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**Research Report**

## Lone-parent incomes and work incentives

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# **LONE-PARENT INCOMES AND WORK INCENTIVES**

**MARK REGAN, CLAIRE KEANE AND JOHN R. WALSH**



# **LONE-PARENT INCOMES AND WORK INCENTIVES**

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**July 2018**

## **BUDGET PERSPECTIVES 2019**

### **PAPER 1**

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# LONE-PARENT INCOMES AND WORK INCENTIVES

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## ABSTRACT

This paper examines how changes to the social welfare system for lone parents, such as the tightening of eligibility criteria for One-Parent Family Payment and the introduction of Jobseeker's Transitional Payment, affected lone-parent incomes and work incentives. Our main contributions are threefold: we examine the cumulative effect of policy changes on the income of lone parents, and how changes to lone-parent-specific schemes affected income and work incentives, and quantify the extent to which childcare costs act as a labour market barrier for lone parents.

Firstly, policy changes do not occur in a vacuum, therefore we assess how all policy from 2011 to 2018 affected lone-parent income. We find that changes to social welfare policy for lone parents resulted in income losses for employed lone parents, but had little effect on non-employed lone parents. All other changes over the period decreased the income of both employed and non-employed lone parents. We examine how these social welfare changes affected the work incentives. The reforms resulted in more lone parents having a greater financial incentive to be out of work, thus weakening the financial incentive to be in work.

Finally, informed by an abundant literature regarding childcare costs as an obstacle to female labour supply, we highlight the impact of these costs on the incentive to be in work. We find that on accounting for childcare costs, being out of work becomes much more financially attractive for many lone parents. The availability of subsidies on childcare costs helps to reduce this disincentive, but even so, childcare costs represent a substantial barrier to lone-parent labour market participation.

## 1. INTRODUCTION

The One-Parent Family Payment (OPFP) has offered income support to lone-parent families since its introduction in 1997.<sup>1</sup> The payment differs from Jobseeker's Allowance in that it is not contingent on seeking employment or engaging in activation measures. Between 2012 and 2015 a raft of changes were implemented, mainly surrounding eligibility for the payment. Prior to the recent changes, lone parents were eligible to receive the payment until their youngest child turned 18, or 22 if the child remained in education. By 2015 this age limit had dropped to 7.

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<sup>1</sup> Prior to this, supports for lone parents included the Lone Parent Allowance and the Unmarried Mother's Allowance.

These changes were enacted in large part due to research at national and international levels showing relatively low employment rates of lone parents, high benefit receipt rates and high poverty and deprivation rates.<sup>2</sup> Research suggests that long-term payments that are not conditional on job-search or other participation commitments, such as OPFP, could lead to welfare dependency and an increase in the pervasiveness of poverty among recipients.<sup>3</sup> A significant aim of these changes, therefore, was to increase activation and encourage parents to return to the labour market as their children become older. The changes have led to more variability in a lone parent's income source over time as different social welfare schemes can be availed of as their youngest child grows older.

This paper aims firstly to assess the impact of these OPFP changes on the disposable income of lone parents. As pointed out by Indecon (2017) in its review of the changes to the OPFP, average incomes of lone parents over time are an amalgamation of the direct impact that changes to the OPFP had on the income and employment rates of lone parents and any other changes over the time period analysed that may have affected lone parents regardless of changes to the OPFP.<sup>4</sup> That report pointed to the importance of assessing outcomes compared to a counterfactual, i.e. what would have happened in the absence of the policy change. Simply looking at the employment rates and incomes of current lone parents and comparing these to the population of lone parents prior to the changes could therefore give misleading and hard-to-interpret results.

Using microsimulation techniques, this paper will isolate the effects of the OPFP policy reforms on the income of the current population of lone parents. This method abstracts away from any behavioural impacts of changes to the payment. As noted above, changes to the OPFP could have had an impact on the incentives to work. Analysis of individual cases will fail to give a clear understanding of the overall context of the landscape for all lone parents. Again, using microsimulation techniques on a representative sample of the population will allow us to profile the current labour market incentives faced by the population of lone parents, rather than actual or hypothetical cases, which may not be representative.

Furthermore, most analyses of financial incentives to work compare in-work and out-of-work incomes. Given relatively high childcare costs in Ireland and the fact that lone parents are the sole potential earner and carer in the family, we examine the current incentives to work faced by lone parents taking account of childcare costs and the recently introduced Affordable Childcare Scheme (ACS) subsidies.

The structure of the paper is as follows. Section 2 profiles the income and employment situation of lone parents and outlines the Irish policy changes

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<sup>2</sup> For example, see OECD (2003) and Department of Social and Family Affairs (2006).

<sup>3</sup> See OECD (2005, 2006).

<sup>4</sup> For example, over the period we analyse, 2011–2018, the economy was recovering; increases in employment rates or incomes of lone parents may in part be due to this recovery.

examined. Section 3 discusses the methodology used, and Section 4 presents the results. Section 5 concludes the paper.

## **2 LONE-PARENT EMPLOYMENT RATES, INCOMES AND POLICIES**

### **2.1 International comparison**

Ireland does not seem to be an outlier in terms of the scale of lone parenthood. OECD (2016a) shows that 17.6 per cent of Irish children live with a single parent, only slightly above the OECD and EU averages of 17.1 per cent and 16.7 per cent. Our nearest neighbour, the United Kingdom, had 23.2 per cent of children living with a single parent; the corresponding figure for the United States was a relatively high 27.4 per cent.

However, Ireland does stand out in terms of poverty and deprivation experienced by these lone parents. Lone parents and their children are particularly prone to experiencing deprivation<sup>5</sup> and poverty<sup>6</sup> across the EU, with lone parents in Ireland having a more heightened risk. Watson et al. (2018) exploit the longitudinal component of EU–SILC data across six waves of the survey: 2005 and 2006, 2008 and 2009, and 2013 and 2014. They isolate individuals in each wave of the survey in adjacent years. Using this method they found that over these years, in 11 countries,<sup>7</sup> an average of 43 per cent of lone parents experienced deprivation in either of the years they were observed in SILC. A fairly similar proportion, 38 per cent, were at risk of poverty in either wave.

In Ireland, persistent poverty, defined as being at risk of poverty in both survey years, was particularly pronounced among lone parents. Persistent poverty was 26 percentage points higher among lone parents than for other adults, compared to an average gap of between 5 and 20 percentage points evident in other countries examined. Due to the time frame of the study, this indicates that poverty among lone parents in Ireland appears to be more endemic and not solely due to transient shocks such as a short-term loss of employment.

