

SUBMISSION TO THE WORK AND PENSIONS SELECT COMMITTEE INQUIRY:  
‘HOW CAN SUITABLE, AFFORDABLE CHILDCARE BE  
PROVIDED FOR ALL PARENTS WHO NEED IT TO ENABLE  
THEM TO WORK?’

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**Submission to the Work and Pensions Select Committee Inquiry:  
‘How can suitable, affordable childcare be provided for all parents  
who need it to enable them to work?’**

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**Summary**

There are efficiency reasons for government policies to provide parents with suitable and affordable childcare in order to enable them to undertake paid work, but it is not clear that these provide sufficient grounds to support *all* parents who wish to work. (*paragraphs 1–2*)

There are extremely large disparities in the availability of formal childcare places across local authorities in England. (*paragraphs 3–8*)

Differences in the availability of formal childcare places across local authorities are related to differences in mothers’ employment rates. (*paragraphs 9–10*)

Even allowing for differences in family size, total hours used and quality choices, the hourly cost of childcare varies considerably across regions. (*paragraphs 11–12*)

Very few families currently benefit from the childcare tax credit, because of low usage of approved forms of care among families that would otherwise be eligible for the credit. (*paragraphs 13–20*)

There are three possible reasons and associated policy responses:

- (i) The care credit is not sufficiently generous to enable these families to use approved care. This suggests that the generosity or scope of the credit could be enhanced. (*paragraphs 20, 23–29*)
- (ii) Parents are unable to obtain a place with an approved childcare provider. This suggests a continuation and expansion of policies directly aiding the provision of formal childcare places on the supply side. (*paragraph 20*)
- (iii) Parents prefer to use informal care. This suggests that the credit could be expanded to cover informal sources of care. (*paragraphs 19–22*)

It is hard to find convincing arguments why employers should contribute to the costs of childcare or why employer involvement can provide childcare at a lower cost than other provision. The current rarity of employer-provided care suggests that any advantages for employers from being involved in providing childcare are generally outweighed by the considerable drawbacks and limitations. (*paragraphs 30–37*)

*If* the 2002 Spending Review provided sufficient childcare for all children in poor households with one adult not working and *if* the parents of these children responded by entering employment and *if* the increase in family earnings were sufficient to lift

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the families out of poverty, then the government could easily meet its target to reduce child poverty by a half by 2010. However, these conditions are unlikely to be fulfilled. In particular, the target of 70 per cent of lone parents in paid employment is extremely ambitious and unlikely to be met through an increase in the supply of childcare places alone. (*paragraphs 38–43*)

### **Should suitable, affordable childcare be provided for all parents who need it to enable them to work?**

1. The underlying premiss of the Work and Pensions Select Committee Inquiry is that there is a role for government in providing childcare to enable parents, and particularly mothers, to undertake paid work. There may be good reasons on grounds of economic efficiency for such a role:

- There may be long-term benefits to parents remaining in paid employment that exceed the costs of childcare, but parents do not act on this because: (i) they cannot afford to work and pay for childcare in the short term; (ii) they are short-sighted in their outlook; or (iii) they lack complete information on the future benefits of remaining in paid employment.
- Even if there is no net positive *private* return for mothers to be in paid employment, there may be positive *social* returns because (i) working mothers enhance the productivity of other workers and the economy as a whole or (ii) working mothers reduce gender inequities in the labour market, which may be a social goal in itself.
- There may be barriers to new provision in the childcare market which mean that the supply of childcare places is insufficient to meet demand.

2. However, it should be noted that these rationales for government policy do not imply that it is ideal to provide childcare to *all* parents who require it to enable them to undertake paid work. Indeed, there may be some very obvious cases where these efficiency arguments for such support do not hold. For example, if the cost of providing childcare for a family is high and the skill and earnings capacity of one parent particularly low, then it may be more efficient for the parent to provide childcare for their own children rather than be in paid work. Unless the government's objective is for every parent to be able to undertake paid work regardless of the economic efficiency, it is important to consider the limitations on how far policy should attempt to support parents in work if the social costs begin to outweigh the social benefits.

