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COM (85) 594

Vol. 1985/0215

Historical Archives of the European Commission

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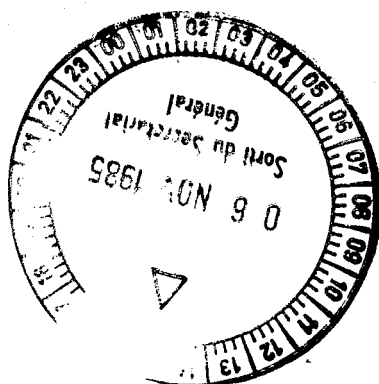
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COMMISSION OF THE EUROPEAN COMMUNITIES

COM(85) 594 final

Brussels, 5 November 1985



REPORT IN RESPONSE TO THE
INSTRUCTIONS OF 18 FEBRUARY 1985
TO THE ARTICLE 65 WORKING PARTY
OF STATISTICAL EXPERTS

Communication from the Commission to the Council

Treatment of family allowances and particularly
changes therein in the report by the Statistical
Office of the European Communities
on the annual salary adjustment
(Article 65 of the Staff Regulations)

Report by the Working Party of Statistical Experts,
widened to include experts in the field of pay
adjustment, in accordance with Section II, N° 1.3
of the Annex to the Council Decision of 15.12.1981
(81/1061/EURATOM, ECSC, EEC)

1. Introduction

In connection with the Statistical Office's 1984 Report on trends in public service remuneration in the Member States, the Council Working Party on Staff Regulations expressed reservations as to whether the 1981 method had been correctly applied in respect of the changes in the Italian system of family allowances.

In addition the question was raised as to whether there had already been comparable changes in the system in the past.

Thus, in a joint statement (Declaration of the Council and Commission of 18.2.1985) the Council and Commission requested the Working Party, "Joint Index, Article 65 of the Staff Regulation" to clarify the following points:

1. How has the procedure been applied in the past in respect of family allowances ?
2. Has the application of the procedure led to anomalies ?
3. If so, can the application of the procedure be improved, so that these anomalies can be avoided in future, without changing the procedure itself ?

The Working Party "Joint Index - Art. 65 of the Staff Regulations", widened to include national experts in the field of pay adjustment, examined the questions at two meetings (21.3.1985 and 10.6.1985) and prepared this report.

2. Background to the "1981 method"

Before discussing details on family allowances the Working Party once again noted the background to the Council Decision of 15.12.1981 on the method for adjusting the pay of officials of the European Community.

The Council Decision of 15.12.1981 changed a number of details in the former method, whereas other details were explicitly or implicitly confirmed. Accordingly, in order to assess the annual adjustment method it is necessary to examine not only the text of the Decision of 15.12.1981 but also the texts of the earlier methods.

Over the years there emerged a need to make decisions on pay adjustment before detailed statistics on pay trends in the Member States became available. Accordingly, the Council in its Decision of 15.12.1981 confirmed the earlier method insofar as the development of pay is not determined in line with the actual average pay of all civil servants, but on the basis of calculations relating to a notional typical civil servant.

This notional typical civil servant is defined as the mean derived from an unmarried civil servant and a married civil servant with a wife and two children.

In this notional calculation it is also assumed that the civil servant's pay constitutes the only source of income of himself and his family.

It emerged from the discussion that all Member States had so far prepared their reports in line with this interpretation of the "1981 method".

3. The family allowance systems and their treatment in the annual report

The Member States' delegations gave detailed reports on what family allowances existed in their countries and explained how these payments were taken into account for the annual report on trends in public service pay.

In addition, the Statistical Office of the European Communities examined the treatment of family allowances in the annual reports for recent years.

It emerged from the accounts given by the delegations and from the annual reports that four systems of family allowances can be distinguished:

1. Fixed sum per child/dependant
(Example: United Kingdom - child allowance : £ 27 per child, payable to the mother).
2. Family allowance in the form of absolute sums, but graduated in line with the family's total income
(Example: Italy - *Aggiunta di famiglia*, new system).
3. Family allowances as part of, and linked to, civil servants' pay
(Example: Germany - *Wohnungsgeld*, dependent on marital status).
4. Tax relief in the form of tax-free allowances for income tax assessment purposes.

