Broken promises: What has happened to support for low-income working families under universal credit?

March 2017

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Summary

This briefing presents some of the analysis to be published in a forthcoming report assessing the impacts of cuts to benefits from 2010 to 2020. This briefing focuses on changes to universal credit since it was first legislated in 2012 and their effects on family incomes, work incentives and poverty rates. It also includes the effect of real-terms cuts to child benefit which took place during the same period.

Overall, families with children have lost more than any other group from changes to universal credit thanks to a series of heavy cuts, in spite of modest giveaways in the form of increased support for childcare costs and a slight reduction in the taper rate. Families with children will be worse off by an average of £960/year in 2020 compared with the income they could have expected in the absence of cuts to universal credit, and single parent families by a huge £2380 on average. The freeze of the child element and child benefit alone will leave families hundreds of pounds worse off. Cuts to universal credit are revealed to be poverty-producing to the effect of around a million children.

Household-level analysis focusing on families with young children, who face trade-offs between work and childcare costs, reveals that the changes to universal credit have different effects on different families. Couple families with two earners, who use a large number of hours of childcare, may become better off under universal credit as it looks today, compared with the original design, because for them the benefit of an increased childcare subsidy outweighs the effect of cuts. But they will be worse off if only one parent works, or the second earner works a small number of hours. A single parent on the minimum wage, with two young children, will be worse off unless she works more than 40 hours/week.

Overall the effect of the package of cuts and changes to universal credit since it was first legislated has been to punish single parents, and couple families with very young children where one parent does not work or works a relatively small number of hours.

The government has argued that work incentives have improved in universal credit because of the reduction in the taper. However for many families it is clear that the rewards from work have been reduced, in spite of some improvements in the amount that can be made from an additional hour's work (because their starting incomes have been dramatically reduced) and for single parents the incentives to move into mini-jobs has been reduced by the work allowance cuts.

Finally we examine the potential for some changes to universal credit to restore its poverty-reducing potential.

1. Background to the analysis

Universal credit – what was promised?

Universal credit was introduced with the promise of reducing poverty while also improving the incentives to enter work and rewarding increased earnings.

The 2010 White Paper 'Welfare that works', introducing universal credit, explained that under universal credit 'people will generally keep more of their earnings for themselves and their families than is currently the case', and that 'no-one will experience a reduction in the benefit they receive as a result of the introduction of Universal Credit'.[1] Universal credit was supposed to transform the benefits system and its central architect, Iain Duncan Smith, has called it 'the biggest change since Beveridge introduced the welfare system'.[2]

The first official impact assessment for the introduction of universal credit indicated that 'Universal Credit will reduce the number of individuals in poverty.... the combined impact of take-up and entitlements will lift around 900,000 individuals out of poverty, including more than 350,000 children'.[3] It was to be, overall, more generous than the systems it replaced.

Universal credit was designed to smooth transitions into work, as claimants would not have to claim a different set of benefits when they started (or ended) a job. It was also intended to eradicate the cliff-edges in the tax credit system at particular hours of work - eligibility for working tax credit and support with childcare costs began at 16 hours/work per week for lone parents, for example, leading to very poor rewards from work for those working less than this. Eligibility for particular elements of universal credit is not linked to earnings or hours of work. In these ways it was intended to help avoid both the unemployment trap (where people do not become better-off if they move into work) and the poverty trap (where it is hard to increase income by earning more, because benefit withdrawals offset increased wages). Universal credit also sought to eliminate very high taper rates resulting from the withdrawal of both tax credits and housing benefit at certain levels of earnings.

Early analysis of universal credit in its original design, by the IFS, concluded that universal credit ought to eliminate 'very weak work incentives' overall.[4] It found that universal credit would 'strengthen the incentive to work at all, on average, particularly for… low-earning single people and primary earners in couples', who under tax credits face very weak incentives to work unless they can reach 16 hours per week. But universal credit was also expected to 'weaken incentives to work for (potential) second earners in couples' who would see universal credit withdrawn more quickly than tax credits because they have no separate earnings disregard before universal credit is withdrawn.

Universal credit was designed to be more generous to couples than single people, with lone parents in particular expected to lose out compared with tax credits. This was a deliberate reaction to the decision, within tax credits, to boost support for lone parents in comparison with couples because of their higher risk of poverty and the greater difficulty of increasing earnings from work if you are a lone parent.

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[1] 'Universal Credit: Welfare that works' White Paper. DWP, 2010. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/48897/universal-credit-full-document.pdf

[2] http://www.telegraph.co.uk/news/politics/conservative/8114432/Iain-Duncan-Smith-My-welfare-reforms-are-Beveridge-for-today-with-a-hint-of-Tebbit.html

[3] Universal credit: Impact assessment. DWP, 2011. http://www.parliament.uk/documents/impact-assessments/IA11-040D.pdf

[4] Brewer, M. et al. Universal credit: a preliminary analysis. IFS, 2011. https://www.ifs.org.uk/bns/bn116.pdf

Many in the voluntary sector were encouraged by universal credit's promise of poverty reduction and smoother work incentives, although strong concerns remained about the effect on lone parents, as well as other features of universal credit, such as the long waiting period for the first payment, an intensified conditionality and sanctions regime, and the shift from a range of weekly and fortnightly payments to a single monthly payment. This analysis does not deal with these other aspects but focuses on the adequacy and poverty-reducing potential of universal credit and how this has changed over time.

Universal credit hollowed out

Since its initial design, universal credit has been subject to a succession of changes and cuts which have substantially reduced its adequacy overall (Table 1). As a result, it is now less generous than the system it is replacing, and no longer offers the promise of reducing poverty.

Table 1. Changes to universal credit since it was first legislated

Change	Date effective	Details
Benefit cap introduced	April 2013	Limits total benefit receipt for claimants earning below £430/month to £26,000 each year.
Work allowances frozen	April 2014	Freezes the amount which claimants can earn before universal credit starts to be withdrawn, rather than uprating in line with earnings or costs.
Work allowances reduced	April 2016	Reduces the amount which claimants can earn from work before universal credit starts to be withdrawn, to £192 for families with children who rent their homes (and claim housing support through universal credit) and £397 for those who do not, and to £0 for non-disabled adults without children. This costs renting couples with children up to £234/year and renting lone parents up to £554/year.
Four year freeze of most universal credit rates (and other working-age benefits)	April 2016	Freezes the value of the main elements of universal credit, as well as child benefit, rather than uprating in line with inflation.
Childcare subsidy increased	April 2016	Increases the proportion of childcare costs which can be claimed back through universal credit from 70% to 85%.
Benefit cap lowered	November 2016	Reduces the limit on total benefit receipt for claimants earning below £430/month to £20,000 each year, or £23,000 in London.
Minimum age introduced for the housing element	April 2017	18-21 year olds will no longer be eligible for the housing element of universal credit, unless limited exceptions apply.
Higher rate child element for first child abolished	April 2017	Removes the premium paid for the first child (equivalent to the family element in tax credits) worth £545 per year.
Child element restricted to two children per family	April 2017	Limits the award of child elements to two children per family, unless very limited exceptions apply.
Taper rate reduced	April 2017	Reduces the rate at which universal credit is withdrawn when claimants' earnings exceed the work allowance, from 65p to 63p in the pound.