### **What is the full extent of regional variations of both availability and cost in accessing childcare?**

3. The following summary on regional variation in availability and cost of childcare is drawn from some of the main findings in Paull and Taylor with Duncan (2002).<sup>1</sup> The analysis uses information from local authority (LA) surveys on the

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<sup>1</sup> G. Paull and J. Taylor with A. Duncan, *Mothers' Employment and Childcare Use in Britain*, Institute for Fiscal Studies, London, 2002.

availability of day nursery, playgroup, childminder, out-of-school clubs and holiday scheme places for 1995–99. It also uses data on employment rates for mothers and the costs of childcare for families with a working mother from the Family Resources Survey for 1994–95 to 1999–2000. Unfortunately, the LA data are only available for England and the analysis therefore omits Scotland and Wales.

### *Regional Variation in the Availability of Childcare*

4. The availability of childcare is measured as the number of places in each type of care for each 10,000 children in the relevant age group. There is a large range in this availability across LAs, as captured in Table 1, which presents average levels of availability over the five years from 1995 to 1999 and the ratio of availability in the LA with greatest availability to the availability in the LA with lowest availability. Playgroup provision has the smallest range in provision, while holiday scheme places have the greatest diversity.

**Table 1. Variation in childcare availability across local authorities**

Type of childcare	Number of places per 10,000 children			Availability ratio: highest LA / lowest LA
	Average	Highest LA	Lowest LA	
Day nursery	630	3,095	140	22 times
Playgroup	1,199	2,499	270	9 times
Childminder	704	1,623	148	11 times
Out-of-school club	375	5,415	53	102 times
Holiday scheme	1,234	6,785	31	219 times

Notes: The base child population is children under the age of 5 for day nursery and playgroup places, children under the age of 8 for childminder places and children aged 5–7 for out-of-school club and holiday scheme places. The availability rates are averaged over the five years from March 1995 to March 1999. The lowest LA is the LA with the lowest non-zero availability. Holiday scheme places are counted as one per holiday period.

Source: Chapter 5, Paull and Taylor with Duncan, op. cit. The LA data were originally published by the Department of Health and the Department for Education and Employment.

5. In addition to the overall range in availability, there are also some distinct patterns of provision. There is a tendency for some LAs to have *generally* low or high levels of availability across different types of care:

- LAs with very low provision of one type of care tend to have low to moderate availability for other types of care.
- Within LAs, if there is low provision of one type of care primarily for pre-schoolers (day nurseries, playgroups or childminders), there tend to be low levels of provision of the other types too.

6. There are several possible explanations as to why some areas have generally higher levels of availability across all childcare types than others:

- Mothers who use care for pre-school children are more likely to need out-of-school clubs when their children reach school age.

- Out-of-school clubs may be needed by the same mothers and staffed by the same people as school holiday schemes.
- Areas of dense population may benefit from a ‘thick’ childcare market: a large number of potential customers in a small area may encourage a greater supply of all types of care, because providers may be more willing to pay the set-up and registration costs if there is a certain and continuous demand for their care.
- There may be a historical or cultural explanation: some areas may traditionally have had high fractions of mothers who were employed, generating the set-up of childcare options, the ongoing operation of which now encourages current mothers to work.

7. Some regions and LAs have very ‘specialised’ provision in terms of the type of care that is available:

- Inner London and the central metropolitan districts tend to have high levels of day nursery places but low levels of playgroup and childminder places, while non-metropolitan counties (particularly those in the south) and outer London tend to have high playgroup and childminder provision and low day nursery place availability.
- Inner London has very high levels of out-of-school club and holiday scheme places, while northern metropolitan districts and non-metropolitan counties have the lowest levels of provision.
- LAs that have high availability of out-of-school club places tend to have high availability of holiday scheme places.
- LAs that have high levels of provision of day nursery places also tend to have high availability of out-of-school club and holiday scheme places.

8. There are many potential factors that may explain the diversity in the *type* of childcare provision between LAs:

- In areas with high employment rates, the main source of demand for childcare is likely to be from mothers who work in the area, who are more likely to require long daily hours of care and year-round care than non-working mothers. Hence, in areas such as inner London and the metropolitan districts, day nurseries and out-of-school clubs may be in greater demand than playgroups or childminders.
- Housing costs may be higher in the metropolitan areas, making it less likely that childminders will be able to afford to live there (although day nursery workers would be able to commute into the area).
- In areas of sparse population, such as the non-metropolitan areas, using local childminders may be more convenient than travelling long distances to centre-based care such as day nurseries or out-of-school clubs.
- There may be economies of scale in running out-of-school clubs, such that one club may serve several schools and may therefore run more economically in areas

of dense population such as inner and outer London. In addition, London tends to have larger schools which may be more efficient in setting up and running out-of-school clubs.

