



## Childcare costs in Universal Credit

A better way to allocate the additional money committed in the 2013 Budget

6<sup>th</sup> August 2013

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## Summary

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Universal Credit as it currently stands, provides support with 70% of childcare costs for all parents whether they work just a few hours a week or full time. This will make it much easier for parents to move into work for just a few hours as under the current system help with costs is only available when working for more than 16 hours a week. However, analysis by Citizens Advice, the Joseph Rowntree Foundation and others, has found that it will be difficult for parents on a low income and with high childcare costs, to make work pay as they increase their hours. This is especially, but not exclusively true, when they start to earn enough to pay tax. Currently, those on a low income receive financial support for 20% of their childcare costs from increased housing benefit in addition to the 70% support they receive from tax credits.

To help address this situation, the Government announced that it would increase funding for childcare in Universal Credit by an extra £200 million from 2016. The Government proposes to target the additional funding on parents earning enough to pay tax. The support that they will get with childcare costs will be raised to 85% which will mean that parents earning over £10,000 a year will pay half the proportion of their childcare costs (15%) than their lower earning counterparts, who will still have to pay 30%.

Our analysis finds that the extra money distributed in this way will indeed make it easier for parents working full time to make work pay. But it does nothing to improve the poor work incentives of parents who earn at or near the minimum wage and choose or are not able to work full time – currently two thirds of lone parents work between 16 and 29 hours a week. In fact, if the current proposal is not changed, Universal Credit will also have a surprising and perverse consequence; many low income parents will find that increasing their hours of work actually decreases their net income, unless they can work full time. Those who earn significantly more per hour than the minimum wage do not have difficulty in making extra work pay. They will however, gain from this proposal even if only working part time.

Not only does the proposal only help the minority of low income lone parents and second earners who work full time, but the introduction of a second tier of support adds significant extra complexity which will make it very difficult for parents to assess whether taking on more hours will actually make them better or in fact worse off. This situation risks forcing parents on a low income into a position where they will have to turn down work and/or reduce their hours and earnings potential.

This paper argues that the extra £200 million would better meet the Universal Credit objectives of simplifying the system and making work pay, if it were distributed evenly by increasing support for all parents, rather creating a second higher rate of support to claimants earning enough to pay tax.

Providing support for 78% of childcare costs for all Universal Credit claimants would be the simplest and most effective solution that keeps closest to the allocated budget of £200 million.

However, it is also clear from the analysis that £200 million would be insufficient to really improve work incentives for all parents with low incomes and high childcare costs. Gains from work would still be much lower than under the current system where some families get up to 90 per cent of their costs met. We recommend that the Government reconsider the split of new funding between the £750 million new funding for childcare vouchers for parents earning too much to be entitled to Universal Credit and the £200m extra in Universal Credit.

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## Section 1: Overview

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This briefing falls into two main parts – this short overview, followed by a longer detailed analysis of the options.

### Introduction

The purpose of Universal Credit is to change “...*the incentives in the benefit system so it acts as a springboard into work rather than a trap*”.<sup>1</sup> Citizens Advice has repeatedly made clear that it supports the principles of Universal Credit. We believe that its aims of simplifying the system and making work pay are important. For many claimants it will achieve these aims however, for low income families with high childcare costs it will not.

### The issue

For those with high childcare costs, it is the amount of support for these costs in the two systems that is crucial in determining whether work will pay. Universal Credit as it currently stands provides support with 70% of childcare costs. This level of support would make it difficult for many parents on a low income and with high childcare costs to make work pay, especially, but not exclusively, when they start to pay tax. Currently 100,000<sup>2</sup> of the lowest paid workers receive financial support for 20% of their childcare costs from increased housing benefit in addition to the 70% support they receive from tax credits as long as they work at least 16 hours a week. Under the current system it is difficult for many to make fewer hours of work, pay. In contrast, in Universal Credit as it currently stands, lone parents will be able to make a few hours of work pay but will struggle to make more substantial work pay if they have high childcare costs. Many second earners in a couple with high childcare costs and on low incomes are also likely to find it difficult to make any work pay.

### The current proposal to increase support for childcare costs in UC

We therefore welcomed the announcement in the 2013 budget that an extra £200 million will be allocated to increase the level of support for childcare costs in Universal Credit from 2016. The Government has proposed a two-tiered approach, with those on the lowest incomes receiving a lower level of support. The level of support will be raised from 70% to 85% for those who are earning enough to pay tax (over £10,000 per annum from 2014) but those earning less than this would only receive support with 70% of their costs.

Our analysis of the current proposal finds the following:

- If Universal Credit had continued to only offer all claimants support with 70% of childcare costs then those on a low income with high childcare costs who were working sufficient hours to be paying tax would have had the greatest difficulty in making work pay. For parents in this situation, the current Government proposal would make it much easier for them to be able to make work pay.
- Parents who work fewer than 29 hours a week on the minimum wage will not pay tax – under this proposal if they have high childcare costs they will struggle to make work of more than a few hours pay. Low income second earners are likely to find it difficult to make work pay for any hours of work for which they have to pay for childcare.
- The Government’s proposal increases the complexity of the system as near the margins it will make it impossible to assess if extra work will lead to a gain or loss of income.

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<sup>1</sup> Department for Work and Pensions (2013) ‘Social Justice; Transforming lives – one year on’ p. 27

<sup>2</sup> PQ from Karen Buck MP 12 July 2011

<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110712/text/110712w0001.htm#11071294001115>

- Parents with a higher earning power will be the most likely to receive support with 85% of their childcare costs as they will more easily reach the tax threshold even when not working full time. As childcare costs increase with hours of work this group will struggle least to make work pay. Therefore, concentrating extra support with childcare costs on higher paid Universal Credit claimants is not an effective use of this extra money.

