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Prime Minister

MINISTERIAL GROUP ON UNEMPLOYMENT AND FAMILY SUPPORT ISSUES

I attach two notes by officials examining possible changes in child benefit and Family Income Supplement (FIS), in response to your private secretary's letters of 15 and 22 October. A prefacing table summarises the main options for our consideration.

2. My officials have co-operated closely with those of the Inland Revenue and I think that these issues need to be considered by us alongside those which the Chancellor sent you on 14 February examining Mr Mount's propositions for the re-introduction into the tax system of some form of family or child allowance and of lower than standard rates of tax. They are all relevant to our decisions on the best way forward on family support.

3. We are all concerned about the unsatisfactory situation which has arisen on the unemployment and poverty traps from changes in the tax and social security systems over the years. The problem is that we are not starting with a clean sheet and, as the attached notes and the Chancellor's show, there is no easy way forward which does not involve either substantial increases in public expenditure (or tax forgone) or in staff or both.

4. For example, increases in tax thresholds and reductions in the basic rate of tax, together with increases in child benefit and appropriate adjustment in FIS, remain the most effective way of relieving poverty and of reducing the effects of the unemployment and poverty traps. But all are expensive (even though the administrative costs of increasing child benefit are negligible, because it is already computerised and it has the advantage of helping the poorest families, which tax allowances do not).

5. It is these costs which had led us to seek ways of targetting family support money more precisely on poorer families in work. The first of the attached notes examines various ways of taxing or means-testing child benefit or future increases in it back from richer families. Paying the extra benefit out to all families through the existing DHSS computers could be done easily and with negligible staff costs. The problems arise in taxing or means-testing some of it back.

6. The notes show that the main problems are:-

a. the costs of any worthwhile scheme that made a significant impact would be substantial - well in excess of £1 billion a year;

b. taxing back through the Inland Revenue system and employers would be expensive in staff and/or more work for employers; so would be taxing back or means-testing through the DHSS. It does not seem sensible to increase civil service manpower or impose extra burdens on employers in this way;

c. the severity of the poverty trap could be alleviated but only at the expense of spreading it much more widely;

✓ 6 d. the transfer from handbag to wallet would be very contentious politically, as the Chancellor has indicated. It may be that our predecessors should not have reversed their plans to pay child benefit to the father in 1972. The fact is that they were forced to do that under strong political pressure;

e. with most of the options, the additional staff would simply be engaged in recycling large sums of money to and from the same people to leave a relatively small amount with a minority. That does not rule them out, but it would be wasteful.

7. Some of the options in the first note for some form of tax credit may be worth further study, especially in less expensive forms, but I do not see anything immediately feasible in the short term, at least until PAYE is computerised in the late 1980s. My officials have gone on, therefore, in the second note to examine a range of possible options for us in the short-term, by changing FIS and marketing it better, because this is a benefit which is already targetted precisely on the group we want to help, of poorer families in work. They show that some of these options look promising (eg, modification of the qualifying hours, making the taper less steep and better marketing) and could be achieved more quickly and cheaply in terms of money and staff than almost all of the child benefit and tax options. But the costs would still be substantial; from £220 million to £330 million, and some 1,350 staff. We also need to consider carefully whether we would be right to extend FIS into such a large benefit giving means-tested support to people in work. It would become a benefit which, instead of going to 160,000 families at a cost of about £90 million a year, as at present, would go to up to 1,200,000 families and cost between £310 million and £420 million a year. There are two quite serious problems about turning FIS into a large-scale benefit like this -

a. it is unlike any other benefit in being awarded for a year at a time; this has great advantages in simplicity of operation and in mitigating the poverty trap (by slowing up withdrawal of benefit), but it would be questionable whether such a relaxed approach could be tolerated for a benefit going to over 1 million families. To introduce more fine-tuning, however, would increase staff costs still further;

b. it allows scope for exploitation, possibly in collusion between employees and employers, to maximise benefit so as to subsidise wages (since it operates to top low wages up to a determined level).



If we did decide to explore the FIS possibilities further, we should have to give a lot more thought to these problems and ask for further work to be done.

8. I understand the Chancellor, whom I have consulted, sees considerable objections to the child support proposals. He also has considerable reservations about the FIS option and would wish to have the proposal studied in depth before any decision on it were taken.

9. Copies of this minute go to the Home Secretary, the Chancellor of the Exchequer, the Secretaries of State for Industry and for Employment, Mr Sparrow, Mr Mount, Sir Robert Armstrong and Mr P L Gregson.

CONQUEROR

18 February 1983

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CHILD SUPPORT

1. This note considers in broad terms the merits and practicalities of providing higher child support than the universal tax free £5.85 a week for each child in a family at present paid through child benefit.

The objectives

2. We understand that the objectives which Ministers wish to make progress towards are as follows:-

- (i) mitigating the effects of the unemployment trap. Increasing child benefit would help because it raises the income of families in work more than the incomes of the unemployed, for whom an increase in child benefit simply means a reduction in child dependency additions to social security benefits;
- (ii) easing the effects of the poverty trap through being able to reduce or abolish family income supplement. Increasing child benefit would help by raising the incomes of all working families with children, and thereby reduce or eliminate the need for means-tested benefits for poorer working families;
- (iii) reducing pressure on wage demands. A sufficiently large increase in child benefit would help if pay negotiations no longer had to take into account the need for a "family wage";
- (iv) easing the way towards a comprehensive tax credit system in the longer term.

