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CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

~~CKBG~~ no! none.
any PU comments?

Prime Minister +

The summary below omits some interesting points, marked in the paper. DLW 13/6

Prime Minister

**Incentives in UK, France and Germany**

You asked at the meeting on Workfare on 2 June for a note on benefits in other countries. I attach a paper which compares the financial incentive to take a job faced by the unemployed in the UK, France and Germany.

Such comparisons are difficult because of the very complicated benefit and tax system in each country. But I believe we have captured the essential differences between the three countries.

Inevitably, the picture is not clear cut. For single people, the financial incentive to find work appears to be higher in the UK. For the lower paid, and particularly for married men who have been unemployed more than a year, the financial incentive to take a job is lower in the UK than in France and Germany. This partly reflects the different benefit systems, which are earnings related in France and Germany, and partly the lower level of taxation. Another essential difference is that their systems of unemployment benefit are more clearly separate from the general social security system. But a common factor is that the incentive gap, at whatever level remains constant in the UK but widens with time in both France and Germany.

This work could be extended and has not covered young people. I believe that a note on benefits paid to young people will be produced by DHSS.

But these comparisons do nothing to allay my concern over the incentive to find work, particularly for the lower paid.

Nf

**INCENTIVES IN THE UK, FRANCE AND GERMANY**

1 This paper compares the financial incentive of unemployed people to take a job under the existing tax and social security systems of the UK, France and Germany.

2 The financial incentive to take a job is usually measured by the gap between net income in work and net income when unemployed (called the "replacement rate"). The size of this gap will depend principally on tax and social security contributions, housing benefits and child benefits, and social security payments made to the unemployed. These typically vary with family characteristics and level of income in work.

3 The tax and social security system in the three countries differ in many ways and the effects of these systems on individuals with particular characteristics vary too. Our approach has been to compare financial incentives for three family types - single, married and married with two children - at varying income levels. This is inevitably a selective approach but these three family types cover 75 per cent of the unemployed in Great Britain.

4 The graphs which are attached show the different replacement rates which people face as they move through a period of unemployment in the three countries. Replacement rates change over time as the benefits which the unemployed receive vary with the length of time they have been unemployed. Replacement rates are compared for the three family types - single, married and married with two children - on both average earnings and two thirds average earnings. In the graphs, replacement rates are defined as the proportion of net income support when in work (made up of gross earnings, child benefit and housing benefit less payments of tax and national insurance and payments for rent, rates and travel to work) received when out of work.

**UK AND FRANCE**

5 The most obvious differences between the UK and France are:

- benefits received by the unemployed in the UK do not vary over the period of unemployment as supplementary benefit sets a floor to benefit payments. In France, benefits fall as the period of unemployment lengthens, typically falling by 35 - 40 per cent.

- replacement rates are higher for single people in France, that is to say the incentive to take a job is lower since they receive a higher proportion of their income support when unemployed than in the UK.

- replacement rates are higher for the first twelve months of unemployment for married couples in France but are then slightly lower than in the UK.

- replacement rates are higher for the first twelve months of unemployment for married couples with two children in France but are then lower than in the UK.

6 Income support is lower in France in particular cases than these examples show. Unemployment benefits are exhausted after a period, which may vary between two and a half years and six years. Then only some people are eligible for means tested benefits in limited circumstances such as families where there are more than two children.

16 - 18 year olds without qualifications are not normally eligible for benefit.

**UK AND GERMANY**

7 The most obvious difference betwen the UK and Germany are:

- incentives to take a job are higher (ie the replacement rate is lower) for the lower paid in Germany, those on two thirds average earnings. The replacement rate is considerably lower for married couples with two children, significally lower for married couples, and slightly less for single people unemployed over a year.

- the financial incentive increases in Germany after one year of unemployment, but in the UK it remains constant.

- the financial incentive is higher in the UK for single people and married couples with no dependants on average earnings.

**ESSENTIAL DIFFERENCES BETWEEN THE COUNTRIES**

8 The main features of the social security systems in France and Germany are set out in Annex 1. The main differences which affect the financial incentives of the unemployed to take a job are:

- unemployment benefit are related to earnings in France and Germany so incentives for the lower paid tend to be higher than in the UK where flat rate benefits are paid.