At the same time other benefits which may be received alongside universal credit have also been subject to cuts. Child benefit was uprated at 1% per year from April 2014 and then frozen for four years in April 2016. Council tax support was localised and in many cases reduced. And substantial reductions were made to local housing allowances

Following these cuts to universal credit, the Office for Budget Responsibility has confirmed that 'universal credit is now less generous on average than the tax credits and benefits system it replaces'.[5] The Institute for Fiscal Studies calculated in February 2016 that, in moving on to universal credit an estimated 2.1 million working families will lose out (by £1,600/year on average) and only 1.8 million working families will gain (by £1,500/year on average).[6]

The cuts have also undone the poverty-reducing potential of universal credit. The government no longer makes any claim that universal credit will reduce poverty, and refuses to answer requests for an updated poverty impact assessment.[7] Iain Duncan Smith himself has lamented the extent of cuts to universal credit, and last year called for the work allowances to be restored.[8]

Overall, the effect of changes to universal credit, since it was first legislated, has been a substantial reduction in adequacy. Cuts to universal credit mean that many families will now have to work more hours to arrive at the income they could have expected in the absence of the cuts. If they cannot do this, or believe that it is not in the best interests of their children to work longer hours, or if the costs of childcare all but wipe out the gains from working more hours, they will simply be worse off.

There are some claimants for whom the gains resulting from the increase in the subsidy for childcare costs (from 70% to 85%) and to a lesser extent the small reduction in the taper rate (the rate at which universal credit is withdrawn as earnings increase) from 65% to 63%, outweigh the effect of the cuts, leaving them better off. Among families with children, these are households with relatively high earnings and hours of work who pay for childcare, as the analysis below shows.

Assessing the impact of the cuts: our approach

CPAG commissioned the Institute for Public Policy Research (IPPR) to conduct modelling of the impact of cuts and changes to universal credit on household incomes and poverty rates at population level, and at household level for a series of model families. This analysis compares the benefits system in 2013/14 incorporating universal credit as originally legislated, with the benefit system as currently legislated, in both cases assuming full implementation of universal credit.

All analysis assumes all households have moved to universal credit and ignores the temporary effect of transitional protection (which some households will receive when they move from tax credits to universal credit, but which will rapidly erode over time). In other words it compares different

[5] Office for Budget Responsibility Welfare Trends Report, October 2016, p.26 http://budgetresponsibility.org.uk/docs/dlm_uploads/Welfare-Trends-Report.pdf

[6] Institute for Fiscal Studies analysis, February 2016 https://www.ifs.org.uk/publications/8135

[7] For example http://www.parliament.uk/written-questions-answers-statements/written-question/commons/2016-03-21/31946

[8] See for example http://www.conservativehome.com/thecolumnists/2016/11/iain-duncan-smith-cutting-universal-credit-work-allowances-would-harm-those-in-greatest-need-of-help.html

universal credit systems as fully implemented. Incomes are projected to 2020/21 and are expressed in real terms (in 2015/16 prices). Changes to incomes are calculated from 2013/14, when universal credit was first legislated, to 2020/21.

The population level analysis was carried out using the IPPR tax benefit model, which uses latest available data from the UK Family Resources Survey to assess the fiscal and distributional impact of changes to the tax and benefit system. This analysis does not currently include changes to local housing allowances, but captures the effect of changes to universal credit and child benefit.

The household level analysis was carried out using the Resolution Foundation micro-simulation model, which allows household income to be analysed for specified in-work families under both real and hypothesised tax and benefit policies. This model is designed to be used alongside IPPR's tax benefit model.

All the analysis presented below is derived from these models unless otherwise stated.

2. Assessing the impact of the cuts: population level analysis

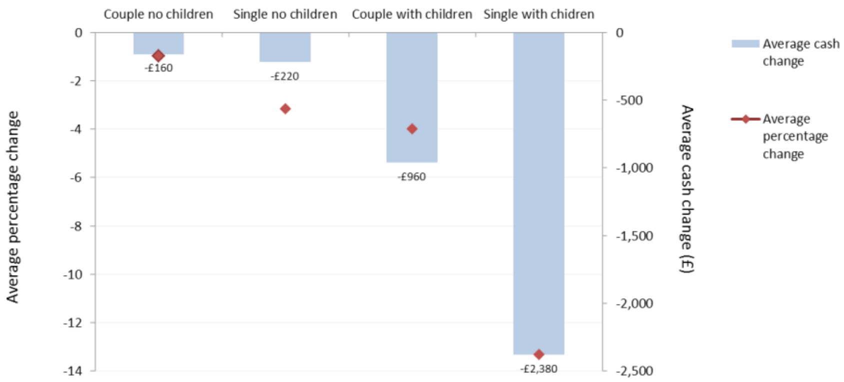
Population level analysis

Key findings

Comparing the benefits system incorporating universal credit (and child benefit) as currently legislated, with the 2013/14 system, it is apparent that families with children stand to lose out much more severely from the cuts than any other group (see also Figure 1). Our analysis shows that as a result of the cuts, on average:

- couples with children will be £960/year worse off.
- lone parent families will be £2380/year worse off.
- families with one child will be £930/year worse off.
- families with two children will be £1100/year worse off.
- families with three children will be £2540/year worse off.
- working-age couples without children will be £160/year worse off.
- single working-age people without children will be £220/year worse off.
- pensioner couples will be £40/year worse off.
- single pensioners will be £30/year worse off.

Figure 1. Average annual losses for working age households from changes to universal credit and child benefit (for the year 2020/21, in 2015/16 prices)



Source: analysis of 2014/15 family resources survey using the IPPR tax-benefit model

The cuts also disproportionately affect lower income deciles (Figure 2)

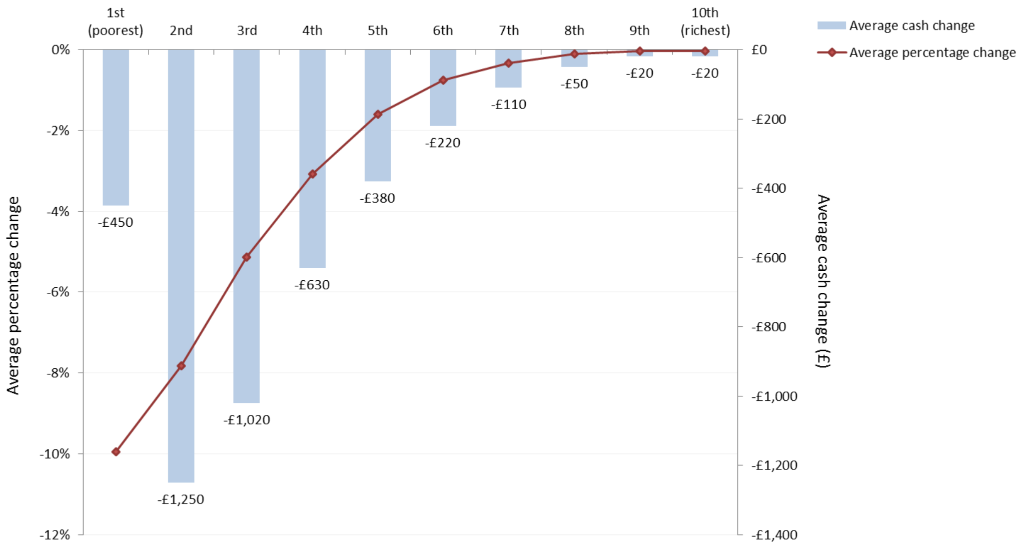
These are average losses across the population, including households who do not claim universal credit. This means that for those claiming universal credit in each group, losses will be higher still.

