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25 November 1985

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REVIEW OF SOCIAL SECURITY: FINAL DECISIONS

Memorandum by the Secretary of State for Social Services

The Social Security White Paper and Bill will mark the culmination of the review of Social Security. The White Paper (a draft copy of which will be circulated before our meeting on 28 November) will endorse the objectives of reform which were agreed by the Cabinet earlier this year and were set out in the Green Paper.

2. The White Paper follows a four-month consultation period in which there were over 7,000 responses. We have taken account of those responses, and accordingly there are a number of changes to the proposals set out in the Green Paper. These proposals for change are set out below and they have been agreed by the Ministerial Group on Social Security. The other proposals remain unchanged.

3. In addition, we are committed to publishing illustrative figures demonstrating the effects of the changes on individuals. I shall be circulating tables showing the effects of the income-related benefit changes on individuals in advance of our meeting.

PENSIONS

4. Our agreed pension aims are to reduce the cost of the State Earnings-Related Pension Scheme (SERPS); to seek expansion of occupational pensions; and to increase choice through the option of personal pensions. The Green Paper proposed to achieve these by phasing out SERPS for all but those within fifteen years of pension age; and replace it by a requirement on employers to provide occupational or personal pensions, with a minimum joint contribution of 4 per cent of earnings.

5. While there is widespread agreement that SERPS cannot stay as it is, our Green Paper proposals have attracted substantial opposition from bodies whose support we would value. In summary, their objections are that the Green Paper would lead to higher costs for employers; that 4 per cent contributions are not enough to give an adequate pension; and that the so-called "consensus" on pensions policy would be damaged.

6. Although the merits of these arguments are debatable, I believe we should recognise the strength of the opposition. At the same time we should recognise that many of the bodies who oppose replacement of SERPS

SECRET

were in favour of reducing the Scheme's emerging cost. Among those in favour of modifying SERPS are the Confederation of British Industry, the National Association of Pension Funds, major insurance companies and the main consumer bodies.

7. There is no doubt that modifying SERPS would provide an alternative way of meeting our objectives, with wider support. I therefore propose that our pension strategy should be to:

a. make changes to SERPS so that we can afford it, while protecting the pensions of people due to retire this century, women who interrupt their careers to bring up a family, and the sick and disabled and people looking after them;

b. give everyone the right to opt for a contracted-out personal pension, instead of remaining in his employer's scheme or fully in SERPS;

c. make contracting-out simpler for occupational pension schemes, so encouraging their spread;

d. give an additional financial incentive to newly contracted-out occupational schemes and personal pensions;

e. take further steps to give as many people as possible a pension from their job.

These proposals are set out in more detail in Annex A.

INCOME-RELATED BENEFITS

8. The main elements in our agreed reform of income-related benefits are that we should:

a. replace supplementary benefit with a much simpler scheme of income support, with all special payments dealt with by a separate discretionary social fund;

b. replace family income supplement with family credit, on a basis consistent with income support and paid through the wage packet as an offset to tax and national insurance contributions;

c. greatly simplify housing benefit, again basing it on the income support rules and treating people in and out of work on the same basis;

d. require that everyone should make some contribution to their rates.

9. There has been an encouraging response to the principle that we should set the income-related benefits on a more coherent footing, and I therefore propose no changes in the broad structure. Annex B sets out the modifications which I propose in the light of consultations.

PHASING OF REFORMS

10. The other major issue is timing. Local authorities will have to implement the housing benefit changes; and employers will need to absorb the pension changes and the move to family credit. Both groups have argued strongly that the Green Paper timetable of introduction in April 1987 would be unworkable, and the local authorities have made clear that on housing benefit they would not co-operate.

11. Given the crucial part that local authorities and employers have to play I am convinced that we would be courting operational disaster if we tried to insist on an April 1987 start. The main legislation will need to be followed by regulations, and thus the time between regulations being passed and implementation in April 1987 is very short. I therefore propose to introduce the major structural reforms in April 1988, so avoiding the risk of operational problems towards the end of this Parliament. Some part of the programme of reform however can be brought in before then, and I have agreed with the Ministerial Group on Public Expenditure a number of measures which bring early savings from the review.

EXPENDITURE

12. The changes in this paper are consistent with my programmes in the Autumn Statement, which were described as provisional and are now confirmed as final.

