TAX CREDITS: POLICY ISSUES FOR UNISON

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1. INTRODUCTION

This paper originates in a request by UNISON to the New Policy Institute to examine the impact of the working tax credit and child tax credit that come into effect in April 2003 on the pay potential of local government staff. The first version of this paper was presented at a seminar in March 2003 for UNISON and others. This final version reflects the discussions of that day.

The working tax credit and the child tax credit constitute a significant revision and extension of the arrangements that have been in place since 1999. These revised arrangements will both increase the numbers of people eligible for tax credits and increase the amounts that they are entitled to. For the first time, they also include a tax credit for low paid workers who do not have dependent children. The net result is that many low paid households will be eligible for tax credits and, in many cases, these tax credits will form a substantial part of their income.

Many of UNISON's members in local government are relatively low paid. Obviously, therefore, the tax credits regime is of interest to UNISON and has potential policy implications for them. In particular, it means that the there is a less direct relationship between gross pay (which is what UNISON negotiates about) and net income (which is what is probably of most concern to its members). For example, if someone in receipt of tax credits receives an increase in their hourly pay of £1, their net income will typically increase by 'only' 30 pence because the amount of tax credit that they are eligible for will decrease.

Perhaps less obviously, the fact that most of UNISON's members work in the public sector is also an important factor in the debate. For example, if a local government employee in receipt of tax credits receives an increase in their hourly pay of £1, the gross pay bill to the local government employers will rise by £1.23 (including employer's national insurance etc) but the net increase to public sector expenditure will 'only' be 42 pence because the Inland Revenue will be paying out less in tax credits as well as receiving more in income tax.

Finally, the revised tax credit arrangements also include revisions for pensioners, with a 'pension credit' replacing the current Minimum Income Guarantee. Again, there are implications for UNISON's stance towards the Local Government Pension Scheme (LGPS).

In this context, the material in this paper has been organised as follows:

- ***Section 2 - 'the facts'***: a summary description of the revised arrangements plus a comparison with previous arrangements. Note that 'the facts with respect to pension arrangements are discussed in Section 5.
- ***Section 3 – issues arising with respect to employers***: a discussion of the issues relating to the unions, employers and pay bargaining
- ***Section 4 – issues arising with respect to employees***: a discussion of the issues relating to the relationship between UNISON and its members.
- ***Section 5 – issues arising with respect to pensions.***

It is sections 3 and 5 which are of most direct relevance to the Local Government Pay Commission submission.

2. TAX CREDITS FOR WORKING AGE HOUSEHOLDS

15 YEARS OF TAX CREDITS

Family Credit was introduced in 1988 for low income families with dependent children. In its final year (1999), it paid an average of £63 a week to 0.8 million households.

In October 1999, Family Credit was replaced by the Working Families Tax Credit.[1]

- More families became eligible and most received more money.
- A substantial element for childcare expenses was included.
- Administration was moved from the DSS to the Inland Revenue and the money was received via the pay packet. Despite being administered as part of the tax system, these credits were means-tested 'benefits' rather than 'allowances'. The move did, however, allow the government to account for the money as 'tax cuts' rather than 'government expenditure'

In its final year (2002), Working Families Tax Credit paid an average of £86 a week to 1.4 million households.

In April 2003, the Working Families Tax Credit will be replaced by a combination of a Working Tax Credit (WTC) and a Child Tax Credit (CTC):

- Again, more families will become eligible and most will receive more money.
- Some families without dependent children will become eligible for the Working Tax Credit.
- By subsuming the child elements of Income Support and Job Seeker's Allowance, the tax credits system will become more integrated with the benefits system (although child benefit remains a separate payment).

The new system represents a number of changes in principle:

- For the first time, tax credits will be available to some low paid adults without dependent children (if they are low paid, work 30+hours and are aged 25+).
- Continuing previous trends, tax credits will become available to the great majority of families with children: at the top end, the new CTC 'family' element of £10 per week is available to families with incomes up to £1,000 per week; at the bottom end, CTC replaces the child elements of Income Support and Job Seekers Allowance.
- CTC and any childcare element of WTC (but not the other elements of WTC) will be paid directly to the main carer, rather than via the pay packet. This represent a reversion to the situation prior to the introduction of the Working Families Tax Credit in 1999.

While the arrangements that take effect in April have much in common not only with those that have applied since 1999 but even those that have applied since 1988, they go much further in two ways: they are more generous and they will benefit more people.

WORKING TAX CREDIT (WTC) AND CHILD TAX CREDIT (CTC)

