The Universal Family Childcare Promise: Guaranteeing support for parents and children

Policy briefing | Tom Pollard and Tom Stephens | July 2025

Summary

From September 2025, the full rollout of the current model of funded hours for accessing childcare provision in England will be complete. This will mean that children in families where all parents work at least 16 hours per week will have access to 30 hours of funded childcare from nine months to four years old. All three- to four-year-olds will have at least 15 funded hours of access, regardless of parental working status, as will two-year-olds from low-income households or with additional support needs. Families on universal credit and in work will also be supported to meet the cost of childcare.

However, this patchwork of policies will fail to ensure childcare is affordable for many families eligible for the full offer of support; accessible to low-income families who are excluded from this full offer; or of good enough quality across the country. The education secretary has acknowledged that the current system lacks coherence and that the government plans to pursue more comprehensive reform:

"There is a big question about how we simplify the system... it's not as easy to navigate for parents as it should be. It's a system that's had bits added on to it at different times - I think there is a need to bring it all together. We will do that, and I'll set out plans later this year around an early years strategy."[1]

This briefing proposes an alternative system, developed by NEF in collaboration with Pregnant Then Screwed and the Joseph Rowntree Foundation. Our proposal is significantly simpler and more progressive than the current system, and it would help families afford more hours of childcare. It is built around two elements:

- Universal core provision of 15 hours a week, free for all children from nine months to four years old, focused on ensuring equitable access to high-quality early years education.
- For working families, a cap on childcare costs as a percentage of family earnings (we propose 5% but we also model for 7.5% to demonstrate the impact on costs) for hours purchased above this core provision to enable them to work.

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[1] Lewis, M. (2025, May 18). *Childcare SPECIAL: Your questions & problems put to Sec of State for Education Bridget Phillipson* [Radio broadcast]. BBC Radio 5. https://www.bbc.co.uk/programmes/m002cb2k

In contrast, the current system is complex, regressive and does not support enough use to help people work or support sufficient high-quality provision across the country. Our analysis finds:

- Low- and middle-income families in full-time work will still need to spend a high proportion of their earnings on childcare once the current system is fully rolled out. Families with multiple children and single parents will be hit particularly hard. A working family on £34k pa (at the 30th percentile on the household income distribution) would have to spend over 11% of their gross earnings to have one child in full-time childcare (40 hours per week). A family on £49k (the 50th percentile) would need to spend 8% of their earnings, while a family on £124k (the 90th percentile) would only need to spend 3.1%. As such, lower income families face stronger disincentives to work full-time, because the proportional costs of paying for childcare are so much higher.
- By contrast, a system with a cap on costs at a percentage of earnings would be inherently progressive – supporting the families who would benefit most from access to childcare. This would incentivise them to purchase more hours than under the current system, by ensuring only modest increases in their childcare costs as their earnings and hours rise – a stark contrast to the current system. On average, those in the bottom 60% of the earnings distribution would be better off by £1,081-£1,259 a year from our proposed system.
- Across the whole earnings distribution, almost 60% of families with pre-school children would be better off under our proposed system, based on our modelling of the most likely usage scenario, with 66% being no worse off. Those faring worse would primarily be families spending less than 5% of their earnings on additional hours above the 15 universal hours, and therefore not benefit from the cap. Further work could explore how to mitigate this impact, but it is a knock-on consequence of a system that is actively encouraging a higher level of usage to support labour market outcomes.
- At current hours of usage our proposed system would initially be cost-neutral, but as usage expanded it would present a net additional cost to the government of ~£3-3.4bn (based on current rates paid to providers, which we believe need to be reviewed regardless of the system in place) compared to the fully expanded funded hours system. However, these costs decline by as much as 11% once a labour market response of increased working hours are accounted for, and would fall further if we were to incorporate the wider economic benefits of this labour market response, such as higher tax revenues.
- Our system would also be much easier for families to understand – directly meeting the education secretary's demand for a simplification of the current system. It would also be easy to communicate, with the universal hours pitched as an entitlement to support child development and the percentage cap pitched as support to families to help them get into work. We believe this could have potential wider behavioural benefits which it is not possible to model for here, but which we plan to explore in future.

Our proposed system would also help to increase the supply and quality of provision, by creating more demand, and therefore incentives for providers, in lower-income parts of the country. However, the government will also need to address the question of what level of payments to providers are required to resource high quality provision, responding to rising costs providers have faced in recent years.[2] We have treated the level of payments required as a separate question from the design of our proposed system, to be able to make a side-by-side comparison to the current system. However, we model for a 10% uplift on current rates paid to providers as a demonstrative example of the impact on overall costs in our system. We fully support calls for a more comprehensive review of rates paid to providers.

Realising the full benefits of our proposed system, and ensuring fewer families lose out compared to the current system, would require additional investment. However, our analysis suggests that, unlike in the current system, the costs would decrease in response to positive labour market outcomes. These outcomes would also result in higher tax revenues and long-term savings from improved prospects for children from low-income households, which, although not modelled for here, would further offset the cost of our proposal.

Finally, we set out how a transition to our proposed system might be achieved. We acknowledge challenges that would need to be addressed but argue that these, along with the additional investment our proposal would require, need to be considered in the context of the failings of the current system. Our model also offers significant flexibility, meaning it could be adapted to fit different funding envelopes and meet different prioritisations of policy objectives.

What's the problem we're trying to address?

The current system of funding to support families to access childcare and early years education (which we refer to from this point as "childcare" for brevity) is confusing and convoluted in terms of both policy intent and user experience. While some policies have looked to promote access for children from disadvantaged families, the current scheduled programme of reforms focus exclusively on increasing support for families where all parents are earning at least the equivalent of 16 hours a week on the national living wage.

There is overwhelming evidence that the strongest social and fiscal benefits from childcare accrue to and from the poorest families (see Figures 1 to 3). Yet the UK government's working families criteria is highly regressive and denies support to precisely the families who would benefit most - only one in five (21.6%) families with young children in the poorest 40% of income distribution are estimated to meet this eligibility criteria (Figure 4). The use of the separate childcare support available to households on universal credit has remained stubbornly low at around 30% of eligible households with children up to four years old, despite the offer becoming more generous in April 2024.[3]

[2] Early Education and Childcare Coalition. (2025). *Impacts of the Minimum Wage and Employer NI Changes in April 2025 on Delivery Costs for Early Years Providers.* https://www.earlyeducationchildcare.org/s/EECC-Frontier-Economics-Report-on-Impact-of-NICs-and-NMW-on-EY.pdf

[3] Department for Work and Pensions. (2024). *Universal Credit childcare element statistics, March 2021 to May 2024.* https://www.gov.uk/government/statistics/universal-credit-statistics-29-april-2013-to-11-july-2024/universal-credit-childcare-element-statistics-march-2021-to-may-2024

Figure 1: The fiscal benefits and costs of a universal, high-quality childcare offer for low-income children

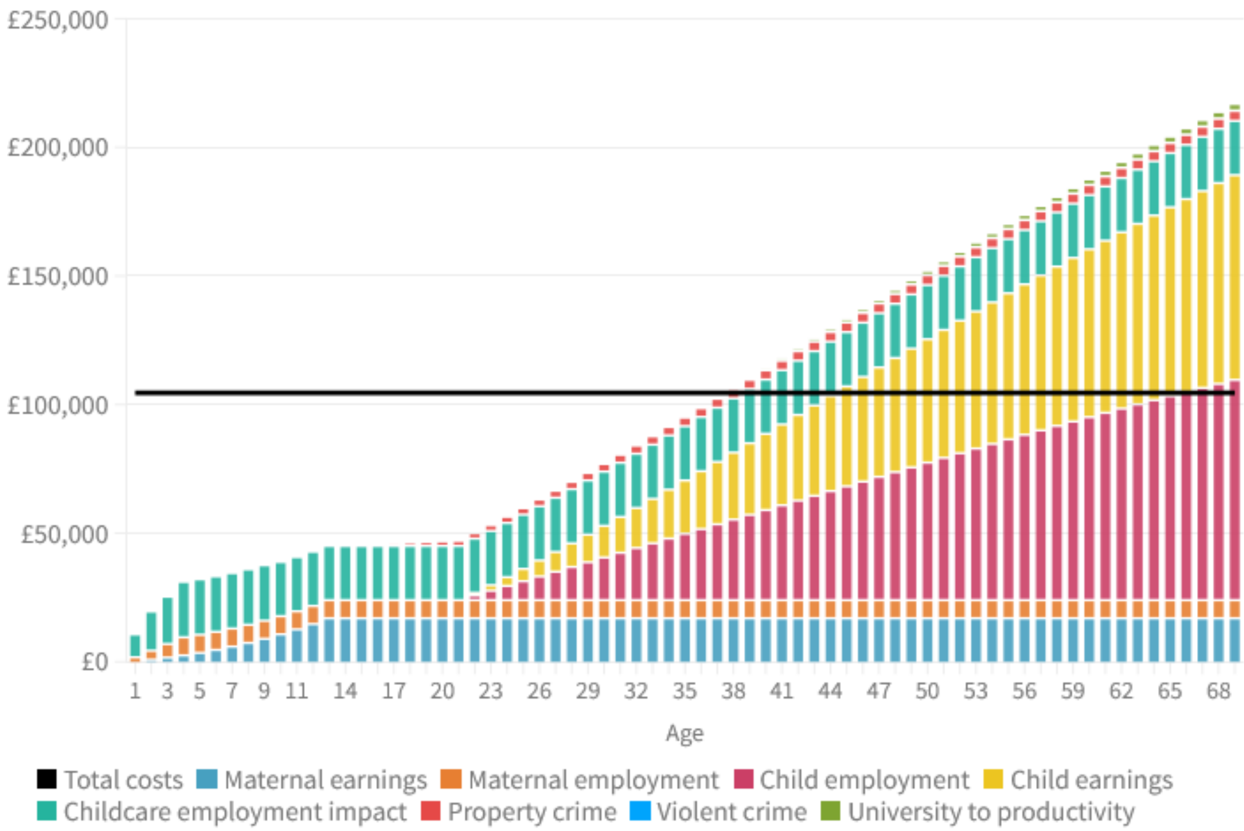


Figure 2: The fiscal benefits and costs of a universal, high-quality childcare offer for middle-income children

