



Credit crunched:

Single parents, universal credit and the struggle to make work pay

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1. Introduction

1.1 About universal credit

The introduction of universal credit, which combines six separate benefits and credits into one single payment, is the most radical restructuring of working age welfare in a generation. Following pilots which started in April 2013, phased national roll-out will begin from October 2013.

From its inception, universal credit has been based on two core policy objectives: to achieve the simplification of a complex system; and to make work pay. Notwithstanding these overarching policy goals, evidence to date has shown consistently that a significant proportion of universal credit recipients will lose out compared to their entitlements under the current system¹. Government estimates show that almost as many universal credit recipients will lose out as those who will gain, once the system is fully implemented: while 37 per cent (3.1 million) of recipients will gain, 34 per cent (2.8 million) will lose out. The remaining 29 per cent (2.4 million) will face no change compared to the current system².

As well as introducing significant changes to the way that benefit entitlements are calculated, the conditionality regime faced by universal credit recipients will be substantially different from that which was previously in place. In particular, conditionality will apply to two groups of recipients who currently face no form of conditionality: some part-time workers will face obligations to seek better-paid or longer hours of work; and some non-working adults whose partners are in low-paid work will face obligations to look for work³.

¹ Once the system is in steady state, ie not including transitional protection

² DWP (2012) Universal credit impact assessment

³ For more on universal credit, see Brewer, Browne and Jin (2011, 2012a, 2012b); Tarr and Fin (2012); and Pennycook and Whittaker (2012). Up to date information can be found at this website: <https://www.gov.uk/government/policies/simplifying-the-welfare-system-and-making-sure-work-pays/supporting-pages/introducing-universal-credit>.

1.2 About single parents and universal credit

There are two million single parents in the UK raising three million children, and around a quarter (26 per cent) of households with dependent children is headed by a single parent⁴. Children in single parent families are twice as likely as children in couple families to live in relative poverty – over four in 10 (43 per cent) children in single parent families are poor, compared to just over two in 10 (22 per cent) children in couple families. Although the majority (60 per cent) of single parents work⁵, paid work is not a guaranteed route out of poverty for them. 31 per cent of single parent families live in poverty where the single parent works part-time; and 17 per cent live in poverty where the single parent works full-time⁶.

In this context, it is unsurprising that government estimates show that virtually all single parent families will be eligible for universal credit. As the sole earners in their household, it is particularly important for single parents that the promise to ‘make work pay’ is delivered. However, in terms of winners and losers, the government impact assessment shows that single parent universal credit claimants do even worse than the overall picture: only around a third (32 per cent) of single parent households will gain from universal credit; two-fifths (41 per cent) will lose out; and the remainder (27 per cent) will face no change compared to the current system⁷.

1.3 About this research

This research examines the likely impact of universal credit on the incomes and work incentives of single parent families, comparing the current system of benefits and tax credits with universal credit. Critically, it not only analyses the situation for single parents under the universal credit system as it is currently planned, but also models the potential impact of changes to different aspects of universal credit to gauge which measures of future investment would have the biggest effect on single parent incomes and work incentives.

2. Methodology

This analysis uses the UK component of EUROMOD, the EU-wide tax and benefit microsimulation model, as no single household dataset records accurately the information needed to estimate entitlement to benefits and tax credits. The base dataset used was the 2009-10 version of the Family Resources Survey (FRS).

Several aspects of universal credit reform are ignored in this analysis, usually for simplicity. The most important two are that:

- The analysis assumes universal credit is implemented fully in October 2014, thereby omitting the complicated phase-in process and transitional protection
- The analysis ignores the reform and localisation of council tax support (previously council tax benefit), given the uncertainties over its reformed state under universal credit and the variation in application of different rules across local authorities.

The analysis is static, in that it assumes families do not alter their employment (or other) decisions in response to universal credit, and it assumes full take-up of all benefits and tax credits, in line with the government’s impact assessment. The analysis was completed after the spring 2013 Budget, and so reflects its announcements on changes to personal taxes and benefits for 2014-15.

