

## Notes on issues concerning second earners

An amendment to the Welfare Reform Bill proposes an earnings disregard for second earners. Amendment 52C is as follows:

*“Page 107, line 26, at end insert—*

*“( ) In the case of joint claimants, regulations under this paragraph must specify that a particular amount of the earned income of a second earner should be disregarded.”*

This note sets out why the amendment is important and details some of the arguments that might be used in its support.

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The structure of tax and benefits systems can affect:

- i) the incentive to earn more once employed,
- and
- ii) the incentive to take employment at all.

These are usually looked at in terms of effects on household income. The incentive to take employment at all is what matters to potential second earners of these but is easier to understand by examining first the factors that affect the incentive to earn more once employed.

### 1) **Incentives to earn more (MDRs):**

- The measure used to assess the incentive to earn more is known as the Marginal Deduction Rate (MDR) and measures the percentage of each extra pound earned that is taken through benefits being withdrawn and/or in tax or national insurance. For households in receipt of Universal Credit (UC), benefits are withdrawn at the same rate for everyone above any earnings disregard, but the tax and NI payable will depend on an individual's earnings i.e. whether they are above or below the NI/tax threshold. MDRs are therefore relatively easy to calculate under UC

- If there are only household level disregards under UC, MDRs will be as follows:

Household earnings below earnings disregard <sup>1</sup>	0%
Household earnings above earnings disregard;	
Individual earnings below tax/NI threshold	65%
Individual earnings above tax/NI threshold	76%

- As can be seen an earnings disregard has a crucial effect on the incentive to earn more.
- If there is only a household earnings disregard, second earners will face MDRs of 65% or 76% on all their earnings unless the first earner earns less than the household earnings disregard.

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<sup>1</sup> If a household had an earnings disregard set above the level of tax/NI threshold their MDR would be 32% if they earned above that threshold, but this will apply to very few if any households.

- However, an earnings disregard for second earners would allow second earners to earn up to the level of that disregard before having to face the higher level of MDRs.

## 2) Incentives to take employment (PTRs)

- Participation tax rates (PTRs) measure the proportion of earnings retained when taking a job at all (or lost in giving up a job). They are used to assess the incentive to take/stay in employment at all.
- They are more complex to calculate than MDRs because they have to take account of cumulative deductions from earnings calculated at different rates (0% when an earnings disregard applies, 65% below the tax/NI threshold, 76% above that - see MDR rates above – and then lower again if household earnings take the household beyond UC receipt).
- Again it can be seen that whether an earnings disregard applies will crucially affect PTRs since with an earnings disregard a range of earnings with an MDR of zero will go into the calculation.
- For those who have no access to an earnings disregard their PTR will be 65% if their earnings remain below the tax/NI threshold and rise above that level if they were to earn more than that, so long as their household is in receipt of UC. By contrast those who receive some earnings disregard will have a PTR that is lower.
- The Impact assessment of Universal Credit (published this month, so including the more generous earnings disregard now proposed) shows that the vast majority of first earners will have a PTR of less than 60%.
- This will be true of many second earners too, but only because their partners earn enough to take them out of UC (or for a smaller number because their partner does not use up all the earnings disregard). However except for this last group, second earners in households that remain in receipt of UC will face PTRs of between 65% and 76%. As the government acknowledges this provides a substantial disincentive to taking employment.

## 3) Childcare

- This disincentive increases when there are childcare costs to be paid. Childcare support under UC will pay up to 70% of childcare costs. However 30% is still a substantial deduction from earnings.
- The effect has not yet been calculated in any of the DWP briefings but the briefing notes on childcare suggest that £1300 a month should buy childcare for 40 hours a week<sup>2</sup>. Even parents who receive the maximum available help with childcare cost will pay 30% of this, that is about £90 per week. This works out, for someone employed for 40 hours a week at the minimum wage (assumed to be £6 per hour as in the UC impact assessment) as a deduction rate of 37.5%. The same will apply to those working shorter hours if their hourly cost of childcare is the same. This means an effective MDR of over 100% for those who need to pay for childcare for the hours that they take employment (so long as their earnings do not take their household out of the UC system).
- This 37.5% also needs to be added to the PTR of such people. Without an earnings disregard of their own, taking a job would not be financially viable.