These results for lone parents are not surprising given their position in the income distribution. In Table 1 we show the distribution of lone-parent households<sup>8</sup> across the income distribution before and after social transfers. Averages for the ‘boom years’ of 2004 to 2007, the Great Recession from 2008 to 2012 and subsequent recovery from 2013 to 2015 are displayed. Before considering social transfers<sup>9</sup> to the working age population, in all time periods a large proportion of lone-parent

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<sup>5</sup> As measured by the inability to afford three or more of the following: annual holiday; meeting unexpected expenses; avoiding arrears on household bills; a protein meal every second day; adequate heating of the dwelling; durable goods like a washing machine, colour television, telephone or car.

<sup>6</sup> Income poverty as measured by the proportion living in a household with annual, equivalised income below 60 per cent of the median income.

<sup>7</sup> Sweden, Finland, the Netherlands, Austria, Belgium, France, the United Kingdom, Italy, Spain, Greece and Ireland.

<sup>8</sup> Households with only one adult where children (aged under 18) are present.

<sup>9</sup> I.e. taking only earned income such as that from employment into account.

households are located in the bottom two household income deciles: 70 per cent in 2004 to 2007, 61 per cent in 2008 to 2012 and 56 per cent in 2013 to 2015.

Once social welfare transfers are taken into account, the concentration of lone-parent households in the bottom two income deciles has been relatively consistent over time – 43 per cent in 2004 to 2007, 40 per cent in 2008 to 2012 and 39 per cent in 2013 to 2015. In general, a slight improvement of the post-transfer income situation of lone parents can be seen, with a movement from decile 1 up to decile 2. In comparison to other households with children, 16 per cent of households comprising two adults and one child were in the bottom two deciles before social transfers in the most recent time period (2013–15), falling to 12 per cent once social transfers have been taken into account.

Once social transfers are taken into account, lone-parent households experience a much larger relative improvement in their position in the income distribution than other household types. They continue to be more likely to be in the bottom two deciles than other one-earner households, however.<sup>10</sup> This indicates that for lone-parent households, the social welfare system has a substantial role to play in improving their position in the income distribution, but even so, a large portion of them remain in the bottom half of the income distribution.

**TABLE 1 DISTRIBUTION OF LONE-PARENT HOUSEHOLDS ALONG INCOME DISTRIBUTION**

	Before working age transfers (%)			After all transfers (%)		
Decile	Average 2004–2007	Average 2008–2012	Average 2013–2015	Average 2004–2007	Average 2008–2012	Average 2013–2015
<b>Lowest</b>	46	35	33	29	17	19
<b>2</b>	24	26	23	14	23	20
<b>3</b>	8	14	16	13	11	13
<b>4</b>	6	8	8	14	11	14
<b>5</b>	4	3	4	15	15	12
<b>6</b>	4	4	3	6	10	9
<b>7</b>	2	3	4	2	5	5
<b>8</b>	2	2	4	2	3	4
<b>9</b>	2	2	3	2	2	3
<b>Highest</b>	1	2	2	1	2	2
Household type	Real mean incomes (equivalised, disposable)					
<b>Lone parent</b>	€7,329	€8,161	€8,755	€15,610	€18,681	€18,095
<b>Couple with children</b>	€22,431	€21,870	€22,474	€25,772	€27,089	€27,371
<b>Overall population</b>	€22,184	€23,583	€23,974	€25,189	€26,954	€27,809

Source: Authors' analysis using SILC Research Microdata Files.

Note: Deciles are based on household equivalised disposable income. Incomes are expressed in 2015 constant prices.

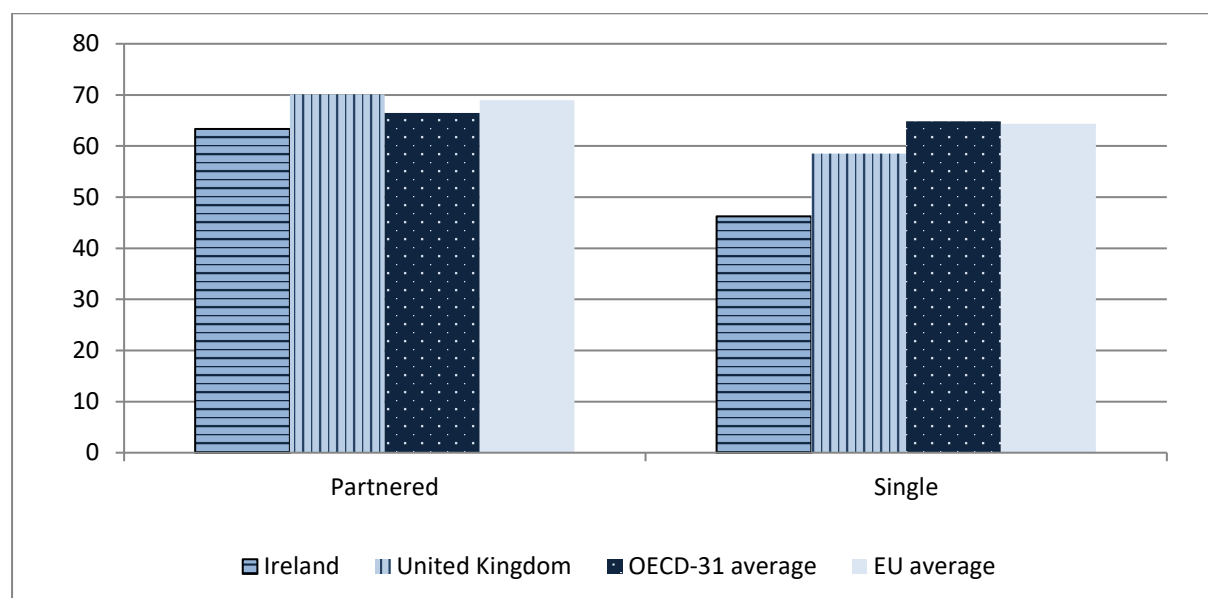
<sup>10</sup> Over the same time period, 28 per cent of one adult households were located in the bottom two deciles after social transfers.

A comparison of the median incomes of lone parents compared to the overall population and to couple-headed families shows that before transfers the median income of lone parents in the 2013–2015 time period was only slightly more than one third of that of the overall population. Again the transfer system reduces this gap sharply, but lone-parent incomes after transfers remain at two thirds of those of the overall population and couple-headed households with children.

This position of lone parents in the income distribution is linked to labour market patterns. Here we focus on females, given that in 2016 86 per cent of lone parents (Census 2016) and 99 per cent of OPFP recipients (Department of Employment Affairs and Social Protection, 2016) were female.

