

Paying to work: childcare and child poverty

Summary

- Under Universal Credit, once childcare costs are factored in, lone parents with more than one pre-school child will face significant disincentives to working enough hours to lift themselves out of poverty under Universal Credit. This group could face having to pay to go to work.
- Lone parents with only one pre-school child could face losing a significant proportion of any extra money that they earn. This could act as a substantial barrier for families looking to work their way out of poverty.
- Barnardo's believes that increasing the proportion of childcare costs covered under Universal Credit to 80 per cent is essential. This would support the Government's commitment on making work pay, and help give families a viable way to work themselves out of poverty.
- The Government should also undertake a feasibility study on how to move towards an extension of the free early years entitlement from 15 hours to 20 hours, or beyond, for disadvantaged children. This would have the twin outcome of supporting employment for parents and helping the life chances of disadvantaged children, something strongly emphasised in its child poverty strategy. In addition it would help alleviate the problems of a lack of funding directed at disadvantaged children aged three and four previously outlined by Barnardo's.

Background

1. When parents choose to enter work, or increase the number of hours they work a number of things can influence the amount of money they take home. For example, they may face losing some of their money through having their benefits withdrawn and they may have to pay more money in the form of taxes and National Insurance. In addition, some parents, especially lone parents and second earners in couple families, will need to find childcare to look after their children while they are at work.
2. Some support is provided through the benefit system to help parents cover the cost of childcare however, Universal Credit will only provide support for up to 70 per cent of childcare costs,¹² leaving the parent with 30 per cent of the costs to find. In addition, all three and four year olds are entitled to fifteen hours of free childcare.³ When increased taxes, reduction in benefit awards and childcare costs are combined, parents could be left with only relatively small amounts of money to show for their work, and in the worst cases they may actually have to pay to go to work.
3. The Government's child poverty strategy paper stated that once Universal Credit is introduced lone parents working 24 hours and couple families with one member working 35 hours at the National Minimum Wage would be lifted out of relative income poverty.⁴ This paper looks at some example families to examine the high cost of childcare, and how it could act as a barrier to families meeting these requirements and lifting themselves out of poverty once Universal Credit is introduced. We also look beyond this, at issues of progression and the problems that parents might face to further increasing their hours in work. We find that under Universal Credit, once childcare costs are factored in on top of tax and withdrawal of

¹ Until 2011 80 per cent of childcare costs were covered. Furthermore, some Housing Benefit claimants currently receive significantly more support through the childcare disregards, a feature that will not be replicated under Universal Credit.

² This is up to certain limits - the maximum support that can be received is £122.50 per week for one child and £210 per week for more than one child.

³ This will be extended to the 40 per cent most disadvantaged two year olds in 2014

⁴ HMG (2011). *A New Approach to Child Poverty: Tackling the Causes of Disadvantage and Transforming Families' Lives*. The Stationary Office, London.

benefits, the incentive for some families to increase the number of hours they work can be small, or even non-existent.⁵

4. In addition to the support provided through the benefits system all three and four year olds are entitled to fifteen hours of free early years education. The Government has committed to extending this entitlement to the 40 per cent most disadvantaged two year olds. This offer is primarily aimed at improving educational outcomes for children based on evidence of the positive impact of high quality early education on child development.⁶
5. All figures in this paper refer to the position in 2014/15, once Universal Credit is operational. This report uses Universal Credit rates announced at Autumn Statement 2012 to examine the incentives that low income families will encounter when deciding whether to enter and progress in work under Universal Credit. We also assume that the example families used for the analysis receive the National Minimum Wage. We have assumed it will increase in the same rate in 2013 as it did in 2012 and so move from £6.19 to £6.30. A complete list of the assumptions used for this analysis can be found in Annex A.

Lone Parents

6. Around one-in-four children living in poverty in 2010-11 lived in a lone parent family either not in employment or working in part time employment.⁷ Whilst significant improvements in employment rates of lone parents have been made in recent years, increasing the number of lone parents in employment is still critically important to reducing the number of children living in poverty.⁸

The Poverty Trap for lone parents with more than one pre-school child

7. Figure 1 gives the example of a lone parent with two children who are not yet of school age. Initially, due to the free 15 hours offer and the fact that their earnings do not impact on their Universal Credit award due to the earnings disregard, the lone parent keeps all of their earnings.⁹ At around 10 hours of work they begin to be subject to the Universal Credit taper and so only keep £2.20 for each additional hour worked.

