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TAX AND SOCIAL SECURITY POLICY GROUP

SUMMARY REPORT

1. At the last Election we made it clear that it would take two full Parliaments to carry out our policies. In the first one we have concentrated on restoring a sound basis to the economy. No significant changes have been made to the income tax and social security structure. In the next Parliament we shall be in a position to go ahead with reforms.
2. We distinguish reform of the mechanics of the present system from the re-allocation of payments and benefits.
3. We are convinced that we must proceed on the basis of the tax benefit scheme, pioneered by Lord Cockfield and updated by Sir Geoffrey Howe in 1974 and Mr Patrick Jenkin in 1978.
4. Major simplification of tax and social security can be achieved by the introduction of a "minimum" tax credit scheme, less ambitious than the 1972 concept but capable of improvement.
5. The computerisation of income tax is making progress but major changes in the tax system before 1987 would delay the whole programme. We are forced to recognise this constraint. Nonetheless we believe moves towards the implementation of a Tax Credit Scheme should be made immediately after the next election alongside the Inland Revenue and DHSS computerisation programme.
6. We recommend that the poverty trap be effectively eliminated by abolishing Family Income Supplement and related benefits.
7. This would be combined with the introduction of a Home Responsibility Payment for mothers who stay at home to look after children under 5, so helping those families who are financially hardest hit.
8. The Home Responsibility Payment would not only help compensate families for the loss of FIS but would significantly ease the "why work problem", because employed families with a child under 5 would receive more child support than an unemployed family on supplementary benefit. This would reverse the present situation under which child support is greater for the unemployed family and makes it financially attractive to be out of work.

TAX AND SOCIAL SECURITY POLICY GROUP

1. Our terms of reference require us to examine the crucial relationship between the tax and social security systems and to suggest ways in which they could be simplified and reshaped to help remedy the "The Poverty Trap" and "The Why Work Problem".
2. We understand that the Treasury Select Committee examination of "The Structure of personal income taxation and income support" is covering the same ground at the same time. Much of the evidence it has taken is relevant to our own study but its report has not yet been published. Our objective in this report is to suggest specific actions which should be taken by Ministers during the next five years of Conservative Government.
3. Our last Manifesto stated that:

"We shall wish to move towards the fulfilment of our original tax credit objectives as and when resources become available. Meanwhile we shall do all we can to find other ways to simplify the system, restore the incentive to work, reduce the poverty trap and bring more effective help to those in greatest need".
4. At the same time we made it clear that it would take two full Parliaments to bring our policies to fruition. In the first one we have concentrated on restoring a sound basis to the economy. No significant changes have been made to the tax and social security structure. In the next Parliament we shall be in a position to go ahead with reforms.

THE TAX CREDIT SCHEME

5. The complexity of the present tax and social security structure is now so great that it is difficult for anyone to understand it let alone reform it. It is important to distinguish reform of the mechanics of the present system from the re-allocation of payments and benefits.
6. We are convinced that reform of the system's mechanics must proceed along the lines of the Tax Credit Scheme pioneered by Lord Cockfield. This was updated in Sir Geoffrey Howe's Policy Paper "Tax Credits: Why and How" in 1974 and by a Policy Group under the Chairmanship of Mr Patrick Jenkin in 1978.

7. The Tax Credit Scheme would greatly simplify taxation by the abolition of PAYE codes and this, in turn, would result in a cut in the number of Inland Revenue staff. There would be additional staff savings by the DHSS because of the large number of retirement pensioners who would be "lifted out" of dependence on supplementary benefits, which currently require over 30,000 administrative staff.
8. There is a widespread view that changes in taxation and in social security benefits since 1974 now makes implementation of a Tax Credits Scheme difficult if not impossible. This is not so. In fact we have already moved a considerable way along the Tax Credit road. Child benefit has been brought in; the reduced rate of income tax has been abolished; and mortgage and insurance payments are now paid net of basic rate tax.