The illustrations below highlight in more detail what the impact will be:

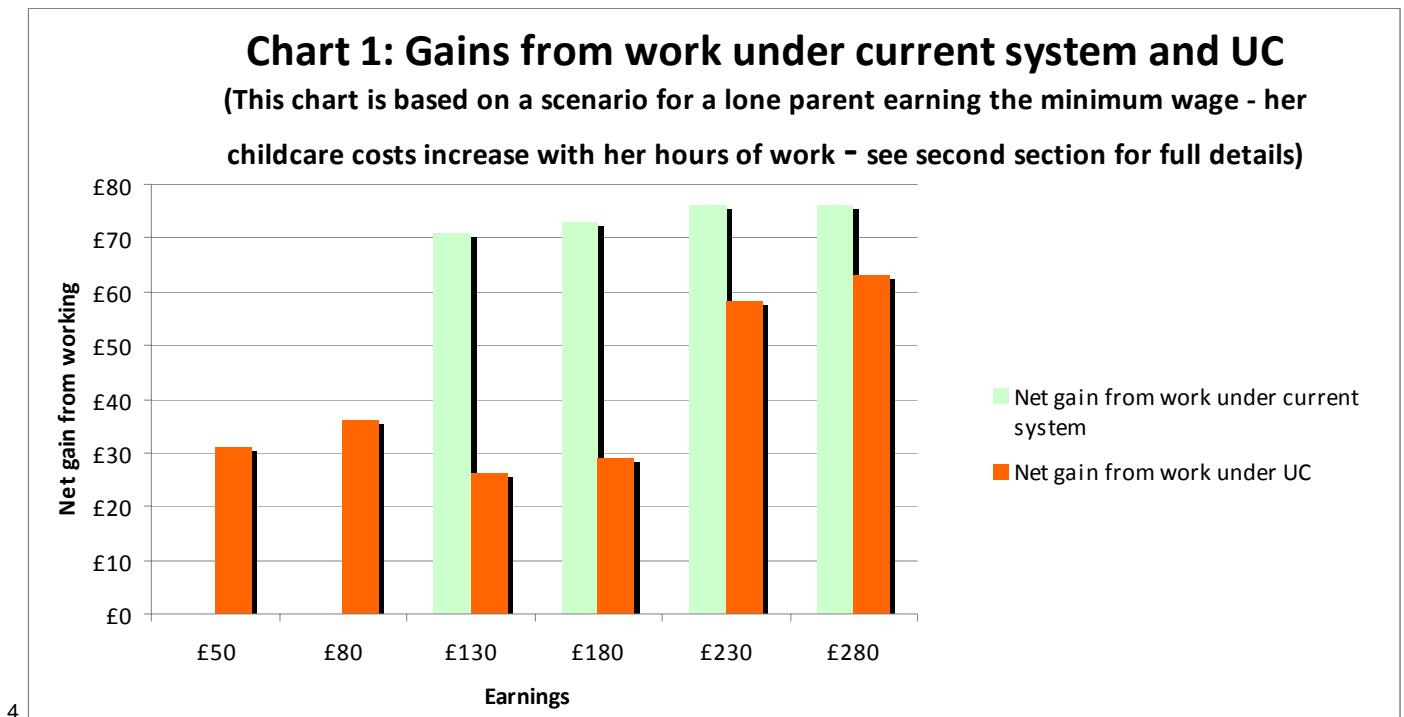
If we consider two lone parents who both want to return to work after maternity leave, both wanting to work twenty hours a week, and both have childcare costs of £100 a week. One is earning the minimum wage, and the other is earning twice the minimum wage.

**Under the current system** the one earning the minimum wage will pay £4.50 out of her gains from work towards her childcare costs, the one earning twice the minimum wage will have to contribute £30 towards her childcare.

**Under Universal Credit**, the one earning the minimum wage will pay £30 out of any gains from work towards her childcare costs, whereas the one earning twice the minimum wage will pay £15 towards her costs

If this proposal goes ahead, the exact level of gain or loss will be different for each individual but the pattern shown in the chart below will be true for many lone parents who can only earn at or near the minimum wage and who are reliant on formal childcare. (This chart is explained in detail in Section 2 of this briefing.)

The proposal to raise the level of support for childcare costs for those working full time (at least 31 hours) on the minimum wage is helpful.<sup>3</sup> Otherwise those working full time and with significant childcare costs will be unable to make work pay. **However as can be seen from the chart, this proposal will leave many lone parents who work between 16 and 29 hours a week earning between £80 and £230 gaining less from work than if they worked for only a few hours.**



<sup>3</sup> 31 hours at the minimum wage is £196/week or £10,200/year

<sup>4</sup> Once transitional protection is exhausted. We have assumed that childcare costs rise as hours of work increase.

When asked to work extra shifts parents may find themselves in situations where it is impossible to calculate whether or not they will have sufficient extra hours for the rest of the month to get support with 85% of their childcare costs instead of 70%. This is crucial information in determining whether they will gain or lose by doing the extra work.

Many low income second earners who need to pay for childcare will find they can't make work pay at all. These are key problems that Universal Credit was meant to solve.

In contrast, the highest earners within Universal Credit, whose hourly rate of pay is much higher, will gain from an extra hour of work even if only 70% of their childcare costs are paid. Under this proposal they will receive 85% support with their childcare costs. For many of those who will receive this extra support it will clearly be helpful, but not essential to make work pay.

For example:

A couple with two children living in privately rented accommodation in the South East. Under Universal Credit they will have a gain from work of £165 a week if one of them earns £30,000 a year. If the second works twenty hours a week and earns £15,000 a year and they also have childcare costs of £115 a week, their gain from work will go up to £218 a week if their costs are covered at 70%. This contrasts very favourably with the gain from work under the present system of £138. Yet under this new proposal they will receive an extra 15% support with their childcare costs giving them a further £17.25 a week.

If the proposal remains, then the steps taken by the Coalition to raise the tax threshold will have proved very costly for some lone parents and second earners with high childcare costs as they will now have to earn £10,000 to become taxpayers and therefore be eligible for 85% childcare support. Those who earn between £6,745 and £10,000 a year will have gained at most £4.73 net a week after the UC taper is applied. But if their childcare costs are, for example, £100 a week, they will have lost £15. This is a total loss of more than £10 a week as a result of the personal tax threshold being raised.