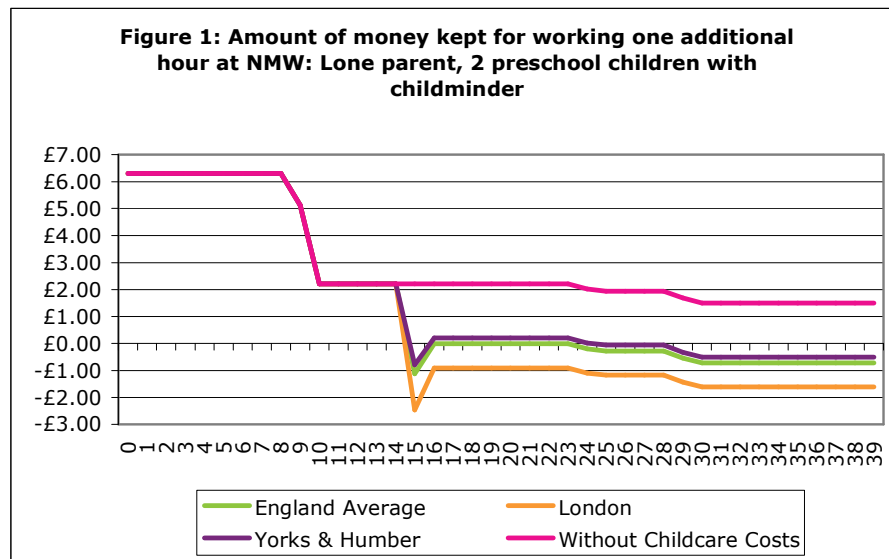
⁵ Note – childcare costs are not counted deducted from household income for the purposes of assessing whether somebody is in poverty.

⁶ Sylva, K. et al. (2004). *The Effective Provision of Pre-School Education (EPPE) Project: Final Report*. Department for Education, Nottingham.

⁷ DWP (2012). *Households Below Average Income*. DWP, London.

⁸ The Poverty Site. <http://www.poverty.org.uk/46/index.shtml>, accessed 2/1/2013

⁹ The earnings disregard is the amount of money that an individual can earn before they begin to have their Universal Credit award tapered away



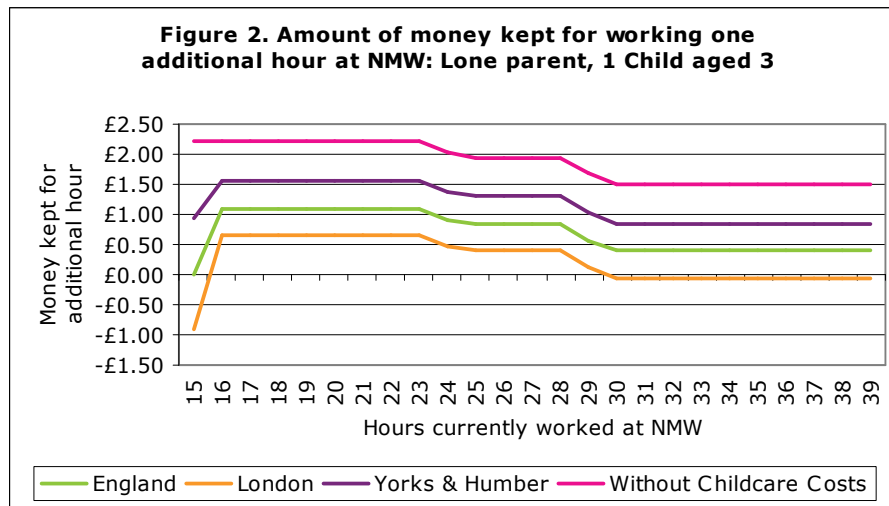
8. However, once the parent wants to work beyond 15 hours they would need to pay a contribution towards the costs of childcare. We have assumed that they will need one hour of childcare for each hour they work,¹⁰ plus one extra hour to cover transport.¹¹ Whilst 70 per cent of their costs are covered through Universal Credit this still leaves them to find the remaining 30 per cent. This, combined with the withdrawal of Universal Credit, means that if this family used a childminder, priced at the English average, they would actually gain nothing from increasing their hours. Furthermore, if they want to work beyond 23 hours their incentives worsen again as they initially become eligible to pay national insurance and then after 28 hours, income tax. This means that they would need to pay £0.28, and then £0.72 for each additional hour they wanted to work.
9. Crucially, for this analysis we have also assumed that parents are able to take advantage of the free offer of 15 hours of free childcare for three and four year olds, and that the two year old is also eligible for 15 hours of free childcare. However, it is important to keep in mind that this will not necessarily reflect the reality for some families who need to work atypical hours and cannot therefore synchronise their work with the free offer.
10. The chart also shows the impact of considerable regional variations in the cost of childcare. In the region with the cheapest average childcare costs, Yorkshire and the Humber, for each hour worked between 16 and 23 hours they earn £0.20. Once they are eligible to pay both tax and national insurance they effectively lose £0.50 for each hour worked. In London, the region with the highest childcare costs, they lose around £0.91 for each hour worked between 16 and 23, £1.17 between 24 and 28, and then £1.61 when they are subsequently eligible for both tax and national insurance.
11. It is important to note that the number of individuals with 2 children below school age living in poverty is likely to be fairly small. However, this group will be provided

