PO CH/NL/0223

PART A

Alex Lawson

PART A

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0223

PART A

CHANCELLOR'S PAPERS ON HEALTH AND SOCIAL SECURITY SERVICES

DD: 25 years

15/9/95

Begins: 24/2/87

Ends: 13/6/88 (CONTINUED)

PART A

Ch

Gill Noble's note below is another element of the package — but cost is troublesome.

AA

Is £6½ bn really right? What proportion is it of gross total yield of NICs? What would be the cost (at [illegible]) of doing this for employees' NICs alone?

g.89

FROM: MISS G M NOBLE
DATE: 24 February 1987

MRS RYDING

NATIONAL INSURANCE

You asked me for some national insurance costings. As it happens, we have some readily available figures, which we use in briefing.

2. The figure we normally quote for turning the lower earnings limit into a threshold (like income tax) is **£6½ billion.** That is a GAD figure, and I think a little out of date. But the order of magnitude is about right. It assumes that contribution rates would be set at 9 percent for employees and 10.45 percent for employers, as now. I have a feeling that, at some stage, the GAD also calculated what the contribution rates would need to rise to for a revenue neutral (or at least NIC-neutral) package; but the figure is not readily to hand. It would clearly involve quite a significant increase, raising "marginal tax rates" at all earnings levels.

GN says (roughly) 1% = £1 billion so need about 13% for both employees & employers for revenue neutrality.

3. The revenue from abolishing the upper earnings limit for employees was quoted by DHSS recently in a PQ. The figure quoted was **£930 million for 1987-88.** That is a full year effect, consistent with the Autumn GAD report, and assuming that we retained the UEL for benefit purposes - that is, we would continue to award SERPS rights only in respect of the balance of earnings between the lower and upper earnings limits, and accordingly, we would continue to apply the contracted out rebate on a restricted band of earnings. The figure is substantially higher than the figure of £770 million DHSS have previously quoted, which was for 1986-87 - a reflection of the fact that the UEL is effectively linked to prices, while the assumptions for the Autumn GAD report implied a continuing (modest) real increase in earnings.

4. As I mentioned, the Chancellor dismissed the option of abolishing the UEL for employees in pretty definite terms in the 1985 Budget speech, saying that it would raise marginal rates to unacceptable levels.

G Noble

MISS G M NOBLE

As now, there will be no National Insurance payable for those earning below the lower earnings limit, which for 1985-86 has been set at £35.50 a week, broadly in line with the single person's pension. But for employees earning between this and £55 a week, the employer will in future have to pay only 5 per cent instead of 10.45 per cent; for employees earning between £55 a week and £90 a week the new rate for employers will be 7 per cent; and for those earning between £90 and £130 a week the employer will pay 9 per cent. The full employers' rate of 10.45 per cent will apply only for those earning over £130 a week.

These changes represent substantial reductions in the cost of employing the lower paid. They will significantly improve the flexibility of the labour market and the prospects for jobs. I recognise that employers cannot be expected to welcome the increased cost of employing higher paid workers, but for business and industry as a whole the increase in the cost of the higher paid will be fully offset - indeed more than offset - by the reduced cost of employing lower paid workers.

Moreover I propose to introduce a similar system of graduated National Insurance contribution rates for the employees themselves at the lower end of the earnings scale. At present, those earning more than the lower earnings limit pay a flat rate of 9 per cent on total earnings up to the upper earnings limit, and nothing on any amount they may earn above that limit.

This system makes National Insurance contributions a particularly heavy burden for the low paid.

I propose that, in future, those earning between £35.50 and £55 a week pay at the rate of 5 per cent, and those earning between £55 and £90 a week 7 per cent. Only those who earn above £90 a week will be liable to the full 9 per cent on their earnings.

But I do not propose to abolish the upper earnings limit for employees' contributions. It is an integral part of the contributory system on which their benefit entitlement is based. Moreover, if it were abolished, those on the higher rates of income tax would face unacceptably high combined marginal rates taking into account liability to both tax and National Insurance contributions.

The changes I have proposed represent a substantial reduction in the burden of National Insurance contributions on lower paid employees. In addition, as I have already indicated, I propose a corresponding reduction in the contributions paid by the self-employed. The flat rate Class 2 contributions will be reduced from £4.75 to £3.50 a week.

RC2.88

CONFIDENTIAL
AND PERSONAL

RD

FROM: CATHY RYDING
DATE: 8 April 1987

MISS G M NOBLE

NATIONAL INSURANCE

The Chancellor was grateful for your minute of 24 February.

2. The Chancellor would be grateful to know what proportion £6½ billion is of the total yield of NICs. He would also be grateful to know the cost (and implications) of turning the lower earnings limit into a threshold for employees' NICs only.

CR

CATHY RYDING

g.153 PERSONAL AND CONFIDENTIAL

For T... meeting

FROM: MISS G M NOBLE
DATE: 16 April 1987

Thanks. £3bn is a great deal of money. But I do not feel v. much force in x. NL

CHANCELLOR

cc Chief Secretary
Mr Gibson (or)

NATIONAL INSURANCE

You asked (Mrs Ryding's minute of 8 April) what proportion of total national insurance contribution £6½ billion represents (the figure we quote as the cost of turning the LEL into a threshold). You also asked what would be the cost and implications of turning the lower earnings limit into a threshold for employees NICs only.

2. The Autumn GAD report showed total national insurance income of £27.2 billion for 1987-88, gross of statutory sick pay and statutory maternity pay, and including the NHS allocation and EPA; net contribution paid into the Fund was projected at £23.4 billion. £6½ billion is 24 per cent of the first figure and 28 per cent of the second. At a rough estimate, turning the LEL into a threshold for employees only would cost about £3 billion.

3. You may, however, be interested to see the attached reply to a recent PQ from Mr Austin Mitchell. As you will see, the cost is put there at £3.5 billion, but that is on a slightly different basis. Firstly, the PQ assumes that the first £44.75 a week is exempt. This contrasts with the current LEL of £39 a week. Also, it assumes that the reduced rates would remain in place, whereas the £6½ billion is what it would have cost if we had turned the LEL into a threshold <u>instead</u> of introducing the reduced rates (because that is how we use the point in letters and defensive briefing). In other words, in the PQ, someone on say, £55 a week would pay no national insurance on the first £44.75 of their earnings and then 5 per cent of the balance (giving a contribution of about 50 pence a week); someone on £95 a week would pay nothing on the first £44.75 and then 7 per cent on the balance (a contribution of about £3.50 a week), and so on. In contrast, the £6½ billion assumes that the first slice of income would be exempt, and then a single rate of 9 per cent would apply on the balance of earnings above that. The main point to note is that

£2.9 billion of the cost of the option in the PQ goes to people who are currently on the 9 per cent rate (ie earning over £100 a week.) To say the least, it does not look a very cost effective way of helping the low paid.

4. Turning the LEL into a threshold would solve the problems we currently get just under steps (eg with overtime earnings and pay settlements being wiped out or worse by higher NICS). But if the main rate is increased to make the package revenue neutral it would mean that all contributors would face higher marginal rates. The structure described in the answer to the PQ would combine the worst of all worlds; for example, someone whose earnings went from just below £100 a week to just over that would switch from having 7 per cent charged on the balance of earnings over the LEL (or on this case £44.75) to paying 9 per cent on that amount. On the face of it that would seem pretty pointless, since the main purpose of changing the LEL into a threshold would be to get rid of the NIC steps. But if we were to substitute a threshold and a 9 percent rate, we would have to explain to some confused low earners why a contribution rate of 9 per cent (or whatever higher figure had to be set to make the books balance) was suddenly a better deal than 5 or 7 per cent. This is only a short term presentational problem, of course; they would notice the difference in their pay packets when it came to the bit (although, depending on the level to which the contribution rate had to be raised for financial neutrality, some low paid could conceivably find they are paying more rather than less national insurance).

5. On the purely practical side, it should not to be unduly difficult to operate the LEL as a threshold, providing national insurance was still charged on a weekly or monthly basis and not switched to a cumulative basis like income tax. The detail of the new structure could simply be incorporated in the "read off" tables issued to employers or programmed into their payroll computers. There are no purely practical reasons that I can think of why you could not operate the LEL as a threshold for employees and a limit for employers contributions (though one can never be sure without talking to DHSS); but it would look rather odd and

X might be difficult to explain, if not defend.

6. Switching NICs to a cumulative basis like income tax, on the other hand, would involve asking employers to keep a whole new set of cumulative earnings records and to do rather more complicated calculation than they have to do at the moment for NICs. If the definitions were aligned precisely to those of income tax, this need not be an impossible chore (but of course any new procedure is regarded as an unreasonable burden by employers). The two records could not simply be integrated unless we either integrate tax and national insurance completely, or Inland Revenue were able to pass their tax records onto DHSS. I believe this would almost certainly require primary legislation, which would prove to be unreasonably controversial since it would open all the arguments about privacy of tax records; but that point would need to be double checked by the lawyers.

7. I a copying this to the Chief Secretary because he asked me to consider whether there were any ways of easing the problems of overtime earnings around about the reduced rate thresholds, particularly for the monthly paid, following his recent conversation with Sir Humphrey Atkins. (A lumpy payment like overtime can take all four weeks of a monthly paid employee's salary into a higher NIC rate, producing a net loss in the worst cases, and this is becoming a more significant problem as more of the low paid switch to monthly pay.) Turning the LEL into a threshold is the most obvious way of resolving the problem. Other options would be increasing the number of reduced rates so that the steps were less than 2 percentage points. That means the steps are less sharp, but it means far more people would be affected by them. I am afraid I cannot think of any other obvious solutions - except those we rejected in relation to pay arrears.

G Noble

MISS G M NOBLE

xtract from Hansard 10.3.87. Reference..

W.A. Col. 478.

National Insurance

Mr. Austin Mitchell asked the Secretary of State for Social Services whether he will publish in the *Official Report* a table showing the number of men and women paying national insurance contributions at the full rate and at each other rate, together with the estimated cost in each case of exempting the first £2,335 of income in calculating the employee's contribution liability.

Mr. Major: The information on the average number of class 1 contributors in 1986-87 is as follows:

Employees' not contracted out Contribution Rates *Per cent.*	*Great Britain: Millions* Males	*Females*	*Total*
5·00	0·3	1·1	1·4
7·00	0·6	1·5	2·1
9·00	10·5	3·6	14·1
Optants 3·85	—	1·2	1·2
Total	11·4	7·4	18·8

The estimated reduction in yield in a full year from exempting the first £2,335 of income from employees' class 1 contributions is as follows:

Employees' Contribution Rates *Per cent.*	*£ billion (Great Britain) (1986-87)*
5·00	0·2
7·00	0·3
9·00	2·9
Optants 3·85	0·1
Total	3·5

Notes:

In assessing the effect of exempting the first £2,335 of income from employees' contributions, it has been assumed that employees would not pay primary class 1 contributions on the first £44·75 of their weekly earnings.

In deriving these estimates, it has been assumed that the contracted-out rebate would apply to the contribution rates of contracted-out employees on earnings between £44·75 and £285 per week (the upper earnings limit).

All estimates are based on the assumptions used in the report by the Government Actuary on the drafts of the Social Security Benefits Up-rating (No. 2) Order 1986 and the Social Security (Contributions, Re-rating) (No. 2) Order 1986 (Cm 24).

ps4/11H

CONFIDENTIAL

NOTE OF A MEETING HELD IN HM TREASURY
ON FRIDAY, 17 JULY

Those present

Chancellor
Financial Secretary
Sir P Middleton
Mr Scholar
Miss Sinclair
Mr Kuczys
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Lewis - IR
Mr Mace - IR

REFORM OF PERSONAL TAXATION: TAXATION OF HUSBAND AND WIFE

Papers: Mr Mace to Chancellor, 7 July;
Mr Isaac to Chancellor, 7 July (Independent Taxation: Timetable to 1990; Summary Agenda);
Mr Isaac to Chancellor, 7 July (Independent Taxation: Timetable to 1990);
Mr Mace to Chancellor, 15 July
Mr Scholar to Chancellor, 16 July.

Transferable allowances

The Chancellor said that transferable allowances were not on at the present time, though he did not want to do anything that was incompatible with that approach. It was arguable that a move to Independent Taxation was incompatible with TAs, and he certainly did not think it could be presented as a step along the road. But it did keep open the option: the time might come when the married man's allowance was considered ridiculous and would be replaced by transferability. Mr Isaac commented that a move from Independent Taxation to TAs would be a step back from full privacy and independence.

Independent Taxation or Wife's Income Election?

2. The Chancellor said that he agreed with the conclusion reached by the Financial Secretary and Inland Revenue officials that the way forward had to be Independent Taxation, rather than Wife's Income Election. He thought it would be very odd to move to the former by way of the latter. So there should be legislation in 1988, in order to implement Independent Taxation in 1990.

3. The Chancellor said that he appreciated the staff consequences of Independent Taxation. The details would have to be considered in another forum, and the numbers would need to be scrutinised very carefully. Mr Battishill agreed, but said that it was clear there would be a net staff cost. Mr Isaac explained that the proposal meant that large numbers of married women would become taxpayers in their own right, and that there would be many more repayments, for example to married women with BT shares.

4. Sir P Middleton pointed out that some married women would become taxpayers for the first time, in the same year as they had to pay the new community charge. The Chancellor agreed, and thought that, at some stage, it would be useful to examine the combined effects of the community charge and Independent Taxation. The only distributional problem of Independent Taxation would be a relative one - there were no cash losers. He noted that there was a consistency between the two, since both took the individual as the tax unit.

Tax penalties on marriage

5. The Chancellor commented that the most important tax penalty arose from mortgage interest relief. He had not been persuaded to move away from the residence basis put forward in the Green Paper. This left two questions: first, what the limit for relief should be - the £30,000 limit would not necessarily hold, and other options should be explored; and second, whether the new regime

should apply only for the future, or should take immediate effect, with some special protection for losers.

6. Mr Battishill thought that the new regime would have to apply only for new mortgages. The problems of locking-in would not be too serious. The Chancellor agreed.

7. On the additional personal allowance, the Chancellor said that the proposal was to turn the tax allowance into public spending. Consultation with the DHSS should begin, on the basis that the proposal was in the Green Paper. The Treasury and the Revenue should take this forward jointly.

8. On maintenance and convenants, Mr Isaac said that a paper would be coming forward the following week.

9. On capital gains tax, the Chancellor said that the proposals in the Green Paper (summarised in Annex E of Mr Mace's 7 July submission) were clearly right, and should be pursued.

Implications for the composite rate

10. It was generally agreed that the implications of Independent Taxation for the composite rate were very awkward. There would be pressure from non-taxpaying wives for repayment of composite rate interest, but the staff consequences would be massive. The Financial Secretary commented that this pressure would mostly emerge after the legislation had been passed. He thought it could be resisted. The Chancellor said that some instrument paying interest gross had to survive. It should be stressed that married women wishing to make use of their tax allowance could invest in either National Savings or equities. This should help with the presentation.

Resources

11. Mr Isaac said that some issues on resources would need an early decision, because they affected the 1987-88 PES bid.

12. The main question was whether consultants employed in Telford should be released. Originally, this had been the intention, to help reduce running costs. But a similar number of people, at much the same level, would be needed the following year for Independent Taxation, and it would make sense to retain the existing staff. But this would entail an extra cost of £1 million this year.

13. The other problem was overtime working to introduce CODA. It was imperative to get the network up-to-date in preparation for the move to Independent Taxation.

14. The Chancellor asked the Financial Secretary to go through these issues, and said that FP Division would clearly need to be involved.

APH

A P HUDSON
21 July 1987

Distribution

Those present
Chief Secretary
Paymaster General
Economic Secretary
Mr Cassell
Miss Peirson
Mr Tyrie
Miss Dyall - IR
PS/IR

HK/C/03

CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

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PWP.

CH/EXCHEQUER

REC. 09 JUL 1987 9/7

TO Mr McIntyre
CST FST PMG
Sir P Middleton
Mr FER Butler
Mr Monck
Mr Burgner
Mrs Lomax
Mr Scholar
Mr Turnbull
Mr Pratt
Mr Shaw Gray
Mr Cropper
Mr Tyrie

CHIEF SECRETARY

REC. 10 JUL 1987

ACTION CX

COPIES TO

The Rt Hon John Moore MP
Secretary of Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
London SE1

30 June 1987

Dear John.

REDUNDANCY FUND - EMPLOYMENT PROTECTION ALLOCATION 1988-89

There was correspondence in October and November last year between Nigel Lawson, Kenneth Clarke and myself about the Redundancy Fund.

Briefly, the Redundancy Fund had a surplus of £650m by April this year and this is projected to rise to about £840m and £1100m by April 1988 and April 1989, respectively. The only way to slow down this steeply climbing, and potentially embarrassing surplus is to reduce the Employment Protection Allocation (EPA) to the Redundancy Fund. The EPA, after the reduction agreed last year, is 0.07 per cent for employees and 0.06 per cent for employers. As the projected annual outgoings in 1987-88 are estimated at only £130m against an income of £365m (£260m from contributions and £105m from investments) we currently have cover for at least 10 years. In the circumstances I would like to propose a zero contribution rate for 1988-89 and, though the position will need to be looked at afresh each year, for the following three years.

I hope that a zero rate of EPA could be reflected in the reduction of the overall NICs but this is a matter for you and Nigel Lawson. I recognise that we might have to defend a situation in which there is a zero rate without any relief, if for other good reasons, NICs overall are not reduced. I recognise, also, that the final decisions about NICs will not be taken until the autumn.

I am copying this letter to Nigel Lawson and to Tom King in Northern Ireland, where, I understand, the (separate) Redundancy Fund is in a similar position.

Yours ever, Norman

NORMAN FOWLER

CONFIDENTIAL

Pps pl. ('X' form)

Pse type / sig.

FROM: J P MCINTYRE
DATE: 3 September 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Gibson
Mr Cropper
Mr Mace (IR)

Ch/ Content to write as proposed?
JS 3/9

OK as above.
NL.

ADDITIONAL PERSONAL ALLOWANCE: CONVERSION TO BENEFIT

X1 At your meeting on 17 July, you asked that we and the Revenue should begin consultations with DHSS on the conversion of this tax allowance into public spending, on the basis that the proposal was in the Green Paper on The Reform of Personal Taxation.

2. The APA (currently worth £1370 a year) is an allowance for those with single-handed responsibility for bringing up children. The Green Paper suggested that there was a case for rationalising support for single parents by replacing the APA with benefit. You have been attracted by this idea because it would remove one of the tax penalties on marriage. At present, an unmarried couple can claim two APAs if they have two children, whereas the married man's allowance available to a married couple is only the equivalent of one APA plus the single person's allowance. The two earner unmarried couple with children can claim allowances of £7,590 compared with £6,220 for the two earner married couple (over 3 times and 2½ times the single person's allowance, respectively).

3. We have had an initial meeting with the Revenue and DHSS about this. (We were careful not to reveal our hand on other aspects of independent taxation, suggesting that the APA proposal was simply part of looking for an "acceptable half way house.") But

DHSS officials are unwilling to do further work on the options for conversion into benefit without instructions from their Ministers.

4. We therefore suggest that you write to Mr Moore, and I attach a draft.

5. The draft letter makes the point that the options should include means testing and ways of minimising windfall gains as a result of the conversion.

6. The letter asks for officials to report by end-November.

Jpm

J P MCINTYRE

CONFIDENTIAL

Re type | ing

DRAFT LETTER:

Rt Hon John Moore MP PC
Secretary of State for Social Services
Department of Health and Social Security
Alexander Flemming House
Elephant and Castle
LONDON SE1 6BT

ADDITIONAL PERSONAL ALLOWANCE (APA)

As you know, ~~I am sure you will remember~~, the 1986 Green Paper "The Reform of Personal Taxation" which ~~proposed a system of independent taxation of husband and wife with transferable tax allowances, and~~ also discussed ways of removing the present tax penalties on marriage. ~~Under the system put forward, various individual tax allowances would be replaced by a single allowance applying to each individual, transferable between spouses.~~ The Green Paper suggested that in the case of single parents there was a case for rationalising support by replacing the APA with benefit. At present, single parents receive support both through the tax system (APA) and the social security system (One Parent Benefit - OPB - and widows' benefits).

2. As you know, we concluded, following the response to the Green Paper, that there was not sufficient support to take a decision now to go ahead with the introduction of transferable allowances. But Norman Lamont told Parliament last March that we considered it important both that the tax system should give women a fair deal and that the tax penalties on marriage should be removed. We undertook to give the matter further consideration

~~and to explore whether there was any satisfactory halfway house to the approach in the Green Paper.~~

3. ~~Against this background, I have been thinking about what steps we can take to reduce the tax penalties on marriage. One~~ Such ~~tax~~ penalty on marriage, ~~problem~~, which is frequently highlighted in press reports, is the scope for unmarried couples living together, with two or more children, each to claim an (additional person's allowance) (APA), whereas the married man's allowance available to a married couple is only the equivalent of one APA plus the single person's allowance. This means that a two earner unmarried couple with two children are entitled to allowances of £7,590 (over 3 times the single person's allowance) compared with allowances of £6,220 for a two earner married couple (2½ times the single allowance).

