Institute for Public Policy Research

Trades Union Congress

A FAMILY STIMULUS

SUPPORTING CHILDREN, FAMILIES AND THE ECONOMY THROUGH THE PANDEMIC

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CONTENTS

Summary....3
Introduction: The need to strengthen the social security system 4
Microeconomic analysis 5
Macroeconomic analysis....8
Covid-19 and childcare provision....12
Conclusion....15
References 16

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SUMMARY

Families in Britain are struggling. Although the job retention scheme and its scaled down successor, the job support scheme, have and will spare some job losses – without significant further government action next year, unemployment could more than double from pre-Covid-19 levels, averaging 9.1 per cent in 2021/22 (OBR 2020).

The social security system will be increasingly important for preventing poverty and destitution among families, with all the knock-on impacts on children that are associated, from poorer educational outcomes to the development of mental and physical health problems amongst parents and their children (CPAG 2020). However, the UK's social security system is one the least generous in the developed world (McNeil et al 2019).

At the same time, parents face new challenges with childcare arising from the pandemic due to reduced supply and possible closures, with potentially drastic consequences for families as well as poorer outcomes for society – limiting labour market participation, reducing household disposable incomes and potentially reversing progress on narrowing the gender pay gap. Furthermore, lack of access to childcare is detrimental to the development of children at a crucial life stage (Nuffield Foundation 2015). Transitional support for childcare and early years should mirror support for schools given this critical role.

This paper makes the case for a "family stimulus" – a much-needed boost to the income of hard-hit families through the social security system and targeted investment in childcare to ensure the continued functioning of the sector. This will put cash directly into the hands of families and provide a stimulus for the economy, whilst improving outcomes for children.

Our modelling finds that doubling child benefit will inject £14 billion into the economy over the next 18 months and **boost GDP by £19 billion (corresponding to about 0.6 per cent of GDP in 2021/22)** when considering the ripple or multiplier effects of additional spending, **whilst lifting 500,000 children out of poverty.** Increasing the child element of universal credit (UC) and child tax credit (CTC) by £20 per week per child and removing the two-child limit would inject £11 billion into the economy, or **increase GDP by £14 billion (corresponding to about 0.5 per cent of GDP), lifting 700,000 children out of poverty.** Although we find uplifts to UC and CTC better target low income families compared to child benefit (CB), we discuss several reasons why CB may remain a more desirable option – including its widespread coverage, reliability, and the fact it is paid to the primary carer which increases the likelihood it will be spent on children.

To prevent further closures of cash-strapped childcare providers, particularly in the most disadvantaged areas, the government should continue to provide free entitlement funding to local authorities and childcare providers at pre-pandemic occupancy rates until these have returned to normal levels at an approximate cost of £400 million in 2021. It should also provide at least £88 million transitional funding in line with that provided to schools to help prevent redundancies and ensure providers can continue to operate. Finally, as part of any stimulus package to kickstart the economic recovery, government must further invest in the sector to create good quality jobs and improve pay and conditions for childcare workers, creating opportunities in social infrastructure in the same way the government invests in physical infrastructure such as roads, transport and clean energy.

INTRODUCTION: THE NEED TO STRENGTHEN THE SOCIAL SECURITY SYSTEM

Running up to the crisis, reforms to social security over the past decade had hit low-income families hard (CPAG 2017). Policies such as the two-child limit, the benefit cap, and increasing taper rates have directly driven hardship for families, even prior to the global pandemic. Freezes to child benefit alone, coupled with changes in how benefits were uprated since 2010, leave a two-child family over £500 worse off in 2020/21 (TUC 2020).

We consider two options for policy change: (i) increasing the generosity of child benefit and (ii) increasing the generosity of the child element under universal credit along with removing *the two child limit* (with equivalent changes in child tax credit). Both policies would quickly move cash towards lower and middle-income families with children.

