rental properties in the private sector. **A link to contemporaneous local rents is clearly more sensible than the pre-COVID system, and the government should not return to the latter.**

7 Making the increase to housing support permanent would cost about £1 billion per year, with renters in London gaining the most. Alternatively, the government could set the maximum support level so that it covers 20% (rather than 30%) of local rented properties. **That would cost about the same as the pre-COVID system, but be fairer and less arbitrary.**

8.1 Introduction

In the wake of the coronavirus pandemic, the government introduced a raft of measures designed to shore up personal incomes. These included creating entirely new programmes – such as the Coronavirus Job Retention Scheme (CJRS, or 'furloughing' – now being replaced by the Job Support Scheme) and the Self-Employment Income Support Scheme (SEISS) – but also expanding the existing working-age means-tested social security system. This expansion came in the form of a number of measures (see Box 8.1) and included three large temporary working-age benefit giveaways that are the focus of this chapter:

- an increase to the standard allowance of universal credit (UC) by £1,000 per year (and an equivalent increase to the basic element of working tax credit, WTC);
- the suspension of the 'minimum income floor' (MIF), boosting entitlement to UC for low-earning self-employed workers; and

- an increase to local housing allowances (LHAs), which govern the maximum amount of support that low-income private renters can receive for housing costs.

The total cost of these reforms is £9.3 billion in 2020–21 (£7.8 billion excluding the increase to WTC, which we do not analyse in this chapter).[2] As things stand, it is unclear if or when some of these giveaways will end: the increase to the UC standard allowance is due to finish at the end of March 2021, the suspension of the MIF is in place until 13 November 2020 and the government has not stated its plans for LHAs beyond March.[3] But the OBR's costings assume that they do not persist beyond the end of this financial year.

In some cases, these temporary changes relate to areas of the UK benefit system that were already ripe for reform prior to the onset of the crisis. It is therefore now a natural time to think about the design of these parts of the system. In this chapter, we discuss the options that the government faces in unwinding, adjusting or making permanent these temporary giveaways. We focus on these specific policy decisions, since they will need to be made in the coming months (either because they are deliberately time-limited or because the end of the outbreak will – hopefully – be in sight over that horizon).

But, of course, the COVID-19 pandemic has also raised much wider questions about the broad shape and generosity of the UK social security system – for example, the extent to which the working-age benefits system prioritises trying to provide a minimum safety net for all versus tying benefits to what the recipient has 'paid in' earlier in life. Although vital, these broader questions are beyond the scope of this chapter; they will require not just the analysis of specific policy options, but a wider political debate on what we want the social security system to look like.

The rest of this chapter proceeds as follows. Section 8.2 gives some context on the UK's benefit system and the characteristics of working-age benefit claimants prior

[2] Office for Budget Responsibility (OBR), Coronavirus Policy Monitoring Database, July 2020, https://obr.uk/coronavirus-analysis/. Note that these figures include a small amount of other measures relating to the operation of the benefits and tax credit system, discussed in Office for Budget Responsibility (2020b, pp. 72–3).

[3] However, the Secretary of State for Work and Pensions has implied that the increase in LHA rates may be a permanent one – though no official plans appear to have been announced yet (https://committees.parliament.uk/oralevidence/447/html/).

Box 8.1. Other temporary working-age benefit measures

As well as the three benefit giveaways that we focus on in this chapter (and the related increases to WTC), the government announced several additional, and important, temporary changes to the benefit system. These include:

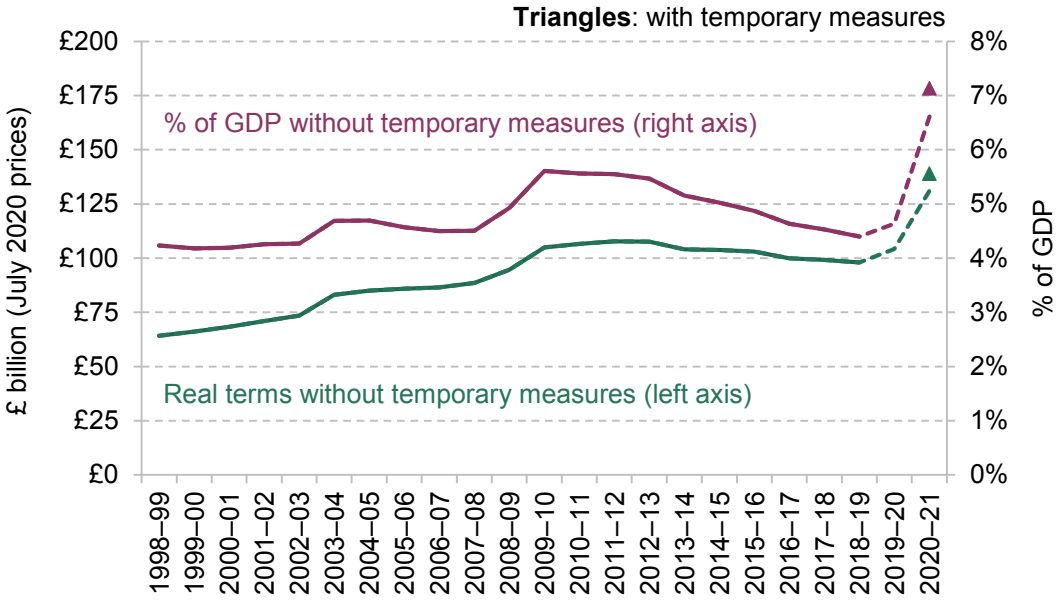
- All appointments at jobcentres were temporarily suspended.
- Work-search requirements and other assessments and sanctions were temporarily relaxed.
- COVID-related statutory sick pay was made payable from the first day of sickness absence, rather than the fourth. Furthermore, it was extended to people self-isolating and shielding.
- Contributory 'new-style' employment and support allowance (ESA) was also made available from the first day of sickness rather than the eighth for those shielding, self-isolating, or incapable of working due to COVID-19 (if they had paid enough in National Insurance contributions over the last two to three years to meet the contribution threshold).
- Most tax credit claims were automatically renewed. Tax credit payments to individuals working reduced hours due to coronavirus or furlough were unaffected as long as they remained employed.
- A £500 million hardship fund was established to allow local authorities in England to reduce the annual council tax bill of individuals on council tax support by £150 for the financial year 2020–21.

to and since the outbreak of the pandemic. Section 8.3 then focuses on the increase in the standard allowance of UC, while Section 8.4 looks at the withdrawal of the minimum income floor and Section 8.5 examines the increase to housing support. Finally, Section 8.6 concludes.

8.2 UK working-age benefits before and since the crisis

Since the crisis, the number of families claiming UC has increased substantially from 2.6 million in February 2020 to 4.2 million in May 2020 (some of these will have transitioned from pre-UC 'legacy' benefits, others will be entirely new claimants). The claimant count – which in normal times measures the number of

Figure 8.1. Spending on working-age benefits



Source: Authors' calculations using DWP Benefit Expenditure and Caseload Tables 2020 (https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2020), DWP Benefit Expenditure and Caseload Tables 2019 (https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2019), OBR March 2020 Economic and Fiscal Outlook and OBR July 2020 Fiscal Sustainability Report.

claimants who have to search for work to receive benefits – increased from 1.3 million individuals in February 2020 to 2.8 million in May 2020. The system is also paying out more per claimant; many who were already in receipt of benefits prior to the crisis will have seen their entitlements rise as their earnings fell. And, of course, the government has made working-age social security more generous overall through the temporary extensions discussed in this chapter.

The implications of these changes are shown in Figure 8.1, which shows spending on working-age benefits in real terms and as a share of GDP, including the OBR's central July 2020 forecast for 2020–21. The triangles denote the extra £9.1 billion spent on the temporary working-age benefit giveaways.[4] The OBR estimates that,

[4] This is different from the total cost of benefit giveaways – £9.3 billion – forecast by the OBR. That is because the increase to LHA rates increases entitlements for pensioners. We have approximated how much of the cost of giveaways is due to more pensioners receiving housing benefit (HB) using pre-crisis data on the share of private HB spending that goes to pensioners.

even without these giveaways, the sharp increase in the number of families receiving working-age benefits, and increased entitlements among existing claimants whose earnings fell, would have pushed up spending by around £25 billion. Consequently, working-age benefits expenditure is now forecast to be 2% of national income higher than it was in 2019–20 and easily the highest it has been since records began in 1978–79, both in cash terms and as a share of national income. These figures are of course only forecasts, and the available data on benefit expenditure thus far has come in below the OBR's expectation (though still substantially above 2019–20).[5] But even under the OBR's more optimistic 'upside' scenario, the hit to the labour market as a result of the crisis adds £17 billion to benefit spending, which, together with the policy measures, again would take spending to record highs.

Characteristics of UC recipients

We now investigate how this influx of new working-age benefit claimants has changed the characteristics of recipients of UC. It is worth noting that this is not the same as the change in the characteristics of recipients of means-tested benefits: some claimants will have moved to UC from pre-UC 'legacy' benefits as a result of the crisis.[6]

Table 8.1 shows the number (and share) of families claiming UC prior to the onset of and during the COVID-19 pandemic (February and May 2020, respectively). Since the onset of the pandemic, there has been growth in the number of UC recipients among all family types and in all regions of Great Britain. Because growth has been relatively greater among some groups, the composition of families claiming UC has shifted. In particular, the share of UC recipients who are lone parents has fallen and the share who are childless singles has increased. Geographically, the rise in UC claimants has been disproportionately among those in the South of England.

Table 8.2 shows the number (and share) of individuals who receive UC by various individual characteristics. The composition of UC claimants has shifted towards

[5] https://obr.uk/docs/September-2020-PSF-Commentary.pdf.

[6] When a legacy benefit claimant has a change in circumstances, such as a job loss, they are moved onto UC. We focus on universal credit recipients rather than all working-age benefit recipients because data limitations prevent us from showing a consistent series of legacy benefit and UC recipients.

men, with both sexes now making up about half of UC recipients. In May, about two-thirds of UC claimants were out of paid work – the same share as prior to the crisis. This suggests that the sharp rise in claims was caused in part by falls in earnings, not just job losses. The age composition of UC claimants has also not changed much over the crisis.

Table 8.1. Families claiming UC by family type and region (Great Britain only)

	Number of families on UC (thousands)			Share of families on UC		
	Feb. 2020	May 2020	Change	Feb. 2020	May 2020	Change (ppts)
Family type						
Single, no children	1,318	2,339	+1,020	51%	55%	+4.0
Single, children	859	1,035	+177	33%	24%	–8.9
Couple, no children	93	276	+182	4%	7%	+2.9
Couple, children	305	590	+286	12%	14%	+2.1
Region						
Central England and Wales	648	1,034	+386	25%	24%	–0.8
North of England	748	1,147	+399	29%	27%	–2.0
Scotland	230	363	+133	9%	9%	–0.4
South of England	948	1,695	+748	37%	40%	+3.2
Total number of families						
	2,575	4,240	+1,665	100%	100%	0

Source: Stat-Xplore, ‘Households on Universal Credit’.