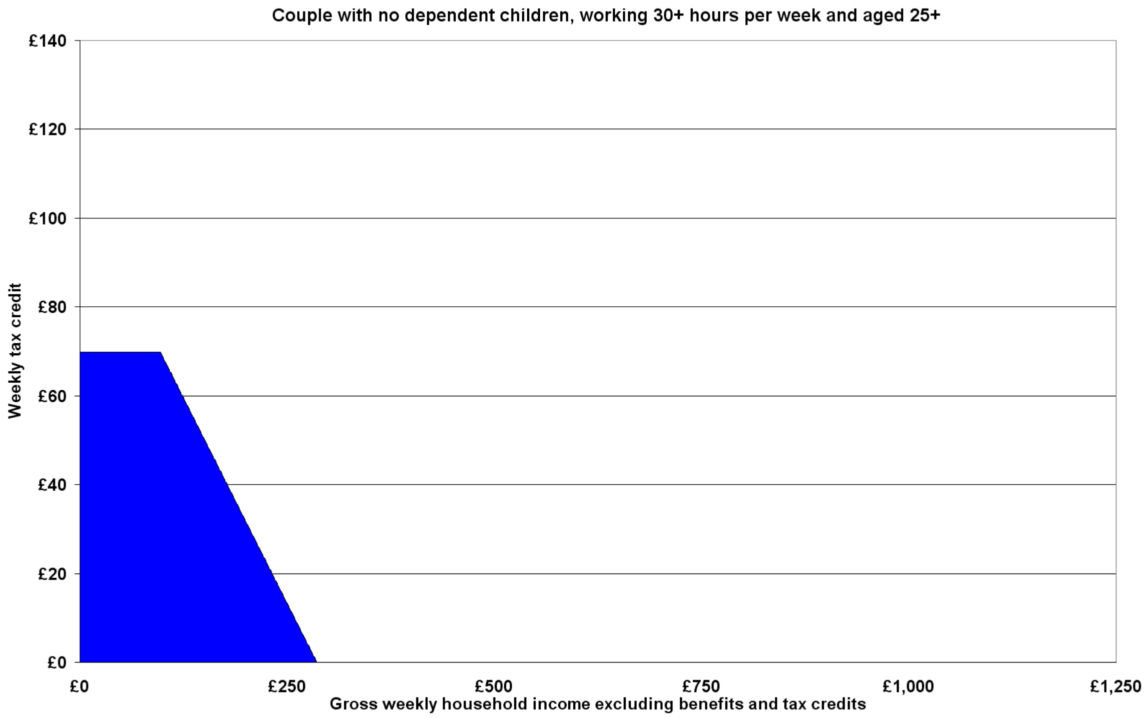
The crucial point about the amount of tax credit received is that it depends on household income rather than the individual's income (which is what counts for the purposes of working out how much income tax or national insurance is paid). This means that the calculation of how much money is to be received requires details about the composition of the household and the income of the other members of the household; it cannot be worked out from looking at the pay of the individual alone.

Working Tax Credit

Three types of family are eligible[2]:

- Households with dependent children where at least one partner works at least 16 hours per week.[3].
- Workers with a disability who work at least 16 hours per week.[4]
- Households without dependent children where at least one partner is aged 25 or over and works at least 30 hours per week.[5]

Subject to eligibility, the maximum is available for households with an average weekly income of up to £97 (about £5,000 a year). For each pound above this level, the amount of WTC reduces by 37 pence. So, for example, couples with no dependent children are entitled to some WTC if their average weekly income is less than £284 (about £15,000 a year).



Some WTC is available for weekly incomes up to £284

WTC has an additional component to help cover the costs of childcare for those households where all partners work at least 16 hours per week (up to 70% of £135 of costs paid for one child, and 70% of £200 for two or more children). This childcare component will be paid to the main carer of the child, alongside the new CTC.

Savings are not taken into consideration.

WTC is paid in the pay packet to the person claiming it.

Child Tax Credit

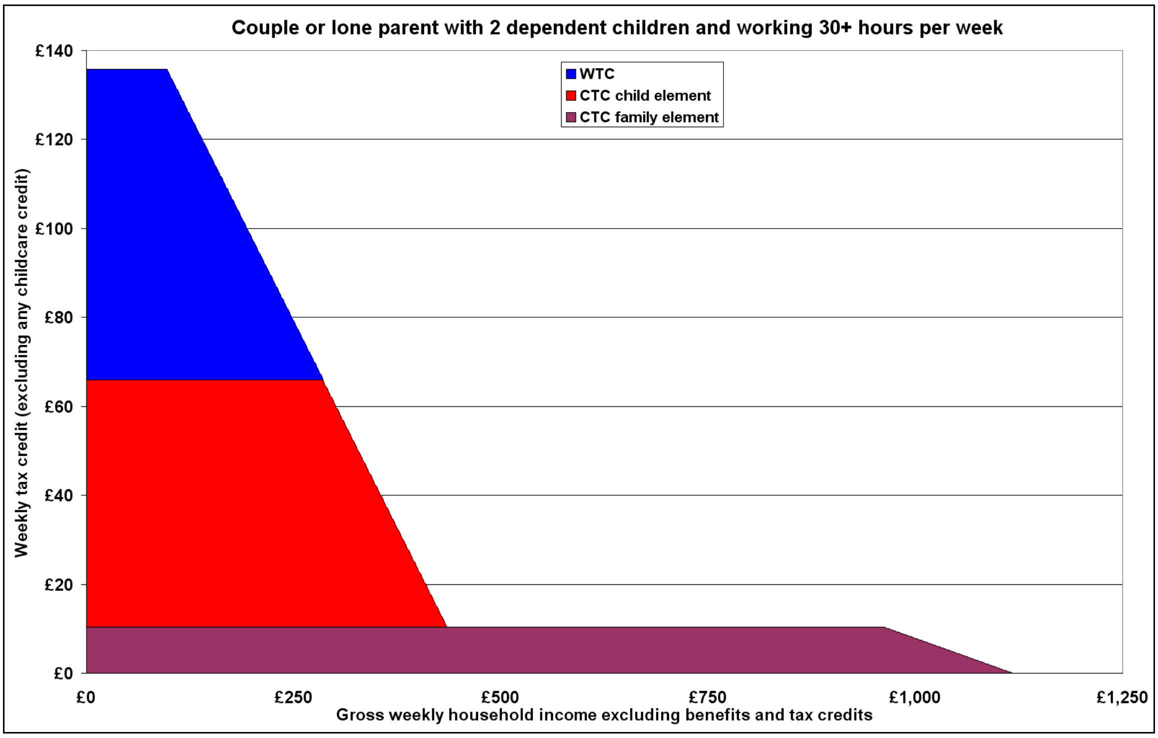
CTC is for any household with dependent children (up to age 19 if child in full time education), whether or not anyone in the household is working.[6].

