Resolution Foundation

The costs of childcare after housing costs

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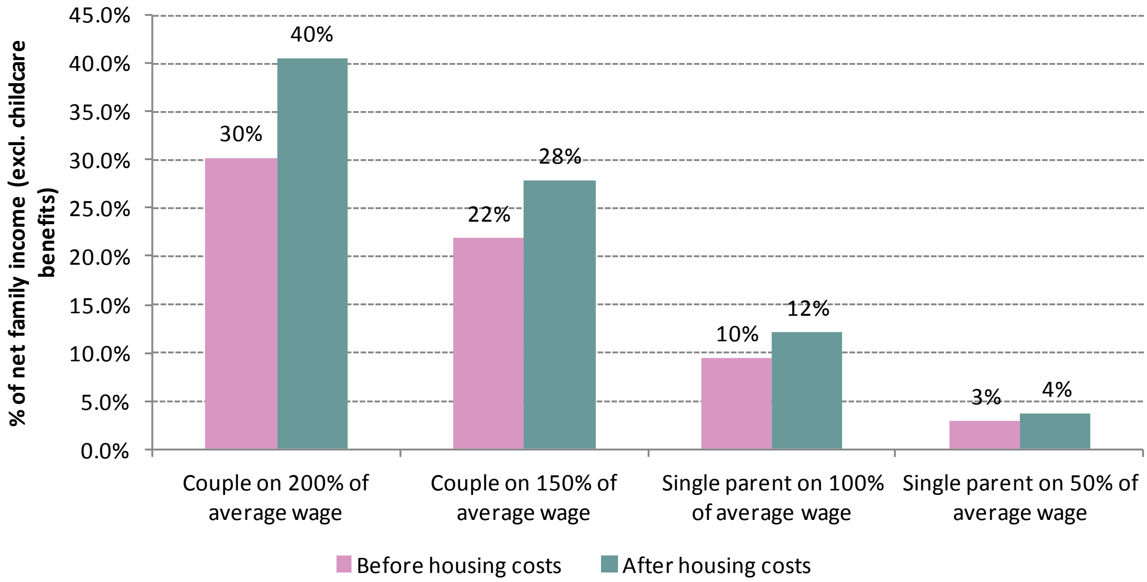
It is well known that the UK has some of the most expensive childcare in the OECD, accounting for a third of household income in some cases. New analysis published by the Resolution Foundation shows that the picture is even bleaker for families than we generally assume. The analysis looks at the costs of childcare after families have paid for housing which is a more accurate reflection of the disposable income they have to meet other costs of living, including childcare.[1]

As Chart 1 shows, after having paid for housing , childcare as a percentage of household income jumps from just over a fifth of household income for a family on £39, 693 (150 percent of average wage)with two children under five in full time childcare to just under 30 per cent. For a family on £53,924 (200 percent of average wage) with two children under five in full time childcare, childcare costs jump from 30 per cent to 40 per cent of household income.

Chart 1: Net childcare costs for two children aged two and four in full time care, as a % of disposable income by family type, before and after housing costs (2012)



Source: Resolution Foundation childcare cost model, 2012. Notes: (1) Full-time childcare defined as 42.5 hours per week for 47 weeks per year. The cost of childcare is assumed equal to the national average of £3.95 per hour (Daycare Trust 2012). (2) Net childcare costs defined as the gross value of childcare used (including the value of the Early Years Entitlement) less all support received specifically due to facing childcare costs. (3) Net family income is calculated as gross earnings net of income tax, NICs and council tax, plus all tax credits, child benefit, housing benefit and council tax benefit received. All benefits received specifically to cover childcare costs are then subtracted to derive net disposable income. (4) Average wage (AW) reflects the earnings of the median full-time UK employee. This was £26,462 (£507 per week) in 2012 (ONS ASHE provisional estimate). (5) Appropriate housing costs were determined based on gross family income and LCFS data (see Appendix for details). (6) The two couples are assumed to own their homes, and are therefore not eligible for housing benefit. The single parents are assumed to rent and are eligible for housing benefit.

Comparing a low and middle income family with two children under five in full time childcare, Chart 2 shows their gross income, net income after taxes and benefits, net disposable income after housing costs and net disposable income after housing costs and childcare.

[1] Housing costs are derived from ONS, *Family Spending, 2012 Edition*. See Appendix for further details.