The four-year freeze in the value of most components of universal credit makes a substantial contribution to the losses because prices are expected to rise between now and 2020/21,[9] meaning universal credit will be worth less in real terms each year as long as the freeze is in place.

[9] November 2016 inflation projections by the Office of Budget Responsibility, see http://cdn.budgetresponsibility.org.uk/Nov2016EFO.pdf p.60-62

The four-year freeze of the child element alone (the part of universal credit designed to help with the cost of bringing up children, equivalent to child tax credits) will cost the average couple with children £260/year, and the average lone parent family £650/year.

Figure 2. Average annual losses to households in different equivalised disposable income deciles from changes to universal credit and child benefit freeze (for the year 2020/21, in 2015/16 prices)



Source: analysis of 2014/15 family resources survey using the IPPR tax-benefit model

Our analysis also indicates that the cuts to universal credit will be heavily poverty-producing. Were universal credit to be fully implemented by 2020 (ignoring transitional protection and any possible dynamic effects), there would be up to a million more children in poverty following the cuts than there would have been had the 2013/14 system been retained. Note that this is *not* a child poverty projection for 2020, rather a comparison of the two universal credit systems and an indication of the extent to which universal credit has been hollowed out and its promise of poverty reduction abandoned.

3. Assessing the impact of the cuts: household level analysis

Asessing the impact of the cuts - household level analysis

Our approach

We modelled the effect of changes to universal credit on overall household income for a number of model families with different working patterns. Modelling the effect on families working different numbers of hours tells us about the work incentives offered by the system, and the possibilities available to families where a balance needs to be struck between work and time spent looking after children.

Here we present the results for three families:

1. Lone parent with two children aged 2 and 5, claiming housing costs for rent in an average area and average hourly childcare costs, working for the minimum wage.[10]
2. Couple with two children aged 2 and 5, claiming housing costs for rent in an average area and average hourly childcare costs, with both parents working for the minimum wage.
3. Couple with two children aged 2 and 5, claiming housing costs for rent in a higher-cost area (outer London) and outer London hourly childcare costs, with both parents working for the median national wage.

Rents for average cost areas are set at the average national local housing allowance cap and for the higher cost area are set at the average local housing allowance cap for outer London (again the 30th percentile of market rents). In reality some families will face rents which exceed their local housing allowance cap, meaning their income (after housing costs) would be lower.

Childcare costs are based on the 2016 Family and Childcare Trust Childcare Costs Survey, uprated to 2020/21 using CPI, which provides both national average costs for children of different ages, and costs in London which are used for the high-cost scenarios.

For each family we examine what has happened to the rewards from work as a result of universal credit cuts, and whether families can realistically make up the losses by working a small number of extra hours.

All results compare an identical family claiming universal credit 'before cuts' (i.e. universal credit and other benefits as originally legislated in 2012) and 'after cuts' (i.e. as now legislated). The 'after cuts' scenario also includes cuts to child benefit (and in spite of the label includes the lower taper and increased support for childcare). Results are calculated for 2020/21, to reflect all policy changes due to come into force between now and the end of the decade, but are expressed in 2015/16 prices.

For each family we consider both a situation in which they do not incur any childcare costs for working additional hours (e.g. because they can rely on grandparents or friends), and a situation in which they must pay for every hour of childcare beyond the government's free provision. Parents can claim back 85% of childcare costs through universal credit, up to a ceiling.

[10] We use this term to refer to the 'National Living Wage' (the government's term for the over-25 minimum wage, which is not based on the cost of living) to avoid confusion with the voluntary or 'real' living wage which *is* based on the cost of living. We are not referring to the under-25 minimum wage (which the government terms the 'National Minimum Wage').

Key findings

Within universal credit it is recognised that where a parent is the main carer for a child aged under three, it is not appropriate to require this parent to work (unlike parents of older children who are mandated to seek work to receive universal credit).

However, it is clear from this analysis that the effect of cuts and changes to universal credit and child benefit has been to penalise lone parents (whether working or not) including those with young children, as well as couples with young children where only one parent works, or where a second earner does not work a large number of hours. These families will, in many cases, be completely unable to make up for these losses by working a few extra hours – they would have to increase their hours significantly, compromising on time spent with their children, just to maintain the same level of income. If they pay for childcare they would also face higher outgoings if they increased their hours, such as the 15% of childcare costs which is not covered by universal credit, and childcare costs mean that the returns from working extra hours can be very low.

The only giveaways which have come in return for cuts tend to benefit families who earn higher amounts and/or work longer hours. This is because the cuts have been to the level of the main elements of universal credit (how much it pays per adult and child) and work allowances (how much families can earn before universal credit is withdrawn) while the giveaways have come in the form of increased support for childcare and a slightly reduced taper rate (the rate at which universal credit is withdrawn as earnings increase). Overall these giveaways are worth much less than the cuts, so do not compensate for losses overall. However, for some families who claim a large amount of childcare and have higher earnings from work, they may outweigh the cuts.

The government has argued that the changes to universal credit have improved work incentives, and when the universal credit work allowances were cut, the government suggested that families could make up the loss by working a few more hours each week.[11]

Overall it is clear that the effect of changes to universal credit has been to reduce family incomes, unless they are working a high number of hours or earning relatively high wages and claiming support for childcare costs. This may be regarded as a work incentive, but for families with young children it may simply not be possible or desirable to increase hours to the extent needed to recoup the losses.

[11] Government response to SSAC Occasional Paper 15: Universal Credit: priorities for action https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/487394/government-response-to-universal-credit-occasional-paper-15.pdf

Family 1. Lone parent of two children aged 2 and 5, working for the minimum wage, renting privately in an average cost area

Without childcare costs

First we consider a situation where this parent is able to work without incurring childcare costs, for example because they have access to a free nursery place of 15 hours/week and grandparents or other relatives providing free childcare.

This family will be substantially worse off as a result of cuts to universal credit, regardless of whether the parent works and for how many hours. If not working, or working up to 5 hours/week, she[12] will be £1,167 worse off per year due to cuts in the adequacy of universal credit basic and child elements as well as cuts to child benefit. At this very small number of hours, the parent is not yet affected by the large reduction in the work allowances for lone parents.

In the absence of the cuts to the work allowance, this parent could have worked around 8 hours per week before universal credit would be withdrawn. So if working 6 or 7 hours she will now be increasingly worse off, relative to the pre-cuts universal credit regime, as her universal credit starts to be tapered away. Working anything from 8 hours up to 40 hours per week, her overall income is reduced by all the cuts to universal credit and the only 'compensation' – the slight reduction in the taper rate announced in 2016 – does little to compensate, leaving the family between £1,619 and £1,743 worse off overall.

If working 16 hours/week this family will be £1,658 worse off under universal credit as it looks today than in the absence of the cuts. This lone parent would have to work 14 extra hours per week – two whole days – just to recoup this difference (Figure 3), almost doubling her hours to 30 per week.