## A better way to allocate the £200 million

This briefing examines the current proposal for the allocation of the additional £200 million and various alternative options. We have outlined the problems with the Governments proposed changes to support for childcare costs and have tested a number of alternative options against three criteria:

### 1. Ability to make working extra hours pay

For those who have low earnings but high childcare costs the key factor in determining whether working extra hours will pay is whether the gain from the extra hours is greater than the extra they have to pay towards their childcare costs and other expenses.

For each of our different options, we considered for someone earning the minimum wage, how much the childcare costs could be per hour, before they lose money by working an extra hour. Our analysis demonstrates that paying everyone 78% of their childcare costs would cost £200m, the same as the current two tiered proposal<sup>5</sup> - but would expose fewer people to the risk that they will lose money by working extra hours. Paying 80% of childcare costs would cost about £50m more, and could arguably be more straightforward for people to understand and calculate, and create clearer gains from work.

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<sup>5</sup> See Appendix 1 for our calculations of the costs of the various options

For example: **Under the current Government proposal** someone working 25 hours a week at the minimum wage would lose money if she worked an extra four hours of work if the cost of the extra childcare was more than £26.

**If she received 78% of support** with her childcare costs she would not lose money by working an extra four hours unless her extra childcare costs were more than £33 – a situation likely to put a lot less parents at risk of losing money by taking on extra work

**If everyone received 78% of support with childcare costs** then lone parents working fulltime at the minimum wage and therefore **paying tax** would lose money by working four extra hours if their extra childcare costs were more than £27.50. This is obviously a lower work incentive for this group than the current Government proposal to pay them 85% - however there is still less risk of losing money by doing extra work than if parents working part time on the minimum wage only received 70% of their childcare costs.

**The best solution is clearly to pay everyone 85%.** This would help ensure work paid for most lone parents and second earners however many hours they worked.

## 2. Ability to make moving into work of 10 to 29 hours per week pay

We looked at the financial gains from moving into work under the different options. Under the current proposal some lone parents and some second earners in a couple will struggle to make work pay in Universal Credit. They are likely to struggle to make the move into work pay if:

- the level of pay is at or near the minimum wage
- they have two or more children
- they have high childcare costs and
- they work between 10 and 29 hours a week

For example: Under the current Government proposal, consider the following scenario: A lone parent (with two children) who returns to work after maternity leave and works eight hours and earns £50 a week. She pays childcare costs of £30 a week and has a gain from work of £31 a week. However, if she worked 28 hours and earned £180 a week, with childcare costs of £155, she will actually have £2 less income than if she earned £50 a week, a gain from work of £29.

For parents with lower childcare costs, because their children are in school or in free childcare for some hours, the gain from work will be higher but the drop in income may still happen when childcare becomes necessary. For example, someone working twelve hours for £80 will have a gain of £53 if their three year old is in free childcare and their other child at school. However, if they work 24 hours per week earning £160 and their childcare costs are £80 a week because they are having to work some shifts out of school hours, their gain from work will drop to £51 a week.

It is important that substantial part time work pays, as it is often not practical for these groups to work longer hours, especially if they have young children. In order to achieve this it is important that the level of support for childcare costs is raised for all income groups, not just those who are paid more than £10,000 a year. Unless this happens, there is a risk that many parents currently working 16 to 29 hours a week will be forced into *reducing* their hours of work. They will initially be covered by transitional protection, but their real terms income will quickly erode following any change in circumstances which will result in transitional protection being removed.

For second earners in couples the gains from work will be significantly less than the previous examples because none of their earnings will be disregarded when they enter work. For example, a second earner returning to work after maternity leave, earning £50 and paying £30 childcare costs

would gain just £6 from working. The incentive for them to remain in work if they have childcare costs will be very low.

### **3. The extent to which the different options reduce income complexity and uncertainty**

Making work pay is not the only consideration. Having two rates of childcare costs payable depending on income introduces a level of complexity and uncertainty into Universal Credit. This complexity will deter people in low income work from taking on extra hours or shifts. For example, an employee who is offered extra shifts at the beginning of the month may not know whether, by month's end, they will have accrued sufficient earnings to take them to the higher level of childcare support. If the shifts involve expensive after school childcare it may mean they will lose money unless they are given financial support for 85% of their childcare costs. Low income families should not be faced with this sort of gamble especially when they are frequently under considerable pressure from their employers to take the extra shifts.

## **Conclusion**

If the current proposal for the additional £200 million funding is adopted it will improve work incentives for those on a low income with high childcare costs who are working full time. However, we are concerned that the current proposal does not address the problem of work incentives for those on a low income who have high childcare costs and who work in more substantial part time jobs. About two thirds of employed lone parents currently work between 16 and 29 hours a week. If they are also working at or near the minimum wage and have to pay for formal childcare many will find their entitlement under Universal Credit, once their transitional protection has gone, to be much less than under the current system. They may also find that they will be worse off as a result of working more hours unless they can regularly work more than thirty hours each week. It may not be appropriate for everyone to work more than 29 hours on a regular basis because of the needs of their children. This is especially true if their children are young and so the childcare costs likely to be high. It is vital that the system works for this group at this level of work. Second earners who earn at or near the minimum wage and who have high childcare costs will find it very difficult to make any work pay. It is clearly also arguably not cost effective to target a substantial proportion of the resources on higher earners who don't have a problem making work pay while those on a lower income have to make a greater contribution to their costs.

## **Recommendations**

We therefore recommend that the Government use the additional £200m funding for childcare support in Universal Credit to increase the single level of support for childcare costs originally proposed rather than create two levels of support. This would be in keeping with the Government's aims of creating a simpler system that incentivises work.

However, it is also clear from the analysis that £200 million would be insufficient to really improve work incentives for all parents with low incomes and high childcare costs. Gains from work would still be much lower than under the current system where some families get up to 90 per cent of their costs met. We recommend that the Government reconsider the split of new funding between the £750 million new funding for childcare vouchers for parents earning too much to be entitled to Universal Credit and the £200m extra in Universal Credit.