The scale and cost of a substantial increase in child benefit

3. The most obvious way of meeting these objectives would be to increase child benefit substantially across the board, but the cost would be very large, even though there would be no problems of administration or a need for additional staff, because the system is computerised. To abolish the national insurance child dependency addition of £7.95 would mean increasing child benefit to £13.85 a week and cost about £4.4 billion a year. To abolish family income supplement at its

present level, child benefit would have to be increased by £21 for the first child and £2.15 for each subsequent child, at a cost of over £7.3 billion a year. Because of these prohibitive costs, this paper examines other possible ways of achieving Ministers' objectives more cheaply.

Taxation of child benefit

4. One possibility would be to increase child benefit, but to tax the benefit so as to reduce the gross cost and concentrate the increase on poorer families. Taxation of itself, however, would not take one far towards Ministers' objectives. If standard rate taxpayers were to be no worse off, as seems essential politically, straightforward taxation would have only a marginal effect in terms of either alleviating family poverty or mitigating the unemployment trap, because the great majority of people now pay tax at the standard rate and any advantage would accrue only to the relatively small number of the very poorest families who were working.

5. Ministers have moreover expressed their opposition to the taxation of child benefit and the 1979 Manifesto recognised the benefit as a form of tax credit. If child benefit were to be taxed, there would be pressure for the reintroduction of child tax allowances, and the take-home pay of many workers would be reduced.

6. If this type of option is to be pursued, additional resources would have to be made available, for redeployment to selected groups. One possibility would be to use the extra resources to add a second tier of child benefit, making that second tier or some part of it taxable for those with a substantial income. The tax on the second tier (and on the basic child benefit) could be imposed either:-

- (a) on the husband through the PAYE system, by some device such as deducting a fixed sum from his personal allowances;
- or (b) on the mother through the PAYE system if she were in work;
- or (c) on the child benefit at source, at the Child Benefit Centre, Washington.

7. Each of these three possibilities has disadvantages:

- (i) taxing child benefit through the PAYE system to recover a proportion of expenditure selectively was in operation for family allowances (for higher rate taxpayers) until 1979. The reintroduction of such a system would need substantial extra manpower within Inland Revenue;
- (ii) the staffing consequences would be more modest if the taxation were confined to mothers with incomes in their own right (ie option (b)). But this would severely reduce the resources available for redistribution and it would produce anomalies, such as the position of the one parent family;
- (iii) if child benefit were to be taxed at source (ie option (c)), a satellite tax unit would have to be set up at the DHSS Child Benefit Centre to take into account both the father's income and any income the mother might have. It would not make sense to ignore the father's income and tax the mother's child benefit if she had no other income. In addition to the normal changes in family circumstances during a tax year which the child benefit system already has to record, such problems as self-employment and movements in and out of employment would complicate the system much more. Some 1,000 extra staff might be needed in DHSS for option (c).

An in-work credit tied to the award of child benefit

8. An alternative approach might be to introduce a family/child credit which would be available only to employed persons. It would be paid to them by their employers as an addition to the pay packet and employers would offset their disbursements against their payment of PAYE to the Inland Revenue. The credit could be administered in the form of a voucher to be issued to all families (perhaps included in the child benefit order book) but usable only if the family breadwinner were in employment. The credit could be adjusted independently of the rate of child benefit and the advantage would be that increased support for families would be channelled into the pay packet and would go only to families in work. If this

credit were means-tested there would be problems of administration. If it were not means-tested the cost of providing a credit for each child in working families would come to about £500 million a year for each £1 of credit. The problems would seem to be:-

- (a) like child tax allowances, the scheme would involve concentrating the additional family support on the father instead of the mother in all those cases where the father was the breadwinner;
- (b) it would be expensive to apply across the board, but a more selective approach would raise some practical problems to be solved both for employers and the Government machine.

A Canadian system?

9. One possibility which has been suggested is to introduce a child tax credit on the lines of the system that operates in Canada. A detailed note on the Canadian system is in the Annex to this paper. It shows that the income tax system in Canada is fundamentally different from that in the United Kingdom. In Canada there is self-assessment; income tax unlike PAYE is not calculated on a cumulative basis; and in general everyone who has any income must make an individual and separate tax return (eg in particular husbands and wives who each have incomes must file separate returns). The basic family allowance in Canada is itself taxable, and the tax system there is fully computerised. Moreover, the Canadian child credit is related to income earned in the previous tax year and thus does not reflect current need. On all these fundamental points it differs completely from that in the United Kingdom, and the Canadian child tax credit could not be grafted on to the UK system until at least some of the main features of the UK system have been changed, in particular the computerisation of PAYE and the taxation of husband and wife.

Two other possible schemes

10. In view of the cost of increasing child benefit for all and the problems of introducing a taxable second tier of child support, officials have gone on to examine two other possible schemes which, at some benefit and administrative costs, might meet some of Ministers' objectives, by setting the levels of benefits and tax at certain points which were designed to achieve just that.

- (1) The first option would provide for a second tier child benefit of £20 a week for the first child, plus £5 a week for each additional child, to be clawed back through the tax system at the rate of £0.25 for every £1 of income above the Married Man's Tax Allowance level.
- (2) The second option would combine a child tax allowance with a child tax credit. There would be a tax allowance of, say, £2,250 for the first child plus £500 a child for all additional children, to be added to the Married Man's Tax Allowance. The additional allowances would be reduced by £0.67 for every £1 of income above the new thresholds. Families whose income fell below the new tax thresholds would receive credits set so that all such families would receive the full after-tax value of the new allowance (that is £675 a year for a one child family, equals £2,250 x 0.30 standard rate of tax).