Table 8.2. Individuals claiming UC by age, employment status and sex (Great Britain only)

	Number of individuals on UC (thousands)			Share of UC claimants		
	Feb. 2020	May 2020	Change	Feb. 2020	May 2020	Change (ppts)
Sex						
Female	1,644	2,668	+1,024	56%	51%	–5.7
Male	1,271	2,591	+1,320	44%	49%	+5.7
Employment status						
Not in employment	1,906	3,433	+1,526	65%	65%	–0.1
In employment	1,009	1,827	+818	35%	35%	+0.1
Age						
16–24	475	852	+377	16%	16%	–0.1
25–49	1,855	3,342	+1,487	64%	64%	–0.1
50+	585	1,066	+481	20%	20%	+0.2
Total number of individuals						
	2,916	5,260	+2,344	100%	100%	0

Note: Numbers may not add up due to missing information on characteristics.

Source: Stat-Xplore, 'People on Universal Credit'.

As discussed above, some new UC claimants are likely to have been claiming the 'legacy' benefits that UC replaces prior to the crisis, but then had a change in circumstances (such as a job loss) that meant they were moved onto UC. This means that the change in the composition of UC claimants specifically (which we show in Table 8.2) may differ from the change in the composition of people claiming any means-tested working-age benefit. Edmiston et al. (2020) analyse the

latter using a specialist survey.[7] They find that, relative to the existing stock of working-age benefit claimants, new claimants during the crisis are younger and more likely to be male, to come from minority ethnic backgrounds, to have had a higher-skilled occupation, to be university graduates, and to own their own home; they are less likely to be disabled. In some cases, these differences are quite large: for example, whereas only 15% of existing claimants had worked in a high-skilled occupation, among new claimants that figure rose to 26%.

Policymakers should keep these changes in mind for at least three reasons. First, as the labour market recovers, the characteristics of the stock of benefit claimants have implications for the speed at which claimants can get back into paid work or increase their earnings, and thus the speed at which the benefit caseload returns to something more like its pre-crisis level. Second, and closely related to the first, it will affect the type and amount of employment support that claimants should be provided with to help them move into paid work and off working-age benefits. Third, some of these characteristics are predictive of higher or lower lifetime incomes (see Brewer and Gardiner (2020)). This changes the distributional effects of benefit increases or decreases analysed on a lifetime basis.

8.3 Increasing the standard allowance of universal credit

We now turn to discussing the temporary benefit giveaways and the options the government faces. We make two key assumptions for the rest of the analysis in this chapter. First, we assume that UC has been fully rolled out (under current plans, it is only expected to be fully rolled out by September 2024, though the recent increase in claims could bring that forward as more have been brought onto UC sooner). Second, we assume that, in the long run, the labour market will look similar to its pre-crisis state in terms of the distribution of earnings across different types of individuals. Clearly, this assumption will not be perfect: economic activity has changed a lot since the onset of the pandemic, which will in turn change the

[7] The authors categorise ‘existing’ claimants as those who were claiming employment and support allowance, jobseeker’s allowance, UC or tax credits prior to the crisis. Claimants to the other two legacy benefits (housing benefit and income support) who begin a claim to a new benefit following the onset of the crisis will therefore be classified as a ‘new’ rather than existing claimant. However, claiming housing benefit or income support on its own is relatively unusual for working-age claimants, so this is unlikely to have had a material effect on results.

cost and impact of policies as well as the demographics of the households and individuals they affect. In both cases, we make these choices because our analysis is focused on the long-run impact of policy options, once the immediate effects of the pandemic have receded.

In March 2020, in reaction to the weak labour market following the onset of the COVID-19 pandemic, the government announced a temporary £1,000 per year increase to the standard allowance of UC (see Box 8.2 for information on the structure of UC), costing an estimated £5.5 billion in 2020–21.[8] Because it is a flat cash amount, it is more generous in proportional terms for groups with a lower standard allowance: this translates into a 17% increase in the standard allowance for couples and a 27% rise for singles aged at least 25.[9]

Box 8.2. The structure of the universal credit system

A claimant's UC entitlement is determined in three steps.[a]

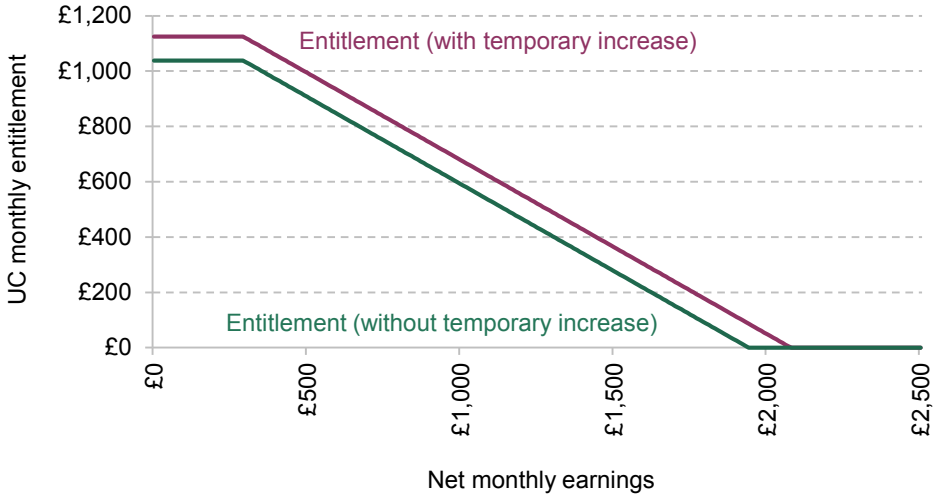
- First, their maximum entitlement – the amount they would get if they had no other income or savings – is calculated. This is the sum of a 'standard allowance' and additional allowances for children, rent, disabilities and childcare.
- Second, they are assigned a 'work allowance' – the amount they can earn before their UC starts to be withdrawn. This is higher for owner-occupiers than for renters, and is zero for all claimants without children and without a disability.
- Third, their final award is calculated by reducing their maximum entitlement by 63p for every pound of (after-tax) earnings above the work allowance.

This process is illustrated in Figure 8.2, which shows how entitlements vary with earnings for an example household (a single parent with one child, no disability and rent of £100 per week), with and without the temporary increase to the standard allowance in UC. With the temporary increase, their maximum allowance is £1,124 per month (made up of a standard allowance of £410, a child element of £281 and a housing element of £433). That is how much they would receive out of work. Their work allowance is £292 per month, and after-

[8] Office for Budget Responsibility, 2020b. Note the related increase in working tax credit (WTC) was costed at an additional £1.5 billion.

[9] The government also increased the WTC basic element by the same amount; however, we do not cover this here, given tax credits are in the process of being replaced by UC.

Figure 8.2. UC entitlement by earnings for an example household



Note: The example household is a single parent with one child, no disability and rent of £100 per week.

tax earnings above this level reduce their entitlement by 63p in the pound until the entitlement hits zero (when their after-tax monthly earnings exceed £2,070).

[a] We exclude some additional steps that affect a small number of claimants, including deductions for unearned income, savings, and the application of the benefit cap or minimum income floor.

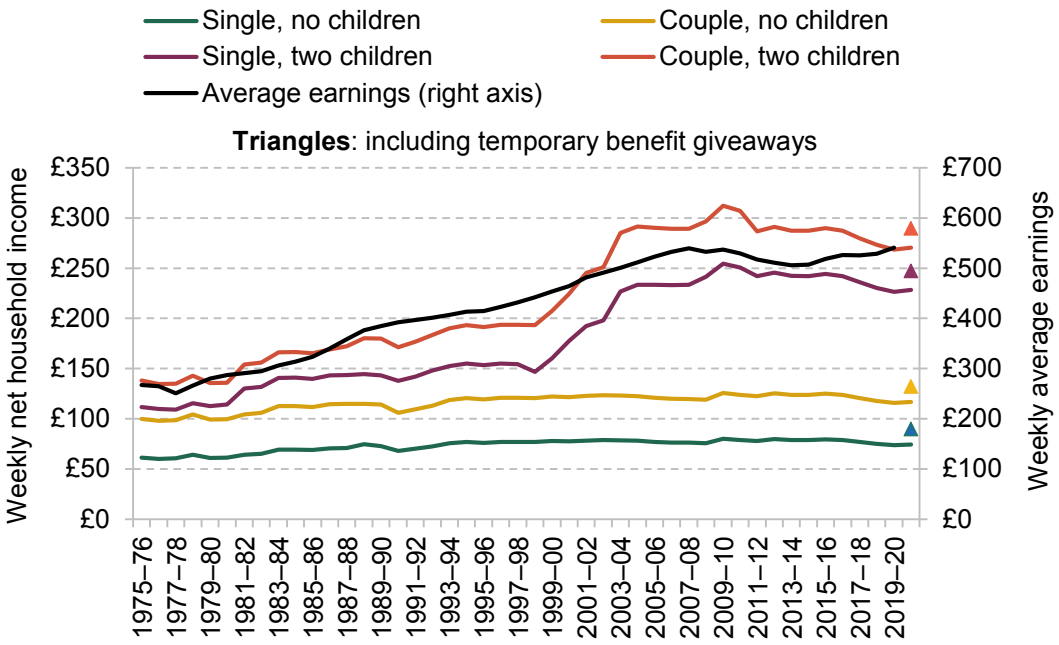
Increasing the standard allowance of UC benefits both in-work and out-of-work families.[10] However, it has a smaller proportional impact on the incomes of families in work who receive UC because they will have other sources of income.

Changes in the UK benefit system

In this subsection, we put this reform in the context of the out-of-work benefit system in the UK over time. We use TAXBEN, the IFS tax and benefit microsimulation model, to simulate incomes for different types of households over

[10] Note that the government did not increase rates of legacy employment and support allowance (ESA) and jobseeker's allowance (JSA) or 'new-style' contributory-based ESA and JSA. The rationale behind this may be a combination of feasibility and, for the non-contributory legacy benefits, a desire to benefit those who directly saw a change in circumstances due to the pandemic (who would have been moved off legacy benefits because of the change). However, of course, even those already on out-of-work benefits will likely have a harder time finding paid work than they did before the crisis.

Figure 8.3. Net household income over time for out-of-work families, by family type (July 2020 prices)



Note: Entitlements for out-of-work, owner-occupier households with no other source of income who do not have a disabled family member. For families with children, the first child is aged 4 and the second 0. Figures in July 2020 prices, deflated using CPIH.

Source: Authors' calculations using TAXBEN and ONS average weekly earnings.

time (Waters, 2017). Figure 8.3 shows net household income (in July 2020 prices) for out-of-work families who own their own home under each tax and benefit system since 1975–76.[11]

While families with children have always received higher benefits than those without, the gap increased significantly in the late 1990s and early 2000s with the introduction and expansion of child tax credits. In 2020–21, before the temporary measures, a single person with two children would receive around three times as much as a single person without children (£228 per week, compared with £74).

The expansion of benefits for out-of-work families with children contrasts starkly with the treatment of childless households. Prior to the pandemic, out-of-work

[11] Renting families would have higher before-housing-costs income, as they are typically eligible for housing benefits. However, so long as all of their rent is covered by housing benefits, their after-housing-costs incomes would be the same as those shown here.

benefits for the latter group had been essentially unchanged in real terms for 25 years, and not grown much in the two decades prior to that. In fact, for childless families, the temporary £20 per week increase in benefits (denoted by the triangles) is larger than the change in out-of-work benefits over the entirety of the past 45 years. Over that period, single and coupled childless families saw their out-of-work support rise by a total of £12 and £16 per week respectively (in July 2020 prices). Average incomes have risen significantly since 1975, so out-of-work benefits for childless households have looked ever less generous relative to average income. For example, out-of-work incomes for a single childless person made up 23% of overall average weekly earnings in 1975 and just 14% in 2019.