Firstly, we use the IPPR tax-benefit microsimulation model to assess the likely expenditure impacts arising from these reforms, the impacts on child poverty as well as how the gains are likely distributed amongst different income groups. Secondly, this analysis is then used to inform an assessment as to the wider GDP implications for the macroeconomy. Finally, we conclude with an analysis of childcare services that have been heavily hit by the pandemic and whose future viability is under threat. We outline what policies are needed to strengthen their finances.

Alongside other stimulus measures, these interventions could be crucial to prevent the economy from entering a negative spiral of low growth, low incomes and higher poverty. A broad-based stimulus should be aimed at accelerating good job creation and wider productive investment, along with strengthening social security more generally. At a minimum, this should include retaining the additional £20 boost to universal credit and tax credits and removing the benefit cap.

MICROECONOMIC ANALYSIS

METHODOLOGY AND ASSUMPTIONS

We use survey data from the Family Resources Survey (DWP 2020) to simulate the impacts of benefit reforms As the most recent data available relates to financial year 2018/19 – collected prior to the Covid-19 crisis, we first construct a *Covid Baseline Scenario* on which the impacts of changes to the social security can be estimated. In effect, we simulate a deterioration of economic conditions between when the data was collected to the expected economic situation. We explicitly model 2021/22,[1] however the findings can be extrapolated to consider the impacts from introducing these changes earlier.

We model the following economic changes.[2]

- Unemployment reaching 9.1 per cent as estimated by the OBR in 2021/22 in the latest forecast (OBR 2020).
- A reduction in hours worked for 8 per cent of private sector employees, reducing by 40 per cent or the equivalent of shifting from full time to part-time work. This reduction in hours is broadly equivalent to a shift in the part-time worker population from 25 per cent now to 29 per cent.

We then model the following reforms to social security:

- Doubling child benefit – in effect increasing it by £21.30 per week for the first child and £14.15 for the second child (HMRC 2020).
- Increasing the child element of UC by £20 a week per child, with an equivalent increase in child tax credits (CTC), whilst also removing the *two child limit.* This change introduced in 2017 restricted the number of children (born after 2017) for whom a recipient could receive UC child elements and child tax credits.

POVERTY RESULTS

We report here on the change in the number of people who are projected to be in relative poverty as a result of the reform option. The relative poverty line is defined as having a household income below 60 per cent of equivalised household income (that is, after adjustment for who lives in the household as is standard in income analysis) in the absence of the reform.

TABLE 1: ESTIMATED POVERTY IMPACTS FROM REFORM OPTIONS (2021/22)

	Reduction in number of children under relative poverty line	Reduction in number of adults under relative poverty line	Reduction in the number of people under relative poverty line[3]
Doubling child benefit	500,000	200,000	800,000
Increase child element of UC and CTC and remove two child limit	700,000	300,000	1,100,000

Source: IPPR Tax Benefit Model

1 This assumes UC and tax credits are returned to pre-pandemic levels as is currently scheduled

2 When economic conditions are worsened in the Covid baseline, workers are selected at random, with higher probabilities for lower earners based on evidence from the Understanding Society COVID-19 survey. The model is ran several times to account for this uncertainty and averages taken.

3 Totals may not sum due to rounding.

Both policies cause a substantial reduction in child poverty, as well as both lifting at least 800,000 people above the projected poverty line.

Expenditure impacts

We estimate that expenditure would be £10 billion for the child benefit changes and £7.5 billion for the UC changes if introduced in 2021/22. Introducing these policies earlier (for example from November 2020) would likely cost an additional £4.2 billion for child benefit changes for a total of £14.2 billion and £3.1 billion for UC changes for a total of £10.6 billion.

The table below shows how, if the policy was introduced from November 2020, how this additional income would be expected to fall across the income distribution.

