Paying the Price

Childcare in universal credit and implications for single parents

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About this report

This report was commissioned by Gingerbread and is a supporting paper to The childcare challenge, the third report from Gingerbread's Paying the Price project.

The project runs until December 2015, and examines single parents' experiences of the 'age of austerity'.

Stay up to date with the project: www.gingerbread.org.uk/payingtheprice

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Introduction

The government proposes to increase childcare support in universal credit to 85 per cent of costs up to £175 for one child and £300 for two or more, in April 2016. This replaces the current system of 70 per cent up to the same limits. This paper reviews some consequences of the proposed changes for the adequacy of childcare support for single parents on low incomes.

For low income families using a substantial amount of eligible childcare, the change will produce a big gain, halving the cost to themselves of childcare from 30 per cent to 15 per cent of fees. It will improve the gain for working additional hours where this means more childcare is needed, and ensure that unless the relationship between wages and childcare costs is particularly unfavourable, net income will normally increase with additional hours – addressing the 'hours trap'. However, this will not be the case where childcare costs exceed the maximum eligible for reimbursement, and the failure to uprate this capped level over the past decade while childcare fees increase will make this a growing drawback if not addressed.

The calculations presented here ask the following questions:

1. How will the change in policy in 2016 typically affect the adequacy of the incomes of single parents with young children?
2. How will the change affect the incentive to work more hours for single parents with various wages and childcare costs?
3. What will happen in the future, both with the present cap on eligible support and if it is raised, and how much difference will the changes have made by 2018 to single parents' living standards?
4. Would lifting or redesigning the cap be costly?

Main effect of the policy

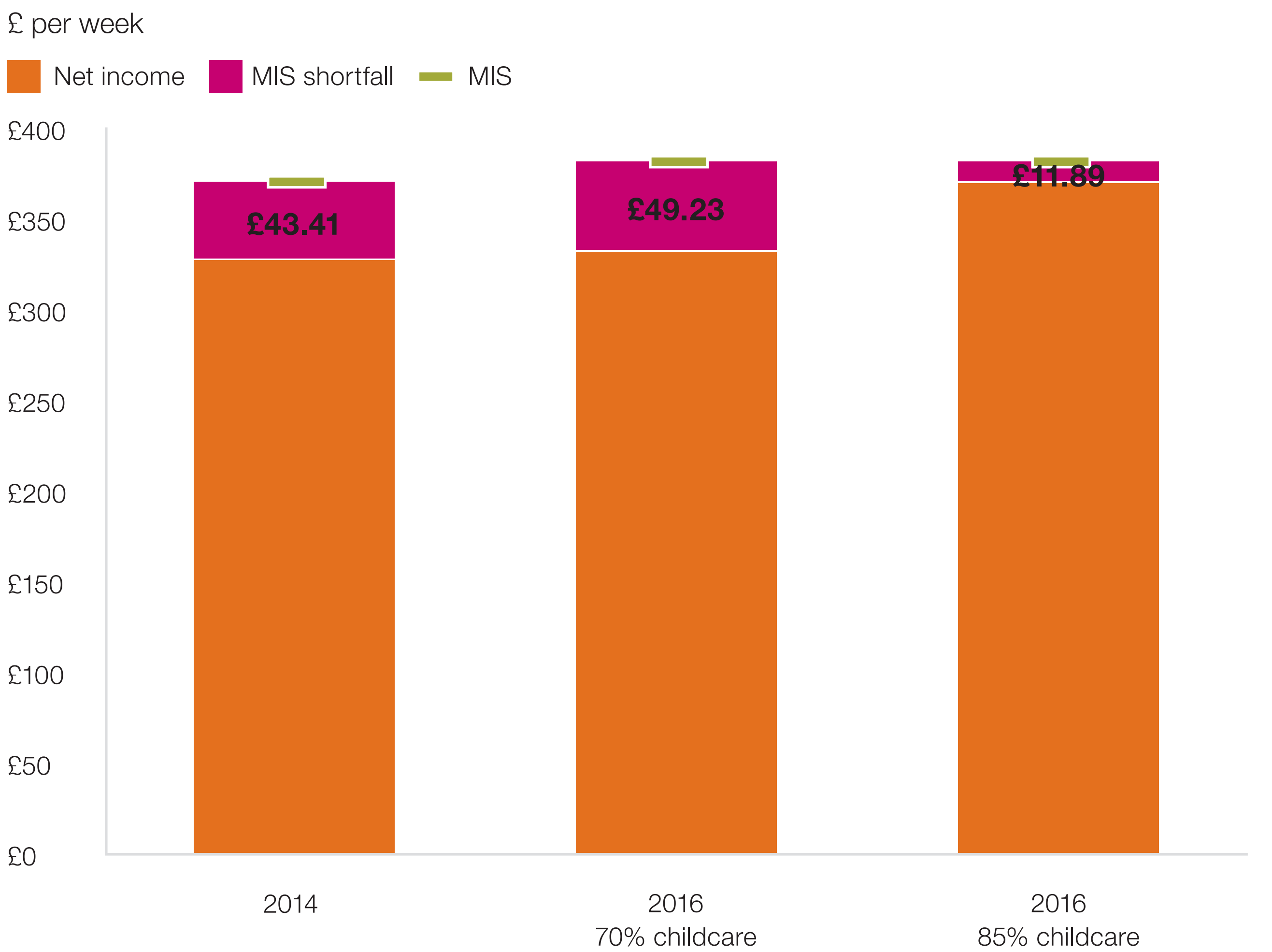
To assess the effect of the policy on the adequacy of family income, we can consider the net net income of single parent families before and after the policy, relative to the Minimum Income Standard (MIS). This standard represents what families need for a minimum acceptable standard of living, as defined by groups of members of the public in detailed discussion about what things need to go into a minimum household budget (Bradshaw et al., 2008; Davis et al., 2014).