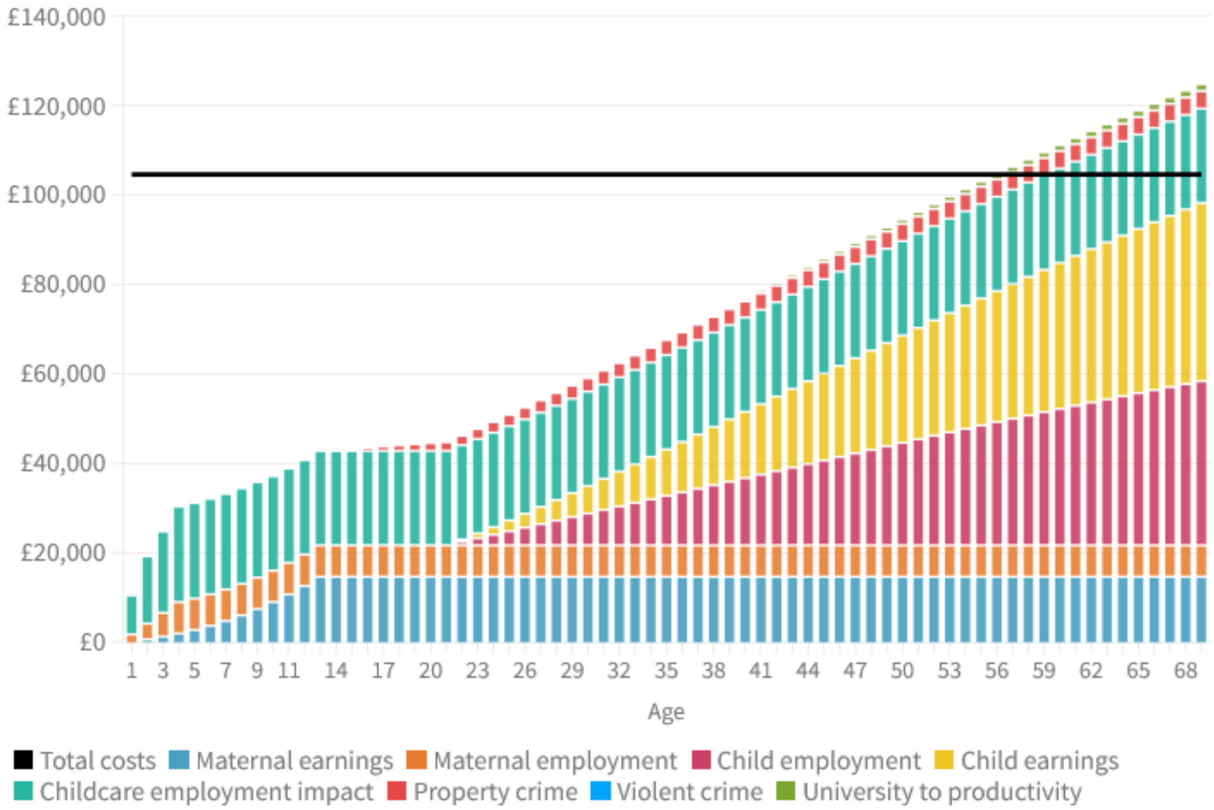
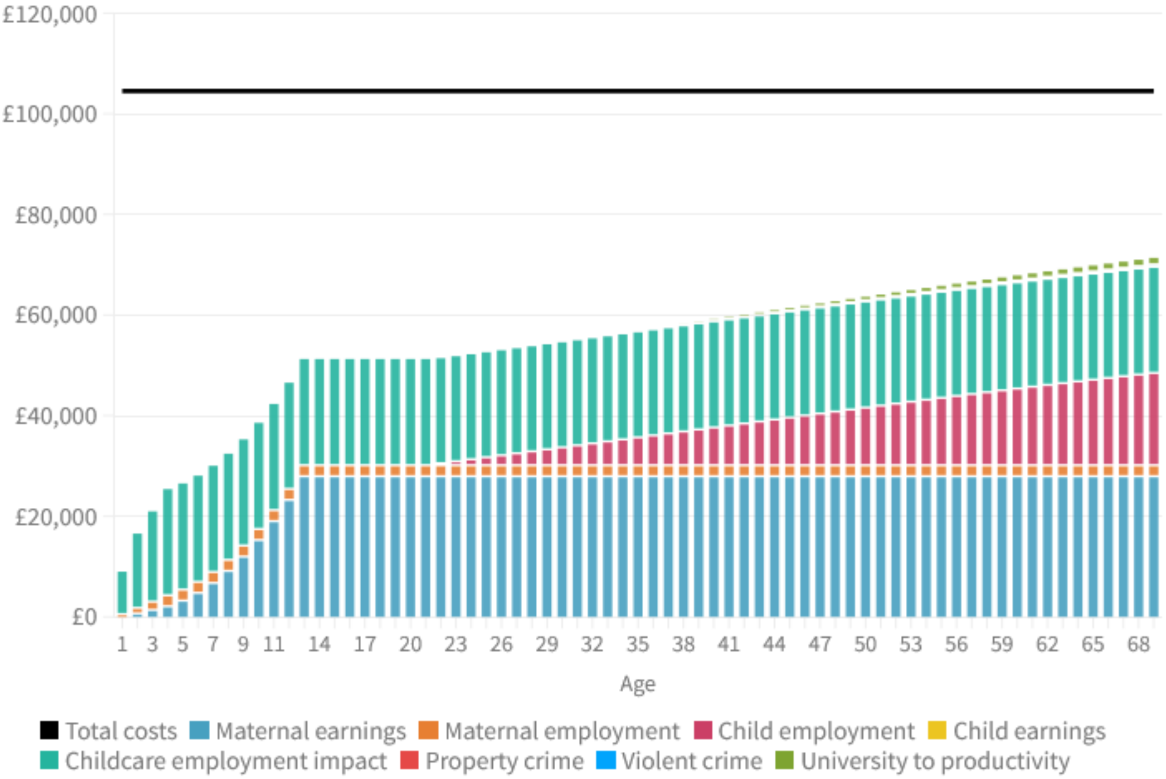


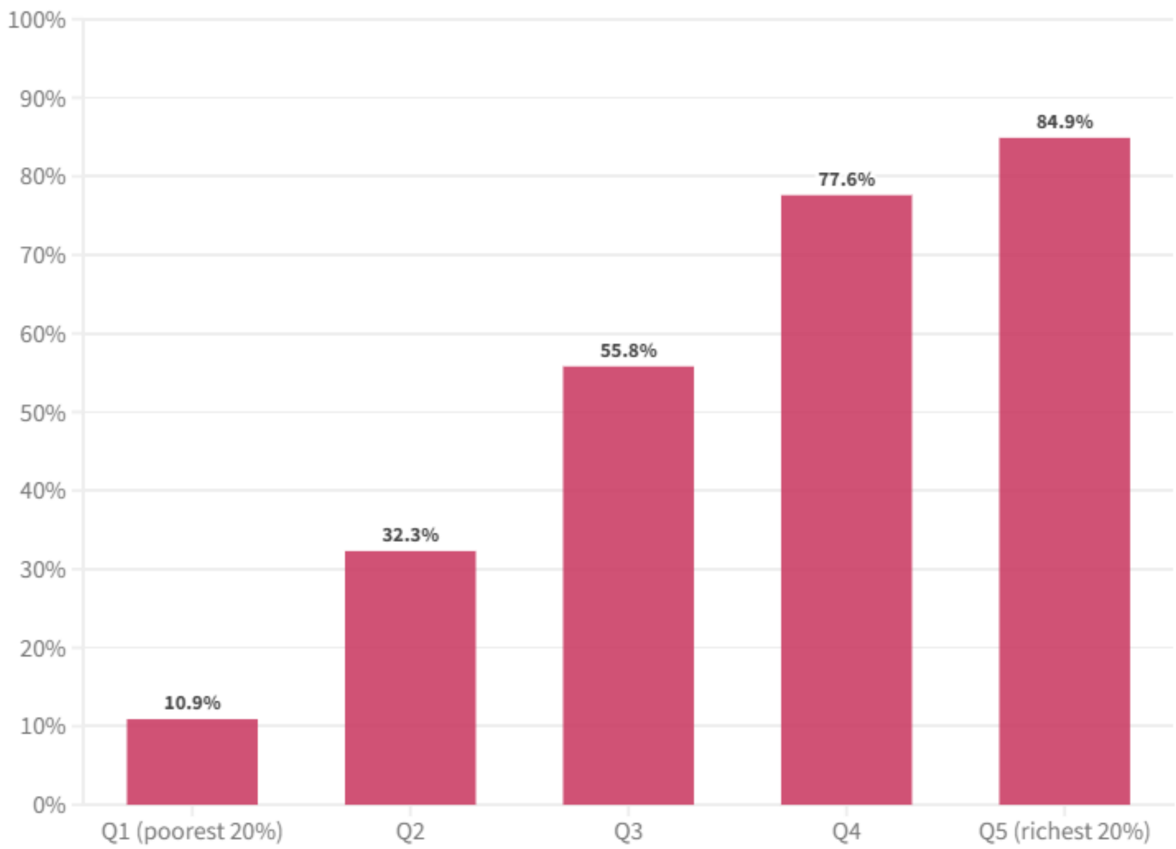
Figure 3: The fiscal benefits and costs of a universal, high-quality childcare offer for high-income children



Source: NEF analysis based on review of research on benefits of childcare by socio-economic status.[4]

[4] Sandher, J. and Stephens, T. (2023). *Investing in universal early years education pays for itself*. New Economics Foundation. https://neweconomics.org/2023/07/investing-in-universal-early-years-education-pays-for-itself

Figure 4: Estimated proportion of families in England with children under five years old who meet the eligibility criteria for the expanded funded hours, by quintile of the income distribution



Source: NEF analysis using Family Resources Survey (FRS).