International comparisons of out-of-work benefits

How does the level of out-of-work benefits in the UK compare internationally? One way to measure this is with replacement rates – what a family's income would be if one earner moved out of work, expressed as a fraction of its in-work income. Table 8.3 shows replacement rates, excluding housing benefits, for example families with one worker on average earnings in 2018 (so pre-dating the onset of the COVID-19 crisis and related temporary benefit measures; were the UK to make the £1,000 increase in UC permanent, replacement rates would be 3–4 percentage points higher).[12] In the UK, out-of-work incomes are largely unrelated to how much a worker previously earned (and how much they 'paid in' to the system, via payroll taxes (National Insurance contributions)): a family with no income or savings gets the same benefits regardless of their work history. This is relatively unusual internationally; in most countries, there is a much stronger 'contributory' element, which means that workers with stronger work histories and higher earnings are entitled to higher benefits when they lose their job. This means that comparisons of the generosity of the UK's out-of-work benefit system with those in other countries will depend on the earnings of the worker in question.

In Table 8.3, we therefore show the replacement rates of the UK's out-of-work benefit system against the OECD average for a worker with and without access to contributory benefits. Replacement rates in the UK are, for all family types, below

[12] These results are for families with one worker paid average earnings. Replacement rates in the UK and across the OECD are higher for workers with lower earnings, but the qualitative and quantitative differences are similar.

Table 8.3. Replacement rates for different family types for workers on average earnings, 2018

	UK	OECD average	
		Without contributory benefits	With contributory benefits
Single, no children	0.13	0.20	0.55
Single, two children	0.35	0.40	0.66
Couple, no children	0.20	0.31	0.57
Couple, two children	0.41	0.47	0.66

Note: Based on a family with one worker paid average earnings. 'With contributory benefits' shows what replacement rates would be for a worker receiving unemployment benefit who is aged 40 and has worked uninterrupted since age 19. All figures relate to the second month of unemployment. Ignores housing benefits. Children are 4 and 6 years old. The OECD average is measured across 36 OECD countries (Turkey is excluded because of lack of data availability). The replacement rate measures out-of-work income as a share of in-work income.

Source: Authors' calculations using OECD.Stat.

the OECD average for workers without contributory benefits – and they are well below those for workers with them. In fact, for families without children who have access to contributory benefits, the UK's replacement rates are the lowest in the OECD. As mentioned briefly in the introduction, the lack of contributory benefits in the UK has become more salient in the coronavirus pandemic, as a large number of workers have become exposed to substantial losses in income – something which has partly been addressed by the CJRS and SEISS.

Making permanent the increase in the standard allowance

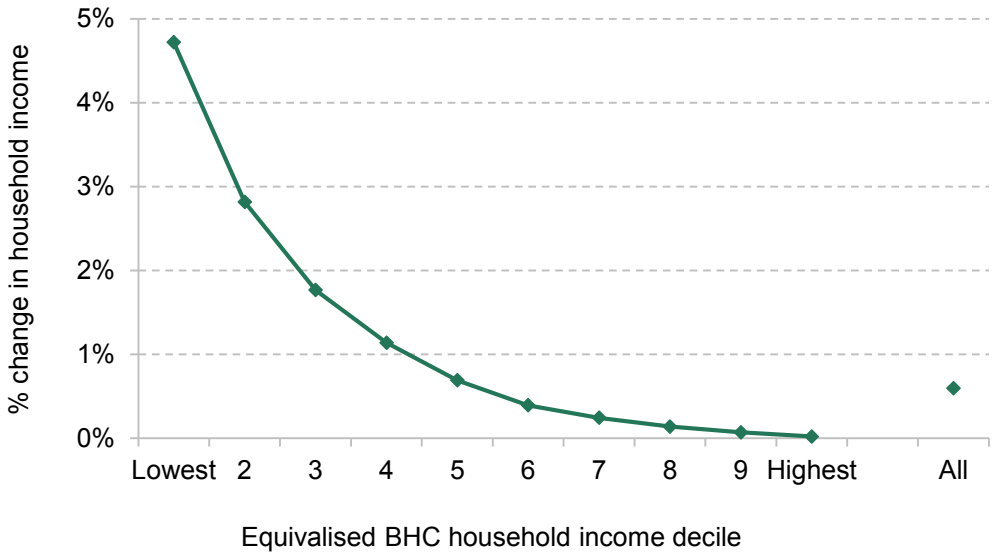
Given these historical and international comparisons, a government might wish to increase the support available for out-of-work families in the UK. One way to do that is to make the temporary increase in the standard allowance of UC permanent.[13] When UC is fully rolled out, this would cost the government

[13] As proposed by the House of Lords Economic Affairs Committee (2020).

£6.6 billion per year (in today's prices). In the short run, this reform would also mean that those on UC would have higher entitlements than those on out-of-work legacy benefits. The government could, of course, increase the rates of legacy benefits as well as UC and, in any case, many legacy benefit recipients in this situation might choose to move across to UC.

Figure 8.4 shows the effect of increasing the standard allowance by £1,000 per year on household incomes, by household income decile.[14] Not surprisingly, the policy is clearly progressive: on average, it increases the income of the poorest 10% of households by 5%, with a fairly rapidly declining impact on each decile above that.

Figure 8.4. Impact of temporary increase in the standard allowance of UC, by household income decile



Note: Sample is households in the UK. All incomes have been equivalised and are measured before housing costs have been deducted. Households are put into household income deciles based on their pre-UC increase equivalised before-housing-costs (BHC) net household income.

Source: Authors' calculations using the Family Resources Survey 2018–19 and TAXBEN.

[14] To show the impact of the temporary increase in the standard allowance of UC on household income, we use the Family Resources Survey (FRS) and TAXBEN. The FRS is an annual survey of around 20,000 households with detailed information on incomes. The latest data cover the financial year 2018–19.

However, increasing the standard allowance also weakens work incentives, as it means that out-of-work incomes become larger relative to in-work incomes. Work incentives are weakened the least for richest individuals, both because the £1,000 increase makes up a smaller share of their in-work income and because other income sources mean that the family might not be entitled to UC even if one worker stopped working. The weakening of work incentives is the greatest for those in low- to middle-income families, while the impact on the work incentives of the poorest families is smaller; these families are more likely to be on UC whether or not they work, and so gain from the standard allowance increase either way.

If the government were minded to make the system more generous in a permanent way then, rather than maintaining the higher allowances, it could instead increase work allowances (the level of earnings at which UC starts to be withdrawn) or cut the UC taper rate (the speed at which UC is withdrawn as earnings rise). This would increase incomes among low-income working families, and improve incentives to have at least one member of the household in work – something that the government might find appealing during the recovery period. However, it would not benefit those out of work: they would still experience the £20 a week drop between March and April 2021, when the temporary boost to allowances expired. For the same cost as the £20 per week increase, the government could instead raise work allowances[15] by roughly £86 per week or reduce the taper rate by 22 percentage points.

Alternatively, the government could continue with the default policy of returning to pre-crisis standard allowances. If part of the rationale for increasing the standard allowances in the pandemic was that the weak labour market meant higher benefits had a more limited effect on work incentives, then accordingly as the labour market recovers that rationale recedes. (An intermediate option, of course, is to extend the increase in the standard allowance, say for another year, in the event that come April the labour market still looks weak.)

If the government does return to the pre-crisis UC standard allowance levels, it is important that it communicates this well in advance, as it will result in a significant and sudden drop in households' benefit entitlements. If the number of UC claimants

[15] For those who have a work allowance, i.e. those with children or a disability.

in March 2021 is the same as it was in May 2020, around 4 million families would see an £87 drop in their monthly UC entitlements overnight – equivalent to a 13% fall in entitlement on average.[16] But for some households, the proportional fall will be much greater. For example, a childless, non-disabled, single owner-occupier with no other source of income would see a 21% decline in their total UC entitlement.

8.4 Minimum income floor

As part of its response to the COVID-19 crisis, the government has also temporarily suspended the 'minimum income floor' (MIF), meaning that low-income self-employed workers are now entitled to higher levels of support through UC.[17] This change affects around 450,000 households, who on average will benefit by £3,200 per year (at a total cost to government of around £1.4 billion).

The MIF affects some self-employed claimants of UC, who – prior to the crisis – were treated as earning the full-time minimum wage even if they reported earning less (and so were eligible for less support than their reported earnings would suggest). Indeed, the low-income self-employed are one of the clear groups of losers from the UC reform. A fuller description of the MIF can be found in Box 8.3.

The MIF can be interpreted as achieving several possible aims. First, it disincentivises self-employed claimants from (illegally) under-reporting their earnings – which is easier for self-employed workers than employees – in order to get a higher UC award (or lower tax liability). Second, because self-employed claimants are not required to search for additional work, the MIF disincentivises individuals from claiming UC as a self-employed worker with low or zero earnings to avoid job-search requirements.[18] Third, it avoids the government subsidising low-earning or non-viable self-employment. The 'start-up period' element of the MIF is intended to allow people time to build their business.

[16] Authors' calculations using Stat-Xplore.

[17] https://www.understandinguniversalcredit.gov.uk/employment-and-benefits-support/self-employment/.

[18] There is an additional protection against this possibility: work coaches at Jobcentres must decide whether they think that a claimant is 'gainfully self-employed'. If not, then job-search requirements can be applied (and the MIF not applied).

Box 8.3. The minimum income floor

Unlike legacy benefits, UC includes a 'minimum income floor' for the self-employed, which reduces the entitlement to UC for self-employed workers who report low earnings. If a self-employed claimant's earnings are below the MIF, the government calculates their UC award as if their earnings were in fact equal to the MIF.

The MIF is specified as the minimum wage that applies to the claimant[a] multiplied by the number of hours that they are expected to look for and be available for paid work,[b] net of any income tax and National Insurance contributions that would be payable on earnings of that level. In other words, a self-employed worker cannot receive more UC than an otherwise-identical minimum-wage employee working the number of hours deemed appropriate by their Jobcentre Plus work coach (for most, 35 per week).

The MIF is applied on earnings (from employment and self-employment) each month and does not apply during the first year of a UC claim, provided an individual set up their business within the 12 months before the claim (the so-called 'start-up period' or 'grace period').[c] For couples, total family earnings from self-employment and employee jobs are compared with a combined minimum income floor. Broadly, the MIF is then applied to each individual's earnings if both their individual earnings are below the individual MIF *and* the combined household earnings are below the combined MIF.

[a] This is the National Minimum Wage for those aged under 25 and the National Living Wage for those aged 25 and over.
[b] For most, this is 35 hours per week. For lone parents with children aged 3–13, it is 25 hours per week. For others, including lone parents with a child under 3, individuals with limited capability for work or work-related activity and those with certain other caring responsibilities, no MIF is applied.
[c] Note that claimants can only have the 'start-up period' applied again if they have started new self-employed work and at least five years have passed since the beginning of their last start-up period.