The heavy cuts to the work allowance have also meant that the rewards for starting work are reduced. Table 2 shows the effective hourly earnings this parent would take home, after deductions, universal credit withdrawals and rent payments, if starting work at 12 or 24 hours per week, as well as the effective tax rates in terms of pence lost for every pound of gross earnings.

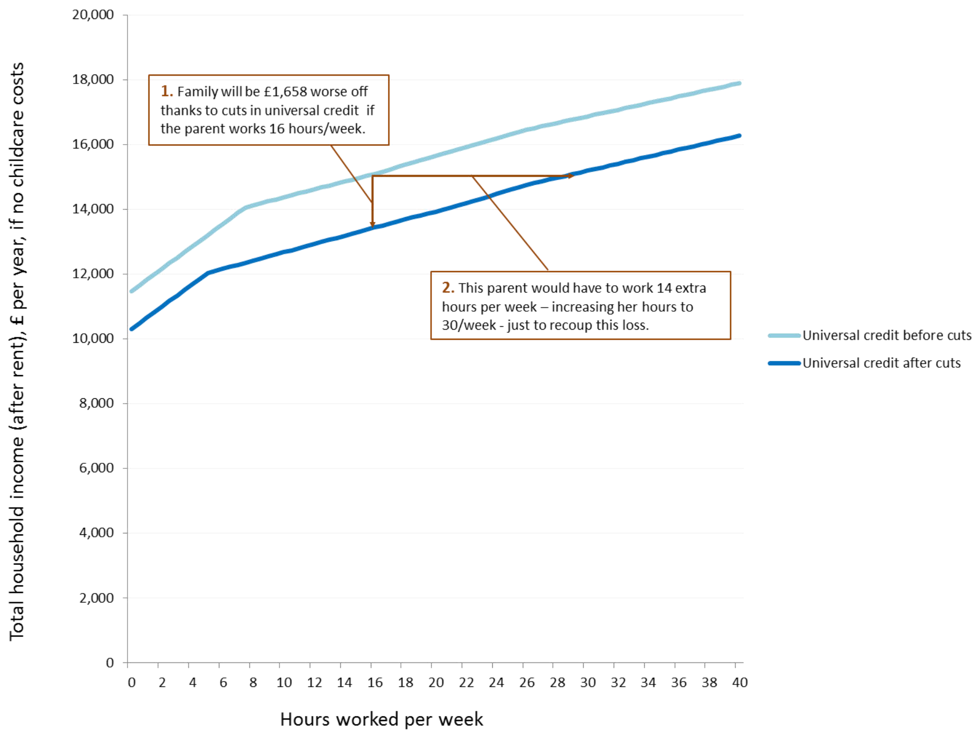
Table 2. Effective hourly earnings[13] have reduced, and effective tax rates[14] increased, for a lone parent entering work on the minimum wage with no childcare costs

	Family income (£/year)		Effective hourly earnings		Effective tax rate	
Weekly hours	Before cuts	After cuts	Before cuts	After cuts	Before cuts	After cuts
12	£14,610	£12,925	£5.01	£4.18	39%	49%
24	£16,185	£14,468	£3.76	£3.32	50%	56%

[12] 'She' is used throughout the report for simplicity because most lone parents and second earners in couples are women. The findings would apply equally to families with a male lone parent or second earner.
[13] After tax, national insurance, universal credit withdrawals and rent
[14] Deduction rate including tax, national insurance, universal credit withdrawals and rent

Source: CPAG analysis of IPPR modelling output

Figure 3. Net household income (after rent) against working hours: lone parent of two children, working on the minimum wage and renting in an average cost area, no childcare costs (Family 1)



Source: IPPR analysis using the Resolution Foundation micro-simulation model

Only if this parent is already working longer hours will she see any improvement in hourly returns from work, for example if she moved from 24 hours/week to 30 hours/week she would now take home £2.30/hour on average for the additional hours worked, compared with £2.18 under the old system, and keep 2p more in the pound earned. This improvement is negligible when you consider that if working 30 hours/week she will still be £1,678 worse off than in the absence of the cuts.

With childcare costs

Now we consider an identical family who have to rely on paid childcare for any additional hours required outside the government's provision of 15 hours/week for their two year old, and who claim support for childcare costs via the childcare element of universal credit.

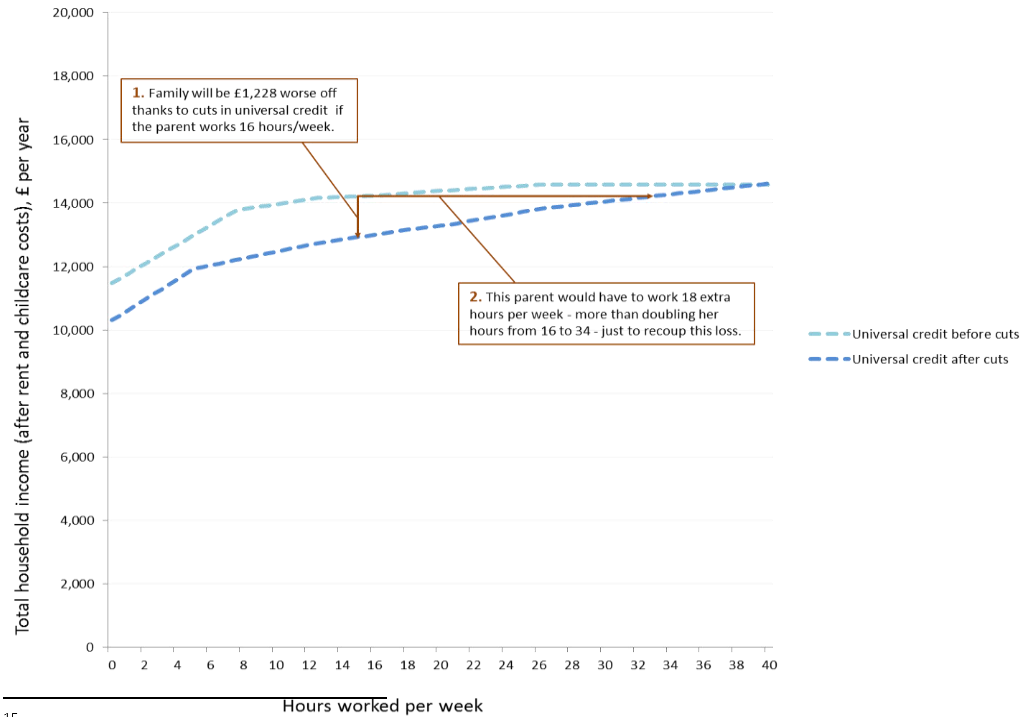
This family will be again considerably worse off under universal credit after the cuts regardless of how many hours the parent works (between 0 and 40 per week). The difference is not quite as stark as for the family above who do not claim childcare costs, because this family benefits somewhat from the increased childcare subsidy. However, overall the family's income once in work is lower, as they still have to pay a proportion of the childcare cost. The amount they have to pay increases as hours of work increase, meaning that it is harder for this family to increase their income by working more hours. Even if working 30 hours/week, this family will have a net income (after childcare costs) of £14,047, compared with £15,189 for an identical family who can access free childcare from relatives.

