DR CHRISTINE DAVIES – WRITTEN EVIDENCE (EUC0100)

The economics of Universal Credit

Introduction and Background

1. I am a retired (now Visiting) Senior Lecturer in Applied Mathematics at Royal Holloway University of London. My evidence concerns the situation of separated parents under Universal Credit. Considerable attention is paid to the situation of the 'primary carer'[1], but little to that of the other parent who may well share the care of the children for much of the time.

2. The main focus of this evidence is the situation of that second parent, in particular the interaction between Universal Credit and the payment of statutory child maintenance. The rules for calculating child maintenance lead to liabilities that are unaffordable for many. Moreover, the interaction with Universal Credit means that parents can find that they become worse off for every £1 that they earn. They cannot afford to work. My aim is to give some understanding of this situation. I hope that other respondents will provide evidence of the human cost.

3. I drew attention to the interaction issue in my evidence[2] to the 2017 Work and Pensions Committee Inquiry into the Child Maintenance Service. That evidence has prompted extensive, ongoing investigations by the Department of Work and Pensions. The Department has confirmed and acknowledged[3] that there is indeed 'an issue' with the way in which Child Maintenance payments interact with Universal Credit. As yet, no action has been taken either to resolve the issue in the long term or to limit the damage currently being caused in the short term.

4. The Centre for Social Justice drew attention to the interaction issue in their 2019 report *THE HIDDEN PARENT POVERTY TRAP: Child Maintenance and Universal Credit*[4]
5. The recent Social Security Advisory Committee Occasional Paper 22, *Separated Parents and the Social Security System*[5] draws attention to the issue and also to additional aspects of the situation for separated parents.

---

[1] The primary care is often referred to as a 'single parent', disregarding the existence of the second parent.
[2] https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/587/58702.htm CHM0079 and CHM0098
[3] See, for example, the Secondary Legislation Scrutiny Committee's 39th Report of the 2017-19 Session
https://www.parliament.uk/business/committees/committees-a-z/lords-select/secondary-legislation-scrutiny-committee/publications/previous-sessions/session-2017-19/

The DWP response to SLSC questions and my evidence are published on the same page.

[4] https://www.centreforsocialjustice.org.uk/core/wp-content/uploads/2019/03/CM-UC-Publication.pdf
[5] https://www.gov.uk/government/publications/ssac-occasional-paper-22-separated-parents-and-

The SSAC concludes[6] that

"… there currently is not a clear government strategy for separated parents in the social security system and … the Government does not appear to be considering separated parents and their children's welfare as a joined-up issue

6. I give the main features of Universal Credit and Child Maintenance, then the consequences of the interaction between them.

Separated parents under the Universal Credi

7. Universal Credit combines the different benefits of the legacy welfare system into one single payment which is withdrawn (after any work allowance) at a rate of 63p in £1 of additional net earnings.

8. The concept of a 'separated parent' does not exist in the UK social security system. Instead, it uses a 'sole parent' model. The 'primary carer' is treated as if they were the 'sole parent', the other parent as 'without children'. This is regardless of the share of the care of the children and remains the situation even if the parents share the care equally.

9. Before April 2016 every Universal Credit claimant had a work allowance, that for a single adult being £111 a month. Since April 2016 only those with a disability or a child get a work allowance. The second parent does not qualify for this since they are regarded as 'without children'.

Child Maintenance

Structure of the 2012 Scheme

10. The Child Maintenance Service (CMS) calculates child maintenance liabilities using the 2012 Scheme[7] It is a 'percentage of income' scheme – the child maintenance is a percentage of the income of the non-resident parent[8], the percentage depending on the number of children being paid for.