Two aspects of the MIF may attract the eye of a reforming government. First, the MIF is applied on a monthly basis – that is, a claimant's earnings are calculated each month and if they are below the MIF, the MIF is applied. However, the income of self-employed workers is often highly volatile, due to seasonality or infrequent, large payments. Applying the MIF each month means that a self-employed worker with volatile earnings is left worse off than one with the same annual income whose earnings are steady: during the lean months, the worker with volatile earnings is subject to the MIF and so sees their UC reduced. But during their higher-earning months, the worker's higher earnings will mean they are

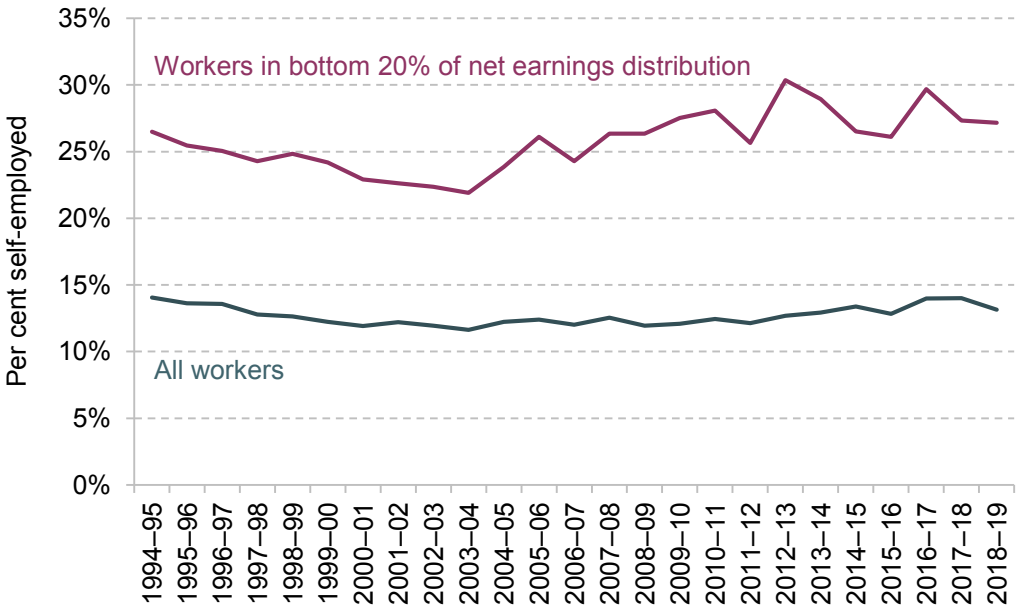
eligible for smaller UC payments (or even none at all), with no consideration of that earlier loss.

Second, it is an open question whether the 'start-up period' of one year is a sufficient amount of time for a claimant to build a new business. If it is not long enough, the MIF may actually harm potentially viable new start-ups. Certainly the 'right' time period is likely to depend on the type of business the individual is starting up.

The earnings of the self-employed

In March 2020, the government announced a temporary suspension of the MIF, set to last until 13 November 2020. In this subsection, we analyse trends in self-employment, the distribution of self-employment earnings and their persistence, and the effect of the MIF on household incomes. With those results in mind, we discuss policy options that the government could consider when the temporary suspension ends.

Figure 8.5. Proportion of individuals aged 25–59 in work that are self-employed



Note: Sample is individuals aged 25–59 in Great Britain. We define 'self-employed' workers as individuals who receive more than 50% of their earnings from self-employment.

Source: Authors' calculations using the Family Resources Survey 1994–95 to 2018–19.

We begin by examining trends in self-employment over the past 25 years. Figure 8.5 shows the proportion of workers that are self-employed, both overall and for workers in the bottom fifth of the net earnings distribution. Self-employment (as a proportion of those in work) has risen in the UK over the last two decades, having declined over the late 1990s. This rise has been seen both overall and among lower-earning workers. Research has shown that the recent increase in self-employment has been driven by the 'solo self-employed' – sole traders who operate without employees – and an increase in the number of older and younger people becoming self-employed (Cribb and Xu, 2020).

Cribb and Xu (2020) show that, although on average they earn less, the earnings of the self-employed have a much wider distribution than those of employees, with large numbers at the bottom and top of the overall earnings distribution. Adam, Miller and Waters (2020) find that self-employed workers are also more likely to be in low- and high-income families than employees.

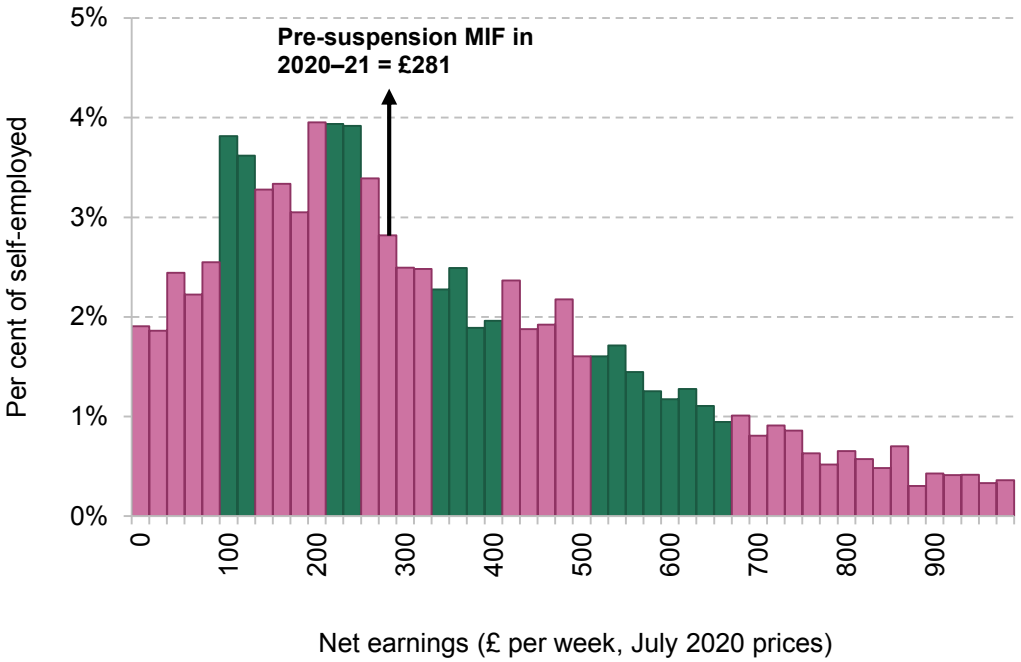
Figure 8.6 shows the distribution of net earnings from employment and self-employment for the self-employed.[19] The alternate green and pink coloured bars mark the deciles of net earnings, with the top decile omitted to aid readability.

Without the temporary suspension of the MIF in 2020–21, the MIF would have been £281 per week for men aged 25–64 and women aged 25–59 who were expected to work 35 hours a week. We find that – prior to the pandemic – over two-

[19] This distribution is derived from survey data. It is well known that self-employment earnings are not well captured by surveys. This is partly because self-employment earnings are more variable than employee earnings and snapshots of individuals' earnings may give a false impression of earnings of the self-employed. The Family Resources Survey (FRS) partly accounts for this by asking for average monthly (or weekly) earnings from self-employment over the last 12 months rather than relying on last period's earnings. We compare this distribution with that found in the Survey of Personal Incomes (SPI) – a sample of all income tax records, which is made available by HM Revenue and Customs (HMRC) and has detailed information on individual taxable incomes – to check the employment income distribution of the self-employed. These distributions might differ because of misreporting in surveys, because of under-reporting to tax authorities or because those who only worked part of the financial year will appear to have lower earnings in the SPI (which simply reports total earnings over the year). We find that the employment income distribution in the SPI is fairly similar up to about £1,000 per week, though with more on low earnings in the SPI. The fraction of workers with earnings above that differs between survey and administrative tax data, but this part of the distribution is not relevant for our application. We show the two distributions in Figure 8A.1 in the online appendix.

fifths (43%) of the self-employed, and two-thirds (64%) of the self-employed who receive means-tested benefits, earn below the MIF.[20]

Figure 8.6. Distribution of net earnings amongst self-employed, aged 25–59



Note: Net earnings is weekly employee earnings and average (over past 12 months) of weekly self-employment earnings. We exclude self-employed individuals who are not expected to be available for or look for work for 35 hours per week and therefore are affected by the MIF to a lesser extent if at all. Earnings are uprated to July 2020 using the average earnings index. The MIF is calculated by multiplying the National Living Wage in 2020–21 by 35 and subtracting income tax and National Insurance contributions payable on actual earnings at that level. We therefore ignore the more complex rules that apply to calculating the MIF for couples. We exclude individuals with negative or zero earnings. We exclude the top decile.

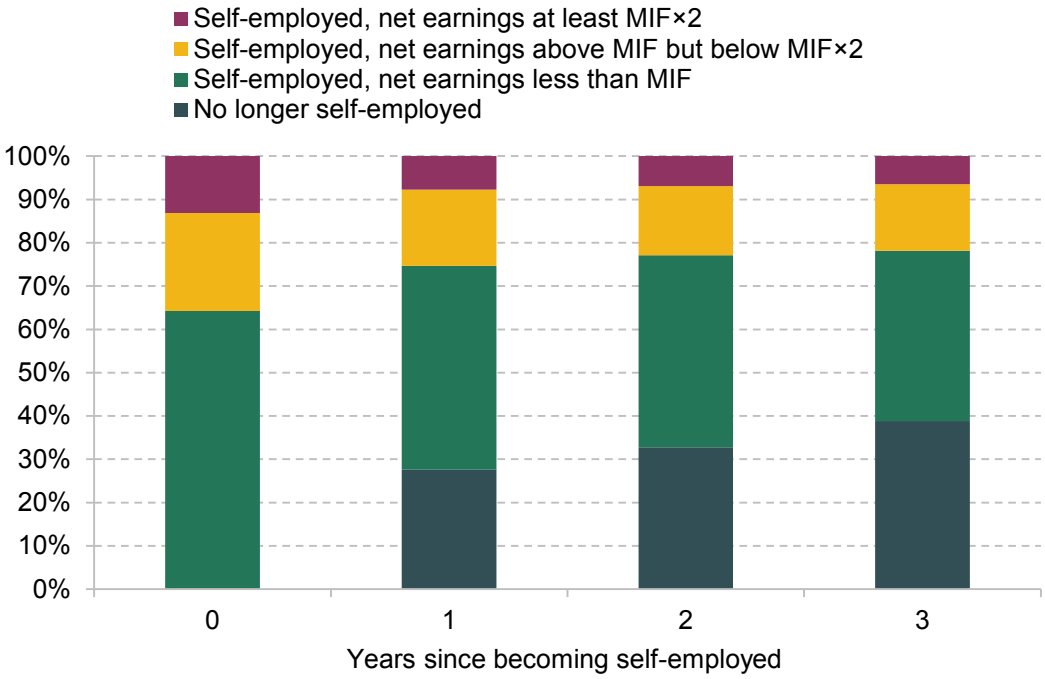
Source: Authors' calculations using the Family Resources Survey and Households Below Average Incomes (HBAI) 2010–11 to 2018–19.

[20] This is the individual MIF. It is possible for self-employed workers earning below the MIF to nonetheless not have the MIF applied if they are in a couple with a working partner (see Box 8.3). Furthermore, we use average weekly or monthly income to determine whether an individual earns above or below the MIF, when in reality actual monthly income is used to determine this. This means we may be slightly over- or under-estimating the number of self-employed earning below the MIF as we cannot account for volatility in income.

These are clearly high fractions. It is therefore important to know whether these workers have low earnings because they are newly self-employed and building their business – and thus not subject to the MIF because they are in the start-up period – or whether this is a more permanent situation.