If the parent in this example works 16 hours/week, the family will be £1,228 worse off as a result of the cuts to universal credit, after rent and childcare costs. She would have to more than double her working hours to 34/week – an increase of 18 hours - just to recoup this difference (Figure 4). Many lone parents of young children currently work around 16 hours/week,[15] and for many it would be undesirable, or simply impossible, to work full time, as this would require sacrificing time with their children and probably having to juggle multiple childcare providers (if they wish to make use of the government's free 15 hours offer as part of their childcare provision). The reality is therefore that many will simply become worse off.

As this parent's hours increase, universal credit in its current form becomes more generous, relative to its pre-cuts design, because the increased support for childcare and the lower taper compensates to a greater extent for the cuts. But this lone parent would have to work 40/hours week to reach a point where her overall income is unaffected by the cuts, something many parents would not deem compatible with caring for children aged two and five.

Indeed, while lone parents of older children are required to work (or seek work) in order to claim universal credit, parents of two year-olds are exempt from this requirement because it is accepted that they ought not to be expected to work; whether they work, and for how many hours, ought to be a personal choice based on what is best for the family and the child in question. Even when children are aged between three and twelve, lone parents are only expected to work hours compatible with childcare or school – considerably less than 40 hours/week.

Figure 4. Net household income (after rent and childcare) against working hours: lone parent of two children, earning minimum wage, renting and paying for childcare in an average cost area (Family 1)



[15] ONS ad hoc analysis of the 2011 Labour Force Survey; over a third of lone parents with children under-5 worked 16-24 hours per week, more than in any other hours range (<6, 6-10, 11-15, 16-24, 25-29, 30-35, 36-44 or 45+ hours)

Source: IPPR analysis using the Resolution Foundation micro-simulation model

If this lone parent currently does not work, she will be £1,167 worse off under universal credit today than pre-cuts. The large cut to work allowances for lone parents has also reduced the rewards she would experience from entering work at between 6 and 18 hours/week. If entering work at 12 hours/week (hours which might be compatible with the government's offer of 15 hours free childcare for two year-olds whose parents claim universal credit, allowing for a small amount of travel time), her effective hourly income (after withdrawals of universal credit, rent and childcare) will be £3.79 per hour under universal credit today, compared with £4.24 before the cuts. Her effective tax rate will be 54% instead of 49%.

If she went into work at more than 18 hours/ week, her effective hourly income would be higher under universal credit today than under the pre-cuts version, thanks to increased support for childcare. For example if she entered work at 24 hours, her effective hourly income would be £2.65 under universal credit today compared with £2.43 before the cuts. However she would still be £880/year worse off overall. See Table 3.

Even with the increased childcare subsidy present in universal credit, and the government's offer of 15 hours free childcare per week for two year olds, childcare costs (along with universal credit withdrawals) still mean that the rewards from working more hours are very limited for this parent. If she doubled her hours from 10 to 20 per week, she would see her net income increase by just £820 per year or £16 per week. Universal credit was intended to encourage in-work progression by ensuring people would always be better off if they increased their hours. Yet it is clear that some lone parent families will see extremely low rewards from working more hours, and could end up 'stuck' in low hours of work.

Table 3. Overall income, effective hourly earnings, effective tax rates for a lone parent entering work on the minimum wage with childcare costs

	Family income (£/year)		Effective hourly earnings		Effective tax rate	
Weekly hours	Before cuts	After cuts	Before cuts	After cuts	Before cuts	After cuts
12	£14,126	£12,683	£4.24	£3.79	49%	54%
24	£14,511	£13,631	£2.43	£2.65	71%	68%

Source: CPAG analysis of IPPR modelling output

The government has argued that universal credit must be considered in the context of other policies designed to assist parents to work, including increased support for childcare. Additional childcare hours for three- and four- year-olds, and the increased subsidy in universal credit compared with tax credits, are important steps and ones which CPAG and others campaigned hard to achieve, but this family illustrates the limitations of existing support for childcare when families have an older or younger child. The cost of childcare undermines work incentives and limits the rewards from work for lone parents.

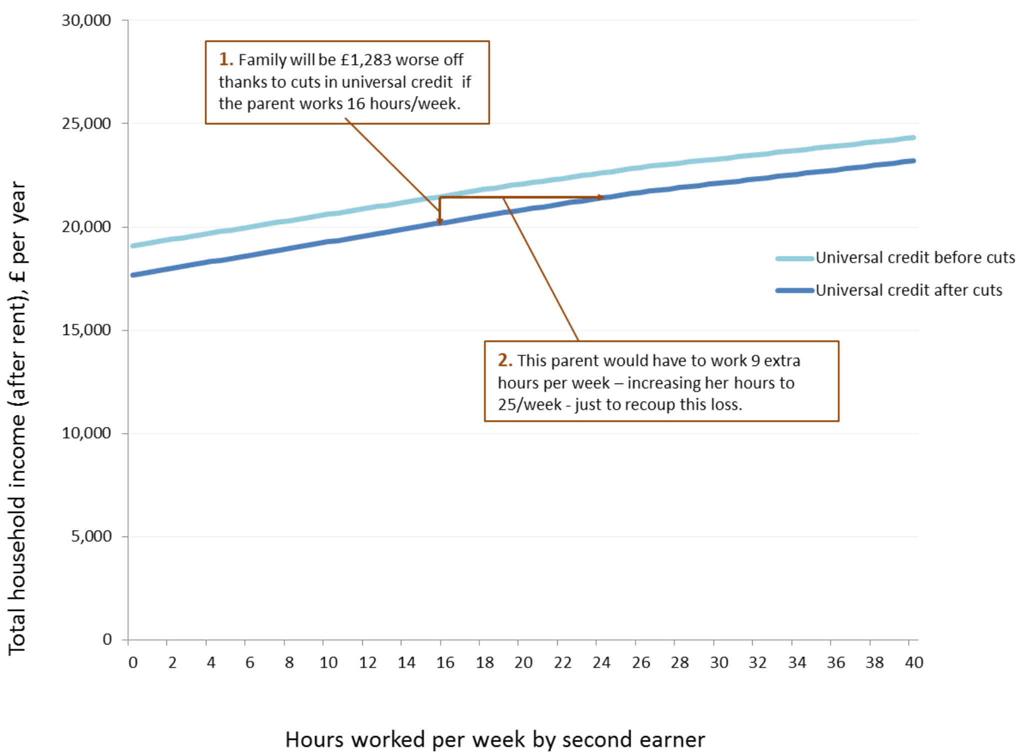
Family 2. Couple both working for the minimum wage, with two children aged 2 and 5, renting privately in an average-cost area

Here we assume that the family already has one full time earner,[16] and examine the effect of variations in second earner working hours on total net household income with and without childcare costs.

Without childcare costs

If this family is not claiming any childcare costs, they will be worse off under universal credit today compared with the pre-cuts regime, regardless of how many hours the second earner works. There is no work allowance for a second earner, so the difference between the family's overall income (comparing before/after the cuts) is similar at all hours of work, though marginally smaller where the second earner works more hours due to the small effect of the reduced taper rate.