Savings are taken into account, but only in terms of the income from these savings (which is treated the same as income from work) rather than via an capital means-test.

Unlike WTC, CTC is paid by the Inland Revenue direct to the main carer for the children in the family. This is in line with the approach taken with Child Benefit and means that all payments for children will be directed to the main carer.

The amount of CTC due depends upon the number and age of the children in the household. For example, the maximum available to a family with two adults and two children both over the age of 1 is £66 per week (about £3,500 a year). Such a family would be entitled to this maximum with an average weekly income of anything up to £284 (£15,000 a year).

Above this level, the credit reduces by 37 pence for every extra £1 in income until all but £10 of it has disappeared (£430 a week or £22,000 a year). The remaining £10 a week 'family' element remains undiminished until household income incomes exceed around £1,000 per week. For all except the highest earning families, therefore, this amounts to a flat rate credit.



Some CTC above the £10 family element is available for weekly incomes up to £433

Applications Based On Previous Year's Income

Applications are normally based on the previous year's income,[7] and awards will be renewed on an annual basis. The size of award can be altered during the course of the year if there are significant changes in circumstances or income, in which case the Inland Revenue must be informed within three months. The award will then be adjusted from the date of change.

One important effect of basing the credit on last year's income is that it means a bigger tax credit for a household that was not in work last year than one whose income is the same this year as last. While this has the perhaps desirable effect of providing an extra financial incentive for people to enter work, that extra incentive is only temporary, disappearing once a person has worked for an entire financial year.

HOW MUCH ARE TAX CREDITS WORTH? EIGHT CASE STUDIES

These case studies illustrate a number of features of the tax credit system as they impact on low paid workers. In the first five cases, the local government employee is on SCP 4 (this being the most common point for part time workers) on an hourly rate of £5.33 (i.e. the rate from April 2003). In the last three cases, the employee is on SCP 8 (£5.89 an hour). In all cases where there is working partner, he or she is assumed to be paid at the same hourly rate as the local government employee.

Employees 1 to 3: Lone Parents With One Child Of School Age

The first three employees are all lone parents with one dependent child of school age. Employees 1 and 2 both work 20 hours a week. However, while employee 1 has only just entered work after spending a number of years at home bring up her child, employee 2 was employed in this job last year, at an effective rate of pay 5% below what it is this year. Employee 3 works 30 hour a week. She too was employed in the same job last year, at a rate of pay 5% below what it is this year.

	Employee 1	***Employee 2***	***Employee 3***
Employee's Gross Weekly Pay	£107	£107	£160
Household Net Pay (Including Child Benefit)	£120	£120	£159
CTC	£38	£38	£38
WTC	£58	£56	£49
Household Income from Pay and Tax Credits	£217	£215	£246

Some notable features of these cases are:

- Employee 1 enjoys the maximum CTC and WTC to which a one child lone parent family would be entitled. This is because she was not working last year and the income on which her entitlement is calculated (i.e. last year's gross pay) is therefore below the £97 a week figure at which that entitlement is a maximum.
- Employee 2 earns the same as employee 1 but because she was employed last year her total household income is about £2 a week lower, due to the fact that her gross pay last year was above the £97 threshold. Of the two tax credits, it is WTC that is below the maximum, reflecting the way in which CTC remains at the maximum until WTC has disappeared.
- Employee 3 also has full CTC. Working 30 hours a week instead of 20, her WTC is lower than employee 2's . Because of that, however, those extra 10 hours a week translate into just £31 a week extra household income.

- If these employees live in rented accommodation, there are also impacts on housing benefit. All three employees here would be entitled to housing benefit and all would receive different amounts because of the impact of the tax credits. The most significant of the impacts is that employee 3's housing benefit is around £12 a week below that of employee 2. In other words, the extra 10 hours worked by employee 3 translates into just £19 a week extra household income once housing benefit has been taken into account.

Employees 4 and 5: Couples With No Dependent Children

The next two employees are both in two-adult households, with no dependent children. They are both aged over 25. Employee 4 works 20 hours a week while his partner works 10 hours week (at the same hourly rate). Employee 5, on the other hand, works 30 hours a week but his partner does not work at all.

	Employee 4	***Employee 5***
Employee's Gross Pay	£107	£160
Household Net Pay	£156	£141
CTC	£0	£0
WTC	£0	£49
Household Income from Pay and Tax Credits	£156	£190

Some notable features of these cases are:

- The household of employee 4 receives no tax credits at all. Obviously there is no CTC but since neither the employee nor his partner works 30 hours a week, there is no entitlement to WTC either.
- Since employee 5 does work 30 hours a week, he is entitled to WTC. As a result, the household's total income is some £34 a week more than employee 4's, even though the total number of hours worked in the two households, and at the same rate of pay, are identical.
- Once again, housing benefit provides a further complication for someone living in rented accommodation. As a result of the WTC, employee 5's housing benefit is some £14 a week lower than employee 4's, reducing the difference between the overall net incomes of the two households to about £20 a week.