Figure 1 compares the employment rates of single mothers and partnered mothers. Across the OECD an average of 67 per cent of partnered mothers were employed, with only a slightly lower rate of 65 per cent for single mothers. Similar employment levels are seen across the EU, with 69 per cent of partnered mothers and 64 per cent of single mothers in employment. The employment rate of partnered mothers in Ireland stood at 63 per cent, 4/6 percentage points below the OECD/EU average. For single mothers, however, the employment rate was significantly below this, standing at 46 per cent, 13 percentage points below that in the UK and 19 percentage points below the OECD average.

**FIGURE 1 EMPLOYMENT RATES OF SINGLE AND PARTNERED MOTHERS**



Source: OECD (2014).

In addition to the fact that the employment rate of single mothers is almost one third lower than the OECD average, when they are in employment single mothers in Ireland are much more likely to be in part-time employment, and therefore likely

to earn less. 52 per cent of lone parents in employment in Ireland work below 30 hours a week compared to only 21 per cent across the OECD (OECD, 2014).

Overall, it seems that the employment levels and work hours of Irish lone parents are outliers in a European and OECD country context. Employment rates are low and those who are in employment are more likely to work part-time and face a higher risk of being in persistent poverty. Were it not for social welfare transfers, over half of lone-parent households would be in the bottom two deciles of the income distribution. This is no surprise, however, given the low employment rate and high rate of part-time employment observed for single mothers.

In light of low employment rates and high at-risk-of-poverty and deprivation rates among lone parents, moves towards increasing lone-parent employment rates, as envisaged by the OPFP policy changes, are likely to improve the position of lone parents in the income distribution if they prove to be effective. Two key issues must be borne in mind in assessing the effectiveness of the policy changes in meeting their aims.

Firstly, childcare costs in Ireland are among the highest across the OECD.<sup>11</sup> Evans et al. (2003)<sup>12</sup> point to the fact that effective activation policies are costly and may require a shift, rather than a reduction, in welfare expenditure, in the short term at least, as income from work may not be sufficient to provide adequate income once childcare costs are taken into account so that many may become working poor. Indecon (2017) found some initial evidence of a rise in labour market participation and labour market earnings among those who lost OPFP between 2013 and 2016,<sup>13</sup> noting a 3 to 4 per cent reduction in benefit receipt.<sup>14</sup> The average total income of those remaining on OPFP was €18,071 – only marginally below the average of €18,720 for those who lost the payment. These figures do not, however, take account of the childcare costs that lone parents returning to work or increasing work hours are likely to have faced.

Secondly, wage rates and work hours will impact upon the total level of earnings from employment for those entering the labour market or increasing their work hours. If employment is concentrated in low-paid sectors or/and is on a part-time basis, the positive impact of employment on poverty and deprivation will be reduced. Indecon (2017) found that the numbers of lone parents in full-time employment rose from 15% while on OPFP to 22 per cent when OPFP receipt finished. 60 per cent remained in part-time employment, however – only slightly down from 66 per cent while on OPFP.

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<sup>11</sup> OECD (2016b) shows that a lone parent on two thirds of the average wage faces childcare costs that are 42 per cent of net income, the second highest level across the OECD.

<sup>12</sup> Summarised in Millar and Crosse (2016).

<sup>13</sup> Of those who remained on OPFP between 2013 and 2016, 44 per cent had earnings from employment in 2016 compared to 60 per cent of those who lost OPFP. Average earnings of those remaining on OPFP were €4,248, compared to €7,576 on losing OPFP.

<sup>14</sup> Based on Indecon's (2017) 'difference in difference/regression discontinuity design' results.

Across the OECD a mix of policies regarding lone parents exist, with some countries having no specific welfare benefit aimed at lone parents, and in countries where such a specific benefit exists requirements to seek work or engage in activation measures differ. As discussed in Millar and Crosse (2016), Rowlingson and Millar (2002) identify three main types of policies to support lone parents' movement into the workforce:

- the introduction of strict work requirements or participation in activation programmes;
- changes to welfare payments and taxes to improve the financial incentive to work;
- the provision of childcare services or subsidies.

As well as aiming to reduce poverty and deprivation among lone parents, an economic rationale exists to provide a larger financial incentive to work for lone parents. One way to do this, as is done under the OPFP, is to provide an earnings disregard. In a study of 17 European countries and the US, Bargain et al. (2014) found that single mothers tend to have larger labour supply elasticities than childless women. In many countries, differences are usually not significant, but notable exceptions included Ireland and Greece. This means that the lone mothers in Ireland react more strongly in terms of their hours worked as the income they earn changes. Therefore, if no earnings disregard is in place, or if it is reduced, a mother's marginal effective tax rate (METR) may be quite high as the benefit is withdrawn as soon as employment income is received. Anything that increases this METR, such as a drop in the earnings disregard, is more likely to result in a reduction in work hours.

## **2.2 Irish policy changes**

In 2011, lone parents could receive the OPFP until their child was 18 years old, or 22 if their child remained in education. The personal rate payment was €188, with a €29.80 increase for a qualified child. An earnings disregard of €146.50 was in place, meaning that this amount of earned income was excluded from the calculation of means. A lone parent was therefore eligible for a full payment of OPFP if their earned income was less than €146.50 per week, and between €146.50 and €425 per week the payment was incrementally reduced to zero.

Various OECD reports (see OECD 2003, 2011) were critical of the lack of an activation requirement for those in receipt of OPFP, under the belief that it was contributing to the low employment rates seen among lone parents. OECD (2003) noted that 'the long periods of leave that lone parents can spend on benefit result in some children growing up in poor, workless and even socially excluded conditions'. A report by the then Department of Social and Family Affairs (2006)

discusses the fact that earlier schemes<sup>15</sup> were structured around the assumption that women should not work and should remain in the home full-time. Indeed, the introduction of the OPFP with its earnings disregard was a step in the process of moving away from this assumption. The report acknowledged the need to move away from supports that ‘have to date been passive in nature, with no active or systematic supports in assisting the person to take up education, training or employment opportunities’ and, in reference to the fact that OPFP can be received until a child is 18 (or 22 if in education), that ‘long term welfare dependency is not in the best interests of the lone parent, their children or society in general’.

As part of the conditions under the Troika financial assistance programme (or ‘bailout’), it was agreed to introduce activation as a requirement for lone parents. The Social Welfare and Pensions Act, 2012, brought about significant changes to the OPFP scheme, for both existing recipients and future applicants. For those who were in receipt of OPFP in 2012 there was a phased withdrawal of OPFP each year once the parent’s youngest child reached a certain age, as shown in Table 2. By July 2015 the changes were fully implemented so that only lone parents whose youngest child was under seven would be eligible for the OPFP.