TABLE 2: EXPENDITURE IMPACTS OF SOCIAL SECURITY REFORM BY INCOME DECILE FROM NOVEMBER 2020 TO END OF MARCH 2022

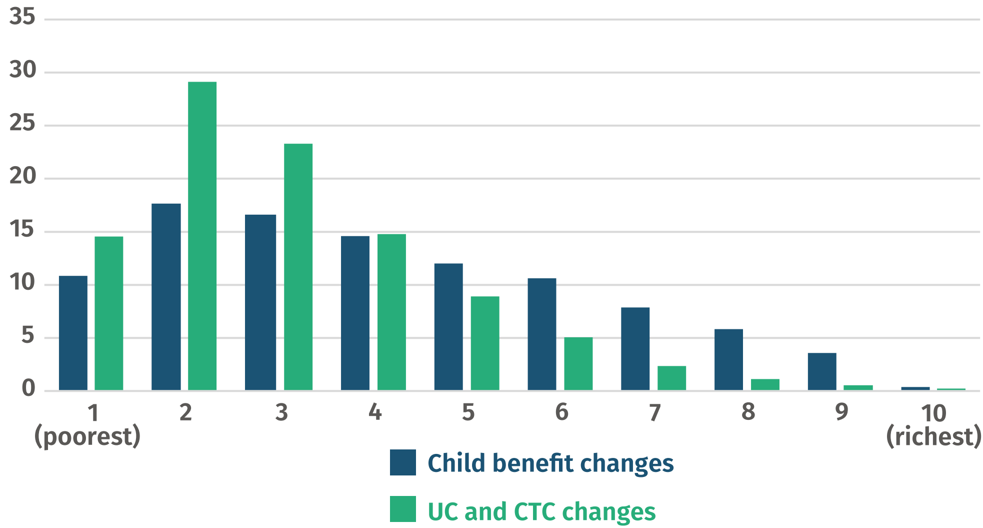
Equivalised household income quintile	Child benefit (£bn)	UC, CTC and two child limit changes (£bn)
1 (poorest)	1.5	1.5
2	2.5	3.1
3	2.4	2.5
4	2.1	1.6
5	1.7	0.9
6	1.5	0.5
7	1.1	0.2
8	0.8	0.1
9	0.5	0.1
10 (richest)	0.1	0.0
Overall	**14.2**	**10.6**

Source: IPPR Tax Benefit Model

The chart below visualizes how the income is distributed amongst the deciles in both cases. Both reform options are progressive in that they distribute more of the stimulus towards lower income deciles, although the universal credit reforms are more tightly targeted – as only those who receive universal credit or tax credits will benefit, and these are much more concentrated in lower income deciles. In the case of child benefit, all households with children will benefit except those household earning £50,000 or more.

FIGURE 1: ADDITIONAL INCOME FROM UC CHANGES ARE MORE HEAVILY SKEWED TOWARDS POORER HOUSEHOLDS BUT BOTH OPTIONS ARE PROGRESSIVE.

Additional expenditure falling into different household income deciles (%)



Source: IPPR Tax Benefit Model

MACROECONOMIC ANALYSIS

We now consider the potential impact of these reforms on the macroeconomy. An increase in government spending can increase economic growth via stimulating spending and investment (IMF 2020). Historically this beneficial effect (the so-called 'multiplier effect') is particularly large when the economy is in recession and when central bank interest rates are low (as they are currently) (Farhi and Werning 2016; Ramey and Zubairy 2018). Accordingly, an increase in government spending during crises – which provides direct support for families – provides a desirable boost to the economy that can exceed the initial injection of funds by the government. If this stimulus is 'progressive' in the sense that it is targeted at those families most in need, it is significantly more effective.