As well as denying access to early education for children from low-income households and contributing to the squeeze on families' living standards, these restrictions on eligibility are stunting the UK's growth prospects. Evidence shows the strongest economic benefits from investing in early years education and childcare come from improving provision to the very group restricted from accessing current support: the most disadvantaged families.[5]

Many aspects of the current funding support offer are difficult to navigate and time-consuming to manage, further disadvantaging low-income families. All of this helps to drive the prevalence of "childcare deserts" - in many parts of the country, there are simply not enough families able to access the funded hours.[6] It also entrenches disadvantage in the country, because families

[5] Sandher, J. and Stephens, T. (2023). *Investing in universal early years education pays for itself*. New Economics Foundation. https://neweconomics.org/2023/07/investing-in-universal-early-years-education-pays-for-itself

[6] Pollard, T. and Stephens, T. (2024). *Childcare deserts: the reality of access to early years education*. New Economics Foundation. https://neweconomics.org/2024/05/childcare-deserts-the-reality-of-access-to-early-years-education

which are struggling most are locked out of accessing one of the best routes for their children to improve their long-term prospects of escaping poverty: high-quality early years education.

Addressing these inequalities is a particular imperative following the pandemic, given that school readiness seems to have reduced and continues to be subject to a steep social gradient. It is also associated with high rates of school absences.[7] The government has set a target of 75% school readiness by 2028, but the exclusion of low-income families from the full childcare offer will undermine their ability to achieve this goal.

Even those eligible for the full offer of funded hours receive an insufficient amount of support to put their children into childcare while working full-time. The current offer of 30 hours is relatively low, and its coverage to the equivalent of only term-time (38 weeks) means that any family working full-time needs to purchase additional hours, The rates of these additional hours vary massively depending on the provider and location.

Key features of our proposed system

In collaboration with Pregnant then Screwed and the Joseph Rowntree Foundation, we have developed a co-payment model that would support higher use of provision, be simpler and more transparent for families to navigate, and could offer as good if not better value to most families than current plans, with particular benefits for lower-income families. The Universal Family Childcare Promise (UFCP) would have two components:

- A universal 15 hours of childcare, free for all children aged nine months to four years, for 38 weeks a year, as an entitlement focused primarily on providing early years education unrelated to parental income or working status. We see this number of universal hours, and the number of weeks per year, as a first step, given funding constraints, but believe both should be adjusted over time in consultation with education experts to calibrate it to the amount of access children require to best support their development.
- For working families, a cap, at a percentage of family earnings, on the cost of all childcare purchased above these 15 hours. The cost of additional hours beyond this core offer, required by working parents (up to a maximum of 50 hours per week 50 weeks per year), would be capped at a fixed percentage of their combined family earnings. We predominantly explore the effects of a 5% cap, but also include a 7.5% cap in our projected costings to demonstrate how varying the level of the cap could impact costs. For ease of comparison, our model retains the current upper earnings limit of £100,000 for any individual, but could allow for a fairer and simpler means-test of total family earnings and a tapering of access to the cap. Our system will also naturally benefit high-earning families

[7] Hobbs, A. and Bernard, R. (2021). *Impact of COVID-19 on Early Childhood Education & Care.* Parliamentary Office of Science and Technology. https://post.parliament.uk/impact-of-covid-19-on-early-childhood-education-care/; Wood, M.L., Gunning, L. and Mon-Williams, M. (2024) *The relationship between 'school readiness' and later persistent absenteeism*, R. Soc. Open Sci.11240272 http://doi.org/10.1098/rsos.240272

less than the current system because the cash level of their cap will mean they pay for the majority of their purchased hours.

Once current plans have been fully rolled out by September 2025, the funded hours offers, tax-free childcare and universal credit childcare support are predicted to cost an estimated £10.6bn per annum, if we assume that the costs associated with the tax and benefit elements of the system will remain static in real terms.[8] The system we propose would replace all of these separate funding streams with one coherent system.

Based on current hours of usage, our model would actually be cheaper than the current system at the point of implementation (see the section below on "dynamic fiscal costs of the proposed system" for more details). However, these costs would ramp up over time as people are supported and encouraged by our model to purchase additional hours of childcare, ultimately leading to a net additional cost to the government of ~£3-3.4bn (based on current rates paid to providers, which we believe need to be reviewed regardless of the system in place) compared to the fully expanded funded hours system.

Because the nominal value of the cap increases as earnings rise, improvements in the labour market situation of families would have a virtuous fiscal effect, unlike the current system. Net additional costs of our proposed system decline by as much as 11.4% once dynamic estimates of potential labour market response are accounted for. These costs also do not consider any wider economic benefits of this labour market response, such as higher tax revenues, which would further compensate for the higher up-front cost of our proposed system.

This level of additional investment would be required to realise the full benefits of our model and minimise the number of families who would be worse off than under the current system (although many would be better off, even under a less generously funded version of our model). However, the cost of our model could be reduced further by increasing the level of the percentage cap, or increasing this percentage for each additional child a family has in childcare.

As well as being more progressive than the current system, our model would send a much clearer signal about policy intent, with the division between core hours focused primarily on supporting children and additional hours focused on supporting working parents. Alongside improvements to the quality and availability of provision, this could help to shift cultural norms

[8] NEF analysis. Cost of funded hours, save for under-2s expanded hours, drawn from Figure 2.1 in: Drayton, E., Farquharson, C., Ogden, K., Sibieta, L., Snape, D. & Tahir, I.(2025) *Annual report on education spending in England 2024-25*. Institute for Fiscal Studies. https://ifs.org.uk/publications/annual-report-education-spending-england-2024-25. Cost of benefits elements drawn from Figure 2.1 in Drayton, E., Farquharson, C., Ogden, K., Sibieta, L., Tahir, I. & Waltmann, B. (2023), *Annual report on education spending in England: 2023*. https://ifs.org.uk/publications/annual-report-education-spending-england-2023. Updated costs of expanded funded hours for under-2s drawn from Figure 3 in Farquharson, C. (2025), *Popularity of new childcare entitlements could leave spending much higher than initially forecast*. https://ifs.org.uk/articles/popularity-new-childcare-entitlements-could-leave-spending-much-higher-initially-forecast. Assumes £1.4bn will continue to be spent on support through the tax and benefits system, and that the fully expanded funded hours offer will cost £9.23bn. Due to unexpected rises in take-up of the new offer this is higher than the spend currently allocated by the government, and £0.68bn higher than the IFS originally forecast earlier in the year.

around expectations that children engage with early education regardless of parental working status. It would also be a more dynamic system, as families that are able to earn more because of support with childcare costs would then pay more towards these costs.

The easiest way to track and manage hours of childcare purchased, above the core universal 15 hours, would be through a single online portal. The portal would require parents to each declare their annual earnings (although over time this should be pre-populated using HMRC data) to calculate a family's cap on costs as a percentage of their earnings and assess whether they meet the "working families" eligibility criteria. The system would then allocate funding to providers accordingly, through a combination of parents' payments and government top-ups.

The "working families" criteria could mirror those used in the current system (i.e. all adults in the family earning at least the equivalent of 16 hours per week at the national living wage), as has been modelled for in the proposal presented here. However, it could be adapted to assume this minimum level of income where someone is in training or education, adopting similar principles to the slightly more progressive eligibility criteria used in Wales. It should also account for the needs of people who care for other family members who are disabled and/or elderly.

Adequate payments to ensure quality of provision

A central question in the childcare debate is how to ensure providers are being resourced to deliver high-quality provision across the country. The current rollout of expanded funded hours is projected to mean that 80% of pre-school childcare hours will be purchased through government funding mechanisms, which determine the price paid to providers for those hours.[9]

Providers have tended to increase their revenue by charging higher rates for non-state-funded hours, but this becomes less viable as the proportion of hours purchased by or through the state increases. Many providers have also been charging "top up fees" to cover things like meals and nappies, or only offering a fixed number of funded hours per day so that, for example, only parents using provision five days a week would be able to benefit from the full offer of 30 funded hours. The government has said it wants to end these practices but it is unclear how effectively it will be able to enforce this.

We contend that it would be better to close this final gap and have a fully state-regulated payment model, more aligned with state education, rather than the current hybrid model. Our proposed system would mean all payments (from parents and the state) to providers would come through one state-run portal. This would mean providers could be paid at fixed hourly rates (adjusted for location), and prevent them from charging higher fees for non-funded hours, restricting when funded hours can be used, or charging top-ups - by banning any payments outside of the portal. Providers could opt out of this system, but they would need to operate as private providers without state subsidies, in the same way that a private school would.