### *Relationships between the Variation in Childcare Availability and the Proportion of Mothers in Paid Employment*

9. There is considerable dispersion in mothers' employment rates across LAs that relate to the variation in childcare availability. Using a multivariate analysis that controls for the levels of provision across different childcare types,<sup>2</sup> the following relationships can be observed:

- Areas with greater availability of day nursery and childminder places have higher proportions of mothers of pre-school children who work full-time rather than part-time or not at all.
- Areas with greater availability of playgroup places have higher proportions of mothers of pre-school children who work part-time rather than full-time or not at all.
- Areas with greater availability of childminder places have higher proportions of mothers of school children who work, full- or part-time, rather than not work.
- Areas with greater availability of holiday scheme places have higher proportions of mothers of school children who work part-time relative to not working.
- The association between employment and childminder availability is much stronger than that between employment and availability of other types of care.

10. This evidence shows that there is a positive relationship between the availability of childcare and the proportion of mothers who are in paid employment across different areas of the country, but it does not establish a direction of causation. In particular, it cannot be established whether low employment rates in some areas generate a low demand for childcare places which leads to low provision, or whether low availability of childcare in some areas is preventing some mothers from undertaking paid employment.

### *Regional Variation in the Cost of Childcare*

11. Table 2 presents the average amount spent on childcare for families with two or more children and a working mother paying for care during school holidays in different regions of the country. The patterns are similar for those with one child and for payments made during term-time. Families with a working mother in London and the southern non-metropolitan counties spend much larger weekly amounts on childcare than those in other areas of the country, although the gap in terms of the proportion of family income spent on childcare is smaller.

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<sup>2</sup> Full results of this analysis are available in chapter 5 of Paull and Taylor with Duncan (op. cit.).

**Table 2. Family expenditure on childcare during school holidays for families with two or more children and a working mother**

Region	Average weekly amount	Average percentage of family income
Inner London	£106	18
Outer London	£96	18
Southern non-metropolitan	£75	16
Central non-metropolitan	£67	15
Central metropolitan	£62	16
Northern metropolitan	£59	13
Northern non-metropolitan	£54	14

Notes: The non-metropolitan areas consist of the shire counties. The amounts are in January 1999 prices.

Source: Chapter 6, Paull and Taylor with Duncan, op. cit. The data are from the Family Resources Survey for 1994–95 to 1998–99.

12. Some of this variation in childcare expenditure may be due to differences in family size, the total hours of care or the quality of care chosen. But even when controlling for these differences, there is still considerable regional variation in the hourly cost of care for a given quality and number of hours.<sup>3</sup>

- The LAs with the lowest prices for pre-school care are predominantly in the north, while central metropolitan districts and southern non-metropolitan counties are strongly represented among those with low prices of care for school children.
- The LAs with the highest prices are the London boroughs and northern metropolitan districts.

### **Is the childcare tax credit working? What can be done to boost take-up?**

13. According to official government statistics, 175,100 families benefited from the childcare tax credit in August 2002, amounting to only 13 per cent of the total working families' tax credit (WFTC) caseload (1,355,000 families) and less than 3 per cent of all families with children.<sup>4</sup> The relatively low number of families receiving the credit may lead one to conclude that it is 'not working'. In the analysis below, then, we will try to explain why so few families are benefiting from the childcare tax credit. Whether the credit is really 'not working' depends, though, on what objectives were set for it by government.

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<sup>3</sup> Full results of this analysis are available in chapter 7 of Paull and Taylor with Duncan (op. cit.).

<sup>4</sup> Tables 1.3 and 1.1 of Inland Revenue, *Working Families' Tax Credit Statistics: Quarterly Enquiry: United Kingdom: August 2002*, January 2003.

14. There are two possible explanations for the low caseload:

- few families are eligible for the credit; or
- many families are eligible for the credit, but only a few are actually claiming and receiving it.

15. A key point to note is that a family must pass three tests in order to be eligible for the childcare tax credit:

- (i) the work test: lone parents must work 16 or more hours a week and couples must have both partners working 16 or more hours a week (or caring or disabled);
- (ii) the income test: the family must have an income that is low enough not to exhaust entitlement to WFTC;
- (iii) payment-for-care test: the credit pays 70 per cent of actual spending on 'approved' forms of childcare. The credit amount is subject to upper limits of £94.50 for families with one child and £130 for families with two or more children. Approved care includes most forms of registered formal childcare.