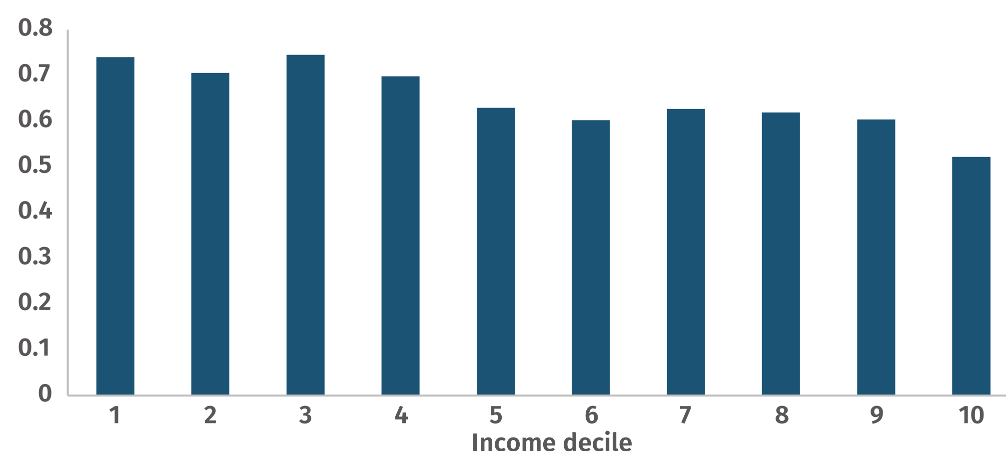
METHODOLOGY AND ASSUMPTIONS

To model this, we estimate multiplier effects for our proposed policies, taking into account the characteristics of households with different incomes levels. We do so, based on Bank of England estimates for household spending responses to income shocks (Bunn et al 2018). Their work provides estimates for marginal propensities to consume by income group (Figure 2). Bunn et al's findings show the huge differences in how different households react to negative changes in incomes. In particular, the bottom 40 per cent have a much higher propensity to consume than the top 60 per cent. The likely reason for this is poorer households are much more likely to depend on wages to pay for goods and bills (rather than accumulated wealth) (ibid). Therefore, if they are faced with a sudden fall in income, they are much more likely to reduce their spending immediately. In turn, government transfers can help maintain their incomes, and prevent cutbacks in spending that would be damaging for the macroeconomy.

This highlights that fiscal spending that is targeted at those on lower incomes is expected to have a much higher impact on GDP than less targeted transfers. We show below how this translates into growth outcomes through multiplier analysis.

FIGURE 2: POORER HOUSEHOLDS ARE MORE DEPENDENT ON THEIR INCOME AND ARE THUS MORE RESPONSIVE TO NEGATIVE INCOME SHOCKS FACED IN THE CURRENT CRISIS

Consumption response to negative income shock (%)



Source: Bunn et al (2018)

RESULTS

We use the above information to estimate how the size of the fiscal multiplier varies depending on where the spending is targeted. As the baseline for our multipliers we rely on the ranges provided in the review by Ramey (2019) who concludes overall multipliers can be between 1.5 and 2.5 when interest rates are near zero. This is broadly in line with the overall multipliers the IMF (2020) expects to see during the type of crisis we are facing. We combine this with a standard textbook way of calculating fiscal multipliers, adding in government transfers to households which allows us to incorporate the spending distribution of our two policy options from Table 2.[4] A range of multipliers for our two policy options is thus shown in Table 3, ranging between 1 and 1.8. The reason that multipliers vary between policy options is that the different approaches affect different income groups differently, which feeds through into aggregate effects.[5]

TABLE 3: ESTIMATED FISCAL MULTIPLIERS OF THE DIFFERENT POLICY OPTIONS

	Lower estimate	Central estimate	Upper estimate
Doubling child benefit	1.0	1.3	1.7
Increase child element of UC and CTC and remove two child limit	1.1	1.4	1.8
For comparison: flat multiplier (in which all deciles receive the same amount of funding)	1.0	1.3	1.6

Source: IPPR analysis of Bunn et al (2018), Ramey (2019) and estimates in table 2

These findings suggest that our proposed reforms would have significant positive impacts on the economy. In combination with other stimulus measures, they could be a key ingredient for preventing the economy from sliding into a negative economic spiral.

For our central multiplier estimates, we find that the £11 billion injection of money through the universal credit scenario (over November 2020–March 2022) could provide a boost to GDP of about £14.9 billion thanks to its multiplier effects . The child benefit scenario would inject about £14 billion into the economy, leading to a £19.1 billion boost to GDP. This would correspond to 0.5 per cent of GDP and 0.6 per cent of GDP respectively in the fiscal year 2021/22.