4. I would like DHSS, Revenue and Treasury officials to look once again at the options for abolishing the APA and taking account of its abolition in the benefit system, (as proposed in the Green Paper). The aim would be to make such a change in 1989-90 though, because of the lead-times involved in changing tax codes, it would be necessary to legislate in the 1988 Finance Bill. I would like our officials to prepare, by the end of November, a paper setting out the options for conversion, including public expenditure costs and implications for administration. The options should include means-testing and ways of minimising windfall gains. The treatment of widows, who can currently take advantage of APA but are not eligible for OPB, will also need to be covered. Officials will also need to consider how to avoid undesirable knock-on effects, since the abolition of APA would reduce net incomes and

could thus lead to increases in benefits such as family credit and housing benefit.

5. This timetable should allow the paper to take full account of Survey decisions in related areas.

6. I would be grateful for your agreement that this work should now proceed on the basis I have outlined.

NIGEL LAWSON

MR 1/55

CONFIDENTIAL

cc: CST
FST
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr McIntyre
Mr Gibson
Mr Cropper
Mr Mace - IR

PWP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

4 September 1987

Rt Hon John Moore MP PC
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6BT

Dear John

ADDITIONAL PERSONAL ALLOWANCE (APA)

As you know, the 1986 Green Paper "The Reform of Personal Taxation" discussed ways of removing the present tax penalties on marriage.

One such penalty on marriage, which is frequently highlighted in press reports, is the scope for unmarried couples living together, with two or more children, each to claim an additional personal allowance (APA), whereas the married man's allowance available to a married couple is only the equivalent of one APA plus the single person's allowance. This means that a two earner unmarried couple with two children are entitled to allowances of £7,590 (over 3 times the single person's allowance) compared with allowances of £6,220 for a two earner married couple (2½ times the single allowance).

I would like DHSS, Revenue and Treasury officials to look once again at the options for abolishing APA and taking account of its abolition in the benefit system, as proposed in the Green Paper. The aim would be to make such a change in 1989-90 though, because of the lead-times involved in changing tax codes, it would be necessary to legislate in the 1988 Finance Bill. I would like our officials to prepare, by the end of November, a paper setting out the options for conversion, including public expenditure costs and implications for administration. The options should include means-testing and ways of minimising windfall gains. The treatment of widows, who can currently take advantage of APA but are not eligible for OPB, will also need to be covered. Officials will also need to consider how to avoid undesirable knock-on effects, since the abolition of APA would reduce net incomes and could thus lead to increases in benefits such as family credit and housing benefit.

This timetable should allow the paper to take full account of Survey decisions in related areas.

I would be grateful for your agreement that this work should now proceed on the basis I have outlined.

Yours ever
Nigel

NIGEL LAWSON

CONFIDENTIAL

I am content with 15(i) & 15(ii); but as for 15(iii) any further package should be confined to the NHS allocation & OPA changes, which do not require primary legislation, & the Treasury Supplement should be scrapped & cut from 7% to 5%.

NL

FROM: J P MCINTYRE
DATE: 8 September 1987

CHANCELLOR

Ch
Relevant background for your discussion with Mr Moore.
Do you want a meeting to discuss para 15 questions?
AA

(It is very bad that this minute hints at possible action in the Budget on NICs, with low classification & wide circulation. I shall speak to Mr McIntyre.)

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Turnbull
Miss Peirson
Mr Mowl
Mr Gibson
Mr Macpherson
Mr Cropper
Mr Tyrie
Mr Mace (IR)

Indeed — v. firmly. (Also inform PSM) NL

NICs: AUTUMN REVIEW

We will need to decide by the end of October what changes to the NICs regime should be announced at the time of the Autumn Statement for implementation next April, bearing in mind the possibility of further changes being announced in the Budget for implementation in mid 1988-89. The attached paper by Mr Macpherson sets out the background for these decisions, giving our preliminary estimates for the state of the National Insurance Fund (NIF) and setting out the effect of measures which might be announced in November without cutting across your Budget plans.

The Base Case

2. Table 1 in the Annex to the paper shows a base case, the main features of which for 1988-89 are:

(i) Lower Earnings Limit (LEL) increased in line with prices by £2 to £41;

(ii) Upper Earnings Limit (UEL) increased by the maximum permitted, by £10 to £305;

(iii) Thresholds for reduced rate bands increased by £5 to £70, £105 and £155;

(iv) Contribution rates unchanged;

(v) Treasury Supplement cut from 7 per cent to 5 per cent (ie maximum reduction under current legislation);

(vi) Employment Protection Allocation (EPA) and NHS Allocation unchanged (within total unchanged contribution rates)

3. On these assumptions, plus the current PES economic assumptions there would be a NIF surplus of £1.4 billion in 1988-89, raising the balance at the end of the year to £8.1 billion (equivalent to 30 per cent of outgo, compared with the projected 26 per cent for the end of this year).

4. Carrying forward these assumptions into 1989-90 would increase the balance to £9.1 billion at the end of the year (32 per cent of outgo).

5. In absolute terms, these would be record surpluses though, as table 2 in the paper shows, there were larger surpluses as a proportion of outgo in the late 70s and early 80s. (But note that if earnings rose by 7½ per cent in 1988-89 instead of the assumed 6 per cent, and unemployment fell to 2.5m, the balance at the end of the year could rise to 34 per cent, closer to the high figures in the late 70s.)

6. As the paper recognises, there are arguments for running a substantial NIF surplus. In the short term, the introduction of personal pensions makes our projections more uncertain, justifying a larger cushion in the NIF. And in the longer term it reduces the burdens on future generations which, because of demographic changes, will be greater than now. However, if you feel that these arguments do not justify a surplus on the scale projected, two measures could be taken to reduce it, without changing the rate structure or unduly narrowing your options for the Budget. These are increasing the NHS Allocation and abolishing or

accelerating withdrawal of the Treasury Supplement. (At the same time, the Department of Employment are pressing for a zero EPA which would increase the surplus.)

Increasing the NHS Allocation

7. A 0.1 per cent increase in both employers' and employees' allocations (the maximum allowed under current legislation) would reduce the surplus by £350 million next year and increase the amount appropriated in aid of health service votes to some £2,600 million.

8. The risk is that DHSS would argue that this extra income from the NIF justifies more expenditure on health. On the other hand, surveys suggest there is a widespread belief that NICs pay for the health service and that this is thought to be a good thing.

Treasury Supplement: Abolition/Accelerated Withdrawal

9. Abolition in 1988-89 would reduce the NIF surplus by £1.6 billion compared with the base case, turning the surplus into a small deficit. Reduction to 2 per cent (allowing abolition in 1989-90) would reduce the surplus by £950 million.

10. Either of these options would require primary legislation, because the maximum reduction permitted by current legislation is 2 per cent. We would need to persuade Mr Moore to put the clause into his new Social Security Bill, and he may argue for cuts in contribution rates rather than a reduction in the Treasury Supplement. (The Finance Bill could not be used because that covers the Consolidated Fund only, not the NIF.)

Employment Protection Allocation

11. Mr Fowler copied to you a letter written to Mr Moore on 30 June, pressing the case for a 5 year EPA holiday. Your reply was, of course, noncommittal. If current rates were unchanged (0.6 per cent for employers and 0.7 per cent for employees), the Redundancy Fund surplus would increase from £840 million to around

£1,100 million by the end 1988-89. This would be over eight times likely outgo in 1988-89.

12. However, a zero EPA in 1988-89 would add £200 million to the NIF surplus and the EPA surplus gives rise to few complaints.

A Possible Package

13. If you were prepared to:

(a) persuade Mr Moore to include a Treasury Supplement clause in his Bill;

(b) be helpful to Mr Fowler on EPA;

(c) increase the NHS allocation;

a November package could look like this:

		£ billion
	1988-89	**1989-90**
NIF surplus (base case)	1.4	1.0
EPA holiday	0.2	0.2
	1.6	1.2
Increase in NHS allocation	(0.35)	(0.4)
Treasury Supplement: abolition	(1.6)	(1.0)
NIF surplus	(0.3)	(0.2)
Balance at end year (and as % of outgo)	6.35 (24%)	6.2 (22%)
Memorandum:		
NIF balance at end year (base case)	8.1	9.1
Minimum balance recommended by GAD (17 per cent of outgo)	4.6	4.8

14. This package would leave you with a margin of £1.75 billion over the GAD recommended minimum at the end of 1988-89. If you wanted more room for manoeuvre on NICs at Budget time, you could retain a Treasury Supplement of 5 per cent (raising the balance at the end of 1988-89 to £8.0 billion and avoiding the need for legislation) or 2 per cent (balance becomes £7 billion, legislation required). Another option would be to delay announcement of abolition until the Budget, with implementation from mid-year. This would have the disadvantage of requiring a another Bill, because we would miss the opportunity of the Social Security Bill, due to receive Royal Assent by February. On the other hand, another Bill may be necessary next year in any case. Moreover, the case for abolishing the Supplement might seem stronger in the context of the Budget proposals.

Conclusions

15. It would be helpful to know whether, for the November announcement:

(i) you are content that, as a minimum, it should include the changes to LEL, UEL and reduced rate bands set out in paragraph 2 (i)-(iii) above);

(ii) we should assume no changes in contribution rates;

(iii) you are attracted by the kind of package outlined in paragraph 13 above.

16. Firm decisions are not needed at this stage. For one thing, the numbers are subject to revision when we have the Autumn Forecast next month. But it would be helpful to know now how you see the broad shape of the November announcement and whether there is any further work you would like us to do.

JPM

J P MCINTYRE

NATIONAL INSURANCE CONTRIBUTIONS REVIEW

This paper sets out the current state of the National Insurance Fund and options for the autumn review of national insurance contributions.

The State of the Fund

2. The National Insurance Fund continues to generate substantial surpluses. GAD are currently projecting a surplus of £1.1 billion for the current year, compared to a forecast of £0.7 billion made in their report last November. The results of a base run made on the Treasury National Insurance Fund model are shown in Table 1 attached. They point to surpluses of £1.4 billion in 1988-89 and £1.0 billion in 1989-90, the reduction in the latter year reflecting extra contracting out as a result of the Fowler reforms. On these projections, the balance of the fund as a proportion of expenditure would increase from 26 per cent of outgo this year to 30 per cent in 1988-89 and 32 per cent in 1989-90; this would be higher than in most recent years, though 34 per cent was reached in 1980-81.

3. The assumptions underlying the base run are as follows:

i) **Benefits** uprated in line with current PESC assumptions, that is a 4.25 per cent uprating in April 1988 and 3.75 per cent in April 1989.

ii) **Earnings** uprated in line with current economic assumptions, that is, averaging 7 per cent in 1987-88, 6 per cent in 1988-89 and 5½ per cent in 1989-90. (Higher assumptions would clearly add to the surplus).

iii) **Unemployment** at 2.7 million throughout. (A lower assumption would increase the surplus by reducing benefit expenditure and increasing contribution income, but most of the saving of reduced unemployment now comes on non contributory benefits).

iv) **The lower earnings limit (LEL)** uprated in line with prices, that is in line with the basic pension, rounded down to the nearest pound, as required by the 1986 Social Security Act. For 1988-89 this means LEL of £41 a week unless the actual pensions uprating is less than 3.8 per cent or more than 6.3 per cent.

v) **The upper earnings limit (UEL)** uprated to the maximum permitted within the current legislative constraint that it must be between 6½ and 7½ times the basic pension (rounded to £5). For 1988-89 this suggests a UEL of £305 a week, (£15,860 a year), a £10 a week increase in the present level, unless the April 1988 pensions uprating exceeds 4.6 per cent, in which case a UEL of £310 would be possible. A £10 increase in the UEL to £305 would mean a maximum 90p per week loss for individuals earning more than about £16,000 a year.

vi) **The earnings limit on the reduced rate bands** uprated by £5 a week each both in 1988-89 and 1989-90, with the exception of the £150 limit which would be raised by £10 in 1989-90. This seems the minimum credible uprating (although there is no legal obligation to uprate) and could be presented as being roughly in line with the uprating of the LEL.

vii) No change in any of the **Class 1 contribution rates. Class 2 rate** increased in line with formula to £4.05 a week. No change in **Class 4 rate. Lower profit limit** uprated in line with prices; **upper profit limit** uprated in line with UEL.

viii) **EPA and NHS allocations** remain unchanged, i.e. EPA at 0.06 per cent for employers and 0.07 cent for employees; NHS at 0.7 per cent for employers and 0.85 per cent for employees.

ix) **Treasury Supplement** reduced by 2 per cent p.a. to 5 per cent in 1988-89 and 3 per cent in 1989-90. These are the maximum possible reductions under current legislation.

3. It is interesting to see the combined effect on the base run of higher earnings and lower unemployment assumptions. For example, were earnings to rise by 7½ per cent in 1988-89 following a similar rise in 1987-88 and unemployment to fall to 2.5 million in 1988-89, the NIF surplus would be almost £1 billion higher with the balance rising to 34% of outgo.

Is the surplus defensible?

4. Although the surplus for 1988-89 is likely to surpass the record which is going to be set in the current year, substantial surpluses are not unprecedented. For example, in November 1980 a surplus of £682 million was projected for 1980-81; as a percentage of contribution income, 5.4%, this was greater than the 1988-89 surplus, which is projected to be 5.2%. But the outturn in 1980-81 was slightly lower than expected, with a surplus of £631 million, 4.9% of contribution income. Similarly, a surplus of £932 million was projected for 1984-85 in a GAD report in July 1984, the outturn again falling short at £660 million.

5. However, the Government Actuary would probably argue that it is the balance of the fund rather than short term flows which are important. Here, precedent gives more justification to the current position. In the late 1970s and early 1980s, the balance of the fund was consistently higher as a percentage of outgo than the 30 per cent projected for 1988-89. DHSS have in the past argued that on these occasions the size of the balance was unanticipated. Table 2 shows prior year and in year forecasts as well as outturn balances; it gives little evidence to support the DHSS view.

6. Uncertainty provides an additional argument for implementing the base case. A dip in the surplus is already being projected for 1989-90 as a result of take up of personal pension and money purchase occupational pension schemes. The base case assumes that one million people currently not contracted out will contract out from 1988-89 onwards. This assumption is highly speculative, and if it proves to be wide of the mark the surplus could be significantly smaller (or bigger).

7. A longer term argument but one which will have to be examined sometime in the next decade relates to demography, SERPS and healthcare for an ageing population. If the line can be held on price upratings, with its implication of a basic retirement pension of 14% of average earnings by 2003 compared to 20 per cent in 1983, then there should be little pressure to raise NIC rates. However, if the Government succumbs to earnings upratings or chooses to finance the increased health expenditure resulting from an ageing population through the NIF, there would appear to be a strong case for buliding up a large NIF balance now to avoid imposing the burden of higher NIC rates on future generations. Such an approach would follow the prudent example of the Japanese, whose main national insurance scheme at the end of 1984 had a balance six times annual outgo. The problem with this approach is that the NIF was set up on a pay as you go basis; turning it into a de facto funded scheme might result in legal challenge. To promote this argument would also give a hostage to fortune, tieing the Government's hands in relation to future fund policy.

Further Options

The Treasury Supplement

8. The base run assumes a Treasury Supplement of 5 per cent in 1988-89, at a cost to the exchequer of £1.6 billion. Were the supplement to be cut by more than 2 per cent, primary legislation would be required; a social security bill is planned for the next session and should come into effect before April.

9. Abolition of the supplement would result in the fund running a small deficit of around £200 million in 1988-89 and being in broad balance in 1989-90. The balance of the fund would remain well above the 17 per cent level, deemed by GAD to be actuarily prudent (see Table 3). This would still enable further NIC changes with a first year cost of £750 million, if implemented in April, or approaching £1 billion, if implemented in the more likely date of October.

10. An alternative would be to accelerate the phasing out, with a cut to 3 per cent in 1988-89 and outright abolition in 1989-90.

EPA and NHS allocations

11. Mr Fowler has already written to the Chancellor seeking a five year holiday for EPA contributions, currently 0.6% for employers and 0.7% for employees. The Redundancy Fund (RF) is likely to have a surplus of £840 million by April 1988; given that outgo from the fund is likely to be little more than £100 million in 1988-89, projected EPA income of £235 million, combined with investment income of over £100 million, would clearly exacerbate an already excessive RF surplus. A contribution holiday would solve this problem, but at the same time it would increase the NIF surplus, assuming NIC rates are left unchanged. This would not matter if the Treasury Supplement was abolished, but if the base case was followed, a choice would have to be made concerning the relative priority of the NIF and Redundancy Fund surpluses. It should be noted that the RF, with its lower profile, has so far been the cause of few complaints.

12. Last year's rise in the NHS allocation proved an effective means of siphoning money out of the NIF. A further 0.1% rise in the employee and employer allocation, the maximum permitted without primary legislation, would reduce the NIF surplus by around £350 million in 1988-89. Again, the attraction of this option depends on whether the intention is to abolish the Treasury Supplement. A number of permutations are shown in Table 4. Treasury Supplement abolition and a rise in the NHS allocation would clearly narrow some of the room for manoeuvre in relation to future NIC reform.

Reduced rate limits

13. A further way of reducing the NIF surplus would be to increase the reduced rate limits in line with earnings. This could justify limits of £70, £110 and £160 a week, compared to ones of £70, £105 and £150 in the base case. The reduction in contribu-

tion income would be small at £120 million. As a rough guide, further increases in the limits in 1988-89 would cost, for every £5 on each: £40 million on the first limit, £80 million on the second and £50 million on the third.

Health warning

14. Finally, the usual health warning should be registered in relation to the estimates given in this paper. They are all subject to confirmation by GAD and could change with later information, particularly economic assumptions, and with more accurate estimates of the consequential effects on the minor rates (Class 2 etc.)

ETS division
1 September 1987

Table 1

Prospects for the Autumn NIC Review: Base Run

Assumptions:- £ a week

	1987-88	1988-89	1989-90
Lower earnings limit (UEL)	39	41	43
Upper earnings limit (LEL)	295	305	320
Main rates			
employer	10.45	10.45	10.45
employee	9	9	9

Reduced rate structure:

	1987-88			1988-89			1989-90		
Employers -reduced rate%	5	7	9	5	7	9	5	7	9
-on earnings up to £	65	100	150	70	105	155	75	110	165
Employees -reduced rate%	5	7		5	7		5	7	
-on earnings up to £	65	100		70	105		75	110	

Summary of NIF (£ billion)

	1987-88	1988-89	1989-90
Treasury Supplement	2.1	1.6	1.0
- Rate %	7	5	3
Surplus	1.0	1.4	1.0
Balance of fund at year end	6.7	8.1	9.1
- as % of outgo	26	30	32

Table 2

End year balances of NIF as % of outgo

	November prior year forecast	November in year forecast	Outturn
1977-78	n.a	n.a.	39
1978-79	n.a.	37	37
1979-80	34	34	36
1980-81	29	34	32
1981-82	30	27	23
1982-83	24	19	22
1983-84	16	22	23
1984-85	22	25	24
1985-86	27	21	24
1986-87	20	23	[23]
1987-88	26	[26]	n.a.

Table 3

Abolition of the Treasury Supplement from April 1988

<u>Summary of NIF (£ billion)</u>

	1987-88	1988-89	1989-90
Treasury Supplement	2.1	0	0
- Rate %	7	0	0
Surplus	1.0	-0.2	0
Balance of fund at year end	6.7	6.5	6.5
- as % of outgo	26	24	23

Table 4

EPA and NHS allocation options: Effect on NIF surplus, 1988-89

	£ million
a) EPA holiday; NHS allocation unchanged.	+200
b) EPA unchanged; NHS allocation up 0.1%*	-350
c) EPA holiday; NHS allocation up 0.1%*	-150
d) EPA holiday; NHS allocation up 0.1%*; Treasury supplement abolished.	-1700
Memo item: Projected NIF surplus (base run)	+1400

* 0.1% rise for both employers and employees.

CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 9 September 1987

CHANCELLOR

Ch
See also Michael's note below
AA

cc Sir P Middleton
Sir T Burns
Mr Cassell
Miss Peirson
Mr Scholar
Mr Gibson

Thanks. discuss? OK. N.

NICs: MEETING WITH MR MOORE

I understand from DHSS officials that Mr Moore may make the following points when you see him tomorrow:

(i) The Department must have adequate time to consider any proposals you may wish to make for changes in the NICs regime;

(ii) There is a strong case for reducing the flow of revenue to the NIF;

(iii) At some point during the life of this Parliament, there are attractions in going for some radical changes eg an hypothecated social security tax.

2. On the first point, Mr Moore will no doubt be thinking primarily of any measures which might be announced in November, for implementation next April. The background to the Autumn decisions is set out in my submission of yesterday.

3. On the second point, you can acknowledge that the NIF surplus looks likely to increase in 1988-89 (again, see yesterday's submission), though we will need to see the revised figures emerging from the Autumn forecast next month before coming to any firm conclusions about this. The new incentive rebate for people contracting out of SERPS will tend to reduce the surplus in 1989-90. Further reductions in the Treasury Supplement would be a high priority if the state of the NIF permitted it. Mr Moore might have in mind a significant increase in the NHS allocation, or a cut in contribution rates.