The net income calculations consider how much families have after paying rent (assuming the most modest costs, a social housing model), childcare costs and tax, and receiving universal credit and Child Benefit. They are based on scenarios of single parents working full- or half-time on the median wage for all UK workers or on a low wage (represented by the lower quartile of the UK wage distribution). This gives a sense of whether people in ordinary or low-paid jobs can support families through work, on the assumption that going out to work causes them to incur childcare costs when their young children are not at school or benefiting from the 15 hours a week free childcare to which three and four year olds are entitled.

Figure 1 gives a core example of how the policy affects the adequacy of a single parent's income (using a model of childcare costs based outside London – see Appendix 1). Table 1 extends this to other family types at various wage rates, working full-time and part-time. These comparisons enable us to see not just how people's incomes are changing over time in a changing policy environment, but also how this compares to a presumed increase in the costs that they face (assumed here to be in line with inflation).

Figure 1 shows the general pattern: under current policy, a single parent of two young children faces a growing shortfall compared to the minimum needed. This is because in-work benefits are not keeping up with rising costs, and the freezing of the universal credit work allowance means that pay rises are sharply clawed back through the benefit's taper. However, the proposed increase in childcare support in 2016 will get families much closer to what they need for what the public deems to be a minimum acceptable living standard. This general pattern is also true in all the examples shown in Table 1, although the cases range from the shortfall being removed entirely (for a single parent working full-time on the median wage, with one small child) to being left with a shortfall of over £80 even with the new policy (a single parent working part-time on a low wage, who has three young children).

Figure 1 Weekly net income relative to MIS: Single parent with two children aged one and four, working full-time on the median wage



Broadly speaking, Table 1 shows that:

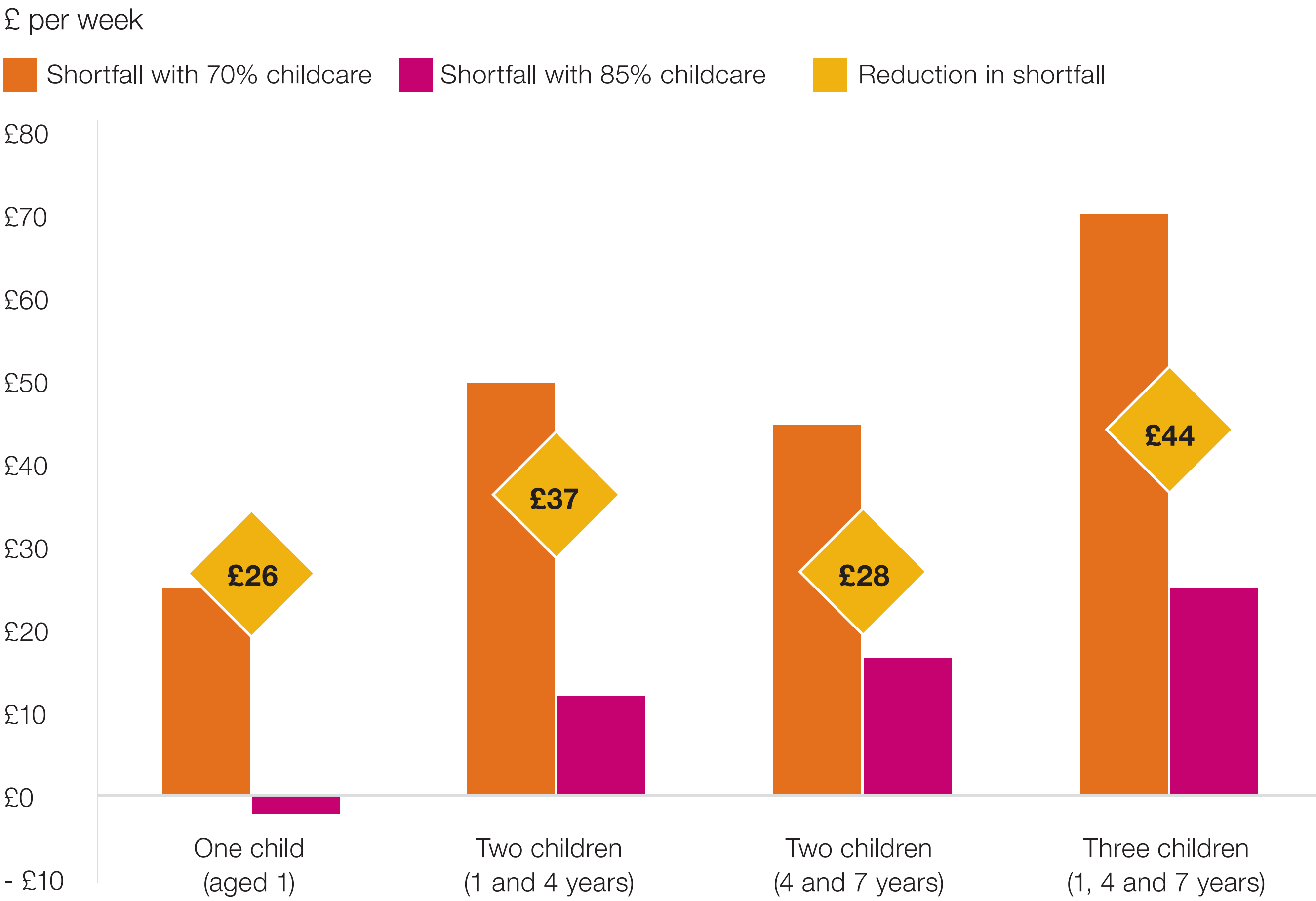
- The shortfall is, not surprisingly, higher with more young children, especially those who are not yet in school
- There is less difference for people working part-time, since they use less childcare. For these groups, low earnings more than high childcare costs make a difference, but (as noted below), better support for childcare at least improves the opportunity to change this by working more hours.

Table 1 Weekly net income of single parents relative to MIS, by number and age of children, working hours and wage

	MIS	Actual net income							
		(i) Full-time, median wage		**(ii) Half-time, median wage**		**(iii) Full-time, lower quartile wage**		**(iv) Half-time, lower quartile wage**	
Child age 1		**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**
2014	£290.98	£273.46	£17.52	£243.25	£47.73	£242.58	£48.40	£225.07	£65.91
2016 70 per cent childcare	£299.48	£275.15	£24.32	£247.47	£52.01	£242.68	£56.80	£227.58	£71.90
2016 85 per cent childcare	£299.48	£301.40	-£1.93	£261.67	£37.81	£268.93	£30.55	£241.78	£57.70
Children age 1 and 4		**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**
2014	£369.10	£325.69	£43.41	£304.58	£64.52	£294.81	£74.29	£286.41	£82.69
2016 70 per cent childcare	£379.88	£330.65	£49.23	£309.08	£70.80	£298.18	£81.70	£289.19	£90.69
2016 85 per cent childcare	£379.88	£367.99	£11.89	£327.15	£52.73	£335.51	£44.37	£307.26	£72.62
Children age 4 and 7		**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**
2014	£383.18	£344.08	£39.10	£319.81	£63.37	£313.20	£69.98	£301.63	£81.55
2016 70 per cent childcare	£394.37	£350.28	£44.09	£325.37	£69.00	£317.81	£76.57	£305.48	£88.89
2016 85 per cent childcare	£394.37	£377.80	£16.57	£334.46	£59.91	£345.32	£49.05	£314.57	£79.80
Children age 1, 4 and 7		**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**	**Income**	**Shortfall**
2014	£445.21	£384.26	£60.95	£370.21	£75.00	£353.38	£91.83	£352.03	£93.18
2016 70 per cent childcare	£458.21	£389.23	£68.99	£375.27	£82.94	£356.75	£101.46	£355.38	£102.83
2016 85 per cent childcare	£458.21	£433.46	£24.75	£394.67	£63.54	£400.99	£57.22	£374.78	£83.43

Figure 2 summarises the effect of the policy by number and age of children. With just one child, the new policy will eliminate the shortfall for a single parent working full-time on the median wage, but the absolute size of the reduction is greater for those with more than one child requiring childcare – a reduction of nearly £40 a week for a single parent working full-time with a pre-school child and an infant. A larger family can gain even more, but as shown in the last example in Figure 4, may still be left well short of what they need, because of high family costs regardless of childcare.