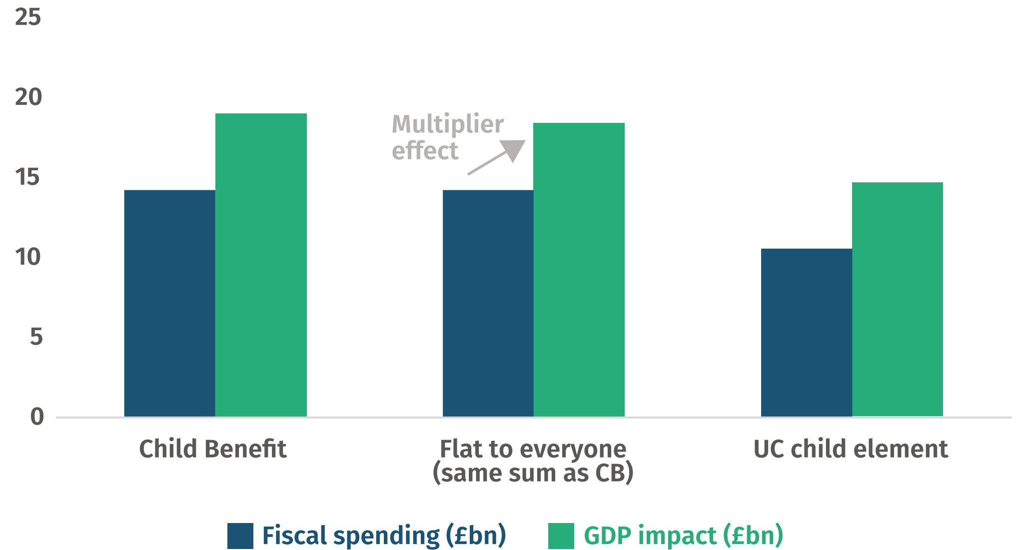
Combined with other stimulus measures, such a family stimulus can serve as a backstop for family incomes and thus as a backstop for the economy as a whole in this time of profound economic stress.

4 See note below chart for more detail on its derivation.

5 The calculation can be written as $Family\ stimulus\ multiplier = Overall\ multiplier\ at\ ZLB \cdot \sum_1^{10} c_i \beta_i$, where c_i is the marginal propensity to consume (MPC) of decile i and β_i is the share of the family stimulus that is going to that income group. To calculate this we use the negative income shock multiplier from Figure 2 given for the majority receiving it, it is aimed at preventing a negative income shock from the covid crisis. This is likely the case for families beyond those losing income due to unemployment. The mere large uncertainty caused by the pandemic afflicting large parts of the population mean that families will cut back on spending due to the risk of reduced future income.

FIGURE 3: A FAMILY STIMULUS IS EXPECTED TO HAVE SIGNIFICANT BOOSTING EFFECT FOR THE ECONOMY

Size of fiscal spending and the resulting effect on GDP

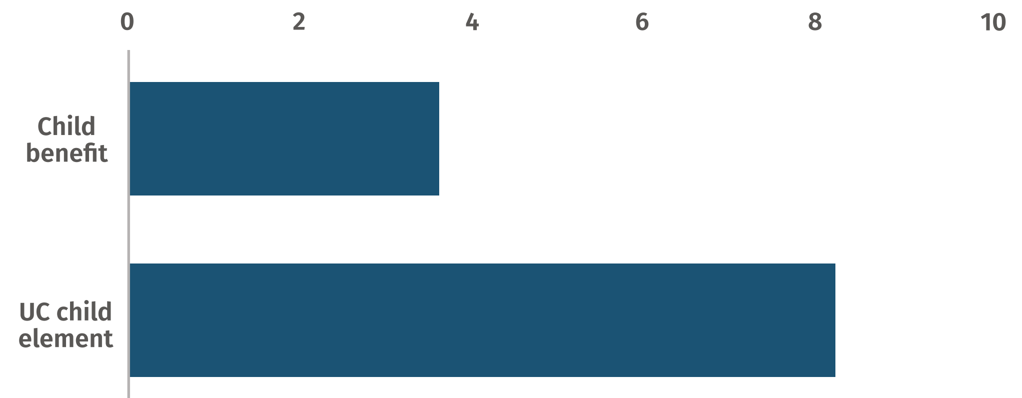


Source: IPPR analysis of Bunn et al (2018), Ramey (2019) and estimates in table 2