**TABLE 2 TIGHTENING OF AGE LIMITS FOR OPFP AFTER REFORMS**

OPFP payment commencement	Terminal payment age			
	2012	July 2013	July 2014	July 2015
<b>Before 27 April 2011</b>	18	17	16	7
<b>Between 27 April 2011 and 3 May 2012</b>	14	12	10	
<b>After 3 May 2012</b>	12	10	7	

Source: Joint Committee on Social Protection (2017).

A complementary welfare payment, Jobseeker’s Transition Payment (JST), was introduced to support lone parents transitioning into the labour market, whose youngest child was aged between 7 and 13 years. The scheme was very similar to OPFP except that a labour market activation component was introduced. A lone parent has no obligation to actively seek employment under the scheme but recipients of JST are obliged to meet with one of the Department of Employment Affairs and Social Protection’s (DEASP) case officers to facilitate the individual’s movement towards labour market participation by identifying employment schemes, educational options and other training which may augment their employment transition. Failure to engage in this process may result in a reduced rate of JST payment.

The Back to Work Family Dividend (BTWFD) was also introduced in 2015. This policy

<sup>15</sup> Such as the ‘Unmarried Mother’s Allowance’.



was aimed at improving the work incentives of families who enter paid employment. For lone parents this meant that when entering paid employment, they could retain the top-up payment for having a dependent child availed of in the OPFP or jobseeker's scheme for the first year of employment. In the second year, half the top-up payment was retained. This amounted to an additional €1,550 per qualified child in the first year and €775 in the second year.

By 2018, the year of our analysis, the OPFP maximum personal rate stood at €198 per week with an increase of €31.80 per qualified child and an earnings disregard of €130 per week. The benefit is fully withdrawn if means exceed €425 per week. The same rates and earnings disregard are in place under the JST payment. Notably, between 2011 and 2018 there was an increase in the personal rate (€188 to €198) and qualified child allowance (€29.80 to €31.80) but a decrease in the earnings disregard (€146.50 to €130). This means that a lone parent can now earn only €130 per week before their OPFP payment begins to be withdrawn. Budget 2012 originally announced that the earnings disregard would fall on a phased basis, over a five-year period, from €146.50 to €60 per week.<sup>16</sup> This would have brought it in line with the disregard in place for those on Jobseeker's Allowance. Given the finding by Bargain et al. (2014) that Irish single mothers have a highly elastic labour supply, there is certainly an economic rationale for having a higher earnings disregard under the OPFP.

Overall, the changes in the social welfare entitlement of lone parents from 2011 have aimed at reducing the incidence of unconditional payments and encouraging labour market participation through activation policies. Bonoli (2010) classifies labour market activation policies into four types: incentive reinforcement, employment assistance, occupation, and human capital investment.<sup>17</sup> He notes that English-speaking countries commonly combine incentive reinforcement policies with employment assistance philosophies. The new Irish policy developed for lone parents would fit this profile. Incentive reinforcement policies aim at strengthening work incentives for people in receipt of welfare whereas employment assistance consists of a broad set of measures aimed at removing barriers to labour market participation such as job search programmes and placement services. The availability of in-work benefits, time limits on unconditional payments of OPFP and sanctions in the form of reduced JST for failure to engage in case officer meetings would be typical of incentive reinforcement strategies. The activation element under JST is aimed at facilitating lone parents back to work by providing counselling for career options from a DEASP case officer.

Given time lags in data for analysis – the final change to OPFP was only

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<sup>16</sup> The earnings disregard did fall to €90 a week in 2014 before being increased to €130 in 2018. This drop to €90 will not be picked up in our analysis as we focus on the income and work incentives of lone parents under the current (2018) rules (i.e. an earnings disregard of €130) as compared to the rules in place in 2011 (i.e. a disregard of €146.50).

<sup>17</sup> For a full discussion of all four measures see Bonoli (2010).

implemented in July 2015 – and the fact that it is likely to take time for activation policies, particularly education and upskilling based approaches, to affect employment prospects and wages, it is too early to say if the OPFP policy changes have had the desired effect. Further work investigating how these policies affect employment prospects and human capital formation can be conducted as more timely data become available.<sup>18</sup>

### 3 METHODOLOGY

#### 3.1 Distributional analysis

As discussed in the introduction, in order to isolate the impact of changes in OPFP policy on the income and work incentives of lone parents, it is necessary to examine an appropriate counterfactual, i.e. what would have happened in the absence of the policy changes. We do this using microsimulation techniques which allow us to isolate these policy change impacts.

SWITCH, the ESRI's microsimulation model, provides an extremely useful platform of analysis for isolating the impact of tax-benefit policy changes on the incomes of the lone-parent population. The model is based on pooled 2013 and 2014 data from the CSO's Survey of Income and Living Conditions and the data are adjusted to be representative of the current 2018 population.<sup>19</sup> We will compare the cumulative change of policy impacts from 2011 to 2018 by analysing how the current lone-parent population would fare if they were to face the 2011 set of budget policies as opposed to the policy in place at present. In doing so we will also estimate the distributional impact of all budgetary tax-benefit changes over the time frame on lone-parent income alongside analysing the impact solely of changes in the OPFP, as different policies may have countervailing effects.

The model effectively allows us to ask 'what if' the changes to the OPFP had not occurred. In practice this reverses the changes in OPFP eligibility so that the current set of lone parents – some of whom are receiving OPFP as they have a child under 7, some of whom are in receipt of JST as they have a child in the 7–13 age band, and others who are in receipt of other benefits such as JSA or WFP – are assessed under the old OPFP scheme.

In order to arrive at a satisfactory counterfactual, i.e. what would have happened to the OPFP rates in the absence of policy changes, we provide results under a number of options. We firstly consider results assuming the 2011 OPFP rates were increased in line with 2011–2018 wage growth of 8 per cent<sup>20</sup> (known as wage

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<sup>18</sup> Indeed, the official evaluation of the scheme changes carried out by Indecon (2017) concludes that as the number of years since the final changes occurred is low, more analysis will be needed in the future.

<sup>19</sup> The pooled SILC 2013 and 2014 data contain 714 lone parents, of whom 404 receive OPFP.