⁴ Office for National Statistics (2012) Lone parents with dependent children

⁵ ONS (2013) Statistical Bulletin: Working and Workless Households, Table P

⁶ DWP (2013) Households Below Average Income (HBAI) 1994/95-2011/12, Table 4.5db

⁷ DWP (2012) Universal credit impact assessment

3. Key findings: how do single parents fare under universal credit?

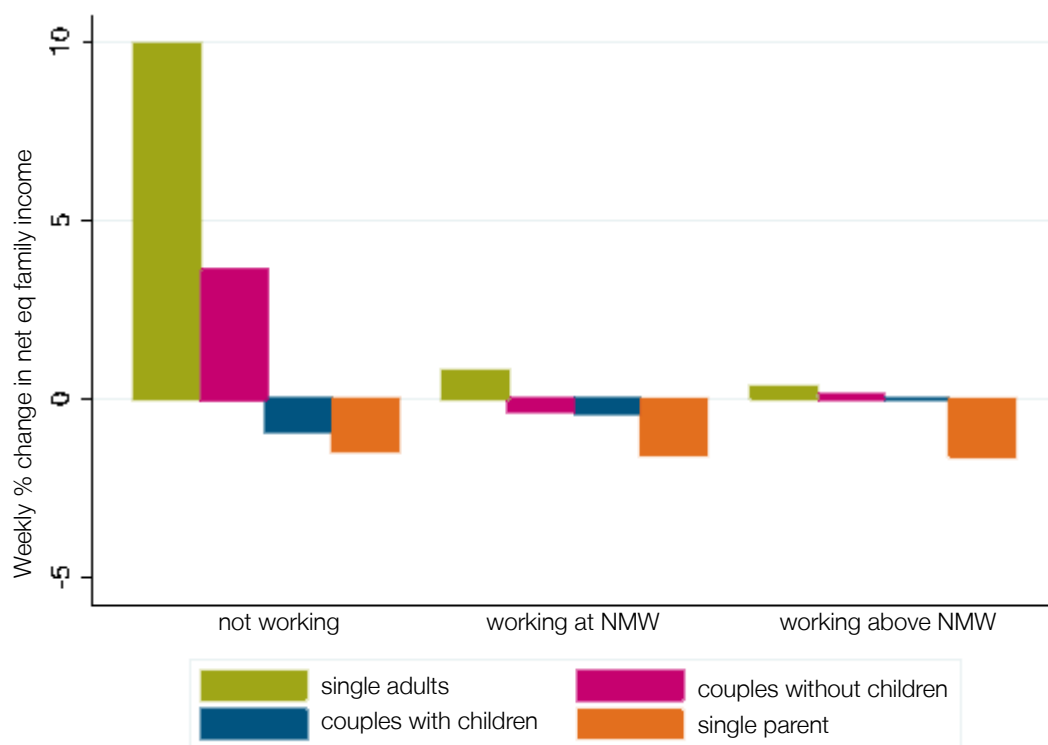
3.1 Impact of universal credit on the income of single parent families

We have calculated the impact of universal credit on the income of single parent families by comparing families' weekly net equivalised incomes⁸ under the current system and under universal credit. We looked at three different employment and earnings scenarios and compared single parent households against other working age households, categorised as:

- Not working
- Those working and earning the national minimum wage (NMW)
- Those working and earning above the national minimum wage.

Notably, not only do single parents in all three scenarios lose out in cash terms under universal credit compared to the current system, but working single parents – whether earning at or above the minimum wage – also lose a higher proportion of their weekly income under universal credit than any other household type (see Figure 3.1). This compares to an overall picture whereby mean incomes across all households are slightly higher under universal credit.

Figure 3.1 Changes in mean weekly net equivalised income by employment status, earnings and family type, under universal credit compared to the current system [working age households only]



Source: Authors' calculation based on FRS, 2009-10, using EUROMOD and assumptions specified in the text to simulate 2014-15.
Notes: FRS 2009/10, weighted

⁸ Household income data is adjusted by the OECD scale to take into account household composition. This is consistent with standard government practice

3.2 Impact of universal credit on the work incentives for non-working single parents

This section estimates the impact of universal credit on the incentives to enter work facing non-working single parents, by measuring the participation tax rate (PTR)⁹. High PTRs represent weak incentives to enter work, and our focus is on how these incentives change for non-working single parents under universal credit compared to the current system. In the analysis presented here we assume that single parents enter the labour market at the national minimum wage, and we compare the PTRs under four different scenarios of hours worked:

- 10 hours per week
- 20 hours per week
- 30 hours per week
- 40 hours per week.