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[9] Institute for Fiscal Studies. (2023, March 15). *Childcare reforms create a new branch of the welfare state - but also huge risks to the market* [Press release]. https://ifs.org.uk/news/childcare-reforms-create-new-branch-welfare-state-also-huge-risks-market

However, the consequence of this is that payments to providers would need to be adequate to ensure that they are able to resource high-quality provision, including providing well-paid and secure employment to staff. This must include higher payments to reflect additional resourcing needs for SEND provision and supporting children from more disadvantaged backgrounds. We don’t attempt to answer the question of what would constitute adequate rates in this briefing, as we believe this is a wider issue to be addressed by government regardless of whether it adopts our proposed system. We support calls for an independent arms-length body to review payment levels annually.[10] However, we include analysis at a 10% uplift to current payments, as a demonstrative example of the impact on the overall cost of our proposed system.

If provider payments were set at adequate levels, our proposed system would ensure a greater level of transparency, consistency and predictability for parents. As well as resourcing providers to deliver high-quality provision and good pay and conditions for staff, it would allow government to set clear expectations and standards as a condition of funding. It would also help to equalise the quality of provision within and between areas, by moving away from a model where providers can charge higher fees for non-funded hours and greater top ups if they are able to attract more affluent parents, which entrenches and exacerbates inequalities.

Notional impact of our proposed system

Figure 5 provides notional estimates of how families at different levels of income would fare under our proposed system as their circumstances change and the hours of childcare purchased increase. It does this by comparing what families would spend as a percentage or their earnings to purchase a certain number of annualised childcare support (at 50 weeks a year), given their entitlements under the current system compared to the UFCP system.

We include three example families (with one, two or three children using childcare) in each of the middle three quintiles of the household income distribution (from either one or two earners), who are in receipt of the fully rolled out working families entitlement to funded hours, in addition to any universal entitlements. It assumes these families also make full use of tax-free childcare. As the figure illustrates, even when the full rollout of funded hours is complete, ordinary working families will struggle to purchase a reasonable number of hours of childcare for their children. This is especially the case for families lower down the income distribution. A family earning £34,000 a year – close to median annual earnings for an individual, and at the 30th percentile of gross income for families with children aged 0 to four years old – would have to spend over 11% of their gross earnings to have one child in childcare for an average of 40 hours per week for 50 weeks a year.

These figures show that the current system incentivises the purchase of a relatively low number of hours of childcare, especially in a context where housing costs take up a large proportion of many households’ incomes and other costs (such as energy, food and transport) are also high.

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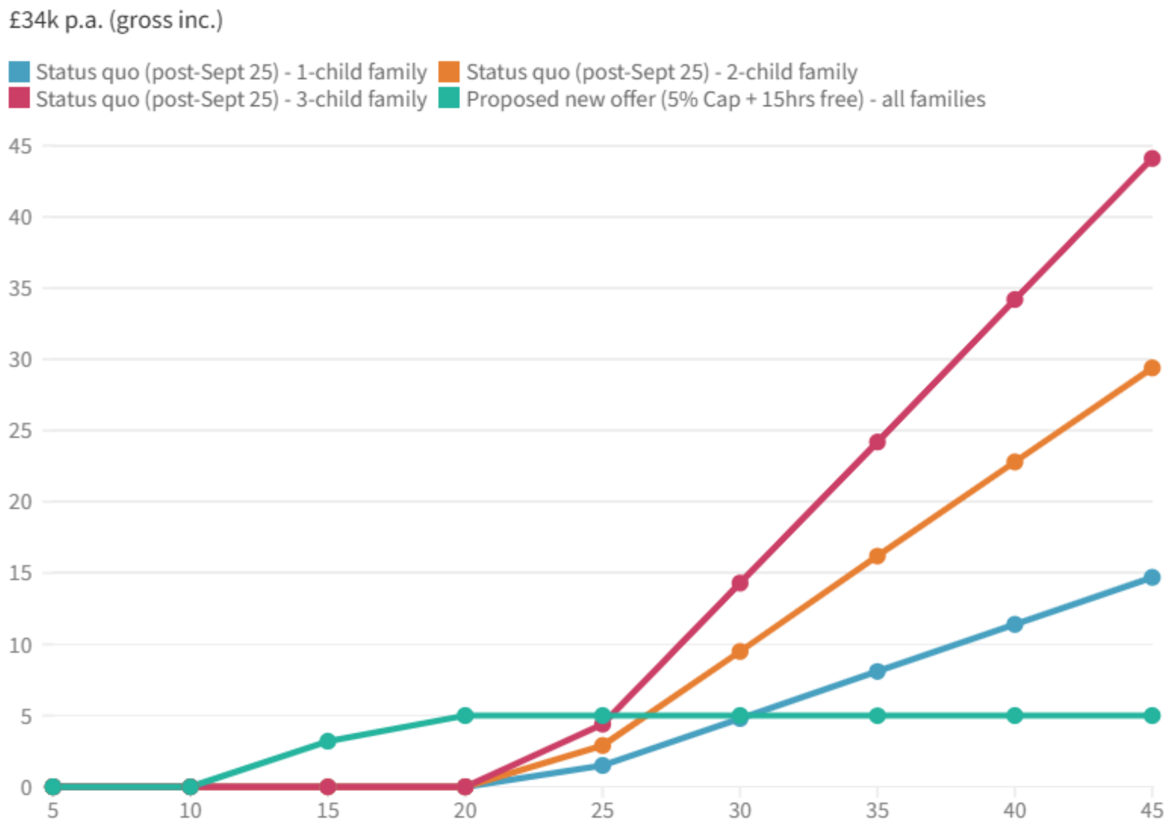
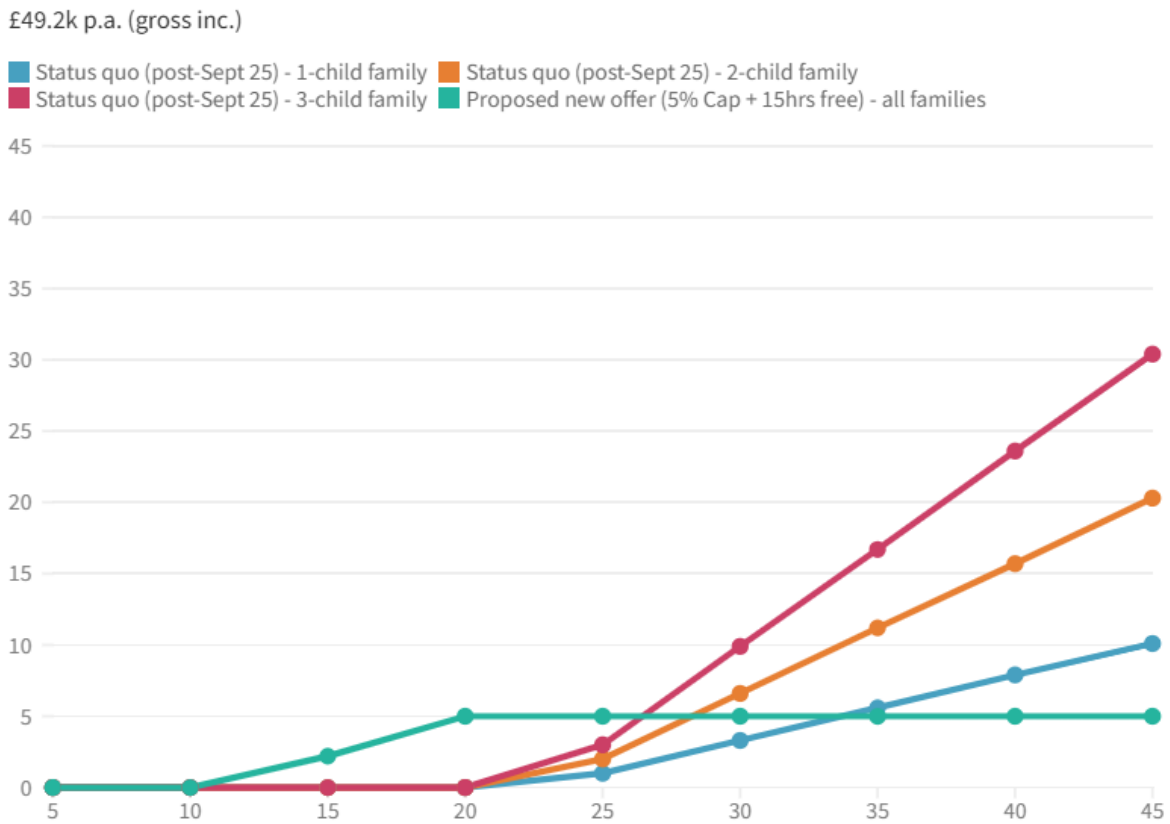
[10] Early Education and Childcare Coalition. (2024). *Rescue and Reform: A Manifesto to Transform Early Education and Childcare in England.* https://static1.squarespace.com/static/646ca30371a2ef6a657e9309/t/664640d370c06c337dbd2995/1715880148539/Rescue%26Reform+Manifesto+FINAL.pdf