¹⁰ Note – we have assumed parents use a childminder to cover their childcare costs. However, in most regions (except London) nursery care is more expensive than childminders. If parents are only able to take out this more expensive nursery care the incentives we have quoted would be even lower.

¹¹ Note – some parents may need significantly more than this to cover transport. If this is the case the returns to work that we have reported may be substantially lower.

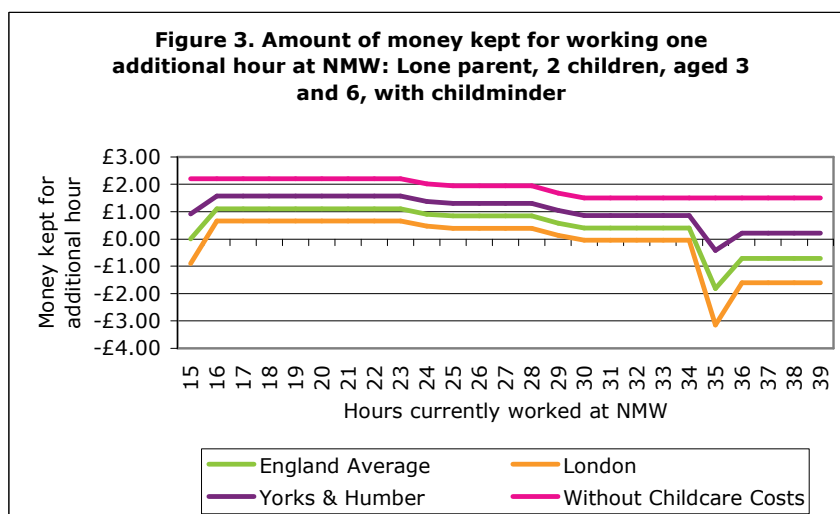
with little incentive to work longer hours and ultimately lift themselves out of poverty.

Lone parents with one pre-school child



12. For lone parents with only one child not yet old enough to go to school the incentives are slightly better, as they do not have to pay for as much childcare. However, the incentives to progress in work are still relatively low. A parent with average childcare costs wanting to work beyond 15 hours initially keeps £1.10 for each hour extra worked. Once they begin to be subject to tax and national insurance this drops to only £0.40 for each extra hour worked.

13. In Yorkshire and the Humber, they would initially keep £1.56 for each extra hour worked, then £0.86 after tax and national insurance are due. However, in London where an average childminder costs around £5.16 per hour, they would only keep around £0.66 initially. Once they earn enough to pay tax and national insurance they would actually need to pay £0.05 for each additional hour they wanted to work, indicating the very low incentive to work beyond this point.