We therefore now turn to look at a self-employed worker's earnings over time. Figure 8.7 shows the earnings, over a four-year period, of the self-employed who

Figure 8.7. Self-employment status and net earnings among individuals receiving means-tested benefits in their first year of self-employment



Note: Sample is individuals who move into self-employment at time *t*, who are receiving means-tested benefits at time *t*. We exclude self-employed individuals who are exempt from the MIF and focus on individuals aged 25–59 for females and 25–64 for males. While most of our data pre-date the MIF, we construct a notional 'MIF level' for each worker. To do this, we downrate the National Living Wage for each relevant year with average earnings growth (to strip out the effects of successive increases in the minimum wage), multiply it by the number of hours individuals are required to work, and apply the relevant tax and National Insurance system to get the net MIF. We then compare nominal earnings (employee and self-employment earnings) with the net MIF. In doing so, we ignore the more complex rules used to calculate the relevant MIF for couples.

Source: Authors' calculations using Understanding Society (UKHLS) waves 1–9 (2009 to 2018).

were receiving means-tested benefits in their first year of self-employment.[21] This can be thought of as the trajectory of self-employed workers who might be subject to the MIF.

In the first year of self-employment, 64% of individuals earned below the MIF, 23% earned between the MIF and twice the MIF, and 13% earned at least twice the MIF. In the second year after having entered self-employment, around 28% of these workers are no longer self-employed; two years after this, 39% of the original group are not still self-employed. This is consistent with previous research finding high rates of exit from self-employment (Cribb, Miller and Pope, 2019). Importantly, the group that exits self-employment will likely include both some workers who are not successful (and so choose to give up on their business and return to employment) and workers who are sufficiently successful that they choose to incorporate in order to enjoy the tax advantages of being a company owner-manager.[22]

Taking just those individuals who remain self-employed throughout the four-year period, Figure 8.7 shows that in all four years, two-thirds earn below the MIF, with the proportion in each of the other groups also remaining stable over time. This is a striking finding: it suggests that self-employed workers on means-tested benefits who begin with low earnings do not, on average, go on to build their business into a considerably higher-earning endeavour. (It is worth noting that the benefits that new self-employed workers claim in our data are almost entirely the pre-UC, 'legacy' benefits, which did not include a MIF, and so these patterns are not *caused* by the MIF.)

[21] Here we use the UK Household Longitudinal Study (UKHLS; also known as Understanding Society, or USoc), which is a household survey that follows the same individuals each year (between 2009 and 2018) and contains detailed information on individual and household characteristics and incomes.

[22] In general, USoc classifies owner-managers as employees. However, it is possible that individuals who perceive themselves as being self-employed, but are in fact legally owner-managers and therefore employees of their own business, are classified as being self-employed and thus are in our sample. It is also possible that some of the self-employed who exit self-employment in reality have incorporated and therefore are no longer self-employed. Unfortunately, we are not able to identify these people adequately.

Options for the MIF beyond 2020–21

Current government policy is to suspend the MIF until 13 November 2020. We now turn to discussing the implications of the results presented thus far for alternative options that the government could pursue.

First, the government could simply make the temporary suspension of the MIF permanent. This would largely benefit the poorest households (and would benefit them quite a lot), at an annual cost to the exchequer of roughly £1.4 billion. Households affected by the MIF have on average a 27% lower income than employee households on UC, and would see their average income rise by 25%.

However, as discussed at the beginning of this section, the MIF does have sensible aims, particularly disincentivising fraud. Getting rid of the MIF permanently would also have some downsides for both efficiency and equity. It would amount to subsidising low-earning self-employed workers whose businesses do not grow. It would arguably also be unfair: currently, employees earning less than their full-time minimum wage are not subject to a MIF, but are (at least outside of the COVID-19 lockdown) subject to in-work conditionality (i.e. they need to show that they are looking for higher-paid work or more hours of work to continue to claim benefits). Abolishing the MIF, at least without instituting in-work conditionality for the self-employed, would mean that employees would be unfavourably treated relative to otherwise-similar self-employed workers. This would inappropriately encourage lower-earning employees receiving UC to instead engage in low-income self-employment.

As a second option, the Chancellor could instead choose to retain the MIF but to extend the start-up grace period.[23] This would cause the MIF to affect fewer claimants (a one-year extension would reduce the number of affected households from 450,000 to 400,000) and would mainly boost the incomes of low-income households. It would also give more time for self-employed workers to build their business. However, Figure 8.7 indicates that self-employed workers on means-tested benefits do not, on average, see their earnings from self-employment rise over time. This suggests that having a start-up period of only one year does not typically choke off what would turn out to be high-earning businesses. Instead, changing the length of the start-up period is best thought of as representing a trade-

[23] As proposed by, for example, the Low Incomes Tax Reform Group (2017).

off between boosting the entitlements of (relatively poor) self-employed workers and weakening the MIF's anti-fraud advantages.

Third, the government could of course just reinstate the MIF, as implied by current policy. This would lead to some self-employed claimants receiving a sharp drop in their income from one month to the next. If the government is minded to do this, then it is important this is well communicated in advance to those claimants who are likely to be affected so that they are able to try to boost their income or to move into standard employment. The government could also consider reinstating the MIF gradually rather than putting it back all at once. This would come at a small and time-limited budgetary cost, but would reduce the extent to which individuals whose self-employment earnings (and other circumstances) are not changing see a sizeable drop in their income from one month to the next.

These three options all involve a variant of standard equity–efficiency trade-offs. However, the Chancellor could instead choose this moment to make some structural changes to the MIF and potentially improve its design with a view to mitigating the problems of volatile earnings discussed above.

One obvious option would be simply to treat the self-employed the same as employees, and replace the MIF with in-work conditionality – the requirement for those on low earnings to look for additional work. Like the MIF, this would help combat fraud and avoid the government subsidising non-viable businesses, and in one sense it would make the system for employees and the self-employed more similar. The downside is that, while a low-earning employee is almost certainly working a low number of hours (and therefore may have more hours available to search for additional or higher-paid work), the same is not true for the self-employed. Thus, searching for additional or alternative paid work might be quite difficult without actually working and thus earning less, potentially weakening the business the claimant is trying to build. It could also be difficult for work coaches, who assess adherence to in-work conditionality, to distinguish between a self-employed person who is spending the requisite amount of time searching for additional work (for example, looking for new clients) and a self-employed person who is simply working a lot of hours for low pay without any real prospect of their earnings rising.

A much more appealing option would work as follows:

- Determine whether or not to apply the MIF using a 12-month rolling average of earnings, rather than monthly earnings.
- If a claimant's 12-month rolling average is above the MIF, then calculate monthly entitlements using actual earnings that month.
- If a claimant's 12-month rolling average is below the MIF, then calculate monthly entitlements as if they earned equal to the MIF.
- Maintain a one-year start-up period; then from the start to the end of the second year, steadily increase the MIF level from zero to its full amount.[24]

The purpose of steadily increasing the MIF over the second year is to avoid a situation where, in the thirteenth month of self-employment, the MIF determination is made using earnings over that first year when they had just started their business. Steadily increasing the MIF over the second year ensures that, for a worker who had reached the MIF level by the end of their first year, each month would see a rising MIF applied against a rising level of average earnings from the previous 12 months.

What are the effects of this reform on those with volatile earnings, who sometimes earn above and sometimes below the MIF? Under this scheme, claimants with volatile earnings whose monthly earnings sometimes dip below the current MIF but who, on average, earn above it would not have the rolling MIF applied to them. These workers would receive higher benefit payments in months where their earnings are lower (unlike in the pre-COVID system, where this inverse relationship between earnings and benefits holds only as long as earnings are above the MIF threshold). They would also receive the same annual support as similar employees. In high-earning months, their UC entitlements would be the same as under the current system (since the MIF would not apply in either case). In low-earning months, their UC entitlements would be greater under this scheme (as the MIF would not be applied).

Conversely, claimants with volatile earnings whose average earnings are below the MIF would always have the MIF applied and would receive the same amount each month. In low-earning months, they would receive the same amount as they do under the current application of the MIF; in high-earning months where they earn

[24] As discussed by the Work and Pensions Select Committee (https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/847/84707.htm#_idTextAnchor013).

above the current monthly MIF, they would receive more benefits (since the system would take account of their lower earnings in other months).

The reform would also mean that the MIF would take longer to be applied for those who see a sharp, sustained drop in earnings (as their 12-month average might remain above the MIF for a period). And those who were earning below the MIF who see a sustained rise would continue to receive higher awards for a short while (as their 12-month average might remain below the MIF for a period).

Applying the MIF in this way would come at the cost of making UC more expensive (by an unknown, but likely small, amount), since relative to the pre-COVID system this change only creates winners. In some cases (those with fluctuating incomes that average above the MIF and those seeing a sustained fall), it would make benefit entitlements more responsive to changes in earnings; in other cases (such as those with fluctuating incomes that average below the MIF and those seeing a sustained rise), entitlements would respond more slowly, giving higher entitlements to claimants in high-earning periods.[25]

While the effect on the responsiveness of the system is ambiguous, what is clear is that those with volatile incomes would be treated more similarly to otherwise-identical claimants with stable incomes. This seems to be a desirable feature: it is difficult to see why the government should want to give more support to those with stable incomes.

In the absence of a strong reason for prioritising support to those with stable incomes, a design along these lines would be well worth considering. Such a design could even be made cost-neutral relative to the pre-COVID system by, for example, raising the MIF slightly.

[25] In general, there is a fairly basic trade-off in benefit design: calculating incomes over longer periods allows a better targeting towards those who are persistently poor, but means that the system is more sluggish in responding to sharp changes in incomes. That the effect of this proposal on responsiveness is *ambiguous*, despite using information about incomes over a longer period, is unusual.

8.5 Housing support for private renters

In this section, we discuss the temporary increase in local housing allowance (LHA) rates, which cap the housing benefits available to private renters (see Box 8.4 for a summary of how the system works).

Box 8.4. The system of housing support for private renters in the UK

Low-income private renters can claim housing benefit (HB) or get support for housing as part of their UC claim. Housing benefit covers a household's entire rent, but in most cases it is capped at the 'local housing allowance' rate. LHA rates vary geographically (with the UK split into around 200 'Broad Rental Market Areas', or BRMAs) and with the size and composition of the household (with larger households receiving a higher LHA rate).

From 2008–09 to 2010–11, LHA rates were set at the median of local private rents (excluding properties where the tenant was in receipt of housing benefit).[a] In 2011–12, they were reduced to the 30th percentile, and national caps were introduced which reduced LHA rates in some parts of central London. Since 2013–14, the government has ceased to uprate LHA rates according to changes in local rents, and instead has at different times frozen them, uprated them by 1% per year or uprated them in line with CPI inflation.[b] This has reduced the generosity of housing support (as rents have tended to grow faster than LHA rates), with the greatest reductions experienced in areas with the fastest rent growth.

In March 2020, the government announced an increase in LHA rates, back to the 30th percentile of local private-sector rents (aside from where the national caps bite). It also raised the national caps, setting them at 20% above the highest LHA rate in the outer London BRMAs.[c] The government has not stated its plans for LHA rates beyond March.[d]

Methodology: Prior to the introduction of universal credit, housing support for private renters was provided through a specific benefit – housing benefit. Claimants could receive other benefits (such as tax credits or out-of-work benefits) at the same time. Under UC, however, for most working-age benefit recipients these benefits are all wrapped up into one. In this chapter, we quantify support for housing in UC by taking the difference between a household's actual UC entitlement, and what their UC entitlement would be in the absence of any support for housing (i.e. if all LHA rates were zero). For simplicity, we also refer to this amount as 'housing benefits'.