Table 3.1 – Average PTR of non-working single parents compared to all non-working adults in any household type under the current system and under universal credit at different hours worked [assuming minimum wage earned, working age households only]

	Under current system – mean PTR		Under universal credit – mean PTR		
	Single parents	All households ^a	Single parents	All households ^a	
10 hours	41%	40%	10 hours	2%	20%
20 hours	40%	37%	20 hours	17%	27%
30 hours	37%	32%	30 hours	24%	27%
40 hours	38%	32%	40 hours	30%	30%

Notes and Sources: as for Figure 3.1

^a In this report we use households to mean tax units or benefit units

On average, universal credit increases the financial payoff from working through reduced PTRs, and this is particularly evident for non-working single parents looking to move into employment of up to 20 hours per week. More single parents – especially those in the lower part of the income distribution – will face lower PTRs when they take up a part-time job, and this will be particularly evident when starting a job at 10 hours per week. This arises mostly because universal credit removes the 16 hours minimum limit for the entitlement to in-work support, and on average the benefit withdrawal due to an increase in earnings is lower under universal credit than under the current system.

However, the gain decreases significantly as hours of work increase beyond this point and towards full-time hours.

⁹This is calculated as the proportion of gross earnings lost in withdrawn benefits or taxes paid when moving into work, on the assumption that one would earn the minimum wage

3.3 Impact of universal credit on the work incentives for working single parents

We estimate the impact of universal credit on the incentives for working single parents to seek more work – either more hours or better-paid work – by calculating the marginal effective tax rate (METR) faced by working single parents under universal credit compared to the current system¹⁰. High levels of METR are an indicator of low incentives to seek more work, as a high proportion of extra earnings would be taxed away (either because of extra tax or because of benefit and tax credit withdrawal).

In these calculations, we break METRs down into three broad categories:

- Very weak work incentive: very high METR, defined as 80 per cent or higher
- Weak work incentive: high METR, defined as a rate of 60 to 80 per cent
- Moderate to strong work incentive: medium-low METR, defined as a rate below 60 per cent.

It is important to note that under both the current system and under universal credit, working single parents face on average significantly weaker work incentives – ie higher METRs – than other household types. METRs do fall slightly on average under universal credit, and working single parents see larger falls in METRs on average under universal credit than other groups. Low paid single parents will benefit most from lower METRs under universal credit.

Across all families, our calculations show that universal credit reduces the number facing very weak incentives to work, but increases the number facing weak incentives. Because we have excluded consideration of council tax support (CTS)¹¹, no marginal tax rate is higher than 77 per cent under universal credit. However, were CTS to have been taken into account using the national council tax benefit rules which were applicable until the end of the tax year 2012-2013, then some of these rates of 77 per cent would rise to 82 per cent and the number of people facing very weak work incentives would increase.

While it would have been impractical in this analysis to incorporate council tax support in our calculations, given the number of different schemes now in operation, its omission means that our figures are likely to under-estimate the number of households facing very weak work incentives.

Table 3.2 – Average METRs under current system compared to universal credit, for single parents and for all households [working age only]

	Current system		Universal credit	
	Single parents	All households ^c	Single parents	All households ^c
Average METR	62%	36%	56%	36%
Medium-Low METR (<60%) ^a	34%	89%	35%	88%
High METR (60%-80%) ^a	47%	9%	64%	12%
Very high METR (>80%) ^{a, b}	19%	2%	0.3%	0.01%

Notes and Sources: as for Figure 3.1

^a Proportion of working-age households facing METRs within a given interval (0-60%, 60%-80% and more than 80%)

^b Excluding consideration of council tax support, the number of people facing very high METRs is reduced.

^c In this report we use households to mean tax units or benefit units.

¹⁰ The METR measures the fraction of earnings lost to withdrawn benefits and taxes paid when working one extra hour

¹¹ In April 2013 the previously-national system of council tax benefit – offering support with council tax bills to those on low incomes – was replaced by a localised system of council tax support. This allows all 326 local authorities across England to develop their own schemes of support, intended to allow them to respond more flexibly to their local demographics

[The Welsh and Scottish Governments have, for now, both chosen to retain the previous council tax benefit rules]

4. Key findings: what impact would changes to universal credit have on single parent families?

In light of the evidence that shows that a significant proportion of single parent families will not fare well under universal credit, in this section we consider four changes to universal credit as it is currently planned, to see which (if any) would achieve improvements for single parent families under universal credit.