16. Table 3 presents the numbers of families who meet the work and income tests and who use approved childcare and are therefore eligible to claim the childcare tax credit. It also shows the proportion of families that pass the work and income tests and are eligible to claim WFTC with or without the care credit. The numbers are sample estimates grossed up to the national level and hence do not match exactly official caseload statistics.<sup>5</sup> It should be noted that the data are averaged over three years (from April 1998 to March 2001), half of which period was prior to the introduction of the WFTC and childcare tax credit and half of which was after their introduction. Yet the patterns are almost constant over the three years: there is no evidence that the enhanced incentives for employment or use of approved childcare with the introduction of the WFTC have influenced actual choices within this time frame.

17. The table provides several insights as to why so few families are benefiting from the childcare tax credit:

- Less than half of all families with children have all adults working 16 hours or more each week, the work test for the childcare tax credit.
- Of those meeting the work test, half (49 per cent) are not eligible for the childcare tax credit because their income is too high, while 29 per cent have a family income such that they are only eligible if they claim support for sufficient approved childcare costs<sup>6</sup> and 22 per cent have sufficiently low income that they are eligible for the WFTC regardless of childcare use.

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<sup>5</sup> In particular, the number of families estimated to be eligible for the childcare tax credit is lower than the actual caseload number. This may be due to under-reporting of childcare use in the survey data, to differences in the time period considered or to the sampling and weighting procedures used in this analysis.

<sup>6</sup> It should be noted that these families are eligible for a combined WFTC and childcare tax credit amount that is less than 70 per cent of their approved childcare expenditure because the subsidy covers only the proportion of the childcare expenditure that

- Only 12 per cent of those eligible for WFTC regardless of childcare usage and facing a 70 per cent subsidy for spending on childcare actually use approved forms of care. Only 3 per cent of those eligible for WFTC if they spend a sufficient amount on approved forms of childcare actually use approved forms of care.
- Consequently, while 23 per cent of all families are estimated to be eligible for the WFTC, less than 2 per cent are eligible for the childcare tax credit. This 21 percentage point difference consists of couples with only one adult working 16 or more hours each week (12 per cent) and families with all adults working 16 or more hours but not using approved childcare (9 per cent).

**Table 3. Families' employment and childcare use: eligibility for WFTC and the childcare tax credit**

	Number of families in thousands (Percentage of cell above) 6,951							
	<i>no</i>			<i>yes</i>				
<b>Pass work test?</b>	<i>No adult works 16+ hours</i>	<i>One adult of a couple works 16+ hours</i>		<i>Lone parent works 16+ hours or both adults of a couple work 16+ hours</i>				
	1,534 (22%)	2,023 (29%)		3,394 (49%)				
		<i>no</i>	<i>yes</i>	<i>no</i>	<i>yes, if use sufficient childcare</i>		<i>yes, regardless of childcare use</i>	
<b>Pass income test?</b>		1,220 (60%)	803 (40%)	1,680 (49%)	973 (29%)		741 (22%)	
<b>Pass payment-for-care test?</b>					<i>no</i>	<i>yes</i>	<i>no</i>	<i>yes</i>
					945 (97%)	28 (3%)	654 (88%)	87 (12%)
<b>Eligible for WFTC?</b>	no	no	yes	no	no	yes	yes	yes
<b>Eligible for childcare tax credit?</b>	no	no	no	no	no	yes	no	yes
<b>Percentage of all families</b>	22.1	17.6	11.6	24.2	13.6	0.4	9.4	1.3

Note: The families in the column headed 'yes, if use sufficient childcare' would be eligible for WFTC and the childcare tax credit if they spent the maximum amounts allowed for the credit, although most would also be eligible at lower levels of expenditure.

Source: Authors' calculations from Family Resources Survey for 1998–99, 1999–2000 and 2000–01.

takes them over the eligibility threshold. In other words, the high level of their family income means that they are on the credit 'taper' and part of the subsidy is effectively withdrawn by the income test.

- Looking at the numbers from the perspective of those using approved forms of formal care, 17 per cent of families using approved formal care are eligible for the childcare tax credit, while 13 per cent do not fulfil the work requirement for the care credit and 70 per cent fulfil the work requirement but are too rich to pass the income means test for the credit.<sup>7</sup>
- The estimated number of families eligible for the childcare tax credit is close to the number of reported claimants. Hence, the second explanation for the low number of families benefiting from the credit (poor take-up amongst eligible families) is probably not the main reason why so few families are benefiting from the childcare tax credit.