TIMETABLE

13. I intend to publish the White Paper in mid-December. It is possible that the Bill can be ready for introduction just before Christmas, but it is more likely to be introduced as soon as the House resumes after the Christmas Recess. That will mean Second Reading will be in the middle or end of January, with Royal Assent by the end of July. The Sub-Committee on Local Government Finance have agreed that, to present a coherent overall Government policy and put the housing benefit proposals in context, there would be advantage in the Secretary of State for the Environment's Green Paper on Local Government Finance appearing before the Second Reading of my Bill.

CONCLUSIONS

14. The responses to the Green Paper do not seriously challenge our diagnosis of the problems of Social Security today - namely that it is too complex; it fails to get help to some groups who most need it; and that we are handing down too great a pensions bill for future generations. I believe that the reforms on which we are already agreed, with the changes proposed in this paper, will provide us with a better structure for Social Security. We will have achieved a radical simplification of the system, coupled with effective controls over spending. At the same time - as the figures which I am circulating will show - those who will gain from our reforms are some of those in greatest need, like families with children.

15. I invite the Cabinet to -

1. approve the changes from the Green Paper set out above;

2. agree the revised timetable for implementing our reforms;

3. note the timetable for publishing the White Paper and Bill.

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Department of Health and Social Security

25 November 1985

ANNEX A

A NEW PENSIONS STRATEGY

Key features of the State earnings-related pension scheme (SERPS)

As it stands, SERPS works in the following way:

First, pensions are based on 25% of revalued earnings since SERPS started in 1978. The band of earnings on which pensions are calculated is that between the national insurance (NI) lower and upper earnings limits

Second, for people retiring after 1998 pensions will be based on their best 20 years of earnings. This particularly helps people with periods out of work (eg mothers bringing up children, long-term sick and unemployed)

Third, people in good occupational schemes can contract out of SERPS (and pay a lower NI contribution). The State inflation-proofs their occupational pension after award.

Reducing the costs of SERPS

The proposals for reducing the emerging costs of SERPS are to:

(i) make schemes responsible for inflation-proofing contracted-out pensions to 3% a year with the present arrangements for inflation-proofing taking over above this. This reduces the cost of State topping up of good occupational pensions.

(ii) base SERPS pensions on lifetime earnings since 1978, not on the best 20 years. This would put SERPS and contracted-out schemes on a more equal footing and reduce over-provision. We will build in protection for people who have breaks in employment to bring up children, for the long-term sick and disabled, and for people looking after them.

(iii) calculate the SERPS pension as 20 per cent of earnings. rather than 25 per cent. But SERPS rights built up between 1978 and 1988 will still be based on 25 per cent.

(iv) widows and older widowers to inherit half their spouse's SERPS rights. The present arrangements which let them have their own and their spouse's full SERPS pension (up to a ceiling) are widely recognised as over-generous.

The first change would apply to pension rights earned from 1988/9; it will not affect pension expectations. The abolition of the best 20 years cannot take effect until after 1998/9, and I propose that the changes for widows and widowers should not do so either. SERPS pensions for people retiring up to 2000 will still be calculated as 25 per cent of earnings, and the move to 20 per cent will be phased in over 10 years, to give transitional protection to those retiring early next century.

This package of measures will save over £12 billion on retirement pensions by 2033 at November 1985 prices. It fully protects the position of people retiring this century, as we promised in the Green Paper.

Encouraging the spread of occupational schemes

i. Changing contracting out arrangements

Only "final salary" schemes can contract out at present (ie schemes which promise a pension related to the level of earnings at retirement). We should allow "money purchase" schemes tocontract out as well. These are schemes which promise a return on contributions invested over a working life, rather than on final salaries. They do not expose the employer to open-ended commitments, and so will be more attractive for many small employers. They are also the key to expanding industry-wide schemes.

The complex contracting out requirements for salary-related schemes, which are a burden on employers and deter people from setting up schemes, will be simplified.

Contracted-out schemes will be required to provide survivors' benefits for men as well as women. Not all occupational schemes cover widowers, and our Green Paper proposal to make them do so was widely welcomed.

ii. <u>A special incentive for new occupational and personal pensions</u>

Contracted-out pension schemes get a reduction (the "contracted-out rebate") in employers' and employees' national insurance contributions. As a special incentive to encourage new occupational and personal pensions, I intend to add 2 per cent to the rebate. The incentive will be available from 1988 to 1993 to occupational schemes and personal pensions becoming contracted-out for the first time during that period.

iii. <u>Improving pension coverage</u>

Pension rights will be preserved (instead of refunding contributions) for everyone who has been in a scheme for 2 years or more - not 5 years as now. There was pressure for this from all sides during the 1985 Social Security Bill, and it would significantly increase the numbers of people with occupational pension rights.