The changes modelled¹² – and costed on the basis of applying them to all universal credit claimants – were:

Table 4.1 - Estimated annual costs for each policy reform proposal compared to currently proposed universal credit (in millions)

	Universal credit change	Indicative annual cost
1	Reducing the universal credit taper rate from 65 per cent to 55 per cent	£3,528 million
2	Increasing the standard allowance for everyone within universal credit by £39 per year	£363 million
3	Increasing the amount of income disregarded before the taper applies by £39 per year	£85 million
4	Increasing the income tax threshold (personal allowance) for the basic tax rate by £300	£1,489 million

4.1 Reducing the universal credit taper rate from 65 per cent to 55 per cent

Universal credit will be withdrawn at a rate of 65 per cent as earnings increase. However, the first policy paper which outlined the idea of a universal credit-style system, back in 2009, originally proposed a system with a taper rate of 55 per cent, which it identified as the “preferable withdrawal rate”¹³. We have therefore modelled what impact a reduction in the universal credit taper from 65 per cent to 55 per cent would have on single parents.

Changes to the taper rate only affect workers earning over the limit of earning disregards¹⁴. The main positive effect for single parents is therefore found amongst workers in the middle to high section of the income distribution; and is particularly concentrated amongst those earning over the minimum wage. [Lowering the taper rate obviously has no effect for those not in work].

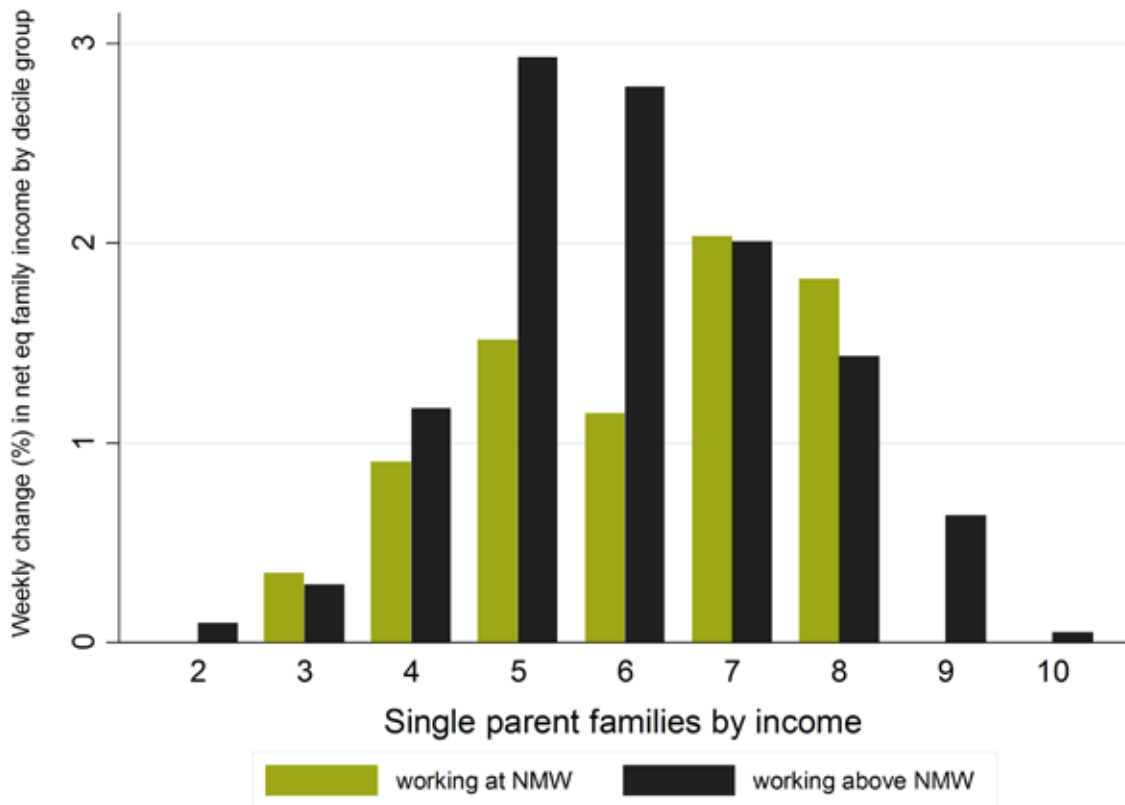
A reduced taper rate also reduces the number of working single parents facing high METRs; reducing the rate to 55 per cent would mean that the average METR faced by working single parents would fall by six per cent, meaning that more single parents would face stronger incentives to progress in work under universal credit. However this reform does little for single parents at the lowest part of the income distribution who are out of work or earn too little to get over the disregard thresholds.

