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# Hidden Costs of the Welfare State: Employers' Compliance Costs and the Working Tax Credit

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*This paper explores the impact of the decision to make the Working Tax Credit (WTC) payable via the employer, until March 2006. A unique survey shows the unequal distribution of compliance costs across firms and industries. It also suggests that the arrangement had some unanticipated results, and may have damaged the effectiveness of the WTC. Some employers' compliance costs may have been shifted to employees. So from a social policy perspective administration is policy – the delivery system affects outcomes. However the switch to payments through HMRC from April 2006 does not remove all compliance costs from employers.*

## Introduction

The provision of resources to low-paid working households has long been a significant aspect of UK social policy. But the form of the resources, tax allowances, benefits, or credits has changed frequently. For example in the 1970s there was Family Income Supplement (FIS) and a tax allowance for households with children. But the latter was of no help if you did not pay tax, and so was eventually changed to a child benefit. FIS was relabelled Family Credit in 1988 and eligibility eased by reducing the threshold weekly working hours from 24 to 16.

Family Credit was superseded by the Working Families Tax Credit (WFTC) in October 1999. The Government's motivation was not just to reduce poverty, but also to link welfare payments more closely to work and so raise labour supply and flexibility. That is WFTC was part of a policy to move the UK system of income support from one of benefits towards one of tax credits. So at the same time the Disability Working Allowance was replaced by the Disabled Person`s Tax Credit. But less than four years later, in April 2003, WFTC was replaced by two separate credits, the Working Tax Credit (WTC) and Child Tax Credit (CTC). At the same time the Disabled Person`s Tax Credit was abolished and replaced by the disabled and severely disabled elements of the WTC noted below. Whereas the WFTC had been assessed on both family and employment circumstances, WTC separated these contingent payment characteristics. In part consistent with this approach, WTC was, unlike WFTC, claimable by households without children whose members were over 25 and worked at least 30 hours a week.

The Government's aims in replacing the WFTC were fourfold.[1]

1. To design a system of support for low-income families with children that was more responsive than the WFTC.

2. To provide more income security when families left benefits to move into work.
3. To reduce the non-take-up of WFTC.
4. To reduce compliance costs of low income families with children.

The WTC is a tapered benefit payable to employees and the self employed who are at least 16 years of age, have low incomes, but work a minimum of 15 hours a week. In addition claimants need to fall into at least one of the following categories:

1. Responsible for a child under 16, or one between 16 and 20 on certain education or training courses.
2. Have a disability that leads to a disadvantage in getting a job.
3. Aged at least 50 and returning to work after a period on benefit.
4. Aged at least 25 and work at least 30 hours a week.

The award's size depends on income, partner's income, and the ages of any children. It is composed of a series of elements viz. a basic entitlement, a second adult element, a lone parent element, an element paid if you work for a minimum of 30 hours a week, a disability element, a severe disability element, a childcare element and an element paid if the claimant is aged at least 50 and returning to work after a period on benefit.

So far only the first objective of the switch to the WTC has been achieved, for households no longer have to wait six months for their payments to respond to changed circumstances. But putting in place an annual cumulative income assessment system has substantially increased the problem of overpayments, mainly because recipients have not reported income changes as quickly as required. Consequently, their income over time has become more uncertain to them, as the Inland Revenue, later the Revenue and Customs (HMRC), has tried and often failed to recover overpayments. For example, from financial year 2003/04 to 2005/06 HMRC paid out £47 billion in tax credits,[2] including £5.8 billion overpayments, of which by April 2007 it had written off £500 million and expected to have to write off a further £1.4 billion. The latest attempt to reduce the scale of overpayments, by raising the limit on the disregard – the maximum amount of income increase a claimant does not have to report within a payment year – from £2,500 to £25,000 – will cost around an extra £500 million a year. Thus increased flexibility to changes in claimants` circumstances has been bought at the cost of increased costs both to the programme and to claimants who have to cope with repayments. The trade-off between flexibility and such compliance costs is steep, and here initially perhaps underestimated, but well known (Whiteford *et al*., 2003).