The Scope of the Scheme

9. The initial scope of the Tax Credit Scheme should be the same as that set out in the 1972 Green Paper. This excluded the self-employed, those on very low earnings and supplementary benefit recipients. The scope of the Scheme could be extended once it has been firmly established.

The Cost

10. Our terms of reference particularly required us to take account of the financial constraints likely to prevail throughout the 1980's. However, the cost of introducing a minimum Tax Credit Scheme is not too great. The Treasury figures we have suggest that replacing tax allowances with the equivalent tax credits would have cost around £450 million in 1982-3 and a further £170 million in tax cuts would be necessary to get rid of the means-tested element of the age tax allowances.
11. There is one vital difference between the original Green Paper and our proposals. The former was extremely expensive because the tax credits would have been worth substantially more than the personal tax allowances they were going to replace; by contrast, our proposals assume that they would be worth the equivalent of the personal tax allowances .

Computerisation

12. Our enquiries have made it clear that the computerisation of income tax is making progress and that major changes in the tax system before 1987 would delay the whole programme. We are forced to recognise this constraint. Nonetheless we believe moves towards the implementation of a Tax Credit Scheme should be made immediately after the next election alongside the Inland Revenue and DHSS computerisation programme.

Recommendations

13. We therefore recommend that:
- A) There should be a clear Manifesto commitment to the Tax Credit Scheme, so that the impetus is not lost by administrative delay and lack of will;
 - B) the Government should issue a White Paper soon after winning the next election setting out its exact proposals;
 - C) the computerisation programme should be developed so that the commitment to Tax Credits is taken into account at all stages;
 - D) legislation should be introduced to provide the necessary framework in the first session of the new Parliament;
 - E) arrangements be made for bank interest to the lender to be paid net of tax at the basic rate. This would ease the problems for Inland Revenue of switching to Tax Credits and would mean increased revenue by improving cash flow and reducing the scope for tax evasion;
 - F) tax credits for retirement pensioners should be introduced in advance of the full Tax Credit Scheme. We understand that retirement pensions are already computerised and that the DHSS would welcome such a move. Large numbers of retirement pensioners would be lifted out of dependence on supplementary benefits (over 40% of supplementary benefit recipients are over pensionable age), which would enable staff to be reduced.
14. Our objective must be to get the Tax Credit Scheme into operation, and its advantages appreciated, before the end of the next Parliament.

THE POVERTY TRAP AND UNEMPLOYMENT TRAP

15. We define "The Poverty Trap" as existing when someone in work is little or no better-off as a result of a wage increase and "The Unemployment Trap" as existing when someone is better-off out of work than in work.

Numbers affected

16. Estimates of the number of people affected by the poverty and unemployment traps vary very widely from about 300,000 to a figure of around 6,000,000.
17. The poverty and unemployment traps have one particular point in common: both primarily affect families with children. This is because the unemployed family on supplementary benefit receives more for its children out of work than in work and, as regards the poverty trap, because the family with children receives means-tested benefits like Family Income Supplement (FIS) and free school meals. Single people and married couples without children are not affected by these considerations.
18. Examination of the first chart (see below) leads us to conclude that single people and married couples without children are not significantly affected by the poverty trap and that few, if any, are better-off out of work. On this analysis, the number affected by the poverty and unemployment traps is unlikely to be more than 700,000.
19. Moreover, account must be taken of the fact that families with children get FIS and related benefits on an annual basis. If they qualify for 5 weeks they get them for the next 47 weeks, regardless of how their income changes or whether they are in work or not. The effects of the poverty and unemployment traps are correspondingly reduced in that period.
20. Our overall impression is that in practice the number affected by either trap (particularly in relation to a total workforce of around 24 million) is small. The difficulty is that the public perceive them to be large. This must be taken into account. But we are not convinced that there is any case for a massive redistribution of resources (such as the £15,000 million suggested by Mr Ralph Howell).