Employees 6 to 8: Couples With Two Children Of School Age

Employees 6 to 8 each belong to a two earner couple, and each has two dependent children. Employee 6 and her partner both work 20 hours a week; employee 7 works 30 while her partner works 20; and employee 8 and her partner both work 37 hours a week.

	Employee 6	Employee 7	Employee 8
Employee's Gross Pay	£118	£177	£218
Household Net Pay (Including Child Benefit)	£250	£291	£386
CTC	£66	£66	£18
WTC	£23	£2	£0
Household Total Income	£339	£359	£405

Some notable features of these cases are:

- Employee 6 and her partner receive both CTC (at the maximum level) and some WTC, even though neither works more than 30 hours a week (compare with employee 4). This is because with dependent children, it is only necessary to work 16 hours a week to become entitled to WTC.
- Employee 7 and her partner are just about at the point where WTC disappears, with a total household income of almost £360 a week. Since WTC has not quite disappeared, however, CTC remains at the maximum.
- Employee 8 and her partner are approaching the point where CTC has shrunk to the 'family' element only. Between them, they are working 74 hours a week, compared with 50 hours for employee 7 and her partner. Those extra 24 hours, however, translate into just £46 more total household income.
- With incomes at these levels, housing benefit is no longer a factor.

HOW MANY WORKING PEOPLE CAN CLAIM TAX CREDITS?

Low Pay and Low Income Households Generally

Survey data (from the government's Households Below Average Income dataset) have been used to work out the chances that a low paid worker lives in a low income household and is therefore entitled to credits, on the assumption that the necessary hours conditions is met. Stated in terms of 2003/4 wage and salary levels, this analysis suggests that:

Of those employees with dependent children:

- Among those earning less than £5,500 a year, 30% of women and 70% of men will be entitled to both WTC and CTC while a further 35% of women and 20% of men will be entitled to CTC above the 'flat-rate' family element.
- Among those earning between £5,500 and £14,500 a year, 30% of women and 50% of men will be entitled to both WTC and CTC while a further 25% of women and 35% of men will be entitled to CTC above the 'flat-rate' family element.
- Among those earning between £14,500 and £28,500 a year, 25% of women and 50% of men will be entitled to CTC above the 'flat-rate' family element.

Of those employees without dependent children:

- 50% of women and 80% of men earning less than £14,500 will be entitled to WTC.

The reason that the percentages are generally higher for men than for women is that low paid men are more likely than low paid women to be in low income households. As a result, if tax credits are thought of as part of earnings (contributing to, or being represented as part of, the 'effective wage rate'), then they could be seen as contributing to a worsening of the gender pay gap.

Local Government Employees

Combining the percentages above with data on the local government workforce provides estimates of the number of local government employees who will be eligible for tax credits. This analysis is based on the distribution of local government employees by salary point, sex and whether they are part or full time.[8] It was then combined with information from the 2002 NOP Survey of Unison Local Government Members in order to estimate the distribution of hours worked (for part time employees) and whether or not the employee has dependent children.[9]

The table below summarises the results. In total, up to half a million local government employees may be entitled to one or both of WTC and CTC (above the 'flat rate' family element), while almost all other employees with children – more than a quarter of a million - may be entitled to the that family element of CTC. Together, these represent about 55% of the local government workforce.

Thousands of Local Government Employees Eligible For Tax Credits

	WTC only	*WTC and CTC*	*CTC only above flat rate*	*Others with children*
FT Women	40	5	20	60
PT Women	95 - 160	55	75	170
Total Women	135 - 185	60	95	230
FT Men	50	10	25	30
PT Men	5 – 25	10	10	5
Total Men	55-75	20	35	35
All FT	90	15	45	90
All PT	100 - 185	65	85	175
All Total	190 – 275	80	130	265

The key points are:

- Between 190,000 and 275,000 employees – more than two thirds of them women and all of them without dependent children – may be entitled to WTC only. The uncertainty in this figure (and hence the range) reflects the fact that the employee or their partner has to work at least 30 hours a week to be entitled to WTC and this information is not known.
- A further 80,000 employees are likely to be entitled to both WTC and CTC (in other words, they have dependent children but are sufficiently lowly paid to be due some WTC).

- A further 130,000 employees are likely to be entitled to CTC (but no WTC) above the 'flat rate' family element.
- Almost all other local government employees with dependent children are likely to be entitled to the 'flat rate' family element of CTC – a further 265,000 employees.

It is possible to go on from this and estimate the overall cost of providing tax credits to local government employees. A calculation that uses a series of cautious assumptions yields an estimate of £1.1bn a year for this cost. This implies average figures of about: £17.50 a week for those receiving WTC only, £60 a week for those receiving CTC above the flat rate (some of whom also get WTC); and £10.45 a week for those receiving the flat rate CTC only.

Overall, this £1.1bn represents more than 6% of the pay of local government employees. For part time employees, the tax credits represent about 14% of total pay among women and as 29% of total pay among part time men. Among full timers, tax credits represent between 1% and 2% of total pay.