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## Section 2: Detailed analysis of the options

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The four options this paper considers are:

- Option 1: The current government proposal - provide support with 85% of childcare costs for taxpayers and 70% for rest (cost £200million)
- Option 2: Provide support with 78% of childcare costs for all UC claimants (cost £200 million)<sup>6</sup>
- Option 3: Provide support with 80% of childcare costs for all UC claimants (cost £250 million)
- Option 4: Provide support with 85% of childcare costs for all UC claimants (cost £400 million).

### Costs of childcare

In considering the above options and their impact on UC claimants we have worked through a number of scenarios based on average childcare costs as reported in the *Childcare costs survey 2013*.<sup>7</sup>

The average cost of a nursery place for a child under two is now £4.26 per hour across Britain. That works out at about £85 a week for twenty hours childcare for a child under two. In practice it may work out higher as parents often have to pay for whole sessions even if they only work for part of the time. Childminders who pick up children after school charge on average £72.78 a week, so collecting an older child two days a week would be about £30. The free childcare now offered to three and four year olds, and due to be offered to some two year olds, will certainly help, but it tends to be quite inflexible. Childminders offering wrap around care either side of the free care will often charge for those hours as well.

This doesn't take into account school holidays and the fact that the free childcare offer for three and four year olds is also only during term-time. Even if a parent is allowed to take all of their leave entitlement in school holidays they will still be working for at least seven and a half weeks when their child is on holiday from school or not getting free childcare plus any days leave they have to take because their child is ill. The average cost of one week's holiday childcare in Britain is now £109 a week<sup>8</sup>. Under the current system the gains from work during these periods don't drop significantly for low income workers because they are only paying 5% of the extra costs. The gains from work under UC during holiday months will drop much lower than shown in Tables 1,2 & 3 later in this section because the parent will be paying 30% of the much higher childcare cost.

There is a degree of variation in childcare charges in different regions. Parents in London are likely to find it particularly difficult to find affordable childcare. However, even with regional variation in childcare costs this proposal will be a problem nationally.

The choice for some, and the only affordable position for many, has been care by grandparents and extended family. However a number of grandparents and extended family members may themselves be claiming Universal Credit. With the increased levels of conditionality, many people may not be available for family childcare in the future.

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<sup>6</sup> NB these are very approximate and have been rounded to the nearest £50million as DWP figures on which they are partly based are rounded to nearest £100million. For further information on our calculations of the costs of the various options – see Appendix 1

<sup>7</sup> Daycare Trust and Family and Parenting Institute *Childcare costs survey 2013*

<sup>8</sup> <http://www.familyandparenting.org/news/Press-releases/2013+Press+Releases/Holiday+Childcare+Costs+Survey>



## 1. Make working extra hours pay

For each of the options presented below (childcare support at 70%, 78% or 80%):

- our example is a person who earns the minimum wage and is asked to work an extra shift outside school hours.
- we have identified the break-even point (BEP) at which her net gain<sup>9</sup> from the extra work would equal the contribution she would have to make to her childcare costs<sup>10</sup>
- we have used childcare costs at £6.50 per hour<sup>11</sup>

The breakeven point will be different for different income groups. This is because the amount they would keep, if they had no childcare costs, will depend on whether they pay any tax or national insurance. Under Universal Credit, their contribution to their childcare costs will depend on the percentage of help paid under the different options.

A lone parent who works in a supermarket earning the minimum wage is asked to do an extra shift working from 2pm to 7pm. Her childcare costs for two children for this extra shift are £6.50/hour (the horizontal line on the chart is at childcare costs of £6.50/hour). Under UC as it currently is (70% of childcare costs for everyone) she will gain a little by working the shift if she does not pay tax or NI. She will be at her breakeven point and gain nothing if she pays NI but not tax. She will actually lose money if she pays tax.

Under the current proposal she will gain significantly if she pays tax but the position remains the same for the two groups who don't pay tax. If her childcare costs are greater than £6.50 an hour for the after school shift then she will lose money if it brings her into the NI bracket.

It can be seen from Chart 2 below that the option of raising support for childcare costs to 80% for all those on a low income would lift the BEP for all the groups and ensure low paid parents can gain from working more hours.

Supporting childcare costs so as to ensure that those paying neither tax or NI, those paying NI but not tax and those paying both tax and NI all have a BEP which is as far as possible above this line is the optimally fair solution.

If a lone parent (or second earner in a household, working part time), is put under a lot of pressure to work extra shifts at times when their childcare costs are going to be expensive, it is important that the system does all it reasonably can to limit the risk that they will be worse off as a result of doing the extra work.

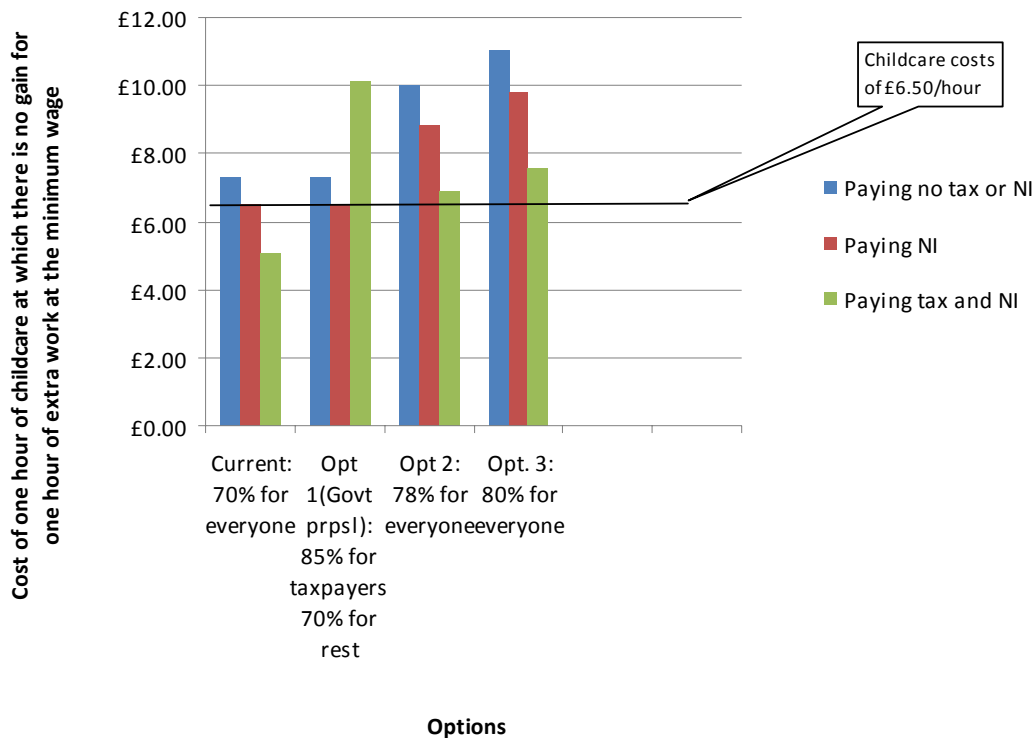
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<sup>9</sup> The net gain is calculated after paying any tax and national insurance, and after applying the UC taper