¹² The size of each intervention was chosen on the basis of previous Gingerbread research (Hirsch, 2012)

¹³ Centre for Social Justice (2009) Dynamic Benefits: Towards welfare that works

¹⁴ Earnings disregards for single parents in 2014-15 are estimated at: a) £3,191 per year for those with rental costs; and b) £8,900 for those without rental costs. Taken from HM Treasury (2012) Autumn statement 2012 policy costings and applying 1% uprating to the given 2013-14 figures

Figure 4.1 Distributional effect for single parent families of a 55% taper rate in universal credit, as a percentage increase in equivalised weekly income compared to a taper rate of 65%, for two scenarios: working at national minimum wage; and working above minimum wage



Source: Notes and sources: as for Figure 3.1

4.2 Increasing the basic allowance within universal credit

The second reform we consider is an increase in the basic allowance within universal credit of £39 per year (75 pence per week). Overall our calculations show that this reform is progressive in income terms, effectively targeting the poorest families as well as those who are out of work or low paid, while leaving those at the top end of the income distribution largely unaffected.

However, conversely this change would also slightly damage incentives to work, increasing both marginal and participation tax rates.

4.3 Increasing the amount of income disregarded before the taper applies

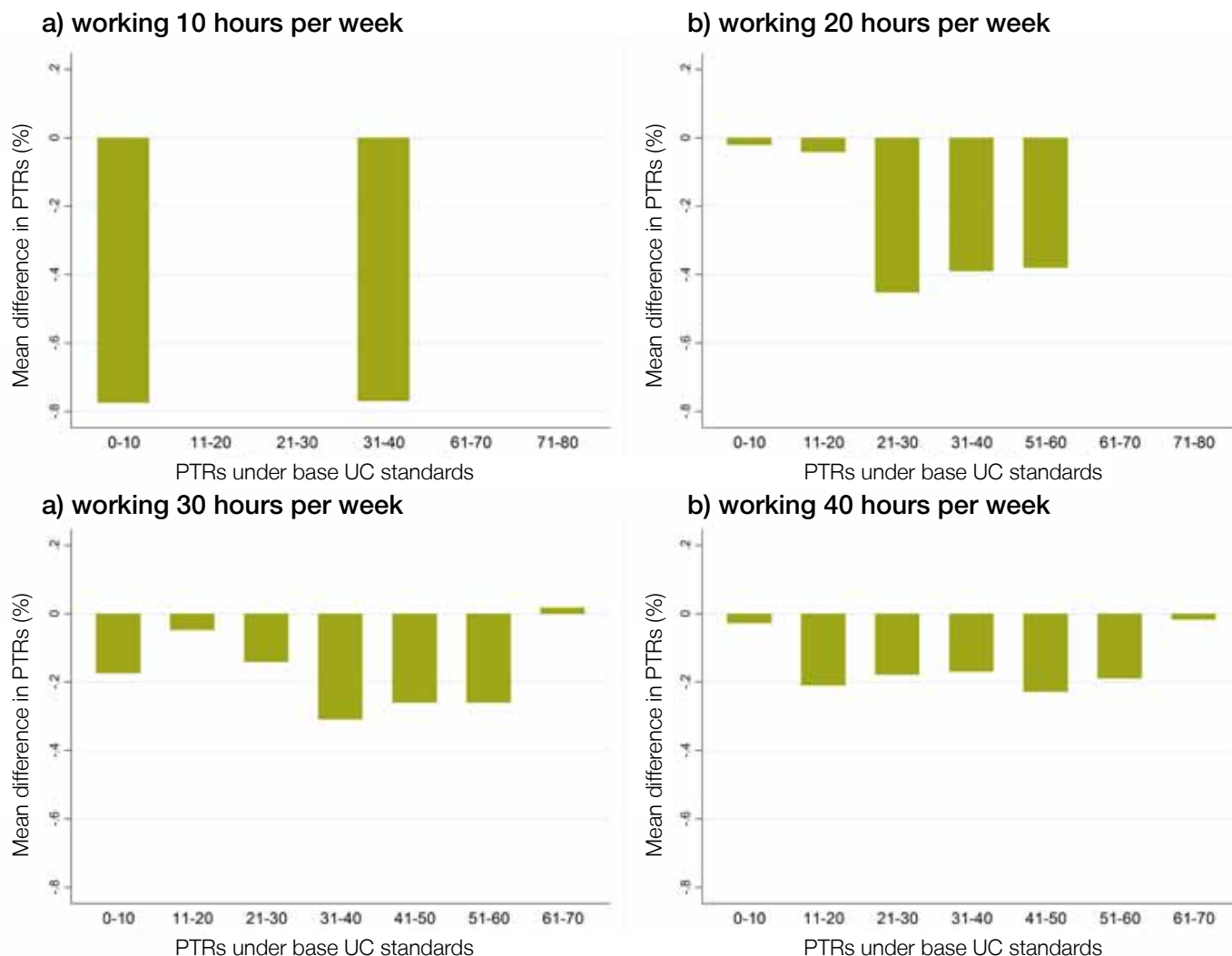
The third reform we modelled is an increase in the universal credit income disregards – the amount of earned income disregarded before the (65 per cent) taper rate is applied. Under universal credit, different household types will have different income disregards to reflect their different needs and intended to ensure that work pays. In this example we have applied an increase to the income disregard across all household types of £39 per year (75 pence per week).