This analysis also shows that a more 'progressive' stimulus – aimed at those families who need it the most and are therefore likely to spend more of it – is more impactful. The more targeted a measure is at low income households the more 'bang for the buck' of government spending. Compared to a "flat stimulus" whereby all households receive the same amount, both UC and child benefit changes are more effective at stimulating the economy. Figure 4 shows that a 'progressive' UC-based stimulus is about 8 per cent more effective than a 'flat' stimulus in which all income groups receive equal amounts of funding, whilst the child benefit option is almost 4 per cent more effective.

FIGURE 4: 'A PROGRESSIVE STIMULUS' IS MORE EFFECTIVE THAN A FLAT STIMULUS

Increase in effectiveness compared to a flat stimulus (%)



Source: IPPR analysis of Bunn et al (2018), Ramey (2019) and estimates in table 2

WIDER CONSIDERATIONS

These two reform options differ in that increasing child benefit is a more 'universalist' approach to welfare whereas increasing UC only benefits those out of work or on low incomes. The analysis suggests that reforms to UC and tax credits would be more effective *per pound spent*, in terms of impact on child poverty and in stimulating the economy. However, there are wider considerations as to why child benefit may be attractive as well:

Widespread coverage: Many individuals have fallen through the net in terms of the government's response to the pandemic so far, notably many of the self-employed, those ineligible for universal credit (for example those living with a partner who is earning or with savings of over £16,000) and those on legacy benefits which did not receive the emergency increase to universal credit. By contrast, an increase to child benefit would reach the vast majority of families with children under-16.

Reliable source of income: Universal credit payments can fluctuate as income is regularly assessed, and they are therefore often not a predictable source of income. For those on the lowest incomes, having a reliable source of income is paramount. Child benefit is a consistent amount paid regularly, and as such it is a popular benefit (Commission on Social Security 2020). The five-week wait for the first UC payment also presents challenges for those who find themselves newly out of work and who need immediate financial support (IFS 2020a)

Payment to primary carer: Child benefit is paid to the primary carer in a family who is often the mother. There is evidence in turn that women are more likely to spend their income on their children (CPAG 2014), improving their outcomes.

COVID-19 AND CHILDCARE PROVISION

Covid-19 has placed significant strain on the childcare sector, which was already struggling pre-crisis. There is a long history of underfunding in the sector. Childcare providers receive approximately one quarter of their funding from the 'free entitlement' – funding from the Department of Education for disadvantaged two year-olds and all three and four year-olds – with the rest coming largely from parent fees. It has been estimated that the funding shortfall per hour of childcare delivered through the free entitlement is between 37 and 20 per cent (Ceeda 2019). The sector is therefore heavily reliant on income from parent fees to recoup these costs, and these fees are typically charged at a higher rate – a form of cross-subsidy.

This unstable funding model has come under considerable pressure since the pandemic began. During the lockdown, the childcare sector played a vital 'emergency service' role, with many providers continuing to open their doors to key workers and vulnerable children. It has been estimated that during this period, childcare providers in England lost up to £228 million – or 13 per cent of the sector's total income (Blanden et al 2020). Since then parental demand has remained lower than normal, including due to limits on the number of childcare providers who can deliver places for due to Covid-19 restrictions.

Early years entitlement funding has been maintained over the crisis at pre-pandemic levels, however, this arrangement is due to end in January 2021 when it will be based on actual occupancy rates, which could result in funding reductions of up to £400 million.[6] The government has provided some support to the sector through its emergency schemes, but this has been very limited. Providers have had very patchy entitlement to the government's business support grants and self-employed income support scheme, while funding via the job retention scheme was only available for the proportion of providers' income accounted for by private sources.

