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| Raising incomes for low-paid families |
| A TUC analysis |

Introduction

There is increasing political concern about the prevalence of low pay and the need for action to increase the incomes of low-paid households. With more than five million workers across the country earning less than the living wage, amidst the toughest living standards squeeze in living memory, the need for action is not in doubt. But it is important to consider carefully which policy interventions can provide the greatest help, and to understand the role that earnings, in-work benefits, hours worked and tax cuts all play in raising the incomes of those on low pay.

This analysis makes a contribution to this debate by considering six case studies where working adults see their pay increase from below the living wage to the living wage rate. The research is based on the system as it is now, with reductions in tax credits up to financial year 2014/15 and increases in the personal allowance (which is currently £9,440) taken into account.

The case studies show while reducing income tax and raising wages are important changes that can help boost the incomes of those on low pay, working families with children who are living on low wages still need substantial support from the benefits system to make ends meet even when they are paid at living wage rates. Put simply, low-earning working families need benefits to survive. In addition, those who see their disposable incomes rise the most from pay rises tend to be adults without children or higher income households with children where one adult is a low earner. This is because low-paid households with children will be receiving additional in-work tax credits, which taper off as their earnings rise.

If politicians are looking to increase the incomes of low-paid families with children, increased earnings need to go hand in hand with measures to increase their household tax credit entitlements, or significantly reduce the rate at which their benefits are withdrawn.

Under its current design Universal Credit (UC) should mean some improvement on the current situation, as the rates at which benefits reduce as earnings rise should fall a little (although households will only keep 35p in the pound of higher earnings). But at the same time, as UC is based on after tax incomes, the gains that a higher personal allowance has brought for households on tax credits will be significantly reduced under UC (meaning that for every £1 a low-income family gains from a higher personal allowance, they will lose 65p as their UC is withdrawn). In addition, substantial reductions in the real values of working and child tax credit and child benefit have hit low-income working families hard, and under current plans the real values of these entitlements are not set to be restored.

In conclusion, our analysis suggests that while it is vital for the earnings of low-paid households to rise, a more generous system of in-work benefits is also urgently needed.

Case studies

1. Jean in Manchester

Jean lives in Manchester and is a single parent with two school age children. She works 40 hours a week in a minimum wage cleaning job. Her mum helps look after the kids after school, which means that Jean doesn’t have to pay for any extra childcare. Jean pays £100 a week in rent.

Jean has a real pay boost when her employer decides to start paying the living wage. Her earnings rise from £252.40 to £298 a week, an increase of £45.60.

As her pay goes up, she pays an extra £9.12 in income tax and £5.47 in national insurance each week. Jean’s benefit entitlements also change as a result of her pay rise as she loses £18.70 a week in working tax credit. This means the net benefit she gets from the pay rise is £12.31 a week (or £640.12 a year).

Even though this money will be a real help, her earnings are still far too little to cover her rent and her family’s living costs. That’s why even after the pay rise, Jean is still entitled to £166.53 a week in child benefit and tax credits.

1. **Jean’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income | £252.40 | £298.00 | £45.60 |
| Income tax | £14.27 | £23.39 | £9.12 |
| National insurance | £12.41 | £17.88 | £5.47 |
|  |  |  |  |
| Council tax | £18.70 | £18.70 | £0.00 |
|  |  |  |  |
| Child benefit | £33.70 | £33.70 | £0.00 |
| Child tax credit | £114.78 | £114.78 | £0.00 |
| Working tax credit | £36.75 | £18.05 | -£18.70 |
|  |  |  |  |
| Total taxes | £45.38 | £59.97 | £14.59 |
| Total benefits and credits | £185.23 | £166.53 | -£18.70 |
| **Total disposable income** | **£392.25** | **£404.56** | **£12.31** |

1. **2. Mark and Heather in East London**

Mark and Heather live in Stratford, East London and have two young school age children. They own their terraced house, and spend £200 a week on their mortgage. Mark works 40 hours a week as a security guard, and earns £8 an hour. Heather works as a shop assistant for their local dry cleaners for 24 hours a week. They spend £120 on childcare every week which means a childminder can pick their children up from school on the four days Heather is working.

