

Ami... 1



Agree that the options for a cut-off be Yes not looked out at this stage? (see para 4)

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The Chancellor progress to commission further work on this.

PRIME MINISTER

BENEFIT LIMIT

Econ Pol - Incentives for lower Paid - Jan 1980. PL 1977

At the meeting of E Committee on 26 February (E(80) 8th meeting) I was asked to arrange for officials to examine further the possibility of a cut-off on the size of benefit payments.

.... 2. I attach a report by officials. It examines three options and concludes that any one could be made to work, given the manpower and legislative backing. The three options were:

- a. a limit expressed as a proportion of gross national average earnings, with no reference to individual circumstances;
- b. a limit related to an individual's income when in work, adjusted by broad tariffs to take account of net in-work deductions and in-work benefits (FIS etc) broadly to reflect family circumstances;
- c. a compromise between a. and b. which takes the broad limit in a. and adjusts it by reference to the family circumstances ~~tariff~~ in b.

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3. The report's conclusions are that all three options are broad brush in that they will not home in on specific cases where out-of-work benefits are higher than expected in-work income, and they would all, to varying degrees, affect a substantial proportion who would not expect higher in-work incomes. Option a. would be simple to apply and less open to dispute but would bear particularly hard on large families. Option b. would take some account of family circumstances, but would be more expensive to administer and might be more open to challenge and appeal in individual cases. Option c. would have some of the advantages of both a. and b., but it would still require additional staff and would give rise to pressure for refinement and to alleviate hardship.

4. This report by officials provides useful background, but its focus is essentially narrow. Any of the options would be attacked as unfair and discriminatory and would require additional staff. In my view the rationale for a scheme of this kind - that it would have a broad psychological effect in helping incentives across the board - is insufficiently strong for us to act at this stage.

5. I am concerned, as I said in my earlier memorandum on incentives (E(80)17), with the imbalance in society which makes it more attractive to remain out of work than to find and keep work. This is not related to specific comparisons of theoretical examples but to the general belief that, provided the financial effects of unemployment are not too uncomfortable, it provides leisure and opportunity which must be valued highly in relation to employment. In other words many people nowadays prefer the security of unemployment to the insecurity of employment. This, as I said, is a deep-seated problem and lies behind much of our present economic trouble.



6. Ways of tackling it, by action on the balance between total income in and out of work, raises the whole question of the level of social security benefits. The real value of benefits for the unemployed has just about doubled since 1951 - along with earnings in general. Thus the out-of-work have shared equally with those in work in past improvements in living standards. We have thus moved some way from the concept of absolute poverty. But we must ask ourselves whether in present circumstances benefit levels should continue to compensate fully for price increases, especially if earnings over the next year are to rise less than prices, as I believe necessary. Particular questions are the level of housing support (more than 5 million households out of a total of 20 million receive some form of help from public funds for housing costs) and supplementary benefit children's rates (where we might consider restricting the upratings so as not to let the substantial cash margin over child benefit grow any further).

7. These questions will also of course be relevant to our discussions on public expenditure. The Chief Secretary's memorandum to Cabinet raised the question of the need to find savings on social security expenditure, by uprating certain benefits by less than prices. I think that in our public expenditure discussions we must bear in mind the different dimension of work incentives and social policies generally.

8. I suggest therefore that we return to this question in the autumn. We might then have a discussion related to the wider context, sketched out in this letter, on the basis of a review by officials which develops and widens the themes in E(80)17 as the report that was attached to it. I will ask my officials to put this in hand.

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9. I do not rule out the possibility of applying a form of cut-off on benefit. But I would like to put it in a wider context so that it can be considered in relation to our future policies more generally.

10. I am sending copies of this letter to other members of E Committee, Sir Robert Armstrong and Mr Ibbs.

(G.H.)