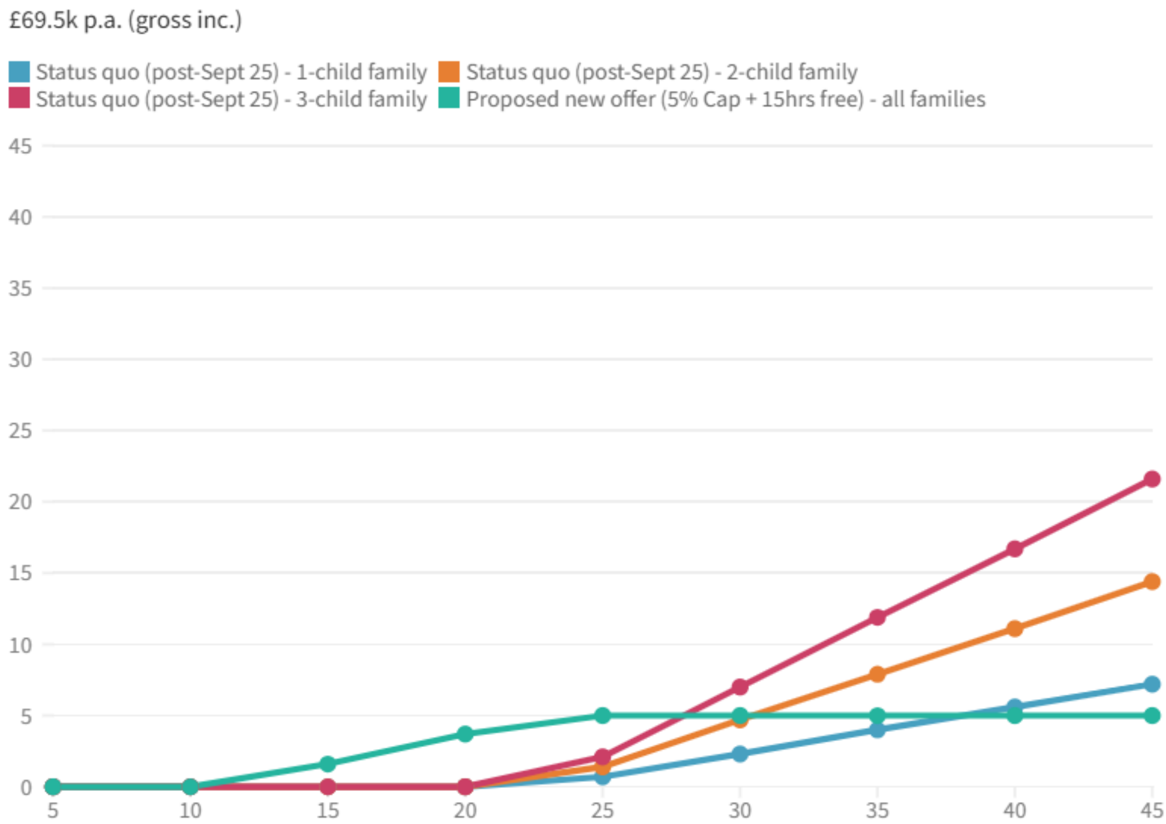
Ordinary working families, even when eligible for the full “working families” offer, would in many cases have to spend a high amount of their earnings on childcare to purchase enough hours to work. By contrast, our proposed system has the potential to fundamentally change the incentives in the childcare system, supporting more families to purchase enough hours to get into work, as well as easing the strain on many household budgets. This would help address some of the issues with the current rollout, increasing the quantum of available childcare hours purchased throughout the system, and in every part of the country. This would have corresponding labour market benefits which could reduce the costs of funding the system, which we will return to later.

For families on universal credit, this policy would provide an opportunity to simplify the support they receive, and integrating it into the wider childcare system. They would have access to the universal 15 hours without any need to demonstrate eligibility, which would support them to progress towards work. If each parent is working the equivalent of at least 16 hours at the national living wage, the cost of all hours purchased, beyond the universal 15 hours, would be capped at 5% of their family earnings. Basing this cap on earnings (and therefore disregarding additional income from benefits) will mean that the lowest-income families (i.e. those on universal credit) will have their cap on costs reduced as a proportion of their total income, in comparison to a family that is affluent enough to not be eligible for universal credit.

Figure 5: Comparison of what families would spend on childcare as % of gross family earnings (y) by weekly hours of childcare use (@ 50 weeks pa) (x) and family size







Source: NEF analysis.

Note: Calculations based on annualised family childcare use over the first five years of a child's life, with family earnings constant across these years (with under one-year-olds using only a quarter of hours of other ages). To generate data on costs, the model uses Coram Family and Childcare's latest (2024) costs of full-time childcare for each age of child. Assumes families eligible for the working families and universal elements of the fully expanded (September 2025) offer, and maximum use of tax-free childcare.

Modelled impact of our proposed system

The previous figures provided only notional costs and benefits. To date, it has been difficult for analysts to estimate how families might respond to a new childcare system in the UK, due to a lack of data to base their models on. Families will of course respond to an expanded offer by increasing the number of hours they purchase and changing their labour market behaviour, meaning current rates of use cannot be relied on.

NEF has made progress addressing this problem using data from the 2022-23 Family Resources Survey (FRS). Using a range of regression-based techniques (see Figure A.1 in the annex), we model how real families represented in FRS data (covering a wide range of configurations and circumstances) might respond to an improved offer by increasing their use of reported formal childcare. Estimates of the local cost of childcare are also introduced into the FRS using data from Coram surveys (see Table A.2). This model predicts the likelihood of families using formal childcare with 77.8% accuracy. It also correctly predicts the general pattern of hours of childcare use, with a 24% error (which is well within reasonable bounds for a model of this kind).

The model makes three sets of assumptions about how families might respond to a change in the costs of childcare under the UFCP system. These are used to compare our proposed offer with what families would receive after full rollout of the existing system:

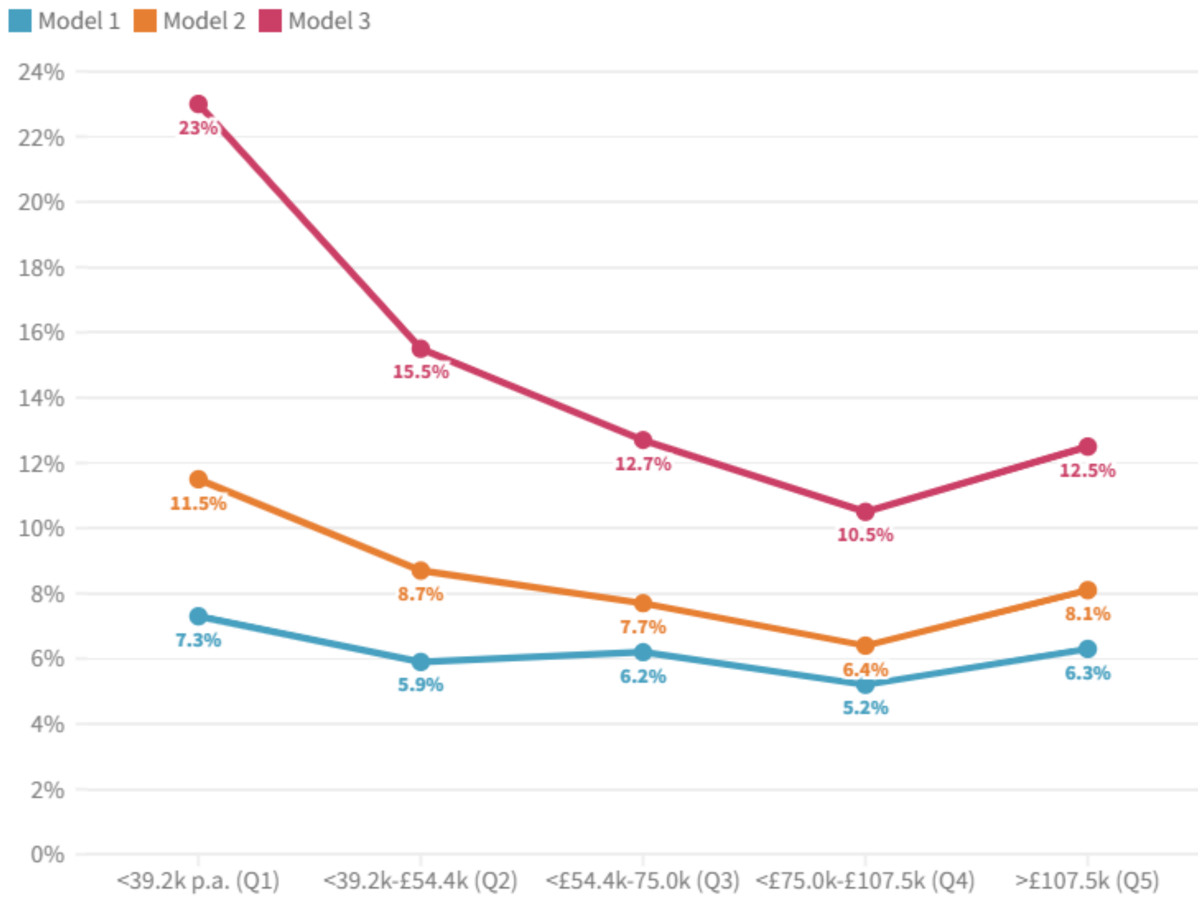
- Model 1 assumes families will only respond to a fall in the price of childcare under the UFCP, with local price based on Coram's regional childcare costs and measured as a percentage of their earnings. When a UFCP is introduced, the costs fall to 5% of their earnings. Whilst this fall in local prices assumes a marked increase in childcare use, it is more conservative than the other models and most of its effects are concentrated in families with the oldest children, as this is where we currently see the strongest relationship between childcare prices and usage.
- Model 2 assumes that in addition to the above, there will also be a broader behavioural shift in childcare use and families with children aged one to three years old will start to use childcare at similar hours of use as four-year-olds currently do. It therefore predicts more hours of use than Model 1 but not a radical shift beyond the current levels of use for four-year-olds. In other words, hours of use will continue to be relatively low.
- Model 3 makes a further upwards adjustment to childcare use beyond Models 1 and 2, assuming families will adopt a pattern of use closer to full-time hours, to enable them to fit childcare around their work patterns.