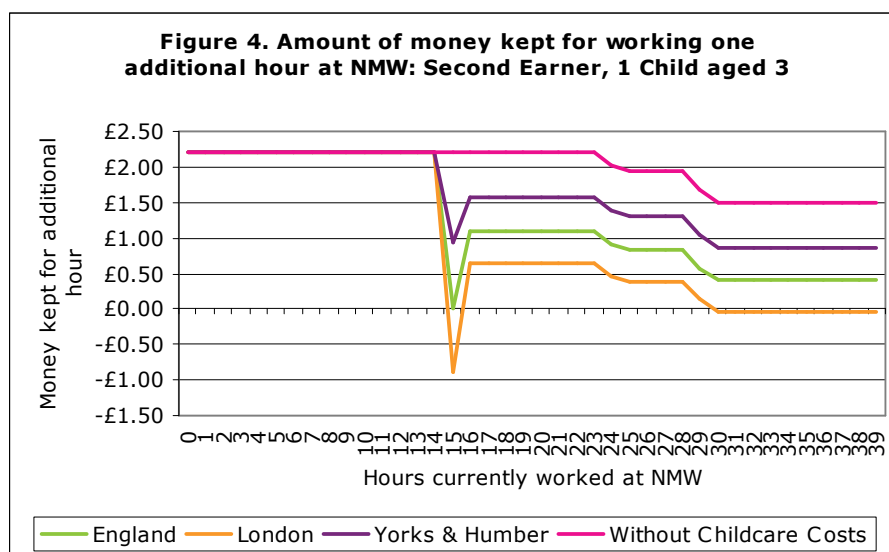


14. Figure three shows the situation for a lone parent with two children, one aged three and one aged six. In this case, they would have to find childcare for the three year old when working more than 15 hours, and for the six year old during non-school

hours. The picture is broadly similar to the one child family. However, once the parent wants to work beyond 35 hours they are required to find extra childcare, which reduces the financial incentive to work. Even in the cheapest childcare region, Yorkshire and Humber, they would only retain £0.22 of their gross pay for each hour worked beyond this point. Given the average childcare costs in England they would actually be required to pay an additional £0.70 above their gross pay for each extra hour worked.

Second Earners

15. Where one member of a couple family is already working it is the incentives faced by the potential second earner that can make a real difference to the income of the family.



16. Figure four demonstrates how much money a second earner would keep for each additional hour worked in a family where one member is already working full time (35 hours) at the national minimum wage. In this scenario the family would be lifted out of poverty according to the criteria set out in the child poverty strategy paper.
17. The initial gains from entering work at lower hours are reduced compared to a lone parent family. This is because they will immediately be subject to the Universal Credit taper as their partner already earns above the earnings disregard. After they work 16 hours their incentives are similar to the lone parent family in keeping around £1.10 for each additional hour worked up until they become eligible to pay tax and national insurance, and £0.40 per hour thereafter.

Policy Options

18. The remainder of this report considers two potential options to help alleviate some of the burden that expensive childcare can create for low income families seeking to work longer hours:
- Increasing the subsidy for childcare costs within Universal Credit from its current level of 70 per cent back to the previous level of 80 per cent.
 - Increasing the number of hours of free childcare available during the early years.

Increasing the subsidy to cover 80 per cent of childcare costs.

19. Increasing the proportion of childcare covered through Universal Credit would increase incentives to both enter and progress in work as parents would be able to

retain more of what they earn rather than spending it on childcare. For those on low income the impact of increasing the proportion of childcare costs covered is to increase work incentives for all hours worked.

20. During debates on the Welfare Reform Bill Lord Freud announced that increasing the proportion of childcare costs covered by Universal Credit would cost £400million.¹² Barnardo's welcomed the recent Government commitment to £300million of extra funding to ensure those working below 16 hours would be entitled to childcare support. However, the analysis presented in this report shows that further investment will be necessary to help families avoid the negative impact of high childcare costs.
21. Table 1 shows the impact of increasing the subsidy for a lone parent with two preschool children from 70 to 80 per cent of childcare costs covered. Increasing the subsidy to 80 per cent would mean that there would be a financial gain from working 24 hours instead of 16 hours for this parent, even if their costs were at the London average. This does not occur with a 70 per cent subsidy.
22. Barnardo's believes that moving back to a subsidy of 80 per cent would support both the Government's commitments on alleviating child poverty, and would also help to make work pay for those working longer hours. It is important to recognise that this does not completely solve the problems associated with high childcare costs. High childcare costs in London would still make it particularly difficult for parents to increase their hours in employment. However, Barnardo's believes that it would help demonstrate the Government's commitments on making work pay.