The Poverty Trap

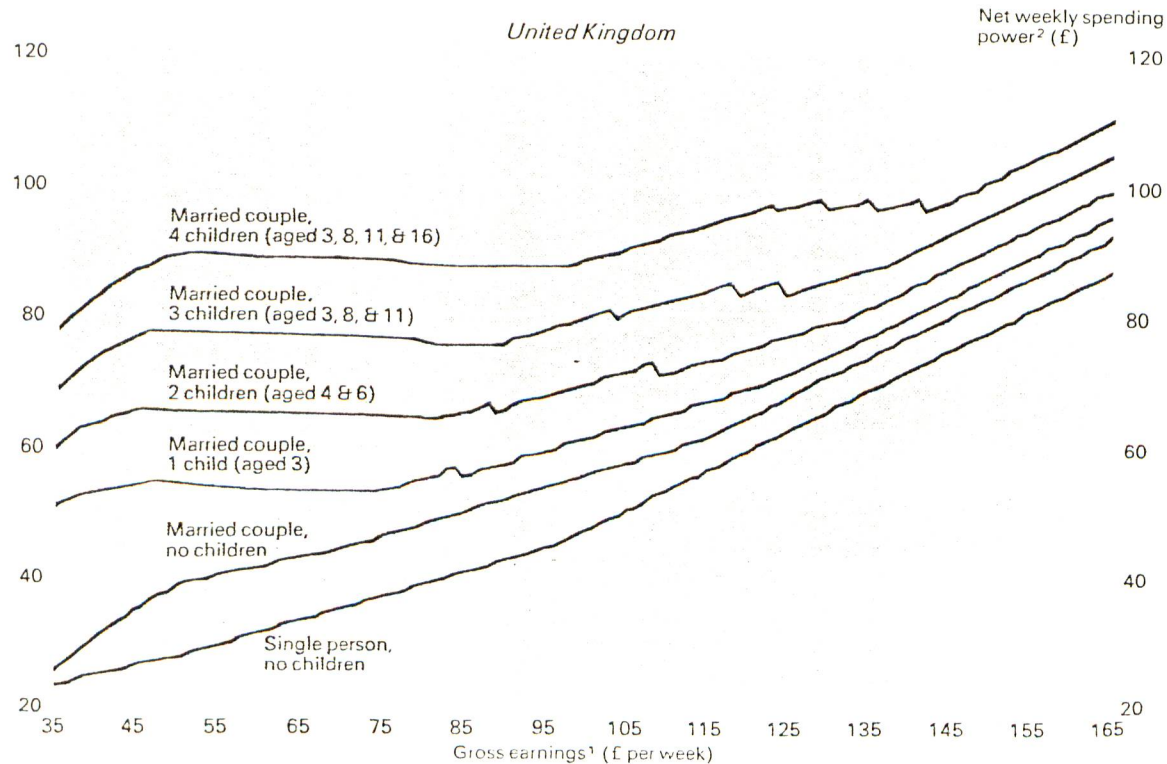
21. The SDP is the only Party which has proposed specifically how the poverty trap could be removed, but its cure was worse than the disease. The SDP plan has been roundly condemned and even the Child Poverty Action Group said that it would "make current poverty trap problems pale into insignificance".
22. The first chart shows how the poverty trap works at present. A family with children is on a lengthy "plateau" in which an increase in wages results in little or no increase in net income.
23. The second chart shows how, after our initial proposals are put into effect, the poverty trap is effectively eliminated.
24. We recommend that:
 - A) Family Income Supplement and the related "passport" benefits (free school meals and free welfare milk) should be abolished for families in work. This is essential as FIS alone produces a 50% marginal tax rate. This proposal must be put in the context of the compensatory measures we suggest later.
 - B) The withdrawal rates for rent and rate rebates/allowances should be adjusted. At present a £1 rise in income often leads to loss of 23p in rent and rate rebates/allowances. A reduction to 20p has the same beneficial effect on the poverty trap as a reduction in the basic rate of tax from 30% to 27% and has the additional advantage of being much cheaper.
 - C) No-one currently receiving FIS should have it withdrawn until it runs out naturally. In this way, existing recipients would be fully protected.
25. These reforms alone mean that the effective marginal "tax rate" for families (i.e., income tax and NI rates plus withdrawal of means-tested benefits) can never - in any circumstances - be higher than 59%. In other words, the poverty trap will have been effectively eliminated.