Figure 5. Net household income (after rent) against working hours: couple with two children and one full-time earner, both parents working for minimum wage and renting in an average cost area, no childcare costs (Family 2)



Source: IPPR analysis using the Resolution Foundation micro-simulation model

If the second earner in this couple starts work at 16 hours/week, while the reduced taper rate would allow them to keep 2p more in the pound (65p rather than 63p) the family will still be more than £1,200 (£1,283) worse off than they would have been in the absence of the cuts, because their starting income – their income if the family had just one earner – has been cut by £1,421. Although

[16] Working 37.5 hours per week

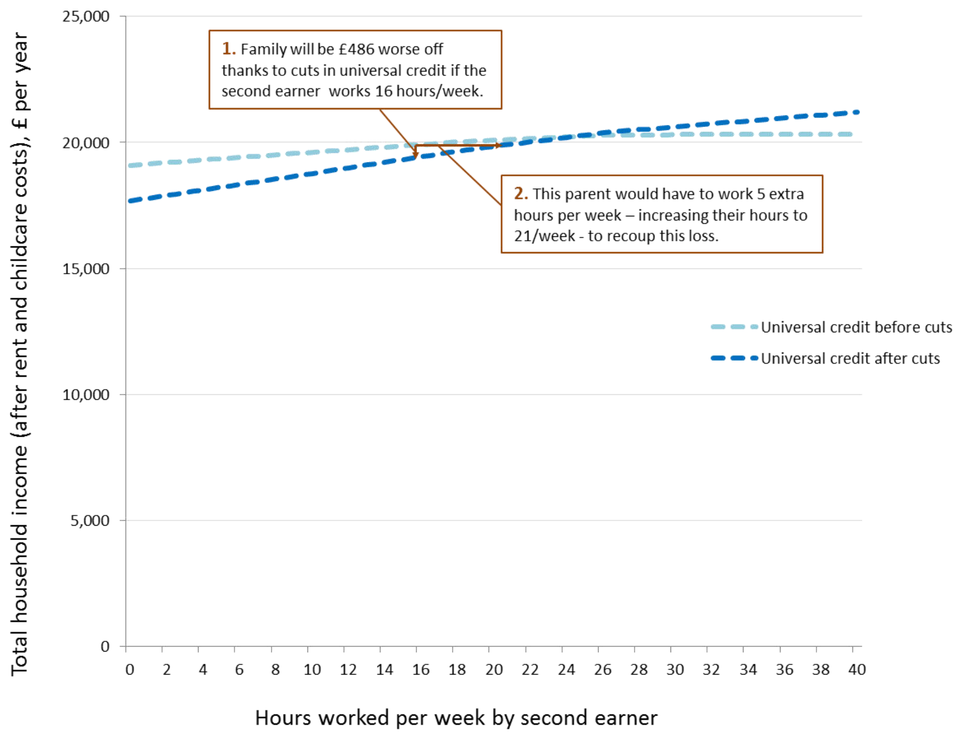
the family income would increase at a faster rate following the changes to universal credit (by £2,548 rather than £2,410), the family would still end up with less overall (£20,228 rather than £21,511) because their starting income as a single-earner family has been reduced by the cuts (from £19,101 to £17,680).

If the second earner already works for 16 hours per week, the family will be £1,283 worse off per year as a result of the cuts. She would have to work 9 additional hours per week just to recoup this amount. (Figure 5)

With childcare costs

Once again for any given number of hours (except when not working), this family has a lower overall income than an identical family without childcare costs. However they lose out less from the changes to universal credit if the second earner works, because they stand to benefit from the increased childcare subsidy. Nonetheless, if the second earner works 16 hours/week this family will be £486 worse off than under universal credit as first legislated, and they would have to work 5 additional hours per week to recoup this loss (see Figure 6).

Figure 6. Net household income (after rent and childcare) against working hours: couple with two children and one full-time earner, both parents working for the minimum wage, renting and paying for childcare in an average cost area (Family 2)



Source: IPPR analysis using the Resolution Foundation micro-simulation model

If the family has just one earner, they will have an income of £17,680/year, compared with the £19,101 which they would have had under universal credit before the cuts. Were the second earner in this family to move into work (from not working) at 16 hours/week, the family would have an effective take home income from this work of £2.10/hour compared with £0.98/hour under universal credit pre-cuts – a change in the effective tax rate from 88% to 75%. This clearly shows the beneficial effect of the increased childcare subsidy (and to a lesser extent the reduced taper), but it is also clear that this is not enough to offset the cuts to universal credit as the family would remain worse off by £486 under the post-cuts system (with an income of £19,430 rather than £19,916).

At smaller numbers of hours, the difference is greater because the family requires less childcare, and so benefits less from the increased subsidy. Conversely if the second earner works 25 hours/week or more, they will be better off under universal credit today than under the original design, because of the increasing value of the childcare subsidy to a family paying for a large number of childcare hours.

Family 3. Couple both working for the median wage, with two children aged 2 and 5, in a higher-priced area (outer London)

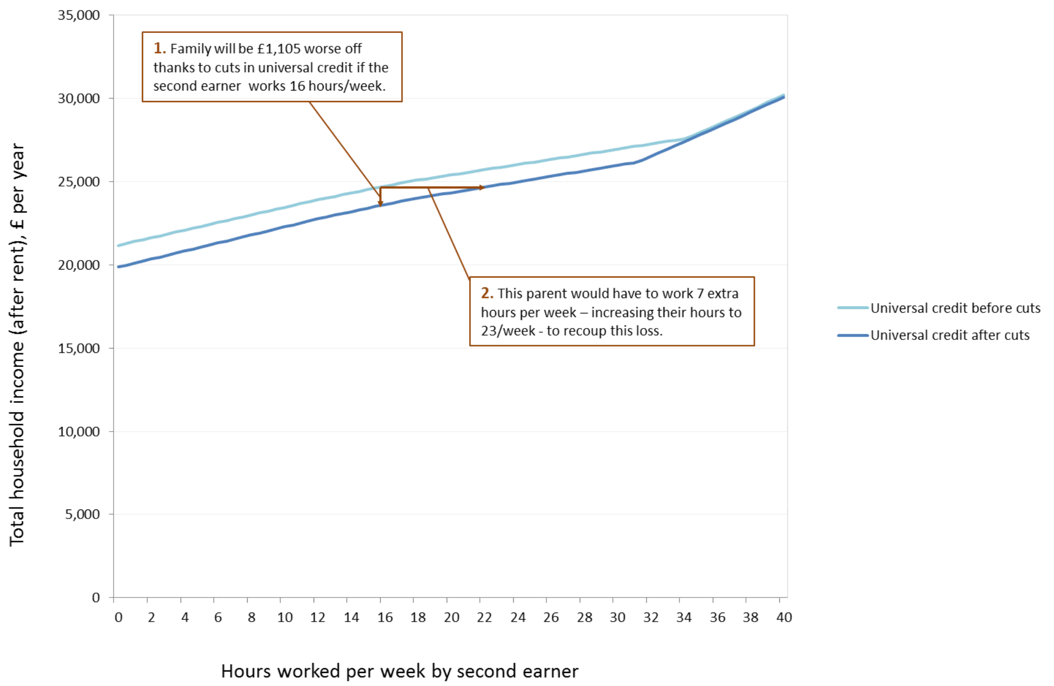
Again we assume that the family has one full time earner,[17] and examine the effect of variations in (potential) second earner working hours on total net household income.