As a result of all of these factors, it has been estimated that a quarter of private nurseries in England may have been operating at a significant deficit over the lockdown period, up from 11 per cent pre-crisis (Blanden et al 2020). The Early Years Alliance has found that one quarter of providers say they are unlikely to be operating by next summer (EY Alliance 2020).

Childminders have also been under pressure, with the Institute for Fiscal Studies finding that even if all childminders received self-employment income support grants, the total loss of parent fees could see an additional 30 per cent of childminders now earning less than £4 of income for every £5 in costs (IFS 2020c). Childminders have little flexibility to change their business models or increase capacity because of the need to maintain ratios between caregiver and children, as well as Covid-19 distancing measures. If this situation persists it could drive many more childminders to leave the market entirely.

All the above points to a potential reduction in supply and higher future costs for families for childcare. The impact is likely to be worst in disadvantaged areas. Providers in these areas are generally less likely to be able to top up income from parent fees. Lower demand from parents is further suppressed by higher levels of unemployment in deprived areas and the poor financial incentives for paying

6 Estimate for England. Assumes 40 per cent reduction in occupancy next year and spend on the policy of £1 billion a year for 30 hours of free childcare.

for childcare for those on lower incomes. As a result, it is unsurprising that 42 per cent of childcare settings in the most deprived areas reported that they may need to make redundancies compared to 31 per cent of settings overall, suggesting substantial disruption (Pascal et al 2020).

Impact of a shortfall in childcare provision for children and working parents

The impact of the lockdown and reduced attendance at school and childcare settings is already expected to have had a negative impact on the 'disadvantage gap' – the average educational attainment gap between disadvantaged children and their more advantaged peers. The Education Endowment Foundation has predicted that school closures will reverse the progress made to narrow the gap in the last decade (EEF 2020) and it can be assumed that the early years will follow the same pattern. The closure of childcare settings in deprived areas will only widen the gap further, hurting the future educational attainment and life chances of disadvantaged children.

If parents are unable to access childcare, or it becomes unaffordable to them, evidence suggests this may force many workers (particularly women due to gendered caring patterns) to reduce their hours or leave the labour market altogether. Indeed, there is already evidence of significant issues for working parents. At the start of the new school term, a poll carried out on behalf of the TUC found that two in five working mums with children under 10 reportedly could not get enough childcare to cover the hours they needed to work for September (TUC 2020a). This was driven both by a lack of usual nurseries and childcare provision, compounded by parents being less able to rely on friends and family members as was the case "in normal times".

One in six reported that they have had no choice but to reduce their hours and this was disproportionately the case amongst those on lower incomes (ibid). We know that lower socioeconomic groups were less likely to have been able to work flexibly through lockdown as they are more likely to work outside the home. For lone parent families, who were disproportionately disadvantaged prior to Covid-19, labour market outcomes could be particularly poor if adequate and affordable childcare is not available. One in two single parents said they would go into debt or be unable to pay bills/rent if their child's school or childcare setting closed or they were required to self-isolate for two weeks (TUC 2020b)

Impacts of childcare closures on household income and gender equality

A failure to intervene and put the early years sector on a more sustainable footing could result in wider negative social outcomes, turning back progress on gender equality. Parents, and others with caring responsibilities, have been one of the groups most likely to be made redundant during the pandemic (McNeil et al 2020). One study found that mothers have been 45 per cent more likely than fathers to have permanently lost their job in the crisis. (IFS 2020b)

Couple families where both parents work experience a significantly lower risk of poverty. But affordable childcare is a key factor in whether both parents, and particularly the primary carer, often still the mother, is able to do so. Reduced availability and flexibility of childcare, particularly in the most deprived areas, is therefore likely to compound the negative impact on parental employment rates, particularly for maternal employment.