<sup>20</sup> Wage growth from 2011 to 2017 comes from the Earnings, Hours and Employment Costs Survey (EHECS), standing at 5 per cent, coupled with predicted 2018 wage growth of 3 per cent coming from an average of predictions in the Winter 2017 Quarterly Economic Commentary and the Central Bank Q4 report.

indexation). This wage-indexed policy increases the 2011 tax credits, tax bands and social welfare rates by 8 per cent to allow for a distributionally neutral benchmark of assessment as income growth is similar at all income levels, while being macroeconomically neutral as average tax rates are constant. Given that increasing social welfare rates and tax credits/bands in line with wage growth can be costly to the Exchequer, particularly in times of high wage growth, we examine a second indexation option. This second scenario bears in mind that the 2011–2018 period was one where the macroeconomic situation was still coming out of recession and fiscal space available to government over this time period was tight. We therefore also consider results increasing (or indexing) 2011 OPFP rates in line with the average increase in personal rates and Increases for Qualified Children/Adults (IQCs, IQAs) of all other social welfare payments (Child Benefit, Jobseeker’s Allowance, Jobseeker’s Benefit, etc.) from 2011 to 2018. The resultant indexation rate is 4 per cent.

We may ask what is the ‘best’ scenario to use. There is no ‘correct’ answer to this question – obviously governments face financial constraints when deciding how much to increase social welfare rates by in a Budget. It is, however, important to bear in mind that income poverty is a relative measure so that a failure to index benefits in line with wage growth will ultimately result in benefit recipients’ incomes growing at a slower rate than those of people in employment.<sup>21</sup> This will tend to increase inequality and poverty rates, both relative measures. It will also result in ‘bracket creep’ whereby workers face an increase in tax liability as tax bands and credits fail to rise in line with incomes. For a full review of indexation see Callan et al. (2015).

### 3.2 Measuring the financial incentive to work

We also make use of microsimulation techniques to isolate the impact of policy reforms on the financial incentives of lone parents to be in employment. We calculate replacement rate (RR), which measures an individual’s out-of-work income as a percentage of their in-work income and is defined as:

$$RR = 100 * \frac{\text{family disposable income out of work}}{\text{family disposable income in work}}$$

For example, an individual with out-of-work disposable income of €250 and disposable income when participating in employment of €500 would have an RR of 50 per cent. A higher RR indicates a weaker financial incentive to work, while a lower RR indicates a stronger incentive.

Obviously, we only observe out-of-work income for those not in employment and in-work income for those in employment. We therefore use SWITCH to calculate out-of-work income for those currently in employment (i.e. what they would

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<sup>21</sup> Price inflation will also reduce the purchasing power of those on fixed income, such as benefit recipients.

receive in benefits if they were no longer working), and for those not currently in employment we estimate how much they would earn if they did work.<sup>22</sup> SWITCH is then used to calculate disposable in-work income.

## 4 RESULTS

### 4.1 Lone-parent income changes

A priori, we are unsure how changes to OPFP eligibility will affect the income of lone parents. Some lone parents remain eligible for OPFP as they have a child under 7. Others with children in the 7–13 age group are eligible for JST while the remainder receive payments under other schemes such as the WFP. In addition, the payment rates for the OPFP have risen while the income disregard has fallen.

In Table 3 we estimate that for the 2018 population of lone parents, approximately 90,000 would be eligible for OPFP if they faced the eligibility rules for the scheme as they were in 2011. Of this group, 53 per cent remain eligible for OPFP and a further 27 per cent avail of JST. In total, 80 per cent of those eligible for OPFP who would have been eligible for OPFP under the 2011 rules are now eligible for either OPFP or JST. The remainder are eligible for the WFP or other schemes.

**TABLE 3** SCHEMES FOR LONE PARENTS ELIGIBLE FOR 2011 OPFP, 2018

2018 Scheme	%
One-Parent Family Payment (OPFP)	53
Jobseeker Transition Scheme (JST)	27
Working Family Payment (WFP)	12
Other schemes	8
<b>Total (N)</b>	<b>89,423</b>

Source: Authors' own calculations using SWITCH.

We begin by examining the average change in income for lone parents as a result of all tax-benefit changes that occurred in 2011 to 2018 under the two different counterfactual scenarios (indexation in line with other social welfare rates; indexation in line with wage growth).

Table 4 shows the average percentage change in income of lone parents as a result of all tax-benefit policy changes from 2011 to 2018. Overall we see that these policy changes put in place over the time period analysed reduced lone-parent incomes

<sup>22</sup> We run an ordinary least squares regression of age, gender and educational qualifications (and their interactions) for earners and use the coefficients to predict hourly wages for non-earners. A random error term is also added. We reduce our estimates of predicted earnings for those returning to employment from a spell of unemployment by 10 per cent to acknowledge the wage-scarring effect of unemployment. We then assume a 40-hour work week to arrive at weekly in-work income. Further details on estimation of potential wages can be found in Callan et al. (2016).

and 3.7 per cent with indexation in line with wage growth).

Table 4 also separates lone parents by labour force status and shows the average change in income across employed and non-employed lone parents. With lower indexation by social welfare growth, both employed and unemployed lone parents lost around 1.4 per cent of income between 2011 and 2018. Wage indexation amplifies this effect, with the employed and non-employed experiencing income losses of 3.4 and 4.8 per cent respectively.

**TABLE 4**                      **PERCENTAGE CHANGE IN LONE-PARENT DISPOSABLE INCOME, 2011 BUDGETS VS 2018, ALL BUDGETARY CHANGES**

	2011, indexation by SW rates (%)	2011, indexation by wage (%)growth
<b>Employed lone parents</b>	-1.4	-3.4
<b>Non-employed lone parents</b>	-1.5	-4.8
<b>All lone parents</b>	-1.4	-3.7

*Source:*                      Authors' own calculations using SWITCH.

These results capture the total impact of all tax-benefit changes such as the changes to OPFP scheme but also changes in income tax bands, tax credits, child benefit, etc. In Table 5 we decompose income changes for employed and non-employed lone parents into those due to the changes in OPFP and those due to all other tax-benefit budgetary measures.

Overall, the OPFP scheme changes held constant, or even slightly increased, the incomes of non-employed lone parents (i.e. zero change under the wage indexation scenario, +1.8 per cent under the social welfare indexation scenario) but other tax-benefit policies served to reduce them (by 3.3–4.8 per cent depending on the indexation scenario chosen). Meanwhile, for employed lone parents changes to the OPFP decreased their income (by 1.3–1.9 per cent), with other tax-benefit changes serving to reduce them further (–0.01/–1.5 per cent). Results of gains in the income of non-employed lone parents and losses for employed lone parents may appear to go against the original aim of increasing lone-parent employment but are not surprising, given the fact that the personal rates and IQCs increased in nominal terms between 2011 and 2018 but the earnings disregard fell.