Notes to Box 8.4

[a] The system prior to 2008 was fairly similar. Maximum HB entitlement was the lower of a claimant's rent and the median of 'reasonable market rents' in the local area, where the 'local area' was defined in a somewhat less precise manner than BRMAs.
[b] In 2014, the government introduced 'targeted affordability funding' (TAF), where a proportion of savings that had accrued from uprating LHA rates by 1% or zero instead of CPI were used to increase rates (by up to 3%) in selected areas that had drifted furthest from local rents. However, LHA increases were capped at 3%, regardless of how far rents had fallen behind.
[c] https://www.legislation.gov.uk/uksi/2020/371.
[d] Though, as noted in footnote 3, the Secretary of State for Work and Pensions has implied that this change may be made permanent.

The temporary increase would have cost the government around £1.1 billion a year based on pre-pandemic caseloads; now, with higher numbers of benefit claimants, the cost will be higher as well. As things stand, it is unclear what the government plans are for LHA rates beyond the coronavirus pandemic.

Trends in private renting and housing benefits

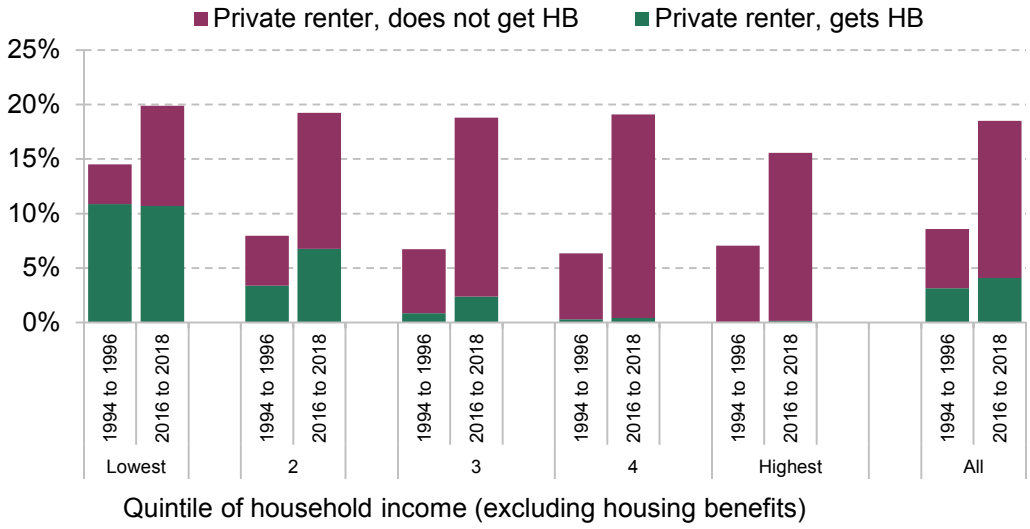
We begin by examining trends in private renting and housing benefits over the past 25 years. Over this period, there have been substantial changes in housing tenure. Figure 8.8 shows the share of households in Great Britain[26] that were private renters in 1994–95 to 1996–97 and 2016–17 to 2018–19 by quintile of household income (excluding housing benefits). It splits this up into households that report receiving and those that do not report receiving HB.

There has been a substantial 10 percentage point (ppt) increase in private renting overall, driven by a decrease in both social renters and owner-occupiers. The rise in private renting has been relatively widespread across the income distribution, though smaller at the bottom (Joyce, Mitchell and Norris Keiller, 2017).

But although the proportion of private renters overall has increased substantially over this period, the proportion of households that are privately renting and receiving housing benefits has remained largely unchanged (up by just 1ppt). This is partly due to the rise in the number of private renters further up the income

[26] We are not able include Northern Ireland in this part of the analysis, as the earlier data do not include it. However, further down, when we investigate the different options for unwinding the temporary increase to HB, we include the whole of the UK.

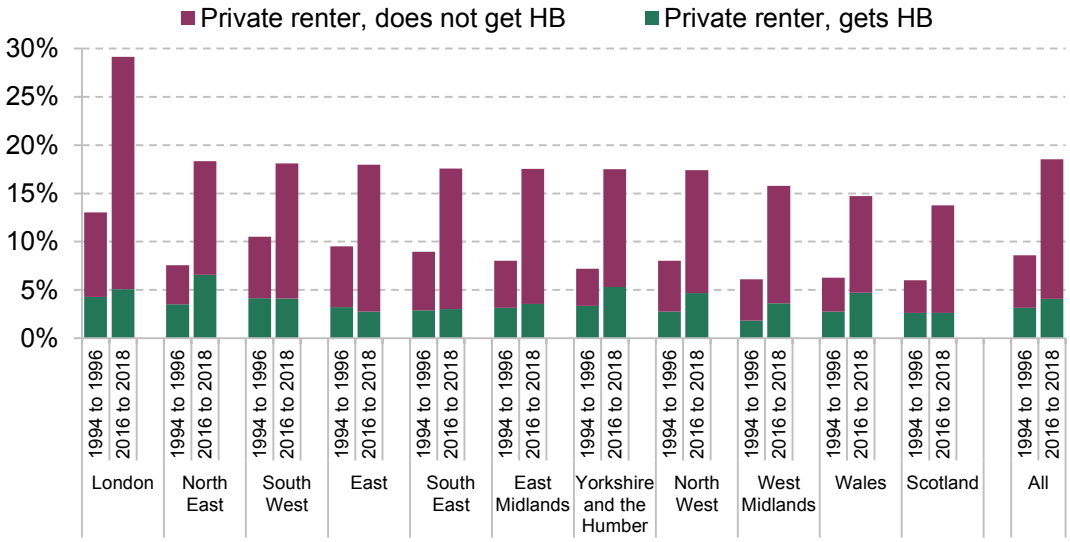
Figure 8.8. Share of households that are private renters with and without HB, by quintile of non-HB income



Note: Great Britain only. All incomes have been equivalised and are measured before housing costs have been deducted.

Source: Authors' calculations using the Family Resources Survey, 1994–95 to 1996–97 and 2016–17 to 2018–19.

Figure 8.9. Share of households that are private renters with and without HB, by region



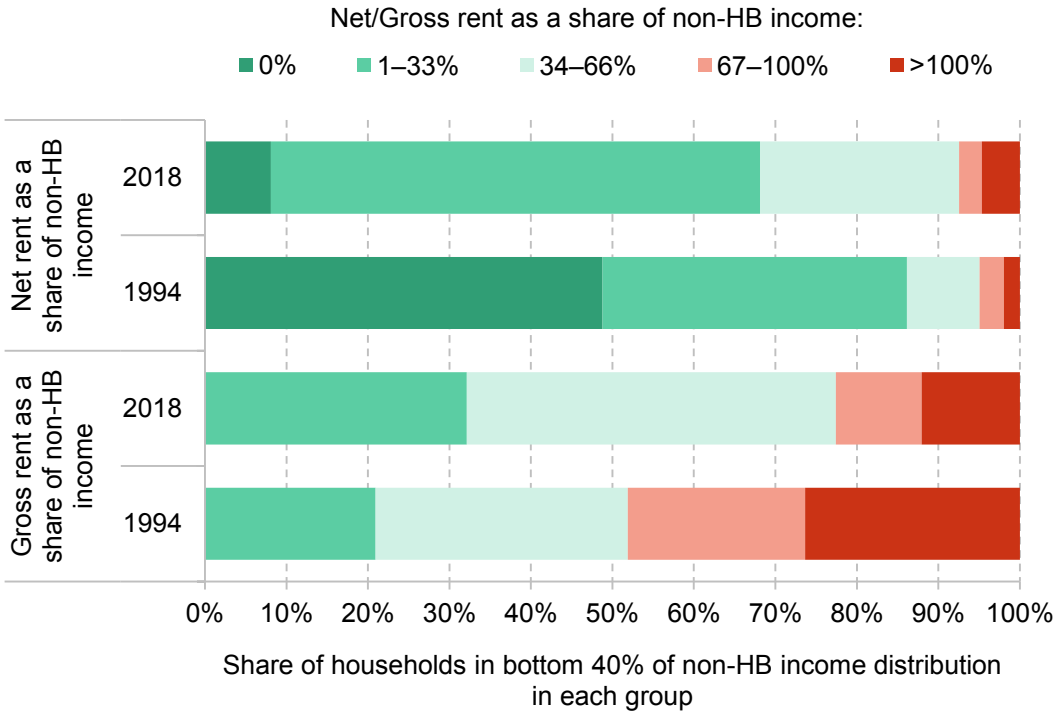
Note: Great Britain only.

Source: Authors' calculations using the Family Resources Survey, 1994–95 to 1996–97 and 2016–17 to 2018–19.

distribution (who rarely receive HB). But even within income quintiles, the share of private renters who receive HB has declined or remained constant. This reflects the fact that the generosity of the housing benefits system has been reduced over time (see Box 8.4).

Figure 8.9 shows that the growth in private renting has also been widespread across regions, although London stands out as having experienced by far the largest increase in private renters. The figure also confirms that, across all regions, the share of households privately renting and receiving housing benefits has changed little in the last 25 years.

Figure 8.10. Net and gross rent as a share of household income (excluding housing benefits) among private renters in bottom 40% of household income distribution



Note: Great Britain only. We exclude households with negative or zero gross rent or non-HB household income. The poorest 40% of households are the poorest in terms of equivalised household income (measured before housing costs have been deducted and excluding housing benefits). Assumes full take-up of housing benefits.

Source: Authors' calculations using the Family Resources Survey, 1994–95 and 2018–19 and TAXBEN.

We now turn to understanding the role that housing benefits play in covering rent, and how that role has changed over time. Figure 8.10 looks at private renters in the bottom 40% of the distribution of household income (as Figure 8.8 shows, this is the group most likely to receive HB). It shows the fraction of their non-HB income that is made up of gross rent (the total rent their landlord is due) and net rent (the amount of rent that they have to pay after deducting HB).

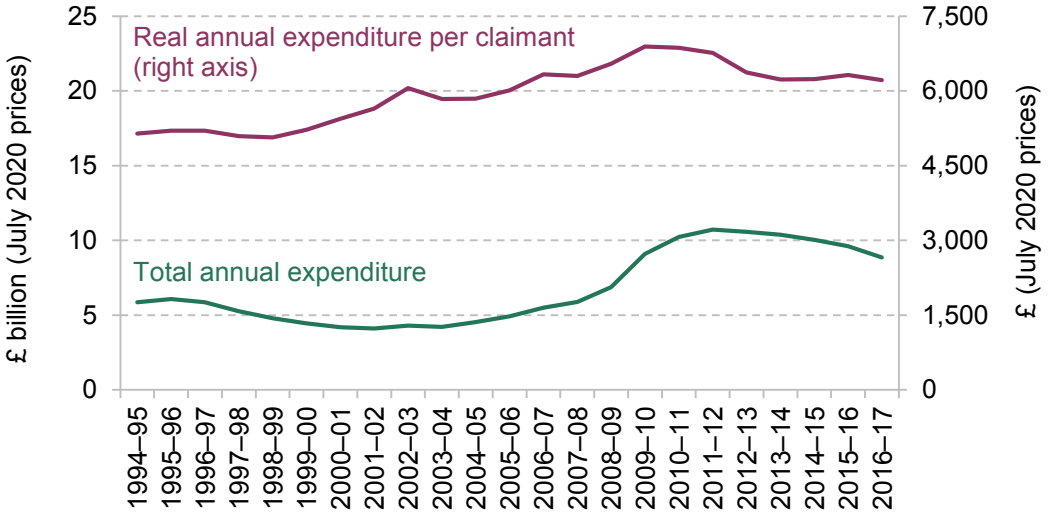
We find that, for poorer privately renting households, *gross* rent has been falling as a share of income. In 1994–95, gross rent made up at least two-thirds of income for around half of these households; by 2018–19, that figure had fallen to a quarter of such households. This implies that their income has grown faster than their gross rent over this period.

