

File (A)

PRIME MINISTER

BENEFIT REVIEWS : BRIEF FOR MEETING WITH NORMAN FOWLER

At your meeting with Norman Fowler, you could discuss with him some of the important general themes to be incorporated in the benefit reviews, and some of the detailed options.

General principles

1. **The contributory principle:** People should feel the cost of providing benefits directly in their pay-packets. Where possible, when benefits are paid by the State, they should be related to contributions. People should be encouraged to insure themselves for income above the basic State provision.
2. **Targeting benefits:** Basic benefits should provide a safety-net for those in need. Non-contributory benefits should be means-tested and tapered so that those who do not need them do not get them. Child benefit now goes even to millionaires, and the average householder in the top one-fifth of income-earners gets £540 a year in cash benefits.
3. **The unemployment and poverty traps:** People should always be better off in work than out of work, and should be at least 30p better off for each extra pound they earn.
4. **Savings:** Any reform should yield public expenditure savings so that people can be taken out of tax.
5. **Losers:** There will be some losers in any major reform of taxes and benefits, but the poorest should not be made poorer by that reform; nor should any group of losers find themselves dramatically worse off.
6. **Simplicity:** The tax-benefit system should be as simple as possible and should be easy for administrators and beneficiaries to understand. There are 77,000 DHSS social security administrators, and another 58,000 handling personal tax in the Inland Revenue.

Options

We have set out some options for each of the four reviews, though it is early to become involved in too much detail:

Pensions

The basic State retirement pension is a popular pledged benefit and will remain a central part of the National Insurance system. It should continue to be contributory, although the review could ask the question whether it should continue to be compulsory. People might be allowed to opt out if they were on an approved private pension plan.

The State Earnings-Related Pension Scheme (SERPS), introduced by Barbara Castle in 1975, should go. There are now about 9.3m pensioners. Their numbers stay below 10m until 2005 and then rise steeply to more than 11m by 2015 and more than 12m by 2025. This increase coincides with the maturity of SERPS as the "20 best years" rule begins to bite. Options for abolition:

1. Calculate the SERPS entitlement not on the basis of the best 20 years' earnings but on the average real lifetime earnings multiplied by 20. This would make the scheme cheaper.
2. Discontinue SERPS for everybody from an appointed date. The arrangements would be similar to the winding-up of the graduated pension: everyone would receive a written record of his entitlement, which would be updated annually in line with prices.
3. Discontinue SERPS from an appointed date and give everyone his entitlement as a capital receipt to be paid into his own personal pension fund once the portable pension scheme is running. This would extend personal wealth ownership but would cost the public sector a great deal on the appointed day, though it would buy out the expensive entitlements which would otherwise continue to accrue.

We recommend the second option.

Supplementary Benefit

Supplementary benefit costs well over £2 per benefit payment to administer. About 15% of all benefit payments are supplementary benefit, but almost 40% of staff work on it, because it is means-tested and because the 15,000 paragraphs of regulations are complex.

1. Have simpler and fewer categories of need and fewer special payments. Savings will be in administration rather than in benefit cuts.
2. At present, anyone with savings of more than £3,000 is not eligible for supplementary benefit. Therefore those who are now in work but who fear they may one day find themselves on social security have a disincentive to save. The reviews should look at the scope for raising the savings disregards to solve this problem.

Housing

Housing benefit extends too far up the income-scale and helps to force up house prices and rents. It makes people less worried about the level of council rents and rates and encourages private landlords to overcharge in the knowledge

that the State will pick up the bill. And, as central Government squeezes the spending of councils, they put up their rents and the DHSS automatically has to shell out extra housing benefit.

Housing benefit is complex and is a major contributor to the poverty trap. It is paid to more than one-third of all households and therefore goes to many whose need is questionable. Of the £4bn total annual cost of housing benefit, £2.5bn goes to people on basic supplementary benefit, and they will need to go on having their full rent and rates paid. But savings could be made on the £1.5bn paid to families not on supplementary benefit:

Simplify housing benefit by meeting the full housing costs of those without any non-State income, as now, and by tapering those full costs at a single, uniform rate so that the benefit received is, say, 25p less for each extra pound earned. This single taper would replace the four existing tapers and the other needlessly complicated features of the system. And, if the taper were steep enough, public expenditure would be reduced.