4. On the third point, you will want to find out a little more about the sort of radical ideas Mr Moore has in mind.

JPM

J P MCINTYRE

RC2.58

CONFIDENTIAL

J Moore
Meeting Fold

FROM: CATHY RYDING
DATE: 9 September 1987

MR MCINTYRE

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Turnbull
Miss Peirson
Mr Mowl
Mr Gibson
Mr Macpherson
Mr Cropper
Mr Tyrie
Mr Mace - IR

NICs: AUTUMN REVIEW

The Chancellor was grateful for your minute of 8 September.

2. The Chancellor is content with paragraphs 15(i) and (ii) of your minute ie. that the November announcement should include as a minimum the changes to the LEL, UEL and reduced rate band set out in your paragraphs 2(i) to (iii) and should assume no change in contribution rates. However, as for paragraph 15(iii), he thinks that any future package should be confined to the NHS allocation and EPA changes, which do not require primary legislation, and the Treasury Supplement should simply be cut from 7 per cent to 5 per cent.

CR

CATHY RYDING

TASK FORCE SECRET

COPY 1 OF 15

FROM: M C SCHOLAR
DATE: 9 September 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Miss Peirson
Mr McIntyre
Miss Sinclair
Mr Cropper
MrTyrie
Mr Mace, IR

NICS: AUTUMN REVIEW

May I add a brief note to Mr McIntyre's minute to you of 8 September?

2. From the point of the Task Force work the autumn review of NICs is a sideshow, and I think the main objective should be to get through it drawing as little attention to these issues as possible. Either of two possible conclusions may be drawn from this:-

i. we should go for something like the base case in paragraph 2 of Mr McIntyre's minute, increasing the LEL in line with prices, altering the other numbers consistently with that and recent past practice, and cutting the Treasury Supplement by 2 per cent as last year. In other words, business wholly as usual;

ii. lest this approach, in conjunction with the large consequent NIF surplus, were to lead people to think you were developing plans to announce reduced contribution rates in the Budget, announce in November abolition of the Treasury Supplement - in part as a red herring.

3. On the whole I prefer i., because ii. will certainly stimulate press interest in the subject, with re-runs of the

Hencke article and so on. Abolition of the Treasury Supplement - which, on the basis of the present package, looks perfectly affordable - could come later.

MCS

M C SCHOLAR

CONFIDENTIAL

KP/0371t

OF with advice or 10/10

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

CH/EXCHEQUER
REC. 25SEP1987
ACTION MR McINTYRE
COPIES TO CST FST
SIR P. MIDDLETON
MR FERBUTTER
MR ANSON
MISS PEIRSON
MR SCHOLAR
MISS SINCLAIR
MR GIBSON
MR CROPPER
MR MACE I/R PSIR

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Sept 24. '87.

Dear Nigel.

ADDITIONAL PERSONAL ALLOWANCE (APA)

Thank you for your letter of 4 September proposing that officials should look again at the options for abolishing the Additional Personal Allowance (APA) and taking account of its abolition in the benefit system.

As your letter recognises any such change would not be straightforward, and you refer to some of the difficulties: eg the treatment of widows and the need to look for a scheme which is economical and effective in both programme and administrative terms. I share your concerns in these areas. I should however want, as I am sure you would too, to be sure that any decisions we might take would be consistent with our wider objective of reducing taxation; while abolition of APA would of itself increase it, no doubt you would want to ensure that such a decision was taken in a wider context which preserved our general objective. There is also the point that the "benefit" solution would cut across our policies of minimising public expenditure and running costs.

For these reasons, I do not think that it would be sensible for a study by officials to exclude other possible ways of achieving the desired results. I would therefore suggest rather wider terms of reference, for officials to suggest what Ministerial objectives should be in this area, to identify possible ways of achieving these objectives, and to bring out the costs and benefits of each. In addition, I should wish to stress a point of great importance relating to your proposal, given its likely impact on benefit and running costs and the strong pressures I face in both these areas. Should such a proposal emerge from the official study, I would see

E.

very great difficulty in accepting it if I were expected to meet any of the resource costs from within existing provision, or if these costs were to be prayed in aid in future Surveys as an argument for reductions elsewhere. I hope that we can reach some understanding on this point from the outset.

If you can meet me on these two points, I am very content for officials to proceed with a study. I should, perhaps, put up a marker on the question of timing. I appreciate your desire to make rapid progress, but it is important that our policies are coherent and that any action in this area is consistent with other changes we may make to the benefit system. It may be difficult for officials to carry the work through as you propose by the end of November, given the decisions in related areas which we still have to take, and the complex issues which will have to be reviewed.

Yours ever
John

JOHN MOORE

P.155 SECRET

Understood

o.k. J. 13/10

FROM: J P MCINTYRE
DATE: 30 September 1987

1. CHIEF SECRETARY
You are asked to approve this before it goes to the Chancellor in view of the public expenditure aspects.

2. CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Gibson
Mr Cropper
Mr Mace (IR)

No. Para 3 is far too charitable! We must give him the ~~...~~ clearly make clear that this is provided that the option is acceptable to me given an ~~...~~ adequate assurance on X. (as on other ...)

Ch, Content to write as ~~proposed~~ proposed? JS 13/10

ADDITIONAL PERSONAL ALLOWANCE (APA)

Mr Moore's letter of 24 September says he is content for officials to prepare a paper on the options for converting APA into benefit, subject to two conditions:

a. The work should have wider terms of reference ie it should consider what Ministerial objectives should be and then look at the options for achieving them; it should not be confined to examining how APA could be converted into benefit.

b. An "understanding" should be reached at the outset on how we would deal with the additional costs (in benefit expenditure and administration) arising from the conversion of APA into benefit.

Terms of Reference

3. Mr Moore says he wants wider terms of reference because converting APA to benefit would cut across policies to minimise public spending and running costs and to reduce taxation. Other options, he implies, might avoid these problems. What the Department may have in mind is retention of the APA with measures

to prevent unmarried couples with two or more children claiming two APAs (this is the tax penalty on marriage you want removed).

4. One way of doing this, discussed in the March 1986 Green Paper "The Reform of Personal Taxation", would be link APA entitlement to receipt of One Parent Benefit (OPB), which DHSS ensures goes only to those with single-handed responsibility for bringing up children. But to police this effectively would mean DHSS being able to tell the Revenue who should be entitled to APA. The Green Paper said this would be possible with computerisation of both Departments in the early 1990s, and the Revenue do not think a satisfactory scheme on these lines could be introduced earlier. Any scheme introduced in 1989-90 would have to rely on claimants of APA making a declaration that they were OPB recipients, backed up perhaps by sample checks.

5. But if DHSS want this and other possibilities to be looked at as the price for getting on with an assessment of the conversion option, it is probably not worth resisting. The important point to establish with Mr Moore, about which he should have no argument, is the objective of eliminating this tax penalty on marriage.

Public Expenditure Consequences

6. Conversion would be expensive in public expenditure terms. Using the current value of the allowance (£1370 a year), conversion might add very roughly £200 million to the annual social security budget assuming no means testing. (GEP are aware of this possible call on the Reserve in 1989-90 onwards.)

7. Mr Moore wants an assurance that we would not expect him to meet any additional costs from within his existing PES provision nor use them as an argument for offsetting savings in future Surveys. We cannot give him a guarantee on these points: we do not want to give him any encouragement to support relatively expensive conversion options. But an assurance of sympathetic consideration on the costs of an agreed proposal should be enough to secure his cooperation.

X

Timing

8. Mr Moore says it may be difficult for officials to complete their work by end-November, as you proposed in your 4 September letter, because decisions in related areas (ie child benefit) have still to be taken. However, if you want to announce the APA change in the next Budget, we cannot wait until decisions have been taken on child benefit: this may not happen until well into next year. In any event, the two benefits do not necessarily have to move in step. For example, a decision could be taken to means test OPB without yet having reached the same conclusion on child benefit. And for administrative reasons, any restructuring of child benefit is unlikely before April 1990, whereas you would want APA conversion in April 1989.

9. You will therefore want to press Mr Moore for the work to be done by end-November even if the child benefit issue is still outstanding.

10. I attach a draft reply, which reflects discussion with FP and the Revenue.

JM

J P MCINTYRE

DRAFT LETTER TO:-

The Rt Hon John Moore MP PC
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6PY

ADDITIONAL PERSONAL ALLOWANCE (APA)

Thank you for your letter of 24 September.

2. I am quite happy for officials to look at ways of meeting our objective, other than abolition of APA and taking account of this in the benefit system. However, I do not think that their terms of reference should be further widened to include an examination of what our objective should be. Our objective is clear: the elimination of the tax penalty on marriage which arises from the present APA arrangements. The paper by officials should consider feasible ways of achieving this.

3. On the question of the additional public expenditure costs John Major and I could not of course give any guarantees as to how these might be treated in next year's Survey before we have seen the options paper by officials. Public expenditure considerations are bound to influence our decision on which of the options to choose. Having said that, I know that John would give sympathetic consideration to any additional cost to your programme arising from our decision. I hope that will give you sufficient reassurance for the work now to go ahead.

4. As far as timing is concerned, ~~I would like~~ it is most important to keep to the end-November timetable for the paper by officials. As you say, decisions in some related areas will not have been taken by then. But I do not think this need hold up the work; officials can draw attention in their paper to the implications of possible changes elsewhere.

NIGEL LAWSON

RJ8.96

SECRET

FROM: J M G Taylor

DATE: 14 October 1987

BF with reply

cr 19/10

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Gibson
Mr Cropper
Mr Mace - IR

ADDITIONAL PERSONAL ALLOWANCE (APA)

The Chancellor has seen your minute and enclosure of 30 September.

2. He thinks that paragraph 3 of your draft letter needs to be recast. He must clearly give Mr Moore the understanding he seeks, but make clear that this is provided the option is one that is acceptable to us. That would give us adequate insurance against relatively expensive conversion options.

3. I should be grateful if you could redraft the letter appropriately.

JT

J M G TAYLOR

CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 15 October 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Gibson
Mr Cropper
Mr Mace - IR

Ch/ Content?
JT 15/10

Thanks.
OK - one small change.

ADDITIONAL PERSONAL ALLOWANCE (APA)

Mr Taylor's minute of 14 October asked for a revised version of paragraph 3 of the draft letter submitted with my minute of 30 September. I attach a re-draft including a new paragraph 3 which gives Mr Moore the reassurance he has sought on the treatment of any additional public expenditure costs.

JPM

J P MCINTYRE

Re type [illegible]

DRAFT LETTER TO:-

The Rt Hon John Moore MP PC
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6PY

ADDITIONAL PERSONAL ALLOWANCE (APA)

Thank you for your letter of 24 September.

2. I am quite happy for officials to look at ways of meeting our objective, other than abolition of APA and taking account of this in the benefit system. However, I do not think that their terms of reference should be further widened to include an examination of what our objective should be. Our objective is clear: the elimination of the tax penalty on marriage which arises from the present APA arrangements. The paper by officials should consider feasible ways of achieving this.

3. On the question of any additional public expenditure costs, John Major and I would not expect you to meet these from within your existing provision, provided of course that we were in full agreement on the option to be implemented. I hope that will give you sufficient reassurance for the work now to go ahead.

4. As far as timing is concerned, I would like to keep to the end-November timetable for the paper by officials. As you say, decisions in some related areas will not have been taken by then. But I do not think this need hold up the work; officials can draw attention in their paper to the implications of possible changes elsewhere.

NIGEL LAWSON

CONFIDENTIAL

PPS - P1.

FROM: J P MCINTYRE
DATE: 16 October 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Miss Peirson
Mr Scholar
Mr Turnbull
Mr Mowl
Mr Gibson
Mr Macpherson
Mr Cropper
Mr Mace IR

C/Letter to issue?

CR 16/10.

NATIONAL INSURANCE CONTRIBUTIONS: 1988-89

The proposals in Mr Moore's letter of 14 October are almost entirely in line with those that you approved last month (my submission of 8 September and Mrs Ryding's minute of 9 September). Mr Moore's proposals are:

i. No changes in contribution rates.

ii. A 2 per cent cut in the Treasury Supplement from 7 per cent to 5 per cent.

iii. An Employment Protection Allocation of zero.

iv. An increase in the Lower Earnings Limit from £39 to £41, in line with the basic pension.

v. An increase in the Upper Earnings Limit from £295 to £305, the maximum permitted increase.

vi. An increase of £5 in each of the thresholds for the reduced rate bands to £70, £105 and £155 respectively.

vii. For the self employed, an increase in the Small Earnings Exception for Class 2 to £2,250, in the Lower Profits Limit for Class 4 to £4,750, and in the Upper Profits Limit for Class 4 to £15,860.

2. The proposals affecting employees are exactly those which you approved last month. As for the self employed, the proposals are those we would have expected. The Upper Profits Limit has to be the same as the Upper Earnings Limit for the purposes of Class 1. The Lower Profit Limit and the small earnings exception are adjusted in line with this. Though they are not mentioned in the letter, we understand from DHSS that the Class 2 and 3 rates are also as expected, namely £4.05 and £3.95 respectively.

3. A more controversial omission from the letter is the NHS allocation. In the current year, this is set at 0.7 per cent for employers and 0.85 per cent for employees. Each of these can be increased by up to 0.1 per cent under existing legislation, and you agreed last month that we should go for the full increase in order to reduce the NIF surplus by some £350 million next year.

4. DHSS officials have explained to me that Mr Moore has been advised to avoid announcing an increase in the NHS allocation at the same time as controversial decisions on Health arising from the Survey. Although of course the size of the NHS allocation makes no difference to the money available for the NHS, DHSS are concerned that the government's critics would link the two decisions and at least be given a good debating point.

5. From the point of view of the large NIF surplus (see below), it would certainly be preferable to increase the NHS allocation. And the Survey decisions on Health would be attacked by the Opposition, whether or not the NHS allocation were increased; DHSS' presentational worries on this score appear rather marginal. There is also the point that Mr Moore is proposing an EPA holiday, which adds £200 million to the NIF surplus and helps Mr Fowler

with **his** presentational problem on the Redundancy Fund surplus. An increase in the NHS allocation would more than offset the effect of an EPA holiday on the NIF surplus.

6. However, you may not wish to dispute Mr Moore's judgment on this point given the acceptability of the rest of his package and his readiness to defend a £2.4 billion surplus. The attached draft letter therefore offers alternative paragraphs covering this issue.

Projection for the National Insurance Fund

7. Mr Moore reports that, on the basis of his proposals and the Government Actuary's assumptions, £2.4 billion would be added to the NIF surplus in 1988-89. An increase in the NHS allocation would reduce this to £2.05 billion. This compares with £1.25 billion we were projecting last month, assuming the same proposals. The difference is very largely explained by changes in economic assumptions, namely lower unemployment and higher earnings.

Announcement

8. Mr Moore proposes that, in line with the usual practice of the last few years, you should announce the main changes in the Autumn Statement with Mr Moore making a more detailed statement in a Written Answer the same day.

9. I attach a draft reply to Mr Moore agreeing to his proposals with alternative paragraphs covering the question of the NHS allocation.

JM

J P MCINTYRE

CONFIDENTIAL

o161

~~DRAFT~~ LETTER

Please type for signature

The Rt Hon John Moore PC MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON SE1 7RE

NATIONAL INSURANCE CONTRIBUTIONS: 1988-89

Thank you for your letter of 14 October.

I am content with your proposals. [I would, however, like to suggest one further measure we might take. This would be to increase the NHS allocation by the maximum amount permitted under current legislation. This would not of course affect the contribution rates nor the total amount of money to be spent on Health. But it would result in a helpful reduction in the projected surplus in the National Insurance Fund~~. I understand that the reduction would be~~ of the order of £350 million, ~~and this~~ which would more than offset the effect of the zero Employment Protection Allocation which Norman Fowler is seeking. ~~] OR [You do not refer in your letter to the NHS allocation. I understand you are proposing no change, and I am happy to accept that.]~~ You may recall that we did this last year, and it did not give rise to any comment.

I also agree with your proposals for the handling of the announcement, namely that the main changes should as usual form part of my Autumn Statement and that you should make a more detailed statement in a Written Answer on the same day.

I am sending copies of this letter to the Prime Minister, Norman Fowler and Tom King and also to Sir Robert Armstrong.

NIGEL LAWSON

ps2/43R

CONFIDENTIAL

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Sinclair
Mr McIntyre
Mr Gibson
Mr Cropper

Mr Mace - IR

pmp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

16 October 1987

The Rt Hon John Moore MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON SE1 6PY

Dear John

ADDITIONAL PERSONAL ALLOWANCE (APA)

Thank you for your letter of 24 September.

I am quite happy for officials to look at ways of meeting our objective, other than abolition of APA and taking account of this in the benefit system. However, I do not think that their terms of reference should be further widened to include an examination of what our objective should be. Our objective is clear: the elimination of the tax penalty on marriage which arises from the present APA arrangements. The paper by officials should consider feasible ways of achieving this.

On the question of any additional public expenditure costs, John Major and I would not expect you to meet these from within your existing provision, provided of course that we were in full agreement on the option to be implemented. I hope that will give you sufficient reassurance for the work now to go ahead.

As far as timing is concerned, I would like to keep to the end-November timetable for the paper by officials. As you say, decisions in some related areas will not have been taken by then. But I do not think this need hold up the work; officials can draw attention in their paper to the implications of possible changes elsewhere.

Yours
Nigel

NIGEL LAWSON

psl/27A

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

19 October 1987

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Miss Peirson
Mr Scholar
Mr Turnbull
Mr McIntyre
Mr Mowl
Mr Gibson
Mr Macpherson
Mr Cropper

Mr Mace - IR

The Rt Hon John Moore PC MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON SE1 7RE

Dear John

NATIONAL INSURANCE CONTRIBUTIONS: 1988-89

Thank you for your letter of 14 October.

I am content with your proposals. I would, however, like to suggest one further measure we might take. This would be to increase the NHS allocation by the maximum amount permitted under current legislation. This would not of course affect the contribution rates nor the total amount of money to be spent on Health. But it would result in a helpful reduction in the projected surplus in the National Insurance Fund of the order of £350 million, which would more than offset the effect of the zero Employment Protection Allocation which Norman Fowler is seeking. You may recall that we did this last year, and it did not give rise to any comment.

I also agree with your proposals for the handling of the announcement, namely that the main changes should as usual form part of my Autumn Statement and that you should make a more detailed statement in a Written Answer on the same day.

I am sending copies of this letter to the Prime Minister, Norman Fowler and Tom King and also to Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

003/2981 CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

FROM: **JILL RUTTER**

DATE: **19 October 1987**

PS/CHANCELLOR

cc:
Financial Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Miss Peirson
Mr Scholar
Mr Turnbull
Mr McIntyre
Mr Mowl
Mr Gibson
Mr Macpherson
Mr Cropper
Mr Mace - IR

NATIONAL INSURANCE CONTRIBUTIONS: 1988-89

The Chief Secretary has seen Mr McIntyre's minute of 16 October.

2 The Chief Secretary believes that we should increase the NHS allocation. Given the size of the Health PES settlement he believes that this would seem eminently reasonable. He would therefore wish those sections to be included in the letter the Chancellor sends.

Jill Rutter

JILL RUTTER

Private Secretary

RA

FROM: N I MACPHERSON
DATE: 20 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mr Scholar
Mr Riley
Miss Sinclair

NICs AT THE LOWER END

My minute of today.

Revision to paragraph 3. 1989-90 cost of Option F1: For £880 million, substitute £730 million.

N. I. Macpherson

N I MACPHERSON

RO

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 23 OCT 1987 23/10
ACTION MR MCINTYRE
COPIES TO CST FST SIR P. MIDDLETON SIR T. BURNS MR F.E.R. BUTLER MR ANSON MR CASSELL MR KEMP MR MONCK MR PEIRSON MR SCHOLAR MR TURNBULL MR MOWL MR GIBSON MR MACPHERSON MR CROPPER MR MACE I/R.

23 October 1987

Dear Nigel,

NATIONAL INSURANCE CONTRIBUTIONS 1988/89

Thank you for your letter of 19 October.

I am content with your suggestion that we should increase the NHS allocation in the Class 1 National Insurance Contributions by 0.1 per cent aside, the maximum possible within subordinate legislation. My regulations and Press Notice will reflect this.

I am copying this letter to the Prime Minister, Norman Fowler, Tom King and to Sir Robert Armstrong.

Yours

John

JOHN MOORE

JAA/9/C

CONFIDENTIAL

Neil pl find final copy of X ~~PS~~ BHP with advice M

CH/EXCHEQUER
REC. 4 NOV 1987 4/11
ACTION MR MCINTYRE
COPIES TO CST FST
SIR P. MIDDLETON
SIR T. BURNS
MR CASSELL MR MONCK
MISS PEIRSON MR SCHOLAR
MISS SINCLAIR MR GIBSON
MR CROPPER MR TYRIE
MR MACE I/R PS/IR.

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

Switchboard 01-213 3000 GTN Code 213

Facsimile 01-213 5465 Telex 915564

MP

The Rt Hon John Moore PC MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON SE1 7RE

29 October 1987

Dear John

NATIONAL INSURANCE CONTRIBUTIONS RERATING 1988/89

I was grateful to receive a copy of your letter of 14 October to Nigel Lawson about the national insurance contributions rerating for 1988-89 and his reply of 19 October. X

I was pleased that you have been able to pick up the point I made to you in my letter of 30 June about the surplus in the Redundancy Fund. Our latest figures are that the surplus will be about £900m by April 1988 and that we probably have cover for at least 10 years on current redundancy payment volumes. I, therefore, warmly welcome your proposal and Nigel Lawson's agreement that there should be a zero Employment Protection Allocation (EPA) for 1988-89. On the face of it there will need to be a zero EPA for some years but we can look again at the position next year.