Both Mark and Heather’s employers decide to pay the London living wage. This means that Mark’s earnings increase by £22 a week and Heather gets a £53.70 a week pay rise. In total, their earnings go up by a welcome £75.76 a week, although their income tax and national insurance contributions also rise, reducing that total by £22.62. In addition, their benefits and tax credits reduce slightly in response to higher pay, so they get 12p less a week in child tax credit, and £30.74 less in working tax credit. In total, their pay rise means that they are £22.08 better off a week. The pay rise helps Mark and Heather. But without extra help their income would still be too low to cover their living costs, and they continue to receive £148.36 a week in benefits and tax credits. Without this help Heather wouldn’t be able to work (as they would not be able to pay for childcare), and their income would fall substantially.

1. **Mark and Heather’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income (Mark) | £320.00 | £342.00 | £22.00 |
| Gross earned income (Heather) | £151.44 | £205.20 | £53.76 |
|  |  |  |  |
| Income tax (Mark) | £27.79 | £32.19 | £4.40 |
| National insurance contributions (Mark) | £20.52 | £23.16 | £2.64 |
| Income tax (Heather) | £0.00 | £4.83 | £4.83 |
| National insurance contributions (Heather) | £12.41 | £23.16 | £10.75 |
|  |  |  |  |
| Council tax | £24.93 | £24.93 | £0.00 |
|  |  |  |  |
| Child benefit | £33.70 | £33.70 | £0.00 |
| Child tax credit | £114.78 | £114.66 | -£0.12 |
| Working tax credit | £30.94 | £0.00 | -£30.94 |
|  |  |  |  |
| Total household earnings | £471.44 | £547.20 | £75.76 |
| Total taxes | £85.65 | £108.27 | £22.62 |
| Total benefits and tax credits | £179.42 | £148.36 | -£31.06 |
| **Total disposable income** | **£565.21** | **£587.29** | **£22.08** |

1. **3. Jessica in Kent**

Jessica lives in Margate where she is bringing up her two children on her own. Her youngest is only two, but her eldest son has just started school. She works 24 hours a week as a care assistant earning the minimum wage, which is possible because her two year old spends a few days a week in their local nursery (costing Jessica £170 a week). Her ex-husband also takes care of their daughter every Friday, which saves a little on childcare costs. Jessica’s rent is £110 a week, which pays for a two bedroom flat.

Jessica’s employer increases her hourly pay to the living wage. This raises Jessica’s earnings by £27.36 a week. Despite higher pay she remains exempt from income tax, but her national insurance contributions rise by £3.29 a week. The wage rise also means she loses some of her benefit entitlement. Her housing benefit falls by £8.36 and her working tax credit entitlement by £11.21. The pay rise makes a difference and as a result Jessica has £4.50 a week more to spend (£234 a year). But at the same time, benefits and tax credits still make a bigger contribution to her household income than her earnings, and she continues to receive £170.78 a week in working tax credit (much of which goes to help with her childcare costs), in addition to child tax credit and child benefit to help her with the costs of clothes, nappies and food.

1. **Jessica’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income (Jessica) | £151.44 | £178.80 | £27.36 |
| Income tax | £0.00 | £0.00 | £0.00 |
| National insurance contributions | £0.29 | £3.58 | £3.29 |
|  |  |  |  |
| Council tax | £18.70 | £18.70 | £0.00 |
|  |  |  |  |
| Housing benefit | £33.77 | £25.41 | -£8.36 |
| Child benefit | £33.70 | £33.70 | £0.00 |
| Child tax credit | £114.78 | £114.78 | £0.00 |
| Working tax credit | £181.99 | £170.78 | -£11.21 |
|  |  |  |  |
| Total taxes | £18.99 | £22.28 | £3.29 |
| Total benefits and credits | £364.24 | £344.67 | -£19.57 |
| **Total disposable income** | **£496.69** | **£501.19** | **£4.50** |

1. **4. Fatima and Ali in Glasgow**

Fatima and Ali live in Glasgow and have two children. Their youngest is only two while their eldest daughter is five and has recently started school. Ali works 40 hours a week in a restaurant, earning just above the minimum wage, while Fatima looks after their children.