11. A 'percentage of income' scheme may seem to be a reasonable approach and one that is attractive in its simplicity. Since a simple percentage cannot work for very low incomes, the 2012 Scheme has two income thresholds. Below the lower income threshold, the non-resident parent pays just a nominal sum, the **'flat rate'**. Above the upper income

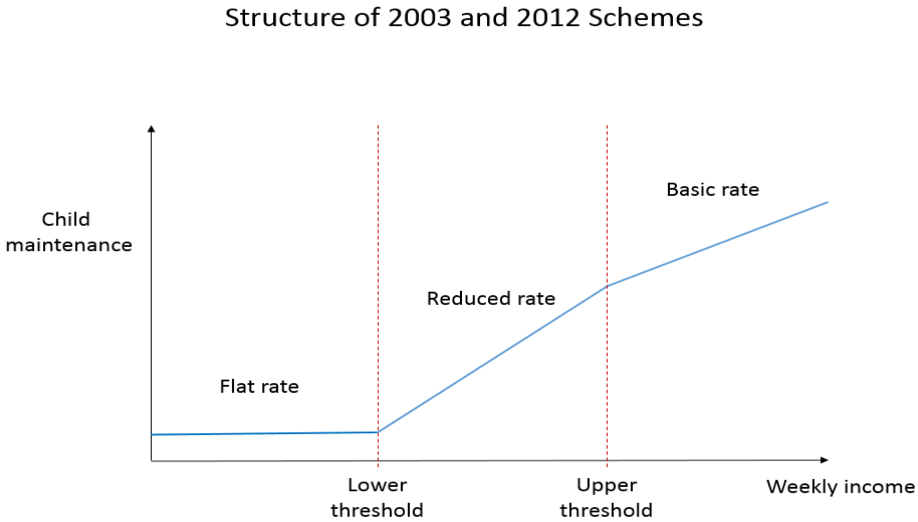
---

the-social-security-system First published 22 October 2019, revised version 18 February 2020
[6] Page 3 of SSAC Occasional Paper 22
[7] The CMS 2012 Scheme has the same structure as the previous CSA 2003 Scheme but is based on gross earnings (before tax) rather than net earnings (after tax). Different percentages are used in the two Schemes with the intention that, overall, they produce similar amounts
[8] Legislation uses the term 'non-resident parent' for the parent who does not have primary care. The Child Maintenance Service uses the term 'paying parent'. The parent with primary care is the 'parent with care' or the 'receiving parent' respectively.

threshold, the non-resident parent pays the full percentage, the **'basic rate'**. In between the two thresholds the non-resident parent pays a big enough percentage of each extra pound earned to lift them from the flat rate to the basic rate. This is the **'reduced rate'**.

12. A simple diagram[9] might help understanding.

Figure 1



13. This may appear to be quite a good scheme. The limited financial resources of non-resident parents with low earnings is addressed by requiring them to pay only a nominal sum until their income reaches a level (the lower threshold) when they can afford to pay more. However, this structure is a root cause of unaffordable child maintenance assessments.

14. An understanding of this can be gained by considering the situation concerning income tax and National Insurance. In the 2019-20 tax year, income tax at 20% is paid on annual earnings above £12,500, National Insurance at 12% on weekly incomes above £8,632.

    Using the approach of the 2012 Scheme, one could argue that:

- those earning more than £25,000 a year could afford to pay a full contribution of 32%
- those earning less than £12,500 a year should pay nothing
- in order to reach the full contribution by the time earnings reached £25,000, those earning between £12,500 and £25,000 should pay 64%

This clearly does not make sense. However, this is the pattern for statutory child maintenance that has been imposed since 2003[10].

---

[9] Taken from *Separated families – poverty and child maintenance* 2015 A briefing paper prepared for the Joseph Rowntree Foundation, available on request from JRF or c.m.davies@rhul.ac.uk

16. Percentage of income scheme elsewhere but the usual practice is to include a 'self-support allowance', with child maintenance being paid on income above that allowance. This is similar to the tax-free allowance used for income tax in the UK. The 2012 Scheme for Child Maintenance has NO such allowance.

Threshold value

17. The values of the lower and upper thresholds in Figure 1 were set in 1998[11] at £100 and £200 net weekly earnings. They remained unchanged during the lifetime of the 2003 Scheme and were taken over into the 2012 Scheme, though now relating to gross income.