- unemployment benefits tend to fall as the period of unemployment lengthens in France and Germany so that the incentive to find work is increased. In the UK the incentive remains the same irrespective of the length of unemployment.

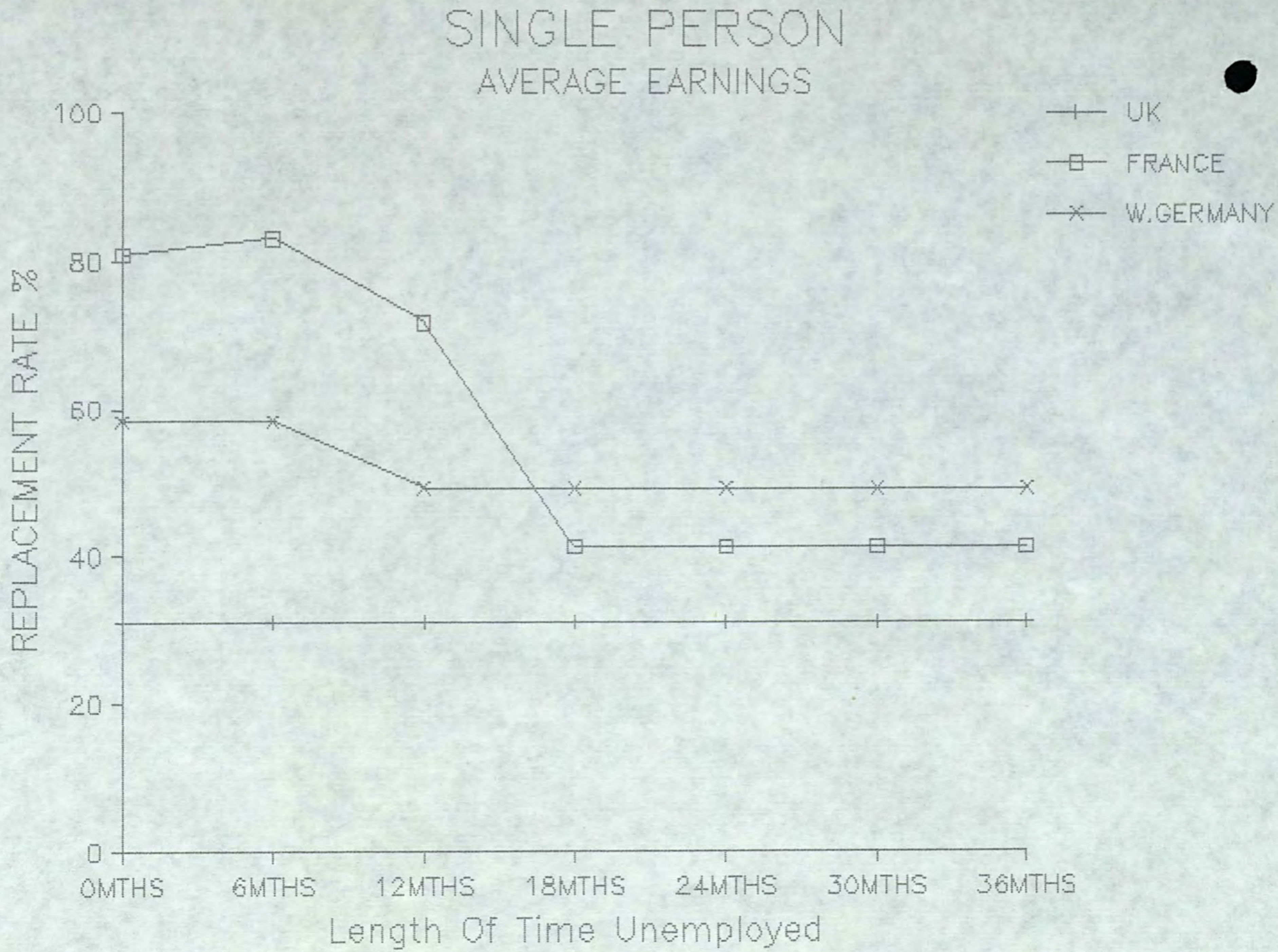
- the tax burden on the lower paid is significantly less in France than in the UK. It is less in Germany too.