I am sending copies of this letter to the Prime Minister, Nigel Lawson and Tom King and also to Sir Robert Armstrong.

Yours ever,
Norman

NORMAN FOWLER

CONFIDENTIAL

CONFIDENTIAL

FROM: J D PORTES
Date: 20 November

J M
20/11.

1. MR MCINTYRE

2. CHANCELLOR

Ch/ Content with line to take?

MPW
20/11

OK

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr Anson
Mr Kemp
Mr Scholar
Miss Peirson
Mr R I G Allen
Miss Sinclair
Mr Mowl
Miss O'Mara
Mr Cropper
Mr Tyrie
Mr Call

GOVERNMENT ACTUARY'S REPORT ON THE NATIONAL INSURANCE FUND

The Government Actuary's report on the state of the National Insurance Fund will be published on 25 November, at the same time as DHSS lay the necessary Orders to achieve the changes to the earnings limits announced in the Autumn Statemnt.

2. The Report will reveal an increase in the projected Fund surplus from £1.1 billion in 1987-88 to £1.8 billion in 1988-89. These surpluses would take the balance in the Fund at the end of 1988-89 to £8.6 billion, equivalent to 34 per cent of annual expenditure.

3. We have considered the presentational issues arising from this and have prepared a 'line to take', as in the attached note. It has been cleared with DHSS. We would be grateful to know whether you are content with this.

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4. The Actuary's report is otherwise uncontroversial. It will be possible for an acute observer to deduce from both this year's and last year's report, taken together, that the recent fall in unemployment is producing a smaller fall in expenditure on unemployment benefit than previously assumed (largely because of a different mix between those receiving unemployment benefit and supplementary benefit). Last year's report assumed 3.05 million unemployed, whereas this year's assumes 2.7 million in 1987-88 and 2.6 million in 1988-89.

JDPortes

J D PORTES

NATIONAL INSURANCE FUND SURPLUS - LINE TO TAKE

a) Why such a large surplus?

(i) Surplus reflects healthy state of Fund, caused by higher employment and the growth of real earnings.

(ii) Level of balance not unprecedented - balance in Fund as percentage of outgo was at similar or higher levels in period 1977-78 to 1980-81.

(iii) Surplus appears artificially large in 1988-89 because some benefit expenditure attributable to 1988-89 will be paid in 1987-88 because of the Easter Bank Holiday (this is worth £400 million).

b) Why not cut contribution rates or increase benefits?

(i) Should not make judgements on contribution and benefit rates solely on basis of projections for Fund in coming year.

(ii) The main contribution rates have been held steady for five years running despite the rising claims on Fund, and the introduction of the reduced rates for the low-paid in 1985.

(iii) GAD expects expenditure on contributory benefits to increase by over £800 million next year as a result of the annual uprating and also because of the increased number of pensioners and increasing average payments to pensioners.

(iv) Introduction of personal pensions and easing of contracting out rules for occupational schemes means added uncertainty about number of people who will contract out of SERPS and hence about Fund income and expenditure.

(v) Greater uncertainty than usual attaches to economic assumptions (as mentioned in Autumn Statement).

[If pressed: "Aren't you just storing up money for tax cuts in the Budget"]

Not first time the balance in Fund has been this high (see above). Cannot comment on Budget, which is a matter for the Chancellor, but it is obviously far too early to speculate.

(wish it was!)

CONFIDENTIAL

pmp

FROM: MISS M P WALLACE

DATE: 23 November 1987

MR PORTES

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Scholar
Miss Peirson
Mr R I G Allen
Miss Sinclair
Mr Mowl
Miss O'Mara
Mr McIntyre
Mr Cropper
Mr Tyrie
Mr Call

GOVERNMENT ACTUARY'S REPORT ON THE NATIONAL INSURANCE FUND

The Chancellor has seen your minute of 20 November, and is content with the "line to take".

MPW.

MOIRA WALLACE

ds20

CONFIDENTIAL

FROM: D SAVAGE
DATE: 22 January 1988

SIR G LITTLER

cc: Sir T Burns
Mr Lankester o.r
Mr Odling-Smee
Mr Evans
Mr Mountfield
Mr Peretz
Mr Sedgwick
Mr Bottrill
Mr Matthews
Mr C Allen

Mr Alex Allan
Nothing pressing, but the Chancellor might like to skim through this note.
26/1

Thanks - letter of 8 - what are we doing via OECD, GATT, etc to get trade barriers down in Korea & Taiwan? NL.

A
It would be interesting to see some bilateral trade balances (with US & Japan in particular).
AA

EAST ASIAN NICS

Your minute of 14 December to Mr Matthews suggested that a short review might be sent to the Chancellor of the Balassa-Williamson study of the East Asian NICs. After discussion with Mr Evans and Mr Matthews, I have prepared the attached note, which draws on the study but also suggests a line we might take ourselves on each of the countries.

2. There is a tendency to treat the four countries as a block, but this is misleading. Taiwan and Korea are protectionist. Singapore and Hong Kong are models of free trade. Taiwan has an enormous structural current account surplus (20-25 per cent of its GDP in 1987) and Korea has recently developed a substantial surplus (6-7 per cent of GDP). On the other hand, the current accounts of Singapore and probably Hong Kong (though full data are lacking) are close to balance. And there are political sensitivities in the case of Hong Kong.

3. The policies of Taiwan and Korea are against our commercial interests. They are against the wider interests of the world economy, contributing to the major trade imbalances and inciting protectionist pressures in the West. And (as Balassa and Williamson convincingly argue) they are against the interests of these countries themselves. It makes no sense that countries with their potential for further economic development should be major exporters of capital.

4. Under American pressure, Taiwan and Korea have lowered their tariffs and removed some restrictions on imports of manufactures. But much still remains to be done to complete their import liberalisation. Undervalued exchange rates have contributed to the strengthening of Taiwan's and Korea's current accounts. Taiwan allowed its exchange rate to appreciate a little during last year - but not enough.

5. The exchange rates of Singapore and Hong Kong have also got out of line as the US dollar has depreciated since early 1985.

6. The maintenance of a fixed dollar link is leading to overheating and mounting inflation in Hong Kong. A revaluation would be desirable on economic grounds - if it could be accomplished without unsettling the financial markets.

DS.

D SAVAGE

EAST ASIAN NICS

1. The policies of the four East Asian NICs, as well as those of the three largest industrial countries, now figure prominently in discussion of how best to reduce the huge international payments imbalances. This note discusses these policies. It draws heavily on the monograph by Balassa and Williamson*, thouqh this is now already out of date in some respects.

2. The first section gives basic facts about the four countries, by way of essential background. The second gives general arguments why the countries should adjust. The third discusses the particular situation in each of the four countries in turn and the measures that each should take.

3. Tables, referred to in the text, are mainly located at the end. An appendix gives extracts on the East Asian NICs from recent communiques.

* 'Adjusting to Success: Balance of Payments Policy in the East Asian NICs' by Bela Balassa and John Williamson, Institute for International Economics, June 1987.

General Perspective (Table 1)

4. The four East Asian NICs have grown very rapidly over the past twenty five years. Their combined GDP has increased at a rate of 9 per cent a year, partly because their population has been growing quite fast, but mainly because their GDP per head has been improving at the remarkable rate of 7 per cent a year - much faster even than in Japan. What makes this performance still more impressive is that it has been achieved by countries which are geographically small in relation to population and poorly endowed with natural resources.

5. Even in the less affluent of these countries, Korea and Taiwan, GDP per head is probably now as high (and certainly more equitably distributed) than in the large Latin American NICs with their superior natural resource base. In the more affluent two, Hong Kong and Singapore, GDP per head is probably already substantially higher than in the poorest OECD countries*.

GDP per head, 1985

	US dollars
Taiwan	3,100
Korea	2,000
Singapore	6,900
Hong Kong	6,300
Brazil	1,640
Argentina	2,130
Mexico	2,080
Greece	3,294
Portugal	2,032
Spain	4,255

* Such comparisons are hazardous of course. To the extent to which their exchange rates were overvalued in 1985, the relative positions of Hong Kong and Singapore may be overstated by the figures in the table which are at actual exchange rates rather than purchasing power parities. On the other hand, their growth since 1985 has been much faster than in OECD countries.

ds20(a)

Table 1: Comparative Statistics, 1985

	Taiwan	Korea	Singapore	Hong Kong	Japan	OECD
GDP (billions, US$)	60	83	18	34	1,323	8,735
Population (millions)	19.3	41.2	2.6	5.4	120.8	807.8
GDP per head (US$)	3,100	2,000	6,900	6,300	10,900	10,800
Growth rate (%): GDP*	9.2	8.7	9.5	8.5	5.9	3.3
GDP per head*	6.8	6.8	7.8	6.2	4.7	2.4
Exports (% of GDP)**	58	40	168	106	13	21
Savings rate (%)*	27	23	29	32	34	23 ?
Budget balance (% of GNP)***	-0.3	-0.3	2.5	0.8	-5.7	-4.2

!??

* 1963-85 average.

** Including re-exports (which account for two-fifths of exports of gcods in Hong Kong and one-third in Singapore).

*** Central government, 1980-85 average.

6. The remarkable record of the East Asian NICs testifies to the importance of sound policies in fostering economic development. All four countries are very open, in the sense of having a high level of trade relative to output. Unlike the inward-looking Latin American NICs, they have not discriminated against exports, and their trade has expanded rapidly. In the mid-1960s, their combined exports accounted for only 2 per cent of world trade; in 1986 their share reached 6½ per cent, of which over one third went to the United States (table 4).

7. Unlike the Latin American NICs, which have engaged in inflationary public finance, the East Asian NICs have not run large budget deficits. Their rapid growth rates have not been associated with expansionary fiscal policies.

Implying what?

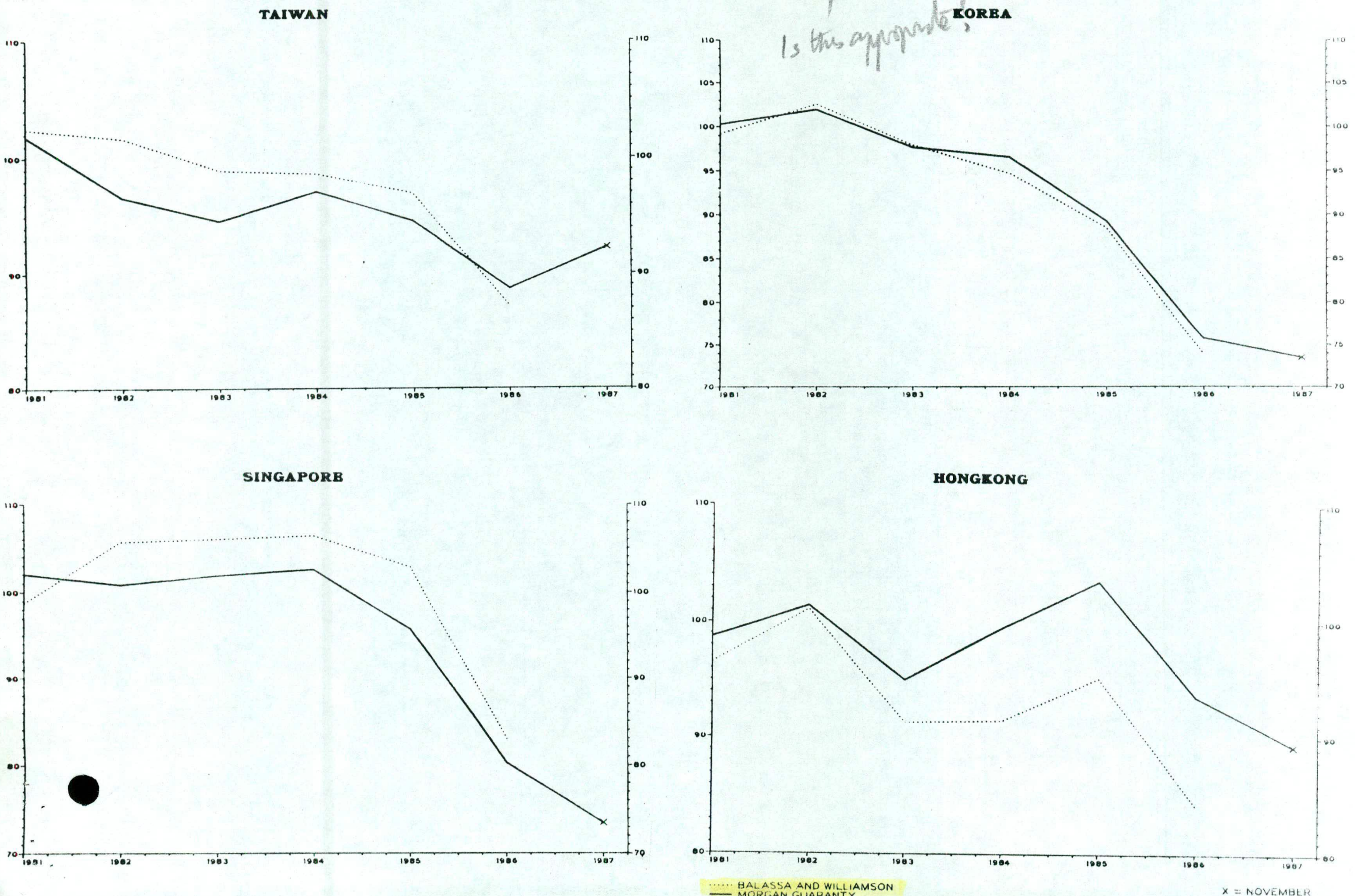
8. They have been associated with high rates of domestic saving. Saving ratios in the East Asian NICs are generally higher than in the Latin American NICs, and higher than in any of the OECD countries save Japan.

9. In the past these high savings were devoted to domestic capital formation. But recently - as the necessary counterpart to mounting current account surpluses, particularly in Taiwan and Korea - they have been increasingly invested overseas. If the outflow of savings continues, it could cause growth rates eventually to slow down.

10. Weakness in the prices of oil and other primary commodities imported by the East Asian NICs contributed to the strengthening in their balance of payments from 1985. But exchange rate policies also played a part. After the dollar peaked early in 1985, the exchange rates of the East Asian NICs all to a varying extent followed it down. The resulting gain in competitiveness seems to have been largest for Singapore, but substantial also for Korea and Hong Kong. However appreciation last year in the Taiwanese dollar appears to have brought it back, by November, almost to its average real level in 1985 (chart 1).

CHART 1. REAL EXCHANGE RATES (CALCULATED FROM CONSUMER PRICES; 1980-82 = 100).

Is this appropriate?



General Arguments for Adjustment

11. The balance of payments policies of the East Asian NICs are contributing to the present imbalances in the world economy. They conflict with the commercial interests of other countries and they are bad for international relations.

12. They are <u>also</u> not in the best economic interests of the countries themselves:

(a) As rates of return are high in the Asian NICs, it is inefficient that these countries should devote domestic savings to the accumulation of low-yielding foreign assets rather than to investment at home.

(b) The Asian NICs do not need to run surpluses in order to improve their creditworthiness. Korea is the only one of the four countries with substantial external debt.

What are their inflation rates?

(c) The easy monetary stance needed to prevent currencies rising is inflationary.

(d) Very large surpluses incite protectionist pressure - particularly in the United States, the NICs major market.

13. Each of these arguments applies in some degree to all four of East Asian NICs. However, the four countries form a much less homogenous group than sometimes assumed. There are similarities but also great differences - in strength of external positions, in openness of markets, and in political sensitivities. Policy prescriptions need to take each country's individual situation into account.

Individual Countries

Taiwan

14. Taiwan has run a huge current account surplus throughout the 1980s (table 2). Its foreign exchange reserves are the third largest in the world and almost double the annual value of its

imports (table 5). Taiwan - like Korea and unlike Hong Kong and Singapore - has protected its home market and encouraged exports through fiscal incentives.

15. It has already recognised that its current account surplus is too large for its national interest and has taken some adjustment measures, including some appreciation, fiscal expansion, and (under American pressure) reductions in tariffs*. However the surplus showing little sign of diminishing.

16. Tariffs should be further reduced, administrative requirements for prior licensing of imports dismantled, services transactions (especially in shipping and insurance) liberalised, and export incentives (rebates for tariffs on imports used in the production of exports and export credits) abolished.

17. However trade liberalisation alone would not reduce Taiwan's current account surplus sufficiently. Further appreciation is also required.

Korea

18. Korea had a current account surplus of $4½ billion (5 per cent of GNP) in 1986, but this was the first surplus since 1977. The Sixth Korean Economic Plan prepared in 1986 envisages a continuation of the present surplus in order to reduce the country's external indebtedness. However Korea's debts, as percentage of its exports, are declining sharply and are modest by the standards of non-Asian NICs and lower than in some OECD countries.

* Tariffs were cut on over 1,800 items at the beginning of 1987 and on additional items of interest to the United States in April. Further reductions are planned: on raw materials to 0-5 per cent and on final goods to about 20 per cent.

Gross External Debt, 1985

	$ billion	% of GNP	% of Exports
Korea*	48 (40)	58 (35)	145 (75)
Brazil	107	51	365
Argentina	48	80	470
Mexico	97	58	328
Greece	19	58	262
Portugal	15	74	183
Turkey	26	49	230

* 1987 estimates in brackets.

19. Balassa and Williamson argue convincingly that, in the interests of continued economic development, Korea should aim for current balance or even a small deficit, which would still allow its debt-export ratio to decline as exports continue to grow rapidly.

20. Tariffs and imports quotas have been substantially reduced since 1983, but remain prohibitive on some products.* Further reforms should include the lifting of all remaining restrictions on manufactures (including controls on cars), liberalisation of imports of food (including rice, the domestic price of which is double the world market level), and the elimination of export credits.

* By April 1987, the tariff ceiling had been reduced to 30 per cent (from 100 per cent in 1983), with rates of 0-10 per cent on raw materials and 30 per cent on consumer goods. Further cuts are promised. The proportion of imports free of quotas has been raised from 85 per cent in 1984 to 95 per cent. The remaining 5 per cent includes cars, some other consumer durables, and cigarettes.

21. The Koreans describe their exchange rate policy as one of pegging to a basket of currencies (the five that constitute the special drawing right), but in practice the Korean won has been devalued more or less in line with the US dollar. Unlike the Taiwanese dollar, the Korean won hardly appreciated in real effective terms in 1987, and in November was 15-20 per cent lower than on average in 1985. Appreciation of the won would avoid the risk of overheating, help stabilise prices and reduce the current account surplus.

Singapore

22. Singapore has traditionally run a current account deficit (which has been more than offset by an inflow of long-term capital). However Singapore's Economic Committee has urged a permanent move into current account surplus 'like Japan'*. Balassa and Williamson argue that an appropriate target to aim at could rather be a zero basic balance (i.e. the sum of the current account and long-term capital account), which corresponds to a small deficit on current account.

23. Singapore (like Hong Kong) has no trade restrictions (or capital controls) to liberalise; balance of payments policy is therefore essentially exchange rate policy. Singapore has pegged its dollar to the US dollar. An appreciation of over 25 per cent (from the November level) would be required to reverse the whole of the gain in consumer price competitiveness since 1985. However a more modest appreciation than this would seem adequate - given that Singapore's current account is currently close to balance and allowing for the fact that wage decrees pressed by Prime Minister Lee Kuan Yew have squeezed profit margins.

* 'Singapore Economy: New Directions' (1986). The Economic Committee was chaired by Brigadier General Lee Hsien Loong, the Prime Minister's son.

Hong Kong

24. Hong Kong's balance of goods and services was in modest deficit from 1978 to 1983, but has moved into surplus since 1984. There is thought to be a deficit on net property income but data are lacking.

25. Until recent years the Hong Kong dollar was allowed to float. But since October 1983, when a crisis of confidence resulting from fears of possible adverse implications of absorption by China led to a sharp depreciation, it has been linked to the US dollar at the fixed rate of HK$7.80 to US$1.00. On the Morgan Guaranty index, the real effective exchange rate was 14 per cent lower last November than on average in 1985 but not very much lower than in 1983. The depreciation on the Balassa - Williamson index (chart 1) is considerably larger however - which clearly demonstrates the very substantial margin of error in calculations of real effective exchange rates.

26. Inflation has remained relatively low in the other East Asian NICs, despite loose monetary conditions and economic boom (table 7). But it has risen sharply in Hong Kong - which is particularly small and particularly open, and where wages and prices are particularly flexible. Unemployment is very low by historical standards (table 8), and the economy is now overheating.

27. The argument for sticking with the dollar link is that it is crucial to the maintenance of financial confidence, which remains fragile. However it is liable to lead to recession (as in 1985) when the US dollar rises and to over-heating and inflation (as currently) when it falls. Balassa and Williamson argue that this instability could be avoided by switching to a basket peg. However under existing monetary arrangements the only option is a step change in the dollar parity - which seems justified on economic grounds.

Taiwan is the only one of the East Asian NICs to have run a large current surplus persistently. The others were on average in deficit over the first half of the 1980s.

