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PRIME MINISTER

SOCIAL SECURITY REVIEW

We are to discuss family support at the next meeting of MISC 111 on Monday. My original proposals were concerned mainly with the need to improve the position of low income working families relative to those out of work. The mechanism for this is the family credit discussed in MISC 111(85)6. But you and the Chief Secretary have raised wider questions about child benefit itself. I thought it might be helpful if I set out some of the options here in case you wish to discuss them as a part of our consideration of family support in MISC 111.

Help for low income families

2. My paper (MISC 111(85)6) made out the case for replacing Family Income Supplement by a new family credit scheme which will provide an economical and effective means of directing help to poor working families. FIS suffers from a number of fundamental defects: it is not aligned with supplementary benefit; it gives disproportionate help to younger and smaller families; and it is awarded on insufficiently tight criteria. It was introduced as a temporary measure and is now largely discredited. Family credit will be better targeted; improve work incentives by evening up support for working and non-working families; be more tightly controlled and efficiently administered; and have much more impact on wage flexibility and readiness to take jobs because it will be paid through the wage packet. Although the tax and contribution changes in the Budget provided extra help to the low paid, most of that help went to single people not families. The family credit is, therefore, still needed in order to improve incentives for that group and to reduce the effects of the unemployment and poverty traps.

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3. A central part of the family credit proposal is that it will be paid by employers through the wage packet. In practice it will be offset against any deduction for tax and national insurance contributions or, where these deductions have been partly or fully cancelled out, paid in addition. Following the Budget, we could consider, as part of the study of integration between the tax and benefit delivery systems which will contribute to the Chancellor's Green Paper, how far the family credit could in the long term be integrated with the tax system. In the meantime, there would be presentational advantage in treating it as revenue foregone.

4. Financial effects. The impact of the Budget changes is to reduce the cost of the family credit scheme described in MISC 111(85)6 from £74 million to £67 million. That cost could be more than covered by abating a child benefit uprating. An abatement of 25p would, for instance, produce savings rising to £125 million in a full year, only half of which would be needed to meet the cost of family credit. The introduction of a family credit system which would protect the low paid would, I believe, make it possible to justify savings of this sort from child benefit.

Options for savings from child benefit

5. The Chief Secretary has suggested that we should seek further savings from child benefit. I do not agree with him that this should be done either by means-testing or by a cut in the value of the benefit.

6. Means-testing child benefit - or any other option which involved changing the basis of the benefit - would be inconsistent with our clear and recent public commitments. It would also go against the view we reached at your seminar last October. It would mean losses for 3½ million people averaging £10 a week; it would treble the number of people facing marginal tax benefit withdrawal rates of over 75 per cent; it would bring an extra 2½ million families within the scope of means-testing; and it would mean that we gave no recognition of family responsibilities through the tax or benefit systems to anyone with above average earnings.

7. A substantial reduction in the value of child benefit would also be impossible to deliver purely as a savings measure. The benefit is popular, well understood and paid to the wives in 7 million families. We could justify some savings if they were being used, at least in part, to pay for an improved system to help low paid working families.

Families and tax

8. You raised with me the possibility of reflecting family responsibilities in the tax system. Apart from a general return to child tax allowances there are a number of options which could be considered:

- (i) the introduction of a standard family tax allowance for all families irrespective of the number of children. This would be much simpler; it would allow us the flexibility to target increases in tax thresholds towards families if we wished; and it would be consistent with our family credit and income support plans;
- (ii) offering the option of child benefit or child tax allowances. This would reduce public expenditure if people opted for the tax allowance; but would only be advantageous to higher rate taxpayers (if allowable against higher rates of tax); and it would be more complicated to administer;
- (iii) a modification of the independent taxation approach. If independent taxation were only available for families with children, it would be a comparatively well targeted change. But such a restriction would seem unfair to older single-earner couples with no children or where one spouse is staying at home to look after a disabled relative.

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9. If colleagues feel that any of these suggestions are worth pursuing, they could presumably be taken forward in the context of the work for the Chancellor's Green Paper.

10. I am copying this minute to colleagues who will be attending MISC 111 and to Sir Robert Armstrong.

A handwritten signature in black ink, consisting of several loops and a final flourish.

21 March 1985

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