Using the FRS, we have adjusted families' childcare use upwards to reflect their predicted use under each modelled scenario. We then compare what working families would receive under the fully rolled out offer compared with what they would receive under our proposed system.

Figure 6 shows that under all three scenarios the proposed system would have a progressive effect on the income of families already eligible for the funded hours offer. Indeed, even once the funded hours system is fully rolled out, working families with gross earnings less than £39,200 a year (quintile 1 of the "working family" income distribution) would have to spend between 7.3%-23% of their net earnings on childcare under any scenario. This also reinforces a further finding from Figure 1: the current funded hours policy is ill-suited to supporting higher rates of childcare use. Even if families respond to the planned expansion of funded hours by modestly increasing their childcare use (Model 2), families in quintiles 1-3 of the earnings distribution would spend on average 7.7%-11.5% of their net earnings on childcare. For most, this would likely be a prohibitive amount to spend. The funded hours system is particularly unsuited to supporting rates of use which would enable full-time work (Model 3).

By contrast, Figure 7 shows that on average, our proposed policy would deliver a net gain to working families across the income distribution. Even the lowest modelled hours (Model 1) would deliver a modest gain in income to families across the distribution. On average, families in quintiles 1-3 of the distribution would enjoy a 0.7%-1.1% gain in their net earnings. This increases considerably under the higher modelled hours scenarios – rising to an average of £1,000-£1,200 a year (2.2% to 5.2% of net earnings) under Model 2 and £3,500-£3,700 a year (6.9% to 16.5% of net earnings) under Model 3. In short, our proposed policy would target support to those who need to increase their working hours and access childcare if Labour's economic objectives are to be realised: working families at the bottom of the income distribution. Although we have not modelled for it here, the increase in working hours among this group would also lead to higher tax revenues.

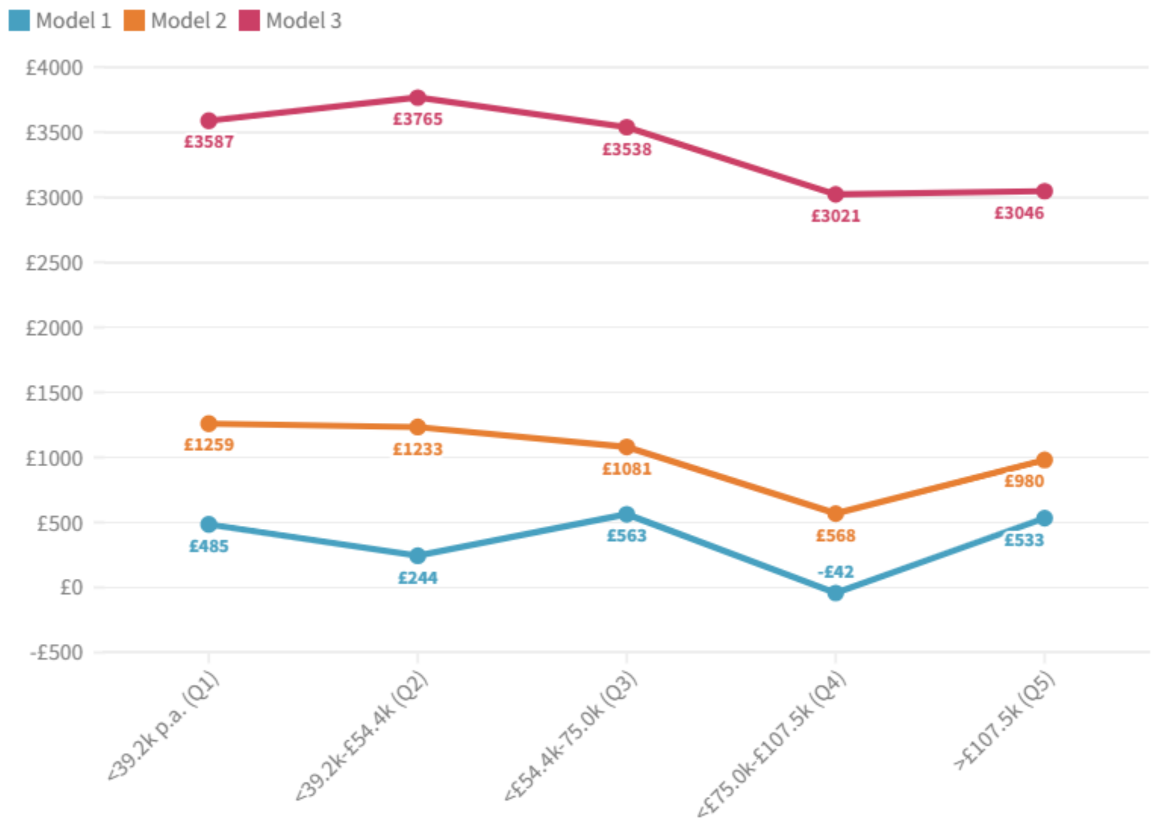
Figure 6: Mean childcare spend by working families as a percentage of their net earnings, by quintile of the gross income distribution and modelled childcare use

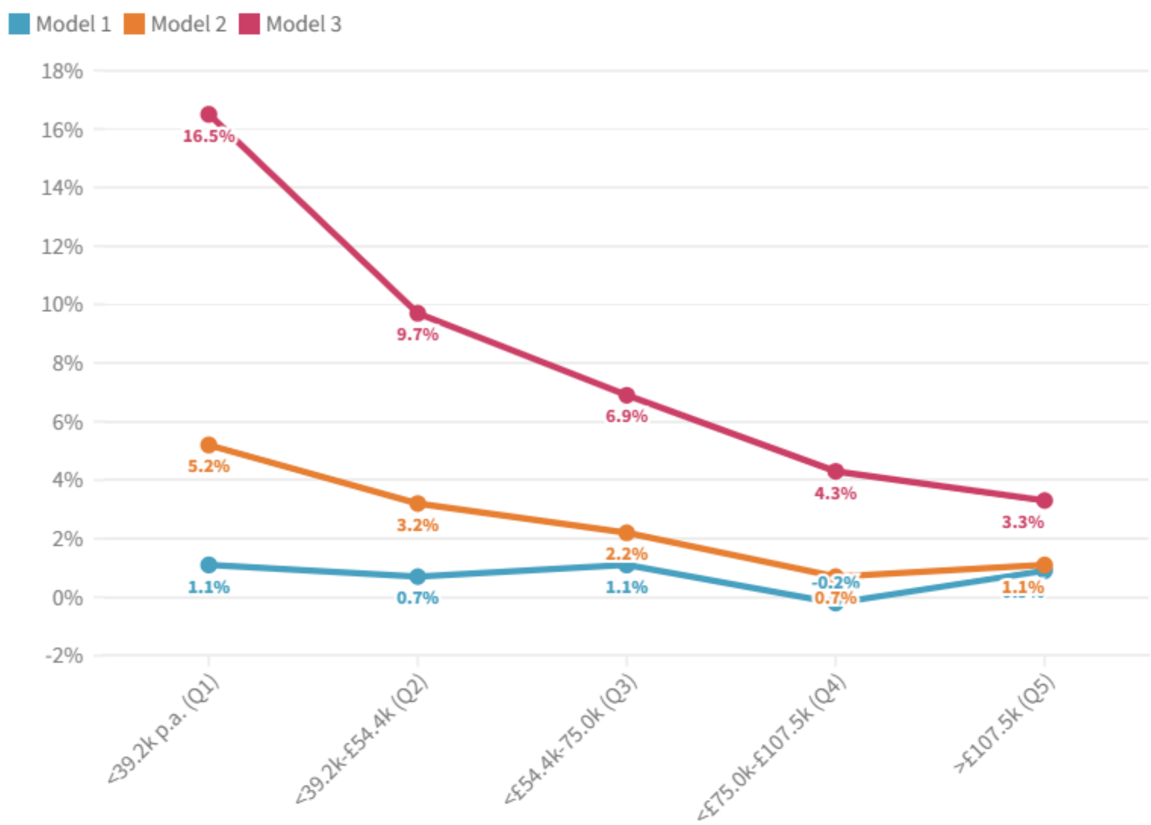


Source: NEF analysis using the Family Resources Survey.

Note: Model assumes all these families are eligible for, and would take full advantage of, the fully rolled-out entitlements to working families – including universal and means-tested funded hours, and tax-free childcare – and calculates their percentage spend on modelled hours after deducting for these.

Figure 7: Mean net gain/loss in working families' annual income in pounds (top) and as a percentage of their net annual earnings (bottom), by quintile and modelled childcare use





Source: NEF analysis using the Family Resources Survey.

Table 1 sets out the percentage and number of families who would be better off, or at least no worse off, under our proposed system compared with the current system. Those who would be worse off are primarily families who would not purchase enough additional hours beyond the 15 universal hours to benefit from the cap. This is in part because our system actively encourages greater use of hours to facilitate labour market outcomes, tilting the benefits more towards those in full-time work. Those losing out will be, by definition, spending less than 5% of their family earnings on childcare, so they are unlikely to be significantly worse off than under the current system, but it would be worth exploring how to mitigate these losses.

Table 1: Number and proportion of all families who are no worse off and net winners under 'current' hours + levels of use (vs. the then-state of funded hours roll-out) and each use scenario

	Current hours + use	Model 1	Model 2	Model 3
No worse off (%)	68.4%	62.4%	66.4%	82.8%
Net winners (%)	48.6%	54.0%	58.5%	80.2%
Net winners (#)	650,000	830,000	899,000	1.23m

Dynamic fiscal costs of the proposed system

Using this model, we also provide estimates of the net fiscal costs of introducing an alternative system. Our model can produce dynamic estimates of the government cost of both the proposed policy and the existing funded hours-based system. Indeed, using our model, we have investigated how well the 2022-23 FRS predicts the cost of funded hours and tax-free childcare during the same year, and found it is close to the true figure (see Table A.3). This enables us to predict how well the different childcare systems will respond to different patterns of childcare use, and different labour market scenarios.