The subject of this paper is less well known. This is the employers' compliance costs of operating the WTC. These are the costs specifically associated with the introduction and operation of the WTC. They may involve time and money. Some may be mandatory such as the extra payroll costs until 2006 associated with paying the Credit. Others such as providing employees with advice may be more discretionary. In particular, the paper focuses on the issue of payment via the employer (PVE), which was finally phased out in 2006 after a long and bitterly fought campaign by employers and their advocates.[3] The paper shows that the compliance costs for some employers were significant and unevenly and arguably unfairly spread across employers, some of whose reactions may have partly negated the welfare through work aspects of the WTC.

The remainder of the paper is divided into five sections. Section 2 describes the methodology of the survey. Section 3 sets out the reasoning behind PVE, and how it



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operated. Section 4 sets out the results, which are discussed in Section 5. A brief summary concludes the paper.

## Methodology

During the period April 2003 to March 2004, 40 interviews were carried out with a focused sample of employers and employers' representatives concerning the costs and problems of operating the tax credit system, in particular the switch to the WTC, and the reduction in compliance costs predicted by the Revenue. As the number of interviews was limited, the initial focus was with experts who had extensive experience of operating tax credits, namely organisations offering training and advice to employers, specialist payroll agencies and large employers. The payroll agencies we interviewed dealt with more than 15,000 companies. Some 'snowballing' was employed particularly with advice organisations, who were asked to recommend payroll managers with WTC experience. The first 20 responses from these interviews showed that the smallest employers (less than 50 employees) were not adequately represented by these organisations. So we allocated the second tranche of 20 interviews to randomly selected firms from two cities using Yellow Pages telephone directories.

The incidence of WTC is uneven by size and sector, depending on the number of low-paid employees on a particular payroll: IR assumed that only one in ten small employers – with one to four employees – would have any involvement with WTC (Inland Revenue, 1999: 8). Therefore our view was that the use of a focused sample of experts, advisers and payroll managers would yield more valuable data than a random sample, many of whom would have little or no experience of operating WTC. Full statistical representatives could never have been achieved in 40 interviews: at the time of the survey of 1995/6 PAYE compliance costs, there were approximately one million registered payrolls (Bath University, 1998). So it is important to note that our results are tentative, but we hope illustrative of the types of issues a larger survey would reveal. Thus our survey work is best viewed as a large pilot study, and our quantitative findings cannot be definitive.

Virtually all the focused sample agreed to be interviewed, though occasionally the payroll manager was unavailable and a payroll officer was interviewed instead. In the random sample, 42 employers were approached, of whom 20 were interviewed. The response rate for the randomly selected payrolls was 48 per cent, and the overall response rate was 65 per cent.

The amount of useful information obtained per interview from the random sample was lower than that from the focused sample, confirming the value of the focused approach. The randomly selected employers reported fewer cases of WTC, and consequently fewer problems. Nevertheless, certain problems were so widespread across both focused and random samples that the researchers believe their approach gained more in depth and breadth of employers' experiences than was lost in representativeness.

Interviews were conducted face-to-face, lasting up to an hour, and using detailed questionnaires (available on request), tailored to reflect whether the interviewee represented an employer, a training organisation or a specialist agency. For example the employer questionnaire had 23 formal questions and a further 16 additional question topics if they seemed appropriate. The formal questions involved a detailed examination of the employer`s payroll activities and costs, their experience with WTC and CTC, information requests from Revenue and Customs, their views on the various administrative changes and on other compliance issues. The supplementary topics covered these areas in finer detail and enquired about experiences with the Child Support Agency (CSA), Student Loans and Statutory Maternity Pay.