11. The advantages of scheme (1) would be:-

- (i) at the very bottom of the earnings scale (up to about £50 a week) it would fully buy out family income supplement (FIS);
- (ii) above this minimum level, net family income for a two-child family would be higher than it is at present on earnings up to £150 a week. The gains would be greatest - £10 a week or more - for families with incomes at around £100 a week;
- (iii) above the cut-off points the new benefits or allowances would be fully clawed back and improvement would be largely concentrated on families with incomes at or below the current level of average male earnings (£160 a week);

- (iv) over 2.5 million families would be better off than at present, at a total net cost of £1.3 to £1.5 billion a year;
- (v) the scheme would significantly improve the poverty trap between £40 and £100 a week;
- (vi) the scheme would improve the unemployment trap, on the assumption that the new benefits or credits were offset against supplementary benefit entitlement.

12. The disadvantages of scheme (1) would be:-

- (i) it would be administratively more complex than scheme (2), because it would involve two administrative channels (paying out child benefit through post offices and recovering some of it through taxes); the Chancellor has argued against this administrative complication in his paper on child support;
- (ii) the increased child benefit would normally be paid to the wife, but the tax on it would normally be deducted from her husband's pay. This transfer from wallet to handbag would not be popular with husbands and might adversely affect wage negotiations;
- (iii) increasing child benefit counts as public expenditure, whereas tax allowances/credits do not;
- (iv) fewer families (2.5 million) would be better off than in scheme (2) (3.5 million).

13. The advantages of scheme (2) would be:-

- (i) at the very bottom of the earnings scale (up to about £50 a week) it would largely buy out FIS, with some small losses in net income;
- (ii) above this minimum level net family income for a two child family would be higher than it is at present on earnings up

to £180 a week. The gains would be greatest - £10 a week or more - for families with incomes at around £100 a week;

- (iii) above the cut-off points the new benefits or allowances would be fully clawed back and improvement would be largely concentrated on families with incomes at or below the current level of average male earnings (£160 a week);
- (iv) over 3.5 million families would be better off than at present, at a total net cost of £1.5 to £1.7 billion a year;
- (v) the scheme would significantly improve the poverty trap between £40 and £100 a week. It would have particularly favourable effects as no income tax would be paid on earnings up to £100 a week, although national insurance contributions and reduced housing rebates would still affect take home pay;
- (vi) the scheme would improve the unemployment trap, on the assumption that the new credits were offset against supplementary benefit entitlement.

The major disadvantage of scheme (2) is that it entails reinstating child tax allowances, with all the disadvantages (including significant staff costs in Inland Revenue) which the Chancellor of the Exchequer has pointed out. It would, again involve two different channels for getting child support to families. Otherwise, it has the disadvantage by comparison with scheme (1), that its cost is higher (because it covers more families).

Conclusion

14. Because of the prohibitive cost of increasing child benefit substantially enough to achieve Ministers' objectives, the only feasible route seems to be through introducing a second tier of child benefit support, with a measure of recovery from those who are better off. The unemployment and poverty traps would be eased, but it is uncertain whether the new system would have a telling effect on work incentives because:-

- (a) there is no good evidence on the degree to which, in wage negotiations, men and their trade unions have regard to the totality of family income from all sources, however derived rather than simply to gross and take-home pay; and
- (b) family men with children are in a minority among the unemployed, and the research evidence shows that they seek work at least as actively as younger men who receive less in benefit.

15. Of the two schemes discussed in paragraphs 10-13 above, the second seems better because it benefits more families. But there is a large cost to both schemes (from £1.5 billion to £1.7 billion); and both entail reintroducing complexity into the administration of child support by involving Inland Revenue, with a significant staff cost (about 1,000) for them.

Department of Health and Social Security
February 1983

The Canadian Child Tax Credit

Income tax system. The child tax credit must be viewed against the Canadian Income tax system as a whole - this differs from that in Britain -

- (i) self-assessment - tax returns are submitted by all individuals in the tax system
- (ii) non-cumulation
- (iii) computerisation - greatly reduces administrative costs of tax credits
- (iv) tax unit - individual, unless there is a dependent relative with no earnings
- where both have income, husband and wife both have to file a return
- (v) tax year - calendar year, 1 January-31 December.

Nature of credit. A credit for each dependent child under 18 on December 31 of tax year for whom "family allowance" is paid. A child is dependent if not paying income tax. Credit given on top of family allowance which is taxable.

Credit is income-related and basic credit is reduced as income rises. Income is taken from the line marked "net income" on the income tax form and is "family" income, defined as that of parent eligible for credit (virtually always the mother) plus that of spouse (defined as person to whom legally married and residing with on 31 December of tax year). Tax department have the right to disclose the income of her husband to the mother if, for some reason, he will not disclose direct. For person married during the year, the income of the spouse is limited to the portion of his income earned after the marriage.

Level of credit. Introduced in 1978 at \$ 200 where family income is not more than \$ 18,000 (1978 average income about \$ 19,500). Then reduced by 5 cents for each dollar. The following table gives examples of family size, income and level of credit.