Personal pensions

For the first time there will be a right for all employees to opt for a contracted-out personal pension. Personal pensions are an essential element in our policy of improving job mobility and giving people more choice. They must have the option not to stay in an employer's scheme, or fully in SERPS. Personal pensions will add another dimension of choice - of pension provider. People will be able to decide on the kind of body to invest their pension savings - bank, building society, unit trust. This will end the virtual monopoly of the insurance companies in pension provision.

Holders of personal pensions would have the advantage of the total rebate to pay to their pension. This would be between 5 and 6 per cent of salary, plus the 2 per cent incentive of salary. Although personal pensions would be contracted-out, employers would simply pay full NI contributions. The DHSS would then pay into the personal pension an amount reflecting the difference between full and contracted-out NI contribution rates. This system is much easier - and much more acceptable to employers - than the one in the 1984 personal pensions consultative document.

Anyone changing his job will be able to transfer all his pension rights to a personal pension. People not changing jobs will be able to transfer rights built up after 1988 - and before then, if their employer agrees.

The tax regime envisaged for personal pensions will be broadly similar to that which applies now to retirement annuity contracts. Thus contributions by employees will attract relief at their marginal rate of income tax; the build-up within the fund will be exempt from tax; and part of the ultimate benefit may be commuted and taken as a tax free lump sum. There will be provision for employers' contributions within appropriate limits which will be tax-deductible in the normal way.

Additional Voluntary Contributions

People in occupational schemes are able to pay extra contributions to boost their pension rights. But at present they can only do so _if_ their employers is prepared to make the necessary arrangements. The Green Paper proposal that all schemes _must_ allow employees to pay additional voluntary contributions was universally welcomed, and it is proposed that we should go ahead with it.

ANNEX B

CHANGES FROM THE GREEN PAPER PROPOSALS ON INCOME RELATED BENEFITS

1. I propose to make a number of modifications to the Green Paper proposals for income related benefits in the light of consultation. The main changes are set out below.

INCOME SUPPORT

2. The proposal that claimants under 25 should receive lower rates of benefit than older claimants has attracted a great deal of criticism. Although I think we should hold to our position for single claimants, I do not think we can sustain it for couples, particularly couples with children. I propose therefore to treat all couples aged 18 and over on the same basis. The other main change I propose is that we should give limited help with mortgage interest - rather than none - during the first six months on income support. Negotiations are continuing with the building societies about this.

SOCIAL FUND

3. A good deal of concern has been expressed about operating a fund on a discretionary basis and with a fixed budget. But I am convinced that this is the only way forward if we are to stop the present flood of single payments. Detailed accounting arrangements are under discussion with the Treasury.

HOUSING BENEFIT

4. Although the main structural changes in housing benefit have been welcomed, there has been strong opposition, particularly from the local authority associations, to our proposal that everyone should pay 20% of rates. We will want to stand firm on

this proposal because of its implications for accountability in local government, but I propose a number of other changes to make the housing benefit proposals more acceptable:

- Instead of one combined taper, I propose that there should be separate tapers for rent and for rates. This reduces the heaviest losses that owner occupiers - especially pensioners - would have faced under the original proposals.

- We had proposed that local authorities' powers to operate local schemes - within their own resources - should be abolished. We have had a large number of representations about the effect of this on special arrangements for war pensioners, and I propose that we should allow local authorities to keep local schemes for that purpose only.

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SECRET

33

C(85)27: REVIEW OF SOCIAL SECURITY:

EFFECT OF CHANGES IN INCOME RELATED BENEFITS

1. Attached are the tables of illustrative figures referred to in paragraphs 3 and 14 of the memorandum by the Secretary of State for Social Services (C(85)27), previously circulated.

2. The tables are illustrative of the kind of changes which the reform of social security will involve. They concern the plans for income related benefits under which supplementary benefit is replaced by income support; family income supplement by family credit; and the housing benefit scheme is restructured and reduced in scope. Inevitably there are complications in showing the picture after implementation of the changes. One of these concerns rates. It is not yet possible to illustrate what the effect of the Secretary of State for the Environment's rates reform proposals will be - in particular their effect on single pensioners. Nor is it possible to illustrate any additions to income resulting from an increase in tax thresholds.