### *Origins and operation of PVE*

Both the 1999 WFTC and its 2003 successor, the WTC, are subsidies to low-paid work. Both were designed to reduce poverty and to encourage people into work. From their first being mooted it was felt by the Treasury that to associate their receipt with work the tax credits should be in the wage packet. In other words the formal responsibility for delivery lay with employers, on the instructions of the Inland Revenue, rather than through the benefits system administered by the Department of Work and Pensions. As Millar (2008: 25) notes:

> As an early Treasury paper put it, 'A tax credit will associate the payment in the recipient's mind with the fact of working, a potentially valuable psychological change' (Taylor, 1998: 8); It was also argued that association with the tax system would make this transfer more popular with the public at large, because it would be seen as a positive reward for work, rather than as a handout for dependency. A tax credit rather than a social security benefit would 'reduce the stigma associated with claiming in-work support, and encourage higher take-up'. (HM Treasury, 1998: 3)

It is worth noting that when the WFTC was introduced, no evidence was presented on the likelihood of this 'potentially valuable psychological change' or on its consequences. Neither has there been any evidence presented in the subsequent decade. It is hard to see quite how the psychological change would have been necessarily associated with PVE. If payment via the benefits system had been operated, only those working would have been eligible, and the long complex application form and the necessity to liaise with their employers would have reinforced the link between work and benefits, as would the subsequent requirement to report a whole range of changes in work-related events, including some changes in earnings and hours worked.

Two further preliminary points are worth recording. First, employers were from the first opposed to PVE as it clearly imposed unrecompensed activities on them. Interestingly the 1985 Green Paper Reform of Social Security had proposed Family Credit should be administered as a tax credit. But this was rejected in part because of employers` compliance costs, and in part because it would involve less payments to women and more to men (McKay, 2002). This shift from 'purse to wallet' (Goode *et al.*, 1998) was unpopular with WFTC recipients and the design of the WTC arguably responded to this by paying the child-related elements to the main carer (McKay, 2002).

On the face of it, PVE did not appear very onerous to the employer. Until November 2005 there were seven stages in the assessment for WTC:

(i) Employee claim to HMRC, providing family and pay details.
(ii) Claim accepted or rejected.
(iii) HMRC assessment of accepted claims.
(iv) Start notice issued to employer.
(v) Employer actions start notice.

(vi) WTC payment continued until:
   (a) employee left, or
   (b) entitlement stopped (HMRC sent employer stop notice),or
   (c) entitlement amended (HMRC sent employer amendment notice).
(vii) Employer funded WTC payments out of income tax (PAYE) and national insurance (NI) monies that would otherwise have been paid over to the state. So employers had to adjust PAYE and NI payments to reflect WTC payments. The smallest employers, whose PAYE and NI payments were less than their WTC, could apply for the difference in advance to avoid cash flow losses.

Thus employers should not have been involved in calculation or assessment: they were to merely follow HMRC instructions. But in practise as our survey showed they were often drawn into the assessment process, either because they learnt to spot errors and refer them back to HMRC, or because employees enlisted their assistance with problems.

Our research showed that an employer with low-paid employees was likely to become involved at stage (i): colleagues informed new employees that they might have had a claim, whereupon the newcomers sought payroll department advice on claiming. Employer problems reported to us at stage (iv) included the issuing of stop notices before start notices, and the issuing of multiple start notices for different amounts. At stage (vi – a) there were problems with actioning the stop in time, as many sub-units of firms failed to notify payroll departments of the exact date an employee left. So, although firms had systems in place to avoid overpayment of leaving employees, these systems continued to pay out WTC until the end of the month. At stages (vi – b) and (vi – c) complications arose with frequent amendments and stop—starts.

