

PRIME MINISTER

P 03590

THE NATIONAL INSURANCE FUND

Paper by the Secretary of State for Social Services

E(A) (89) 33

DECISIONS

The National Insurance Fund is due to go into deficit by 1992-93 on present policies. E(A) rejected Mr Newton's earlier recommendation to avoid this by abolishing the allocation to the NHS but agreed that the Social Security Bill should include a power to vary National Insurance contributions by Order by wider margins than allowed under existing legislation. Mr Newton now recommends that, instead of this new power, the Bill should remove from the Fund expenditure on the non-contributory benefits: that is, industrial injuries benefits and statutory sick pay and maternity pay. An early decision is needed for the Bill. The Committee will want to decide whether to accept Mr Newton's recommendation.

2. You may wish to focus on:

i. the long-term prospect. In the last discussion you stressed the need to ensure that the Fund was on a sound footing for the future. Mr Newton says that there is no structural problem with the Fund. What is needed is a way of meeting the problems caused by the success of personal pensions "until the natural buoyancy of the Fund restores stability in the medium and longer term". You will wish to consider whether to accept this analysis.

ii. measures to deal with the short-term problem. Mr Newton does not want to rely solely on increased National Insurance contributions to solve the Fund's prospective deficit. Rather than widen the power to vary contributions in the Bill, he proposes to legislate to remove expenditure on non-contributory benefits (industrial injuries, statutory sick pay and maternity pay). He says that this should solve the problem for two to three years and allow time to see how things develop; and that any further action needed could be accommodated within existing powers to vary contributions and the NHS allocation. You will wish to decide whether to approve the package which Mr Newton proposes.

BACKGROUND

3. Mr Newton told E(A) on 23 November that the balance in the National Insurance Fund would fall below the minimum level of one-sixth of annual benefit expenditure recommended by the Government Actuary in 1991-2 and would go into deficit in the following year. He recommended abolishing the Fund's allocation to the National Health Service. The Committee rejected this proposal, and asked Mr Newton to consider further the options for putting the Fund on to a sounder basis.

ISSUES

The long-term prospect

4. At the last E(A) you were concerned whether the Fund was on a sound basis for the longer term. Mr Newton says once the short-term difficulties have been dealt with the natural buoyancy of the Fund will restore stability in the medium and longer term. You may wish to ask about the factors underlying this analysis and check that the Treasury is content that it is robust:

i. link with earnings. Mr Newton probably has it in mind that contributions are related to earnings, whereas most benefits are related to prices, and that if this trend continues it should reduce the long-term burden on the Fund.

ii. long-term impact of personal pensions. Mr Newton also makes the point that personal pensions are an alternative to SERPS and their success will reduce the Fund's outgoings on that account in the longer term.

You may wish to ask how big the effect of these factors is likely to be and over what timescale they are likely to make themselves felt. Line A of annex 2 appears to show a steady decline into deficit up to 1996-97 if no change is made.

Non-contributory benefits

5. Instead of taking power to vary National Insurance contributions by Order by wider margins than at present permitted, Mr Newton recommends that the balance in the Fund should be maintained by removing expenditure on the non-contributory benefits funded from it: industrial injuries benefits, statutory sick pay and maternity pay. The change would be made in the forthcoming Social Security Bill. You will wish the Committee to reach a view on this proposal. Points to be considered include the following:

i. National Insurance contributions. One alternative to Mr Newton's proposals would be an increase in NI contributions, which he puts at 0.5% for both employers and employees in both 1991 and 1992. You will want to decide whether to accept Mr Newton's recommendation against such increases.

ii. the minimum balance. E(A) at its last meeting asked whether the minimum level for the balance in the Fund could be reconsidered. It is based on a recommendation by the Government Actuary, and is not statutory. On this, Mr Newton says that a balance is needed to deal with short-term fluctuations, that the size of the minimum level has fallen over the years and is now if anything lower than the Actuary would now recommend if formally asked.

iii. the need for further measures. Mr Newton says that his proposals would keep the Fund above its minimum level until at least 1992-93. He cannot guarantee that they are a complete solution, but says that probably any further adjustments would be small.

iv. controversy. Mr Newton does not discuss likely reaction to his proposals for legislation. Would it be alleged that the position of recipients of non-contributory benefits would be less well protected?

v. expenditure. Mr Newton's proposals would appear to mean financing over £1 billion of expenditure from the Consolidated Fund, and thus from general taxation, rather than from the National Insurance Fund (para 14). You will wish to check that Treasury Ministers are content.

The NHS allocation

6. At E(A)'s last meeting it was suggested that there might be a case for doing more to identify the NHS contribution as a separate element and relating changes in it more closely to changes in spending on the NHS. Mr Newton does not mention this. You may wish to consider whether this possibility should be studied further.* One step in this direction would be to widen the margin within which the NHS allocation can be changed (at present 0.1%) without primary legislation.

* It is a two edged weapon. While it might bring home to people the costs of the NHS, it could also increase pressures for more spending if their source of revenue was buoyant

Power to vary contributions

7. On 23 November E(A) decided that the Bill should contain a power to widen the margin within which the NIC rate can be varied (at present 0.25% for both employers and employees) without primary legislation. Mr Newton argues that this is now unnecessary. You will wish to decide whether it is right not to take this extra flexibility.

HANDLING

8. You will wish to ask the Secretary of State for Social Security to introduce his paper. In writing it he has consulted the Chancellor of the Exchequer and the Secretary of State for Health. The Lord President of the Council will be interested in the effect on the Social Security Bill.

R.T.J.

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Cabinet Office
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