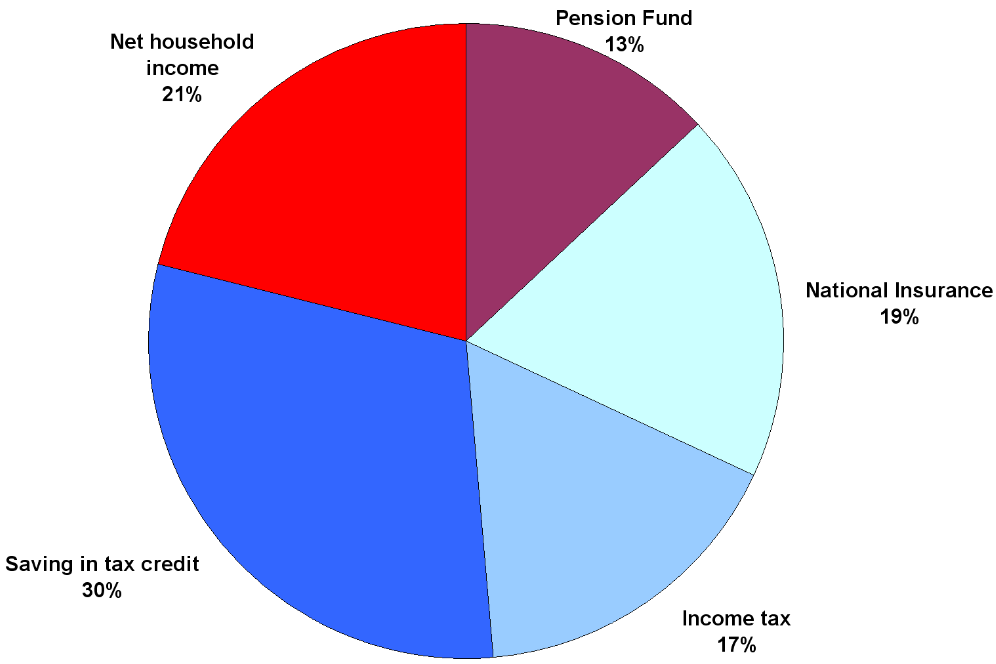
3. ISSUES ARISING WITH RESPECT TO LOCAL GOVERNMENT EMPLOYERS

THE KEY ISSUE

When gross pay rises by £1 for a worker receiving tax credits:

- The ***gross cost*** is £1.23 (after adding on employer contributions to NI and pensions).
- But the ***employee benefit*** is 'only' 42 pence. Of this:
  - The net increase in household income is 26 pence.
  - The net increase in pension contributions is 16 pence.

  In other words, 'only' one fifth of the money paid out by the employers ends up in net household income.
- And the ***Treasury*** saves 81 pence, due to a mixture of lower tax credits and higher tax and national insurance.



When that worker works in the public sector:

- The ***gross cost*** to the employer is £1.23.
- But the ***net cost*** to the public sector is 'only' 42 pence (because of the 81 pence saving to the Treasury).

In the case of local government, there is the further complicating factor of whether there are any rises in central government grant to help fund the pay rise. If, for example, central government grant stays constant, then the full £1.23 would need to be funded out of Council Tax, with the Treasury saving 81 pence. If, however, central government grant funds two thirds of the pay rise, then the Treasury would break even and 'only' 42 pence would need to be funded out of Council Tax.

POLICY QUESTONS ARISING

Net Costs Rather Than Gross Costs

During pay negotiations, it is common for either the employers or the unions to consider the overall costs of that settlement. The figure that is usually talked about is the overall cost to the employer – the 'pay bill'. The cost to local government is, however, by no means the same as the cost to the public sector as a whole.

In particular, as discussed earlier, the net costs of pay rises for people with tax credits is much lower than the gross cost to the public sector as a whole. ***If the gross costs solely are considered in negotiations, would this not substantially over-estimate the affordability of the pay increase from the point of view of the public sector as a whole? Rather, should such negotiations not consider the net costs to the public sector as well as – or even instead of – the gross costs of the pay rises?***

It would seem somewhat bizarre if the main beneficiary of any pay rises was HM Treasury (through reductions in tax credits). ***Should HM Treasury not be giving such 'profits' back to local authorities, particularly as a mechanism for so doing (i.e. central government grant) already exists?***

In our view, this is an issue where employers and trade unions have a shared interest in seeing that central government gives due recognition to the gains it makes from local government pay decisions – and responds accordingly.

Government Views on the 'Real' Minimum Wage

By making the Working Tax Credit available to low paid workers whether or not they have dependent children, central government is clearly recognising that working age adults should not have to live on solely the income from the minimum wage. Rather, it is effectively setting a 'real' minimum wage which is somewhat higher than £4.20 per hour:

- For a couple with no dependent children, 30 hours work per week at the minimum wage would result in a Working Tax Credit eligibility of £59 per week.[10] This is around £2 per hour, implying a 'real' minimum wage of £6.20 per hour.
- For a single person with no dependent children, 30 hours work per week at the minimum wage would result in a Working Tax Credit eligibility of £30 per week.[11] This is around £1 per hour, implying a 'real' minimum wage of £5.20 per hour.

Since much of the extra wage bill would be offset by reductions elsewhere in the public sector in the amount of money paid out in tax credits, would it not be better to pay all local government employees at least the rates above rather than pay less and then make up the difference through tax credits? Would not such an approach also help with recruitment and retention?