<sup>10</sup> Appendix 2 gives a table showing the breakeven point for each of the options

<sup>11</sup> See childcare costs section for an explanation of average childcare costs

**Chart 2: For each option - Cost of childcare/hr at which there is no gain for earnings of £6.31/hr**



CAB advisers continue to see a lot of parents who are being pressured into taking shifts that lead to expensive childcare.

One bureau in the South East advised a lone parent with two school age children. She had worked for ten years as a part time care worker in a residential nursing home. She was told she had to start working weekend shifts. She found it very difficult to get a reply to her request not to work these shifts and in the meantime faced a lot of unpleasantness from her manager.

Another client reported having to take extra shifts at very short notice therefore she was forced to use childcare agencies.

Providing support with childcare costs at 78% for all income groups would cost the same as the current Government proposal. However if everyone had 80% of their childcare costs paid then even those who are paying tax would have a breakeven point at childcare costs of £7.57an hour. This would at least make it likely that those with two children would be able to make most hours of work pay.

## 2. Making moving into work pay

Support for childcare also plays a significant part in determining whether moving into work will pay. We are concerned that under the current proposals many who are only able to earn the minimum wage and who have relatively high childcare costs will struggle to make work pay until they are able to earn more than £10,000.

## Work incentives for lone parents

Unsurprisingly lone parents are much more likely to be working fewer hours than the main earner in a couple. Of all the lone parents who are working and claiming tax credits, almost two thirds (about 700,000 out of the 1.15 million lone parents in work) work between 16 and 29 hours a week. Anyone working 29 hours a week at the minimum wage will be earning about £9,500, so will not be earning under the 2014 tax threshold.

Of the 446,000 households who receive the childcare element in their tax credit award, approximately 100,000 of these households<sup>12</sup> also receive further help with their childcare costs through increased levels of housing and council tax benefit. Someone in this position could be receiving 95% of support for their childcare costs in the present system, that is 70% through tax credits and a further 25% (actually 25.5%) through increased housing benefit and support for council tax.

### *Free school meals*

An additional factor which has to be considered in any calculations as to whether work will work pay is how access to free school meals will be withdrawn as someone moves up the income scale. Citizens Advice has advocated a tapered system of withdrawal so that there is not a sudden drop in income as hours of work increase. However it seems to be likely that at least in the short term there will be an income threshold at which free school meals will be lost. In the following tables we have assumed it will be around the £7000 a year mark.

## Work incentives under the different options for support with childcare costs

*The tables below show the financial gain from moving into work, for a lone parent with 2 children<sup>13</sup>, aged one and five in both the current system and under Universal Credit.* The scenario assumes she has been on maternity leave and now wishes to return to work. The scenario looks at the various options for hours of work. She lives in rented accommodation costing £100 a week and pays council tax of £20 a week. On moving into work in the current system and at an income above £7000 per year in UC we have assumed the loss of free school meals worth £7 a week for the older child. In the current system we have assumed a loss of £7 for all the in work scenarios.

Table 1 shows what happens to her income under Universal Credit if the current proposal to pay 85% of childcare costs to taxpayers and 70% of childcare costs to everyone else is followed. Tables 2, 3 and 4 show the impact of providing support for childcare costs for all claimants at 78%, 80% and 85%. The first line of the tables assumes she is working about seven hours a week at around the minimum wage and paying childcare costs of £30 a week. As her hours of work increase her childcare costs also increase. For the first two lines of the tables, she is only paying childcare costs for her younger child. In the third and subsequent lines as her hours of work increase, the scenario assumes she is also paying for some after school care for her older child.<sup>14</sup> This is because once her hours of work reach about 20 hours per week it is difficult to find work entirely within school hours and it becomes necessary to purchase out of school hours childcare.<sup>15</sup>

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<sup>12</sup> PQ from Karen Buck MP 12 July 2011

<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110712/text/110712w0001.htm#11071294001115>

<sup>13</sup> About a third of lone parents in work have two children - HMRC statistics Working tax credit and child tax credit Dec 2012

<sup>14</sup> Once hours of work increase to this level -about 20 hours/week - and often for fewer hours than this, it is hard to find work that is solely within school hours.

**Table 1: Gains from work under i) the current system and ii) Universal Credit (the current Government proposal).**

Gross income /yr	Gross income /wk	Hours of work	Childcare costs /wk	Gain/wk from moving into work in current system	Weekly net gain from work in UC <sup>16</sup>
£2600	£50	7	£30	<b>Loss</b>	<b>£31</b>
£4200	£80	12	£60	<b>Loss</b>	<b>£36</b>
£6780	£130	20	£115	<b>£71</b>	<b>£33 (£26)<sup>17</sup></b>
£9385	£180	28	£155	<b>£73</b>	<b>£29</b>
£12000	£230	36	£200	<b>£76</b>	<b>£58</b>
£14600	£280	42	£250	<b>£76</b>	<b>£63</b>

As can be seen a lone parent under this scenario gains from working a lower number of hours but when she increases her hours to between 16 and 29 hours (the hours which most lone parents currently work) she starts to lose money compared to when she was working fewer hours. If the earnings threshold at which free school meals are lost is lower then the dip will be even greater.