18. The families that pass the work and income tests for WFTC regardless of their childcare use (9.4 per cent plus 1.3 per cent, from Table 3) face a generous subsidy of 70 per cent towards anything they spend on approved forms of childcare. Yet only a small proportion of them (12 per cent) are estimated to use approved forms of care. This is comparable to the fact that only 17 per cent of all families with a working mother use approved care in the survey data. To explore this further, Table 4 presents the childcare choices for those families passing the work and income tests for WFTC regardless of childcare use.

**Table 4. Childcare use by families fulfilling the work requirement for childcare tax credit and passing the means test for WFTC (regardless of childcare use)**

	Percentage of families				All
	With pre-school children		Only school children		
	Couples	Single parents	Couples	Single parents	
Use no care	49	15	77	58	55
Use only uncovered care	36	53	20	33	33
Use approved care	15	32	3	9	12
Total	100	100	100	100	100
Number of families (1000s)	66	103	154	418	741

Source: Authors' calculations from Family Resources Survey for 1998–99, 1999–2000 and 2000–01.

19. Table 4 highlights the following points:

- Families with only school children account for 81 per cent of the families that would otherwise be eligible for the childcare credit but do not use approved childcare (percentage not directly shown but can be derived from Table 4). Most of these families manage without any reported childcare. These families are less likely to require childcare in order to work either because they can fit all (or some)

<sup>7</sup> These percentages are derived by authors' calculations from the Family Resources Survey for 1998–99, 1999–2000 and 2000–01.

of the work hours around school hours or because the children are old enough to look after themselves.

- Many families with pre-school children (especially couples) also manage to work without using any care from outside the immediate family.
- Some 33 per cent of families exclusively use uncovered types of care, most of which is informal care by relatives or friends. Most informal care for this group is free (79 per cent) and, if paid for, it has a lower average hourly cost than formal care (£1.35 for uncovered types of care compared with £2.13 for covered forms).<sup>8</sup>

20. Hence, there are three main conclusions about why so few families use the childcare tax credit:

- The low caseload is *not* due to poor take-up by eligible families.
- A substantial proportion of families that are eligible for WFTC but do not use the childcare tax credit have only school children and may have no need for childcare.
- Yet only a small proportion of families that are eligible for WFTC and have pre-school children use approved forms of formal care. There are three possible explanations for this:
  - Parents would like to use approved types of care but do not do so because they must pay for 30 per cent of the cost of approved forms of care even with the benefit of the childcare tax credit. This suggests that increasing the generosity of the childcare tax credit would boost use of approved childcare. This is discussed in paragraphs 23–29.
  - Parents would like to use approved types of care but are unable to obtain a place with an approved childcare provider. Hence, take-up of the credit may only increase if there is a rise in the availability of places, suggesting a continuation and expansion of policies directly aiding the provision of formal childcare places on the supply side.
  - Parents prefer informal care (even allowing for differences in cost) because they consider it better for the child or because it is more convenient. This suggests that coverage of the childcare tax credit might be extended to other types of care, including informal care. This is discussed in paragraphs 21 and 22.

### **Should more financial assistance be made available to enable parents to use their network of family and friends to help provide childcare to enable them to work?**

21. The numbers in Table 4 have shown that many low-income families would stand to benefit if the childcare tax credit covered informal care. Indeed, the fact that so many families use informal sources of care over formal options even in the face of

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<sup>8</sup> Source: authors' calculations from the Family Resources Survey for 1998–99, 1999–2000 and 2000–01.

a generous subsidy for only the latter suggests the possibility that parents may prefer this kind of care. Extension of the childcare tax credit to cover informal childcare would even the financial incentives between the two types of care and allow parents to choose the type most suited to their families' needs and preferences. Whether such an extension of the subsidy would increase the provision of childcare from informal sources has, as far as we are aware, not been established.

22. Only 21 per cent of the families meeting the work and income tests for the childcare tax credit and using informal care currently pay for that care. Hence, only a small number of families would benefit from an extension in the childcare tax credit to cover informal care if current levels of payment for this informal care did not alter. However, a subsidy for this type of care, even if covering only 70 per cent of the costs, would create extremely large incentives for families to pay for the care and to increase the amount of that payment. In particular, in the informal arrangement, the amount paid for an hour of childcare may be of no relevance, either because the transfers can be returned in some way (monetary or non-financial) or because the parent and carer care sufficiently about each other that they effectively operate as one household (for example, a parent purchasing care from the child's grandparents). Any subsidy would create an incentive for both parent and carer to report the greatest possible cost of the care in order to maximise the amount of the childcare subsidy that can be shared between them. Hence, some way of capping the credit would be needed to prevent a considerable expansion in childcare expenditure beyond that genuinely required to facilitate employment. One way would be to establish a fixed hourly maximum for the subsidy.