3. Tables 1 and 2 illustrate what effect the changes would have if the new structure were substituted for the existing structure as it is now in November 1985. Table 1 illustrates the effect of the social security reforms without making any allowance for any changes from the requirement to pay 20% of rates or the rates reform - either providing gainers or losers. Table 2 illustrates the effect of the social security reforms including the requirement to pay 20% of rates. Thus this includes the losers from the 20% rates requirement but not any gainers or losers which come from rates reform.

4. Tables 3 and 4 give the illustrative effect in cash terms - recognising that an uprating of benefits will take place when the reforms are introduced and that transitional protection is being given to ensure that no-one loses in cash terms from the change from supplementary benefit to income support.

5. These are the kind of illustrative figures that will be in the White Paper. But they are only a selection from a range of possible analyses and the figures themselves are subject to further working.

6. The overall picture of gainers and losers demonstrates the inevitable turbulence in such a fundamental restructuring of the social security system. Within that overall framework the pattern of re-distribution is much as expected. It shows in particular that the aim of re-directing resources to low income families with children is being achieved.

7. This note and the tables should be handed back to the Prime Minister's Private Secretary at the end of the meeting.

26 November 1985

Department of Health and
Social Security

SECRET

SECRET

TABLE 1

EFFECT OF SOCIAL SECURITY REFORM OF INCOME RELATED BENEFITS [1] (000)

Client Group	Gain £5+	Gain £4-5	Gain £3-4	Gain £2-3	Gain £1-2	Gain <£1	No Change	Loss <£1	Loss £1-2	Loss £2-3	Loss £3-4	Loss £4-5	Loss £5+	Total Gainers	Total Losers
Pensioners age 80+	10	40	60	150	90	60	180	100	50	50	30	20	30	400	270
Pensioners age 60-79	90	50	60	210	580	650	680	220	340	200	130	60	140	1650	1100
Sick or Disabled	110	40	30	40	50	10	50	10	*	10	*	*	10	270	40
Single parents	200	10	*	30	10	110	70	40	80	20	20	*	30	370	190
Couples with children															
- in full-time work	160	30	30	40	30	20	20	20	20	10	10	*	30	300	90
- not in full-time work	40	110	50	130	110	20	40	10	20	10	10	10	10	460	60
Others															
- in full-time work	10	*	*	*	10	*	40	30	30	20	20	20	50	30	170
- not in full-time work	10	*	160	10	30	20	690	50	110	70	210	30	200	240	660
Total	630	270	400	600	910	900	1750	460	650	380	420	150	510	3710	2560
All pensioners	100	90	110	360	670	720	860	320	390	250	160	90	170	2050	1360
All couples with children	200	140	80	160	140	30	60	30	40	20	10	10	40	760	150

Notes

1. This excludes any changes which may result from a 20% rates contribution or from the rates reform proposals.

2. Gains/Losses up to 50p included in 'No Change' column.

3. All figures rounded to nearest 10,000. * means a figure of less than 5,000. Therefore, in many cases, totals will not sum.

SECRET

TABLE 2

EFFECT OF SOCIAL SECURITY REFORM OF INCOME RELATED BENEFITS PLUS 20% RATES CONTRIBUTION [1.] (000)

Client Group	Gain £5+	Gain £4-5	Gain £3-4	Gain £2-3	Gain £1-2	Gain <£1	No Change	Loss <£1	Loss £1-2	Loss £2-3	Loss £3-4	Loss £4-5	Loss £5+	Total Gainers	Total Losers
Pensioners age 80+	10	30	20	50	120	60	170	80	130	70	40	30	40	280	370
Pensioners age 60-79	60	30	30	90	190	230	950	470	550	280	200	100	190	620	1790
Sick or Disabled	110	30	20	20	30	10	50	10	20	10	*	*	10	230	60
Single parents	200	10	20	10	20	*	130	30	60	80	20	10	50	260	240
<u>Couples with children</u>															
- in full-time work	150	30	30	30	30	20	20	20	20	20	10	10	30	280	100
- not in full-time work	20	10	90	70	140	60	50	20	30	20	10	10	20	390	100
<u>Others</u>															
- in full-time work	10	*	*	*	10	*	10	20	50	40	20	20	60	10	200
- not in full-time work	10	*	150	10	10	20	520	160	130	250	30	40	230	210	850
Total	580	130	370	270	540	410	1890	810	1000	760	320	210	610	2290	3730
All pensioners	80	60	40	140	290	300	1130	550	690	350	230	120	220	900	2160
All couples with children	170	40	120	100	160	80	70	30	50	30	10	10	50	680	190

<u>Notes</u>

1. This includes an illustration of the effect of a 20% rates contribution but makes no allowance for any changes from the rates reform proposals.