In effect, the Working Tax Credit represents a subsidy to employers. Whereas there are arguably economic arguments for such a subsidy in the private sector (to avoid a loss of jobs), there is no such argument in the public sector. If the 'local government minimum wage' were set at, say, £6.50 per hour then little or no subsidy would be required. ***Why should any local government job be paid at such a low rate that it requires subsidy from central government? Should there not be a 'local government minimum wage' of, say, £6.50 an hour, with the Treasury contributing their proper share to such a settlement (by not making a 'profit' out of it)?***

Setting an Example for the Private Sector

Many of the low paid workers in local government are part-time women working in the catering, cleaning and caring professions.[12] These are precisely the sectors which are also often low paid in the private sector.[13]

As discussed above, the wages of these people in the public sector could be raised at relatively low net cost to the public sector as a whole. This would, in turn, put upward pressure on wage rates in the private sector, if the private sector is to attract such workers, starting with contracted-out staff. If such wage rates rose, not only would be workers be better off, but HM Treasury would also save money in reduced tax credits. ***Are there not attractions in using the public sector to set an example on low pay, as this could be done at relatively low cost – and potentially no cost - to central government?***

Non-Financial Ways of Remunerating Staff

If two thirds of any pay rise for low paid workers is 'lost' to HM Treasury, this creates obvious incentives to employers to find non-financial ways of remunerating staff (which do no get 'taxed' away by government). Benefits in kind, such as extra holidays, shorter hours and childcare facilities, could start to look more cost-effective to employers. It is not immediately clear whether this represents an opportunity or a threat to the relevant workers:

- The opportunity is that the workers can receive benefits without corresponding reductions in their levels of tax credits.
- The threat is that it could lock them into a permanent cycle of low pay.

4. ISSUES ARISING WITH RESPECT TO EMPLOYEES

THE KEY ISSUE

Clearly, the families of many UNISON members benefit from tax credits and will benefit further from the changes about to come into force.

The extent to which a particular UNISON member will gain cannot be estimated from their gross pay alone. Rather, it depends on their family composition and the earnings of their partner (if applicable). This means that two different UNISON members with identical jobs can have very different net incomes.

Furthermore, as discussed earlier, the amount of tax credit declines as income rises. The net effect of this is to increase the marginal 'tax' rates that apply to any pay increases. The table below sets out these marginal 'tax' rates for households with different levels of household income and differing household compositions. The figures in grey are where the marginal 'tax' rate is noticeably higher than that which applies to households not in receipt of tax credits.[14]

		Employee's Annual Gross Earnings					
	Partner's Gross Earnings	**£5,000**	**£10,000**	**£15,000**	**£20,000**	**£25,000**	**£30,000**
2 children	**£0**	21%	70%[15]	70%	70%	70%	33%
	£5,000	58%	70%	70%	70%	33%	33%
	£10,000	58%	70%	70%	33%	33%	33%
	£15,000	58%	70%	33%	33%	33%	33%
0 children	**£0**	21%	70%	70%	33%	33%	33%
	£5,000	58%	70%	33%	33%	33%	33%
	£10,000	58%	33%	33%	33%	33%	33%
	£15,000	33%	33%	33%	33%	33%	33%

The combination of these two factors means that the connection between changes in gross pay and changes in UNISON members' net household incomes is increasingly weak and variable. This has potentially important, but non-obvious, implications for relationships between UNISON and its members:

- The 'opportunity' is that UNISON can help its members achieve higher levels of income, for example by advising them on how to apply for tax credits.
- The 'threat' is that some members begin to feel that UNISON is somewhat marginal to them, as government decisions on tax credits may have a greater impact on their net incomes than any pay rises negotiated for them by UNISON.

POLICY QUESTONS ARISING

Encouraging Take-up

Statistics on the take-up of tax credits are not directly available but it is widely agreed that take-up of Working Families Tax Credit was a problem in the early years: it was not immediately obvious to people that they were eligible and any application required both proactivity and a knowledge of partner's income. Since Working Tax Credit and Child Tax Credit both extend eligibility, further problems of low take-up are bound to arise.

High Marginal 'Tax' Rates

As discussed earlier, high marginal 'tax' rates means that many workers will 'only' be 30 pence better off overall for every £1 rise in gross pay. This creates potential for disappointment amongst these workers, in that an increase in gross pay has a less than expected impact on their pay packet.

It also creates potential for confusion; for example, if a person's tax credit decreases because of a rise in their partner's salary. This confusion may be worsened because some of the tax credits (the Working Tax Credit) will be paid in the pay packet whilst others (the Child Tax Credit) will be paid to the main carer.

They also have potential implications for the stance taken during pay negotiations. ***Small pay rises for low paid workers in receipt of tax credits are going to end up making a tiny difference to their net income. Tax credits also reduce differentials among low paid staff. Yet because pay rises are relatively affordable in terms of net public sector costs, there is a case for larger increases for low paid employees.***

Given the importance of tax credits to the incomes of some of the low paid, there should be annual up-rating of WTC/CTC thresholds by government. 'Negotiation' with central government over these thresholds is likely to become part of pay 'bargaining' activity.

The potential for disappointment and confusion amongst low paid workers is increased because on the way that tax credits are calculated. With some exceptions**,** tax credits are based on last year's gross income. One consequence of this is that the eventual ***permanent*** effect on pay packets of a pay rise will be less than the ***initial*** effect. When a pay rise is first implemented, the initial impact on pay packets will be to increase net pay by 67 pence in the pound.[16] Come the following April, however, a further 37 pence will be deducted.[17] So, employees will see falls in their pay at the start of each financial year as the tax credit is recalculated.

This will need to be explained to employees.

The Rate for the Job and Equal Pay for Work of Equal Value

A traditional principle of union pay bargaining has been that people doing the same jobs should receive the same pay. Employers are also required to comply with the Equal Pay Act and provide equal pay for the same work, or for work of equal value. The NOP survey of UNISON local government members confirms that 80% of members regard 'equal pay for work of equal value' to be something that it is important for UNISON to achieve.[18] Yet to some extent, tax credits conflict with this because the amount of tax credit (and thus net pay) is significantly affected by both the income of the employee's partner and the extent to which they meet the hours and age criteria.