Chart 2: Incomes before and after housing and childcare costs, by income level – two parents working full time with two children aged two and four in full-time care (2012)

Source: Resolution Foundation childcare cost model, 2012. Notes: (1) Full-time childcare defined as 42.5 hours per week for 47 weeks per year. The cost of childcare is assumed equal to the national average of £3.95 per hour (Daycare Trust 2012). (2) Both parents work full-time (37.5 hours per week). (3) Low income family corresponds to two parents working full-time on minimum wage, which puts them just below the 20th percentile in the distribution of equivalised gross household income across working age households. The family is assumed to have housing costs of £97 per week (see Appendix for details). (4) Middle income family has a gross annual income of £43,400, which corresponds to the projected median equivalised gross income among working age households for 2012-13 based on 2010-11 FRS data. The main earner is assumed to earn 50 per cent more than the second earner (£26,040 and £17,360 respectively). The family is assumed to have housing costs of £174 per week (see Appendix for details).

Although the middle income family starts off 79 per cent better off than the low income family, after housing and childcare costs it is almost no better off – only 10 per cent - because together, housing and childcare costs represent a considerable share of its net income and it receives less support towards these costs than a low income family.

While the percentage of income that families spend on childcare is an important measure of affordability, it does not provide a full picture of how childcare costs affect incentives to move into and progress in work. While childcare costs represent a smaller proportion of the household income for lower income families, childcare costs nevertheless significantly erode work incentives. A second earner on the minimum wage is only £4 better off a week if she works full-time than if she did not work at all.[2] Targeted support remains vital to improve the work incentives faced by those on low incomes but additional support is required to prevent middle income families also facing unduly high barriers to work.

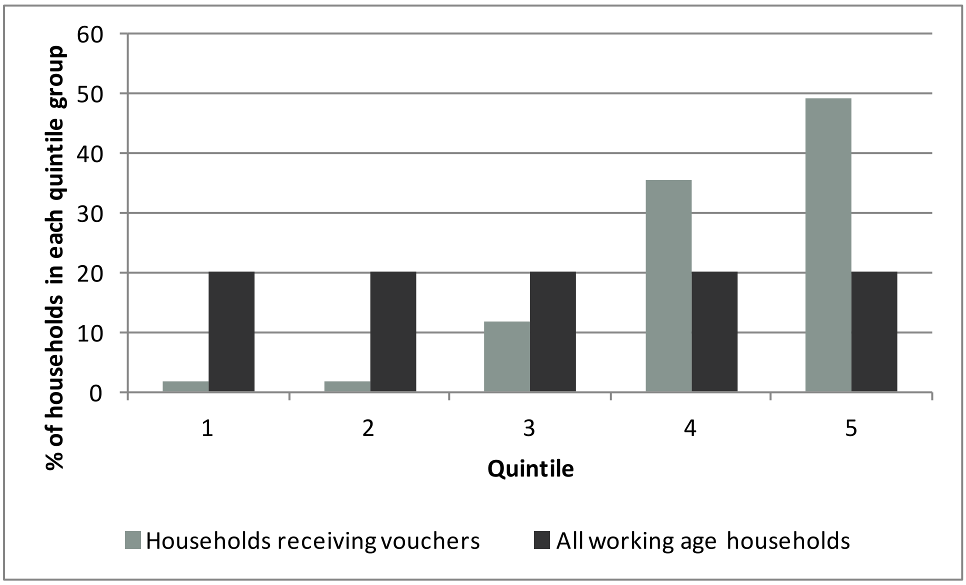
The impact of tax relief for childcare

The government established a Childcare Commission in July 2012 to address the provision of wraparound and holiday childcare for children of school age; identify regulatory burdens on childcare providers; and look at how childcare supports families to move into sustained employment. The Commission is expected to put forward proposals in January 2013. Reports indicate that the government may introduce tax relief on up to a third of child care costs to improve the affordability of childcare.[3]

Employer-supported childcare vouchers currently provide basic rate tax relief to parents who use childcare and whose employers voluntarily offer the voucher scheme. Parents can claim £55 a week free of tax and National Insurance Contributions if they are basic rate tax payers, £28 a week if they are higher rate tax payers and £22 a week if they pay the additional rate of tax. Employers have to offer vouchers to all employees to prevent the scheme being a perk for higher earners, with the exception of minimum wage employees who can be exempt.[4]

Resolution Foundation analysis highlights that the take up of employer supported vouchers currently favours households on higher incomes as shown in Chart 3.