<u>Family income</u>	<u>Number of children in the family</u>			
	1	2	3	4
\$ 18,000 or less	\$ 200	\$ 400	\$ 600	\$ 800
20,000	100	300	500	700
22,000	0	200	400	600
25,000	0	50	250	450
28,000	0	0	100	300
30,000	0	0	0	200

The basic credit was increased to \$ 342.24 in the June 1982 budget. It is, of course, an annual credit.

Procedure.

A one-page claim form included with January's family allowance cheque -- receiving parent claims credit. Tax is paid currently during year but value of credit not finally known until 31 December. Presumably offsetting of tax credit against tax due on basis of income in previous year, adjusted as necessary and especially at tax year end. If tax credit exceeds tax due, positive payment made but believed to be available only from April of year after relevant tax year.

Leaflet.

A 1978 explanatory leaflet is attached for information.

IMPROVED INCOME SUPPORT FOR LOW-INCOME FAMILIES THROUGH FAMILY INCOME SUPPLEMENT

Introduction

1. A number of specific proposals about Family Income Supplement (FIS) have been identified by the Family Policy Group arising from preliminary consideration of the CPRS Report on Unemployment. This note examines these proposals individually, but against the background of a more general examination of improving income-support for the low paid by means of a selective scheme.
2. This note is supported by a separate paper examining options for the amendment of the Child Benefit scheme and by other papers, prepared by the Inland Revenue, analysing the possibility of re-introducing Child Tax Allowances, either on their historical basis or as a flat-rate 'family responsibility' allowance for those having the care of children.
3. A description of the present Family Income Supplement scheme is at Appendix 1.

The case for income-support on a selective basis

4. The low-paid are a relatively small and relatively well-defined group. There may be about 0.72 million to 1.25 million families for whom improved income support is desirable and 160,000 of them are already receiving FIS. Providing benefit for the low-paid alone will clearly be less expensive than providing an equivalent level of support for all families with children either through the Child Benefit system or by means of Child Tax Allowances. The separate papers dealing with Child Benefit and Child Tax Allowances indicate the magnitude of the figures required for effective support: they run into £ billions. Costs of that size seem unlikely to be acceptable even within the next Parliament. By contrast, and of course depending on the extent of the improvement offered, a selective scheme is likely to cost no more than £500 million and would also have a smaller staffing requirement.
5. The second strand of argument in favour of a selective approach is that the criticised aspects of the present benefit in relation to work incentives and to wage rigidity apply only to relatively low-paid workers. The unemployment trap is mainly related to the smallness of the gap, and sometimes to the absence of

any gap at all, between the total out-of-work income of those who qualify for Supplementary Benefit and their total in-work income. The poverty trap, whereby because they are receiving means-tested benefits workers are subject to very high marginal tax rates, is also a consequence of low-pay. If softening the poverty and unemployment traps is a major objective, and if significant increase in benefits for all families for children has to be ruled out on cost grounds, then the only available course is to improve the structure of the FIS scheme, or to construct a replacement which would also have to be means-tested in character.

6. As regards wage rigidity caused by the 'benefit-floor' effect (employers not wishing to pay less than benefit rates for family men), this too is a problem affecting directly only low-paid employment, though action to counteract it might reasonably be expected to have an effect extending beyond the low-paid alone. But it should be said that while wage-subsidy, of which FIS is a variant, may be expected to increase labour supply at any particular wage-rate and thus to place downward pressure on wages, this effect may be modified in practice. If employees and employers hold strongly to the view that wage rates should be above benefit qualifying levels, including wage-support qualifying levels, then an expansion of selective wage-support may provide a stimulus for higher wage-claims particularly in highly unionised sectors. It would be prudent therefore not to expand selective wage support too much until the consequences of fairly small improvement can be observed in practice.

Is Family Income Supplement the best route to improvement?

7. There are some obvious advantages of using the present FIS scheme as a basis for an improved scheme of income support. The administrative machinery is already in place and, within limits, could be expanded fairly quickly. However, the FIS scheme was introduced as an interim measure and is administratively fragile. It is very open to abuse and specific features of it would require careful consideration before embarking on its large-scale expansion.

8. As appendix 1 describes, FIS is at present awarded for a 12 month forward period. Entitlement is established on the basis of earnings in the 5 weeks preceding the claim (normally). The benefit is paid at a fixed rate for the whole 12 months regardless of any change in the family's circumstances, whether for the better or for the worse.

9. This insensitivity to changes in circumstances is a virtue insofar as it gives certainty of income and removes, or at least defers, the bite of the poverty trap. But the dangers are also apparent. Earnings may be manipulated, with or without the collusion of employers, to increase benefit entitlement artificially. Claims can be advanced, or deferred, to avoid high earnings periods perhaps when overtime is worked. Wives may defer taking up full-time work, or even any work at all. On the other hand family circumstances may worsen because, for example, of short-time working, loss of opportunities to work overtime, or because of the birth of a child, without there being any increase in the FIS rate. A study is shortly to be carried out by the DHSS social security policy inspectorate to find out just what changes do occur during the currency of FIS awards and to discover if there is a trend toward improvement, or otherwise.

10. Any move away from a 12 month entitlement period would be expensive in staff. A six-month entitlement period requires a doubling of staff, a three-month one a quadrupling, and so on. Any such change, especially combined with initiatives which would themselves greatly expand the number of FIS beneficiaries (see later), could place in jeopardy the continued administration of FIS on a centralised basis.