The following tables consider the impact on the same lone parent if all childcare costs were paid at 78% (Table 2), 80%. (Table 3) and 85% (Table 4)

**Table 2: Gains from work under i) the current system and ii) Universal Credit (support for 78% childcare costs)**

Gross income /yr	Gross income /wk	Hours of work	Childcare costs /wk	Gain/wk from moving into work in current system	Weekly net gain from work in UC
£2600	£50	7	£30	<b>Loss</b>	<b>£33</b>
£4200	£80	12	£60	<b>Loss</b>	<b>£41</b>
£6780	£130	20	£115	<b>£71</b>	<b>£42</b>
£9385	£180	28	£155	<b>£73</b>	<b>£41</b>
£12000	£230	36	£200	<b>£76</b>	<b>£44</b>
£14600	£280	42	£250	<b>£76</b>	<b>£46</b>

**Table 3: Gains from work under i) the current system and ii) Universal Credit (support for 80% childcare costs)**

Gross income /yr	Gross income /wk	Hours of work	Childcare costs /wk	Gain/wk from moving into work in current system	Weekly net gain from work in UC
£2600	£50	7	£30	<b>Loss</b>	<b>£34</b>
£4200	£80	12	£60	<b>Loss</b>	<b>£42</b>
£6780	£130	20	£115	<b>£71</b>	<b>£45</b>
£9385	£180	28	£155	<b>£73</b>	<b>£45</b>
£12000	£230	36	£200	<b>£76</b>	<b>£48</b>
£14600	£280	42	£250	<b>£76</b>	<b>£50</b>

<sup>16</sup> The calculations in this document are based on council tax eligible for support being 91.5% and council tax reduction being calculated according to the default scheme.

<sup>17</sup> If FSMs lost at income threshold of £6000

**Table 4: Gains from work under i) the current system and ii) Universal Credit (support for 85% childcare costs)**

Gross income /yr	Gross income /wk	Hours of work	Childcare costs /wk	Gain/wk from moving into work in current system	Weekly net gain from work in UC
£2600	£50	7	£30	<b>Loss</b>	<b>£36</b>
£4200	£80	12	£60	<b>Loss</b>	<b>£45</b>
£6780	£130	20	£115	<b>£71</b>	<b>£50</b>
£9385	£180	28	£155	<b>£73</b>	<b>£52</b>
£12000	£230	36	£200	<b>£76</b>	<b>£58</b>
£14600	£280	42	£250	<b>£76</b>	<b>£63</b>

As can be seen the higher the support for childcare costs the more substantial the gain from work and the less risk that a parent will lose money by working extra hours.

### Work incentives for families with more than two children

The calculations above are based on two children. If the lone parent in the above scenario had three children then her gain from work under the current system is £9 higher. Her gain from working and earning £130 a week will be £80 a week. For each subsequent child her gain, in working, would go up by an extra £9 a week. Under the current system and probably under UC claimants will have lost entitlement to free school meals if they are earning this much. Families with higher numbers of children are also likely to have to make a higher contribution to childcare as well as losing more from the loss of free school meals. The extra gain for each child in the current system when a parent moves into work only partially compensates for these extra costs. In Universal credit on the other hand, there is no extra gain on moving into work for households with more than one child. There are also likely to be extra costs when working, such as for transport and for informal payments of extra informal childcare when formal care isn't available. Many lone parents with three or more children will really struggle to gain anything from working if they have to pay childcare costs. The difference in the level of support for childcare costs will be even more crucial for these parents if they are on a low income and have high childcare costs.

Advisers in bureaux already see lone parents who are struggling to make work pay because of expensive childcare.

*A bureau in the South West saw a lone parent who worked part time as a bank auxiliary home carer. She had a ten year old son. The adviser remarked that her client's employer kept changing the client's hours and asking her to "work difficult hours which in turn forced her into using expensive childcare". The impact of the changing hours, expensive childcare and slowness of employer to pay expenses was that she was in a lot of debt including rent arrears and close to losing her home. She felt trapped because she was worried that if she gave up work her benefits would be sanctioned.*

### Second earners

Second earners in a couple are in a slightly different position. They may have more flexibility to share the childcare with their partners after school and during school holidays by taking some leave at different times. The proportion of couples claiming the childcare element for older children is much lower than for lone parents<sup>18</sup>.

However those who have young children and who have a relatively low earning power compared to their childcare costs are likely to find it extremely difficult to move into work at all unless they can

<sup>18</sup> HMRC statistics Working tax credit and child tax credit Dec 2012

find work which fits into any hours of free childcare or informal childcare they are offered. This is because as the second earner in the household they are not entitled to any disregard of earnings.

**Under the current system**, many couples, where both are in work will be receiving tax credits but not housing or council tax benefit. Any extra earnings will be subject to the tax credit taper of 41% so they will keep **£59 of the first £100 earned**. If their childcare costs are £100 they will contribute £30 so **will gain £29**.

**Under UC**, they will keep £35 of the first £100 earned once the UC taper has been applied. Under the current Government proposal they will receive support with 70% of their childcare costs so their contribution to childcare costs of £100 will be £30 leaving them **with a gain of £5**. It is hard to see how a low income second earner in a couple, that doesn't have access to informal childcare, will be able to return to work after maternity leave for a second child.

Even under the current system some have trouble making work pay:

*A client of a London bureau wants to go back to work after her maternity leave finishes. However she has had twins and cannot see how she can work without losing money unless her employer is prepared to offer very flexible working.*

### Making work pay for those higher up the income scale

However for those higher up the income scale there is not the same issue of making work pay. Table 5 below shows the scenario for a couple who have also have two children aged five and one. They are both teachers one works full time earning £30,000 a year and his partner wants to return to work part time after her maternity leave at the full time equivalent of £30,000 a year. They live in a privately rented house in North London and pay rent of £250 a week. We have assumed the same hours of work and the same childcare costs as for the lone parent in the previous scenario but the hourly rate of pay is higher so in this situation they would receive 85% support with their childcare costs when she works twenty hours.