**CONCLUSION**

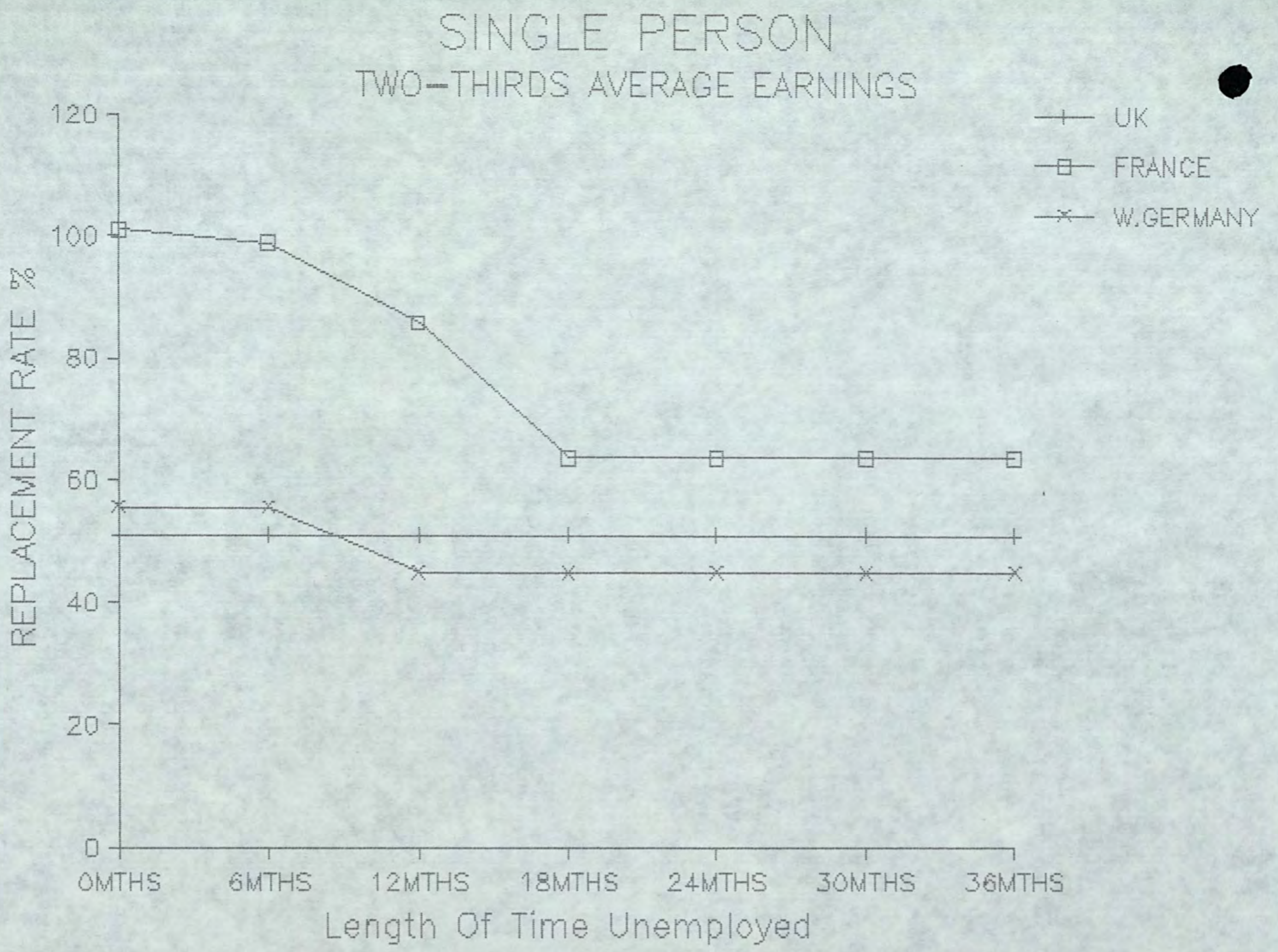
9 The financial incentive to take a job varies considerably with family type and previous level of income. Inevitably, the comparisons here capture only part of the picture since so many variations in payment can occur and we have been unable to compare some features, for example, the treatment of mortgage interest payments under the different social security systems.