15 July 1980

BENEFIT LIMIT

Report by Officials

Introduction

1 When E Committee discussed E(80)¹⁷18, relating to the report by officials on work incentives and benefit levels, they ruled out the re-introduction of a "Wage Stop" in the form of the supplementary benefit rule ^{which} was abolished in 1975, but invited the Chancellor of the Exchequer to arrange for officials to examine further the possibility of imposing some sort of cut-off on the size of benefit payments. Officials from the Treasury, CPRS, DHSS, Employment and CSD have considered the main types of benefit cut-off and their administrative and legislative implications and now seek Ministers' views on the next steps to be taken.

The previous "Wage Stop"

2 The National Assistance and Supplementary Benefit schemes contained a wage stop which was abolished in 1975. The principal reasons for its abolition were:

- (a) Its complexity - it attempted originally to adjust the level of wage stop according to an individual's earning capacity. This caused difficulties in administration, often considerable nugatory work and a high error rate. Complexity increased in the early 1970s when the introduction of FIS and rent and rate rebates and allowances for those in work added to the difficulties of calculation.
- (b) Its arbitrariness - the rules were difficult to apply in the case of a man who had been unemployed for a long time or one who was intermittently employed in a variety of jobs. The rules were changed in 1968 to apply, not to an individual's earnings if he was unskilled, but to National Joint Council rates for local authority manual workers. Concessions often had to be allowed to mitigate real hardship and this, and the error rate, increased the number of appeals.

- (c) Its ineffectiveness - at its peak in 1970 the scheme applied to 35,000 claimants (15 per cent of those required to register for work). But, chiefly because of the development of rent and rate rebates and the introduction of family income supplement (FIS), by 1975 it affected only 6,000. The administrative cost for this handful was very high (1 per cent of those required to register).

Nature of problem

3 We have taken Ministers objective to be that, as part of their policy of improving work incentives there should be some ceiling on benefit payment so that either those claiming benefit can be seen to be receiving a lower income than the generality of those in work or, more specifically, that those out of work do not receive a higher income than when they are in work.

4 To achieve such an objective fully might mean applying the chosen limit to unemployment benefit (UB) as well as to supplementary benefit (SB). But in practice it does not seem necessary to do this, because with the withdrawal of earnings related supplements it will be very rare for UB on its own to exceed in work income. This report therefore excludes unemployment benefit from consideration and concentrates on whether there should be any limit to SB entitlement (though where UB and SB are both paid the limit would apply to the total).

5 The Cohort Study of the Unemployed will provide us, later this year, with a better picture of the financial circumstances of the unemployed. But, in broad terms, there are three main factors which can lead to out of work income (from supplementary benefit) reaching or exceeding in-work income (from earnings and social benefits available to the low paid):

- (a) High housing costs;
- (b) Very low earnings;
- (c) Large family.

Each of these factors may be enough to cause incentives problems; but in most cases the problem will arise from a combination of factors. For example, a man with only one or no children would have to have

very low earnings or very high housing costs to make him potentially better off out of work.

6 Given the difficulties that arose on the administration of the wage stop, we have sought a solution which would be both simple to administer and fair to the beneficiary. These objectives may be in conflict - a simple scheme may be arbitrary in its effects and no solution is free from administrative difficulty.

7 Number of working age who claim SB

- required to register for work	600,000
- not required to register (e.g. one parent families)	600,000
	1,200,000
TOTAL	1,200,000

Estimated numbers of those required to register receiving higher income on benefit than they would in work (5%)	30,000
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NB This figure would be lower if all available in work benefits were claimed.

8 The estimated average benefit payments (unemployment benefit and supplementary benefit) at November 1979 to unemployed persons receiving supplementary benefit were as follows:

	<u>Table 1</u>				
	No children	one child	two children	three children	four children and more
Average payment*	£23	£40	£43	£46	£51
% of families required to register	0%	31%	32%	20%	17%

These figures cannot be compared with after-tax earnings when in work because those in work may qualify for benefits such as rent and rate rebates on top of their earnings.

*including unemployment benefit for those cases in which UB is in payment.

The options

9 There are three main alternatives:

Option A: A benefit limit related to average earnings; or

Option B: A benefit limit based on individual net in work income;

Option C: A compromise between A and B.