Many parents who are newly unemployed are at risk of losing their childcare place and access to the free entitlement. Where childcare is unavailable, we would expect more women to switch from paid employment to childcare because they are more likely to reduce their working hours due to childcare pressures (ONS 2019), as well as because women on average earn less than men. These effects could persist as evidence suggests that once women have left the labour

market it is harder for them to return to it in future years (Newton et al 2018). Without action, the consequent loss of income for women is likely to increase the 'motherhood pay penalty', as well as wider gender pay and wealth gaps.

Benefits of investing in the childcare sector

There is ample evidence that high quality early years education and childcare is critical for young children's cognitive and social development, impacting on their future opportunities and life chances. (Nuffield Foundation 2015) As such, it is a critical a form of social investment in schools and higher education.

There are wider economic factors which point to an urgent need for investment in the childcare sector. Given the labour-intensive nature of care work, investment will create job opportunities at a time when these are in short-supply, right across the country. This in turn will generate new sources of income which will be spent and re-circulated in the economy (WiSE 2014).

Women's Budget Group has shown that that a net investment of around 2.5 per cent of GDP in child care and social care could create over 2 million well paid jobs; increase overall employment by over 5 percentage points and decreasing the gender employment gap by 4 percentage points. (WBG 2020). Higher levels of maternal employment also produce a significant return to the Treasury. IPPR has previously shown that a 5 percentage-point increase to the maternal employment rate generates £750 million a year in benefit savings and tax revenue (Ben-Galim 2014).

POLICY IMPLICATIONS

Given sector-wide challenges from Covid-19 and the huge benefits of childcare investment both today and in the future, other countries have sought to tackle the childcare crisis directly. In Germany, the government has pledged an additional €1 billion (£911 million) investment in childcare infrastructure along with expediting existing funding (Fillman 2020). In Canada the federal government has invested $625 million (£365 million) to protect access to childcare (Government of Canada 2020), whilst the Ontario government has offered direct support to cover operating costs (CBC 2020).

The UK government has a chance to do the same at the upcoming Spending Review. It is clear that without action from government, January will be make-or-break time for many childcare providers when the government's commitment to sustain free entitlement funding a pre-pandemic levels is due to end.

As we saw above, the sector endured losses of up to £228 million in order to perform the vital role in caring for the children of key workers and those who are vulnerable during the lockdown. There have been significant underspends in childcare funding that the sector has not benefited from (EY Alliance 2020). Neither has the sector received funding for the additional costs occurred through the crisis as schools have (EEF 2020) . In There is therefore a very strong case for financial assistance from government in order to sustain the sector at a vital time. We recommend the following.

- The government should continue to provide free entitlement funding to local authorities and childcare providers at pre-pandemic occupancy rates until these have returned to normal levels. We estimate this will cost £400 million.
- It should also provide at least £88 million transitional funding in-line with that provided to schools to help prevent redundancies and ensure providers can continue to operate
- As part of any stimulus package to kickstart the economic recovery, government must further invest in the sector to create good quality jobs and improve pay and conditions for childcare workers, creating opportunities in social infrastructure in the same way the government invests in physical infrastructure such as roads, transport and clean energy

CONCLUSION

Families have and will continue to struggle through the pandemic. To limit the damage, urgent uplifts should be applied to the significantly weakened social security system for families with children. Such payments will reduce child poverty, whilst also stimulating the economy. Although our proposed UC and child tax credit reforms (including removal of the two child limit) may be more *efficient* per pound spent than child benefit increases, wider considerations should weigh in as to the right approach. The figures involved are relatively modest in relation to the government's response so far, but could make a huge difference to the lives of millions of people.

Childcare services have been heavily hit by the pandemic and the future viability of the sector is under threat. Recognising the strategic importance of the sector for our economy, as well as for children's attainment and reducing the educational disadvantage gap, the government must support the sector by providing transitional funding. It should follow other countries by ramping up public investment in childcare, recognising it for what it is – a key social investment with huge job creation potential.

These interventions should sit alongside a wider stimulus geared at accelerating good job creation and wider productive investment, along with strengthening social security more generally (including through removal of the benefit cap and retaining the higher UC rates) and bolstering job support schemes to improve outcomes for all.

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