**Table 5: Gains from work under i) the current system and ii) Universal Credit (current proposal)**

Gross income /yr of couple	Gross income /wk of second earner	Hours of work	Childcare costs /wk	Gain/wk from moving into work in current system	Weekly net gain from work in UC <sup>19</sup> (support for 70% childcare costs)	Weekly net gain from work in UC (support for 85% childcare costs)
£30,000	£0	0	£0	<b>£98</b>	<b>£165</b>	<b>£165</b>
£36,000	£115	7	£30	<b>£101</b>	<b>£196</b>	<b>£196</b>
£38,500	£163	12	£60	<b>£87</b>	<b>£203</b>	<b>£203</b>
£45,000	£288	20	£115	<b>£138</b>	<b>£218</b>	<b>£235</b>

As can be seen there is the same problem of working less than 16 hours in the current system but under Universal Credit there are significantly higher gains. In the current system, when the couple have a joint income of £45,000 a year and childcare costs of £115 a week they are £138 a week better off than if the second earner were out of work. Under Universal Credit with childcare costs covered at 70% they are £218 better off than if she was not in work after they have paid their childcare costs. Yet under this proposal they will receive an extra 15% support with their childcare

<sup>19</sup> The calculations in this document are based on council tax eligible for support being 91.5% and council tax reduction being calculated according to the default scheme. The gain from work is compared to the current system as in UC the benefit cap would reduce the out of work income by a further £11

costs giving them a further £17.25 a week. The second earner in this scenario does see a steady gain for increased hours of work because her hourly pay rate is higher.

### 3. Reducing complexity and uncertainty

Providing different levels of support with childcare costs depending on the level of income introduces a level of complexity and uncertainty that risks deterring claimants from taking extra hours of work. Workers are frequently unable to predict what work they are going to be offered from week to week. Someone working in a supermarket or in a residential home may be pressured to do a couple of extra evening shifts for a couple of weeks because several people are off sick but may be unable to predict whether these extra shifts will be available for the full month. This may mean that they don't know whether they will receive 85% of their costs or 70% yet if they don't receive 85% of their costs they may lose money by doing the extra work.

This could be a particular problem for those employed on zero hours contracts, a type of highly flexible and precarious employment, in which the employer is not required to offer any set number of hours per week to the employee<sup>20</sup>. In October 2012 to December 2012 208,000 people reported they were on a zero hours contract up from 134,000 in 2006<sup>21</sup>. They tend to be in low hours low paid work. Workers on zero hours contracts report that their hours and earnings fluctuate and made it difficult to budget. Although technically they are not obliged to take disadvantageous hours, workers report that they are often afraid that refusing antisocial or inconvenient offers of shifts might result in their loss of future possible work. Given this pressure not to refuse the work it is vital they have enough information to know the likely impact on their finances.

Bureaux see a lot of clients who are expected to work variable hours or are on zero hours contracts. Sometimes the demands for them to work extra hours are at very short notice.

*One adviser reported seeing a lone parent with a three year old child. The client resigned from her job because of the level of unpleasantness caused by this issue. She worked for a clothing company and was frequently rung at very short notice and asked to work an extra shift. The adviser commented that the client "felt under pressure to agree to the shift as she felt that she couldn't face the uncomfortable atmosphere at work when she would return if she refused." With the help of the bureau she managed to get an agreement about not being pressured into taking shifts that caused her difficulties with her childcare. However as a result, the atmosphere between her and her manager became so unpleasant that she felt she had no option but to resign.*

**Claimants should not be put in a position where they are being pressured to take a gamble as to whether they will lose money if they agree to do an extra shift.**

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<sup>20</sup> <http://www.resolutionfoundation.org/publications/matter-time-rise-zero-hours-contracts/> p6

<sup>21</sup> <http://www.resolutionfoundation.org/publications/matter-time-rise-zero-hours-contracts/> p8

## Conclusion

We welcome the fact that childcare support will be available in Universal Credit for those working less than 16 hours. This will make it possible to make a few hours of work pay. However, about two thirds of employed lone parents currently work between 16 and 29 hours a week. If someone is paid the minimum wage or near it (£6.31 up to about £7.50 per hour), and works between 16 and 29 hours, they are likely to be in the group paying National Insurance but not tax. Someone working 29 hours at the minimum wage will earn about £9,500. It may not be appropriate for everyone to work more than 29 hours on a regular basis because of the needs of their children. This is especially true if their children are young and so the childcare costs likely to be high. It is vital that the system works for this group at this level of work. Second earners who earn at or near the minimum wage and who have high childcare costs will find it very difficult to make any work pay.

Providing support with 78% of childcare costs for all Universal Credit claimants would have the same approximate cost as the current Government proposal to pay 85% of costs to those earning at least £10,000 and 70% to those earning less than this. However paying 78% of childcare costs for everyone would have the advantage of lifting everyone further away from the risk that they might actually lose money as a result of working an extra shift. The current Government proposal assists those who are paying tax but leaves those paying only NI not able to make extra work pay if their childcare costs are roughly equivalent to their earnings and as they are more likely to be on a low wage per hour, they as a group are also more likely to struggle to make moving into work pay.

About two thirds of lone parents who are in work, work between 16 and 29 hours a week on average. Anyone who works these hours at or near the minimum wage will be likely to not be paying tax or NI, or just be paying NI. It may well not be appropriate, even if the work was available, for them to work longer hours than this on a regular basis because of the needs of their children. This is especially true if their children are young and so the childcare costs likely to be high. It is vital that the system works for this group at this level of work.

About 55% of second earners in a couple also work between 16 and 29 hours a week. Second earners in low income couples, will find it even more difficult to make any gain from working part time.