Employee queries were a major compliance cost, and were also the cause of considerable frustration, because the employer had no control over the amount of WTC paid, and generally had no insight into the way that the assessment had been calculated. One employer characterised this important limitation of the system succinctly: 'We don't know why they get credits, we just pay them' (Public utility firm, 1,500 employees). Although the WTC system had not envisaged that employers would be involved in assessment, it was clear that 'responsible' or 'caring' employers wanted to ensure that employees received the correct amount in their pay packets, including any WTC. As a result, employers who could see how a problem arose often found themselves acting as the employee's representative to the Inland Revenue. This had not been anticipated, and the Inland Revenue's help lines were clearly unprepared for the volume of enquiries they received, both from employers and employees.

There was a difficult choice for the employer, between taking the formal approach of advising the employee with a WTC problem to contact Inland Revenue (later HMRC) directly, saving the employer compliance costs at the expense of good personnel relations, and acting as a more 'responsible' employer prepared to incur the costs of assisting the employee by answering WTC queries and chasing up problems. One interviewee stated that under Master and Servant laws, the employer has a general responsibility for the employee, which would include ensuring that the amount in the pay packet was correct. This was problematic with WTC, where the employer has no knowledge of the assessment details; consequently, WTC difficulties tended to undermine the employer–employee relationship, because they created payslip queries outside the control of the payroll department.



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### *Results*

It was clear that employers' costs of operating their payroll operations had increased significantly over the previous decade. In response to a general question on factors that might have changed their costs since 1996, over half the respondents, unprompted, mentioned tax credits. When probed about which employees were affected, in addition to WFTC/WTC other duties cited were their compliance costs in the administration of the statutory maternity pay, CSA payments, statutory sick pay and student loan repayments.

About half the respondents gave detailed reliable data on payroll costs. Payroll costs clearly showed economies of scale. In small firms, annual payroll costs per employee could be more than £100, whereas in some large firms they were below £20. The average proportion of payroll costs attributed to government regulation was 40 per cent. One employer commented 'It would be a doddle without the governmental stuff because the rest is all computerised' (clothing industry, 55–60 employees).

Respondents were asked to estimate the percentage increase in payroll costs if an employee claimed WTC. Responses varied widely. Many employers paid an all-in fee to payroll bureaux or software providers, which made it difficult for them to quantify the costs of this specific regulation. However, 15 of the 26 respondents who replied to this question stated that WTC costs were 'minimal'. Recurrent problems and costs were reported by half of all respondents but, interestingly, ten of the respondents who stated that WTC costs were 'minimal' reported at least one administrative problem: six of these ten problems could be classed as significant.

If 'minimal' is interpreted as a 1 per cent increase, the overall mean cost increase for a WTC case was 4.5 per cent. If it is interpreted as 0 per cent, the mean cost increase is 3.2 per cent. But five respondents stated that WTC increased costs by 10 per cent or more, including one high estimate of 40 per cent from a specialist cleaning firm employing mainly part-timers. This firm's annual labour turnover was high at 90 per cent and it appeared that, along with low pay, high labour turnover importantly influenced WTC compliance costs. Other employers who stated that WTC increased costs by 10 per cent or more were a small manufacturer, a machinery hire firm, a large educational organisation (again with a very high labour turnover) and a specialist accounting consultancy.

It was clear that compliance costs of WTC had a very inequitable impact, depending on pay rates and the employment structure of the workforce. Respondent firms in low-paid industries such as retailing and catering reported extensive problems with the operation of WTC; high labour turnover exacerbated these difficulties and some large employers had encountered multiple problems. But employers with only a small number of WTC cases generally reported few problems. In large part the inequity arises because, as one respondent said, compliance costs hit low wage, labour-intensive sectors like retailing especially hard, while others such as banking are little affected. Itinerant workers are a particular problem, because they have often moved on before the WTC has been assessed and paid, which makes it difficult for the employer to keep track of them.