Conversely, *net* rent made up a much larger proportion of non-HB income in 2018–19 than it did in 1994–95. For example, in 1994–95, nearly half of poor private renters had a net rent of zero – or, in other words, had their rent fully covered by HB. However, in 2018–19, that share had fallen to just 8%. So while gross rent has been making up a declining share of income for poorer privately renting households, the amount that they actually have to pay themselves has increased markedly. This reflects both the fact that housing benefits have declined relative to income, and also declining worklessness, meaning that more households in the bottom 40% of the income distribution have had their housing benefits (at least partially) means-tested away.

What has the effect of these trends been on HB spending? Figure 8.11 shows real spending on private-rental-sector housing benefits from 1994–95 to 2016–17[27] (in July 2020 prices). Between 1998–99 and 2007–08, expenditure per HB claimant steadily rose as rents increased, but overall spending was roughly constant as the number of claimants declined. In the wake of the Great Recession in 2008–09, total spending increased driven by a rising caseload. Between 2011–12 and 2016–17, a decline in both the number of claimants and per-claimant spending has led to a decline in overall expenditure.

[27] We show spending on housing benefits only up to 2016–17 to avoid complications of the introduction of UC.

Figure 8.11. Real spending on private-rental-sector housing benefits, overall and per claimant



Source: Authors' calculations using DWP Benefit Expenditure and Caseload Tables 2020 (https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2020).

The temporary increase in LHA rates

We now turn to the temporary increase in LHA rates that the government introduced in the wake of the pandemic. As discussed in Box 8.4, in 2013–14 the government disconnected LHA rates from contemporaneous local rents, taking existing LHA rates and variously freezing them, uprating them by 1% or uprating them by CPI inflation from year to year. The consequence is that the set of LHA rates in place before the pandemic were largely based upon rents in the year to September 2011 (which are then used to determine LHA rates in 2012–13).[28]

This point can be seen in Figure 8.12, which compares the 30th percentile of local rents with the LHA rates that would have been in place in 2020–21 had the March 2020 temporary increase not been introduced.[29] If LHA rates were perfectly tied to the 30th percentile of local rents, all of the BRMAs (shown as purple triangles) would be located on the green line. Instead, many BRMAs – particularly those with

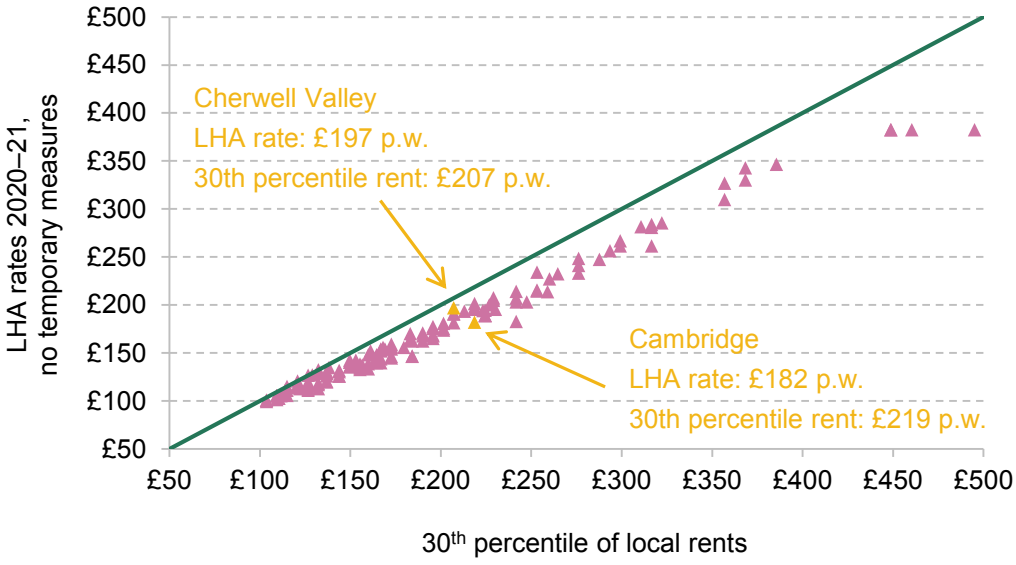
[28] The actual picture is slightly more complicated than this as the government introduced 'targeted affordability funding', which increased LHA rates in some Broad Rental Market Areas with fast rent growth.

[29] We do this for three-bedroom properties. For properties of other sizes, the actual rent and LHA levels will of course differ, but the patterns remain broadly similar.

higher rents – are located below the line, meaning that the LHA cap is below the 30th percentile of rents. In some cases, this has led to inequities between regions: for example, although the 30th percentile of rent in Cambridge is 6% higher than that of Cherwell Valley, its LHA rate (before the temporary HB increase) was around 8% *lower* than that of Cherwell Valley. This is because rent growth since 2011 has been higher in Cambridge than in Cherwell Valley. The effect of the national cap can also clearly be seen on the right of the figure, where the BRMAs whose LHA rates have been capped lie (these include most of Inner London's BRMAs).

There are several options that the government could consider for LHA rates beyond the coronavirus pandemic. It could **return to pre-crisis LHA rates (uprated with CPI for 2021–22 and onwards) and LHA caps**. This option would imply a return to basing LHA rates on the distribution of rents in 2011.

Figure 8.12. LHA rates for three-bedroom properties 2020–21 without temporary measures versus 30th percentile of rents



Note: LHA rates and local rents are given in £ per week (2020–21 prices). Each data point represents a Broad Rental Market Area. England only.

Source: 30th percentile of local rents, https://www.gov.uk/government/publications/local-housing-allowance-lha-rates-applicable-from-april-2020-to-march-2021. Rates before temporary measures downloaded from the same address in March 2020.

Against this, we consider two alternative policies:

- **Making the temporary giveaway permanent:** Keep the LHA rates indexed to the 30th percentile of local rents and apply the higher national caps. This would cost the government £1.1 billion a year more than returning to pre-crisis LHA rates (with this amount increasing in line with rents thereafter).
- **Linking LHA rates to the 20th percentile of local rents:** This is equivalent to a roughly 9% cut to the 30th percentile LHA rates.[30] Relative to returning to pre-crisis plans, this reform would be broadly cost-neutral in the short run (though costs would grow in the longer term if rents continue to rise in real terms).[31] Like making the current giveaway permanent, this policy would also preserve the link between LHAs and contemporaneous local rents going forward, but within a system that is less generous overall than the current giveaway.

The advantage of the two alternative policies is that they both ensure that housing benefit entitlements are linked to current rents in the local area, as opposed to rents in 2011. The second alternative policy does this without any immediate additional cost. However, it is worth noting that if rents rise in real terms, indexing LHA rates to rents rather than the CPI would cost more in the long run (though, in the very long run, allowing support for housing costs to continue to fall relative to the average cost of housing might not prove sustainable). For every 10% that real rents increase by, the second alternative policy would cost the government £1.2 billion more than the pre-COVID policy.

There may, however, be a problem with choosing the 20th percentile: if the distribution of properties gets thin, that could lead to big changes. That is, depending on the distribution of the rents, the 20th percentile could be a long way below the 30th percentile. We estimate that, on average, it is 9% below the 30th percentile, but the gap will be larger in some BRMAs. It is also possible it might be

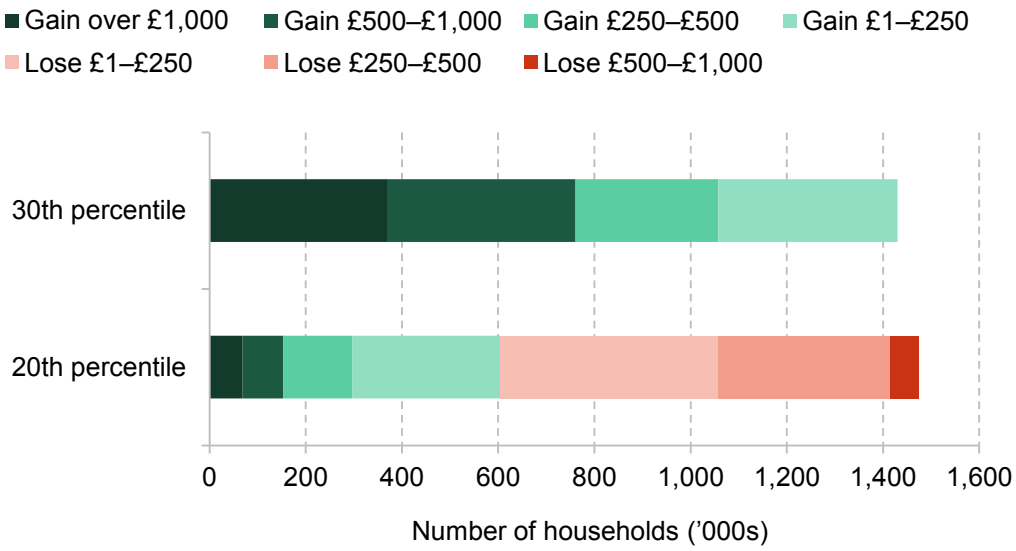
[30] Among private renters who do not claim HB (the basis for LHA rates) in the UK, the 20th percentile is approximately 9% lower than the 30th percentile. Thus, we describe this 9% cut as 'the 20th percentile'. In different BRMAs or for different household compositions, a 9% cut might be below or above the 20th percentile of rents.

[31] In estimating the cost of the various options for LHA rates, we consider the cost to the central government. This means that we do not incorporate the fact that raising LHA rates results in higher UC, which for many local authorities will result in savings on council tax support (CTS). However, in the following figures, we show the impact of reforms on total household income (so this includes any knock-on effects of CTS).

hard to find properties available at the 20th percentile (of course, the same might well be true of the 2012–13 30th percentile CPI uprated, and certainly will be at some point).[32]

We do not discuss or analyse the possibility of getting rid of national caps in detail. The rationale behind the national caps is to avoid subsidising renting in rich areas. That in itself is not an incoherent policy: there may be a case for HB not to reflect local rents in expensive areas, to avoid subsidising poorer renters living in the most expensive areas. However, there is also a case for HB to reflect contemporary (not 2011) local rents to avoid low-income renters being priced out of certain areas – for example, because those places may have better jobs available or they might rely on low-paid key workers.

Figure 8.13. Distribution of gains and losses from setting LHA rates to the 20th or 30th percentile of local rents, relative to pre-crisis plans



Note: The figure shows the effect of reforms relative to setting LHA rates to the level they would have been at had they not temporarily been increased to the 30th percentile.

Source: Authors' calculations using the Family Resources Survey 2018–19 and TAXBEN.

[32] There might also be a concern that relatively cheap accommodation in university towns might be dominated by students, meaning that setting the LHA rates to the 20th percentile of rent would lead to the type of rented housing affordable with the maximum HB amount being determined by students' incomes and preferences. The government could choose to avoid this problem by excluding properties rented entirely or mostly by students when calculating the distribution of private rents.

In the following, we show the impact of setting the LHA rates to the 20th or 30th percentile of local rents, compared with returning the LHA rates to the level they were at before the onset of the crisis.