Figure 2 Reduction in weekly net income shortfall: Single parent working full-time, on the median wage, by number and age of children, 2016



Rewards for additional hours

As has been documented elsewhere (eg Hirsch and Hartfree, 2013), universal credit gives good incentives to work up to about nine hours a week, but beyond that the rapid reduction of support combines with childcare costs to bring little or no return for extra hours (especially once income tax kicks in). How much will the new policy alleviate this problem?

Figures 3 and 4 show for different childcare costs (ranging from the cheapest region for childminders, West Midlands, to the most expensive, London) how much a family would gain from moving from half- to full-time in 2016. Figure 3 shows that under the 70 per cent system, these gains are very modest or even negative (ie single parents are worse off working longer hours), and strongly negative in London. Figure 4 shows that with the 85 per cent policy, there is in most cases a much larger gain from working full-time: for example, someone on a median wage and paying the average national childcare rate gains £37 a week from working full-time rather than half-time with the new policy rather than £14 under the existing one.

However for London, while the loss resulting in moving to full-time and taking on extra childcare is reduced under the new policy, it remains large. This is because average London childcare costs for a full-time worker already exceed the limit for support, so the additional expense associated with working extra hours is far greater, and does not all benefit from the increase to 70 to 85 per cent support. The final part of Figure 4 therefore shows what would happen if universal credit supported Londoners' childcare costs at least up to the average level of London childcare rates, and that therefore the full fee was eligible for the subsidy. This shows that for someone on the median wage, this would make the difference between a loss of £36 and a gain of £29 a week, and that even for someone on the minimum wage it would result in a small gain.

To understand better these calculations for London, we can express the current caps in terms of hours of childcare fees at average London rates (projected to be £5.90 for 2016). For one child without any subsidy, the present limit of £175 a week covers just less than 30 hours, whereas a parent working full-time would need cover not just for the additional hours that she works above this amount, but also for drop-off and pick-up times. A median wage, net of taxes and universal credit reductions, will yield only about £2.90 an hour, leaving an additional shortfall of £3 for each hour worked and requiring additional childcare above the limit. For families with children at school or benefiting from the 15 hour free childcare entitlement, the number of hours at which the caps kick in will be greater, although neither of these free forms of childcare last all the year. For a family with at least three young children, the chance of hitting the cap is considerable, given that the limit of £300 for two or more children is only about 1.7 times the one-child limit of £175, but may have to cover three or more times as many childcare hours.

Table 2 below supplements the above analysis of work incentives by looking at whether there are circumstances in which single parents are still worse off as a result of working additional hours under the 85 per cent policy, even where the cap on eligible costs does not take effect. There inevitably are: as long as families are liable for some childcare costs, there will be a level at which these costs exceed marginal income on a low wage. However, the table shows that even in the extreme case of someone on the minimum wage supporting four children in childcare, the family will gain from work unless childcare costs are above average. In general it is only a triple combination of low pay, high childcare costs and multiple children requiring childcare that would make a family worse off by working full-time.

Table 2 Hourly wage required to break even when working an additional hour, if 85 per cent of childcare costs are supported, 2014

Hourly wages in red are above the current national minimum wage

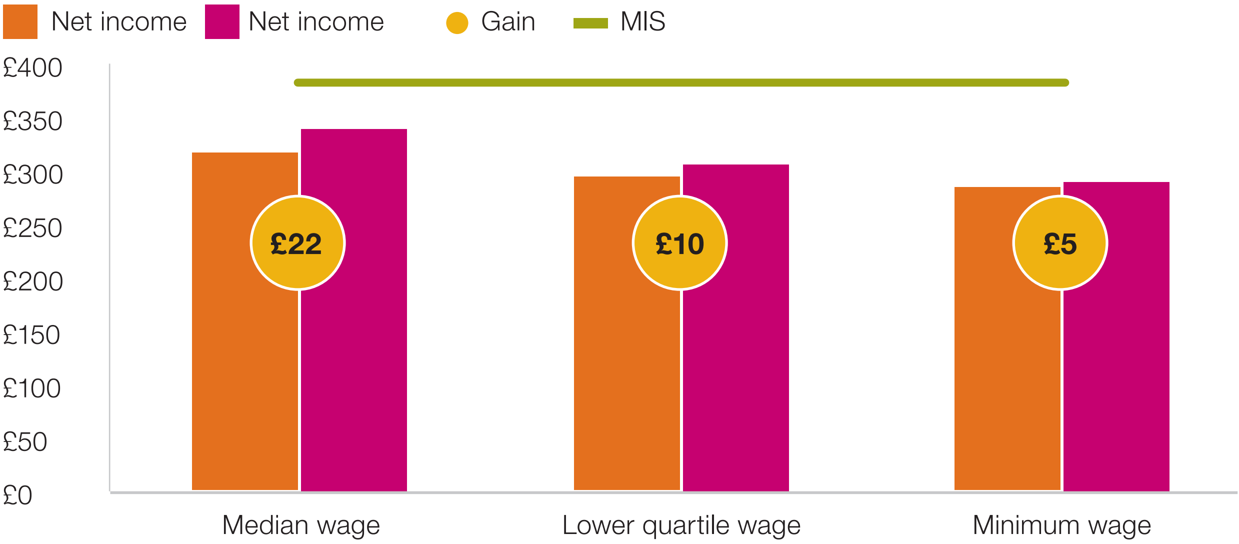
Average childcare costs	**Childcare cost per hour**	**Hourly wage required to break even when working an additional hour, by number of children**			
		1 child	***2 children***	***3 children***	***4 children***
UK average childcare cost (including London)	£4.02	£2.51	£3.77	£5.03	£6.28
London average childcare cost	£5.55	£3.47	£5.20	£6.94	£8.67
Lowest childcare costs at which a single parent is no better off on the minimum wage, by number of children					
Two children	£6.93	£4.33	£6.50	£8.67	£10.83
Three children	£5.20	£3.25	£4.88	£6.50	£8.13
Four children	£4.16	£2.60	£3.90	£5.20	£6.50