We therefore recommend that the Government use the additional £200m funding for childcare support in Universal Credit to increase the single level of support for childcare costs originally proposed rather than create two levels of support. This would be in keeping with the Government's aims of creating a simpler system that incentivises work. Providing support for 78% of childcare costs for all Universal Credit claimants would be the most effective solution that keeps closest to the allocated budget of £200 million.

However, it is also clear from the analysis that £200 million would be insufficient to really improve work incentives for all parents with low incomes and high childcare costs. Gains from work would still be much lower than under the current system where some families get up to 90 per cent of their costs met. We recommend that the Government reconsider the split of new funding between the £750 million new funding for childcare vouchers for parents earning too much to be entitled to Universal Credit and the £200m extra in Universal Credit.

In any event we believe that in order to make both entering work and taking extra hours pay, as well as to reduce complexity and uncertainty, it is vital that costs are paid as evenly and as transparently as possible.



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## Appendix

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### 1. Costs of the options

Of the 446,000 households who receive help with childcare costs through the tax credit system, 120,000 of them face childcare costs of more than £120 a week (71,000 lone parents and 49,000 couples) and the average allowed cost of childcare is £89<sup>22</sup> a week. Adjusting for inflation using predicted RPI we would expect the average allowed cost to be about £100 a week in 2016. To increase the percentage help with childcare for all of those on tax credits from 70% to 85% would therefore cost approximately £15 a week, £780 a year for an average claimant or about £350 million for all the claimants currently claiming the childcare element within the tax credit system.

There are a further 80,000 families who are not entitled to support for their childcare costs through the tax credit system. The cost for paying 70% of their childcare costs in UC was covered by the extra £300 million put into the system in 2011<sup>23</sup>. We assume therefore that the cost of raising the help with childcare costs by 15% for this group is just over £60 million.

This gives an approximate cost of just over £400 million in total which correlates with the answer given by Esther McVey to a PQ on June 18th<sup>24</sup>. The cost of raising the level of support for all claimants to 78% will therefore be approximately half of £400 million - about £200 million.<sup>25</sup> The cost of raising support to 80% for everybody will be just under two thirds of the cost of raising it to 85% - about £250 million<sup>26</sup>

### 2. Calculating the breakeven point for the various options

**The breakeven point is the point at which the gain from working the extra shifts will equal the contribution they have to make towards their extra childcare costs.**

**For example: The current proposal is that 70% of childcare costs will be paid for those earning enough to pay national insurance (NI) but not tax. The following calculation shows what the breakeven point would be for that group.**

Someone who earns an extra £100, after paying NI (at 12%) will have net earnings of £88. After the UC taper is applied, they will be left with 35% of £88 so their gain from working will be £31. *So £31 would be the gain from earning an extra £100 if there were no extra costs from doing the extra work*

Under the current government proposal they would have to pay 30% of any extra childcare costs. Their extra expenses including their childcare costs must be no more than £31 or they will be losing money as a result of working. If 30% = £31 then 100% = £103. *If her total extra childcare costs for working extra shifts paying £100 gross are £103 then she will be at breakeven point – she will gain nothing from the extra work.*

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<sup>22</sup> HMRC statistics Dec 2012, Table 4.4

<sup>23</sup> <https://www.gov.uk/government/news/more-families-will-be-paid-childcare-support-than-ever-before>

<sup>24</sup> **Hodgson - Universal Credit (Recovery of childcare costs)**

Tue, 18 June 2013 | House of Commons - Written Answer

<sup>25</sup> Although 8% rise for everyone is slightly more than half of 15% - this will be balanced by the loss of some claimants at the top of the income range from the system if support for them is lowered from 85% to 78%. The raising from 70% to 78% for those earning less than £10,000 is unlikely to bring any new claimants into the system. However the lowering of the support for higher earning claimants from 85% to 78% must take some people out of the system

<sup>26</sup> Rounded to nearest £50 million

The average costs of a childminder looking after a child is about £4 an hour<sup>27</sup> if there are two children it is not hard to envisage that, even if childcare costs are not required for the whole of the fifteen hours, then the cost could be in the region of £100.

For the various options, the following table shows the childcare costs breakeven point for extra earnings of £100. At the breakeven point the gain from working the extra shifts will equal the contribution they have to make towards their extra childcare costs. Clearly the higher the childcare costs at the breakeven point the better chance that someone will be able to find childcare which costs less than this and so gain something from working an extra shift.

**Appendix table 1: For 4 possible options – the level of extra childcare costs at which there is no gain from earning an extra £100 for different income groups**

Options for % of childcare costs covered				Cost of options (millions) <sup>28</sup>
	Paying no tax or NI	Paying NI	Paying tax and NI	
Gain/hour if no childcare costs	£2.21/hour	£1.95/hour	£1.51/hour	
	<b>Level of child care costs/hour at which there is no gain from work if you earn the minimum wage of £6.31/hour</b>			
	Paying no tax or NI	Paying NI	Paying tax and NI	
<b>Current position: pay 70% of childcare costs</b>	At £7.32/hour childcare costs there is no gain from £6.31/hour extra pay	£6.50 /hour childcare costs	£5.05/hour childcare costs	0
<b>Option 1: Current government proposal -Pay 85% to taxpayers and 70% to rest</b>	£7.32/hour	£6.50/hour	£10.10/hour	£200m
<b>Option 2: pay 78% of childcare costs</b>	£10.03/hour	£8.83/hour	£6.88/hour	£200m
<b>Option 3: pay 80% of childcare costs</b>	£11.04/hour	£9.78/hour	£7.57/hour	£250m
<b>Option 4: pay 85% of childcare costs</b>	£14.70/hour	£13/hour	£10.10/hour	£400m

<sup>27</sup> [http://www.daycaretrust.org.uk/data/files/Research/costs\\_surveys/Childcare\\_Costs\\_Survey\\_2013.pdf](http://www.daycaretrust.org.uk/data/files/Research/costs_surveys/Childcare_Costs_Survey_2013.pdf)

<sup>28</sup> NB these are very approximate and have been rounded to the nearest £50million - DWP figures are rounded to nearest £100million. For further information on our calculations of the costs of the various options – see Appendix 1