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<sup>2</sup> Universal Credit Policy Briefing Note 10, Childcare, page 2, para 2e

#### 4) **Comparison with the current system**

- This problem is not new, it occurred with tax credits and was one reason why tax credits while effective in raising lone parents' employment rates, had a more ambiguous effect on couples. As the IFS showed tax credits increased first earners' work incentive but lowered second earners'.
- Under tax credits this disincentive problem was subsequently mitigated, though only in the short-term, by introducing a very large disregard for within year increases in earnings and raising the childcare subsidy to 80% (which meant that for some claimants on housing or council tax benefit the childcare subsidy could be even higher).
- The introduction of Universal Credit is therefore an opportunity to ameliorate a problem with the current system in a longer-term way.
- However, without an earnings disregard for the second earner, the PTRs of many second earners will be even higher (that is their work incentives will be worse) than those of the current system. The DWP's briefing note on Second Earners<sup>3</sup> Briefing Note 5 shows that of those potential second earners whose PTR will be affected i.e. those living on households that would be in receipt of UC or tax credits, three quarters would see an increase in their PTR should they consider work at 10 hours at the national minimum wage and those affected would see their PTR increase from 35% to 65% on average.
- This DWP briefing note also considers the PTRs of existing second earners i.e. their incentives to give up work. Since no figures are given for those whose PTR would fall, it would appear that for all of those affected by the change, their PTR will rise, although by a smaller amount on average, from 30% to 45%. As the briefing note remarks, this is much lower than for many first earners and must be because many of them either are augmenting very low earners of partners (so would benefit from some of the household's earnings disregard) or are second earners whose earnings take the household out of the UC system altogether.<sup>4</sup>

#### 5) **Why do second earner incentives matter?**

As mentioned earlier, the introduction of UC is an opportunity to improve the deleterious effects on the work incentives of second earners of the current system. Improving those work incentives is important because:

- i) *The earnings of second earners are crucial in keeping households out of poverty.* The latest analysis by the IFS shows that the child poverty rate (after housing costs AHC) drops from 18.9% in couples with one full-time worker to 5.1% in couples where there is also a part-time earner and 2.1% where there is a second full-time earner.
- ii) *An individual's human capital and future earning power can depreciate rapidly during time out of the labour market.* Retaining some connection with the labour market is important in improving future employment prospects and earning power. A short time spent out of the labour market because it is not financially viable to remain in it can have severe long effects on income over a lifetime.

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<sup>3</sup>Universal Credit Policy Briefing Note 5, Second Earners, page 2, para b.

<sup>4</sup> *ibid*, page 3, para e

- iii) *For the aims of the UC system itself, keeping second earners in employment is important.* Indeed, in many cases there will be conditions on potential second earners to look for employment, even though they will get no earnings disregard once they find employment. This gives contradictory messages and may appear unfair.
- iv) *It can also be seen as short sighted, because many of those second earners could become first or sole earners.* This will happen to those whose partners lose their jobs and also to the large numbers whose partnerships will break up (including many with children). In both circumstances a second earner is better equipped to become a main earner if she (typically) is in employment. And her family is then less likely to be in poverty. In so far as a second earners disregard aids this process it offers a potential route out of UC as well as poverty
- v) *In the longer-run the benefits of improving the earning power of second earners by keeping them in employment will outweigh the costs of any earnings disregard.* This has been shown to be case for families with the cost childcare. Similar considerations apply for the government. Keeping women in employment through motherhood should make a disregard for second earners highly cost-effective in a dynamic sense; future tax revenues should outweigh the relatively low costs of an earnings disregard. (On similar grounds raising the support for childcare back to 80% or even 90% as proposed in amendment 51 should also be cost effective.)

**6) Summary and reflections on gender implications**

- i) *Keeping second earners in work is a cost effective way of meeting a number of government objectives in the longer run: reducing joblessness in households, reducing child poverty, reducing dependence on UC and raising tax revenues.*
- ii) *It also may mitigate some deleterious aspect of the gender equality impact of Universal Credit, whose Impact Assessment notes that because of the reduced work incentive for second earners “in some families, second earners may choose to reduce or rebalance their hours or leave work” and that “in these cases, the improved ability of the main earner to support his or her family will increase the options available for families to strike their preferred work/life balance.”<sup>5</sup> It is more likely that households might prefer to rebalance their hours in the opposite direction i.e. towards more equality. This is the direction in which families tend to move when they can, and is the more “modern” way - i.e. to have two earners, and shared parenting. The government’s Consultation on Modern Workplaces suggests that it sees this as a worthy goal. The gender pay gap already discourages such sharing; unless the UC system incorporates an earnings disregard for second earnings it will make shared partnering an even more costly option for families.*
- iii) *Further, making a contribution is important in a relationship. Although mutual sharing within a household is beneficial, and there are other contributions to make besides financial ones, total financial dependence on a partner can reduce a person’s autonomy and well-being.*

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<sup>5</sup>Universal Credit Impact analysis page 20, para 70

- iv) *It could be argued that it is unfair to make second earners the only group of which many will have no access to an earnings disregard and, indeed, then to impose conditionality on some of them.*
- v) *Although the impact analysis notes: “Where men and women are in the same circumstances they are treated equally under Universal Credit”<sup>6</sup>, most second earners are women, and it is they who face the second earner work disincentives that the Universal Credit system provides and are the only groups of potential earners who may have no access to an earnings disregard despite having conditionality imposed on them. This makes the impact of UC not “gender neutral”. *The government has a statutory duty to promote gender equality in its policies or to consider mitigating measures to those policies that do not. Introducing a second earner disregard would be an important step in doing that.**

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<sup>6</sup> Universal Credit Impact analysis page 21, para 70