11. These administrative issues will require further consideration in the light of any decisions made about the specific improvements in in-work benefit support dealt with in the following paragraphs.

THE SPECIFIC PROPOSALS MADE BY THE FAMILY POLICY GROUP

Proposal 1: Market FIS better (placing emphasis on its role as income support)

12. This could be done easily and speedily. It would not however be desirable to carry out a revised marketing strategy without real improvements in the benefit. Thus revised publicity should be seen only as part of a larger package. The effect on take-up of revised publicity is uncertain: and FIS has up to now suffered from a very poor level of take-up (around 50%). Take-up of around 70% is the most that could be reasonably hoped for and even that may prove optimistic. (Illustrations of benefit cost later in the paper are based on 75% take-up to avoid risk of cost under-estimation at this preliminary stage.)

13. A sum of £0.65 million is allocated for FIS advertising in 1983/84 and an effective advertising campaign could probably be substantially accomplished within that sum.

Proposal 2: Extend FIS to cover part-time work

14. This could be done reasonably quickly given that the additional benefit cost can be met and additional staff supplied to deal with an increased volume of claims. The effects of allowing FIS qualification on the basis of part-time work are however uncertain in terms of work behaviour. Some individuals who are at present unemployed may be encouraged to take-up part-time work. There may also be a significant incentive provided for some individuals to remain in part-time work rather than move to full-time work. Some individuals, particularly lone-parents, may move from full-time to part-time work, though this may not be a wholly undesirable effect in terms of child-caring.

15. Because the effects of the change on work patterns is uncertain it would be best to make only a modest change in the qualifying hours tests until better data can be obtained. These might be two appropriate steps.

a. Allow couples to fulfil the present 30 hours test by aggregation of the working hours of the partners. (At present the 30 hours must be worked by the man alone, though from November 1983 equal treatment provisions will mean that the woman will also be able to satisfy the test on the basis of her own working hours.) AND

b. Reduce the hours qualification for lone-parents from the present 24 hours to 20 hours.

16. The best estimate which can be made is that these two changes combined would cost about £5 million and would require 15 extra staff to deal with an extra 12,000 beneficiaries.

Proposal 3: Provide a more gradual FIS taper

17. Reducing the taper from its present 50% rate ^{with compensating change in the prescribed amount} allows improvement in both the poverty and unemployment traps. If that is the central objective of change, then taper adjustment is the best of the options available. It is not practicable simply to amend the taper and to do nothing more since the effect of that would be that 90% of beneficiaries lose substantially: about £4.20 a week if the

change is to 30% and about £5.50 if the change is to 25%. To counterbalance this loss the prescribed income limits have to be increased. But this, for any significant change in the taper rate, pulls very large numbers of people into FIS qualification and therefore to higher marginal tax rates than they at present experience. The overall effect of the taper change combined with adjustment in prescribed amounts is therefore to improve the unemployment trap (because more people qualify for income supplement and thus improve their in-work income relative to their out-of-work income); to reduce the severity of the poverty trap (by reducing the size of the FIS component of the marginal tax rate) but to increase the numbers affected by the poverty trap; to increase benefit costs because of larger numbers of beneficiaries; and to increase staffing requirements.

18. The effect and cost of a change in the FIS taper rate depends on the balance to be drawn between all these things, and that must be a matter of judgement. A reduction resulting in a higher taper rate than 30% would probably be too small to make the benefit significantly more attractive. A reduction below 25%, on the other hand, would probably allow entitlement to be established too near to average earnings rates and pull in too many beneficiaries. The practical choices therefore lie probably in the 25 - 30% range. The former provides higher benefit rates, because of higher prescribed amounts, and lowers the highest marginal tax rates to about 90%. But it draws about 1 million families, assuming 75% take-up,

into the 60 - 80%+ range. A 30% taper does not have such a large effect on marginal rates, though it still allows between a 13/14 point reduction. The benefit and staffing costs of a 30% and a 25% taper are set out below. A 75% take-up is assumed in each case.

30% Taper

Additional benefit cost.....	£210 million	(Total £300m)
Additional beneficiaries.....	520,000	(Total 680,000)
Additional staff needed.....	690	(Total 930)

25% Taper

Additional benefit cost.....	£320 million	(Total £410m)
Additional beneficiaries.....	1.02 million	(Total 1.18m)
Additional staff needed.....	1,350	(Total 1,600)

Proposal 4: Calculate FIS on a net income basis

19. The effect of a change to a net income basis of calculation instead of gross income, as at present, is to reduce the effect of the unemployment trap (it increases in-work income). If the calculation is a true net income one, taking exact account of tax and national insurance, or if it is a notional calculation on the basis of an allowance weighted according to income, it causes a softening of the poverty trap. A notional flat-rate deduction helps with the unemployment trap, but has no effect on the poverty trap.

20. It would be possible to introduce a net income based calculation, but only by means of a flat-rate deduction. Anything else would be a major complication to the scheme administration and would require large extra numbers of staff. Since a flat-rate deduction has exactly the same effect on the benefit as a straightforward increase in the prescribed income limits (and that can be achieved more easily) there seems no good reason to introduce an artificial net income calculation. Doing so would simply open the door to pressure to move to a true, and administratively expensive, net income calculation.

21. A change to a notional net income scheme is not recommended, but the following table illustrates the effect of a notional deduction of £18 from gross pay. (£18 is chosen because it is the figure used within the Housing Benefit scheme.) The table assumes a take-up rate of 75%.