Ali’s employer starts to pay the living wage, which means that Ali’s earnings rise by £38 a week. As a result his income tax also goes up (by £7.60 a week), as do his national insurance contributions (by £4.56). Higher earnings also mean that some of the benefits and tax credits his family receive are reduced, with their housing benefit falling by £6.67 a week and their working tax credit reduced by £15.58. Overall, the pay rise is worth an extra £3.59 a week to Ali and his family (£186.68 a year).

Ali and Fatima continue to receive £217.68 a week in benefits and credits. This allows them to cover their £125 a week rent as well as school uniform and food costs.

1. **Fatima and Ali’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income (Ali) | £260.00 | £298.00 | £38.00 |
| Income tax | £15.79 | £23.39 | £7.60 |
| National insurance contributions | £13.32 | £17.88 | £4.56 |
|  |  |  |  |
| Local taxes | £24.93 | £24.93 | £0.00 |
|  |  |  |  |
| Housing benefit | £57.82 | £51.15 | -£6.67 |
| Child benefit | £33.70 | £33.70 | £0.00 |
| Child tax credit | £114.78 | £114.78 | £0.00 |
| Working tax credit | £33.63 | £18.05 | -£15.58 |
|  |  |  |  |
| Total taxes | £54.04 | £66.20 | £12.16 |
| Total benefits and credits | £239.93 | £217.68 | -£22.25 |
| **Total disposable income** | **£445.89** | **£449.48** | **£3.59** |

1. **5. Ahmed in Leicester**

Ahmed is single and works 40 hours a week on the minimum wage on the production line in a small food processing plant. He lives in a bedsit, which costs him £95 a week. Ahmed is not entitled to any in-work benefits or tax credits.

Ahmed’s employer becomes accredited for the living wage, which means that his weekly pay goes up by £45.60 a week. While his income tax and national insurance contributions rise (by £14.59 a week in total) he is still better off by £31.01 a week, or £1,612.52 a year.

1. **Ahmed’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income | £252.40 | £298.00 | £45.60 |
| Income tax | £14.27 | £23.39 | £9.12 |
| National insurance contributions | £12.41 | £17.88 | £5.47 |
|  |  |  |  |
| Council tax | £18.70 | £18.70 | £0.00 |
|  |  |  |  |
| Total taxes | 45.38 | 59.97 | 14.59 |
| Total benefits and credits | - | - | - |
| **Total disposable income** | **£207.02** | **£238.03** | **£31.01** |

1. **6. Margaret and Tom**

Margaret and Tom live in Burnley, and have two young children aged one and three. They recently bought their own home and pay £300 a week in mortgage repayments. Tom is an accountant in a local firm and works 40 hours each week earning £20 an hour. Margaret works in the local packaging depot for 40 hours a week earning the minimum wage. While their families help out with some of the childcare while they are working, they also pay substantial costs themselves. Their combined household income means that they don’t qualify for tax credits, but they are entitled to child benefit.

When Margaret’s employer decides to become accredited for the living wage she is glad of the pay rise and her weekly earnings go up by £45.60. Although she is now paying higher income tax and national insurance contributions, she is better off by £31.01 a week or £1,612.52 a year.

1. **Margaret and Tom’s weekly income**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Original wage (weekly)** | **Living wage (weekly)** | **Change (weekly)** |
| Gross earned income (Tom) | £800.00 | £800.00 | £0.00 |
| Gross earned income (Margaret) | £252.40 | £298.00 | £45.60 |
| Income tax (Tom) | £124.81 | £124.81 | £0.00 |
| National insurance contributions (Tom) | £77.82 | £77.82 | £0.00 |
| Income tax (Margaret) | £14.27 | £23.39 | £9.12 |
| National insurance contributions (Margaret) | £12.41 | £17.88 | £5.47 |
|  |  |  |  |
| Council tax | £24.93 | £24.93 | £0.00 |
|  |  |  |  |
| Child benefit | £33.70 | £33.70 | £0.00 |
|  |  |  |  |
| Total gross earnings (Tom and Margaret) | £1,052.40 | £1,098.00 | £45.60 |
| Total tax | £254.24 | £268.83 | £14.59 |
| Total benefits and tax credits | £33.70 | £33.70 | £0.00 |
| **Total disposable income** | **£831.86** | **£862.87** | **£31.01** |