To provide a wider range of policy options, we include estimates of four different versions of the proposal. Two different percentage caps are calculated – a 5% cap (our desired option) or a transitional 7.5% cap. In addition, two different hourly rates are paid to providers (see Table A.2): a rate based on the current rate ("current government rates"),[11] and a 10% higher rate to demonstrate the impact on the overall costs of our system ("enhanced government rates").[12] As

[11] Early Years Funding Agency and Department for Education (2025), *Guidance: Early Years Funding 2025 to 2026.* Uses national average funding rates to Local Authorities in the step-by-step calculations file, tab 3, rows 9-11. https://www.gov.uk/government/publications/early-years-funding-2025-to-2026.
[12] Based on Drayton, E., Farquharson, C., Ogden, K., Sibieta, L., Tahir, I., & Waltmann, B. (2023) *Annual report on education spending in England: 2023*. Institute for Fiscal Studies. https://ifs.org.uk/sites/default/files/2023-12/IFS-Annual-report-on-education-spending-in-England-2023-new.pdf, which estimated that even with the government's increases in the hourly rate to providers, real-terms core resources to providers are 10% lower than in 2012-13 once accounting for the sector's higher inflation. More recently, Drayton, E., Farquharson, C., Ogden, K., Sibieta, L., Snape, D. & Tahir I. (2025), *Annual report on education spending in England 2024-25*. Institute for Fiscal Studies. https://ifs.org.uk/publications/annual-report-education-spending-england-2024-25, found that funding rates for 3-4 year-olds have failed to keep pace

highlighted previously, we believe a wider conversation is required to settle on a level of payments to providers that sufficiently resources high-quality provision.

Our calculations suggest the additional fiscal costs of our proposed system could be managed in a staged way in the medium to long term, and that our system compares well relative to the current offer under dynamic labour market scenarios where earnings or hours worked improve. If implemented straight away, based on current reported hours of use in the FRS, our system would be essentially fiscally neutral compared with the fully rolled out funded hours system. Depending on the size of the cap and government rates set, it costs an estimated £27m more to £331m less than the funded hours-based system under these same reported hours and rates of use. However, because our proposed offer is more generous, it costs more as hours and use increase, rising to a net addition*al* cost of £3.0-£4.1bn a year more for our system under Model 1 (assuming no labour market response).

We suggest this figure provides the most reasonable estimate of medium term costs, since Model 1 reports a similar cost for the current funded hours-based system as the government's own projections. Any expanded system would not cost the full amount presented immediately, as it would take time for families to respond to the new offer. The government's own estimates assume that the funded hours costs will not be fully realised until 2027-28, despite the full rollout being completed by September 2025.

In combination, the likely gradual increase in use, and the scope to flex the level of the cap and government rates, could be used to aim towards fiscal neutrality with current plans in the early stages of a new system. However, in this proposal we have set out the likely eventual levels of spending we believe would be required to achieve a significant shift in usage and a more progressive model that increases access among lower-income families.

However, our analysis has found that the percentage of family earnings cap has an additional virtuous effect on the fiscal cost of delivering childcare, which the current model does not. Any increase in family earnings also increases the proportion of costs being met by the family in cash terms, thus reducing the government costs associated with the delivery of the policy relative to the funded hours-based system. To demonstrate this, we provide dynamic estimates of fiscal costs based on changes in the labour market situation of families in the FRS. Figure 8 provides the full net costs for these estimates, showing the cumulative effect of each of these scenarios::

- Scenario 1 presents the net costs under Model 1, before accounting for any labour market effects (i.e. no increase in the number of families who meet the 'working families' criteria).
- Scenario 2 entails the labour force increasing employment in response to the childcare policy, thus pushing more families into the eligible "working families" category. In line with the government's long-term labour market ambition, we increase the employment rate to 80% for men and women, allocating a random number of them into the labour

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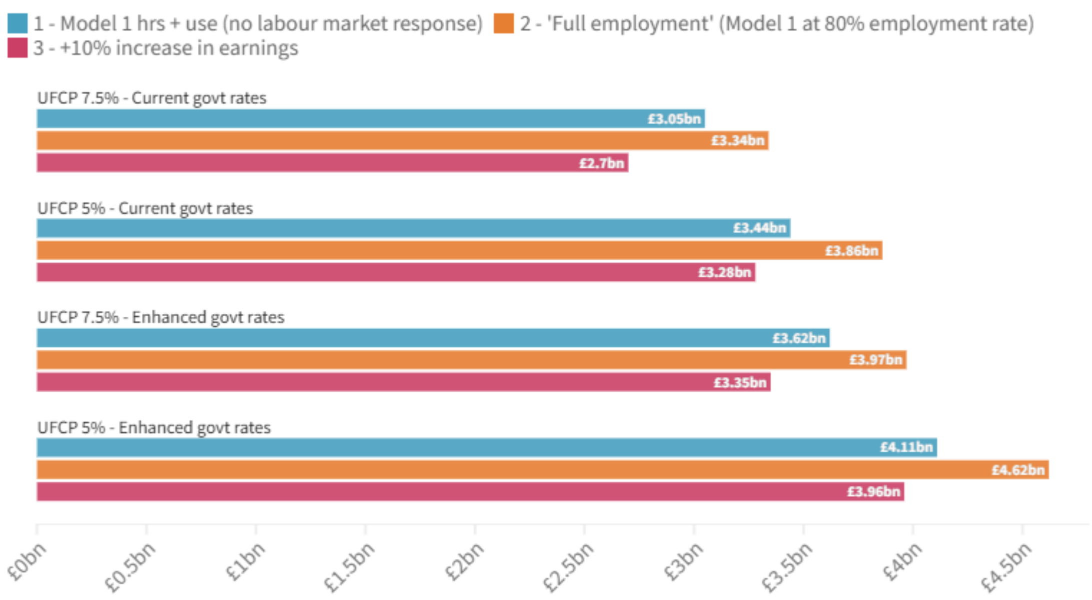
with provider costs, and are 8-15% lower in real-terms (depending on the baseline year used), but funding rates for 2-year-olds have exceeded provider costs.

force, and assigning them the mean earnings of workers in their respective income quintile. This slightly increases the net additional costs of our system relative to Model 1.

- Scenario 3 applies a 10% increase in the earnings of all workers, including those newly employed above. This is designed to capture potential increases in working hours rather than wages per se, such as a fall in part-time working. When earnings are increased, the additional fiscal costs of our proposed system fall by 14.2-19.2%% relative to Scenario 2, and 3.7-11.4% relative to Scenario 1.,In other words, it is more resilient to improvements in the labour market than the current system: if the policy is successful in supporting families into work, this will have a virtuous effect on costs – even before the wider economic and tax benefits from increased employment and earnings are accounted for.

Figure 8: Net additional fiscal costs of our proposed policy, compared to modelled cost of current system, under the four hypothetical labour market scenarios



Source: NEF analysis using the Family Resources Survey.

Transitioning to our alternative system

The government has indicated it will set out a longer term strategy for reforming childcare and early years education later this year, acknowledging that the current system is difficult to navigate and not efficiently achieving key policy objectives. Our proposed system would address many of these issues but, given the funding implications and scale of change, may require a transitional period to achieve, including to address some key challenges outlined below.

One key first step towards the system we propose would be to guarantee 15 funded hours for all children from nine months to two years, to mirror those already available to all three and four-year-olds. This would establish the principle of a block of core hours for all children to support early education, regardless of whether parents are working. It would begin to address the inequality of access for children from low-income households, help to develop a cultural norm of all children accessing early education, and provide a basis to eventually phase in a progressive model of co-payment for additional hours.

A key political priority will be to try to ensure that the transition to an alternative model doesn’t lead to significant numbers of people ending up worse off than under the current system. Under our most realistic future use scenario (Model 2), almost 60% of families would be better off under our alternative system (see Table 1), but the government may choose to introduce the system on less generous terms. We are also aware that the chance of being worse off under our proposed system is higher for families only purchasing a small number of hours in addition to the 15 universal hours, as many would not be spending enough on the additional hours to exceed the cap at 5% of family earnings.

This could be navigated by introducing our alternative system in parallel, so that families could initially choose to opt in if the offer is attractive compared to their current settlement. This would be the case for some families even with a cap set at a higher percentage of family earnings, or with other mitigations to lower the overall cost, such as a variable cap based on the number of children in childcare at any one time. This could be done in a limited number of locations initially to explore the impact on provision.

There is precedent for such an approach, with the childcare voucher scheme running alongside the alternative tax-free childcare model while the former is being phased out. This phasing would allow for the system to be tested with a smaller number of families initially (and potentially in just a limited number of locations), for people to become familiar with the model and for initial issues to be ironed out. The alternative system could be made more attractive over time through better terms until the old system is fully phased out.

As part of any implementation, the government would also have an opportunity to consider changing the upper earnings limit at which families become ineligible for childcare support. Under the current system, families where any one partner has an adjusted net income above £100,000 are ineligible for support. This could be replaced with a simpler family-level upper limit of for example £150,000. This would make the system much fairer, and easier for families to plan around. There is also the potential to consider various means tests to avoid a cliff edge, for example by tapering maximum state contribution to costs for higher earners.