The poverty trap

Chart 5.13 shows examples of the way net weekly spending power varies with gross earnings for several types of families. These examples are based on a number of assumptions. The families are assumed to be living in local authority property and paying average rent and rates. They are assumed to have no income other than the husband's earnings and social security benefits, to claim their full entitlements, to have only their personal tax allowances, and not to be contracted out of the state pension scheme. Travel to work expenses are deducted, and measured as the average (£5.00 per week) for householders using public transport to work. The value of free welfare milk and free school meals has been added to earnings. The chart is purely illustrative; different assumptions, of course, would produce different results.

For single people and married couples without children, weekly spending power, on these assumptions, increases steadily with increases in gross earnings. However, for couples with children there is clearly a range of gross earnings for which net income remains unchanged or is even lower at higher earnings levels. This range of earnings represents the more severe effects of the so called 'poverty trap'—that is the situation where families receiving means tested benefits can find that an increase in earnings is wholly or substantially offset by the simultaneous reductions in those means tested benefits (eg housing benefit and family income supplement—FIS), and increases in income tax and national insurance contributions. In practice, however, the effect is cushioned by FIS and associated benefits (free welfare milk and school meals) being awarded for 52 weeks without regard to subsequent changes of circumstances.

Chart 5.13 Net weekly spending power: by level of earnings and type of family, April 1982