In order to take advantage of income disregards, claimants must earn enough to take their earned income over the disregarded limit. This means that those who are not working or who are earning too little to get over the current disregard levels are on average unaffected in income terms by this

change, but most working single parents would gain from this reform compared to the system as currently planned.

On average this change would also have a positive effect on work incentives for non-working single parents, with 93 per cent of them seeing a reduction in their participation tax rate (Figure 4.2).

Figure 4.2 – Effect of an increase in the amount of income disregarded, of an additional £39 per year, on the average PTRs of single parents compared to base [current planned] universal credit scenario



Notes and sources: as for Figure 3.1

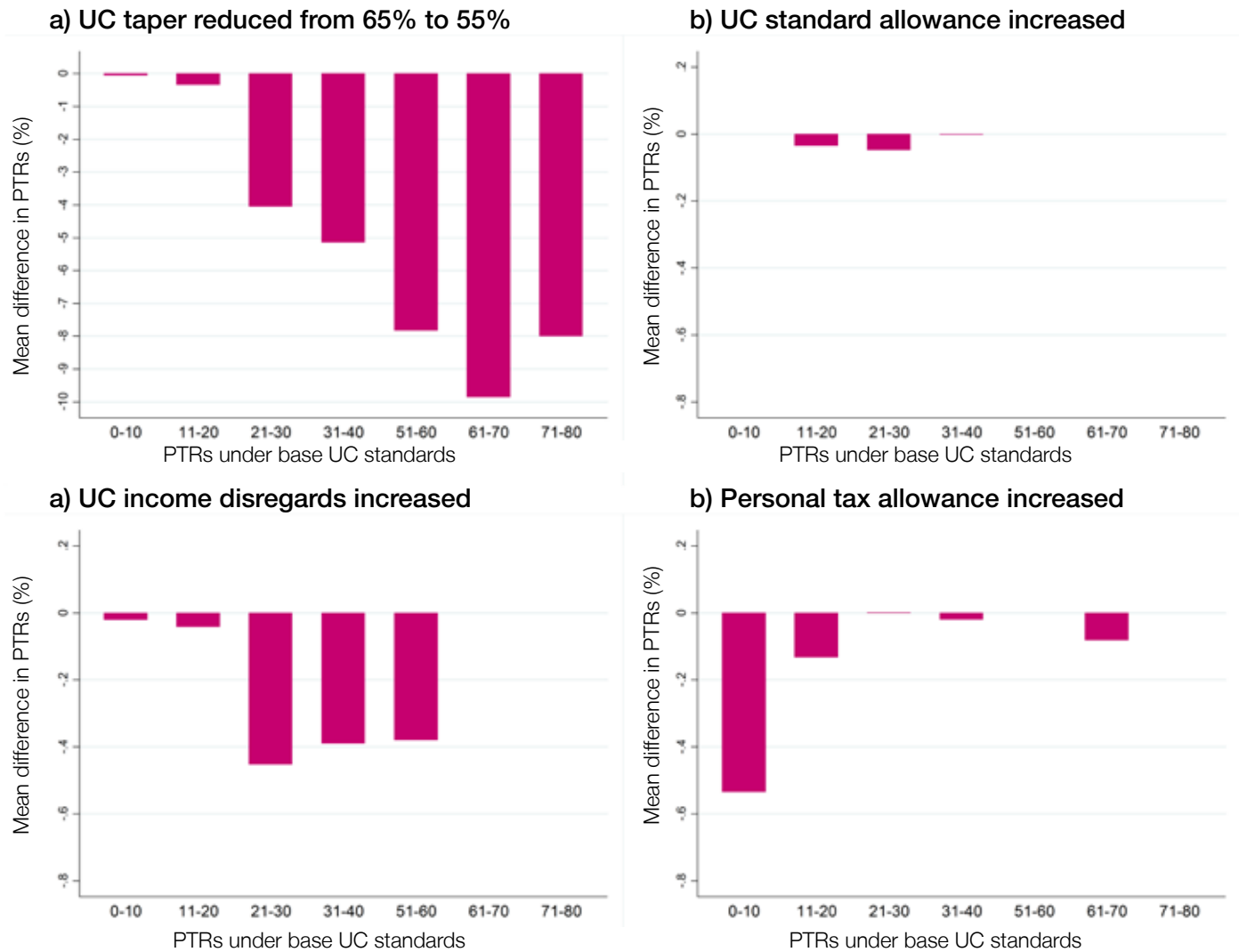
The x-axis represents PTRs faced by non-working adults under the base UC system. The charts then show where, along the distribution of “current UC PTRs”, the reform is more likely to change incentives to work. For example, increasing income disregards in this way would improve incentives to work by approximately 4 percentage points for non-working single parents who, if joining the labour market at 20 hours per week at national minimum wage, would currently lose between 21% and 60% of their extra income in taxes and benefit withdrawal (panel b).