In the longer term, the “working families” criteria to qualify for the cap could be eased to support more families. For example, it could be extended to cover those in education and training, or those with other caring responsibilities (such as for a disabled adult), or the income threshold could be reduced. The criteria could even be scrapped entirely, with income from benefits treated as earnings to calculate a family’s cap, which would disincentivise the use of extra provision without an intent to use it to enable work. However, this would need to be accompanied by a commitment to ensuring that benefits cover family’s essential costs.

Appendix

Figure A.1: Approach to modelling predicted proportion of families using formal childcare, and hours of formal childcare use, in the UFCP system.

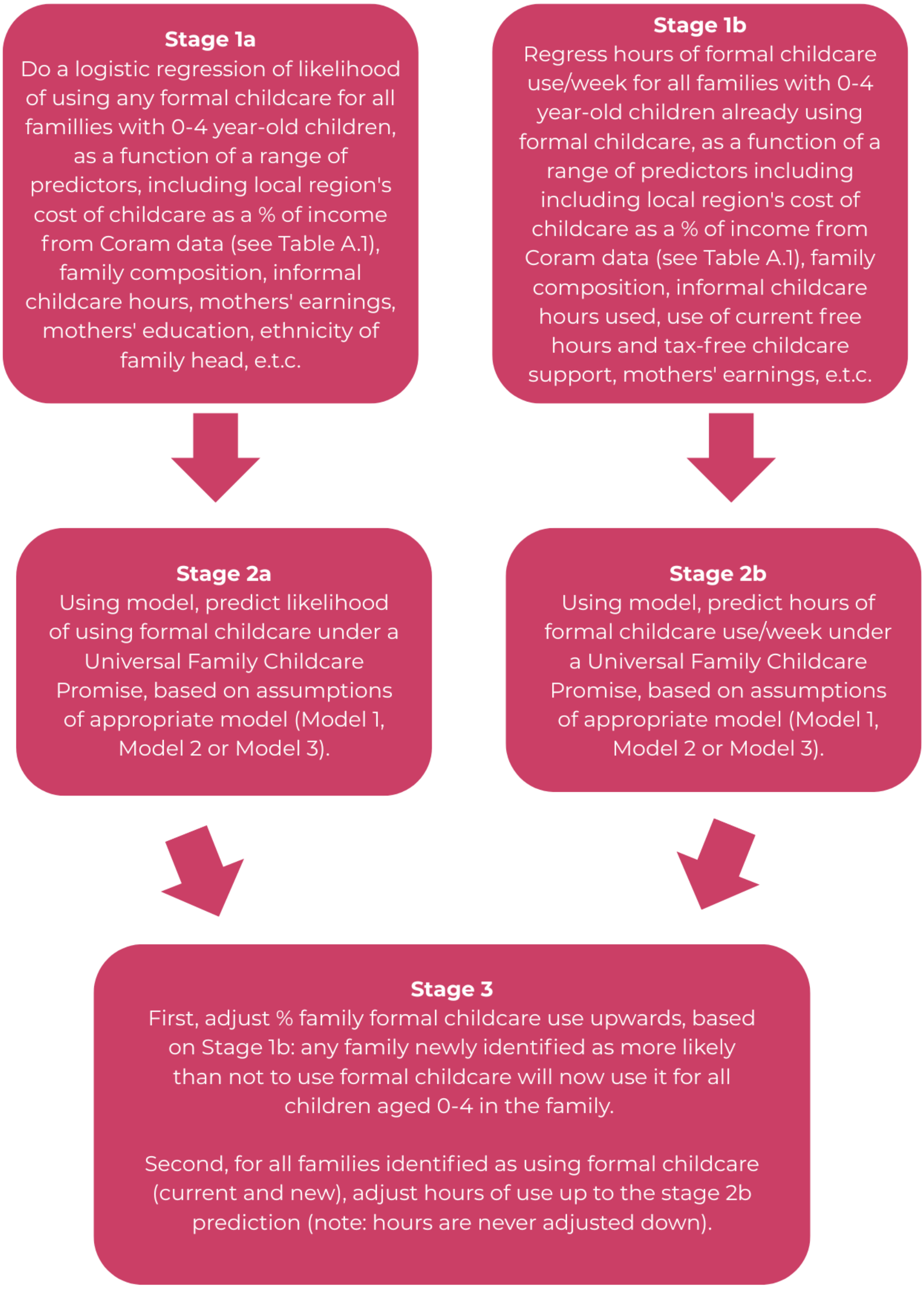


Table A.1: Hourly costs of full-time childcare in every region of the UK, by age of child, for the survey period in the Family Resources Survey (2022-23). Calculates an hourly rate for nurseries and childminders based on full-time (50 hours/week) rate by region, in Coram tables.[13] Note that figures are from the 2023 Coram report to align with the survey period of the FRS used.

Country	Region	Nursery rate			Childminder rate		
		<2 years	2 years	3-4 years[14]	<2 years	2 years	3-4 years[15]
England	North-east	£5.06	£5.03	£4.76	£4.50	£4.50	£4.47
	North-west	£5.10	£4.94	£4.74	£4.29	£4.29	£4.29
	Yorkshire and the Humber	£5.12	£5.14	£5.06	£4.62	£4.63	£4.59
	East Midlands	£4.86	£4.84	£4.95	£4.17	£4.17	£4.12
	West Midlands	£5.70	£5.51	£5.18	£4.69	£4.59	£4.49
	East of England	£5.85	£5.53	£8.73	£5.10	£5.13	£5.04
	London[16]	£7.55	£7.20	£7.26	£6.77	£6.79	£6.67
	South-east	£6.24	£6.08	£6.60	£5.12	£5.08	£5.04
	South-west	£5.39	£5.57	£5.29	£4.81	£4.80	£4.81
Wales		£5.02	£4.98	£4.94	£4.78	£4.76	£4.76
Scotland		£4.54	£4.51	£5.12	£4.93	£4.69	£4.93

[13] Coram. (2023). *Coram Family & Childcare Survey 2023.* https://www.coram.org.uk/wp-content/uploads/2023/07/Childcare-Survey-2023_Coram-Family-and-Childcare.pdf. Note that rates for <2 years and two years columns for nursery rates and childminder rates are all taken from Table 4, p. 13. Details for rates for three to four-year-olds are provided in separate footnotes below.
[14] Ibid, Tables 5 and 6, p. 14. Note that the hourly rate for three to four-year-olds is divided by 20 hours (Coram's estimate of the hours a family actually pays for, excluding the funded hours entitlement) rather than 50 hours as for the others.
[15] Ibid, Tables 7 and 8, p. 15. Same point as in the above footnote on the nursery rate for three to four-year-olds applies to the childminder rate.
[16] The London rate shown here is the average of the London (inner) and London (outer) rates in the Coram report, because the FRS general licence dataset doesn't contain data on the sub-regions or boroughs of residence of respondents.

Table A.2: Hourly provider rates used for calculating the cost to the government of funding the UFCP system. Rates are applied separately based on the number of hours purchased for each age of the child.

	Under two years old	Two years old	Three to four year olds
Current government rates (2025/26)	£11.54	£8.53	£6.12
Enhanced government rates (government rates + 10%)	£12.69	£9.38	£6.73

Table A.3: Government childcare costs 2022-23 Family Resources Survey. Calculates costs vs. closest possible actual figures from the same fiscal year. Figures are for the stage of the rollout of the funded hours as at the 2022-23 FRS,[17] and therefore uses the Government hourly funding rates at that stage of the rollout.[18]

Policy	FRS	Actual	Difference
Funded hours (England)[19]	£3.85bn	£4.000bn	-£115m[20]
Tax-free childcare (UK)[21]	£538m	£533m	+£5m

[17] To elaborate, during this 2022-23 FRS, there was no roll-out of funded hours for under two-year-olds (save a disadvantaged two-year-old entitlement), but a universal and working family funded hours entitlement for three to four-year-olds. Tax-free childcare was available for all children. These costings are calculated using reported formal and childminder use by families in the FRS, and account for self-reported use of tax-free childcare and whether they meet the earnings eligibility test for funded hours. Government costs for funded hours assume hours are paid for at national-level childcare rates, and costs for tax-free childcare assume families buy the hours at the regional rates from the Coram survey of the same year, and account for the £2,000-a-year per child cap in government contributions (they do not account for the higher cap for families with disabled children). Figures assume childminders are subsidised at the same rate as formal childcare. After accounting for this, costs are multiplied by the family (benefit unit) grossing factor and added together for the geography of interest to generate comparison figures.

[18] Education and Skills Funding Agency (2021), *Guidance: Early years funding: 2022 to 2023*. https://www.gov.uk/government/publications/early-years-funding-2022-to-2023.

[19] Actual cost derived from Figure 2.1 in: Institute for Fiscal Studies. (2023). *Annual report on education spending in England*. https://ifs.org.uk/sites/default/files/2023-12/IFS-Annual-report-on-education-spending-in-England-2023-new.pdf. This reports the funded hours entitlements – comprising the universal, extended, and two-year-old element – costing the government £4bn in England in 2022-23.

[20] Note that the FRS analysis does not currently account for the cost of the disadvantaged two-year-olds entitlement, so isn't an exact comparator of the IFS figure (which does not disaggregate these costs). This may explain part of the discrepancy in costs reported here, and the net effect after accounting for this may mean the FRS figures are a slight over-estimate of actual government costs.

[21] Derived from HM Revenue and Customs (2023). *650,000 families cut childcare costs using tax-free childcare*. https://www.gov.uk/government/news/650000-families-cut-childcare-costs-using-tax-free-childcare which reported the tax-free childcare system cost £533m across the UK in the previous year.

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