Chart 3: Position of childcare voucher recipient households in the income distribution, 2010-11 (%)



Source: Resolution Foundation analysis of FRS data. Notes: (1) Quintiles have been defined based on equivalised net income before housing costs such that each quintile contains 20% of working age households. Working age households are defined as those where the household head is below state pension age. (2) Households that receive childcare vouchers have been identified in the FRS data based on the *chvsac* variable in the 'job' dataset. In all, 228 households in the sample

[2] Alakeson, V. and Hurrell, A. (2012) *Counting the Costs of Childcare*, London: Resolution Foundation.
[3] http://www.dailymail.co.uk/news/article-2246205/Tax-relief-scheme-cut-cost-childcare--plans-announced-help-working-families.html
[4] http://www.hmrc.gov.uk/childcare/employees-guidance.htm

reported receiving vouchers. Using this variable, we estimate there were 304,155 individual childcare voucher recipients in 2010-11, corresponding to 242,980 households.

- In 2010-11, nearly 50 per cent of households receiving vouchers were among the richest 20 per cent of working age households.
- Almost no voucher recipients were found among the poorest 40 per cent of households. This is despite that fact that around half of households containing young children are found in the bottom two deciles.
- Nearly 60 per cent of individuals receiving vouchers are among the top 20 per cent of earners.

The distribution of the take up of vouchers stands in stark contrast to targeted support for childcare provided through tax credits that supports low to middle income families and the free entitlement to 15 hours of childcare for three and four year olds that is offered universally and is taken up by families across the distribution (98 per cent take up for 4 years olds and 70 per cent take up for 3 year olds).[5] While the details of any tax relief proposal are unknown, current experience suggests that the take up of tax relief would favour better off households.

The Commission on Living Standard's alternative proposal

As the Resolution Foundation's Commission on Living Standards recommended, if additional money were available to invest in childcare, as a first step, it should be directed towards expanding the universal entitlement for three and four year olds from 15 hours of childcare for 38 weeks a year to 25 hours of childcare a week for 47 weeks a year to better support women who want to work part-time. This would cost £2.1 billion annually and could be financed through reductions in universal pensioner benefits.

Additional investment in the universal offer is preferable to greater investment in means-tested support through the tax credit or forthcoming Universal Credit system given that investment in means tested support reduces incentives to progress in work. Given that second earners in the tax credit system already lose over 70 pence of every additional pound they earn, further targeted support would lead to them losing even more of each additional pound they earn.

[5] Smith et al. (2010) *Childcare and Early Years Survey of Parents,* London: Department for Education

Appendix: Calculating housing costs

Appropriate housing cost expenditure was determined for each family scenario according to the following steps. First, the family's 2011 gross income was compared to the unequivalised gross income distribution (projected based on FRS 2010-11 data) in order to identify in which decile the family sits. The ONS Family Spending 2012 edition release provides estimates of average annual expenditure on housing by unequivalised gross household income deciles for 2011.[6] The headline housing expenditure figure is based on net rent (i.e. rent reduced by the value of housing benefit) and includes council tax. For our purposes we adjust these figures to include rent covered by housing benefit and exclude council tax (since these are both taken into account in our net income figures).Each family's housing expenditure is then assumed to be equal to their decile's average, and the proportion of their gross income that this represents is calculated for 2011. This is then assumed to be constant for each family type, allowing 2012 annual housing expenditure to be derived from 2012 gross income.

Chart 1 example families: gross income and housing expenditure (2012)

Family	Gross annual income	% of gross income spent on housing costs	Estimated average annual expenditure on housing
Couple on 200% of average wage	£52,924	20.0%	£10,563 (£203pw)
Couple on 150% of average wage	£39,693	17.6%	£6,998 (£134pw)
Single parent on 100% of average wage	£26,462	18.9%	£5,010 (£96pw)
Single parent on 50% of average wage	£13,231	31.6%	£4,185 (£80pw)

Notes: (1) Percentage of gross income spent on housing costs assumed to be consistent between 2011 and 2012 for each family type. (2) Median full-time annual wage was £26,462 in 2012 (provisional ONS 2012 ASHE estimate).

[6] http://www.ons.gov.uk/ons/rel/family-spending/family-spending/family-spending-2012-edition/index.html

The Resolution Foundation

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- undertaking research and economic analysis to understand the challenges facing people on a low to middle income;
- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision-making and bring about change.

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