10 And of course, the incentive to find a job is much more than the financial comparisons which have been made in this paper. The tests of availability for work and severity of means testing are likely to differ between countries quite apart from wider cultural differences.

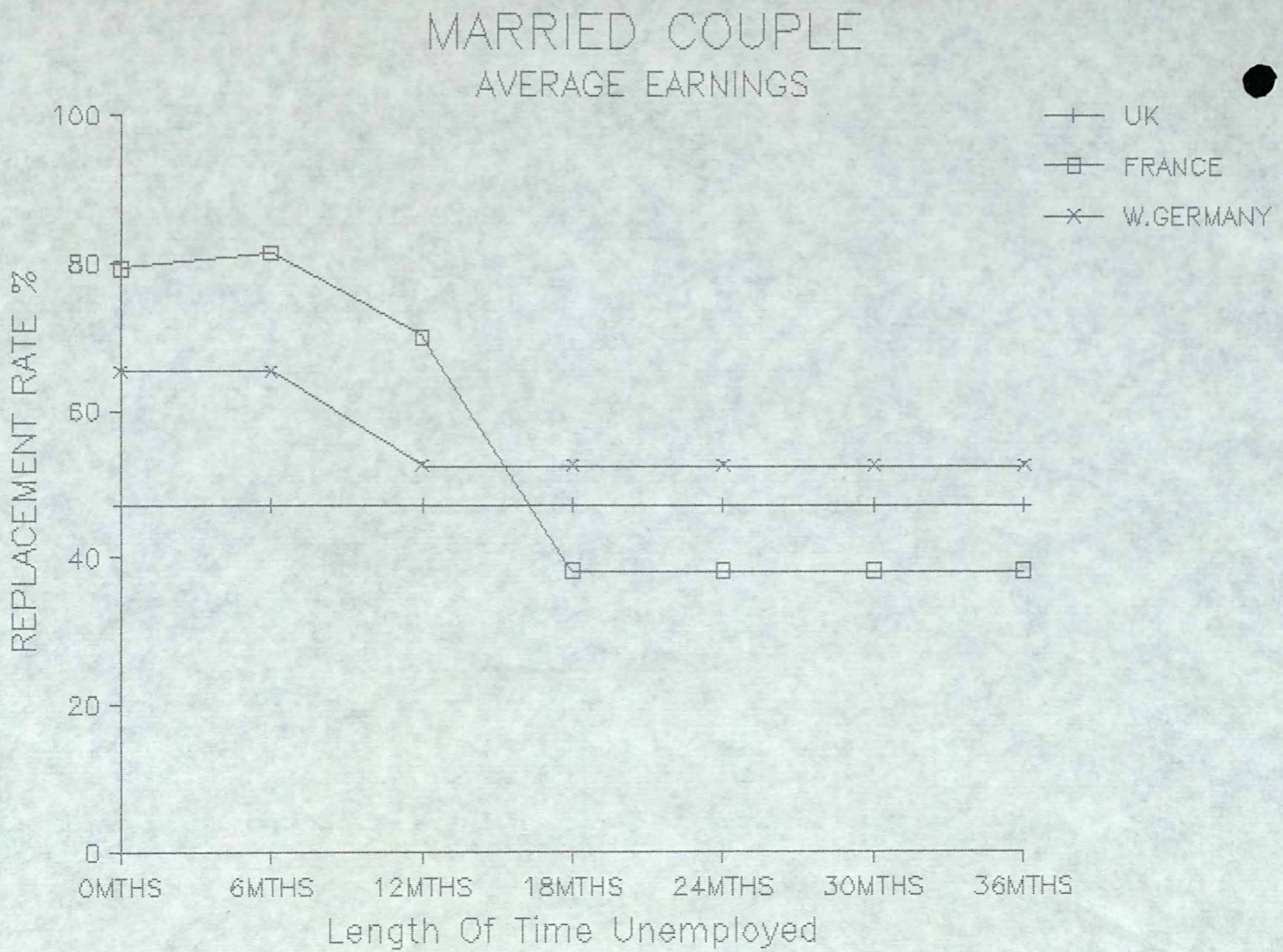
11 But, it is apparent that the financial incentive for married men, particularly those on below average earnings, and particularly those who have been unemployed for a long time, is generally lower in the UK than in France and Germany.