Table 1. Impact of increasing subsidy to 80% – lone parent, two pre-school children with childminder

Total increase in income from working 24 hours rather than 16	70%	80%
London	-£7.24	£1.05
Yorks & Humber	£1.64	£6.97
England	-£0.14	£5.79
Total increase in income from working 35 hours rather than 24		
London	-£15.26	-£3.85
Yorks & Humber	-£3.05	£4.28
England	-£5.50	£2.65

Increasing the number of free hours available

23. From April 2007 the previous Government began to extend the number of hours available through the free offer from 12.5 to 15. In detailed qualitative interviews conducted for the evaluation of this policy parents reported that the hours of free childcare provided supported them in being able to access employment or training opportunities. Whilst the evaluation could not quantify the impact of the increase in hours from 12.5 to 15 it concluded that it was likely this policy enhanced employment prospects for parents.¹³
24. Another potential solution would therefore be to increase the number of free hours available to parents with pre-school children. A stated intention of the previous Government's childcare strategy was to increase the universal free offer for three

¹² Hansard HL Deb 13 Oct 2011, vol 730, col GC522

¹³ Clarke, C. et al. (2009). Extended flexible entitlement for three and four year olds: pathfinder evaluation. London: Department for Education

and four year olds to 20 hours.¹⁴ Increasing the free entitlement to 20 hours, or more, would support lone parents to reach the 24 hours of employment that the Government has stated will lift them out of poverty under Universal Credit. This could be either through directly encouraging them to take up employment opportunities, or giving them the flexibility to take up training opportunities.

25. Increasing the number of free hours and targeting this at the most disadvantaged children would also be consistent with the Government’s agendas on social mobility and child poverty which focus strongly on life chances. Good quality pre-school education has been demonstrated to have a positive impact on attainment, which is sustained throughout primary education.¹⁵ Furthermore, Barnardo’s has previously stated its concern around the lack of a consistent approach to providing uplift funding for disadvantaged three and four year olds, arising from local early years funding formulas.¹⁶ Increasing the number of free hours for disadvantaged three and four year olds would go some way toward solving this problem.
26. As table 2 shows, the advantages of this would be to substantially increase work incentives where parents are able to take advantage of more free hours of childcare, compared to both the current system and a system with an 80 per cent subsidy. However, once the free hours have been exhausted the same incentives that exist in the current system would remain, meaning that there would still be relatively little incentive to increase to full time hours for some parents.

Table 2. Impact of different childcare policies on financial gains for lone parent, 1 child aged 3, on NMW

Policy	Total increase in income from working 24 hours rather than 16
70% costs covered, 15 hours free offer	£8.82
70% costs covered, 20 hours free offer	£12.13
70% costs covered, 25 hours free offer	£17.64
80% costs covered, 15 hours free offer	£11.76

27. This option is significantly more difficult to implement as it would rely on sufficient capacity being available within the childcare sector to deliver the increased number of hours. Furthermore, it is important to note that the primary aim of free hours of childcare is to support child development in the early years. The success of this policy would therefore be contingent on increased investment to build capacity in high quality childcare settings. For this reason Barnardo’s believes the immediate priority should be an increase in the proportion of childcare costs covered through Universal Credit back to 80 per cent. However, the Government should look to undertake a feasibility study to examine the potential for increasing the number of free hours for disadvantaged children aged below five. In addition the Government could consider ideas such as compelling schools to open up their empty buildings during school holidays in order to increase capacity within the childcare sector more widely.

Potential cost

28. Table 3 shows various options for increasing the free offer for three and four year olds and estimates of the potential annual costs of doing this. These figures represent the annual cost that would be incurred through the Dedicated Schools Grant.

¹⁴ Choice for parents, the best start for children: A ten year strategy for childcare. (2004).

¹⁵ Sylva, K. et al. (2004). *The Effective Provision of Pre-School Education (EPPE) Project: Final Report*. Department for Education, Nottingham.