Without childcare costs

If the family does not face any childcare costs, they will be worse off under universal credit after the cuts compared with its original design by between approximately £980 and £1300/year, where the second earner works up to 30 hours/week.

If the second earner works 16 hours per week, the family will be £1,105 worse off a year. She would have to work 7 additional hours each week (working 23 hours) to recoup the difference (Figure 7).

Figure 7. Net household income (after rent) against second earner working hours: couple with two children, one full-time earner, both parents working for the median wage, renting privately in a high cost area, no childcare costs (Family 3)



Source: IPPR analysis using the Resolution Foundation micro-simulation model

If the potential second earner does not currently work, the family will be £1,308 worse off. If the second earner decided to start work at 16 hours/week, their effective hourly income would be £4.50 under universal credit as now legislated. This is slightly better than under its original design, when the effective hourly income would have been £4.25, but overall the family will still be worse off by £1,105 than they would have been under universal credit before the cuts. Again this family would only be keeping two more pence in the pound after the changes to universal credit.

[17] Working 37.5 hours per week

Above 30 hours/week the income gap for this family between the two regimes narrows, because the family would move out of entitlement to universal credit completely after 31 hours per week under the current system (and consequently gain more from each additional hour of work above 31 because there is no universal credit to be tapered away), while under universal credit as originally designed they would have retained some universal credit entitlement if working up to 34 hours/week (and additional income if working between 31 and 35 hours/week would have been reduced by the taper).

Once the family is no longer entitled to universal credit, at higher numbers of hours, there is a smaller difference in incomes between the pre- and post-cuts regimes of £128/year, the result of cuts to child benefit.

With childcare costs

Comparing the 2017 and 2013 incarnations of universal credit, this household will be worse off due to the changes if the second earner works less than 18 hours per week. If the potential second earner is not currently working, but instead staying home with the young children, the family will be £1,308 worse off as a result of the cuts. In order to make up this difference, the second earner would have to work 8 hours per week.

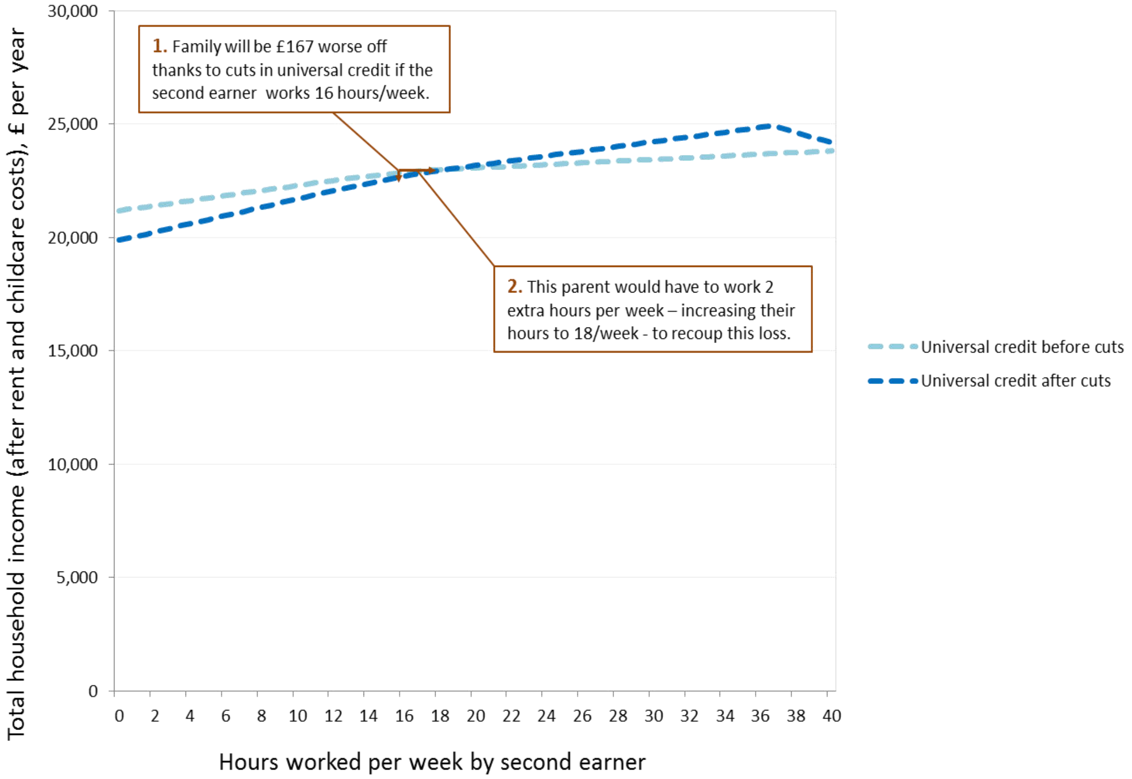
If the second earner works 16 hours per week, the family will be worse off to a lesser extent (£167/year) and would have to work 2 extra hours per week to recoup this difference (see Figure 8).

If the potential second earner is not working, but decides to enter work at 16 hours per week, she will take home an effective hourly income of £3.37 per hour compared with £2.00 per hour in the original version of universal credit. The effective tax rate for these hours has reduced from 84% to 73%. But overall the family's income will still be lower and the rewards from entering work are reduced overall at this number of hours (or fewer).

If the second earner works more than 18 hours per week, the family will be better off under universal credit as now legislated compared with the original design, because the additional support for childcare outweighs the effect of cuts for families with a high requirement for childcare. The taper rate reduction is also worth more to families with higher earnings, although this alone does not make the family better-off under the new version of universal credit, as seen in Figure 7.

Again it is evident that the overall effect of changes to universal credit has been to reward couple families where the second earner works more than half-time, but to penalise those where the second earner does not work or works less in order to care for the children (as well as low-paid lone parent families who lose out even if they work full-time). Families with young children will either have to choose between working a high number of hours, meaning spending considerably less time with their children, or living with an income lower than that originally promised by universal credit.

Figure 8. Net household income (after rent and childcare) against second earner working hours: couple with two children, one full-time earner, both working for the median wage, renting privately and paying for childcare in a high cost area (Family 3)



Source: IPPR analysis using the Resolution Foundation micro-simulation model

Household level analysis – some key statistics

All incomes are after rent and childcare costs (where applicable).

Table 4. Family 1. Lone parent, 2 children (aged 2 and 5), minimum wage, average housing and childcare costs.