Table 2: Current Accounts

	1980-85	1986	1987**
Taiwan			
$ US billion	3.7	16.2	19
% of GDP	7.0	22.9	23
Korea			
$ US billion	-2.8	4.6	7½-8
% of GDP	-4.3	4.9	6½
Singapore			
$ US billion	-0.9	0.5	0
% of GDP	-5.7	2.7	0
Hong Kong*			
$ US billion	-0.2	1.6	1-2
% of GDP	-0.6	4.2	3½

* Balance of goods and services

** Forecasts (except for Taiwan)

Export volumes have increased rapidly since 1985. So have import volumes, although in the case of Taiwan from a very low base. Taiwan's exports are over half as large again as its imports; so the value of exports would need to grow over half as fast again as that of imports for the trade surplus to be reduced.

Table 3: Growth rates in trade volumes

	Average annual percentage rates of increase			Exports as Percentage of imports**
	1980-85	1986	1987*	
Taiwan				
Exports	10.4	25.0	21.7 (Q2)	155
Imports	-1.4	29.3	37.1 (Q2)	
Korea				
Exports	13.0	13.3	23.9 (Q3)	114
Imports	9.8	8.4	24.7 (Q3)	
Singapore				
Exports	5.9	13.4	8.6 (Q3)	88
Imports	4.2	8.9	14.4 (Q3)	
Kong Kong				
Exports	7.9	15.3	27 (Q2)	100
Imports	10.1	13.0	22 (Q2)	

* Change on a year before

** Value, 1986 (1987 for Taiwan).

All of the East Asian NICs, but particularly Taiwan, are heavily dependent on the American market.

Table 4: Geographical Distribution of Exports, 1986

Percentages

	Taiwan	Korea	Singapore	Hong Kong	Total
US	48	37	21	31	36
Japan	11	16	9	4	10
Germany	3	3	2	4	3
France	1	1	2	1	1
UK	2	3	3	4	3
Other OECD	9	12	10	10	10
OPEC	4	7	5	3	5
Non-OPEC/Non OECD	21	21	47	42*	31
Centrally planned	0	0	1	1	0

* Includes re-exports to China.

Germany and Japan have larger foreign exchange reserves than Taiwan. But at almost 200 per cent of imports, Taiwan's reserves are a far larger proportion than Germany's (35 per cent) or Japan's (63 per cent).

Table 5: Foreign Exchange Reserves*

	1980	1985	1986	1987 latest
Taiwan				
$ billion	7.2	22.6	46.3	75 (Dec)
% of imports**	37	104	183	198
Korea				
$ billion	2.9	2.9	3.3	4.5 (Nov)
% of imports**	7	11	11	11
Singapore				
$ billion*	6.6	12.8	12.9	13.6 (June)
% of imports**	29	52	55	40

* Hong Kong's reserves are not published

** Imports of goods, fob.

Growth rates since 1985 in Taiwan, Korea and Hong Kong are rapid even by the historical standards of these countries.

Table 6: Growth rates in output

	Average annual percentage rates of increases		
	1976-85	1986	1987***
Taiwan			
GDP	8.5	10.9	11
Industrial production	10.0	15.1	15.4 (Q2)
Korea			
GDP	7.9*	12.5	12
Manufacturing output	9.0*	9.3	9.0 (Q3)
Singapore			
GDP	7.2	1.9	8½
Manufacturing output	8.2	7.2	15.4 (Q2)
Hong Kong			
GDP	9.0	11.0	12
Industrial production**	7.8	13.7	24.0 (Q2)

* 1980-85

** Industrial consumption of electricity

*** Country forecasts for GDP; latest available quarter on a year earlier for industrial production.

Inflation is still low in Taiwan and Singapore, but is rising in Korea and especially in Hong Kong - partly because of the depreciation of their currencies against non-dollar currencies.

Table 7: Consumer prices

	Average annual percentage rates of change		
	1976-85	1986	1987**
Taiwan	6.3	0.7	-0.6 (Aug-Oct)
Korea	6.0*	2.3	4.1 (Aug-Oct)
Singapore	3.4	-1.4	1.1 (Jul-Sep)
Hong Kong	8.7	3.2	6.2 (Sep-Nov)

* 1980-85

** Change on a year before.

Unemployment is quite low in Taiwan and Korea and very low in Hong Kong.

Table 8: Unemployment rates (per cent)

	1981-84	1985	1986	1987 (latest)
Taiwan	2.2	2.9	2.7	2.0 (July)
Korea	4.2	4.0	3.8	2.8 (July)
Singapore	2.9	4.1	6.5	n.a.
Hong Kong	4.0	3.2	2.8	1.8 (July-Aug)

APPENDIX: EXTRACTS FROM COMMUNIQUES

Louvre Accord, 22 February

'The Ministers and Governors noted that a number of newly industrialised economies were playing an increasingly important role in world trade. These economies have achieved strong growth based significantly on their access to open, growing export markets. Recently, some have accumulated trade surpluses which have contributed importantly to the present unsustainable pattern of global imbalances, thus increasing protectionist pressures. The Ministers and Governors considered that it is important that the newly industrialised developing economies should assume greater responsibility for preserving an open world trading system by reducing trade barriers and pursuing policies that allow their currencies to reflect more fully underlying economic fundamentals'.

Venice Economic Declaration, 11 June 1987

'We call on newly industrialised economies with rapid growth and large external surpluses to assume greater responsibility for preserving an open world more fully to reflect underlying fundamentals'.

Statement of Group of Seven, 23 December 1987

'The Ministers and Governors believe that the reduction of world trading imbalances requires co-operative action by other countries, particularly those with surpluses. They expressed particularly serious concern that some newly industrialised economies have failed to take adequate action to deal with large and growing trade surpluses which are exacerbating global imbalances and fostering protectionist pressures. They urged the newly industrialised economies to implement without delay trade and exchange rate policies that will facilitate the reduction of excessive trade surpluses and allow their currencies to fully reflect the strong competitive position of their economies'.

RA7.25

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

pup

FROM: A C S ALLAN

DATE: 1 February 1988

SIR G LITTLER o.r.

cc Sir T Burns
Mr Lankester
Mr Odling-Smee
Mr Evans
Mr Mountfield
Mr Peretz
Mr Sedgwick
Mr Bottrill
Mr Matthews
Mr C Allen
Mr D Savage

EAST ASIAN NICS

The Chancellor was grateful to you for showing him Mr Savage's minute of 22 January, which he thought was an interesting account.

2. He would be grateful to know what we are doing via the EC, GATT, etc to get trade barriers abolished in Korea and Taiwan.

ACSA

A C S ALLAN

108/G/GBH/150/05

CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 8 FEBRUARY 1988

Chancellor

SIR G LITTLER

cc Mr H P Evans
Mr Peretz o.r

ECOFIN: NICs

The Foreign Office rang me this afternoon to say ~~the~~ they had just heard from UKREP that Stoltenberg is likely to raise the NICs issue at some point during tomorrow's ECOFIN, having come under pressure from the Americans last week. I believe Mr Peretz already had wind of this and you mentioned at this morning's OF meeting that the subject was bound to come up sooner or later.

2. You may like to warn the Chancellor en route for Brussels tomorrow - although he is unlikely to have to deal with the topic unless it comes up over lunch. I assume he is only too well aware of the awkwardness over Hong Kong.

MOM

MISS M O'MARA

4436/017

P/P/S/P.

FROM: R MOLAN

DATE: 8 February 1988

1. SIR G LITTLER
2. CHANCELLOR

cc Sir T Burns
Mr Lankester
Mr Odling Smee
Mr Evans
Mr Mountfield
Mr Peretz
Mr Sedgwick
Mr Bottrill
Mr P G F Davis
Mr Matthews
Mr C Allen
Mr D Savage
Miss Preston

Thanks. I agree that the ECGD problems has I think been launched 15 days? But no follow up for Geoff Chase? Lawson

CA Geoff Littler chase x trad AA

EAST ASIAN NICS

Mr Allan's minute of 1 February asked what was being done to reduce trade barriers in South Korea and Taiwan.

2. Unlike Taiwan, South Korea is a member of GATT. The current GATT Round will hopefully play an important part in the campaign to reduce trade barriers in NICs, Korea being a prime target. One of the chief priorities for the UK is the acceptance by these countries of the full obligations of GATT membership. Many NICs continue to maintain tariff levels, quantitative restrictions etc which are permitted by the GATT Agreement for members with low levels of economic development. Their refusal so far to honour their full obligations has been assisted to some extent by the fact that developing country status is nowhere defined in GATT so they can continue to claim such status.

3. The aim will be to seek concessions by the NICs as part of the package that the Round will probably produce. It is accepted that this package will have to include concessions by developed countries, the argument being that a bargaining process will be the most effective means of achieving the liberalisation we want to see. The areas in which developed countries could offer concessions include textiles, agriculture, tropical products and "grey areas measures" such as VRAs. (There is currently an industry to industry VRA on footwear operating between the UK and South Korea.)

A further objective in the Round will be to seek agreement that developing country status will be subject to review in GATT by reference to agreed yardsticks eg GDP per capita.

4. As with all GATT issues, progress towards the UK's objectives is initially dependent on the degree to which our Community partners and the European Commission share them. While the Commission have been prepared so far to take a robust line in certain areas of the Round negotiations they have not been as forceful in their approach as we would like in others. This reluctance to press the issue is shared by certain other developed countries and it is proving an uphill struggle to secure agreement that the issue of integration should be set high amongst the objectives for the Round. With Treasury encouragement, DTI have identified a number of ways in which the UK might raise the profile of the integration issue within developed countries. These include stimulating wider discussion within the Community, arguing that the GATT Mid-Term Review (probably taking place at the end of this year) should be used to impart more momentum to the integration process and securing stronger language on integration in the OECD Ministerial in May.

5. In the case of Taiwan, pressure to open up their home markets generally comes from the US with the Community encouraging the US to press for liberalisation in particular areas where the EC exporters will benefit. Within the last few days the US has revoked certain tariff exemptions from exports from Taiwan, Korea, Singapore and Hong Kong declaring that these concessions, which are reserved for developing countries, were no longer appropriate for these four countries. However, there is a view that the decision was prompted by the reluctance of the four countries to let their currencies appreciate fast enough against the dollar.

One point to add: Before Christmas I got Monetary Committee agreement formally to ask the Commission to explore ways in which we could bring pressure to bear on, especially, Taiwan and Korea. I also raised the point personally with Delors. I have been promised but have not yet received a reply.

[signature]

R MOLAN

[signature] 8/2

PAM32

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 9 FEBRUARY 1988

PvP

SIR GEOFFREY LITTLER

cc Sir T Burns
Mr Lankester
Mr Odling-Smee
Mr Evans
Mr Mountfield
Mr Peretz
Mr Sedgwick
Mr Bottrill
Mr P G F Davis
Mr Matthews
Mr Molan
Mr C Allen
Mr D Savage
Miss Preston

EAST ASIAN NICS

The Chancellor was grateful for Mr Molan's minute of 8 February.

2. He raised at the ECOFIN lunch today whether the Commission could bring pressure to bear on, especially, Taiwan and Korea. Delors has, he thinks, taken the point on board. But there would be no harm in your chasing up with the Commission a reply to the formal request from the Monetary Committee.

J M G TAYLOR

mjd 2/143Jn

CONFIDENTIAL

cc: [illegible]retary
[illegible] Secretary
Mr Savage Sir G Littler
Mr Evans
Mr Matthews or
Mr Molan
Ms Life
Ms Symes
Miss Brewer (FCO)

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

24 February 1988

L Parker, Esq
PS/Secretary of State
Foreign and Commonwealth Office
King Charles Street
London SW1

Dear Lyn

MEETING WITH OECD SECRETARY GENERAL

The OECD Secretary General, M. Jean-Claude Paye, paid a courtesy call on the Chancellor this morning. He was accompanied by his Private Secretary, Mr Tom Alexander. Sir Geoffrey Littler and Mr Bayne were also present.

Paye expressed concern about the economic outlook in the United States. He noted that a recession in the United States would have a particularly adverse impact on the German economy, and he expressed surprise at the apparent lack of concern in Germany about this. The Chancellor said there were considerable uncertainties in relation to the prospects for the US economy. On the one hand, there was evidence of an improving trade balance since the turn of the year. On the other, it was worrying that Mr Gephardt had attracted support by playing the protectionist card. He expected some slowdown in US growth this year, though not a recession. But we were cautious about the prospects for 1989. The Chancellor thought that the Germans were more worried about the prospects than they were able to make public. Stoltenberg knew that supply-side measures were required to free up the German economy. But it was politically difficult for him to achieve these (as exemplified by the Germans' obduracy over CAP reforms). Stoltenberg had the consolation, however, that the high living standards and low inflation enjoyed by Germany made slow growth tolerable.

Paye said that the Germans were anxious to hold the ERM together, to avoid further upward pressure on the Deutschmark. But the view was taking hold in France that if holding the ERM together meant slow growth, it was not worth the candle. The Chancellor agreed; he also had the impression that the French increasingly thought the

ERM was run for the benefit of the Bundesbank. The immediate French objective would be to secure improvements in the workings of the ERM, and so build on the improvements already made at Basle and Nyborg. He did not think the French would want to leave the ERM at this stage. But there might be difficulties after the French elections and, in particular, pressures for realignment.

The Chancellor said that Paye should seek to ensure that the OECD secretariat did not produce scenarios which falsely encouraged the view that there should be major devaluations. These were misguided and destabilising. Paye took note.

The Chancellor hoped that the next OECD Ministerial would not devote too much time to discussions of the debt problem. The principal forum for this should be the IMF/IBRD discussions. He would only use the OECD Ministerial as an opportunity to push forward his own Sub-saharan Africa initiative if this fitted the agenda. He would, however, be developing his initiative at the Interim Committee in April, and at the Toronto Summit.

The Chancellor said that the OECD should try to find a role in relation to the problems caused by the Far Eastern newly industrialising countries. Although Singapore and Hong Kong had completely open markets, Taiwan and Korea maintained substantial barriers. Paye said there might be difficulties in using the OECD as a forum. For example, it was debatable whether Korea had a sufficiently democratic system of Government. But there might be scope for an informal gathering under the auspices of the OECD.

I am copying this letter to Shirley Stagg (MAFF) and Marjorie Davies (DTI).

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary

Ch:/ Seems like a good idea - you will remember that you discussed something on these lines with Paye, when you saw him on 24/2.
AA 16/3

A good idea provided representation of the NICs are really high-powered. Otherwise a waste of time.

From: Sir G.Littler
Date: 14 March 1988

MR ALEX ALLAN

c.c. Sir P.Middleton

PROBLEM OF NICS

This should wait until the Chancellor is clear of the Budget.

2. There is a widespread wish among the main industrial countries to find some way of getting at the NICs - especially Taiwan and South Korea, but Singapore and Hong Kong are always mentioned in parallel with varying degrees of understanding of their different positions. One problem is the lack of any forum and especially with Taiwan (and Hong Kong) not represented in any international groupings.

3. In the margins of my Working Party 3 meeting last week, the OECD Secretary-General (Paye) speculated about the possibility of his arranging, with help from others, an informal meeting in some quiet venue outside Paris, between representatives of the four Asian NICs and himself plus me as Chairman and three or four other representatives from WP3. It would be seen as an opportunity to convey face-to-face our concern about the NIC surpluses, the trade restrictions of some of them, their exchange rates, and the need in their own interests to develop new and more neighbourly policies which should also advantage their own economic growth.

4. There was tentative interest in the idea, but most of those present wanted to reflect, and consult diplomatic colleagues. It seems to me that the idea could be worth pursuing, there being no other idea for contact around at all. Obviously I shall need to consult FCO, but I wonder whether the Chancellor has any immediate reaction before I do so.

GL

(Geoffrey Littler)

ps3/34T

CONFIDENTIAL

PWP

FROM: J M G TAYLOR
DATE: 18 March 1988

SIR G LITTLER

cc Sir P Middleton

PROBLEM OF NICs

The Chancellor has seen your minute of 14 March.

2. He has commented that the idea of an informal meeting of the sort suggested is a good one, provided the representatives of the NICs are really high-powered. Otherwise it would be a waste of time.

JT

J M G TAYLOR

psl/3A

CONFIDENTIAL.

BF ~~29/3~~ 31/3

FROM: A C S ALLAN
DATE: 25 March 1988

MR McINTYRE

cc Mr Scholar
Mr Culpin
Miss Sinclair
Mr McPherson
Mr Mace - IR

NICs

The Chancellor would be grateful to know what the cost would be if employers' NICs were set at a flat 10 per cent and employees' NICs were set at a flat 5 per cent.

ACSA

A C S ALLAN

Mr Culpin

FROM: N I MACPHERSON
DATE: 30 MARCH 1988

MISS EVANS

cc. Mr Portes

NATIONAL INSURANCE CONTRIBUTION BRIEFING

Q. What would be the marginal rate of NIC be if steps were smoothed?

A. Steps could be smoothed by making the LEL (ie £41) an allowance for those earning less than £105 a week. Marginal rate would be 14.8 per cent for those earning below £105 a week, and would remain at 9 per cent for those earning above, who would continue to pay NICs as at present. This would involve losers (running into 100,000's). If want to ensure no losers, need 11.4 per cent marginal rate and allowance of £41 for those earning below £195 a week.

Q. What is the cost of making the LEL a threshold?

A. The cost of making the LEL a threshold for employees would be £3½ billion (1988-89, full year).

Q. To what extent are high marginal rates at the bottom of the income scale due to benefit withdrawal rather than taxation?

A. Withdrawal rates for benefit far higher than marginal tax rates:

Family Credit	70 per cent
Housing benefit (including rate rebates)	85 per cent
Housing benefit (incl. rate rebates) plus Family Credit	95.5 per cent
Income tax + NIC	30 to 34 per cent

Mick Macpherson

N I MACPHERSON

RM6.83 UNCLASSIFIED

FROM: MOIRA WALLACE

DATE: 30 March 1988

MR MACPHERSON

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Riley
Miss Sinclair
Mr McIntyre
Mr Mace - IR

NICS

The Chancellor was most grateful for your minute of 29 March.

MPW.

MOIRA WALLACE

Note ~~~~

From: Nigel Forman.
21st April 1988.

To: Chancellor.

c.c. Chief Secretary
Paymaster-General

The politics of the elderly.

1. I and others in the Parliamentary party are a little concerned, as you may be, about the politics of our relations with the elderly. In many constituencies they make up 15% to 20% of the electorate and ever since the last General Election I think we have been in danger of alienating many of them, perhaps irreparably.

2. As you know, they are not a homogeneous group, but there was some disturbing evidence in the recent M.O.R.I. survey for The Times and there is also in our post-bags as M.P.s that we are slipping in this section of the electorate. For example, the M.O.R.I. poll showed that in the over 55 age group Labour has increased its support by 5% since the General Election compared with a 1% increase for us. Among those reliant exclusively upon state pensions it showed that Labour has gained an extra 7% since the General Election compared with an extra 1% for us. I also know from my own constituency that those of the elderly who might be described as 'nearly poor' feel quite threatened and angry about the recent social security changes and are unlikely to feel any better about the Community Charge when it comes in, especially if they are a couple rather than a single person household.

3. Assuming that a healthy level of economic growth can be maintained for the rest of this Parliament, I think there is a strong political case - quite apart from the case on grounds of social equity - for finding ways of doing more for state pensioners (principally the very elderly who typically do not have other income streams) and of alleviating the impact of steeper social security tapers and lower capital cut-offs upon those with only modest levels of income or capital.

4. In the case of very elderly state pensioners, they are people who have not shared in the general rise in personal disposable income to anything like the extent of those in work. We should also remember that opinion polls show that the general public is usually more kindly disposed towards the elderly than, for example, to families with children or the unemployed. More generous help for pensioners would therefore be a popular cause.

5. In the case of the 'nearly poor' who have often been our supporters, I believe that the essential problem is psychological, namely that they are made to feel very uneasy when they are expected by Government to dip into their savings year in and year out until they fall below the line at which they would qualify for benefits. A free capital limit of £6000 is really rather low in today's world and people with capital resources just above that level do not have all that much to meet emergency expenditure needs, let alone regular financial commitments; and in retirement they have no realistic prospect of rebuilding their level of savings once these have been used up in such ways. They get unduly worried by the prospect of having to meet the medical and other expenses associated with old age and they often fear that in today's less sympathetic climate they will not necessarily be able to count upon their children or their families to help them. Indeed, many of them cherish their physical and financial independence and are loathe to lose it if this can be avoided. While the economic justification for private savings may be to have assets which can be liquidated when necessary, the psychological attraction is principally the idea of having a nest-egg which remains untouched and therefore provides psychological reassurance in an uncertain world when life expectancy for those who reach retirement age is much longer than it was before.

6. In these circumstances I suggest that, as and when resources permit, we should: (a) increase the state pension by more than the R.P.I. at least from time to time on a discretionary basis; (b) raise the free capital limit for social security purposes at least to £10,000 in today's money and possibly index it thereafter (at a cost of £70 million I am told); and (c) make it clear in our speeches and other statements

CONFIDENTIAL

FROM: N I MACPHERSON
DATE: 29 MARCH 1988

JM 29/3

1. MR McINTYRE

2. CHANCELLOR OF THE EXCHEQUER

Thanks

cc. Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Riley
Miss Sinclair
Mr Mace - IR

NICS

You asked what the cost would be of setting employers' NICs at a flat 10 per cent and employees' NICs at a flat 5 per cent (Mr Allan's minute of 25 March).