### **Is the childcare tax credit the best way to provide help with childcare costs for those on low incomes?**

23. In this section, we consider whether the childcare tax credit could be modified in order to improve its ability to provide help with childcare costs for those on low incomes. Various modifications to the childcare credit have been analysed in depth by Paull (2003)<sup>9</sup> and we draw on material from her chapter to address this issue. Further details and, in particular, estimates of budget costs can be found there.

24. There are several specific ways by which the generosity and impact of the childcare tax credit could be increased, all of which would increase the number of families eligible to receive some support:

#### *A. Raise the ceilings on the weekly amount of eligible childcare expenditure*

25. Very few families (less than 2 per cent<sup>10</sup>) who meet the work and income tests for the childcare tax credit spend an amount on childcare near or in excess of the current ceilings. Hence, any change in the ceilings is unlikely to have any substantial impacts.

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<sup>9</sup> 'Childcare subsidies', in R. Chote, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2003*, Commentary no. 92, Institute for Fiscal Studies, London, 2003.

<sup>10</sup> Authors' calculations using Family Resources Survey data for 1998–99, 1999–2000 and 2000–01.

*B. Increase the eligible proportion of childcare costs from the current 70 per cent*

26. This would reduce (and, if raised to 100 per cent, would remove completely) the financial barrier to families using approved types of childcare. However, by reducing (or removing) the co-payment that families currently make for care (their 30 per cent share), it would create greater incentives for families to expand their childcare expenditure to the maximum covered by the credit. It should be noted that parents might increase their spending by purchasing higher-quality (and therefore more-expensive) care instead of (or as well as) purchasing more hours of care.<sup>11</sup> With the current weekly ceilings on eligible expenditure, this could prove extremely expensive for budget costs, especially if families not currently using approved forms of care began to do so. Hence, any movement towards the credit covering a greater share of childcare expenditure would probably require modifications to the ceilings (discussed further below) to contain the potential cost to the exchequer.

*C. Include informal care, such as that provided by relatives and friends, as eligible for the credit*

27. See the discussion in paragraphs 21 and 22.

*D. Modify the value of the credit to include*

- *coverage of formal and informal care*
- *coverage of 100 per cent of actual cost up to a maximum amount for each hour of care*
- *a maximum number of eligible care hours related to the prime carer's work hours as well as to the number of children*

28. Payment of 100 per cent of costs for formal and informal care would remove any financial barriers to the use of all types of childcare. Setting a maximum subsidy on the cost of an hour of care would be necessary to prevent expenditure on the childcare credit rising substantially, particularly for informal care. Setting a limit to the number of hours of childcare that can be subsidised (we suggest that this be related to the prime carer's work hours) targets support towards those who need the greatest amounts of care to cover the longest work hours, and also enhances incentives for parents to work longer hours. It should be noted, though, that this system, if introduced, would lead to some families losing out as well as to a large number gaining.

*E. Weaken the work requirement for the credit from 16 hours each week to any hours of employment*

29. A sizeable proportion of families with children have incomes sufficiently low to pass the income means test for the childcare tax credit, but are not eligible for the credit because although all adults are in paid employment, one adult is working less than 16 hours each week. Some 3 per cent of couples with children and 6 per cent of single parents are estimated to be in such a position. These families would stand to benefit from the childcare tax credit if they used approved care, although not many currently do (only 0.1 per cent of couples with children and 0.2 per cent of single parents are in this position). The argument in favour of reducing the work requirement

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<sup>11</sup> The analysis of hours and quality choice responses to variation in childcare price in chapter 7 of Paull and Taylor with Duncan (op. cit.) suggests that quality responses to an increase in the generosity of the subsidy may even be more important than quantity reactions.

is to encourage parents to have at least some involvement in paid employment, be it at very low hours. On the other hand, it would create incentives for those currently working 16 or more hours to reduce their hours of work, particularly if the value of the childcare tax credit was not related to the number of hours worked.

### **Should employers be doing more to help with childcare for their employees?**

30. In addressing this question, we cannot provide any substantial evidence on the current nature of employer help with childcare or bring to bear direct evidence of likely responses to new policies in this area. However, there are a number of theoretical points that should be borne in mind when considering possible policy developments.