4.4 Increasing the basic rate income tax threshold (personal allowance)

The fourth reform to universal credit that we consider is an increase in the personal tax allowance of £300 per year for all working-age people, which would take the threshold up to £10,040 per year. Increasing the income tax threshold for the basic rate of tax would mainly affect the higher part of the income distribution. However, it is not an effective way of increasing the income of those who are lower paid because many of them already earn less than the basic rate income tax threshold, and so do not benefit from a reform of this kind. Even where this reform does (slightly) improve incentives to work, the effect for single parents would be lower than the average.

4.5 Comparing the relative effects of the four changes considered

Figure 4.3 - The effect of the four changes outlined on PTRs among single parents working 20 hours per week at the national minimum wage, compared to the baseline [currently planned] universal credit scenario



Notes and sources: as for Figure 3.1

In the charts above, the x-axis represents PTRs faced by non-working single parents under the baseline (current planned) universal credit system. The graphs show where - along the distribution of PTRs implied by the base UC scenario - the various reforms are more likely to change incentives to work. For example, reducing the taper from 65% to 55% (panel a) would improve incentives to work significantly for non-working single parents who, if joining the labour market at 20 hours per week at the national minimum wage, would currently lose between 21% and 80% of their extra income in taxes and benefit withdrawal. These changes would affect mostly those single parents currently facing weak incentives to work.

All the universal credit reform scenarios considered here obviously entail a cost to the Exchequer. Based on the size of each change we have modelled, the most expensive reform is a reduction of the taper rate from 65 per cent to 55 per cent, while the cheapest is increasing the income disregards.

5. Key findings: what impact would increases to the minimum wage and to the level of single parent employment have?

In addition to modelling changes to universal credit as outlined in section four, we also modelled two further scenarios:

- The impact on single parent incomes of a 10 per cent **increase in the national minimum wage** once universal credit is implemented
- The gains to the Exchequer from a **five per cent rise in the rate of single parent employment**.

5.1 The impact of a rise in the minimum wage on the income of single parent families

Low paid families which see incomes change by large amounts after a rise in the minimum wage are either those in which minimum wage workers are facing low METRs, or those in which earnings (rather than benefits) are the principal source of income. Across most of the income distribution, a 10 per cent rise in the minimum wage leads to an increase in net family income among minimum wage families of around 3 per cent; this increases to around 4 per cent for single parent families.

However, our analysis shows that workers without children gain the most from an increase in the minimum wage, reflecting the fact that they will tend to face lower METRs than families with children because they are less likely to be in receipt of benefits.

5.2 The impact on the Exchequer of a five percentage point rise in the rate of single parent employment¹⁵

While the majority of our analysis is, by necessity, static, it is clear that one of the objectives of universal credit is to increase the employment rate. We therefore modelled the financial benefits to the Exchequer of a five percentage point increase in the single parent employment rate – equivalent to getting approximately 85,000 more single parents into work – which shows that the gain would amount to approximately £436 million a year, mainly due to reduced payment of benefits and increased taxes and national insurance contributions.