NB The 'break-even' point is where net hourly wage equals 15 per cent of childcare costs (ie the unsubsidised proportion of childcare)

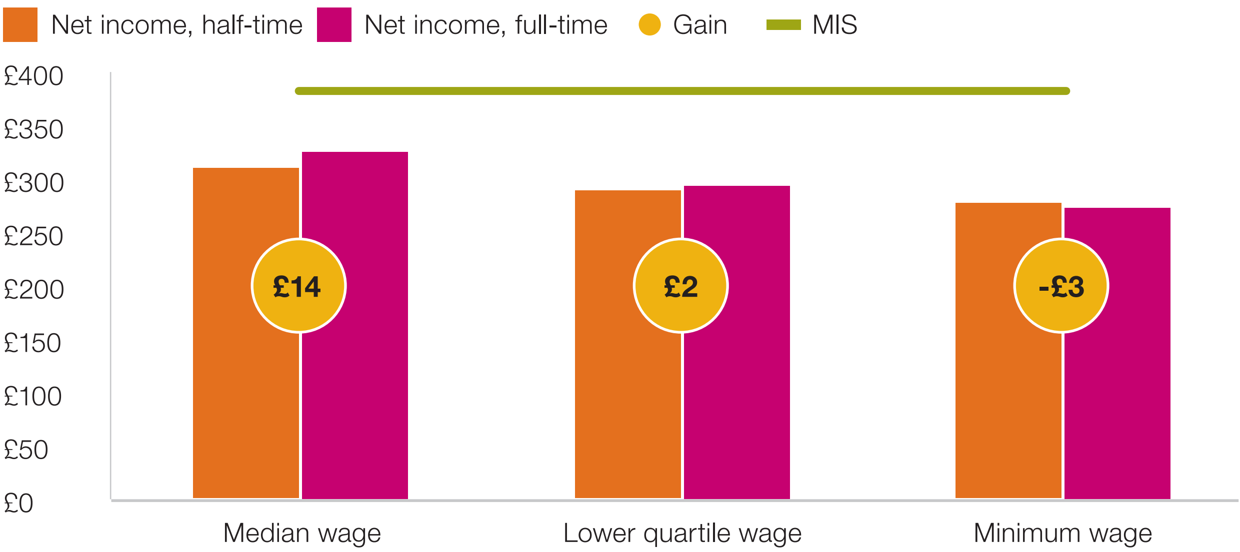
Figure 3 Weekly net income gain from moving from half- to full-time, with 70 per cent childcare: Single parent with two children aged one and four, by wage, 2016