Option A

10 Out of work benefit (i.e. supplementary benefit plus, where applicable, unemployment benefit) would be limited to a given proportion of gross national average earnings (currently about £110) with no reference to individual circumstances. The figure taken would be updated (perhaps each year) in line with average earnings.

Effects

11 The effect of option A depends on the limit chosen. Because the "better off" problem affects only a small number of people, most of them at the bottom of the pay ladder, the limit taken would have to be very low if it were to lead to any significant reductions in benefit payments. A higher limit might still have some presentational impact, but would affect few people in practice. The table below demonstrates this.

Table 2

Benefit limit: % of average male earnings	Number of families with benefit limit at any one time	Annual benefit savings from limit (at current benefit levels)	Staff Numbers*
100%	less than 500	less than £100,000)	
90%	less than 500	less than £100,000)	10
80%	less than 500	less than £100,000)	
70%	less than 500	less than £100,000)	
60%	2,000	£½m	15
50%	12,000	£3½m	50
40%	90,000	£25m	325

*excludes take on costs and appeal costs

Table 3

1 % of gross average earnings	Impact on those affected *			4 % of those affected whose out of work incomes would not exceed in work incomes
	2 Number affected by limit	3 % of those, whose out of work income is higher than expected in work income, affected by limit		
50%	12,000	15		65
40%	90,000	60		80

At higher levels of benefit limit it is expected that the percentages in column 3 would be lower, and in column 4 higher than shown.

Table 4

Those subject to limit, by family size

Limit chosen	Number of children				
	None	One	Two	Three	Four or more
50%	6%	6%	9%	13%	66%
40%	5%	12%	26%	26%	31%

Advantages

12 The case for this option would be:

- (a) The benefit limit would, in a broad sense, reflect earnings levels. Like earnings levels, there would be no variation according to individual or family circumstances, (except to the extent that indirectly the limit would take account of child benefit, because this would be deducted from the supplementary benefit payable);
- (b) The limit would be simple to apply; and
- (c) There would be no scope for dispute on the figures to be used, any more than there is on the benefit rates laid down in regulations.

*This and the subsequent estimates of effectiveness (Tables 5 and 7) are based on simulations of the impact of benefit limits on the men in the DHSS Cohort Study of the Unemployed. The Cohort Study collected detailed information on the family incomes prior to and during unemployment of a representative sample becoming unemployed at the end of 1978. The estimates are sensitive to small changes in both the definition of those receiving more out of work than in work and in the relationship between incomes in and out of work.

Disadvantages

13 The main difficulty about this option is that it would be rough and ready. It would not relate to individual circumstances so that:

- (a) A man with a higher earnings potential than average earnings (and a higher rate of expenditure) would face a larger proportionate reduction in income. Someone with low earnings potential (e.g. youngsters) would face less if any reduction.
- (b) The limit would ignore in-work benefits (e.g. rent and rate rebates and allowances, family income supplement) which vary according to family size and circumstances. Thus families on benefit would be more disadvantaged than a straight comparison with their in-work expectations would imply, and the effects of (a) above would be exacerbated, especially for larger families.
- (c) The option would be open to the criticism that it had a disproportionate effect ^{on} large families, and it would hence be seen as an anti-family measure (see Table 4).

14 In consequence, option A could not be defended as individually fair. It would have to be justified on the more general basis that for anyone to receive a weekly payment of benefit higher than a given proportion of average earnings would be wrong because it undermines work incentives. The resulting "hard cases" would produce considerable pressure for hardship provisions. Such pressure would be difficult to resist, given the fact that, (unlike the case of a striker) the claimant's unemployment would (normally) be no fault of his own and might be for a long period. But, if conceded, such provisions would be difficult to administer; be staff intensive; and open the door to appeals. Even without such provisions, there would be extra pressure and work arising from more claims for exceptional needs payments for clothing etc. Thus the lower the limit chosen, the higher the number of cases affected and the higher the staff cost. The choice for Ministers, if they prefer option A,

is whether a limit which affected only a handful of cases would have sufficient presentational impact to provide a useful addition to the Government's measures to improve work incentives; or whether, to be worthwhile, the limit should affect a significant number of cases.