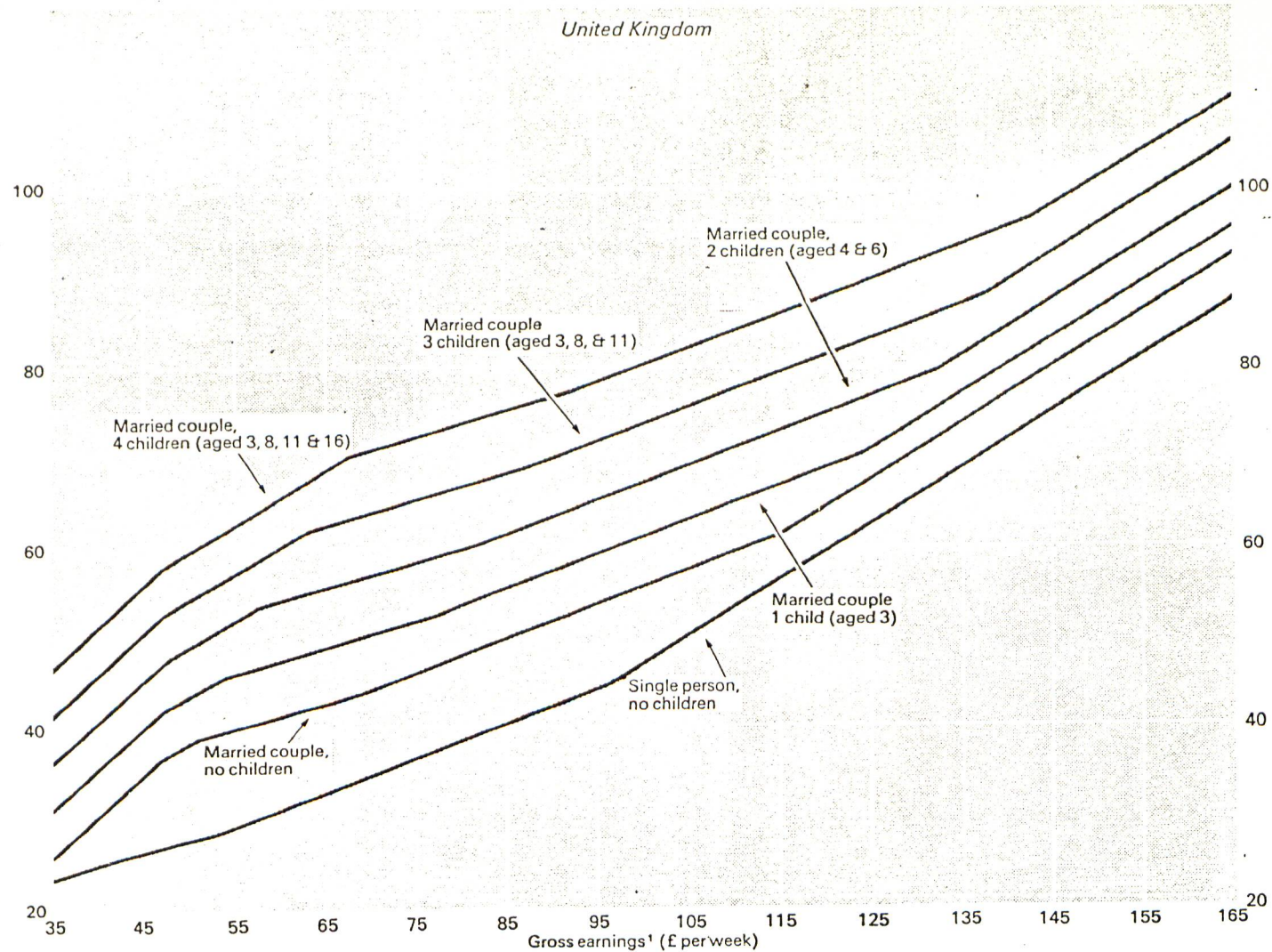


EXISTING
SITUATION

SOCIAL TRENDS
1983

Net weekly spending power where family income supplement, free school meals and free welfare milk³ are not claimed: by level of earnings and type of family, April 1982

Net weekly spending power² (£)



DHSS - 1983

PROPOSED SITUATION

¹ Gross earnings from full-time work where head of household only is in employment.

² Net weekly spending power is defined as gross earnings less deductions for tax, national insurance, rent, rates and work expenses, plus receipt of child benefit, rent and rate rebates if applicable. At levels of gross earnings where there exists an unclaimed entitlement to family income supplement (FIS), the rent and rate rebate awards will as a result be higher than those in the corresponding table published in Social Trends.

³ Apart from the exclusion of FIS, free school meals, and free welfare milk, the examples are based on the same assumptions as those in Chart 5.13, set out in Social Trends, 1983.

26. The obvious disadvantage is that working families would then have less money and some would be better-off out of work. We therefore make further recommendations in the next section.

Family Policy

27. The Prime Minister has emphasised "We are the Party of the Family".
28. One aspect of social attitudes towards the family is the widespread feeling that mothers with young children should stay at home to look after them. There is a considerable body of evidence to the effect that young children need to be close to their mothers and benefit accordingly, and certainly the vast majority of such mothers do not want to be in full-time work. A poll published in the "Sunday Times" illustrates the strong feelings held by the public on this issue, with more than 2-1 in favour of such mothers staying at home.

Question: Women with young children at home should not go out to work but should stay at home to look after them:

	All	Men	Women
Agree:	61	64	59
Disagree:	24	21	26

("Mori" April 1982)

Equally important was a survey of full-time working mothers with children aged 0-4 in which the vast majority (around 90%) said that they would like to do only part-time work or stay at home with their children.

29. Among those in work hardship and poverty is greatest where there is one child under 5. This is not surprising. A couple will find, after the birth of their first child, that there is only one earner in the family instead of two, and that at the same time there is an extra person to feed and clothe. Financial pressures are greatest at this point. Exactly the same can apply again to a family with an older child or children. When a new child is born the family is brought right back into the situation where the mother is unable and often unwilling to find work.

30. We therefore make further recommendations as follows:

A) The Government should introduce a Home Responsibility Payment for mothers with young children under five in the order of £7 per week. This would be tax-free and non-means-tested.