£ per week

a) West Midlands childcare rates



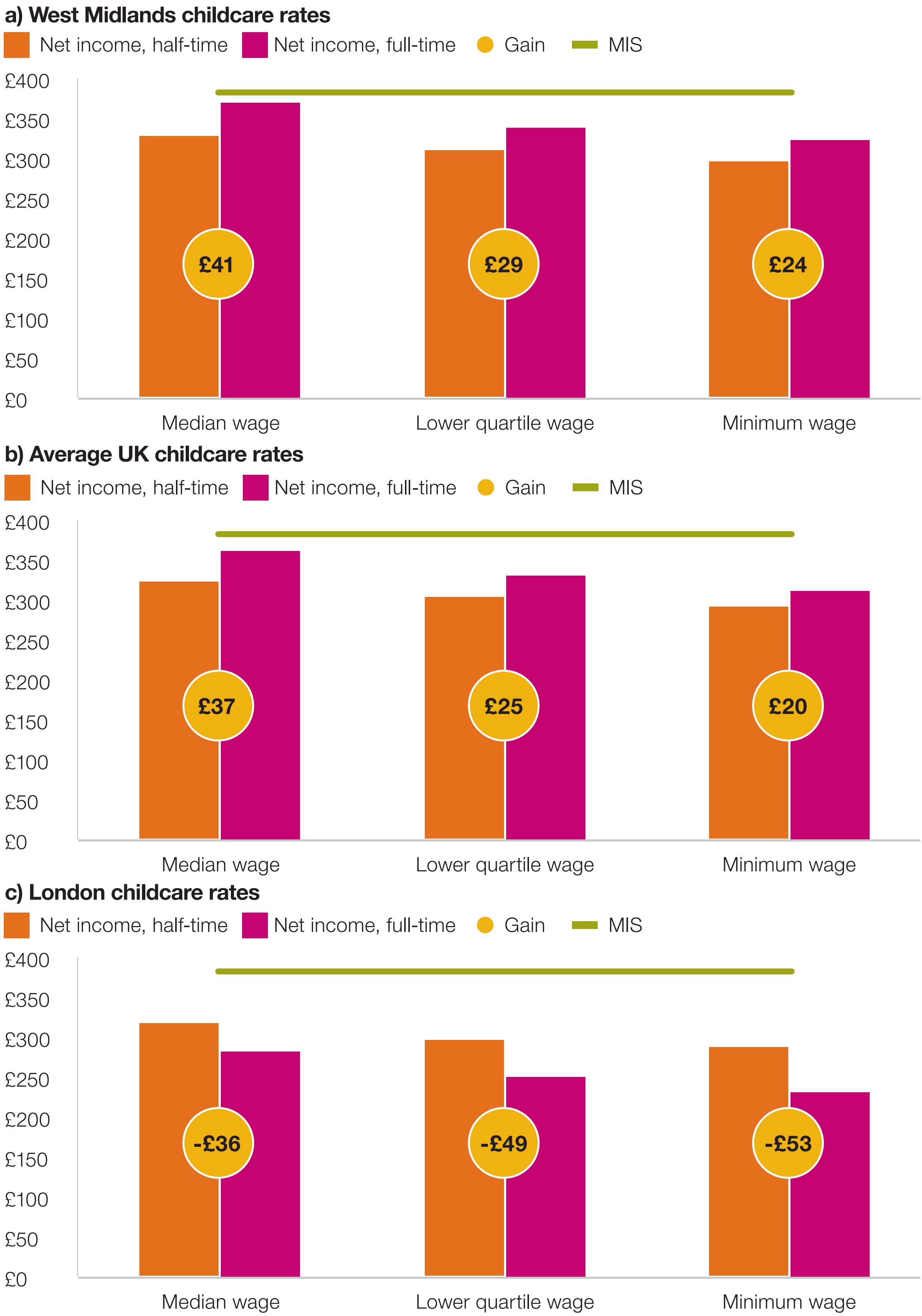
b) Average UK childcare rates



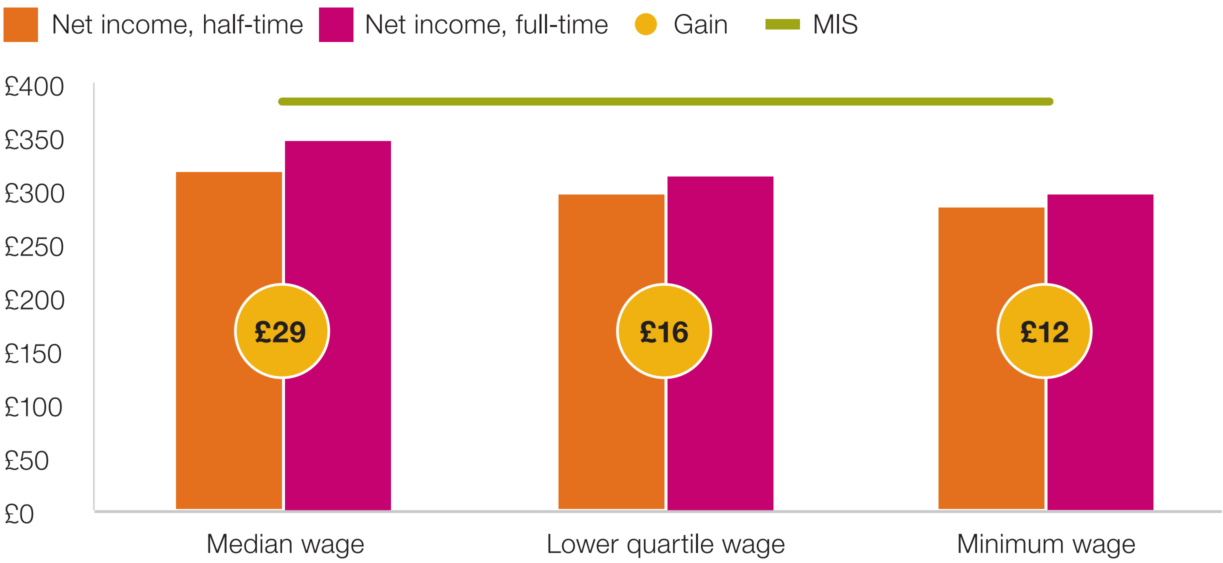
c) London childcare rates

Figure 4 Weekly net income gain from moving from half- to full-time, with 70 per cent childcare: Single parent with two children aged one and four, by wage, 2016