Annex I shows which of these systems is used in the individual Member States.

Adjustment of the fixed sums in the first system is in some cases effected on annual basis, in line with changes in pay; however, in most countries this adjustment is made only occasionally (every five to ten years or thereabouts), in relatively large steps.

Adjustment of the second system (income-related family allowances) requires the adjustment of two elements :

- the income thresholds
- the amount of family allowances.

In the third system adjustment is carried out automatically in line with pay increases.

Adjustment of the tax-free allowances (fourth system) takes place in most countries only occasionally, but then in large steps.

The effect of family allowances on net earnings differs greatly from one system to the next:

In the first system family allowances as a proportion of net income fall as the salary rises. In the period between adjustments there is a reduction in real terms which depends on the rate of inflation, whereas the occasional leaps lead to a (no doubt lower) leap in net pay.

The second system is designed to give the lower-paid groups not only a relative but also an absolute advantage. However, in practice incomplete adjustments or failure to adjust often lead to a real reduction in family allowances in all grades.

In the third system, of which the example given is the Federal Republic of Germany, the basic level of the place-of-residence allowance is graduated in four pay classes, depending on the category to which the civil servant belongs, while the family-related components in this allowance are the same, in absolute terms, for all civil servants. With reference to basic salary, the family-related components are greater in percentage terms for lower grades than for senior ones. However, its impact on the percentage trends in net earnings is very small, because the family allowances are coupled to the general pay trends.

The fourth system (tax-free allowances) works to the advantage of higher-paid groups in countries with high rates of tax progression. Its impact on percentage trends in net pay corresponds approximately to that of the first system: slow real reduction in family allowances with occasional leaps.

The report by the Statistical Office of the Communities, which was based on the reports by the authorities in the Member States, has always taken family allowances into account. Accordingly, the annual special indicator has in all cases incorporated the trends in family allowances.

4. Major changes in the system of family allowances in the past

From the delegations' reports it emerged that the systems of family allowances in various Member States had in some cases been substantially modified in the past.

Annex 2 shows examples of some of the major changes to the national systems of family allowances.

Undoubtedly the transition from tax-free children's allowances for income tax assessment purposes to payment of a fixed sum per child had the greatest impact on the development of net earnings.

With this measure the Member States attempted to increase the tax burden on higher-earning groups while at the same time raising lower incomes. Given the progressive income tax rates applied in the Member States, this measure led to a reduction in net pay down to intermediate grades, whereas only the lowest grades enjoyed tangible increases. On the whole this change has led to lower increases in the net earnings of the average civil servant.

The second change in the system of family allowances which has been adopted by several Member States is the transition from a fixed sum per child to an income-linked children's allowance and this had a similar non-linear effect: reduction in high incomes, relative improvement in low incomes. Even if originally the aim was to redistribute incomes without changing the size of the total budget, in practice the system has often led to a relative reduction in family allowances for all grades and thus to a relative reduction in net average earnings.

Bearing in mind the statements made by the delegations at the meeting and after examining the annual reports for recent years, it can be said that hitherto all these major changes to the system of family allowances have been taken into consideration in the annual reports in calculating trends in net earnings and that, accordingly, these changes have in turn affected the special indicator (generally in a downward direction).

5. Historical survey of family allowances in the Italian public sector (Report by the Italian statistical expert)

- a) Initially (before 1978), allowances were paid for each dependant at levels varying with the degree of kinship involved. They were not subject to tax.

In addition, there was a flat-rate tax reduction for the wife and a further, progressive tax reduction based on the number of dependent children. This tax relief was independent of income and applied equally to all civil servants in identical family circumstances.

- b) Up to 1980 allowances increased and in 1980 were made uniform for all dependants (wife and children Lit 19 760 per month for each person).

As regards tax, the same criteria were applied; the amount deductible from taxable income was increased.