**TABLE 5                      DECOMPOSITION OF PERCENTAGE CHANGE IN LONE-PARENT INCOME, 2011 BUDGETS VS 2018**

		2011, indexation by SW rates	2011, indexation by wage growth
		%	%
<b>Employed lone parent</b>	OPFP effect	-1.3	-1.9
	Other policies	-0.01	-1.5
	<b>Total change</b>	<b>-1.4</b>	<b>-3.4</b>
<b>Non-employed lone parent</b>	OPFP effect	1.8	0
	Other policies	-3.3	-4.8
	<b>Total change</b>	<b>-1.5</b>	<b>-4.8</b>

Source: Authors' analysis using SWITCH.

## 4.2 Impact on financial work incentives

### 4.2.1 High replacement rate levels

To shed light on how the income changes summarised in the previous section have affected work incentives, we will next analyse the current financial incentives (as measured by the RR) for lone parents to be in paid work and how they were affected by changes to the OPFP. It is worth bearing in mind that RR analysis captures the current or short-term financial incentives to work and other considerations will come into play.

Firstly, non-cash benefits and their loss may also play a role, such as the potential loss of a medical card upon returning to employment.<sup>23</sup> Secondly, even if the financial incentives to work for the unemployed are favourable, individuals may find it difficult to find employment due to labour market circumstances. This may have particularly been the case in recent years in Ireland due to high unemployment rates and weak labour demand. Thirdly, other considerations may come into play for those facing high financial disincentives to work. Research by Callan et al. (2012) found that of those financially better off not working (i.e. with RRs in excess of 100 per cent), once work costs such as travel and childcare were taken into account, nearly three-quarters were actually in employment. Individuals may derive personal satisfaction from being in employment, or may want to remain in the workforce to protect their future earnings, which could be damaged by a spell of unemployment. This may particularly be relevant for those with children – there may be a time period during which childcare costs may be high (for example while their children are of preschool age) and financial incentives to work low, but a parent may choose to stay in employment over these years to protect their career and future earnings.

<sup>23</sup> In consideration of this, those in longer-term receipt of OPFP (12 months or more) are allowed to retain their medical card upon a return to employment for a period of 3 years.

In addition, non-financial work incentives are likely to have increased due to the changes made to OPFP, for example by strengthening activation requirements once a lone parent's youngest child is past the age of seven through access to activation supports. As mentioned in Section 1, further analysis will be needed in the future to examine the impact of activation supports on lone-parent engagement in education and employment.

The current distribution of RRs will be compared against counterfactual RRs if current lone parents faced the 2011 OPFP scheme and its eligibility requirements. As before, we consider two counterfactual scenarios:

- 2011 OPFP scheme, with monetary amounts indexed by social welfare growth (4 per cent);
- 2011 OPFP scheme, with monetary amounts indexed by wage growth (8 per cent).

As it is high RRs that determine if an individual faces a low financial incentive to work, our results focus on the number of lone parents who face high replacement rates. We deem this group to be those who would have at least 70 per cent of their in-work income replaced by out-of-work income.

Table 6 highlights the incidence of these high RRs among lone parents across the two counterfactual scenarios. In 2018, 20.9 per cent of lone parents face an RR of over 70 per cent. If the current population of lone parents were to face the 2011 OPFP scheme, there would be a modest drop in the numbers facing RRs greater than 70 per cent to just over 18 per cent.

**TABLE 6 INCIDENCE (%) OF HIGH REPLACEMENT RATE AMONG LONE PARENTS – ACTUAL AND HYPOTHETICAL SCENARIOS**

Replacement rate category	2018, Actual	2011 OPFP, indexation by SW rates	2011 OPFP, indexation by wage growth
>70	20.9	18.2	18.5
>80	10.6	9.6	9.9
>90	5.0	3.1	4.3
>100	2.4	1.0	1.2
<b>Number of cases with RR &gt; 70%</b>	<b>35,087</b>	<b>30,504</b>	<b>30,948</b>

Source: Authors' analysis using SWITCH.

These initial aggregate results for all lone parents indicate that the cumulative changes to lone-parent policy led to a small increase in the incidence of low work incentives among lone parents. The lone-parent group itself is a diverse one and will contain lone parents in and out of work, lone parents whose sole income source is from benefits, and others who receive no means-tested benefits at all. Some continue to be eligible for the OPFP while others are eligible for the JST. We therefore repeat these results in Tables 7 and 8, breaking down lone parents into

two subgroups by receipt of the two main benefits – Table 7 showing the results for lone parents in 2018 receiving the OPFP and Table 8 showing the results for lone parents receiving JST.<sup>24</sup>

Table 7 shows the occurrence of high RRs for lone parents in receipt of OPFP in 2018. These are lone parents whose youngest child is under seven years of age and whose means are below the limit for the OPFP. For this cohort, 26 per cent have an RR greater than 70 per cent in 2018, slightly higher than the 24 to 25 per cent that would be the case under the 2011 OPFP rules.

**TABLE 7 INCIDENCE (%) OF HIGH REPLACEMENT RATES FOR THOSE IN IN RECEIPT OF OPFP IN 2018**

Replacement Rate Category	2018, Actual	2011 OPFP, indexation by SW rates	2011 OPFP, indexation by wage growth
>70	26.0	24.2	25.0
>80	13.0	12.0	11.3
>90	4.1	3.9	4.3
>100	1.0	0.6	1.0
<b>Number of cases with RR &gt; 70%</b>	11,671	10,855	11,185

Source: Authors' analysis using SWITCH.

The results indicate a small increase in the incidence of high RRs for those currently eligible for OPFP. This outcome is driven by two effects. Firstly, the increase in unconditional payments, i.e. the increase in the personal rate of OPFP from €188 to €198, the reintroduction of a Christmas bonus,<sup>25</sup> and an increase in IQCs<sup>26</sup> from €29.80 to €31.80 led to higher out-of-work income for lone parents. Secondly, the decrease in the earnings disregard for OPFP recipients (from €146.50 in 2011 to €130 in 2018) led to a relative decrease in in-work income as the OPFP payment is now tapered away at an earlier stage.

Figure 2 demonstrates this relationship, showing the amount of OPFP/JST a lone parent earning €10 an hour would receive if they were to work between 0 and 40 hours per week. There is a higher income from OPFP/JST in 2018 when a lone parent is unemployed (i.e. at zero hours of work in the graph) due to the increase in the personal rate, IQC and Christmas bonus. Under the 2011 OPFP scheme the benefit was not tapered away until the lone parent was working nearly 15 hours, while under the 2018 OPFP/JST rules the benefit begins to be withdrawn at 13 hours of work. At 40 hours of work per week the effect of a lower earnings

<sup>24</sup> Small sample sizes prohibit us from examining the replacement rates of lone parents on other schemes such as WFP.