£ per week



d) London childcare rates uncapped



Future prospects

Figure 5 shows prospects for 2018. It considers what would happen to the gap between net income and minimum needs under three policies for childcare in universal credit – continuation of the present policy, introduction of the 85 per cent rate while retaining current caps and the 85 per cent rate without caps. In this case, the example used is a single parent with a child aged one, working full-time on a median wage with average childcare costs. The example of one young child is used here to highlight the potential effect of the cap, since in this case full-time childcare costs will have reached the cap by 2016. That is not the case for families with more than one child paying average childcare costs where at least one child is in school or getting the 15 hours early years subsidy, although the limit is also likely to be reached by 2016 in various other cases, such as a single parent with two children aged under three, or with two children under five paying London rates.

Figure 5 shows that:

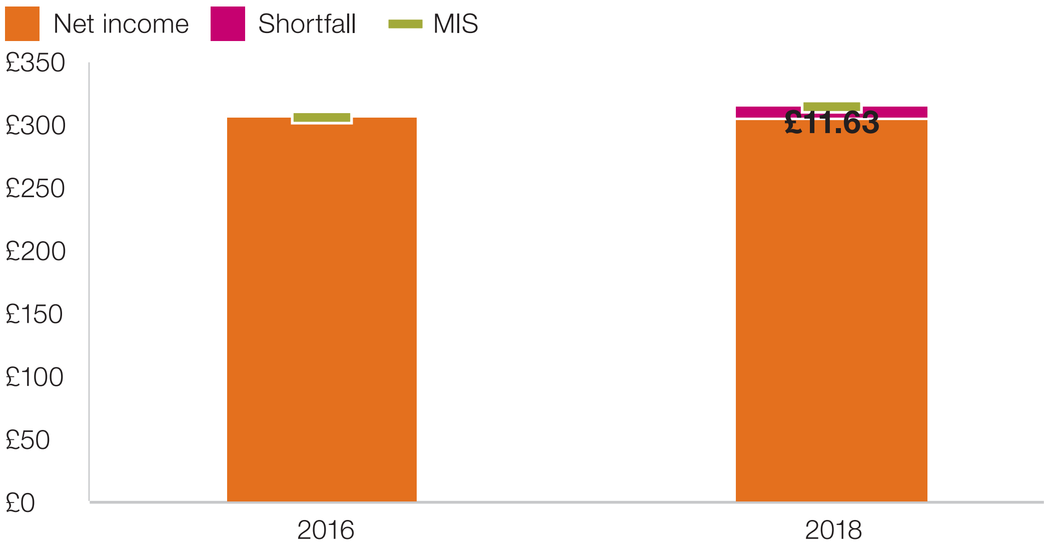
- If the rate remains at 70 per cent, this family's income shortfall will more than double by 2018
- An increase to 85 per cent will eliminate the shortfall in 2016, but it will start to appear again as a result of growing childcare costs being not fully covered because of the cap
- Without the cap, this growing shortfall could be avoided.

Figure 5 Weekly net income relative to MIS: Single parent with one child aged 1, working full-time on the median wage, by level of childcare support

£ per week

a) With 70 per cent childcare, capped

b) With 85 per cent childcare, capped



c) With 85 per cent childcare, uncapped

Overall, comparing scenarios in 2018, a single parent working full-time with a child age 1, would be:

- £26 a week better off with a capped 85 per cent rate than under the present policy
- £41 a week better off with an uncapped 85 per cent rate than under the present policy.

Note that these headline figures apply not just to the median wage example used for Figure 5. The impact of the switch from 70 to 85 per cent is the same in cash terms for anyone with a given level of childcare costs eligible for universal credit, regardless of their exact income.

Would lifting the cap be costly?

It is hard to estimate accurately the additional cost to the public purse of increasing or removing the cap on eligible childcare costs. This is because even if few people at present are on universal credit and using childcare above the limit, since it would generally be against their interests compared to working fewer hours, more might work additional hours with a higher cap. The following is a way of thinking about the effect of raising the cap.