¹⁶ Evans, J; Mathers, I; Rallings, J (2012). *Mind the Gap: Ensuring that all disadvantaged pupils benefit from the pupil premium*. Barnardo’s, Barkingside

29. It is important to note that in addition to the annual costs outlined there would also need to be significant capital expenditure to help this process, similar to the approach currently underway for increasing childcare provision for disadvantaged two year olds.
30. The cheapest option would be to increase funding from 15 to 20 hours but target it on the most disadvantaged children. Barnardo's estimates that the annual cost of funding this through the Dedicated Schools Grant would be in the region of £200million. A larger increase to 25 hours is estimated to cost in the region of £400million. One option to reduce the cost of the policy would be to limit the availability of extra childcare hours to those parents actively seeking employment. The full methodology behind these costings can be found in Annex B.

Table 3. Annual cost of various extensions to free offer

Policy option	Estimated Cost (£ millions)
Increase funding of free offer from 15 to 20 hours for poorest fifth of 3-4 year olds	200
Increase funding of free offer from 15 to 25 hours for poorest fifth of 3-4 year olds	400

Note: Excludes investment costs associated with building capacity to deliver an extended offer

Final Remarks

31. The example families outlined in this paper demonstrate the significant impact that high childcare costs can play in reducing incentives to work for families on low incomes. Ultimately, this has the potential to undermine Government commitments on making work pay and providing a platform for families to work their way out of poverty.
32. Barnardo's believes that an immediate priority of the Government should be to ensure that 80 per cent of childcare costs are covered through Universal Credit. This would increase the amount of money that families take home from work and help to support their own targets on making work pay and lifting children out of poverty.

Annex A - Assumptions

- In each case we have assumed that parents generally require 1 hour of childcare for each hour they work, plus one additional hour per week to cover travel time. This estimate of travel time may be an underestimate. If travel time is higher the returns to work would be lower.
- We have generally assumed that childcare will be taken through a childminder, and used appropriate costs taken from the Daycare Trust's Survey of Childcare Costs. In most regions (apart from London) average costs for childminders are cheaper than for nursery settings. The higher cost of childcare in nursery settings would further reduce incentives for families choosing to use this type of childcare.
- We have generally assumed that the hours that a parent wishes to work synchronise with the free early years education on offer, either through school or through offers in the early years. This is a strong assumption that may not tally with the reality of working life for some parents. For example, there is evidence that lone parents are more likely to work in occupations requiring atypical hours to be worked. In cases where desired work does not match freely available childcare, costs to the parent would be higher and work incentives lower.
- We have assumed that the minimum wage is increased at a similar rate in 2013 as it was in 2012.
- To simplify these calculations we have assumed that the hypothetical families we examine live in rented accommodation and that the rent covered by the housing element of Universal Credit is sufficient to reduce their earnings disregard to the minimum disregard level¹⁷. Owner occupiers and households with lower levels of rent would have a higher disregard, meaning they keep more money before they start to lose their Universal Credit.

Annex B - Assumptions underpinning costing of extending the free offer

- **Population of three and four year olds** – we used the midpoint of ONS population projections for 2014 and 2015, broken down by local authority, to get an estimate of the population of three and four year olds.
- **Take-up of free offer** – we used figures on take-up and proportions taking up different types of provision at January 2012, broken down by local authority, to get an estimate of the proportion of three and four year olds eligible for the free offer.
- **Amount of funding** – for increases to 20 hours we have assumed that each three or four year old identified as being eligible for the free offer is funded at 20 per cent of the Guaranteed Unit of Funding (GUF) used for the calculation of the Dedicated Schools Grant. This is equivalent to funding of an additional five hours. Increases to 25 hours are assumed to be funded at 40 per cent of the GUF for each local authority.
- **Identifying disadvantage** – we have approximated the 20 per cent most disadvantaged children by using figures on the proportion of children living in poverty in each local authority. There are potentially a number of different ways that disadvantage could be classified, changing the way that disadvantage is classified would potentially change the distribution of expenditure across local authorities.

¹⁷ Under Universal Credit the earnings disregard that a family is entitled to is reduced at a rate of 1.5 times their help with housing costs until it reaches the disregard minimum. The earnings disregard does not fall below this disregard minimum.

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