Common sense tells us that values that were appropriate in 1998 will NOT be appropriate in 2020.

18. The income range between the lower and upper thresholds is now one in which the non-resident parent is dependent on welfare support. It will be shown later that the withdrawal (taper) rate of these benefits combines with the child maintenance payments to give a situation in which this parent gains little, if anything, from being in work.

Collection fee

19. On the 2012 Scheme non-resident parents can opt to make the child maintenance payments direct to the parent with care. Those who use the Collect and Pay service are charged a 20% collection fee. The parent with care has 4% deducted from the maintenance payment. The charges were intended to encourage parents to pay direct.

20. Parents who default on direct pay (either by choice or because they cannot afford it) can be moved by the Child Maintenance Service to Collect and Pay. The Child Maintenance Service has the authority to then deduct the maintenance plus 20% fee direct from the parents' salary.

21. Table 1 sets out the rates for the 2012 Scheme. It is clear that the large percentages in the shaded region, together with a 20% fee, will lead to difficulties when combined with the Universal Credit taper rate of 63%

Table 1: Child Maintenance Rates for the 2012 Scheme

	Gross weekly income	**Child Maintenance**
Nil rate	< £7	£0
Flat rate	£7 - £100	£7

[10] The 2012 Scheme has the same structure as the previous 2003 Scheme

[11] The 1998 Green Paper *CHILDREN FIRST: a new approach to child support* set out what became the 2003 Scheme. Available at https://voiceofthechild.org.uk/wp-content/uploads/2017/09/Appendix-A.pdf

Reduced rate	£100 - £200	£7 + 17, 25 or 31% of income above £100
Basic Rate	£200 - £800	12, 16 or 19% of income
Basic rate plus	> £800	As basic rate then 9, 12 or 15% of income above £800

Notes

1. The different percentages in each rate refer to 1, 2 or 3 (or more) qualifying children.
2. Child maintenance payments are increased by 20% for parents using the CMS Pay and Collect service
3. The £100 and £200 thresholds for flat rate and reduced rate payments were set in 1998 for net income in the 2003 Scheme. They were never upgraded and were taken over into the 2012 Scheme

Interaction between Universal Credit and Child Maintenance - Marginal Tax Rate

22. The problems caused by the interaction between the withdrawal of Universal Credit and the payment of Child Maintenance can be demonstrated by considering the 'marginal effective tax rate'.

23. The Marginal Tax Rate (MTR) indicates how much is deducted from each extra £1 earned. A worker on the standard rate of income tax has an MTR of 32%, made up of 12% National Insurance contributions and 20% Income Tax. For every extra £1 earned, 32p is deducted in taxes and the worker keeps 68p.

24. Universal Credit is withdrawn at a rate of 63p in £1 of additional net earnings. This withdrawal is not a tax but has the same effect and so can be incorporated to calculate an overall marginal tax rate. For a standard rate tax-payer, the Universal Credit withdrawal rate is 63% of 68% = 42.84% and the MTR before child maintenance is74.84%.

25. Similarly, child maintenance payments can be incorporated to give a 'marginal effective tax rate'. The calculated values for the 2012 Scheme are shown in Table 2[12]. A percentage exceeding 100 means that the parent becomes worse off for every £1 they earn.

Table 2: Marginal effective tax rates (percentage) for a parent receiving Universal Credit and paying child maintenance on the 2012 Scheme

Income range	Payment	Number of children for whom maintenance is paid

[12] Table supplied to SSAC on 28 October 2019

	method	0	1	2	3
£100 to National Insurance threshold	Direct Pay	70.4[13]	87.4	95.4	101.4
	Collect and Pay	70.4	90.8	100.4	107.6
National Insurance threshold to £200	Direct Pay	67.4	84.4	92.4	98.4
	Collect and Pay	67.4	87.8	97.4	104.6
£200 to tax threshold	Direct Pay	67.4[14]	79.4	83.4	86.4
	Collect and Pay	67.4	81.8	86.6	90.2
Above tax threshold	Direct Pay	74.8	86.8	90.8	93.8
	Collect and Pay	74.8	89.2	94.0	97.6

26. The Social Security Advisory Committee Report[15] chose to illustrate the interaction problems for a parent earning £200 a week. This gives the values in the shaded region in Table 2. It can be seen that their choice understates the scale of the problem.