Additional benefit cost.....	£170 million (Total £260 m)
Additional beneficiaries.....	410,000 (Total 570,000)
Additional staff needed.....	560 (Total 800)

Proposal 5: Withdraw FIS passport benefits

22. The passport benefits are entitlement to free NHS charges and to hospital fares, entitlement to free school meals, and entitlement to welfare foods.

22. Because NHS charges are usually incurred only at intervals, it is not practicable to convert that passport entitlement into a weekly cash equivalent. Hence it is impracticable to compensate for loss of entitlement by enhancing weekly benefit rates. Trying to do so would undoubtedly provoke major criticism. This is also the case with entitlement to hospital fares.

23. It would be technically possible to convert welfare foods entitlement and school meals entitlement into a weekly cash supplement to the FIS rate. However, there would

be formidable opposition to such a move. The medical and nutrition lobby, and the poverty lobby as well, could be expected to be implacably opposed to such a conversion from benefit in-kind to cash payments. Primary legislation would be required to achieve the change. There would also be a substantial extra cost. This is because adding the value of the passport benefits to weekly cash benefit can only be practicably done by increasing the FIS limits. This means large numbers of individuals would qualify for, in effect, part of the in-kind benefit. This is in contrast to the all-or-nothing qualification of the present scheme: families either qualify for FIS, and therefore for full passport benefits, or else they do not. Also, passport benefits do not attach only to FIS. Supplementary Benefit also confers passport entitlements and it would be difficult, if not impossible, to convert the FIS passport to cash entitlement to a cash sum without doing likewise within the Supplementary Benefit scheme. It is very difficult to estimate the total cost of the change. The best estimate that can be made is that it would cost of the order of £120 million to make the change and that may well be an underestimate.

Proposal 6: Devise a replacement scheme for FIS to be paid via the wage packet

24. This proposal was put forward as one to be achieved in the longer-term.

25. The advantage of paying through the wage-packet is that it makes income-support highly visible both to the employee and to the employer. It would encourage the employee to see his total income, and not just his wages, as the reward for his labour. It would therefore maximise the effect of income-support on wages.

26. It would be technically possible to pay an income-supplement through the wage packet, but a number of substantial difficulties would have to be overcome first.

a. Taking money out of the purse

FIS, although the man has to work a minimum of 30 hours to qualify, is in fact paid to the wife. In this respect FIS is exactly similar to Child Benefit. The man is identified as a subsidiary payee on the payment book, but in the vast majority of cases the book is cashed by the woman. Constructing a benefit which transferred payment to the wage packet would therefore be likely to be very unpopular amongst existing beneficiaries. It would certainly provoke strong, well-orchestrated opposition from the poverty lobby. They argued successfully during a previous Government that Child Benefit should be paid to the woman, and FIS is very similar. It is, in effect, a means-tested child benefit since qualification depends on the family having the

care of children (though it is never publicly presented in this way).

b. Placing a new duty upon employers

Small employers especially would be unlikely to welcome responsibility for paying a wage-supplement, even though they were funded to do so. They would be likely to be even more reluctant if the new responsibility followed hard on the heels of the introduction of the Statutory Sick Pay scheme. Getting them to accept such a new responsibility would probably require considerable, and protracted, persuasion. Primary legislation would be needed. Technical problems would have to be overcome in order to fund employers - conversion of tax and/or national insurance deductions seems likely to cause reconciliation problems - but it appears possible to construct arrangements, though at some staff cost.

c. Who should receive payment when both members of a couple work?

If only the husband works, then payment can only be through his wage packet. If both husband and wife work (or from November 1983 entitlement to income supplement is established on the basis of the wife's working hours), should the woman be enabled to receive payment through her employer? Failure to allow this may run contrary to equal opportunity legislation, whereas allowing it will cause administrative complication, preclude any possibility of a taxable credit scheme at least on the basis of current PAYE operation, and would almost certainly diminish the sought for increase in wage-flexibility among male-earners.

d. Confidentiality

Some beneficiaries at least would be concerned about details of their personal circumstances becoming known to their employers as a result of supplement entitlement. Most obviously this could happen in the case of lone-parents, and un-married mothers in particular.

27. Wage-packet payment would however give the considerable advantage that the supplement would become an exclusively in-work benefit. This is not the case at present. FIS is payable for a 12 month period regardless of changes in circumstances, including becoming unemployed. This does not greatly matter if Supplementary Benefit is payable since the FIS is simply deducted in that assessment, though it is a messy arrangement. It does matter in other cases because FIS then loses much

of its work-incentive effect.

28. The simplest means of achieving wage-packet payment would be to issue beneficiaries with a book of vouchers which would be encashed by the employer and the money placed in the wage packet, or included in the wage cheque. The voucher book would have to be lodged with DHSS during any period of unemployment. Such a procedure would mean employers acting in effect as paying-agents in just the same way as the Post Office does now. Many would no doubt ask, rhetorically, why it was necessary to make the change and burden employers with additional administrative costs. An alternative to the voucher book, with its very close similarity to existing payment books, might be some sort of payment authority, possibly a plastic card, to be lodged with the DHSS during any spell in which another benefit was claimed, but otherwise usable either by the husband or the wife via their employer.