- c) From 1 July 1983, supplementary allowances were paid for all dependants in addition to the allowances described above. They varied according to the number of dependants but fell progressively as the family's total income increased. Beyond a certain income level no supplementary allowances were paid.

As regards tax, the situation remained more or less unchanged.

- d) From 1 January 1984, as a result of inflation and the inflation-based wage indexation system, a growing number of civil servants exceeded the income thresholds for entitlement to the supplementary allowance and accordingly lost all or part of this allowance.

Summary

	Stage 1 (before 1978)	Stage 2 (until 1980)	Stage 3 (1.7.1983)	Stage 4 (1.1.1984)
Family allowances	-Allowances depend on the number of dependants	-idem	-idem	-Allowances reduced with increasing income
	-Different amounts for wife and children	-Equal amounts for wife and children	-idem	-idem
Supplementary allowances (1)	-	-	-Proportional to the number of dependants	-idem
			-inversely proportional to income	-idem
Tax relief (2)	-Fixed sum for spouse and additional amounts proportional to number of children	-idem	-idem	-idem

(1) Not paid if total family income exceeds a certain amount.

(2) Tax relief both for dependent spouses and for dependent children has progressively increased.

e) The new System had the following general effects:

Initially, from an individual point of view, there was an increase in the net earnings of the lower-paid and a decrease in the net earnings of the higher-paid.

However, the income thresholds for the supplementary allowance were not raised in line with inflation; as a result a number of civil servants in the intermediate range lost their entitlement to the supplementary allowance. In addition, the increases in the supplementary allowances did not fully compensate for price increases. This led to a drop in purchasing power in the light of relatively high inflation.

The final result of this trend was that the increase in real net earnings which initially applied in 1983 was subsequently reserved, due to the failure to adjust, and that there was a general fall in purchasing power.

The budgets for the years concerned show that expenditure on family allowances remained stable until the first half of 1983, rose considerably from July 1983 on and then gradually dropped until, finally, it fell below the nominal value for 1982.

The impact of these measures has also been felt in the Specific Indicator for Italy, calculated by EUROSTAT.

6. Conclusions

Following this exposé the Working Party came to the unanimous conclusion that the "1981 method" had been applied correctly both in letter and spirit to the reform of the Italian family allowances, that the method had also been applied correctly in earlier years and that there had been no anomalies.

However, some delegations were of the opinion that the 1981 method did not effect the exact average for all civil servants, because it assumed that one half of the civil servants were single and that the other half were married and had two children, although there was no statistical evidence to suggest that this distribution reflected the realities in the Member States.

However, one delegate pointed out that in his country the practice was to compare the special indicator with the per capita wage sum index for public sector employees and that so far no major discrepancy had been noted.

The Working Party was also of the opinion that the procedures for applying the 1981 method should not be altered. Member States which hitherto had prepared their report with July 1 as reference date should continue to do so because - in the long run, at any rate - this procedure did not lead to errors, whereas a change in the reference date might well jeopardize the validity of the results.

Annex 1The systems of family allowances for civil servants in the Member StatesStatus: 1984

		<u>System of adjustment to price trends</u>
<u>Deutschland</u>		
Place-of-residence supplement } Sum per child as part of 13th monthly salary	Forms part of salary	Adjustment is linked to changes in salary
Children's allowance	Depends on family's total income	No adjustments sofar
<u>United Kingdom</u>		
Child allowance	Fixed amount, payable to the mother	Adjusted annually
Family supplement		
<u>Danmark</u>		
Children's allowance	Fixed amount	{Regular but incomplete adjustments
Family allowance	Depends on income	
<u>Hellas</u>		
Family allowance	Fixed amount for all levels	Linked to salary
Tax-free allowance for income tax assessment purposes	Tax relief	Adjusted annually
<u>Ireland</u>		
Children's allowance	Taxable, fixed amount	Regular but incomplete adjustments
Social children's allowance	Tax free	ditto
Tax-free allowance for income tax assessment purposes	Tax relief	No adjustments
<u>Belgique</u>		
Children's allowance	Fixed amount, tax free	{Regular, index-linked adjustments
Tax-free allowance for income tax assessment purposes	Tax relief	
<u>France</u>		
Family allowances (allocations familiales) (supplément familial de traitement)	Fixed amount Forms part of salary and depends on the number of children. It consists of a fixed amount and a sum proportional to salary with a minimum and a maximum	Adjustment is not automatic same
Tax relief	Tax relief in the form of "quotient familial" with a ceiling	same
<u>Italia</u>		
Family allowances (assegno integrativo) (aggiunta di famiglia ordinaria)	Sum per dependant, graduated in line with family's total income Fixed amount, tax free	Incomplete adjustments of income thresholds and amounts Incomplete adjustments
Tax-free allowance	Tax relief	ditto
<u>Nederlande</u>		
Kindertoelage	Fixed amount, tax free	Annual adjustments lower than inflation rate
<u>Luxemburg</u>		