4.a. No childcare costs

	If not working	If working 16 hours/week	If working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,167 (10%)	£1,658 (11%)	£1,717 (11%)
Extra hours required to work, per week, to recoup this loss	4	14	16
	... if the parent increases hours to 16/week	... if the parent increases hours from 16 to 24/week	... if the parent increases hours from 24 to 30/week
Effective hourly earnings[18] *for the additional hours worked* (compared with 2013/14 system)	£3.75 per hour (on average) for hours 1-16 (down from £4.33)	£2.48 per hour (on average) for hours 17-24 (down from £2.62)	£2.30 per hour (on average) for hours 25-30 (increased from £2.18)
Effective tax rate[19] *for the additional income* (compared with 2013/14 system)	55% (increased from 47%)	70% (increased from 68%)	72% (down from 74%)

4.b. With childcare costs

	If not working	If working 16 hours/week	If working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,167 (10%)	£1,228 (9%)	£880 (6%)
Extra hours required to work, per week, to recoup this loss	4	18	15
	... if the parent increases hours to 16/week	... if the parent increases hours from 16 to 24/week	... if the parent increases hours from 24 to 30/week
Effective hourly earnings *for the additional hours worked* (compared with 2013/14 system)	£3.23 per hour (on average) for hours 1-16 (down from £3.30)	£1.50 per hour (on average) for hours 17-24 (increased from £0.67)	£1.33 per hour (on average) for hours 25-30 (increased from £0.23)
Effective tax rate *for the additional income* (compared with 2013/14 system)	61% (increased from 60%)	82% (down from 92%)	84% (down from 97%)

[18] After tax, national insurance, universal credit withdrawals, rent and any additional childcare costs.
[19] 'Effective tax rate' is used to mean pence deducted for every extra £1 earned due to income tax, national insurance, universal credit withdrawals and the additional cost of childcare.

Source: CPAG analysis of IPPR modelling output

Table 5. Family 2. Couple parents, 2 children (aged 2 and 5), minimum wage, average area housing and childcare costs, one parent already working full time (37.5 hours)

5.a. No childcare costs

	If 2nd parent not working	If 2nd parent working 16 hours/week	If 2nd parent working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,421 (7%)	£1,283 (6%)	£1,220 (5%)
Extra hours required to work, per week, to recoup this loss	9	9	11
	... if the 2nd parent increases hours to 16/week	... if the 2nd parent increases hours from 16 to 24/week	... if the 2nd parent increases hours from 24 to 30/week
Effective hourly earnings *for the additional hours worked* (compared with 2013/14 system)	£3.05 per hour (on average) for hours 1-16 (increased from £2.89)	£2.80 per hour (on average) for hours 17-24 (increased from £2.65)	£2.30 per hour (on average) for hours 25-30 (increased from £2.18)
Effective tax rate *for the additional income* (compared with 2013/14 system)	63% (down from 65%)	66% (down from 68%)	72% (down from 74%)

5.b. With childcare costs

	If 2nd parent not working	If 2nd parent working 16 hours/week	If 2nd parent working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,421 (7%)	£486 (2%)	£24 (<1%)
Extra hours required to work, per week, to recoup this loss	13	5	1
	... if the 2nd parent increases hours to 16/week	... if the 2nd parent increases hours from 16 to 24/week	... if the 2nd parent increases hours from 24 to 30/week
Effective hourly earnings *for the additional hours worked* (compared with 2013/14 system)	£2.10 per hour (on average) for hours 1-16 (increased from £0.98)	£1.85 per hour (on average) for hours 17-24 (increased from £0.74)	£1.35 per hour (on average) for hours 25-30 (increased from £0.27)
Effective tax rate *for the additional income* (compared with 2013/14 system)	75% (down from 88%)	78% (down from 91%)	84% (down from 97%)

Source: CPAG analysis of IPPR modelling output

Table 6. Family 3. Couple parents, 2 children (aged 2 and 5), both on median wage, high (Outer London) housing and childcare costs, one parent already working full time (37.5 hours)

6.a. No childcare costs

	If 2nd parent not working	If 2nd parent working 16 hours/week	If 2nd parent working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,308 (6%)	£1,105 (4%)	£1,031 (4%)
Extra hours required to work, per week, to recoup this loss	6	7	7
	… if the 2nd parent increases hours to 16/week	… if the 2nd parent increases hours from 16 to 24/week	… if the 2nd parent increases hours from 24 to 30/week
Effective hourly earnings *for the additional hours worked* (compared with 2013/14 system)	£4.50 per hour (on average) for hours 1-16 (increased from £4.25)	£3.30 per hour (on average) for hours 17-24 (increased from £3.12)	£3.15 per hour (on average) for hours 25-30 (increased from £2.98)
Effective tax rate *for the additional income* (compared with 2013/14 system)	64% (down from 66%)	74% (down from 75%)	75% (down from 76%)

6.b. With childcare costs

	If 2nd parent not working	If 2nd parent working 16 hours/week	If 2nd parent working 24 hours/week
How much worse off after cuts to UC? (in £ per year, and as a % of income)	£1,308 (6%)	£167 (1%)	£377 better-off (2%)
Extra hours required to work, per week, to recoup this loss	8	2	n/a
	… if the 2nd parent increases hours to 16/week	… if the 2nd parent increases hours from 16 to 24/week	… if the 2nd parent increases hours from 24 to 30/week
Effective hourly earnings *for the additional hours worked* (compared with 2013/14 system)	£3.37 per hour (on average) for hours 1-16 (increased from £2.00)	£2.17 per hour (on average) for hours 17-24 (increased from £0.87)	£2.02 per hour (on average) for hours 25-30 (increased from £0.73)
Effective tax rate *for the additional income* (compared with 2013/14 system)	73% (down from 84%)	83% (down from 93%)	84% (down from 94%)

Source: CPAG analysis of IPPR modelling output

4. Where next?

Options to strengthen universal credit

This briefing has demonstrated that the original aims of universal credit may not be fulfilled following extensive cuts. We therefore also modelled the effect of a range of possible changes to universal credit, to determine their effects on household incomes for different types of family and at different points in the income distribution, as well as their impacts on poverty and household level work incentives. The scenarios modelled range from modest adjustments to a more ambitious overhaul, and include both reversing some or all of the cuts already experienced and making other changes, such as the addition of a second earner work allowance or applying a triple lock to the child element of universal credit mirroring that provided for the state pension.

Here we present some initial findings from this analysis, focusing on the poverty impacts of changes to universal credit.

Earlier in this briefing we noted that the reversal of all the cuts could keep up to a million children out of poverty. Reversing even some of the cuts would also make a difference to child poverty:

- Reversing the freeze to the child element and child benefit could keep up to 400,000 children from poverty.
- Restoring work allowances could keep up to 300,000 children from poverty.
- Lifting the two-child limit could keep up to 200,000 children from poverty.
- Removing the benefit cap could keep up to 100,000 children from poverty.

Alternatively retaining the current design of universal credit with some other changes could also have a profound effect:

- A second earner work allowance for couples, equivalent to that available to first earners, could keep up to 100,000 children from poverty.
- Applying a triple lock to the child element of universal credit could keep up to 500,000 children from poverty.
- Further reducing the taper rate to 55% could keep up to 200,000 children from poverty.

Were all the cuts to universal credit to be reversed, and a range of other improvements made (see Box 1), universal credit could keep up to 1.7 million children out of poverty who would otherwise experience poverty under the current design.

Box 1. Hypothesised improvements to universal credit

1. Second earner work allowance introduced equivalent to the current first earner work allowance.
2. Triple lock applied to child element.
3. Triple local applied child benefit.
4. Taper rate reduced to 55%.
5. Disabled child premium increased from £28 to £57/week, matching the level in tax credits.
6. Childcare costs ceiling increased by 50% to reflect cost increases since the ceiling was last uprated.
7. Childcare subsidy increased to 95%.
8. Under-25 rates abolished so that under-25s receive the same level of support as over-25s.

Our forthcoming report will provide more detail of the effect of a range of hypothesised changes on family incomes at population level and for an expanded set of example families.