2. On a full year basis, at 1988-89 earnings levels, it would cost £6.6 billion. Employee contributions would be cut by £6.8 billion and employers' raised by £0.2 billion.

3. 18 million employees earning over £70 a week would gain; reductions in contributions would range from £1.40 a week for someone earning £70 a week to £12.20 a week for someone earning £305 a week or more. Employers would gain in repect of employees earning over £155 a week, but would lose in respect of 8.2 million employees earning between £41 and £155 a week. The aggregate employee-employer NIC burden would be greater than at present in respect of all employees earning under £105 a week.

4. A 1 per cent change in employee NICs, across the board, changes revenue by around £1.75 billion on a full year basis, while a 1 per cent change in employer NICs changes revenue by around £2 billion.

N. I. Macpherson

N I MACPHERSON

that we are well aware of the plight of the very elderly, especially those too poor to pay income tax and wholly dependent on social security, and also of the concerns of the elderly 'nearly poor'; and that we intend to bring more help to both groups.

7. As I have already emphasised, in a society in which the bulk of the working population has become significantly better off, these steps would seem right in equity. I submit that it would also be good politics to do these things well in advance of the next election.

FNF

Mr Forman
cc PMG

I recognise the force of this. However, I am opposed to the suggested remedy – to raise the basic state pension by more than the RPI. We do want the elderly to have more, but want them to have it by other means: SERPS, occupational pensions, personal pensions, savings. And increasingly, the bulk of them have. Those ~~pensioners~~ in difficulty are a small minority of pensioners, most of them very elderly, and if we are to do anything, we should try and target it on them. There are various options, which ought to be looked at – ~~[illegible] because [illegible]~~ and (tho' I do not wish you to reveal this) I will put some work in hand.

[PS Alex: pse set up a mtg with Mr Minr & relevant officials]

BRIEFING FOR PRIME MINISTER ONLY

1988 SURVEY: SOCIAL SECURITY

1. Key numbers are set out at Annex A.

2. Outstanding Issues other than Child Benefit:

(i) Compensation for 20 per cent Community Charge

E(LF) agreed last year that compensation for income support claimants should be set once and for all in 1989-90 when the community charge is introduced in Scotland and that the resulting benefit rates should be uprated in later years in line with inflation in the normal way. Precise amounts of compensation to be included within 1989-90 income support rates now need to be settled.

DSS propose for:	single claimants under 25:	£1.05 (£1.00)*
	single claimants over 25:	£1.30 (£1.30)
	couples:	£2.10 (£1.70)

* Figures in brackets are for rates compensation in current year.

The £1.05 and £2.10 proposals are based on DOE's latest estimate of the average community charge were it to be introduced in April 1989 across Great Britain as a whole. DSS want a higher amount for single claimants over 25 because most of them (in England and Wales) will be ratepayers in 1989-90, and DOE's projection of 20% average rates is £1.50. E(LF)'s decision implied a cut in compensation for this group to reduce windfall gains when the community charge is introduced (at much less than £1.30) in 1990. But DSS are against any cut because of the projected rates bills for next year.

To meet their bid in full, DSS need an extra £ million 97/101/104 (on top of £400m pa already in baseline). Chief Secretary has so far conceded an extra 68/71/74. He has been particularly concerned to minimise windfall gains for single claimants over 25 after the community charge is introduced in England and Wales in 1990.

(ii) Overseas Pensions

DSS want an extra £ million 10/29/48 to unfreeze the UK pensions of those now living in Australia, Canada, and New Zealand. (This is net of savings from the UK not having to pay pensions to Australians, etc living here in respect of their employment before emigration, as we do now.) Money at stake would be much larger in longer term - £175m gross cost in 15/20 years; with much slower growth in offsetting savings. Thus conceding this bid would virtually wipe out savings from CB freeze in longer term. Also hard to give priority to overseas pensioners at same time as freezing CB.

(iii) Disability Benefits

Chief Secretary has asked DSS to identify options for savings of £ million 50/100/150 in view of the rapidly growing cost of these benefits. DSS' bids for disability in this Survey are for an extra £ million 550/820/14000 to pay for higher take-up and rising real benefit payments. (There is also an agreed bid to extend Mobility Allowance to those aged 75-80, who are disallowed under current legislation; this is small within Survey period but substantial in longer term: £130m a year by 2000-1 at today's prices.) DSS are reviewing disability in the light of OPCS reports and want to bring forward proposals in 1989 Survey.

CONCLUSIONS TO MEETING

(i) Further savings in social security justified, despite low bid in 1989-90. Further freeze in child benefit right and defensible in terms of government's policy of targetting resources on those in need. Presentation of freeze could bring out that up to £80 million of gross savings from freeze would be channelled into extra income-related benefits.

(ii) Freeze will help to free extra resources for poorer pensioners. DSS and Treasury to consider options in next Survey.

(iii) Bid to unfreeze overseas pensions would be expensive in longer term and should not be pursued. Unfreezing would be particularly hard to present against background of child benefit decision.

(iv) However, bid for community charge compensation should be agreed in full. Presentation of decision should be agreed between DSS, DOE, and Treasury. Important to take full credit for additional £100m a year being added to programme for this purpose.

(v) DSS should not be pressed to make savings on disability benefits in this Survey, pending review of this area and in view of DSS commitment to bring forward proposals in next Survey to contain growth of expenditure. Presentation of this year's Survey outcome should take maximum credit for additional provision to fund existing range of benefits and for extension of Mobility Allowance to those aged 75-80.

If we don't freeze next year full uprating almost inevitable for rest of this Parliament.
So total cost of decision not to freeze could be as much as £700 million a year by 1991-92.

ANNEX A

SOCIAL SECURITY

	£ million		
	1989-90	1990-91	1991-92
Survey baseline	50,889	53,347	54,681
DSS bid			
Benefits	3*	1204	3123
Administration	184	254	211
Total bid	184	1458	3354
Treasury proposed reductions on bid			
Child benefit	-197	-197	-197
Overseas pensions	- 10	- 29	- 48
Proposed Treasury Settlement	- 20	1232	3089

* The very low bid for benefit expenditure in 1989-90 is explained mainly by the fall in unemployment since the last Survey. The assumption for unemployment used in the last Survey was 2.6 million; the current assumption is 2.0 million. This reduction saves around £1,300 million. However, these savings have been broadly offset by estimating increases (ie higher take-up and higher average entitlements) and the cost of last April's housing benefit concessions. The estimating increases are much larger in later years, resulting in substantial net bids.

BRIEFING FOR MR PARKINSON.

CHILD BENEFIT

Current rate: £7.25 per week per child.

Cost: £4,600 million a year (10 per cent of soc. security programme)

Uprating in April 1989: would add 45p giving rate of £7.70. Extra cost: £197 million a year, net of additional spending on income-related benefits.

Case against uprating

Bad use of extra resources, as CB goes to all families irrespective of need. And the poorest gain nothing from an uprating, because CB is taken into account in setting levels of income-related benefits - income support, family credit (for heads of families in low paid work), and housing benefit. Equally, a CB freeze would leave poor families on these benefits no worse off - income support, etc would be 45p a week higher than they would otherwise be. Thus gross savings of £275 million from a CB freeze would be reduced by some £80 million additional spending on income-related benefits.

NB. DSS propose that income-related benefits will be fully uprated next April, first by making an adjustment for the RPI error and second by applying the corrected ROSSI index (RPI minus housing) ie 4.5 per cent.

Alternatives to CB freeze

Not easy to find in rest of social security programme. Would probably mean imposing heavier losses on smaller groups (eg unemployed). CB freeze is less difficult to defend in terms of distributional effects - 45p per child per week spread over millions of families, with poorest families protected.

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Parliament: Chief Whip will report that CB freeze difficult to get through but he is confident it can be carried.

Cost of deciding against freeze: C/Ex and Chief Secretary believe that, unless we freeze next April, full upratings would be almost inevitable for rest of this Parliament. So total cost of decision not to freeze could be as much as £700m a year by 1991-92.

PAYMASTER GENERAL

FROM: ROSIE CHADWICK
DATE: 22 April 1988

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary

THE POLITICS OF THE ELDERLY

The Paymaster General has seen Mr Forman's minute of 21 April. He remarks that this is an age group in which the Party retains a majority but where, unlike other age groups, it was already losing ground in the last Parliament. This is perhaps inevitable given HMG's views on pension indexation versus the Opposition's. There is always a cost to any (administrative) decision.

REC

ROSIE CHADWICK
Assistant Private Secretary

NH3/12AL

RESTRICTED

FROM: A C S ALLAN

DATE: 28 April 1988

MR CULPIN

cc PS/FST
Mr McIntyre
Mr Pickford
Mr C J Riley
Mr Cropper
Mr Tyrie
Mr Call
Mr Hudson

FIRST ORDER QUESTIONS: THURSDAY 12 MAY

For first order questions, the Chancellor would be grateful for some consolidated briefing about how the poor have faired since 1979.

2. Among the points he would like covered are:

i. the latest figures on the total income of pensioners (recognising that not all pensioners are poor).

ii. Who are the poor? Many of those on low earnings are young people living at home, or married women or pensioners working part-time etc. Would a breakdown by household income help?

iii What is the record on the non-working poor, both those who had jobs in 1979 but have lost them since, and those who were not in work at either time (including pensioners)?

3. I would be grateful for a note by close of play Friday 6 May.

ACSA

A C S ALLAN

psl/34A

PERSONAL

FROM: A C S ALLAN
DATE: 29 April 1988

MR FORMAN MP

cc PS/Chief Secretary
PS/Paymaster General

THE POLITICS OF THE ELDERLY

The Chancellor was grateful for your note of 21 April. He recognises the force in this.

2. However, he is opposed to the suggested remedy - to raise the basic state pension by more than the RPI. In his view, we do want the elderly to have more, but we want them to have it by other means: SERPs, occupational pensions, personal pensions, savings. And increasingly, the bulk of them have. Those in difficulty are a small minority of pensioners, most of them very elderly, and if we are to do anything, we should try and target it on them. There are various options, which ought to be looked at - and (though the Chancellor does not wish you to reveal this) he will put some work in hand.

ACSA

A C S ALLAN

2710/40

FROM: ROBERT CULPIN
DATE: 6 May 1988

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Odling-Smee
Miss Peirson
Mr Turnbull
Mr MacAuslan
Mr McIntyre
Mr Pickford
Mr Riley
Miss Sinclair
Mr Macpherson
Mr Portes
Mr Scotter
Mr Cropper
Mr Tyrie
Mr Call

C.

Some interesting stuff. Next job must be to distil out of it the best positive + defensive points for use at 1st Order Questions etc.

AH

Many thanks.

Yes. Pls do this (or get done). In particular, we need to know how many individuals/families now have incomes below the ~~old~~ 1979 SB level, indexed only for inflation (or inflation + [illegible]).

N.

POVERTY SINCE 1979

This is a quick and dirty response to your request for a note.

How many people are poor?

2. Suppose, as a start, we count as poor anyone whose income is at or below the supplementary benefit or income support level. That has the disadvantage that, if you raise supplementary benefit, you appear to make more people poor. The Treasury has therefore resisted the idea that supplementary benefit can define the poverty line. But for all that, it is not a bad benchmark. It represents the amount of money the State is prepared to give people if they have no other income.

3. On this basis:

- the number of families in poverty increased from 4 million in 1979 to 5¾ million in 1985, the latest year for which figures are available: Table 1

[illegible]

- the number of individuals in poverty increased from just over 6 million in 1979 to nearly 9½ million in 1985: Table 2

- the proportion of all families in poverty increased from about 15 per cent to about 20 per cent: Table 3.

4. Most of these families and individuals receive supplementary benefit, so it could reasonably be said that the social security system has kept them out of poverty. There has been relatively little increase in the numbers <u>not</u> on supplementary benefit: the middle columns of Tables 1 and 2. If we count only these as poor, the numbers for 1985 would be:

- 1½ million families

- 2½ million individuals.

5. Suppose, at the other extreme, we count as poor anyone whose income is at or below 140 per cent of the supplementary benefit level. That is the statistic cited most recently by Mr Gordon Brown. On this measure:

What does this mean...? children?

- there were 16.4 million individuals in poverty in 1983, the latest published figure

- there were 15.4 million in 1985, the latest figure available internally

- Mr Gordon Brown has claimed that there must now be about 18 million, after allowing for 2 million losers, on his estimate, from the social security reforms.

6. 140 per cent of supplementary benefit may measure what the DHSS used to call the hard pressed; but it is a pretty batty definition of poverty. If you believe that people with incomes 40 per cent above the supplementary benefit or income support levels are genuinely poor, you ought, in all decency, to raise those levels. Even then the poverty lobby would move on to looking at people 40 per cent above the new levels.

7. At best, these various measures establish a range within which it is reasonable to think of the numbers in relative poverty. They are all, in a sense, inflated, because there was a significant real increase in supplementary benefit between 1979 and 1985. That surprised me, because I thought the policy was price indexation; but there appears to have been a real increase over the period of the order of 6 per cent. In principle, it ought to be possible to calculate how many families and individuals had incomes in 1985 at or below the 1979 supplementary benefit level, indexed only for inflation; but I do not know what the calculation would show.

yes

8. In principle, it would also be possible to make two other calculations in absolute terms.

Not absolute terms, surely.

(a) We could estimate how many people had incomes of less than X per cent of the average in 1979, and how many in 1985. We are hoping to get that information from the DHSS.

(b) We could probably demonstrate that supplementary benefit in the 1980s enabled the poorest to afford roughly the same real standard of living as the average household enjoyed 20 or 25 years ago. That was last done, so far as I know, in a National Institute study in 1977.

Who are the poor?

9. The poor are predominantly old or unemployed. And the two big stories of the 1980s are that:

(a) pensioners have got better off, so that fewer of them are poor, and fewer of the poor are old, but

(b) the big rise in unemployment has made an awful lot of younger people poor.

10. Looking again at people with incomes at or below supplementary benefit levels:

- the number of pensioner families fell by 140 thousand between 1979 and 1985: Table 1

- the number of individual pensioners fell by 270 thousand: Table 2

- the proportion of pensioner families which were poor fell from over 39 per cent to under 36 per cent: Table 3

- the proportion of poor families which were pensioner families fell from 63 per cent to 42 per cent: implicit in Table 1.

But:

- the number of unemployed families rose by nearly 1.4 million: Table 1

- the number of unemployed individuals rose by 2½ million: Table 2

- the number of sick and disabled also rose; and the proportion of sick and disabled "families" which were poor rose from 30 per cent to 35 per cent: Table 3

11. The changing composition of the poor can be illustrated in at least two other ways:

    (a) looking at the households in the bottom decile of the income distribution, 83 per cent were retired in 1979, only 73 per cent in 1985;

    (b) looking at the bottom quintile, the corresponding figures were 83 per cent and 64 per cent.

What has happened to their living standards?

12. Needless to say, the poor depend principally - indeed, almost entirely - on social security benefits. They do not, in the main, have substantial earnings or savings income. And they are not significantly affected by income tax or national insurance contributions. This comes out clearly in Table N of the regular CSO article on the income distribution, which I attach to this note as Table 4.

13. It is also pretty clear from Tables 1 and 2: most of those who were at or below supplementary benefit levels between 1979 and 1985 received supplementary benefit. So their living standards depended essentially on that.

14. As I have already said, supplementary benefit went up by roughly 6 per cent in real terms over this period. "Real" here means deflated by the RPI.

15. Since supplementary benefit recipients had their rents

paid separately, in full, it would be reasonable, as an alternative, to deflate by the RPI excluding housing. On this basis, supplementary benefit went up by a real 10 per cent, in round terms, between 1979 and 1985.

16. Since 1985, there has been little real change. Compared with 1979, supplementary benefit is up roughly 5 per cent, deflated by the RPI, and 11 per cent, deflated by the RPI excluding housing.

17. However, these are annual averages, and flatter a bit the Government's record. Between the uprating dates of November 1978 and April 1987, supplementary benefit <u>fell</u> 1.4 per cent if deflated by the RPI, rose 5.1 per cent if deflated by the RPI excluding housing.

18. An alternative measure, which abstracts from some of these ambiguities, is to look at the real disposable income of the lowest deciles. Table 5 suggests that the bottom decile had an increase of 7 or 8 per cent, and that their benefits rose in real terms by this sort of order of magnitude. This looks consistent with the simple story in paragraphs 7 and 14.

19. Interestingly, the next decile seems to have done less well. I thought that might be because the poor with benefits did better than the near-poor without benefits; but benefits do not, in fact, seem to have has much to do with it. I leave someone else to explain the result.

My guess is that ~~in 79~~ the ~~next~~ 2nd decile were almost all in work in 79, but a high proportion were unemployed in '85.

Pensioners

20. Turning to particular groups among the poor, it is still the case that a large number are pensioners, and it is on pensioners that there is the best story to tell.

21. Far the most striking statistic is that their average net incomes rose by 18 per cent between 1979 and 1985.

That is a larger increase than many others enjoyed; and it is much larger than the increase over previous periods. It reflects, among other things, the spread of occupational pensions, and the fact that high real interest rates have given a substantial return to anyone with savings.

22. It is not (I think) substantially affected by SERPS, because the build-up was not sufficient by 1985 to make much difference when averaged over all pensioner incomes. But for individual pensioners retiring now, SERPS must be coming to be a significant addition to their incomes.

23. The fact that pensioner incomes rose by 18 per cent still comes as a surprise to most people - including, I suspect, most MPs. But, for the record, it was mentioned in the Manifesto, or at least "Our First Eight Years"; and it was reported this time last year, when the Employment Gazette carried a special feature (pages 243-252).

24. I attach, as Annex A, a paper by Mr Portes giving more detail.

25. The figure of 18 per cent is eminently quotable; but in my usual negative way, I would stress three caveats.

(a) The basic state pension went up much more in real terms under Labour than the Conservatives.

(b) Some of the increase in pensioners' income may have come about because we have been paying them more housing benefit simply to pay more rent.

(c) We ought to be a bit careful about comparing pensioners' incomes with other people's incomes. To take one example, it is potentially an own goal - though no-one seems to have noticed it - to say that the increase for pensioners was "more than twice the increase for the population as a whole" ("Our First Eight Years", page 4). That implies an increase for non-pensioners which is way below the figures we usually quote for living standards. The explanation, of course, is that a lot of people in the population became unemployed.

The unemployed

26. On the same basis as the calculation for pensioners, the average net income of the unemployed fell by about 2 per cent in real terms between 1979 and 1985.

27. I think that probably reflects a compositional change: there were far more young single people unemployed in 1985 than in 1979, and they tend, for obvious reasons, to have the lowest incomes.

28. We know that the rise in unemployment has been the principal cause of poverty in the 1980s. We know that the average duration of unemployment has increased. We know that things have been getting better fast, across the board, in the last couple of years. And we know that the safety net benefits have been broadly price protected. But beyond that, I have not (so far) found much analysis.

29. What seems to be missing is what the experts call longitudinal studies, to tell us what happened to the living standards of people who were (say) employed in 1979, then unemployed, and then employed again. For example, some people who were in overmanned manufacturing industries presumably went from earning around the average to living more or less on unemployment benefit. They may have had redundancy payments, but not the earnings related supplement. They must, at the time, have suffered a large loss of income; but goodness only knows what has happened to them since, or how, therefore, they have fared over the whole period 1979-85.

30. Others, who left school and essentially never got a job, may not have suffered a <u>financial</u> loss in quite this sense. But, again, I am not sure we know what their average experience has been over time.

The low paid

31. As I said in paragraph 12, most of the poor have no earnings. That is what makes them poor.

32. Few people who have earnings, even if they are low paid, live in households which are poor. They are, in practice, supported by husbands or parents or pensions.

33. When I last knew about it, in the mid-seventies, the Department of Employment estimated that only ½ per cent of the low paid lived in households which were poor. I can't remember how low pay was defined. Poor meant at or below supplementary benefit level. I have not, unfortunately, been able to find an update of this statistic.

34. Looking, however, at an estimate of people now earning less than half average earnings, there seem to be approximately 5½ million tax units. Of these, 3 million are children and dependants, about ½ million pensioners, and about another 1 million have income other than earnings. That only leaves about 1 million, in round figures; and only a proportion of them would rank as poor on the supplementary benefit test, because the supplementary benefit level is below half average earnings.

Conclusion

35. It will be obvious that there are large holes in this note. In particular it says virtually nothing about the extent to which people may have gone in and out of poverty.

And it is not really addressed to the question what we might say: in the main, it simply tries to establish facts.

36. Nor does it say anything about different family types: I have not had time even to try to compare the experience of single people with that of couples with or without children. This may, I am afraid, be rather a large reservation. As I have finished this note, I have heard that there is some DHSS estimate - which I have not seen, and which seems to be disputed between DHSS economists and DHSS statisticians - that the bottom quintile of couples with children lost substantially in real terms between 1979 and 1985.