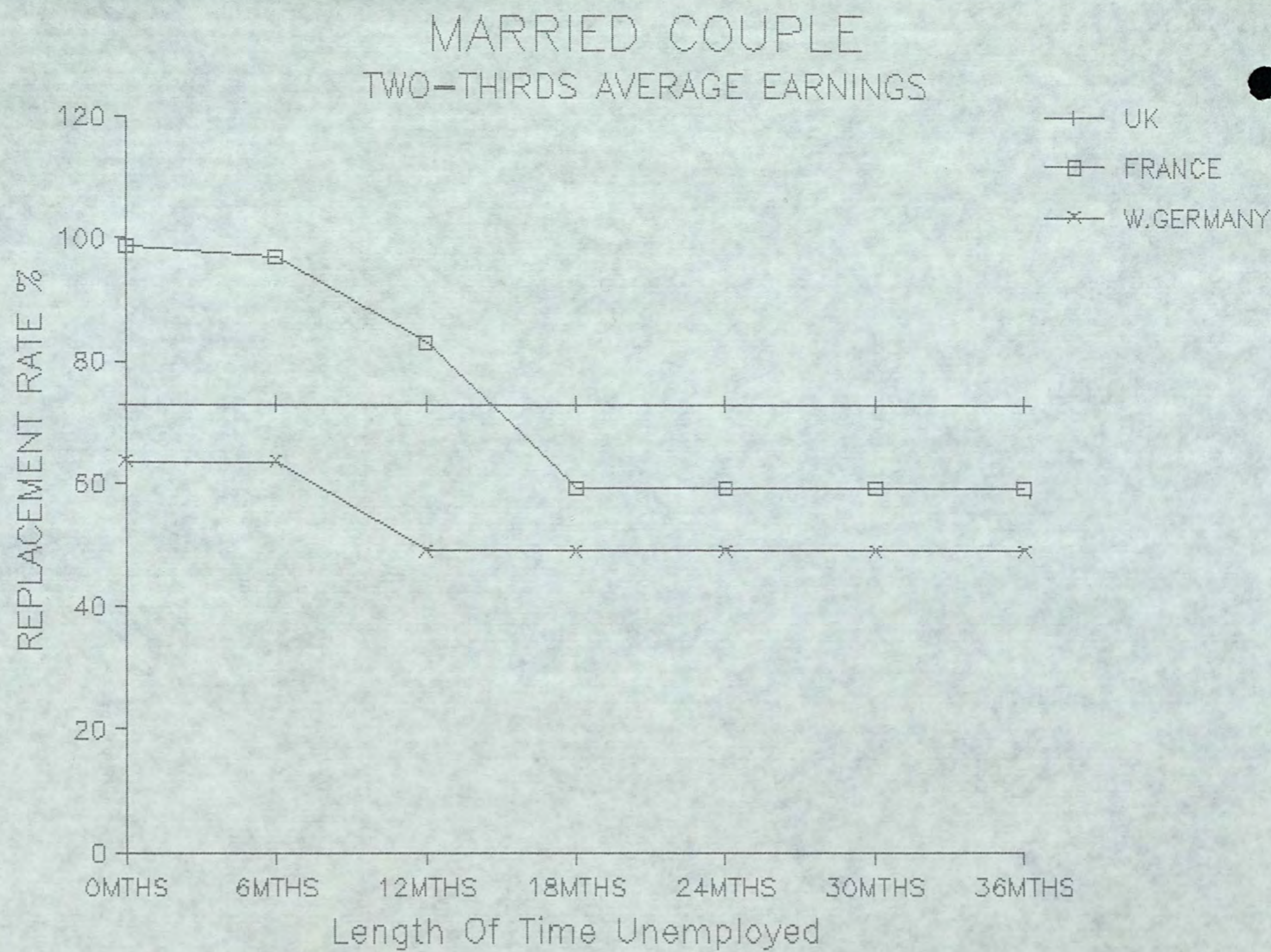
SINGLE PERSON
AVERAGE EARNINGS
REPLACEMENT RATE %
100
80
60
40
20
0
UK
FRANCE
W.GERMANY
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed

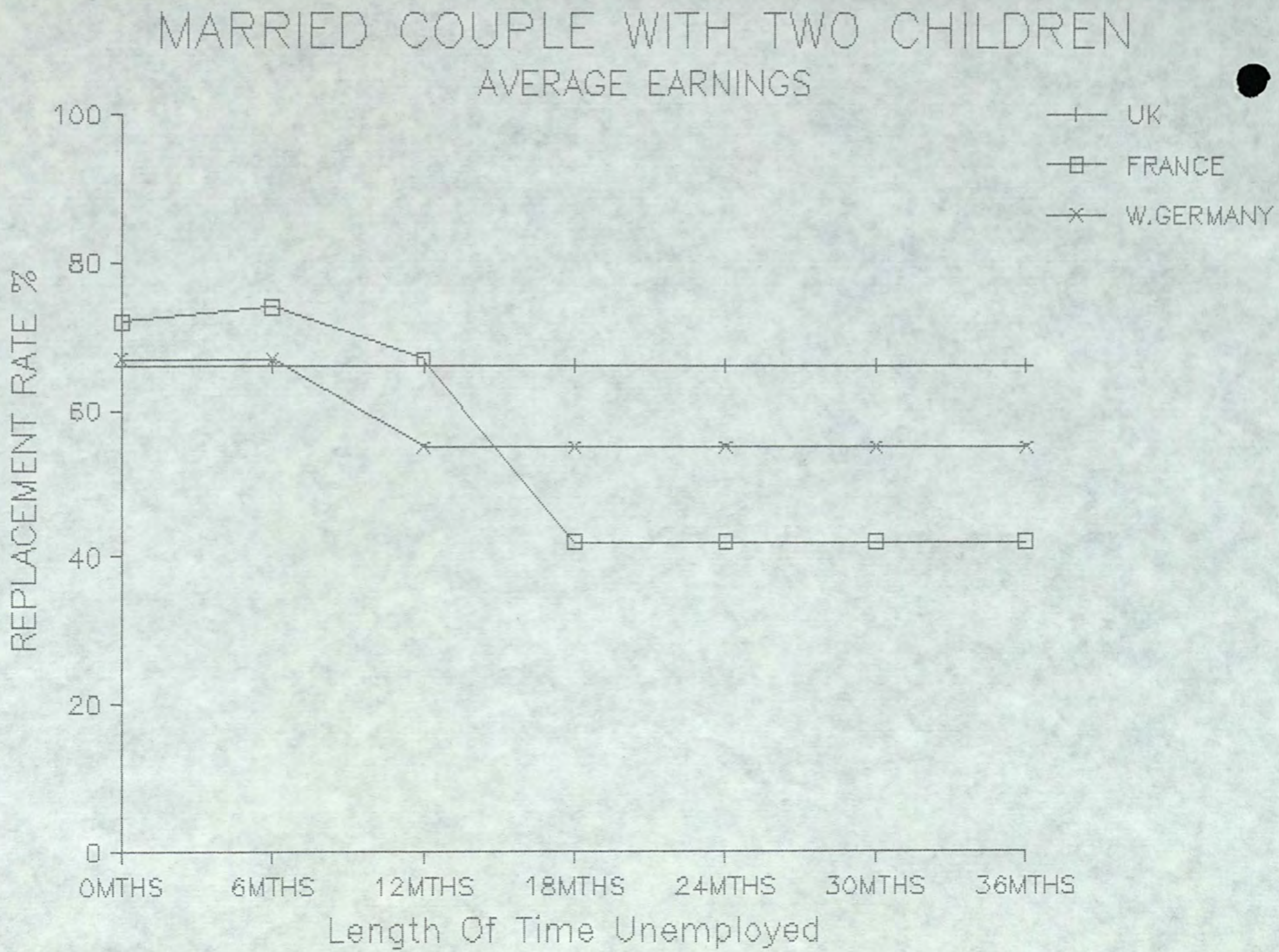


SINGLE PERSON
TWO-THIRDS AVERAGE EARNINGS
UK
FRANCE
W.GERMANY
REPLACEMENT RATE %
120
100
80
60
40
20
0
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed

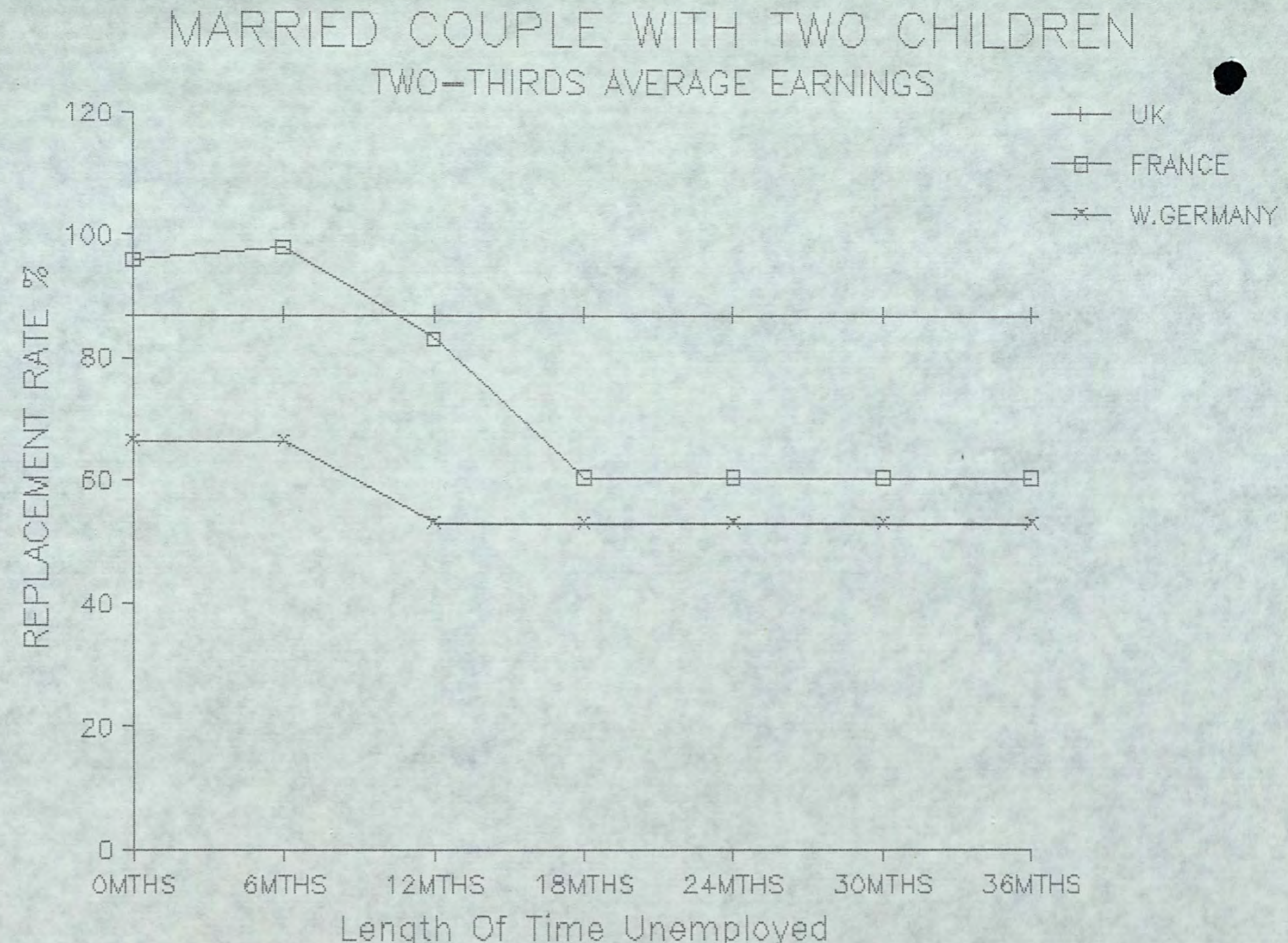


MARRIED COUPLE
AVERAGE EARNINGS
UK
FRANCE
W.GERMANY
REPLACEMENT RATE %
100
80
60
40
20
0
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed


MARRIED COUPLE
TWO-THIRDS AVERAGE EARNINGS
UK
FRANCE
W.GERMANY
REPLACEMENT RATE %
120
100
80
60
40
20
0
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed



MARRIED COUPLE WITH TWO CHILDREN
AVERAGE EARNINGS
REPLACEMENT RATE %
100
80
60
40
20
0
UK
FRANCE
W.GERMANY
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed


MARRIED COUPLE WITH TWO CHILDREN
TWO-THIRDS AVERAGE EARNINGS
UK
FRANCE
W.GERMANY
REPLACEMENT RATE %
120
100
80
60
40
20
0
0MTHS
6MTHS
12MTHS
18MTHS
24MTHS
30MTHS
36MTHS
Length Of Time Unemployed

**Annex 1**

**FRENCH AND GERMAN BENEFIT AND TAX SYSTEMS**

1 As in the UK people who become unemployed after a period of employment initially receive unemployment benefit, which is a contributory benefit, and once this is exhausted they then receive social security payments which are not based on contributions. But there are considerable differences in the details of the French and German system which both provide earnings related benefits in the initial spell of unemployment.

**FRANCE**

**Unemployment Benefit**

2 The length of time for which unemployment benefit is paid depends on age and contribution record. It can last up to 5 years, but average duration is 6½ months. Benefits are taxed as earnings.

3 Unemployment benefit is earnings related. It is based on either 57% of previous earnings or a flat rate payment (Fr 43.87 a day) plus 40% of previous earnings. (It is subject to a minimum of Fr 104 a day, and a maximum of 75% of previous gross earnings.) Once the initial entitlement has been exhausted, benefit may be extended for a period at 85% of the initial rate.

4 After rights to earnings related benefits expire, an "End of Rights" allowance is payable for up to 16 months at a flat rate (Fr 64.00 per day).

**Social Assistance Payments**

5 When rights to unemployment benefits expire, some of the long term unemployed - apparently those with more then two children - can receive means tested social assistance payments. These are payable indefinitely at a flat rate (64.50 Francs a day) to people actively seeking work and with a 5 year work history in the preceeding 10 years.

## Other Payments

6 Other income support payments are available to persons in or out of employment. Family Allowance is a major source of income for larger families, paying Fr 530 a month for 2 children, Fr 1200 for 3 and Fr 1860 for 4. Higher rates are paid for children over 10.

7 Housing benefit is calculated on income in the preceding year. Benefits are increased for the unemployed, and particularly those receiving non contributory benefits.

8 French income tax rates are low. Tax is in theory payable at low levels of income, but tax allowances, particularly for married couples and children, are high, and the rate begins at only 5% of taxable income at the lower end of the scale.

## GERMANY

9 People who become unemployed initially receive unemployment benefit, which is a contributory benefit. Unemployment benefit is based on previous net earnings at the rate of 68 per cent, 63 per cent for those with no dependants. (Net earnings are defined as gross earnings minus income tax, health, pension and unemployment insurance) It is typically paid for up to twelve months, although now older people can receive unemployment benefits for longer (eg up to 2 years for those aged over 55). Unemployment benefit is not taxed.

## Unemployment Assistance

10 Once unemployment benefit is exhausted, people receive a means tested benefit ("unemployment assistance") for an unlimited period. Unemployment assistance is also paid to people who do not qualify for unemployment benefit but who were employed before and are registered as available for work. This means tested benefit nomally amounts to 58 per cent of previous net earnings (56 per cent for those with no dependants.)

## Social Assistance

11 Social welfare payments are paid (by local authorities) to families in need on a variable, discretionary means tested basis. It is generally much lower than unemployment benefit or assistance. It is intended to top up family income to a minimum subsistence level.

## Other Payments

12 Other benefits are paid to people in particular circumstances whether they are in or out of work. This applies to child allowance and housing benefits.

## Receipt of Benefits

13 At the end of 1985, there were 2 million registered as unemployed of whom 60 per cent received unemployment benefit or unemployment assistance.