Option B

15 Benefit would be limited to recent in work income (or could be a given proportion of that income). But to avoid difficulties of the sort that emerged in applying the wage stop:

- (a) A condition of claiming benefit would be, as with FIS, that there is acceptable evidence of recent earnings. But it may not be possible always to apply this condition e.g. where there is no recent work record (probably as much as 30%). In such cases, it would be necessary to prescribe some other yardstick e.g. the Local Authority wage rates for manual workers, as under the wage stop (paragraph 2(b) above).
- (b) The appropriate earnings level taken in each case would be uprated (as in option A) by reference to a prescribed national indicator e.g. average earnings.
- (c) Net earnings would be established by making a tariff deduction of 22% from gross earnings. This deduction would be intended to cover tax, National Insurance contributions and work expenses;
- (d) Allowance for in work benefits would be made by a tariff addition to the net earnings figure to equate with in work benefits such as housing benefits and FIS. The tariff would vary according to family size and, very roughly, according to family income. Unlike (c) it would have to be a cash amount. In current terms, the tariff would be for families whose gross income was below the level at which FIS is payable:

£4 for a first child, £1.50 for subsequent children
£2 for a married couple without children.

16 The advantage of the tariff system used in paragraph 15(c) and (d) is that it reflects, in a broad brush way, the differences in individual circumstances without involving staff intensive enquiries and opening the door to detailed arguments of the sort that arose under the wage stop. The tariff figures have been derived from average work expenses and average current benefit levels and checked against the initial results of the Cohort Study of the Unemployed. The figures given are still tentative and need further checking against the results of the Cohort Study. Like the earnings level (see paragraph 15(b)) the tariffs would need to be regularly reviewed. The tariffs would have to be mandatory; if they were merely guidelines they would not avoid the difficulties that arose on administering the wage stop.

17 The estimated effect of option B would be:

Table 5

1	<u>Impact on those affected</u>	
Number affected by limit	2	3
	% of those, whose out of work income is higher than expected in work income, affected by limit	% of those affected whose out of work incomes would not exceed in work incomes
21,000	45	35

Table 6

Effects on those subject to limit by family size

Number of children

None	One	Two	Three	Four or more
40%	18%	18%	6%	18%

Benefit saving £5m
Staff numbers 210* (100 staff for 10,000 cases)

*excludes take on costs and appeal costs

Advantages

- 19 The case for option B is:
- (a) The limit would reflect individual circumstances much more than option A, although there would still be a substantial element of rough justice especially for families with incomes close to the FIS level for whom an extra £1 a week in the net earnings figure could mean a sharp reduction in the benefit limit.
 - (b) The use of past earnings figures and of tariffs would eliminate some of the most awkward aspects of the wage stop. The most difficult element of the wage stop was the need to forecast total future in work income.
 - (c) The limit would not discriminate against large families to the same extent as option A.

Disadvantages

- 20 The case against option B is:
- (a) There would still be substantial room for argument and appeal especially on individual earnings levels, for example if local authority wage rates were used as a guide (see paragraph 15(a) above).
 - (b) Any tariff system is open to the objection that it is not as sensitive to individual circumstances as the help available under the different schemes it consolidates into a tariff. Accordingly, there would be pressure for a more finely tuned tariff and - as with option A - for hardship provisions.
 - (c) Option B would be more staff intensive than option A.

A middle course: Option C

21 If it were considered that at one end of the spectrum option A was too rough and ready in ignoring in work benefits but that at the other option B was too ambitious in seeking to tailor the benefit limit to individual circumstances, a middle course ^{could be} struck between the two (option C). This could be achieved by starting with an average earnings figure, as in option A, but applying to it an appropriately

modified version of the tariff in option B to take account of family circumstances, including in work benefits.