37. However, for what it is worth, my personal impression is this:

- It is wrong to allege, as the Opposition does, that the poor have got poorer. They seem, indeed, to have got a bit better off on average, though there are bound to be exceptions.

- But, being as objective as possible, there has been an increase in poverty, for the obvious reason that there has been an increase in unemployment.

- There has been a significant change in the composition of the poor: fewer pensioners, more unemployed.

- What matters to them is social security. Fiddling with tax and national insurance makes practically no difference.

- Far the best story is on pensioners: some have been lifted out of poverty; the generality have had a large and striking increase in living standards.

Health warning

38. I hope the facts in this note - so far as there are any - are at least broadly right. But I have not had time to clear it with anybody. So please check before use.

RC

ROBERT CULPIN

Table 1: Numbers of families with incomes at or below supplementary benefit level

Families: (000s)	**on Sup. Ben**		**not on Sup. Ben**		**Total**	
	1979	**1985**	**1979**	**1985**	**1979**	**1985**
All families	**2590**	**4110**	**1400**	**1600**	**3990**	**5710**
Over pension age:						
Married couples	300	260	240	200	540	460
Single persons	1380	1360	610	570	1990	1930
Under pension age:						
Married couple with children	130	440	110	160	240	600
Single persons with children	320	540	40	30	360	570
Married couple, no children	70	260	40	100	110	360
Single persons, no children	390	1250	360	550	750	1800
Full time work	0	0	180	240	180	240
Sick/disabled	170	220	40	50	210	270
Unemployed	380	1540	100	320	480	1860
Other	360	730	220	230	580	960

Notes

A 'family' is defined in terms of the assessment unit for supplementary benefit, ie a single person or married couple with their dependent children, if any.

'Income' is net income less net housing costs and fares to work.

'Other' consists largely of single parents, full time students and persons looking after sick relatives.

Table 2: Numbers of persons in families with incomes at or below supplementary benefit level

Persons in Families: ('000s)	on Sup. Ben		not on Sup. Ben		Total	
	1979	**1985**	**1979**	**1985**	**1979**	**1985**
All families	**3980**	**6960**	**2090**	**2420**	**6070**	**9380**
Over pension age:						
Married couples	610	520	500	390	1120	910
Single persons	1380	1360	610	570	1990	1930
Under pension age:						
Married couple with children	560	1860	450	630	1010	2490
Single persons with children	900	1450	100	80	1000	1530
Married couple, no children	150	520	80	200	230	720
Single persons, no children	390	1250	360	550	750	1800
Full time work	0	0	470	560	470	560
Sick/disabled	220	320	60	60	280	380
Unemployed	830	3020	150	510	980	3530
Other	950	1740	310	340	1260	2080

Notes

A 'family' is defined in terms of the assessment unit for supplementary benefit, ie a single person or married couple with their dependent children, if any.

'Income' is net income less net housing costs and fares to work.

'Other' consists largely of single parents, full time students and persons looking after sick relatives.

Table 3: Population: Total number of families analysed by family type and economic status, and proportion at or below supplementary benefit level

	Families (000s)		% at or below Supp. Ben level	
	1979	**1985**	**1979**	**1985**
All families	**26000**	**28630**	**15.3**	**19.9**
Over pension age	6420	6680	39.4	35.8
Under pension age:	19580	21960	7.5	15.2
Full time work	16770	15690	1.1	1.5
Sick/disabled	690	770	30.4	35.1
Unemployed	610	2300	78.7	80.9
Other	1520	3200	38.2	30.0

A comparison of Table M with Table J shows that although the distribution of original income amongst retired households is much more unequal than that within the non-retired household group, the distribution of final income is more equal amongst the retired than amongst the non-retired. The dispersion of original incomes amongst retired households is similar to that amongst non-retired but economically inactive households (Table K). However, the distribution of final income amongst this latter group remains more unequal than amongst the retired. Chart 5 illustrates the different impact which the tax-benefit system has on retired and non-retired households.

PART II

RESULTS FOR THE PERIOD 1975 TO 1985

This part of the article examines the changes which have taken place between 1975 and 1985 in the impact of taxes and benefits on household incomes. The main conclusion is that although the distribution of original income became more unequal over this period taxes and benefits largely offset this trend. Cash benefits have had the most important role to play in reducing income dispersion and have increased in importance over the period. The shift in personal taxation from income to expenditure has also had an impact.

This shows that government transfer payments have quadrupled in current price terms since 1975, and cash benefits accounted for 53 per cent of the total in 1985 compared with 38 per cent in 1975. Much of this growth can be attributed to increases in the number of recipients of social security benefits, such as retired people and those out of work. The pattern of government final consumption (ie government expenditure in providing services) has remained much more stable. Of the items allocated to households, health expenditure has increased from 21 per cent to 23 per cent of total expenditure whilst education expenditure has fallen from 21 per cent to 19 per cent, reflecting the increase in the number of elderly and the decrease in the number of children (see, for example, Social Trends 17, Charts 1.4 and 1.5).

As a result of policy changes over the period, there have been major shifts in the pattern of government financing. Income tax fell from 28 per cent of government revenue in 1975 to 23 per cent in 1985 whilst indirect taxes have risen from 24 per cent to 30 per cent, in line with government policy to shift the balance of personal taxation from income to expenditure.

Taxes and benefits as percentages of income by quintile groups of households, 1975-85

TABLE N

Households ranked by original income

	1975	1977	1979	1981	1983	1985
Cash benefits as percentages of gross income						
Bottom quintile group	87	91	92	92	96	96
2nd	24	29	33	37	46	49
3rd	6	8	9	11	14	13
4th	3	4	5	6	7	6
Top	2	2	3	3	3	3
Average over all households	11	13	13	14	16	16
Income tax and NI contributions as percentages of gross income						
Bottom quintile group	1	1	-	-	-	-
2nd	14	13	10	11	9	7
3rd	20	19	18	18	18	16
4th	22	22	19	21	21	19
Top	26	25	21	23	23	23
Average over all households	21	20	18	19	19	18
Indirect taxes as percentages of disposable income						
Bottom quintile group	21	22	23	26	25	23
2nd	24	25	25	28	29	29
3rd	23	24	25	27	28	27
4th	22	23	24	25	25	25
Top	20	21	21	22	23	22
Average over all households	22	23	23	25	25	24
Benefits in kind as percentages of final income						
Bottom quintile group	34	34	35	38	37	35
2nd	27	27	27	29	28	28
3rd	24	22	23	24	24	21
4th	19	18	17	18	18	16
Top	14	14	12	12	12	10
Average over all households	21	20	19	20	20	18

Any discussion of trends in the effects of taxes and benefits on household income has as its background the changes which may have taken place in the various components of the tax-benefit system at the aggregate level. Appendix 2 gives some information on the changes in the level and composition of government expenditure and financing between 1975 and 1985, and in particular how the items allocated to households in this article have been affected.

The results of the changing pattern of government income and expenditure are illustrated in Table N. The composition of the lowest quintile group has changed considerably over the period (see separate section below), and now contains less retired households and more families with children. They have different sources of income, different needs for cash benefits, different

TABLE 5

Disposable income for sections of the income distribution (1985 prices)

	Bottom Decile			Next Decile			Bottom Quintile			Average		
	1979	1985	Increase	1979	1985	Increase	1979	1985	Increase	1979	1985	Increase
Original income	304	356	17.1%	937	930	-0.7%	620	643	3.7%	8711	9068	4.1%
Cash benefits												
Age related	1459	1297		1703	1413		1581	1355		710	696	
Child related	5	24		55	80		30	52		250	233	
Income related	431	558		529	792		480	675		245	380	
Other	72	225		140	296		106	261		162	388	
Total	1967	2104	7.0%	2428	2581	6.3%	2197	2343	6.6%	1368	1697	24.1%
Gross income	2271	2460	8.3%	3365	3511	4.3%	2818	2986	6.0%	10079	10765	6.8%
Direct taxes	80	98		140	142		110	120		1803	1934	
Disposable income	2191	2362	7.8%	3224	3369	4.5%	2708	2866	5.8%	8276	8831	6.7%

NB 1985 Benefit allocation on different basis.

Annex A

PENSIONERS' INCOMES

Pensioners' average net incomes grew by 2.7 per cent a year on average between 1979-85 (18 per cent over the period) compared with 0.6 per cent a year between 1974-79 (3 per cent over the period).

Average net incomes (1985 prices)

	£			yearly increase	
	1974	**1979**	**1985**	**74-79**	**79-85**
all pensioner income units	69	71	83	0.6	2.7
married couples	97	100	115	0.6	2.5
single pensioners	52	54	64	0.6	3.0

Components of pensioners incomes (£ per week, 1985 prices)

The growth of pensioner incomes is due primarily to the growth in state benefits and occupational pensions. However the growth in state benefits is not primarily due to increases in the retirement pension (see below).

Income Source	**1979**	**1985**
State Benefits	47	54
Occupational Pension	12	19
Earnings	9	6
Investment income	8	13
Total Gross Income	77	91
Tax	-6	-8
Net income	71	83

(averaged across all pensioners)

Compositional changes

It could be suggested that a large part of the increase in pensioners average incomes is due to changes in composition rather than increases in the incomes of individual pensioners. However the evidence available does not seem to support this. The average income of a pensioner couple was £115 in 1985; for a newly retired (aged 65-69) couple it was £123, significantly higher but not enough to explain a large proportion of the overall increase in pensioners average incomes. The table below shows that the income of given pensioner cohorts has also increased:

Net income (1985 £ per week) couples with husbands aged

	1980	1985	% change
65-69 in 1980	109	111	2
70-74 in 1980	97	111	15
75-79 in 1980	84	107	27

The tentative conclusion would be that pensioner <u>individuals</u> have been getting better off, not just pensioners as a group. It is possible another compositional change has occurred, particularly for the last group; poorer pensioners may die quicker.

Pensioners v others

Pensioners have clearly done substantially better than other sections of the population.

Net incomes (1985 £ per week)

	1979	1985	% change
Pensioners	71	83	18
Workers	153	171	12
Unemployed	61	60	-2
Other	81	92	14
All non-pensioners	141	145	3

Is this what happ btw 79 vs 85 ?

This has led to pensioners moving up the income scale relative to the population as a whole:

% of pensioners in population net income quintiles

	Q1	Q2	Q3	Q4	Q5
1980	38	39	12	6	5
1985	25	40	18	9	7

<u>Pensioner Inequality and Housing Costs</u>

At first sight pensioner gains have been more equitably distributed:

% change 1979-1985 in net income by family type and quintile

	Q1	Q2	Q3	Q4	Q5
Pensioners	18	19	17	15	18
Couples + children	2	1	5	7	15
Childless couples	-5	-2	2	5	16
Singles	-22	-11	-4	2	6

% share of net income by quintiles of net income

		Q1	Q2	Q3	Q4	Q5
Pensioners	1979	13	15	17	20	34
	1985	12	15	17	20	35
Population	1979	7	13	18	24	38
	1985	7	12	17	24	40

The figures show a slight increase in dispersion for both pensioners and the population as a whole. The income distribution is still much more equal for pensioners than for the population.

The tables above would suggest that the increases in occupational pensions and investment income for better-off pensioners have been balanced by increases in state benefits for worse-off pensioners (since the proportion of poorer pensioners' incomes attributable to private sources was still very small in 1985). Basic retirement pension and supplementary pension increased only slightly over the period. However benefit income per pensioner increased by about 15 per cent. This was due to:

- increased rents leading to increased Housing Benefit. HB per recipient increased by 60 per cent (£5 per week) in the period.

- an increase in the number of married women pensioners entitled to pensions on their own contribution.

- some increase in take-up of means-tested benefits

- substantial increase in take-up of disability benefits.

So if the increases in the incomes of poorer pensioners is due to increases in Housing Benefit due to real rent rises, then perhaps poor pensioners haven't done so well:

Net income increase 1979-85, by quintiles of equivalent net income

	Q1	Q2	Q3	Q4	Q5
Gross of housing costs	14	16	16	16	20
Net of housing costs	-2	11	10	15	25

If correct, the picture changes dramatically. We could conclude that the dramatic growth in housing costs (local authority rents rose by about 50 per cent over the period) accounts for most of the gains at the lower end. Unfortunately these numbers are <u>not</u> reliable. DHSS are trying to reconcile them with others which tell a different story.

Conclusion

Pensioners have done well both as individuals and as a group. Moreover their position has improved relative to the whole population. However significantly different factors operate at different points of the income distribution. Rich and middle-income pensioners are better off because of improved private incomes - occupational pensions and investment income - but poor pensioners are better off because of increased state benefits. Insofar as these increases relate to increased take-up, they may have higher standards of living. But if they are primarily caused by increased Housing Benefit as a result of real rent increases, then the increased prosperity of poor pensioners may be at least partly illusory.

J D PORTES

psl/48A

UNCLASSIFIED

BF 11/5

FROM: A C S ALLAN
DATE: 9 May 1988

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Odling-Smee
Miss Peirson
Mr Turnbull
Mr MacAuslan
Mr McIntyre
Mr Pickford
Mr Riley
Miss Sincialr
Mr Macpherson
Mr Portes
Mr Scotter
Mr Cropper
Mr Tyrie
Mr Call

POVERTY SINCE 1979

The Chancellor was most grateful for your note of 6 May. He would be grateful if, when you have received comments from others, you could arrange for your material to be distilled into the best positive and defensive points for use at First Order Questions on Thursday.

2. He would be grateful, in particular, for an estimate of how many individuals/families now have incomes below the 1979 supplementary benefit level, indexed only for inflation (or, perhaps better, inflation excluding housing) - as you suggested in your paragraph 7.

3. A couple of further points. First, who is included in your figures for "individuals in poverty"? (ie are children included?) (your paragraphs 3 and 5).

4. Second, is there any further breakdown of those with incomes at or below supplementary benefit level but who do not claim supplementary benefit? How many of these are eligible for supplementary benefit but do not claim? How many are caught by the capital cut-off? Are there any other notable groups (students?)?

ACSA

A C S ALLAN

3632/16

FROM: P J CROPPER
DATE: 10 May 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Culpin
Mr Odling-Smee
Miss Peirson
Mr Turnbull
Mr MacAuslan
Mr McIntyre
Mr Pickford
Mr Riley
Miss Sinclair
Mr Macpherson
Mr Portes
Mr Scotter
Mr Tyrie
Mr Call

POVERTY SINCE 1979

Mr Culpin's /6 May quick and dirty response gives a good overview of the matter. If one were going to look more closely at it, I think one would want to concentrate on variations among pensioners.

2. It is true that certain categories of pensioner are infinitely better off than they used to be - for example, the 60 year old who has just retired from a steady job, with an occupational pension, the beginning of a SERP, a paid off mortgage or comfortable council house, a nest egg and good health. Never had it so good.

3. But there are still substantial numbers of older people who have:

- no occupational pension (even now, only half the working force have occupational pension)

- no SERP

no nest egg

- poor health

- unsupportive family or none at all.

4. Such people as this may have a pretty grim time even before being carried off to a geriatric ward. As Mr Portes' Annex A suggests, "poorer pensioners may die quicker", and who can blame them.

5. It seems to me that we have a predominantly medium-term transitional problem on our hands while occupational pensions, SERPs and privatised housing build up to being the norm. I come back to the suggestion of differentially higher Old Age Pensions for the over 70s.

6. In the case of retired people we are looking at poverty from which there is no escape: the people concerned cannot re-play their lives. Even if they wish they had been more prudent and worked harder when they were young, it is now too late. It is very different in the case of the young, particularly now that employment is picking up. It is a good deal easier to escape from poverty at the age of 19 than it is at 79. In any case the demographic studies tell us that the world will be knocking at the door of the teenagers in five years time, imploring them to name their price for coming out to work.

7. So, in practical terms, we may end up wanting to concentrate on helping certain old people, even if, as a body, "pensioners have clearly done substantially better than other sections of the population".

P J CROPPER

FROM: J D PORTES

Date: 11 May 1988

JM 11/5.

1. MR MCINTYRE

2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Culpin
Miss Peirson
Mr Turnbull
Mr MacAuslan
Mr Pickford
Mr Riley
Miss Sinclair
Mr Macpherson
Mr Scotter
Mr Ramsden
Parliamentary Clerk
Mr Ford
Mr Cropper
Mr Tyrie
Mr Call
Mr Williams DHSS

This is the distillation of points from Robert's note.

AH

Thanks.

TREASURY QUESTIONS - 12 MAY: THE POOR

I attach a briefing note. There is more specific briefing on the distributional effect of the Budget and the social security reforms in Mr Scotter's subject brief.

2. The next edition of the DHSS Low Income Family Statistics, covering 1985, will be published shortly (but not tomorrow). They will show some improvements (such as a fall from 16.4m to 15.4m in the number of persons in households having incomes less than 140 per cent of Supplementary Benefit). Figures in this brief are accordingly based on the 1983 LIFS.

3. You asked how many individuals/families now have income below the 1979 Supp Ben level, indexed for inflation excluding housing.

Below 1979 Supp Ben level in 1979:	2.1 million
Below 1979 Supp Ben level in 1983:	2.1 million
At or below 1979 Supp Ben level in 1979:	6.1 million
At or below 1979 Supp Ben level in 1983:	2.1 million.

5. The difference of course arises from those on Supp Ben, who are at Supp Ben level in 1979 but above 1979 Supp Ben in 1983. Mr Tyrie has asked me to point out the advantages of using the second set of figures, so that when the Opposition reply "But that's all because you raised Supp Ben", you can say "Exactly!". DHSS say they never quote figures in this form and would not advise it. I would merely point out that this approach enables one to largely eliminate poverty, not just once but every year (relative to the previous year), merely by raising Income Support by 10p more than inflation.

6. 'Individuals' includes children.

7. The breakdown in 1983 for those below Supp Ben level but not claiming was as follows (by Supp Ben assessment units):

	thousands
Entitled but not claiming:	1,120
In work	290
Capital above limits	200
Required to be available for work but unoccupied.	270

I have not had time to check exactly what this last designation means. I assume it covers those deemed unavailable for work and hence disqualified.

J D Portes

J D PORTES

Numbers @ or below 1979 SB level in real terms

1979 6.1m
1983 2.1m

THE POOR

Positive

(i) Real disposable income of bottom 10 per cent of population income distribution rose nearly 8 per cent between 1979 and 1985.

(ii) Pensioners' average net incomes increased by 18 per cent between 1979 and 1985, as opposed to 3 per cent between 1974 and 1979. 70 per cent of newly retired pensioners have occupational pensions. Pensioners' income from savings up 7.3 per cent per year between 1979 and 1985; between 1974 and 1979 it decreased by 3.4 per cent a year.

Defensive

(i) Government has made poor poorer

Government has increased safety net benefits for poorest. Between November 1978 and April 1987 Supplementary Benefit rose by about 5 per cent relative to the RPI excluding housing (housing costs are covered by housing benefit).

(ii) Number of persons (including children) in families with income (net of housing costs) at or below Supplementary Benefit level increased from 6.1m in 1979 to 8.9m in 1983.

- Much (40 per cent) of increase due to real increase in Supp Ben.

- What matters is absolute not relative standards of living. Level of Supp Ben is adequate to relieve poverty - more than doubled since 1948, and increased in real terms under this Government.

- Figures are out of date (based on 1983 data). New figures to be published shortly concentrate more on absolute measures of living standards.

(ii) Number at or below 140 per cent of Supplementary Benefit level increased from 11.6m to 16.4m

- No Government has ever accepted 140 per cent of Supp Ben as a measure of poverty. [Stan Orme, Minister of State for Social Security, said in 1976 that the Government did not accept that a simple poverty line could be drawn].

- Ridiculous to use multiple of SB/IS as measure of low income because means number of families on low incomes is apparently increased if Government increases income-related benefits.

- Many of those with incomes below 140 per cent of SB/IS (families containing 4m persons in 1983) will be in work and hence will have gained from tax and NIC cuts since 1983.

(iii) Low-paid have done badly/benefit little from tax cuts

- Everybody in tax gains from tax cuts - 2p reduction in basic rate reduces tax bill by 7 per cent for basic rate payers.

- Real take home pay up at all points of distribution including bottom e.g. for couple with 2 children in bottom decile grew by 4 per cent April 1979 to April 1987.

- Most low paid live in households that are not poor (of 5.5 million with earnings below half average, only 1 million heads of household of working age in households with no other income).

(iv) Poor have done badly/gain nothing from tax cuts

- Those who pay no tax cannot gain from tax cuts. This is not a reason for not cutting tax. About 1.7 million kept out of tax by 25 per cent real increase in allowances under this Government.

- Best way of helping unemployed is to create jobs. Budget will help by encouraging enterprise and improving incentives.

(iv) <u>2.8m in 1983 at or below Supp Ben levels without claiming</u>

- Increase since 1979 entirely due to real increase in Supp Ben scale rates. Only 2.1m in 1983 at or below <u>1979</u> Supp Ben levels.

- Number at or below 1979 Supp Ben rates - last Labour Governments' poverty line - down from over 6m to 2.1m. [Mr Tyrie's point. I would not use.]

- Many people entitled but living in households above Supp Ben levels.

- Many entitled to very small amounts (eg 60 per cent of pensioners who don't claim entitled to less than £3 per week)

(v) <u>Unemployed had 2 per cent cut in real incomes 1979-85</u>

Largely because more of unemployed were single and hence had low incomes. Unemployed couples with children had 4 per cent increase.