Although 15 respondents reported that costs of operating WTC were then currently minimal, 20 respondents had encountered severe difficulties since its introduction in April 2003. The Inland Revenue's computer did not always operate the assessment stop and start system in a sequential manner and there were serious malfunctions. In particular, amendment notices were being issued far more frequently than employers had been led to expect; and in some instances, employers were receiving stop notices concerning employees for whom no start notice had been issued. Start and stop notices were not received in the correct sequence, and one respondent stated that confusion between 'Start' and 'Restart' notices was a contributory factor.

But the main start-up compliance cost had been employee queries, and this was to remain a significant cost for some employers, even after the payment of the WTC was switched to HMRC. Over 60 per cent of respondents reported queries. The majority reported 'many' queries and some employers reported being 'inundated'. One payroll bureaux emphasised that, although WTC entitlement is not assessed by the employer, a good employer has a duty to help with work-related problems. WTC could undermine the employer–employee relationship, because it creates payslip difficulties outside the payroll manager's control.

Many employers had of course experience of PVE from 1999 to 2003 through the WFTC. But in advance of the changeover to WTC, the regulatory impact assessment (Inland Revenue, 2002) claimed there would be significant advantages in four areas:

(a) The switch from six-monthly to annual reviews of entitlement
(b) Certificates of Payments from employers would be abolished because unlike the WFTC entitlement to WTC automatically ceases when the claimant stops work.
(c) Employers would be no longer required to complete routine earnings enquiry forms.
(d) Improved pre-funding provisions for, in effect, small employers.

Employer's views about the switch from WTFC to WTC were mixed, and possibly dominated by the difficulties encountered during the changeover. The open-ended nature of WTC and the switch from six-monthly to annual returns were the main perceived benefits. However more stop and start notices during an assessment period imposed extra costs on employers, and while most welcomed the abolition of the WFTC's end-of-year certificates of payment, there was some disquiet at the loss of the audit trail that it had provided, raising fears, that turned out to be only too well founded, that the new system was open to abuse.

'Overall we estimate that the new tax credits will be simpler for employers to operate and will reduce overall employer compliance costs by up to £11 million per year' (Inland Revenue, 2002: para 2.20) – or about £37 per employer who paid WTC. This potential saving was in the context of estimated non-recurring (switch-over) costs of £40 million, and recurring (operating) costs of £100 million. It is worth noting that these estimates do not seem to include the costs to employers of assisting employees with their claims, which several respondents in our survey saw as part of their role as responsible and caring employers, and many said could be time consuming and hence expensive. In other words the RIA assumed that employers incurred no costs where there was no regulatory requirement for them to help.

For all the main improvements claimed in the RIA, a large majority of respondents agreed that WTC was an improvement on WFTC: 73 per cent agreed about the switch from six-monthly to annual return periods; 70 per cent agreed about the abolition of payment certificates; and 80 per cent agreed about the abolition of earning enquiry forms. Unfortunately, increased frequency of amendments — the one additional cost envisaged in the RIA – had created chronic problems, outweighing any benefits, for around half of respondents.

Again about half of the respondents believed the problems associated with assessments were temporary, and their compliance costs for the WTC would fall. But half of the respondents disagreed. Some who were interviewed towards the end of the project in December 2003 and January 2004 reported fewer problems, though others firmly disagreed: ‘Six changes in a month is excessive, which was the maximum received; but last month one worker got four tax credit changes simultaneously. This is not a bedding-in problem!’ (Construction industry employer, 12,000 employees).

Bureaux and training organisations appeared more optimistic than employers, but it should be noted that the 32 per cent increase by April 2004 in the number of WTC recipients over the number of WFTC cases in November 2002 was not foreseen in the RIA. Obviously, this will have increased total compliance costs. Certainly 20 out of 37 respondents answered ‘Yes’ to the question ‘Have tax credits generated more queries that you have to raise with the Inland Revenue?’ Agreement was greatest amongst the largest employers, training organisations and bureaux.