B) The Home Responsibility Payment would be:

* paid to all mothers (irrespective of whether the father was employed or unemployed) with one child under 5.

* withdrawn entirely if the mother took up full-time work.

* limited to a single payment of £7 per week irrespective of whether there were two or more children under 5 in the same family.

* available to the small minority of families where the mother is working while the father stays at home to look after the children.

31. A Home Responsibility Payment would be well-received by the broad mass of the people who are currently concerned about the welfare of very young children and would relieve family poverty where it is greatest. The administrative problems would be minimal as the Home Responsibility Payment can be added onto the child benefit computer system.

32. There are further advantages.

33. The 88,000 two-parent families who would otherwise have been entitled to FIS in the future will in most cases be compensated by the new Home Responsibility Payment as well as by our proposals on rent/rebates and allowances. This is because 64% of two-parent families drawing FIS have one child under 5.

34. Many single parents who stay at home with their young children or do part-time work would benefit from the Home Responsibility Payment, and the numbers claiming supplementary benefit would be reduced.

35. However, single parents who would normally claim FIS (about half of FIS claimants are single parents) would not be eligible for the proposed Home Responsibility Payment if they continued in full-time work. To help off-set the abolition of FIS it would seem sensible, in addition to our proposals on rent and rate rebates/allowances, to increase the existing one-parent benefit. The Government has an excellent record in helping one-parent families and this should be maintained .

The Why Work Problem

36. The proposed elimination of the poverty trap would be an incentive to unemployed people to find work. This is because they know that, even if they can only find low-paid work initially, any subsequent increase in their earnings will be matched by a significant increase in their net income. They will no longer be jumping from an unemployment trap into a poverty trap.
37. Secondly, account must be taken of the fact that families with children are primarily better-off out of work is because child support is greater for the unemployed family on supplementary benefit. However, the new Home Responsibility Payment reverses this situation for most families with young children. The combination of child benefit and Home Responsibility Payment means that, in respect of a child under 5, child support will be greater in work than out of work.
38. How many unemployed families will benefit in this way if they get a job? It is estimated that well over half of unemployed families receiving supplementary benefit have one child under 5 and the majority of these will be better-off in work as a result of our proposals.

Summary

39. Our package of proposals, taken as a whole, would:
- * help mothers with young children and make over 2 million families better-off;
 - * relieve the burden on families when they are hardest hit;
 - * effectively eliminate the poverty trap;
 - * substantially reduce the numbers better-off out of work and offer them the attraction of employment without a poverty trap;
 - * cut civil service numbers by abolishing three means-tested benefits for employed families and reducing dependence on (administratively expensive) supplementary benefits.

An estimate of the net cost of our proposals is set out in the Appendix.

31 March 1983

APPENDIX

Home Responsibility Payment

The number of children under 5 in the UK is approximately 3.4 million but the number of families with children under 5 is smaller, because some families will have two children under 5 and a few will have more than two.

It is suggested that the Home Responsibility Payment would compensate mothers for the loss of income that they might otherwise have obtained from employment. Therefore it would be limited to a single payment of £7 per week irrespective of whether there were two or more children under 5 in the same family. It would, of course, be withdrawn if the mother took up full-time work.

This means that about 2.7 million families would be receiving the Home Responsibility Payment.

However because it would be off-set (like child benefit) against supplementary benefit entitlement and because so many families with young children are receiving supplementary benefit, it follows that the savings on supplementary benefit will be considerable.

About 2 million families would be net beneficiaries. A Home Responsibility Payment of £7 per week would therefore cost about £700m.

There are further savings and costs which could be balanced out. The savings on FIS and related benefits would finance the increase in one-parent benefit. The new Home Responsibility Payment would reduce expenditure on means-tested housing benefits, but this saving would be offset by the proposed reduction in the withdrawal rate of rent and rate rebates/allowances.

The abolition of FIS would save about 300 administrative staff and there would also be a reduction in supplementary benefit claimants, which would enable a further cut in social security staff to be made.