(vi) <u>Many people forced into poverty/Supp Ben by unemployment</u>

Situation improved greatly since 1983.

CHANCELLOR OF THE EXCHEQUER

Pry

Ch

Work on targetting more help to poorer pensioners is now being taken forward together with the discussion on child benefit (papers in separate bundle)

AA

Good

3632/23

FROM: P J CROPPER
DATE: 17 May 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

POVERTY SINCE 1979

I put in a note on 10 May about the need for Mr Culpin to distinguish between the affluent old and the poor old.

2. It may be thought mildly interesting that Mr Bellairs wrote a note to the Party Chairman about the same subject, also on 10 May. There was no collusion. Copy attached.

3. Perhaps it is simply that Charles Bellairs and I both envisage a £25 Christmas bonus making all the difference in a few years time.

P J CROPPER

→ Mr Cropper 17/2

PB 11/v

CONSERVATIVE PARTY

Conservative Central Office

32 Smith Square Westminster SW1P 3HH
Tel. 01-222 9000 Telex 8814563

From the office of:
THE CHAIRMAN OF THE PARTY
The Rt. Hon. Peter Brooke MP

Please give me a copy of this, for transmission to HMT special advisers. I agree with CB's basic analysis (sidelined). PB 10/v

THE CHAIRMAN

Pensions

You will have noticed that we are getting quite a few letters from pensioners complaining both about the £6,000 savings limit (now increased to £8,000) for Housing Benefit, and about what they regard as the smallness of their pension increases.

Action has been taken about Housing Benefit which should meet most of their criticisms.

But while it is true that a higher proportion of pensioners are better off than ever before because they have a second pension either from the State Earnings Related Pension Scheme or their firm, I think there are some who have been left behind. These are the older pensioners whose savings were badly eroded by the inflation of the 1970s and who qualified either for only a small second pension from their firm or SERPS which is just enough to raise them above the entitlement for Income Support.

There are three possible steps we might take.

1. We could allow events to take their course in which case most of them would come to depend on Income Support on a means test.

2. We could provide a higher Christmas bonus for those aged over 70 of say £20 or £25. This could well have a good psychological effect but would not of course be sufficient to prevent many of them coming into Income Support - and in any case the Christmas bonus is not taken into account in assessing entitlement to Income Support.

3. We could introduce a pensions addition for all those now aged 70 or over, and all those reaching the age of 70 within a period of say 5 years. Those reaching 70 after say 1993 would not qualify for the addition because we are dealing with an interim problem until all pensioners are covered by an adequate second pension on top of the State Basic Pension.

The difficulty is, of course, cost. But it might be worth trying to get some estimates of the cost involved.

Charles Bellairs

CHARLES BELLAIRS

10th May 1988.

SECRET

8/6/88

0000021

MINISTER OF STATE FOR SOCIAL SECURITY & THE DISABLED

MS0183t

COPY NO 2

CHIEF SECRETARY
REC. -8 JUN 1988
ACTION Mr McIntyre,
COPIES TO Cx, Sir P Middleton, Mr Anson, Mr Phillips, Miss Peirson, Mr Turnbull, Mr Ramsden, Mr Call

PRIME MINISTER (Copy No 1)

Uh / stiffen pensioners p3 et seq

CHILD BENEFIT

Following the meeting with backbenchers on 17 May, I agreed to set out our thinking on child benefit in more detail, bearing in mind specifically the implications of our manifesto commitment. I think it is important to do so in the wider context of our approach to social security during the rest of the current Parliament.

In the 1987 Public Expenditure Survey we agreed with Treasury Ministers that £44 million should be saved by a less than full uprating of the benefit in 1989; but that, at the same time, we should look at the longer term structure of the benefit. The background to this is our need to continue, where possible, the emphasis in the reformed structure on placing resources where they help to meet the greatest financial needs. Despite the great and increasing size of the social security budget we shall undoubtedly come under growing political pressure to do more for particularly vulnerable groups. This means looking where we can for public expenditure savings in existing benefits to pay for such improvements. These are increasingly difficult to find in a way acceptable to our supporters. Frankly, child benefit is the only area where significant savings look possible now, but the difficulty of making them has been well illustrated by the opposition stirred up in Parliament by last year's freeze in the rate, and by the consequent suspicion about our further intentions. To counter this, you have recently reaffirmed our manifesto pledge. We clearly have a pressing need to put our policy on child benefit back on to a clear and public longer-term basis which we can justify to our friends in the House and outside, and to the country at large.

Since last autumn, officials from DHSS and Treasury have therefore been looking at longer-term possibilities and I attach a note summarising the options they have identified (other than to do nothing). Clearly there can be no questions of withdrawing child benefit from the great run of families, including those of particular concern to Timothy Raison and his friends, ie those who are above the income support or family credit level but who are by no means particularly well-off. But there is much less to be said for continuing to pay child benefit on an universal basis, even to families which most people would regard as quite adequately off and well able to meet their family commitments in full. Many such families have enjoyed significant improvements in living standards over recent years and the most well-off will, of course, be keeping considerably more of their own money as a result of successive budget tax changes, particularly the most recent. I see little real social or political justification for continuing to pay child benefit to such families, particularly when there are other, much higher priority groups in need of any resources which could be spared.

Consideration has therefore been given to the possibility of withdrawing child benefit from families with relatively high income (from both partners) - above say £25,000 or £30,000. A £30,000 family cut-off would only affect around 4-5 per cent of families but could save around £180 million in current terms; more, by the time the change was introduced. A £25,000 family income cut-off would affect less than 10 per cent of families but could increase the savings to perhaps over £300 million.

A change of this kind has many attractions. At their meeting with you, Timothy Raison and the other backbenchers recognised that it was not easy to justify paying child benefit to those on higher incomes, particularly when they had benefited so much from tax cuts. They appeared to be more sympathetic to some kind of clawback from the better off than to further across the board erosion in the value of the benefit, affecting middle income as well as prosperous families. Any move from universality would, of course, be criticised; but a cut-off at, say £30,000 ought not to be too hard

MINISTER OF STATE FOR SOCIAL SECURITY & THE DISABLED

to defend. It would certainly put the Opposition in a curious position, were they to emerge as strong defenders of the group they usually define as the "wealthy". The earliest that it could possibly be implemented would be 1990 (probably in the Autumn). This would avoid likely election years and would give some flexibility, at a sensitive time, both to contribute to reducing public expenditure and to do more for those in particular need.

But while I am very much of the view that in principle this kind of option is the right way forward on child benefit, the prior question is whether it could be seen as consistent with the Manifesto pledge. I have consulted John Major. His view is that this would not be the right time to pursue the possibility of means testing. It would be difficult to reconcile with the manifesto commitment and with the introduction of Independent Taxation in 1990. I agree that such a change would be exceedingly difficult to present as anything other than a modification of that pledge. On balance, however, I would prefer to bite this particular bullet now; to achieve significant savings and use some of the proceeds to achieve desirable enhancement elsewhere in the system in time for the next General Election. The decision, however, is essentially political but whatever we decide to do now we will have to take a view about the future, not least because of the sensitivity of all this in the House; a sensitivity that can only increase as the life of this Parliament proceeds.

Were we able to proceed with this change I would see it as enabling us to meet the cost of specific and early measures for pensioners in particular need. For pensioners in general, we can point to the growth in occupational provision and SERPS; but there are significant numbers of older pensioners, and those who are sick and disabled, who are dependent solely on the basic benefits. They are also, of course, a group who suffered particularly badly from the undermining of savings through inflation during the 1970s. Following last month's changes we are already under pressure to do more to recognise the special needs of such people and these pressures may well become stronger as the next election approaches. It will be increasingly difficult politically to justify merely protecting such pensioners against prices when the living standards of much of the rest of the community are rising significantly faster. For these reasons, I believe there is a strong case for action now to increase the income support premiums to give an extra £2 (single) or £3 (couple) to disabled pensioners and those over 80. This would help over a million people at a cost of around £90m. Accordingly I have bid for this in the current Public Expenditure Survey.

We also need to consider in this context the outstanding commitment to save £44 million in 1989 by a less than full uprating. This commitment was made, of course, in the context of looking at the longer term future of the benefit. If we do abandon, for the present, the notion of a more fundamental change, I would have grave reservations about proposing another less than full uprating following the recent strong opposition in Parliament, not least by our supporters. However, the Chief Secretary believes that, rather than means testing, it would be preferable to maintain the current level of child benefit in cash terms and to consider deploying some of the savings to help poorer pensioners (probably those without any significant SERPS entitlement). John Moore and I cannot however support this, as this trade-off would be more difficult to justify politically than the argument we used this year when we could point to the substantial extra resources being put into the new benefits for less well off families with children. We therefore think that there should be a full uprating of child benefit in 1989 and have included a bid for this in this year's Public Expenditure Survey.

We propose to pursue both issues (a full uprating of child benefit and assistance for poorer pensioners) with John Major in the PES discussions over the next few months. But in view of the extreme political sensitivity of the issues - not least with our own supporters - and the pressures for more definite assurances which we can all expect to face over the next couple of months, you may find an early preliminary discussion of the main issues useful.

I am copying this to John Major (Copy No 2), and David Waddington (Copy No 3).

NJS

8 June 1988

NICHOLAS SCOTT

CONFIDENTIAL

CHILD BENEFIT

Background

1. Child benefit was last considered on a comprehensive basis as part of the social security review exercise. The Green Paper on Reform of Social Security (1985) concluded that there was no need to change the benefit; it had a continuing role in its current form as a recognition of the additional costs incurred by all families in bringing up children. The 1987 election manifesto contained the pledge that 'child benefit will continue to be paid as now, and direct to the mother'. Public statements by Ministers at that time and since are at the Annex.

Problems with child benefit

2. The universal nature of the benefit means that it is expensive. All 6.7 million families receive it (in respect of around 12 million children). This will cost £4.5 billion in 1988/89 (10 per cent of the entire social security budget). It is however ill-targetted in the sense that the wealthiest families receive the same level of benefit as those on modest incomes. Poor families, receiving income support or family credit, see no real benefit as child benefit is taken into account in calculation of those benefits. The case for continuing to subsidise all families, including the wealthiest, is weaker now that those at the top of the income scale have done so well from recent tax changes.

3. This year's freeze on the rate of child benefit, and the partial freeze in the 1985 uprating, have helped to slow the growth in expenditure. However freezing of the rate is an unsatisfactory measure. It does not help to improve targetting: on the contrary, families on modest incomes experience the same drop in its value as everybody else. (The poorest families receiving income related benefits are protected). Further, although freezing is consistent with the letter of the manifesto pledge it is widely perceived as contrary to its spirit.

Possible options

4. The need to put child benefit on a more sustainable long term basis has led to consideration of possible options for the future. The range of options falls into three groups

(a) further freezes or reductions in the rate;

(b) bringing the benefit into taxation;

(c) removing it from better-off families (eg families whose income was above £25,000 or £30,000 annually).

All these options, except a freeze, require primary legislation.

5. The first two of these appear unsatisfactory for a number of reasons. Technically further freezes or partial cuts are consistent with the manifesto pledge but would mean

- all families (apart from those on income related benefits) would lose and the losses would be experienced directly by the mother;

- no real improvement in targetting: modest income families would suffer proportionately greater losses than wealthy ones;

- more low income families eligible for income related benefits.

6. Taxation would:

- increase "churning";

- increase the tax burden of families, bringing some into tax for the first time.

In addition, the introduction of independent taxation of husband and wife in 1990 would raise difficult questions about whose income child benefit is. (If the wife's, then the non-earning wife of a very wealthy man might still be able to receive her benefit free of tax.)

7. The third option - removing the entitlement of well-off families - is more attractive because

- most families would continue to receive child benefit (paid direct to the mother and non-taxable)

- targetting would be improved and the anomaly of the wealthiest families receiving social security benefits would be removed (these are the families who have gained most from the recent Budget changes)

- there would be valuable public expenditure savings (of the order of £150 - £300 million depending on the income threshold selected).

As well as primary legislation, this option would require a number of operational changes - the earliest possible implementation date would be 1990. Even this option might still be criticised by those who regarded incomes of, say, £25,000 as modest rather than high - eg a two earner family each earning £12,500, and by those mothers who might have difficulty in establishing and declaring their husbands' income.

ANNEX

CHILD BENEFIT - PUBLIC COMMITMENTS

The following quotations are examples of recent public commitments on child benefit. They reflect the stance established in the Green and White Papers on the reform of social security:

"Everyone with a family will continue to receive child benefit. The standard rate is £7 per week per child. It partly compensates for the removal of the child allowance. .... The right hon Gentlemen is trying to give the impression that child benefit is not going to every family. He is wrong."

Source: Prime Minister's reply to a question from Dr Owen. Official Record, 20 June 1985, Vol 81 Col 432-433.

"We'll review child benefit each year as we always have, but I can't tell you what the outcome of that will be. But I can tell you that child benefit will continue as a non-means-tested universal payment, paid to the mother and tax-free. There ought to be no question about that".

Source: Minister of State for Social Security (Mr John Major) in a pre-election interview with Richard Berthoud. "Poverty", pp 8 Spring 187, No 66.

"Child benefit will continue as a universal tax-free and non-means-tested benefit".

Source: General Election Briefing - Conservative Research Department, 22 May 1987.

"There are no plans to reduce the scope of child benefit. All families will continue to get child benefit and it will be paid to the mother ..."

Source: Minister of State for Social Security (Mr Scott). Official Record, 14 July 1987, Vol 119, Col 464.

"I repeat that I have no specific proposals at present to change the nature of child benefit, but ... there is clearly a need to keep it constantly under review".

Source: Secretary of State (Mr Moore) Official Record 27 October 1987, Vol 121, Col 186 (Uprating Statement).

ANNEX

CHILD BENEFIT - RECENT PARLIAMENTARY STATEMENTS

UPRATING DEBATE 27 OCTOBER 1987

Mr. Moore: My hon. Friend is of course right I find the debate very difficult. There are those who simply cannot get out of the past and understand that, in this announcement, we are focusing £320 million on families with children — 3 million-plus children. I fully understand people's attitude towards child benefit, but we are still talking about a child benefit system that is still spending £4·5 billion on top of the amount that I am talking about, so I find it a very unusual set of priorities for the Opposition to focus on the degree to which we are trying to target — *[Interruption.]* I apologise; from a sedentary position I have been reminded that I did not properly answer one of the questions on child benefit put by the hon. Member for Livingston (Mr. Cook). He asked

whether there was a review in progress. I repeat tht I have no specific proposals at present to change the nature of child benefit, but—I believe that this has been said from the Dispatch Box by almost every Minister of every Government since the benefit was introduced—in view of its cost and its ill-targeted nature there is clearly a need to keep it constantly under review. I am beholden to do that.

Mr. Ronnie Fearn (Southport): If child benefit is to be frozen, is it not a fact that a great administrative cost will be involved? Is it also true that the Secretary of State now has a team working in the belief that child benefit will be abolished some time next year?

Mr. Moore: No. I have made the position on child benefit quite clear. I read clearly the precise words that I obviously intended to use. I am beholden under section 63 of the Social Security Act 1986 to look at the uprating of child benefit each year, but there is no statutory requirement. I have explained precisely why I believe that this year I have been able to target better on those families with children who are poorer. I have also clearly said that there is no review in progress.

REPORT STAGE SOCIAL SECURITY BILL 12 JANUARY 1988

Sir Ian Gilmour: Will my right hon Friend then say what the words in the manifesto really did mean?

Mr. Scott: The words say that the benefit would be paid as a universal benefit, tax-free, and to the mother. That undertaking has not been changed by anything in this year's uprating. I believe that that obligation was right. I am sure, bearing in mind the pattern of linking other social security benefits to the RPI, that had there been an intention to link this benefit it would have been included in the list by one Government or another.

SOCIAL SECURITY BILL (CONSIDERATION OF LORDS' AMENDMENTS) 14 MARCH 1988

Mr. Raison: Will my hon Friend assure me that no decision has been taken that there will not be any further upratings of child benefit? Will he assure me also that the pledge in our election manifesto that child benefit will continue to be paid will not be diluted within this Parliament by any attempt to introduce any kind of means testing or tax on child benefit?

Mr. Scott: I cannot give that assurance to my right hon Friend. The future of child benefit will be reviewed each year as annual upratings are considered. On the fundamentals of child benefit, I can go no further than my right hon Friend did. A benefit of that sort and scale must be under constant review. Certainly, we have no present plans to change the status of child benefit. That is as much as I can say to my right hon Friend at the moment.

BUSINESS STATEMENT 21 APRIL 1988

Mr Kinnock Col 924

Given the anxiety being expressed over the Government's internal review of child benefit, can we have an urgent statement on the nature of the review, its terms of reference and whether the Government are considering taxing or means-testing that method of help for families which, as the Leader of the House knows, is regarded as vital by people in all parties.

Mr Wakeham Col 924

The right hon Gentleman also asked about community care. There are two reports, the Griffiths report and Lady Wagner's report, both of which are being studied. That is the best way to proceed at the moment. I shall pass on to my right hon. Friend the Secretary of State for Social Services the question about the review of child benefit. I am sure that a statement will be made at the appropriate time when the review has been completed. However, I cannot promise a debate in the near future.

PRIME MINISTER'S QUESTION TIME 17 MAY 1988

Mr. Cartwright: As the right hon. Lady reminded her supporters yesterday of her manifesto's commitments, will she assure the House that she will honour the manifesto commitment that child benefit would continue to be paid as now, and that there is no truth in the press suggestions that child benefit is to be cut, taxed, frozen or abolished?

The Prime Minister: I agree with the hon. Gentleman that the manifesto clearly stated:

"Child benefit will continue to be paid as now, and direct to the mother."

That commitment will be honoured.

MP

From: Nigel Forman.
8th June 1988.

To: Chancellor.

c.c. Chief Secretary.

Tax relief for private health insurance.

1. I was disturbed to read an article in the Daily Telegraph recently (copy enclosed) which reported Ministerial approval of tax relief for private health insurance. Surely you still recognise, and are prepared to defend, the strong arguments against such a move. As I see it, they would include the following:

a) It would contravene the clear undertaking given by the Prime Minister in the House on 10th December 1987 (copy enclosed).

b) The initial cost in revenue foregone would include a large dead-weight cost of giving relief to 5½ million people covered by existing schemes.

c) The longer term cost would almost certainly be higher than present estimates if the policy were 'a success'.

d) It would probably put up the cost of private health provision above what it would otherwise have been - in other words it would simply enable B.U.P.A., P.P.P. and others to charge higher premia.

e) It is unlikely to increase the total amount of health care provided, except perhaps at the margin for certain kinds of elective, cold surgery which is often medically unnecessary - vide the examples of certain hysterectomies or most cosmetic surgery in the United States.

f) The greatest benefit would go to higher income people in work who least need such relief and who make the least regular demand on the N.H.S.

g) I thought that your speech to the Leicestershire B.M.A. meant that with 5½ million people already covered by private health schemes and such schemes growing by 3% a year, you saw no need to subsidise something which is growing anyway under its own steam.

h) If private health provision grew substantially in future, it would put even greater pressures on the N.H.S., since the latter would find it more difficult to attract enough of the available doctors and nurses or enough of their 'private time' without having to match the pay and conditions in the private sector.

i) It would be of no benefit to the third of all households who pay no income tax and who, by dint of their relative poverty,tend to need health care more often or to a greater extent than others.

j) It would be no benefit to the 'uninsurables' - i.e. those with incurable, chronic conditions or those in the highest risk groups, e.g. the very old, heavy smokers, AIDS sufferers etc.

k) It might give further, possibly decisive, impetus to the creation of a two-tier structure of health care in the U.K. with all the inevitably adverse political connotations which that allegation could have for us at the next General Election.

l) It would be quite contrary to the main thrust of your tax policy of lowering the rates and broadening the base of tax by eliminating or reducing reliefs as and when you can. Do you really want to create another major distortion which could come to rival mortgage or pension relief?

2. I feel sure that there are some other good points in this argument which I have overlooked, but I hope that those that I have made will be carefully weighed before you agree to any policy package which has private health tax relief as a major component. I should be glad to have a word with you about these points, if you wished me to do so.

FNF

SECRET AND PERSONAL

CHIEF SECRETARY
REC. 13 JUN 1988
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Cx, Mr Anson,
Mr Phillips
Mr Ramsden

MP

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From the Private Secretary

13 June 1988

Dear Nick,

CHILD BENEFIT

The Prime Minister was grateful for your Minister's minute of 8 June.

I should be grateful if you and copy recipients could ensure that this letter is shown only to named individuals, with numbered copies, on a strict need to know basis.

The Prime Minister does not believe it would be consistent with the Manifesto and other commitments to remove entitlement to child benefit from the better off during the lifetime of this Parliament. She considers the question of whether or not child benefit should be uprated in 1989 should be looked at by DHSS and Treasury Ministers as part of this year's Public Expenditure Survey discussions.

I am copying this letter to Geoffrey Podger (Department of Health and Social Security), Jill Rutter (Chief Secretary's Office) and Murdo Maclean (Chief Whip's Office).

Yours,
Paul

(PAUL GRAY)

Nick Bromley, Esq.,
Office of the Minister for Social Security,
Department of Health and Social Security.

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