31. At present, employer-provided childcare is rare. According to the 2000–01 Family Resources Survey – the first year of this survey to ask about employer-provided childcare – only 0.4 per cent of pre-school children of working mothers used employer-provided nurseries. This low usage suggests, on the one hand, that there may be considerable room for expanding the role of employers in providing childcare, but, on the other hand, that there may be good reasons why employers do not play a greater part.

32. It is sometimes argued that employers should contribute towards the cost of childcare for their employees, but this may not be possible in practice:

- If alternative workers are available who do not come with these costs (that is, workers who are not parents), a profit-maximising firm in a competitive labour market will choose to use the cheaper labour source.
- If it does not use the cheaper labour source, the firm may risk losing its market share or the support of its investors and/or shareholders.
- Only firms with some degree of market power could share in childcare costs and maintain their position, but this would require the beneficiaries of that market power (for example, in the form of unusually high profits) to be willing to sacrifice some of their benefits to pay for childcare.

33. There are several examples where employer help with childcare may be disguising the fact that the cost is being borne by another (sometimes third) party:

- It is sometimes argued that firms are willing to pay for childcare because they can attract better, more-productive workers in return. However, the firm is effectively providing a benefit in kind in place of higher wages for more-productive workers and is not actually sharing in the costs of childcare.
- In the case of tax incentives for, say, the direct payment of childcare costs by the employer, the third party is implicitly the taxpayer. A childcare subsidy paid directly to the parent could achieve the same effect in a more transparent manner.
- An employer benefits from reduced care prices by bulk-buying from a particular childcare provider. In this case, the paying third party is either the claimants on

the providers' profits or other users of the facility who consequently pay higher prices for their childcare.

34. Hence, the case needs to be made for why employer provision would reduce the overall costs of providing care or could address problems in the childcare market that cannot be addressed more directly by government.

35. There are a number of arguments why employer involvement in the provision of childcare may improve efficiency:

- Large employers may have the financial resources to initiate and maintain childcare facilities. However, government initiatives could play this role for private provision.
- Large employers can coordinate assembling the required customer base to set up new childcare facilities. However, there is no reason why a private venture could not initiate its business at a particular firm.

36. There are also a number of limitations and drawbacks to employer provision:

- Having childcare located close to the place of work may not be desirable, possibly because it results in a long commute for the child or, in the case of after-school care, requires the child to be moved from school to a different location.
- Employer provision is only available at larger establishments.
- It only provides centre-based care.
- Mothers may feel they have less influence over the childcare facilities (e.g. concerns about quality of care) either if the facilities tend to be responsible to the employer rather than directly to the parents who use it or if mothers feel they have few alternatives (although the latter could just as easily happen with a private provider).
- It is not clear that firms specialised in producing a particular product can be as good in supplying childcare as specialised providers.
- Linking childcare and employment choices may reduce job mobility for mothers and weaken their position in the labour market. For example, mothers may be reluctant to change employers if it means disrupting their child's care arrangements.

37. Overall, it is hard to find convincing arguments why employers should contribute to the costs of childcare or why employer involvement could produce childcare at a lower cost than other provision. The rarity of employer-provided care suggests that any advantages for employers from being involved in providing childcare are generally outweighed by the considerable drawbacks and limitations.

**Will the additional funding provided by the 2002 Spending Review be enough to ensure sufficient childcare to enable the child poverty and lone-parent employment targets to be met?**

38. The Treasury has a long-term economic aim to halve child poverty between 2000 and 2010, and it and the DWP share a short-term Public Service Agreement for child poverty in 2004–05 to be three-quarters or less of its level in 1998–99. The latter target is quantified explicitly – low-income households are defined as households with income below 60 per cent of the median, as reported in the Households Below Average Income (HBAI) statistics<sup>12</sup> – but the target for 2010 has not been. In the light of a better alternative, we assume that the 2010 target will be measured in the same way, although an ongoing consultation may change that.<sup>13</sup> Official statistics suggest that increasing mothers’ employment (and not just *lone* mothers’ employment) could play an important role in reducing child poverty. Some 67 per cent of children in poverty live in families where one adult (typically the mother) is not working, and around half of these children are living in couple families.<sup>14</sup> Reducing child poverty by a half clearly requires poverty in these families to be addressed.

39. However, the magnitude of any reduction in poverty is likely to be limited by two factors:

- Even if childcare were available, it is not clear that these parents would choose to or be able to work.
- The rise in income may be insufficient to lift the family out of poverty.