27. Table 3 gives an example of the impact on the income of paying parent.

Table 3: Illustration - Parent paying for three children through Collect and Pay

For the first £100 of weekly earnings:	
Universal Credit is reduced by	£63.00
Council Tax Support[16] is reduced by	£7.40

[13] The METRs here include Council Tax Support withdrawal rate of 20% after UC reduction of 63%, so 7.4%
[14] The SSAC Paper used 75% in the first publication. This was corrected in the revised version.
[15] See footnote 5
[16] Council Tax Support is decided locally. This uses the recommended rate of 20% after reduction

Child Maintenance[17] is	£7.00
Collection fee[18] is	£1.40
Total	£78.80
Gain to parent	£11.20

For the next £50 of weekly earnings:	
Universal Credit is reduced by	£31.50
Council Tax Support is reduced by	£3.70
Child Maintenance is increased by	£15.50
Collection fee is increased by	£3.10
Total	£53.80
Gain to parent	-£3.80

The loss of £3.80 from earning an extra £50 corresponds to the marginal effective tax rate of 107.6% in Table 2.

28. The marginal effective tax rate of 97.6% in Table 2 indicates that, when earning enough to pay income tax, this parent gains only 2.4p for every £1 earned.

Concluding Remarks

29. The purpose of this evidence was to draw attention to the problems caused by the interaction between Universal Credit and the payment of statutory child maintenance. The 2012 Scheme has a structure that leads inevitably to liabilities that are unaffordable for many. Payments combine with the withdrawal of Universal Credit to produce marginal tax rates that are close to or exceed 100%. Work does NOT pay.
30. Unaffordable maintenance leads inevitably to non-payment, build-up of arrears and attempted reinforcement by the Child Maintenance Service. As of September 2019[19]:

- £315.3m arrears had already accumulated under the 2012 Scheme
- 178,300 parents were on Pay and Collect
- 49,700 parents were subject to Deduction from Earnings Orders/Requests

---

of benefits.

[17] This is the 'Flat Rate' applied for weekly earnings between £7 and £100. It is usually deducted directly from benefits.

[18] The Child Maintenance Service charges a 'collection fee' of 20% for payments that are not paid directly to the Receiving Parent by the Paying Parent.

[19] https://www.gov.uk/government/statistics/child-maintenance-service-statistics-data-to-september-2019-experimental

31. The issues are not new, nor unique to Universal Credit. The earlier 2003 Scheme had the same structure as the 2012 Scheme and the interaction of both Schemes with the legacy welfare system caused similar problems. However, the simple structure of Universal Credit has made it possible to demonstrate them in an unambiguous way. There are two aspects to the situation:

- An inappropriate scheme for the calculation of child maintenance leading to unaffordable liabilities
- The interaction of maintenance payments with the withdrawal of welfare support

32. My evidence to the Work and Pensions Committee in 2017 prompted work by the Department of Work and Pensions, and publications by the Centre for Social Justice and the Social Security Advisory Committee. So the existence of the problems is well-documented.

33. Resolving the problems is non-trivial and will take time. However, the Government has acknowledged that 'there is an issue'. The issue may beyond the remit of the Committee but I hope that it can encourage the Government to take some early action to stop the on-going damage whilst a longer term solution is sought.

34. In the quarter to September 2019[20], 22,000 more arrangements joined the Child Maintenance Service. Each one of the parents involved deserves a system that enables them to contribute to their children's upbringing whilst leaving them enough for their own essential living costs.

6 March 2020

[20] ibid