Annex 2

Major changes in the system of family allowances

1. Transition from tax-free children's allowances for income tax assessment purposes to fixed-sum children's allowances

Countries concerned: Deutschland	Year of change: 1975
United Kingdom	1977-79
Nederland	1978

Impact of the measure on the special indicator:

Substantial reduction in salaries of intermediate and upper grades
Relative increase in lower salaries
Reduction in average salaries.

2. Transition from family allowances without income thresholds to income-related family allowances

Countries concerned: Deutschland	
Italia	1983
Denmark	1977

Impact of the measure on the special indicator:

Reduction in higher salaries
Increase in lower salaries
Reduction in average salaries

Comments on the report by the Netherlands Delegation

Central Statistical Office

First paragraph of the conclusions:

"Following this exposé the Working Party came to the unanimous conclusion that the way in which the changes in the Italian family allowances had been incorporated into the calculations did not conflict with the "1981 method". Neither did the way in which modifications in family allowances in the Member States were treated previously conflict with the above-mentioned method. Accordingly, the Working Party could not find any anomalies (or irregularities)."

First sentence of the fourth paragraph of the conclusions:

"The Working Party was also of the opinion that, as no irregularities had been found in the application of the "1981 method", there was no need to propose modifications to the application."

The second sentence of the fourth paragraph can remain as it stands.

Ministry of Internal Affairs

Final sentence of section 2

Addition:

"Moreover - in view of their brief - the delegations had not made a detailed scrutiny of this interpretation and its merits in the light of the objective referred to in the method. Such task was considered to be the responsibility of the Council. Thus, work was restricted to examining the children's allowance element in the method and, in particular, the problem which had cropped up in incorporating the Italian data."

First paragraph of the conclusions:

"Following this exposé the Working Party came to the unanimous conclusion that the way in which the changes in the Italian family allowances had been incorporated into the calculations did not conflict with the established, standard practice of applying the 1981 method. Neither had the treatment of previous changes in the family allowances in the Member States been in conflict with this method."

Second paragraph of the conclusions:

Addition:

"Some delegations thought that this could lead to a discrepancy between the way in which the method was applied and the basic principle referred to in the method (of reflecting what on average is established in the Member States)."

Fourth paragraph

First sentence:

"The Working Party was also of the opinion that, as no irregularities had been found in the practical application of the "1981 method", and as application was uniform in the Member States, there was accordingly no need to propose modifications to the application."

Comments on the report by the United Kingdom Delegation

"The U.K. members of the Working Party were unable to agree the conclusions of this report and they expressed their reservations in a letter to the Chairman, dated 25 July. They felt that the 1981 Method had been applied generally correctly in spirit, but that anomalies had arisen. In the U.K. view insufficient criteria had been formally agreed by all Member States with regard to the application of the Method, eg reference dates for Member States' annual returns, and anomalies were bound to arise. The U.K. position will be fully explained when the report is discussed at the appropriate meeting of the Working Party on Staff Regulations (Groupe Statut)."

It follows from this that where the report used such terms as "unanimous", it should be amended to "all members except the United Kingdom".