22 If a middle course were followed, and a 50% or 40% limit adopted, the effects would be:

Table 7

Effectiveness in reaching target area

1	2	3	4
% of gross average earnings	Number affected by limit	% of those, whose out of work income is higher than expected in work income, affected by limit	% of those affected whose out of work incomes would not exceed in work incomes
50%	1,000	less than 5	over 50
40%	30,000	25	75

Table 8

Size of families affected

	Number of children				
	None	One	Two	Three	Four or more
40% limit	15%	12%	17%	21%	35%
<u>Benefit saving</u>	£½m p.a. at 50%; £8 million at 40%				
<u>Staff numbers</u>	6 at 50%; 180* at 40% (60 staff for 10,000 cases)				
	*excludes take on costs and appeal costs				

Incentives

23 In principle, the introduction of a benefit limit could help work incentives in two ways. First, in its immediate impact on those whose benefit was cut or whose benefit might be cut if they became unemployed. Secondly, in its presentational/psychological effect generally, in emphasizing that the Government were taking measures to improve work incentives and to ensure that people were not better off out of work. There might also be a reduction, though not a complete elimination, in the number of cases receiving media publicity because their out of work income exceeds their in work income. The extent of the impact under the first head would depend directly on the limit level chosen.

Impact under the second head would depend less directly on the limit chosen: the fact that the Government was seen to be taking action, and that a limit was imposed could be as or more important than the precise level.

The financial and staffing effects

24 The financial and staffing effects (which do not include any allowance for deterrent effects) are:

Table 9

	Benefit savings	Staff numbers and annual cost
Option A		
(i) 40% of average earnings	£25m	325 (£3.2 million)
(ii) 80% of average earnings less than £0.1m		10 (£0.1 million)
Option B	£5m	210 (£2.07 million)
Option C (based on 40% of average earnings)	£8m	180 (£1.8 million)

Staff for those options involving a significant effort, together with the extra staff needed to set up the scheme, could not be found from existing resources. Accordingly, other economy measures would have to be found before the scheme could proceed if the staff needed were not to represent a net addition to the DHSS manpower budget.

Timing and legislation

25 Main legislation would be needed. If Ministers so wished, provision could be included in a social security Bill due to be introduced in the next (1980/81) Session. In addition, regulations would be needed; and these would have to define carefully the basis of the benefit limit and the opportunities for appeal.

26 There are also operational timing constraints. The benefit limit would be applied by the same local offices responsible for

implementing the new supplementary benefits scheme in November 1980. Provided this scheme were satisfactorily under way and that Royal Assent for the enabling legislation were obtained by May 1981, it would be possible to start applying the limit later that year. Operationally the least expensive time to introduce the limit would be when social security benefits are updated in November. Taken together, these factors would put the earliest date for implementation as November 1981.

Summing up

27 Any of the three options would be controversial, given the controversy that surrounded the wage stop and the all party support for its abolition, although the extent of the controversy would probably vary according to the severity of benefit limit imposed. But in the view of officials, any of the three could be made to work, at a differing political and administrative cost, provided there were the necessary manpower and legislative backing. Option A - the single figure unrelated to individual circumstances - would be simple to administer and would offer little scope for challenge on individual cases. The higher the number of cases it affected, however, the greater the administrative complication arising from cases of hardship. Option B is more closely tailored to individual circumstances (though not completely) and would be less open to attack as being unfair in principle as well as individually unfair in practice. But it would require more staff, would not avoid complication arising from cases of hardship and there would be pressure for refinement to meet individual circumstances making it more like the original wage stop. Option C is a half-way house which would remedy some of the lack of flexibility of A by making some allowance for family circumstances and would be simpler and less open to individual challenge than B. But as with A and B, there would be complication arising from cases of hardship and pressure for refinements.

Further Action

28 Ministers are invited to decide:

- (1) Whether they wish in principle to apply a limit to benefit;
- (2) If they do, whether any of the three options examined meets Ministerial objectives.

If one or more option is suitable, Ministers are invited to indicate which should be examined further and whether:

- (3) there are any issues arising which they would wish to consider again in the light of official advice
- (4) they wish legislation to be introduced in the 1980-81 Session
- (5) in the case of options involving a limit as a proportion of earnings, the limit should be relatively high (say 80%) or relatively low (say 40%).

15 JUL 1980