There may be issues of fairness here. And with the connection between gross and net pay neither obvious nor uniform, there are also are also issues for how pay claims and pay awards are presented to employees.

This issue is particularly important for older part-time workers: such workers will often not have any dependent children and, as such, will only be potentially eligible for the Working Tax Credit which, in turn, requires the person to be working at least 30 hours per week. Many of the low paid workers in local government potentially fit into this category - the vast majority are part-time and their average age is 46 – and thus may not be eligible for tax credits.

The government has argued that the Working Tax Credit for people without dependent children should only be available to full-time workers so that it acts as an incentive for full-time work. But, in many cases in local government, such as cleaners and cooks, full-time work may not be either the norm nor possible.

In our view, this full time eligibility criterion seems both unfair and mistaken and is a point of detail in the tax credit system which the government should be looking at again. And although far fewer local government employees are directly affected, a similar point can be made about there being a minimum age of 25 for entitlement to Working Tax Credit if there are no dependent children.

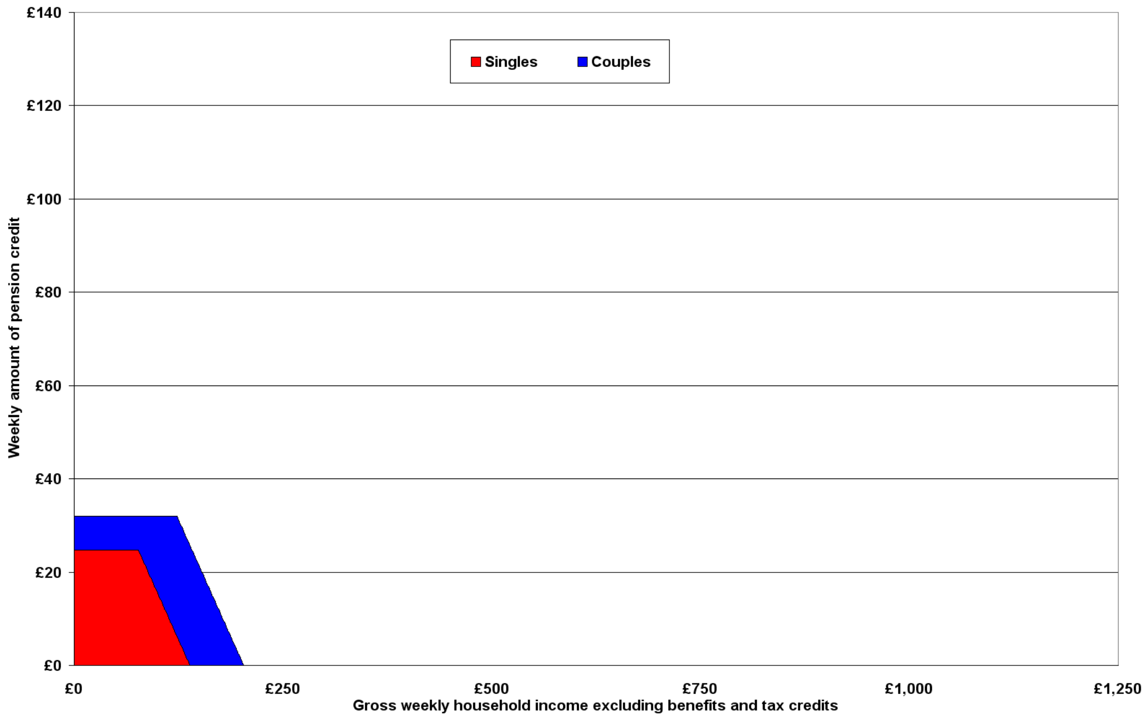
5. ISSUES ARISING WITH RESPECT TO PENSIONS

From October 2003, the Minimum Income Guarantee for pensioners will be replaced by a Pension Credit. This represents a significant change: whereas the Minimum Income Guarantee was a fixed guaranteed minimum income, with the individual losing a full pound in government benefit for every pound that their pension income was above this level, the Pension Credit will operate like the other tax credits, with a reduction of 40 pence for every additional £1 in pension income.

The Pension Credit (like the Minimum Income Guarantee) is also like the other tax credits in that the amount depends on household, rather than individual income.

The guaranteed minimum weekly income from October 2003 will be £102.10 for a single pensioner and £155.80 for a pensioner couple. The basic State Retirement Pension will be £77.45 for a single pensioner and £123.80 for a pensioner couple. So, for someone with the full State Retirement Pension, the maximum amount of Pension Credit will be £24.65 for a single pensioner and £32.00 for a pensioner couple.

Although the level of the guaranteed minimum weekly income will be the same as with the previous Minimum Income Guarantee, the change in the rate at which the Pension Credit declines still means that more people will become eligible: for example, any single pensioner with a weekly income of £137 or less (i.e. with £60 or less in income over and above the basic State Retirement Pension) will be eligible for some Pension Credit. Furthermore, some pensioners will receive more money than before; for example a single pensioner with an income of £10 per week from a second pension will be eligible for £21 per week in Pension Credit compared to the previous £15 in Minimum Income Guarantee.



THE KEY ISSUE

Because the Pension Credit will operate like the other tax credits, the issues arising are analogous to those for these other tax credits. In particular, it reduces the value to the individual of a second pension (such as the LGPS pension), just as other tax credits reduce the value of a pay rise. More specifically, the first £60 per week of LGPS pension is currently actually only worth £36 to the pensioner because of the loss of the Pension Credit that someone with just the State Retirement Pension would otherwise receive. In other words, the value of the LGPS pension to the employee can actually be up to 40% less than its value (cost) to the LGPS fund itself.