29. Precise payment arrangements need considerable further consideration, not least to ensure that abuse can be adequately prevented. However, it is already clear that wage-packet payment would be considerably more expensive than existing Post Office payment. More complicated systems would be required to deal with non-payment by employers and with payment authorities not being released on job-transfer or being accepted by new employers. Much more rigorous policing of the payment system would also probably be necessary to reduce to a minimum the possibility of collusive fraud between employer and employee especially in fringe businesses.

30. Precise figure cannot yet be put to the additional staffing employer payment might require, but it may be of the order of 100 posts. There would also be a substitution cost in running separate payment arrangements for self-employed people.

Summary

31. The selective basis of FIS (or a FIS successor) make it a much more cost-effective route to improved income support than either Child Benefit or Child Tax Allowances. The most effective means of improvement would be to amend the FIS taper rate from its present 50% level to either 30% or 25% and to make in addition a small modification to the qualifying hours tests. Couples could be allowed to fulfil the test by aggregating their working hours and lone-parents could be allowed to qualify on the basis of 20 hours of work instead of 24 as at

present. Assuming 75% take up of the improved benefit and a 30%/25% taper rate instead of the present 50%, this would cost an extra £215/£325 million, increase beneficiaries by 0.53/1.03 million, and need 705/1365 extra staff. These figures are broad estimates and need further refinement, particularly because of knock-on effects in the Housing Benefits and Supplementary Benefit scheme (the former are likely to be 'savings'). It would be possible to publicise FIS as an income-support benefit, but this would best be done in tandem with real improvements to the benefit structure. Changing to a true 'net income' basis for FIS computation would require large increases in staff and for little gain. A notional system of 'net income' computation based on flat-rate deduction is immediately possible, but offers no advantage over a more straightforward increase in the income limits for FIS qualification. It is not practicable to convert passport entitlement to exemption from NHS charges and to hospital fare refunds into weekly cash benefit. It is technically possible to convert passport entitlement to welfare foods and to free school meals into weekly cash benefit, but doing so would be highly controversial, require primary legislation, and involve a minimum of £120 million in benefit expenditure. This cost arises because of knock-on effects in the main. Wage packet payment of income-supplement could be achieved subject to employers accepting payment responsibility and to the necessary primary legislation being secured.

Timetable for implementation of change

32. The speed with which changes can be implemented depends to a large extent on the complexity of the package of changes. If primary legislation is required, and for most important changes it would be, its timetable must be an uncertain one. Changes which require a large increase in numbers of beneficiaries require substantial additional staff and recruitment and training will take time. A reasonable programme might be as follows.

Preparatory work.....begin immediately
Legislation required.....secure by mid-1984
Full operation of new arrangements.....late 1984.

February 1983

Department of Health and Social
Security
Elephant and Castle
London SE1.

THE EXISTING FAMILY INCOME SUPPLEMENT (FIS) SCHEME

General

- (a) The man (or sole parent) must be in full-time work. This is currently defined as 30 hours in cases involving a couple, and as 24 hours for one-parent families.
- (b) There must be at least one dependent child. Normally a child counts until it is aged 16, but may count until age 19 if it remains at school.
- (c) Since FIS is a means-tested benefit, gross income must be within prescribed limits.

2. FIS is paid by order book encashable weekly at the Post Office. In the case of a couple, the order book identifies the woman as the main payee, though the man may also sign the counterfoils and receive the benefit. Almost invariably, however, the woman cashes the order book. The benefit is much more a contribution to the purse than to the wage packet. It is paid for a 12-month period from the qualifying date and is not affected by changes of circumstances, whether these operate in favour of, or against, the beneficiary.

3. It is not a pre-condition of FIS entitlement that the family should be entitled to Child Benefit. However, for practical purposes, all FIS families are also receiving Child Benefit. To that extent, FIS fulfils the role of a means-tested Child Benefit, but it has never been presented as such. It is always publicised as a family benefit.

Costs and numbers

4. FIS is currently:-

- (a) paid to 160,000 families, 72,000 of them one-parent families. Take-up is however estimated only to be about 50 per cent. Therefore approximately 320,000 families could be beneficiaries;
- (b) costs £93 million a year (and would cost approximately £160 million a year if there were full take-up);
- (c) requires 236 permanent staff (at a cost of £3 million a year) for administration. If there were full take-up, the staff requirement would be about 450 (at an approximate cost of £6 million a year). But a full 100 per cent take-up of FIS is in practice impossible to achieve under present rules; and this has always been acknowledged. The benefit is administered centrally from the DHSS's North Fylde Central Office.

ASSESSMENT

The amount of FIS due is calculated by assessing the family's normal gross income at the date of claim, taking this away from a prescribed amount (which varies with the number of children in the family) and halving the difference. Arbitrary maxima are imposed upon this calculation to limit the total amount of benefit paid.

The prescribed amounts at November 1982 levels are £82.50 for a one-child family, increased by £9 for every additional child; the maxima are £21 for a one-child family, increased by £2 for every additional child.