WTC alters the incentives for employers to issue different types of labour contract, by imposing extra costs on them, should an employee be eligible for the credit. Such costs can be avoided by reducing work hours to below the threshold for WTC payments, or by not hiring candidates who are eligible for WTC. Some such reactions may be illegal, and hence employers may be reluctant to confirm their presence. The National Association of Citizens Advice Bureaux has published evidence of the widespread adoption of such practices in the early years of WFTC (NACAB, 2001). Cases had subsequently become less frequent, and the scale of the practice was possibly a transitional phenomenon. Nevertheless, occasional instances continue to be reported (Personal Communication from NACAB, 2004); and Inland Revenue-sponsored research similarly finds some reluctance to employ potential claimants (Athayde *et al.*, 2003: para 6.4.3).

Many of our respondents pointed out such practices were illegal or unethical. But some said, ‘I would consider carefully before employing anyone who would need to claim’ (Small manufacturer with 14 employees); ‘I think that small employers will (prefer not to hire claimants) even though they are not allowed to’ (Training organisation); ‘I have no evidence, but I can believe it is the case with small employers’ (Training organisation); ‘Possibly clients are taking on fewer workers with the increase in regulations. I don’t think they would vary the hours of existing employees’ (Payroll bureau). Inevitably, the issue gets caught up with the wider issue of the burden of regulation: as a representative organisation noted, the government advises small firms to outsource payroll functions, but this can be an expensive obstacle to taking on their first employee.

On the other hand as WTC is a subsidy to low-paid labour it should have lowered wage costs through increasing the supply of labour, and perhaps through inducing some employees to accept lower wages, though there is no systematic evidence on wages. However, Metcalf (2007) reports evidence of some employee–employer collusion to reduce declared wages to increase WTC eligibility. He notes the irony in the failure to enforce the National Minimum Wage, for a significant reason behind its introduction was to cap tax credit payments.

More generally, the WTC impacts on labour supply are complex. There is a wide range of possible individual reactions, from marginal changes in hours to secure eligibility, to significant changes in work patterns due to the potentially large income and substitution effects resulting from the scale of benefits and the changes in marginal effective tax rates. The feeling was that employees were generally acutely aware of the eligibility criteria. A large employer said, ‘People have phoned up to change hours to reach 16 hours. This is not a company policy but an employee thing’ (manufacturer with 670 employees).

As with any benefit, WTC is open to a range of possible abuses. There was a feeling amongst some large employers that the system was being abused, and that the Inland Revenue was not enforcing penalties stringently enough to curb abuse. But a training organisation expressed the view that abuse was lower than under the WFTC – 'WFTC was complicated: you could fiddle the system by working for only six weeks, but getting six months' benefit. Employees would ask payroll to put overtime or bonuses on next months' pay in order to continue to qualify. It is much more difficult to fiddle under WTC' (Training organisation).

## Conclusions

The growth of tax credits has been matched by a growth of employer complaints that they are being asked to undertake unpaid administration of a growing part of the welfare state.

Both the Revenue and the Treasury meet regularly with lobby groups representing employers and the payroll industry. The groups included the Payroll Alliance, the Institute of Payroll and Personnel management, and the Private Sector Payroll Group. In advance of the 2004 Budget there was joint consultation on the issue. Implicitly accepting the employers` argument, the Chancellor's 2004 Budget Statement contained a promise to switch to direct WTC payments from the Inland Revenue to the claimant and to consult on the best way to do this. The change has removed some costs to employers, and reduced others. The result of the consultation was that the Inland Revenue – from April 2005 Revenue and Customs (HMRC) – between November 2005 and March 2006 took over the job of paying the WTC.