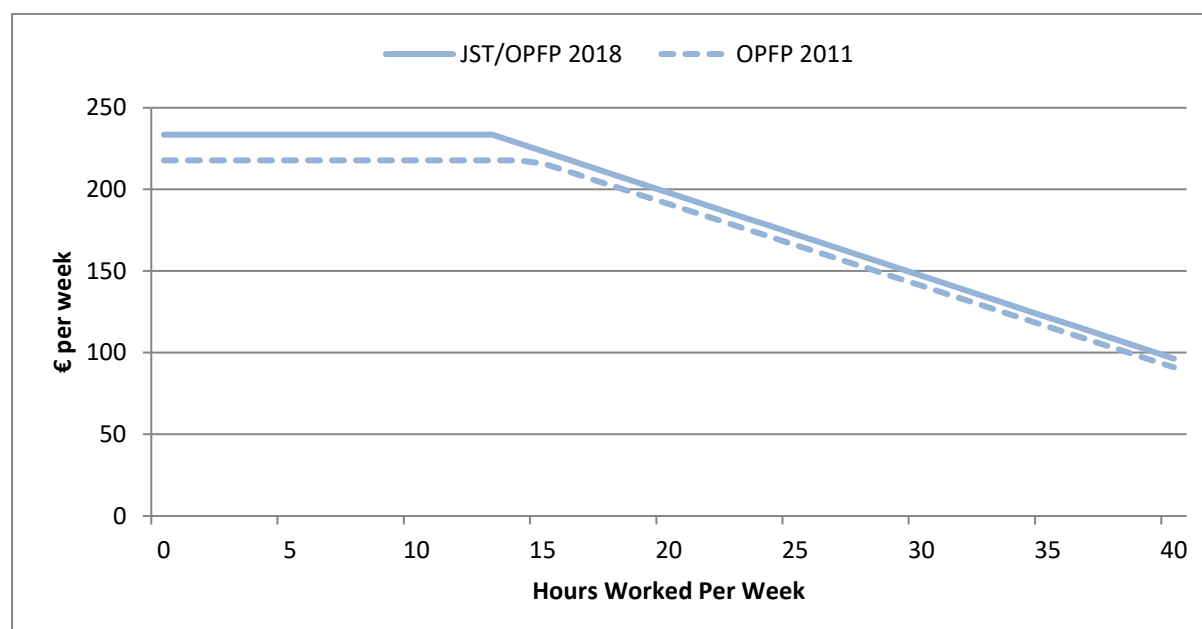
<sup>25</sup> At 85 per cent of the weekly payment rate.

<sup>26</sup> Note that the OPFP IQC increased by 7 per cent while the personal rate increased by 5 per cent. As the full IQC amount will be received by those out of work but generally not by those in work (as it is means tested away), this sharper increase will also contribute to a rise in replacement rates.



disregard means that the 2018 OPFP payment lies just marginally above the 2011 OPFP payment. While the payment for working 40 hours increased only marginally, the payment at 0 hours worked increased more sharply, resulting in increased RRs.

**FIGURE 2 WEEKLY PAYMENT OF JST/OPFP AT VARIOUS HOURS WORKED, JST/OPFP 2018 VS OPFP 2011**



Source: Authors' analysis using SWITCH.

Notes: Lone parent is assumed to earn €10 in gross wages per hour and has one child, aged 6 for OPFP and 9 for JST.

Table 8 examines the occurrence of high RRs among lone parents in receipt of JST in 2018, i.e. those whose youngest child is aged 7 to 13 and whose means are below the JST limit. Again, we compare the current levels of high RRs with those that would have occurred if the 2011 OPFP scheme had remained under our two alternative counterfactuals. Two points are of interest – firstly, this group of lone parents with children in the 7–13 age range face substantially higher RRs than their OPFP-receiving counterparts, with nearly half (49.4 per cent) having a current RR in excess of 70 per cent. Secondly, there is a much sharper increase in the frequency of high replacement rates in 2018 among these lone parents compared to the 42 to 44 per cent that would have been in place if the 2011 OPFP rules still applied.

**TABLE 8 INCIDENCE (%) OF HIGH REPLACEMENT RATES FOR THOSE IN RECEIPT OF JST IN 2018**

Replacement rate category	2018, Actual	2011 OPFP, indexation by SW rates	2011 OPFP, indexation by wage growth
>70	49.4	42.5	44.1
>80	21.8	21.4	21.7
>90	11.3	5.3	9.9
>100	3.1	2.3	3
Number of cases	13,235	11,382	11,817

Source: Authors' analysis using SWITCH.

In all the scenarios examined in Table 8, lone parents in receipt of JST have substantially higher RRs than was observed in

Table 7 for lone parents in receipt of OPFP. As JST has the same payment rates and income disregards as OPFP, these differences cannot be due to differences in these monetary parameters. Instead, these results can be explained by the employment patterns of the employed lone parents in receipt of JST. This group typically work lower hours than lone parents in receipt of OPFP, with 42 per cent of lone parents in receipt of JST working more than 20 hours per week, as compared to 59 per cent for OPFP recipients (see Table 9).

This leads to lower observed in-work income for these employed lone parents. There is no clear reason for these differences as there are no marked differences between the two cohorts in terms of educational attainment, number of children or earnings potential, and further analysis outside the scope of this paper would be needed to examine what is driving such differences.

**TABLE 9 HOURS WORKED BY LONE PARENTS 2018**

Hours worked per week	In receipt of JST 2018 (%)	In receipt of OPFP 2018 (%)
0	26	32
1 to 10	6	1
10 to 20	26	8
≥20	42	59

Source: Authors' analysis using SWITCH.  
Notes: Excludes lone parents in education.

#### 4.2.2 Incorporating childcare costs

A standard examination of financial incentives to work does not usually take account of costs of work; rather the focus is on post-transfer, post-tax/USC/PRSI income. Results presented in the preceding section therefore looked purely at a comparison of in-work and out-of-work income without taking account of any work-related costs. Childcare costs, as discussed earlier, are a particularly prominent issue among lone parents given the high level of such costs in Ireland and the fact that a lone parent occupies the role of primary care giver and sole income earner. Therefore, for lone parents, third-party childcare tends to go hand in hand with full-time employment.

