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David Clark, Esq
Private Secretary to the
Secretary of State for
Social Services

11 March 1983

New David,

SOCIAL SECURITY: ADJUSTMENT

The Chancellor told your Secretary of State yesterday that he was considering three rival drafts of the section in the Budget Speech which will deal with the "adjustment". The three have now been boiled down into one, as in the attached copy - and the Chancellor would be most grateful for your Secretary of State's comments on it.

I am sorry to seem pressing, but the exigencies of the Budget timetable are such that I fear I must ask that such comments reach us this afternoon.

I know that you will ensure that the text is handled with maximum discretion.

Yours ever,

J. O. Kerr

J O KERR

BUDGET SECRET

BLOCK I: Social Security

✓ I now turn to social security. This is much the biggest single element in public expenditure - more than one quarter of the total. About half of social security expenditure is on benefits for pensioners.

why X 2. The House will remember that the effect of last year's uprating of social security benefits was an over-provision of 2.7 per cent. This happened because inflation fell faster than expected. In effect, therefore, beneficiaries received an advance payment of part of the increase due this year, and I announced last autumn that there would accordingly be an adjustment of this year's uprating. The effect of the proposal I am about to make is that part of last year's over-provision will be allowed for in this year's uprating, and that part will be left with the beneficiaries.

3. To leave the whole of this over-provision in place would mean very substantial costs in future years. These costs would have to be borne very largely by contributors. Ever since the Beveridge report our system has been based on the contributory principle. And rightly so. For that principle

/requires

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requires us all to take account of the effect of benefit increases on the working population, who pay the contributions, and who have seen them increase substantially over the years: indeed, only last November we had to announce further increases in National Insurance contribution payments which take place from next month.

4. As the House knows, since 1976 upratings have been based on what is known as the forecast method of uprating. That is, they are based on a forecast made at Budget time of what the ^{and} rate of inflation will be at the time the uprating takes place in the following November.

5. But this method has not worked well. A forecast is necessarily uncertain. Increases can therefore be larger or smaller than intended. There have been years when prices have been under-estimated, as in 1981 - when a 2 per cent under-provision was made good the following year - and others such as 1980 and 1982 when there has been over-provision. (The 1980 over-provision was of course corrected in full.) And in every case there has necessarily been a year's delay before the error of the previous year could be put right.

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6. The system of trying to forecast inflation is a fragile basis for calculations of such importance to millions of our fellow citizens.

The cost in the UK over 1974-75
There have therefore been suggestions from pensioners' organisations that we should restore the more certain system that prevailed until the party opposite withdrew it, in order to make savings, in 1976. This is the system by which benefit upratings are calculated on what has actually happened to prices rather than on what might happen in future if we got our forecasts right. ~~I have decided to accede to this advice.~~

7. From this November, therefore, we shall return to the historic, or actual, method. The necessary legislation will be introduced immediately.

8. The uprating this November will be based on the rise in prices in twelve months to May of this year. That figure will be announced on 17 June. We have chosen May because it is the latest month we can use as the basis of the calculation and still make sure that all recipients get their increase in November.

9. The uprating will be based on whatever the May figure turns out to be. At this stage, of course, I cannot say exactly what that figure will be.

/But it seems

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But it seems likely to be in the region of 4 per cent. It is therefore likely that benefits will be increased by significantly more than would have been the case had the old system been retained - with an adjustment made to take full account of the amount of last year's over-provision. Linked public service pensions will be raised in November by the same percentage. For unemployment benefit the increase will be in addition to the restoration of the 5 per cent abatement which I have already mentioned.

10. Between the November upratings of 1978 and 1983 prices are likely to have risen by some $\underline{67}$ per cent and pensions by some $\underline{72}$ per cent. Our pledge to maintain the value of the pension over the lifetime of this Parliament will thus have been more than fulfilled.



COPY 2 OF
FOUR COPIES

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From the Secretary of State for Social Services

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
LONDON
SW1

11 March 1983

Dear Geoffrey

Thank you for sending me the draft of what you intend to say on the return to the historic method for the uprating of pensions and other social security benefits. My concern is with paragraphs 2 and 3 which seem to me to give the wrong signal about what is to come. I would have thought that it was better in presentational terms to argue the case of principle for change - which is strong - while at the same time being entirely frank about its effect on pensions. I have, therefore (rather rapidly), sought to redraft that part of your speech and I think the effect of this would be to greatly improve the presentation of the case. If I may suggest, this is a crucial point because the tone of the debate which will undoubtedly follow will be set by your initial announcement. I very much hope that you can agree to the lines of this redraft as I think it will substantially help when we come to present the legislation. I am, incidentally, copying this to the Prime Minister in accordance with the Cabinet remit that all three of us should discuss how best the Government's decisions can be presented.

I am available virtually at any time on Sunday to talk to you about this if this would be helpful.

A copy also goes to Sir Robert Armstrong.

[Handwritten signature]

NORMAN FOWLER