We discuss these in turn below.

40. First, the government’s target of 70 per cent of lone parents in employment seems extremely ambitious. After increases in recent years, lone-parent employment stands at around 55 per cent.<sup>15</sup> Meeting the government’s target therefore requires a third of those lone parents currently not working to start working. Improving access to childcare could, though, make a large difference to lone parents’ employment choices: work commissioned by the Department for Work and Pensions using the new Families and Children Survey has investigated the reasons lone parents give for not working (or for working fewer than 16 hours a week).<sup>16</sup> Of the sample of lone parents working fewer than 16 hours a week in the summer of 1999 (including those not working at all), over a third (39 per cent) said that problems finding and affording childcare were preventing them from working. This compares with 27 per cent who

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<sup>12</sup> See HM Treasury, *Technical Note for HM Treasury’s Public Service Agreement (PSA) 2003–2006*, 2002, [www.hm-treasury.gov.uk/mediastore/otherfiles/tech\\_notes.pdf](http://www.hm-treasury.gov.uk/mediastore/otherfiles/tech_notes.pdf).

<sup>13</sup> See Department for Work and Pensions, *Measuring Child Poverty: A Consultation Document*, London, 2002.

<sup>14</sup> Table 4.3, Department for Work and Pensions, *Households Below Average Income 1994/5 to 2001/02*, CDS, Leeds, 2003.

<sup>15</sup> Source: Office for National Statistics, *Work and Worklessness among Households, Autumn 2002*, 2003, [www.statistics.gov.uk/pdfdir/Wwh0103.pdf](http://www.statistics.gov.uk/pdfdir/Wwh0103.pdf).

<sup>16</sup> A. Marsh, S. McKay, A. Smith and A. Stephenson, *Low-Income Families in Britain: Work, Welfare and Social Security in 1999*, Research Report no. 138, Department of Social Security, 2001.

did not want to spend more time away from their children and 25 per cent who said that ill health in their family prevented them from working.

41. However, an employment rate of 70 per cent for lone parents is extremely high compared with past UK trends and with international experience:

- Sutherland (2002)<sup>17</sup> points out that achieving the target is equivalent to all lone parents being in paid employment except (i) those with long-term disabilities or whose children have long-term disabilities, (ii) those in full-time education and (iii) those with children under the age of 3.
- The employment rate for lone mothers in the USA was only 63.3 per cent in November 2002, having reached a peak of 65.9 per cent in April 2000.<sup>18</sup> An employment target of 70 per cent for lone parents would therefore require the UK to have higher employment rates amongst lone parents than the USA, a country in which it is increasingly difficult for lone parents to claim welfare benefits if they are not working.

42. Second, increasing employment rates among parents may not raise family incomes sufficiently to lift many families out of poverty. There is still a significant risk of poverty amongst children in working lone-parent households.<sup>19</sup> Table 7 of Sutherland (op. cit.) shows that assuming that lone-parent employment could rise to 70 per cent and that these newly-working lone parents could obtain employment at 30 hours a week at £5.50 an hour with no childcare costs, then achieving the employment target for lone parents would reduce child poverty by 710,000 children, or only 18 per cent of the current level of child poverty in 2000–01. (These assumptions are particularly optimistic given that the government's definition of employment for the purposes of the target is for lone parents to be doing any paid work in a given week, even 1 hour.)

43. Our view of this area of research is that, if the government is to make substantial reductions in child poverty, a multi-faceted approach will be needed, requiring increases in benefit and tax credit rates to help families with children who are working and not working, alongside measures to increase the proportion of lone parents in paid employment, and that the latter will require more than just policies to improve the affordability of childcare. Childcare policies that help mothers in couples to be in paid employment (should they so choose) should also be of benefit in reducing child poverty, as there are roughly as many poor children in couples where the mother does not work as there are in non-working lone-parent households.

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<sup>17</sup> H. Sutherland, *One Parent Families, Poverty and Labour Policy*, National Council for One Parent Families, London, 2002.

<sup>18</sup> Figures cited were provided by Professor Michael Wiseman of George Washington University from the US Current Population Survey (CPS) using employment in a reference week, the same concept as that used to measure employment and participation in the UK's Labour Force Survey. The figures are not precisely comparable as the UK target is for lone parents, not just lone mothers.

<sup>19</sup> See table 4.3 in Department for Work and Pensions, *Households Below Average Income 1994/5 to 2001/02*, CDS, Leeds, 2003.