In considering the impact childcare costs have on work incentives, it is also important to incorporate subsidies available for childcare costs which aim at making childcare more affordable. The childcare subsidy landscape has changed with the introduction of the Affordable Childcare Scheme (ACS), replacing previous childcare subsidy schemes and expanding coverage. ACS subsidies are aimed at children aged between 6 months and 15 years. ACS subsidises hourly childcare

used based on a means test, parental labour force status and child age. This harmonised scheme<sup>27</sup> that was partially rolled out<sup>28</sup> in 2017 complements the Early Childcare and Education (ECCE) scheme, in place since 2010, which offers 15 hours' free childcare per week for pre-school children between 3 and 5.5 years old. We therefore incorporate childcare costs into our calculation of the current RRs of lone parents and demonstrate how childcare costs may also affect the financial incentive to work. We then take account of childcare subsidies and examine how they affect lone-parent work incentives.

To include childcare cost in the calculation of RRs we require information on childcare costs for a lone parent's current situation (be they non-employed or employed), and need to estimate counterfactual childcare costs when their labour force status changes. For in-work childcare costs we use reported childcare costs (as reported in the SILC survey) for lone parents we currently observe in work. For unemployed lone parents we estimate childcare costs for a 40-hour work week. To do so we assume that these lone parents utilise crèche services.<sup>29</sup> We use the 2016/2017 national average childcare costs as reported by Pobal (2017) as the counterfactual childcare costs for these lone parents. We assume a child less than 5 years old must avail of full-time childcare (€174 per week). For older children in education aged between 5 and 12 we use part-time childcare (€99) and for children older than 12 we assume no childcare costs. When calculating in-work income we then also calculate entitlement to ACS and ECCE and deduct the subsidy from childcare costs. We assume zero childcare costs in the out-of-work situation when an employed lone parent is 'made' unemployed in the model.

Table 10 shows in column 2 the incidence of high RRs in 2018 for lone parents excluding childcare costs (as shown above in

Table 6). In column 3 gross childcare costs are taken into account, while in column 4 childcare costs net of subsidy entitlement are taken into account. The introduction of childcare costs increases the incidence of high RRs, with 31 per cent of lone parents facing an RR greater than 70 per cent as compared to nearly 21 per cent when childcare costs are excluded.

Introducing subsidies for childcare usage mediates slightly the incidence of high RRs, with close to 30 per cent of lone parents facing an RR greater than 70 per cent. Childcare costs also seem to induce a spike in RRs over 100 per cent, where being out of work would be a more financially attractive position than working. RRs in this range increase from 2.4 per cent excluding childcare costs and subsidies to 15.7 per cent with childcare costs. This large increase highlights that large childcare

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<sup>27</sup> For a full summary of the scheme, see <https://www.dcy.gov.ie/documents/legislation/20170126ACSHeadsOfBillandGenScheme.pdf>

<sup>28</sup> Technical and administrative difficulties have delayed full rollout of the ACS.

<sup>29</sup> While a substantial number of individuals use free childcare (e.g. by grandparents), it is important to factor in childcare costs, as not everyone will have this option available to them. Indeed, those who do may be in employment precisely because of this, while those out of work may be so due to a lack of available (free) childcare.

costs are a barrier to participation in the labour market for lone parents. Subsidies seem to have the greatest impact on tempering the rise in very high RRs, with the portion of lone parents facing RRs greater than 120 per cent almost halving, decreasing from 11.4 per cent with childcare costs to 6.5 per cent once subsidies are factored in. This highlights that the subsidies should make work more financially attractive for the lone parents for whom their out-of-work income would have exceeded their in-work income. Through this mechanism such subsidies are likely to encourage increased labour force participation among lone parents in the future.

**TABLE 10 INCIDENCE (%) OF HIGH RATES 2018, WITH AND WITHOUT CHILDCARE COSTS**

Replacement rate category	2018, Excl. childcare costs and subsidies	2018, With childcare costs, no subsidies	2018, With childcare costs and subsidies
>70	20.9	31.0	29.5
>80	10.6	23.4	20.2
>90	5.0	17.3	15.5
>100	2.4	15.7	13.3
>120	0.9	11.4	6.5

Source: Authors' analysis using SWITCH.

Even accounting for subsidies, childcare costs have a non-trivial effect on the incentives to be in paid work for lone parents. Initially 20.9 per cent of lone parents experienced an RR over 70 per cent, rising to close to 30 per cent when net childcare costs are considered. Andrén (2003) suggests that a decrease in childcare cost increases the labour supply of those already working rather than encouraging those out of work to enter employment. As such it is important to consider that the subsidies may benefit working parents as opposed to increasing the likelihood of being employed for unemployed parents. Future work in this area will be carried out as part of the ESRI's Tax, Welfare and Pensions research programme.

## 5 CONCLUSION

This paper set out to examine the impact of changes to the OPFP on the incomes of lone parents and the work incentives they face. It examined how the incomes of the current set of lone parents would have looked if eligibility for the scheme had remained unchanged from 2011, in order to isolate the effect of tax-benefit policy changes between 2011 and 2018. Against a distributionally neutral counterfactual of indexation in line with wage growth, it found a 3.7 per cent reduction in disposable income for lone parents attributable to all tax-benefit policy changes that occurred between 2011 and 2018. Non-employed lone parents experienced slightly larger losses than their employed counterparts. Isolating the impact of the changes in the OPFP benefit alone, and focusing on the wage indexation counterfactual, employed lone parents saw a 1.9 per cent reduction in income due

to the OPFP changes while there was no effect on the incomes of non-employed lone parents.

The paper also examined the work incentives faced by lone parents and how these were affected by changes to the OPFP. The results show that changes to the OPFP led to a decline in financial work incentives faced by lone parents. These results are driven by two effects. Firstly, the increase in payment rates of OPFP (for example the personal rate and IQC) led to higher out-of-work income for lone parents. Secondly, the decrease in the earnings disregard for OPFP recipients led to a relative decrease in in-work income as the OPFP payment is now tapered away at an earlier stage.

The paper points to the importance of assistance with childcare costs for lone parents to facilitate their return to employment. An examination of work incentives that take account of childcare costs for the current population of lone parents demonstrates the positive impact that recently introduced childcare subsidies will have, but also highlights the non-negligible effect that childcare costs net of subsidies will continue to have on the work incentives of lone parents.

The focus of this paper was to isolate the impact of changes in the OPFP payments on incomes and work incentives. In doing so, it does not take account of the fact that a focus on activation measures is likely to increase the attachment of lone parents to the labour market. Given that the OPFP changes were finalised only in 2015, it is as yet too soon to say whether the changes will result in increased employment rates of lone parents. Initial evidence by Indecon (2017) points to some positive impacts on engagement in work, but future analysis will be needed to evaluate the longer-term effect of the changes.

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