¹⁵ For further detail please see Brewer, M and De Agostini, P (2013) Modelling the impact on the Exchequer of changes in the employment rate of single parents: technical note, Gingerbread

Table 5.1 shows the difference in disposable income and its components between the current scenario and a scenario with a rise in the single parent employment rate of five percentage points. It also shows the aggregate¹⁶ change in spending on benefits and receipts of income tax and national insurance.

Table 5.1 – Weekly average changes in equivalent disposable income and its components for single parent families under the hypothesis of a 5 percentage point increase in single parents’ employment rate

	Value level			Aggregate values
	Out of work £/wk	In work £/wk	Changes £/wk	Changes £/yr (million)
Total earnings	0	212.04	212.04	948
Income tax	16.31	31.28	14.97	67
Employee and self-employed NI	0	12.25	12.25	55
Employer NI	0	9.41	9.41	42
Means-tested benefits	244.59	184.02	-60.57	-272
Disposable income	291.5	415.76	124.26	554
Eq. Disposable income	186.31	267.9	81.6	--
Total from income tax and NI	--	--	--	164
Total impact on the Exchequer	--	--	--	436

Notes and sources: as for Figure 3.1

¹⁶Aggregate values are calculated by scaling up weekly amounts to yearly values for all entitled claimants and tax payers

6. Conclusions

Single parent families are still twice as likely to live in poverty as couple families, and they have historically faced weak incentives to work, not only because they face high childcare costs but also because of high withdrawals of means-tested benefits when they join the labour market. Given that a primary aim of universal credit is to make work pay, it is therefore important to understand in detail how single parent families will be affected by its introduction.

This report has looked at how the introduction of universal credit in the UK will affect both the income and the work incentives for single parent families. Overall, our analysis shows that the average income for single parent families is slightly *lower* under universal credit than under the current system, and on average single parents are forecast not to benefit from its introduction.

In terms of work incentives, our analysis shows that under universal credit many non-working single parents who currently have weak incentives to enter work will see these improved, mainly because of the removal of the minimum limit on hours worked per week¹⁷, as well as slower benefit withdrawal¹⁸. Similarly, some working single parents who currently have weak incentives to work more will see these improve. However, it is also important to note that, despite this improvement, single parents will still face some of the weakest incentives to work at all and to progress in work compared to other household types, and especially when they are working 20 or more hours per week.

The report also looked at how various changes to the detail of universal credit would alter the impact of the reform on income distribution and work incentives for single parents. Clearly this is an area for further discussion as additional investment potentially becomes available in the future, but these initial calculations indicate that there are key decisions that could be made which would improve work incentives for single parents under universal credit.

Finally, our research clearly shows that getting more single parents into work would have significant positive effects for the Exchequer, with a 5 per cent increase in the employment rate resulting in a £436 million annual saving.

¹⁷ This is in contrast to working tax credits where claimants must work a minimum of 16 hours per week

¹⁸ For more details on how Universal Credit works see Brewer M., J. Browne and W. Jin (2012) "Universal Credit: A Preliminary Analysis of Its Impact on Incomes and Work Incentives" in *Fiscal Studies*, vol. 33, no. 1, pp. 39-71

7. Appendix

Reform to UC	Household type	Effect on incentives to work at all (PTRs)	Effect on incentives to progress in work (METRs)	Costing to the Exchequer
UC taper rate down	Single parents	Reduces PTRs	Improves METRs overall (reduces high METRs but increases some of lowest METRs)	Most expensive
	All	Reduces PTRs overall (reduces high PTRs but increases some of lowest PTRs)	Damages METRs; rise in high METRs	
UC basic allowance up	Single parents	Very small fall in PTRs	Slightly damages METRs	Medium-low cost
	All	Rise in PTRs	Slightly damages METRs	
UC income disregards up	Single parents	Small fall in PTRs; low PTRs decrease more than high PTRs	Small fall on average	Less expensive
	All	Small fall in PTRs; fall in high PTRs smaller than increase in low PTRs	Very small rise on average	
Personal allowance up	Single parents	Fall in PTRs; low PTRs decrease more than high PTRs	Small fall on average mostly for those facing low METRs	Medium-high cost
	All	Fall in PTRs; small fall in high PTRs, large fall in low PTRs	Small fall on average	



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