Statistics on the local government workforce suggest that most employees are likely to be in this position, in other words, with a pension whose value to them is markedly less than its cost to the employers. So among those aged 55 to 64, the average number of years in local government employment is about 14.[19] With 14 years of service, an employee needs to retire on £18,500 in order to have a weekly pension of £62. Yet only 20% of those aged 55 to 64 have such a salary.[20]

Furthermore, the scale of the issue may well grow over time. The current government is committed to increasing the guaranteed minimum income for pensioners in line with earnings whilst only being committed to increasing the basic State Retirement Pension in line with prices. The implications of this are that both the maximum amount of the Pension Credit and the numbers of people eligible for this credit will grow over time.

POLICY QUESTIONS ARISING

The Value of the LGPS Pension Contribution

If, in pay negotiations, employers want to consider the LGPS pension contribution as a benefit to employees, then the contributions of the first £62 of pension per week should clearly be down-valued by 40%.

This is not, however, the same as employees considering that LGPS to be worth less than previously. In particular, the equations above only apply given current government policy and may not apply when the person actually becomes a pensioner. So, whilst the LGPS represents guaranteed income in the future, the Pension Credit depends on future governments continuing with the current policy. Furthermore, any argument that the LGPS pension is potentially not worth that much to low paid employees weakens the long-standing principle that such pensions are worth having and should be maintained.

Nevertheless, it is a matter of fact that the LGPS is currently worth much less to low paid employees that might first appear. It is also at least arguable that, on straight financial grounds, such employees should either take out substantial pension arrangements or none at all given that much of the first £62 per week simply replaces Pension Credit that would otherwise be due.

These conflicts between the LGPS (and indeed any pension scheme that cover lower paid workers) and the Pension Credit need to be addressed within government policy. For example, these conflicts would go away if the Pension Credit were subsumed back within the State Retirement Pension or in some other way cease to be means-tested.

END NOTES

[1] The WFTC was also accompanied by the Children's Tax Credit, itself a replacement for the Married Couple's Allowance. This was a small element of the overall package and was a different sort of credit (in the sense of being a reduction in the amount of income tax that had to be paid by families with children. It extended to families with gross incomes of around £40,000). The Children's Tax Credit is abolished with effect from April 2003.

[2] Maximum weekly amounts for the various elements are summarised in the table below.

Element	Max. Weekly Amount £	Available to
30 hrs + element	£11.90	If working at least 30 hours per week, and if dependent children, or if aged 25 or over
Lone parent / couple element	£28.80	If dependent children or If a couple and qualifying for the 30+ hours element
Adult element	£29.20	If qualifying for either the 30+ hours element or the lone parent/couple element

[3] Maximum of £70 per week if working at least 30 hours and £58 if working 16-29 hours.

[4] Maximum as per the other family types plus up to £39 for the disability.

[5] Maximum of £70 per week if a couple and £41 per week if single.

[6] The maximum CTC is £28 per week for each dependent child plus £10. Maximum weekly amounts for the various elements are summarised in the table below.

Element	Max. Weekly Amount £	Available to
Child element	£27.75 per child	If dependent children
Family element	£10.45	If dependent children

Note that the Family Element is doubled in the year following a child's birth.

[7] The exceptions to this are either i) when this year's income is more £2,500 above last year's income, in which case the award is based on this year's income less £2,500) or ii) when this year's income is lower than last year's income, in which case the award is based on this year's income.

[8] Taken to be 37 hours a week or more.

[9] The key issue among part time workers is whether they work more or less than 30 hours. The NOP survey suggests that of those who work less than 37 hours, some 30% of men and some 60% of women are in this position. The percentage with dependent children declines with the number of hours worked. A grouping into those working part time and full time does not unduly simplify the pattern: 45% of part time workers have dependent children as opposed to 25%of full time workers. Since the survey also reveals that only 2% of employees are under 25, we have ignored this factor in the calculations.

[10] Maximum eligibility of £70 reduced by 0.37*((30*4.20)-97).

[11] Maximum eligibility of £41 reduced by 0.37*((30*4.20)-97).

[12] According to the 2002 New Earnings Survey, 25% of female cleaners in local government earned less than £5.10 per hour, 25% of female cooks earned less than £5.10 per hour and 25% of care assistants earned less than £5.80 per hour.

[13] For example, analysis of 2002 Labour Force Survey data suggests that 27% of employees in the 'distribution, hotel and restaurant' industry sector are paid less than £4.40 per hour – a much higher proportion than any other industry sector. The vast proportion of these people are women.

[14] Households in receipt of housing and council tax benefit can face marginal 'tax' rates higher than in the table above – up to around 90%.

[15] The 70% comprises 37% for the reduction in tax credit, 22% for the increase in standard income tax and 11% for the increase in national insurance.

[16] i.e. the gross pay increase less 22% in Income Tax and 11% in National Insurance.

[17] i.e. a 37% reduction due to the reduction in tax credits of 37 pence in the pound.

[18] UNISON NOP survey 2002, table 54, p483.

[19] UNISON NOP survey 2002, table 95, p779. The average of 14 years depends on assuming that those employed for 15+ years have themselves on average been employed 19 years.

[20] UNISON NOP survey 2002, table 16, p159. To 'read' that table, the required £18,500 gross pay translates into £270 a week net pay.