2. Gains/Losses up to 50p included in 'No Change' column.

3. All figures rounded to nearest 10,000. * means a figure of less than 5,000. Therefore, in many cases, totals will not sum.

SECRET

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TABLE 3

CASH POSITION AT POINT OF CHANGE

EFFECT OF SOCIAL SECURITY REFORM OF INCOME RELATED BENEFITS [1.] *(000)*

Client Group	Gain £5+	Gain £4-5	Gain £3-4	Gain £2-3	Gain £1-2	Gain <£1	No Change	Loss <£1	Loss £1-2	Loss £2-3	Loss £3-4	Loss £4-5	Loss £5+	Total Gainers	Total Losers
Pensioners age 80+	90	50	150	110	160	30	190	10	10	10	10	10	10	610	50
Pensioners age 60-79	160	160	500	630	910	180	540	80	80	60	40	30	90	2530	370
Sick or Disabled	170	30	40	40	40	10	20	*	*	*	*	*	*	320	10
Single parents	230	10	30	120	40	40	110	*	10	10	10	*	30	470	60
Couples with children															
- in full-time work	240	20	30	40	40	20	20	10	10	10	10	10	20	380	50
- not in full-time work	210	20	200	40	20	20	30	*	10	*	10	*	*	500	20
Others															
- in full-time work	10	*	*	10	10	10	30	30	30	30	20	10	50	40	160
- not in full-time work	10	150	10	30	370	300	560	*	30	10	10	30	40	890	130
Total	1130	430	970	1030	1580	590	1490	130	180	120	90	90	240	5730	850
All pensioners	260	210	650	740	1070	210	720	90	100	60	40	30	100	3140	420
All couples with children	450	40	230	80	60	30	50	10	20	10	10	10	20	880	80

Notes

1. This excludes any changes which may result from a 20% rates contribution or from the rates reform proposals.

2. Gains/Losses up to 50p included in 'No Change' column.

3. All figures rounded to nearest 10,000. * means a figure of less than 5,000. Therefore, in many cases, totals will not sum.

SECRET

280

SECRET

TABLE 4

CASH POSITION AT POINT OF CHANGE

EFFECT OF SOCIAL SECURITY REFORM OF INCOME RELATED BENEFITS PLUS 20% RATES CONTRIBUTION [1.] (000)

Client Group	Gain £5+	Gain £4-5	Gain £3-4	Gain £2-3	Gain £1-2	Gain <£1	No Change	Loss <£1	Loss £1-2	Loss £2-3	Loss £3-4	Loss £4-5	Loss £5+	Total Gainers	Total Losers
Pensioners age 80+	50	40	60	140	180	60	70	170	30	10	10	10	10	530	230
Pensioners age 60-79	110	40	140	430	690	620	550	380	180	70	50	30	90	2010	790
Sick or Disabled	150	20	30	30	50	10	20	*	10	*	*	*	*	300	20
Single parents	220	10	10	30	20	110	50	40	90	10	10	10	30	400	180
Couples with children															
- in full-time work	230	20	30	30	30	10	20	10	20	10	10	10	20	360	60
- not in full-time work	100	90	50	190	30	20	20	10	30	*	*	*	10	480	50
Others															
- in full-time work	10	*	*	*	10	*	10	10	60	30	20	20	50	10	190
- not in full-time work	20	150	10	10	370	160	430	140	190	10	*	20	70	720	440
Total	890	370	320	850	1380	990	1170	770	590	140	90	90	290	4810	1960
All pensioners	160	80	200	560	870	680	620	560	200	70	50	30	100	2550	1020
All couples with children	330	110	80	220	60	30	40	20	40	10	10	10	30	840	110

Notes

1. This includes an illustration of the effect of a 20% rates contribution but makes no allowance for any changes from the rates reform proposals.

2. Gains/Losses up to 50p included in 'No Change' column.

3. All figures rounded to nearest 10,000. * means a figure of less than 5,000. Therefore, in many cases, totals will not sum.

SECRET

281

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