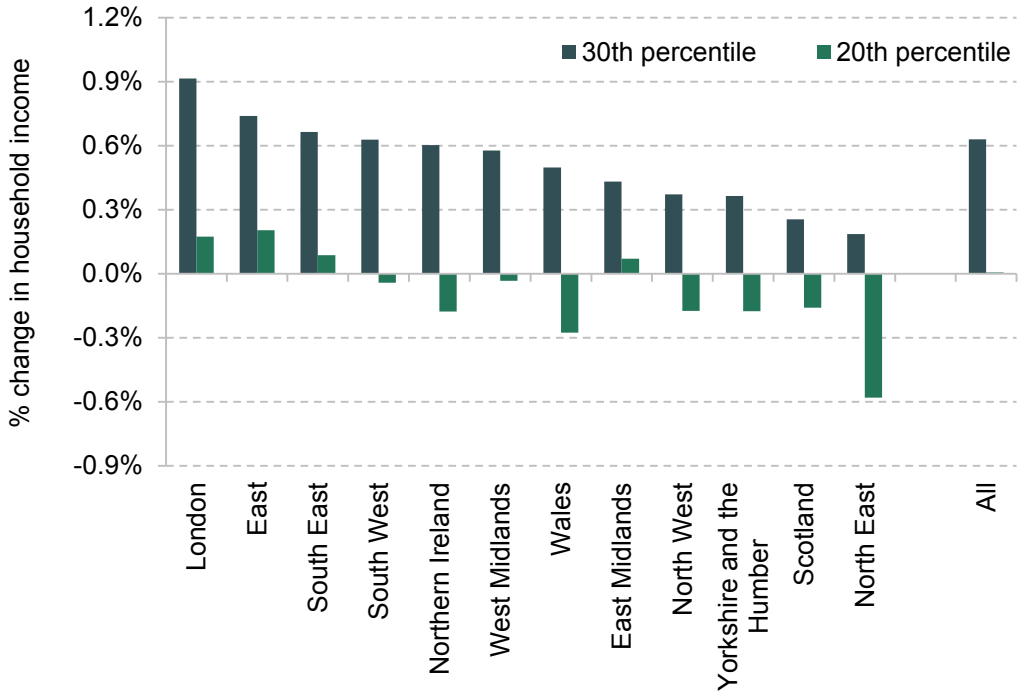
Figure 8.13 shows the number of households that would gain or lose (receive higher or lower HB) for both of these reforms. Not surprisingly, keeping LHA rates at the 30th percentile (rather than letting them fall back to their pre-crisis levels, which are never higher than the 30th percentile) would raise entitlements, benefiting 1.4 million households.

Setting LHA rates at the 20th percentile, however, would create both winners and losers: in broad terms, if you live in an area where rents have grown fast since 2011, your LHA rate is more likely to be below the 20th percentile of rents so you gain from the reform; and vice versa for those who live in an area where rents have grown more slowly. We estimate that around 850,000 households would lose out from switching LHA rates to the 20th percentile, and 600,000 gain. While the policy is cost-neutral in the short term, there are more losers than winners because those that lose from the policy on average lose £253 per year, while those that gain on average gain £388 (with approximately 60,000 households gaining over £1,000 per year and none losing that much). This simply reflects the fact that there are a small number of BRMAs (mainly in London) whose pre-crisis LHA rates were very far below the 20th percentile, and a larger number whose pre-crisis LHA rates were only modestly above.

Given that whether someone wins or loses from the reform depends on whether they live in an area that has seen fast or slow rent growth in recent years, we would expect to see strong regional patterns in the effects of this policy. Figure 8.14 plots the change in average household income for privately renting households under the two scenarios, compared with the policy of returning LHA rates to their pre-crisis levels. Since London and the East have seen fast rent growth since 2011, households in those areas gain from a move to the 20th percentile, while most other regions would lose on average. More generally, households in high-rent areas (BRMAs) gain from the switch to the 20th percentile, while those in low-rent areas lose out. These patterns confirm that high-rent areas have tended to see faster growth in rent in recent years.

Linking LHA rates to the 30th percentile of local rents of course increases incomes among all regions, with a similar regional pattern to the 20th percentile. Figure 8A.2

Figure 8.14. Impact on income of setting LHA rates to the 20th and 30th percentile of rent (among privately renting households), by region



Note: Sample is privately renting households. All incomes have been equivalised and are measured before housing costs have been deducted. The figure shows the effect of reforms relative to setting LHA rates to the level they would have been at had they not temporarily been increased to the 30th percentile.

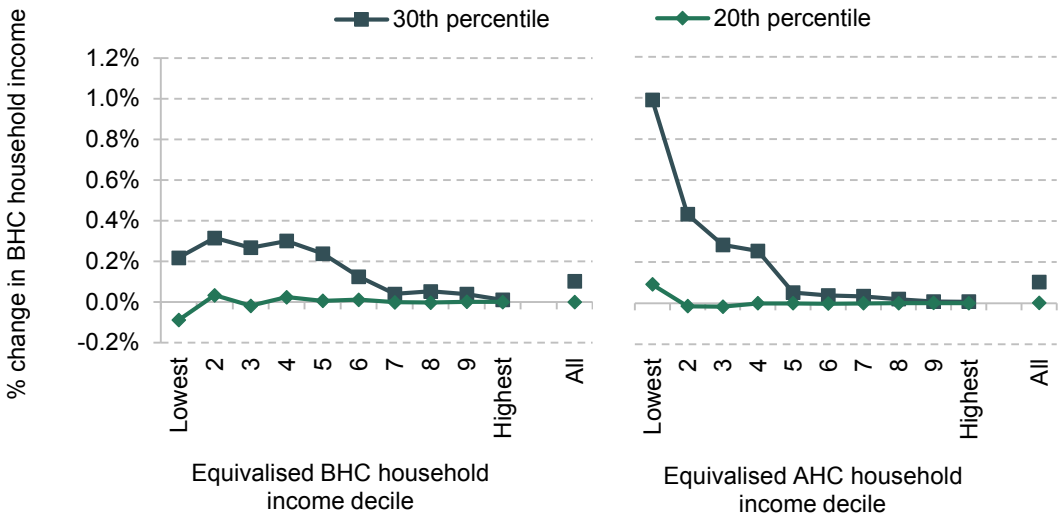
Source: Authors' calculations using the Family Resources Survey 2018–19 and TAXBEN.

(in the online appendix) shows these impacts among all, rather than just privately renting, households.

The distributional patterns of these policies crucially depend upon whether we rank households from poor to rich using income before or after deducting housing costs. This decision changes where in the distribution private renters in high-rent areas appear. If we use before-housing-costs incomes, private renters tend to be further up the income distribution, but once we deduct their (comparatively high) rent, they appear further down.

Figure 8.15 shows the effects of setting LHA rates to the 20th and 30th percentiles of local rent on household incomes of all households, regardless of their tenure, relative to returning LHA rates to their pre-crisis levels. We examine these effects across the distribution when we rank households with before- (left panel; BHC) or after- (right panel; AHC) housing-costs incomes.

Figure 8.15. Impact on income of setting LHA rates to the 20th and 30th percentile of rent, by household income decile



Note: All incomes have been equivalised and are measured before housing costs have been deducted. The base LHA rates are the 2020 LHA rates had they not temporarily been increased to the 30th percentile. Income deciles are calculated using net BHC income (left panel) or net AHC income (right panel) in the base scenario.

Source: Authors' calculations using the Family Resources Survey 2018–19 and TAXBEN.

What these results show is that switching to the 20th percentile of local rents has fairly muted distributional consequences. To the extent that there are distributional patterns, it is that the policy boosts incomes among those who have low AHC incomes but are slightly further up the BHC income distribution.[33]

We observe the same patterns if we just look at private renters (see Figure 8A.3 in the online appendix), though the average absolute impacts are of course larger. For example, private renters in the bottom decile of BHC income would lose 0.5% on average, while private renters at the bottom of the AHC income distribution would gain 0.2%. Linking LHA rates to the 30th percentile of local rents is more clearly progressive, with the lowest-income households experiencing the largest increase in net household income.

[33] This is because those who live in high-rent areas – who have high housing costs – tend to gain from the policy (see Figure 8A.2 in the online appendix), and if we measure incomes deducting housing costs, such households move down the income distribution. Conversely, the policy reduces entitlements among those who have low before-housing-costs income and slightly higher after-housing-costs income.

In sum, the LHA rate system that was in place prior to April 2020 has disconnected LHA rates from actual rent in an odd way. As the government thinks ahead in terms of setting the LHA rates for 2021–22, it faces a variety of options. If it goes back to pre-crisis LHA rates (and national caps), and continues to uprate them in line with the CPI, they will remain tied to the 2011 rents. This is difficult, if not impossible, to justify and will become increasingly bizarre over time.

Alternatively, it could just keep the 2020–21 rates (30th percentile) and uprate these in line with the CPI from April 2021–22 on. This would cost £1.1 billion in 2021–22 (in 2020–21 prices). However, although this would restore the connection between LHA rates and rent, it just 'resets the clock': future differences in rent growth across the country would cause the inequity in LHA rates relative to local rents to re-emerge.

To avoid such a disconnection, the government should consider re-linking LHA rates to current local rents (and maintaining this link going forward). It can do that in a way that – at least in the short run – does not result in any increase in costs. This, of course, has particular distributional implications (as discussed), but it is worth noting that these are only the inverse of the distributional implications of the odd policy since 2012 of allowing LHA rates to drift from local rents.

8.6 Conclusion

The government faces a number of choices for each of the three policies we have discussed: an increase to the standard allowance of universal credit, the suspension of the 'minimum income floor' and an increase to local housing allowances. One option which we have not covered – but is equally applicable to all three policies – is to grandfather in current claimants on the temporary measures and put new claimants on the pre-crisis scheme (or some other, less expensive, alternative). This approach perhaps has the attractive feature of ensuring that no households see overnight drops in their incomes between March and April 2021. But it would create perverse incentives. If a family ceases to claim UC, but later on begins a new claim, it would receive a lower amount (whether because of the standard allowance, the MIF or its housing support) than if it had been continuously claiming. Naturally, this disincentivises households to stop claiming UC (including by increasing their earnings) in the first place. And it would arguably be unfair to have two otherwise-identical households receiving substantially different amounts of benefits into the

future purely because one began claiming just before the end of 2020–21 and the other right at the start of 2021–22.

More generally when considering the future of these reforms, the government faces the standard trade-offs that any government faces in designing welfare policy: it can make the system more extensive, boosting incomes among poorer families (and those made poor by COVID), but at a cost to the exchequer and with the effect of weakening work incentives. Keeping the temporary measures in place would cost around £9 billion a year, and would boost the incomes of UC recipients, who are of course among the poorest in the country. Given the uncertain state of the economy and the labour market, and given the low levels of benefits for many in the UK relative to international standards, there may well be a case for this. But it would weaken work incentives and, in the case of the MIF, inappropriately encourage seemingly low-value self-employment and, potentially, fraud.

The government could, of course, also simply return to pre-crisis policy. If so, then early and clear communication to those likely to be affected is important to ensure that the drop in income that would occur for many does not come as an unpleasant surprise.

But beyond these standard trade-offs that governments face when making welfare policy, for two of the three measures we consider there are more subtle reforms available which could rationalise the system, regardless of its overall size. LHA rates could be linked to current rents, rather than 2011 rents, removing the unfairness and inappropriateness of families in some high-rent areas being able to get less HB than those in low-rent ones. And the MIF could be made more robust to volatile incomes, ensuring that the benefits system treats those with steady and volatile income similarly.

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