Benefits for children and young people

A: Young people. Supplementary benefit to young people living away from home can be so generous as to deter them from finding work. At its extremes it can allow young people to live together in seaside hotels at the public expense or allow families to swap their teenagers so that they can claim full supplementary and housing benefit.

At present, a 16-17 year-old on supplementary benefit of £16.45 a week is better off than a young person who stays at school (because the parents get only £6.50 a week in child benefit). He is also better off than many young people on Government training schemes. This is one of the areas where basic supplementary benefit may be too generous. And it contributes to youth unemployment by holding up the wage-levels which employers offer, so that they are higher than the value of the labour of large numbers of young people.

1. Pay young people only the level of supplementary benefit which would apply if they were living at home, unless they have a good reason to be living elsewhere (eg parents dead or divorced).

2. Extend the age-band for young people's reduced rate of supplementary benefit to 19 years and cutting the rate by £2 a week.

B: Child-related benefits. Child benefit is £6.50 per week per child; FIS starts at £22 per week for the first child with an addition of £2 per week per subsequent child and is then tapered at a steep 50p per pound of earnings. The

disadvantages are a) that many get it who do not need it; b) that the FIS taper is the largest single cause of the family poverty trap; c) that the combination of FIS, child benefit and the child elements in supplementary benefit, is complex.

Replace child benefit, FIS and the child element in supplementary benefit with a consolidated, means-tested child benefit which preserves the financial position of the poorest and is tapered at, say, 20-25p for each pound earned. This would reduce the effects of the poverty trap and would yield significant savings by no longer paying child benefit to richer families. The savings could be passed on in higher tax thresholds.

Options for the co-ordinating unit at DHSS

The central co-ordinating unit must also look at wider options for radical reform. We suggest that the following be considered:

Private provision: Private savings or insurance would be well-suited for topping up a basic State provision (that is why SERPS is unnecessary) or for covering specific and foreseeable costs (such as funeral or maternity expenses). For the poorest, supplementary benefit would meet these costs; for earners, private insurance would be best.

Other candidates for privatisation are sickness benefit and the contributory Industrial Injuries Scheme.

Raising income-tax thresholds: The other side of the benefits coin is taxation. The administrative and benefit savings outlined above could help to finance a further increase in tax thresholds, which would take more people out of tax and further weaken the poverty trap.

Simpler admin: It is possible to simplify the tax-benefit system without destroying its sensitivity to individual needs. The options above allow the number and complexity of benefits to be reduced. At this stage we should encourage fundamental thinking about ways of making a major reduction in the complexity and costs of administration.

Existing benefits should be handled not by a multiplicity of offices but by a single office. You may like to press Norman Fowler further to handle unemployment benefit in his offices rather than separately. In due course, housing benefit should also come back to benefit offices; and personal taxation could eventually be handled in the same offices as personal benefits.

The wider option: There are more fundamental ways of simplifying the system and reducing its costs while focusing on poor people in particular. Our consolidation of child support could be extended to cover all basic benefits, includ-


ing supplementary benefit, unemployment benefit, housing benefit and fringe benefits such as free school meals and welfare milk. It would be a fully means-tested supplementary benefit covering people in and out of work, tapering off at, say, 35-50p for each pound earned. The advantages of the single computation would be in saving administration costs, in making sure that people get their due without difficulty and in giving people greater incentive to earn.

Conclusions

At this preliminary meeting, it may be best to concentrate on the general principles set out at the beginning of this paper (which reflect our understanding of your thinking) and to concentrate on one or two of the options we have suggested in the light of those principles. We suggest concentrating on:

- * ending SERPS;
- * ending abuses in young people's benefit;
- * making Housing Benefit much simpler and cheaper.

You may also want to urge the case for a fundamental re-think, aiming at a more uniform means-tested benefit focusing on the poor.



JOHN REDWOOD
CHRISTOPHER MONCKTON
DAVID WILLETTS



David Willetts

22 June 1984

hek 1

PRIME MINISTER

Mr. Fowler would like to come and see you to report on his four social security reviews which are all now launched and operating. The pensions review, which was started first, is well advanced.

In addition to hearing his reports, you could urge him to draw together in one exercise the poverty and unemployment traps which will arise in each of the separate benefit reviews (housing benefit, supplementary benefit, provision for young people and children.)

A half-an-hour slot is available before Cabinet on 28 June.

Agree?

13 June 1984