But employers will still be involved in certification of earnings and hours worked, so compliance costs will not vanish. Employees will still take tax credit queries to employers, not to mention questions about other aspects of tax. One bureau predicted that the scale of such questions was likely to remain considerable. WTC increased the number of employee queries for the majority of respondent employers, and even if a way is found to pay the credit direct to claimants, employees have got into the habit of seeking help from their payroll department. Many employers see it as part of their function to try to resolve employee problems that lie outside their direct responsibility and will continue to assist employees seeking to claim tax credits. For example, although Child Tax Credit (CTC) was switched from employers to direct payment in April 2003, a surprisingly large 40 per cent of the 27 respondents to a question 'Will you still have any involvement in CTC?' thought they would still have some involvement.

The onus is on the Revenue and Customs to provide effective help lines for both employees and employers. Nevertheless, from an employer viewpoint the policy switch will reduce costs and save resources. Those employers who thought that the spread of tax credits had squeezed resources to the point where the quality of payroll and personnel work had declined will be able to improve quality, while not incurring extra costs. At this stage it is impossible to determine what proportion of employer WTC compliance costs will disappear, as the major determinant will be the method and efficiency with which the Inland Revenue chooses to pay the credit directly, and its responsiveness to its clients.

Thus an important conclusion which is corroborated by many compliance costs studies is that costs of change – even if they are only temporary – are always unwelcome and often high. Quite complex systems, once introduced, become routine to deal with, and any change other than outright abolition can be expected to cause disruption and errors during the learning period. Costs of changing the tax credit system were substantial. Previous regulations had to be 'unlearned' and a new system adopted. The extensive teething troubles with the new system caused additional problems and costs to many employers. Furthermore, the switch to a system which involves an annual reconciliation and adjustment means that extra costs may still be incurred by the Revenue, the employer and the recipient before the overall task of administering WTC is completed.

The earlier WFTC system was only in place for 41 months – barely sufficient for employers to take it on board before it was scrapped. Then after only one year, employers' duties were changed again with the payment of WFT direct to the employee. Although employers will welcome the fact that they will be relieved of the responsibility for the actual WTC payment, they will still have to provide corroboration of income and hours worked. It is regrettable that the opportunity was not taken to introduce direct payment of WFTC in April 2003, at the same time that CTC was switched from payment *via* the employer to direct payment. As it was, employers were engaged in the thankless task of learning a new system which was then quickly modified. The change may have saved employers £110 million a year in payroll costs (HMRC, 2005),but perhaps more thought should have been paid to the Cinderella of public finance – compliance costs – at the very start of the programme.

The social policy implications of this case study are significant. First, it is clear that employers bear a significant part of the burden of administering the welfare state. The burden has increased substantially in recent years, particularly with the introduction of tax credits, and increasingly it is contested. In the case of the WTC part of the compliance costs has been shifted back on to the state, and on to taxpayers, after effective lobbying.

Second, the original imposition of delivery costs on employers had unintended distributional effects. The costs bore relatively heavily on small firms, for there are economies of scale in payroll and advice functions. They also bore heavily on those industries with large numbers of less well-paid workers. As one of the purposes of WTC is to reconnect would-be workers to employers and as such workers are likely to command low wages the insistence on PVE was counterproductive. While WTC is an employment subsidy to low-paid labour, PVE raised the costs of hiring certain low-paid workers. In effect it created an incentive to hire workers not in receipt of WTC, and there is some anecdotal evidence that this happened.

Third, there is a clear trade-off between creating a more responsive benefit, one that can react more quickly to changing household circumstances, and creating higher compliance and administrative costs in issuing more frequent changes to benefit notices. Certainly as far as compliance costs are concerned the more responsive the benefit the greater the chance that some will not be hired who would have been hired under a more rigid system. The incidence of administrative and compliance costs affects policy performance. In this sense administration is policy.

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## Notes

1 See Brewer (2006) for an assessment of achievement of these aims.

2 Comptroller and Auditor General's Standard Report on the Accounts of HMRC 2005/06, HC (2005–06), 1159, table 1, quoted in HC Committee of Public Accounts, 2007:3.

3 The survey data from our project was the only independent evidence available in the consultation that led to the end of PVE.

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