SUMMARY OF FAMILY SUPPORT OPTIONS

SCHEME	COSTS		EFFECTS ON			
	BENEFIT	STAFF & ADMIN	FAMILY INCOME	POVERTY TRAP	UNEMPLOYMENT TRAP	OTHER ASPECTS
<p>1. <u>FIS package</u></p> <p>Reduce taper to 30%/25% plus compensating changes to prescribed amounts and modify qualifying hours rule (assuming 75% take-up)</p>	+ £210m/ £330m.	+ 700/ 1350 DHSS Staff + [£4.1m/ £9m/ P.O. charges	Benefit up to 0.5m/ 1.2m low income families by about £3/£5.50 a week on average	Reduction in FIS taper lowers marginal tax rates from 100%+ to about 90% but number facing tax rates of 60%+ substantially increased. Larger numbers are brought into the 60%+ band by a 25% taper than by a 30% taper	Gap between net income in work and on supplementary benefit increased from £6.50 a week at present to about £9.50/£12 (for family with 2 child- ren on half average earnings)	Net income of low- wage families in- creased, but extra money payable to wife.
<p>2. <u>Substantial increase of CHB</u></p> <p>a. Universal increase of £8 per child P.W.</p> <p>b. Increase of £21 for first child, £2.15 for each subsequent child</p>	a. + £4.4 billion b. + £7.3 billion	Nil Negligible	a. and b. Benefit all families in work	a. and b. Improved, by raising in-work incomes and reducing/ eliminating need for means-tested benefits for poorer working families	a. and b. Alleviated, because CHB offset against Supplementary benefit, therefore families in work better off	a. Buys out long- term CDAs. b. Buys out FIS. Increase paid wife.
<p>3. <u>Increase CHB and tax it either:-</u></p> <p>a. <u>At source</u></p>	Depends on figures chosen (2 above and 5 below are illustrat- ive)	+ perhaps 1,000 at CBC	Depends on new level of CHB and level of taxation chosen. A clawback of £1 for insignificant effect. at 40%+, increase in and both poverty and	£1 at or near tax threshold would have an income for all standard-rate taxpayers, unemployment traps alleviated. An adjustment to FIS would be necessary.		Increase paid to wife

SCHEME	COSTS		EFFECTS ON			
	BENEFIT	STAFF & ADMIN.	FAMILY INCOME	POVERTY TRAP	UNEMPLOYMENT TRAP	OTHER ASPECTS
3. <u>Through PAYE</u> i.e. by clawback	Depends on level at which clawback applies - could be very high.	+ $\boxed{500}$ at I.R.		- SEE ABOVE -		Increase paid to wife and clawed back from husband.
4. <u>In-Work Credit</u> Paid to those in work through the wage packet						
a. Non-means-tested	a. +£500 m. p.a. per £1 of credit	a. Probably substantial	a. Increases income of all families in work	a. No effect unless accompanied by changes in FIS.		
b. Means-tested	b. Depends on cut-off point	b. 750+ in DHSS	b. Increases income of poorer working families		Beneficial - increase paid only to those in work	Increase paid to husband. Probable resentment of employers (administrative burden)
5. <u>Second-tier CHB</u> £20 p.w. first child, £5 p.w. subsequent children Clawed back through tax system at 25p per £1 of income over the MMTA level.	+ £1.3 to £1.5, billion	+ $\boxed{500}$ at I.R.	Benefits over 2½ million families at or below average earnings by £10 p.w. average	Depth of trap reduced and breadth increased. Lowers maximum tax rates from 100%+ to about 90%, but numbers facing tax rates of 60%+ very substantially increased.	Gap between in and out of work income widened.	FIS abolished. Increase paid to wife and clawed back from husband.

SCHEME	COSTS		EFFECTS ON			
	BENEFIT	STAFF & ADMIN.	FAMILY INCOME	POVERTY TRAP	UNEMPLOYMENT TRAP	OTHER ASPECTS
<p>6. <u>Child Tax Allowance and Child Tax Credit</u></p> <p>Tax allowance of £2,250 first child, £500 subsequent children. Additional allowances clawed back at effective tax rate of 20% above new thresholds. After-tax value of allowances payable as credits to low-income families:</p>	+ £1.5 to £1.7 billion	+ $\frac{500}{I.R}$ at I.R.	Benefits over 3 $\frac{1}{2}$ m. families with earnings up to £180 a week, by £8 per week on average. Small losses in net income for those currently on FIS	Depth of trap reduced and breadth increased. On earnings up to £100 a week, reduces maximum rates to less than 40% from current maximum of 100%+ but increases tax rate by 20% on earnings between £100 and £180 a week.	Gap between in and out of work income widened.	FIS abolished. Increase paid to husband.

NOTES:

1. Although there is no proven evidence all the options could have a beneficial effect on wage bargaining, according to the level of income support provided.

EF JV



2 pp's

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522

CF/P1 add to

From the Secretary of State for Social Services

the papers (in my bag today)

Tim Flesher Esq
10 Downing Street

Done ←
R, 23/2
22 February 1983 MS 23/2

Dear Tim,

MINISTERIAL GROUP ON UNEMPLOYMENT AND FAMILY SUPPORT ISSUES

My Secretary of State minuted the Prime Minister on 18 February with three sets of notes. Unfortunately one of the sets was incomplete - that relating to child benefit and Family Income Supplement (FIS) did not have the FIS notes or summary table attached. I now enclose those two items, which should simply be added to the end of the child benefit papers, after the summary of the Canadian Child Tax Credit Scheme.

Copies go as before to the Home Secretary, Chancellor, Secretaries of State for Industry and Employment, Mr Sparrow, Mr Mount, Sir Robert Armstrong and Mr P L Gregson.

Yours, with apologies,

C A H Phillips

C A H PHILLIPS
Private Secretary



DEPARTMENT OF THE ARMY
HEADQUARTERS, ARMY
WASHINGTON, D.C.

22 FEB 1983