It is unlikely that many families on universal credit incur childcare costs above the cap. It would not generally be in their interest to do so if they had a choice to work fewer hours and incur fewer childcare costs. This is because if you are on universal credit and you have to pay all additional childcare costs, you will almost always be much worse off. For example, to produce an extra £4 for an additional hour's childcare at an average cost, you'll need to earn about £16.60 an hour before your income is taxed and subject to the universal credit taper. Few people on universal credit are likely to be on this wage, which is well above the average.

Raising the cap would therefore produce little 'deadweight' payment to people already paying more for childcare than the cap allows, but could induce two kinds of behavioural response. First, it could encourage people to work more hours because they are now able to cover their childcare. Second, it could encourage them to find more expensive childcare.

If a higher cap encourages people to work more hours, the cost to the state is likely to be low or even negative. Suppose someone works an additional hour, incentivised by the fact that the state will cover their childcare above the amount at which it was previously capped. The cost to the state of this event, under the 2016 plans, will be 85 per cent of the additional childcare costs. On average, in the model used here, this will be as follows (in 2014, and assuming a childminder model in which additional children given 50 per cent discount):

Hourly childcare cost	For 1 child	For 2 children	For 3 children
£4 (national average)	£3.40	£5.10	£6.80
£5.55 (London average)	£4.71	£7.07	£9.44

However, there will also be a gain to the state from the fact that the person will pay additional tax and national insurance, and have a greater part of their basic universal credit entitlement tapered away. This gain will amount to 76 per cent of the wage. The following are calculations for 2014:

	Minimum wage	Lower quartile wage	Median wage
Hourly wage	£6.50	£8.15	£11.61
Gain to the state	£4.94	£6.19	£8.82

The gains to the state in this second table offset the costs in the first one above. Hence, for a single parent with one child, even in working in London on the minimum wage, the Treasury would always make a net gain from someone working longer hours at a higher cap. For those with more than one child earning less than average, there will often be a net cost. But even here, the greater part of the cost of a higher ceiling would be recouped by the state. Overall, on this basis, it is unlikely that there would be more than a negligible net cost, and there could be a net gain overall.

The state might nevertheless face an additional bill from people working the same number of hours but choosing more expensive childcare if the cap were higher. If this were reflected in higher childcare quality, the money may not necessarily be 'wasted', especially if it contributed to better childhood outcomes. On the other hand, some sort of limit on the hourly cost of supported childcare may be needed to avoid unduly expensive provision being paid for by the taxpayer. From the above reasoning, it can be argued that while the Treasury may not want to subsidise atypically expensive childcare charges, it may be in its interest:

- To apply any cap to the rate per hour, not to a weekly total
- To ensure that this rate keeps pace with increasing childcare costs and potentially is higher in areas where childcare is more expensive.

Conclusion

This paper has shown that supporting childcare at an 85 per cent rate in universal credit will go a long way in giving single parents the opportunity to use work to improve their incomes, and for many it will reduce or eliminate the shortfall faced between what they have to spend and what their family needs for a minimum living standard. However, this result will be undermined, especially in the longer term, if the decade-old limit on childcare fees eligible support is not raised. Lifting this limit is unlikely to bring a significant cost, because people who work more hours to take advantage of a greater weekly childcare entitlement will pay more taxes and have some of the universal credit gains offset against their higher incomes. Such a policy would create a more rounded strategy for using childcare support to make work pay and improve family income.

References

Bradshaw, J. et al. (2008) *A minimum income standard for Britain – What People Think.* York: Joseph Rowntree Foundation.

Davis, A, Hirsch, D. and Padley, M. (2014) *A minimum income standard for the United Kingdom in 2014*. York: Joseph Rowntree Foundation.

Hirsch, D. and Hartfree, Y. (2013) *Does universal credit enable households to reach a minimum income standard?* York: Joseph Rowntree Foundation.

Appendix 1 Assumptions

1. Economic projections	
Item	**Basis**
Inflation: CPI	OBR December 2014
Wage increases: in line with average earnings	OBR December 2014
2. Wage assumptions	
Item	**Basis**
Median and lower quartile	ASHE, 2014 and projected
Working hours	37.5 hours a week full-time, 18.75 half-time
3. Taxation and benefits	
Item	**Basis**
Tax allowance	£500 a year increase from 2015
Ni allowance	CPI uprated
Higher tax threshold	CPI uprated
UEL	CPI uprated
Benefit, universal credit and Work Allowance rates	Present government policy including freeze from 2016
4. Costs	
Item	**Basis**
Rent (social housing, MIS model)	Assume rises with inflation
Childcare (based on MIS model, using average childcare rates for central England; hours based on 50 hours full-time minus free childcare entitlements and school hours)	Projects 2014 childcare rates, assuming annual increase of 3.3 per cent (2013-14 increase).
Other living costs – based on MIS	Assume rises with inflation

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