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PRIME MINISTER

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AT 8/2

8 February 1985

MISC 111

The political choice

None of this is easy politics. No-one has ever said it would be.

But remember the origins of this exercise. By far and away the largest programme in government has been growing like Topsy. 'Protected' and 'demand-led' programmes have to be scrutinised and cut if we are to stop the momentum of public expenditure. Moreover, the benefit system is cumbersome, widely disliked by the public, and costly in manpower and administrative resources. Worse still, the system is a disincentive to work and a discouragement to self-help.

And it's not just basic principles that are wrong. It's practical politics as well. Because the Government has tried to rein in the rate of growth of the programme, it has had regular rows, has come to be seen as petty and mean-minded, constantly tampering with the problem at the margins. This was inevitable, given the way in which the leaking of the Think Tank Report left the Government in the mire before the last Election, and with the understandable pledges that had to be made in order to win that Election. We have now had a sequence of rows:

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Indexing pensions only to prices	1980
Abolishing earnings-related supplement to UB	1980
2-week deferral of uprating	1980
5% abatement of sickness, invalidity, maternity and UB	1980
Not uprating Child Benefit for 18 months	1979-81
Taxing UB	1982
Delaying period before FIS uprated	1982
Recovery of 1% uprating overshoot	1982
Phasing out child dependency additions from short-term contributory benefits	1980-84
Switch from forecast to historic basis for uprating	1983
Housing Benefit tapers steepened	1983-84
Increasing available scale margin for SB	1983&84
Mortgage interest for strikers	1984
Board and lodging for SB claimants	1984

These are not just isolated examples of ham-fisted politics that can be sorted out by more skilful presentation. They are symptomatic of the whole approach to social security, which does the Government great damage.

What are the political choices?

The Government is now at a point where it has to decide between two very different courses.

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It could decide that the whole thing is too difficult. It could tear up the idea of controlling public spending, and try and accommodate more of the pressure groups for more welfare spending, giving up the notion that it can bring this budget under control. It would involve either tearing up, or being seen to tear up, the rhetoric and ambitions of many years. And it would not necessarily end the arguments. All the evidence is that the more you give to client groups, the more they demand, the stronger their lobby becomes, and the more money they have to advertise against you. Having marched Norman Fowler to the top of the hill, we would then be marching him down again.

The second option is to go the Norman Fowler way, with sensible improvements, as a result of MISC 111 deliberations, to get the best trade-off between money saved and political cost. The advantage of the Fowler way is that by introducing a new structure, issuing a Green Paper, and restating your ambitions and principles for the system, you have a chance to change the debate in your favour. Norman's draft Green Paper is an excellent first draft. Unlike most Government Green Papers, it makes you want to read on; there is a clear thematic unity; and although not everyone will agree with it, it is at least a straightforward statement of the case and builds on what has gone before. Having done that, you can then set benefit rates within the new structure that allow you good savings that make the anguish worthwhile. ??

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There are four strong candidates for action:

i. abolish SERPS, which could be attractive politically if handled well;

ii. a major assault upon Housing Benefit to make everybody pay a little bit of rent and rates, and to make a substantial reduction in the numbers of people eligible;

But the paper doesn't

iii. reduce the numbers eligible for Supplementary Benefit; sweep away expensive and complicated extra payments; and set new basic rates which yield large net savings.

The paper does the opposite

iv. freeze Child Benefit and the other unpledged benefits for a year. This could save £600m in a full year but it doesn't have the political camouflage provided by Fowler's reform.

Discussion

SERPS. The abolition of SERPS is crucial to any sensible public expenditure planning for the future.

It is not as difficult as some people make out. Remember that, on this occasion, you will have the baying hordes of the pension industry, advisers, intermediaries, investors and others on your side if it is put to them in the right

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way. It represents to them a bonanza of business opportunities. The leading institutions might even be persuaded to argue and advertise in favour of the Government's case.

This would leave Labour claiming we have broken faith and have shattered the pensions consensus; and some groups currently covered by SERPS, who will have to make a bigger contribution to their own independent pension, arguing against it on cost grounds. This should be a winnable debate, although far from a trouble-free ride.

Good language can be deployed in its favour. It is part of the wider wealth-ownership movement; of giving people control over their own destinies and future; of giving a great stimulus to private thrift and savings; and preventing people arriving at old age only to discover that their pension scheme is no more than a broken promise, as the succeeding generations refuse to see their tax and National Insurance Contributions hiked from 40% to around 55% to pay for those promises.

Housing Benefit. The bad news in reform of Housing Benefit is that the people most likely to lose by cutting out a million or more small payments, which are expensive to make, are pensioners who used to enjoy some element of rate rebate. But out of the 7.7 million people getting rate rebates, over 4 million are pensioners. So you can't

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simplify and reduce the eligibility for benefit unless you are prepared to attack that group. The cuts don't hit them disproportionately hard.

Cutting Housing Benefit entitlement to some 90% of housing costs, compared with 100%, can save £500m, and builds on the general feeling that everyone should pay a little bit of rent and rates.

Supplementary benefit meets everything.

Together with Norman Fowler's reforms, this would give us a package that:

- sweeps away the complicated system of needs allowances and differential tapers
- takes around 1.25 million people out of Housing Benefit
- saves at least £600m
- exposes everyone to the cost of rents and rates.

1.4 decant

Supplementary Benefit. Currently we spend £200m on special payments. They are expensive to administer, and they grow rapidly and unpredictably as an adjudication decision in one place is exploited by claimants' unions around the country. If a pregnant mother in Carlisle is given £30 to buy a pram then the pregnant woman in Cardiff gets entitlement to

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£30 as well. There is no scope for distinguishing between the deserving and the undeserving. So Norman Fowler is proposing to sweep these special payments away and instead set up a £50m cash-limited purely discretionary budget as a safety valve. Obviously there are problems with leaving more discretion in the hands of SB offices. It is not a particularly Conservative way of going about things. But if you want to save staff and money, the system has to be drastically simplified, and the political cost accepted.

He also wants to make the earnings and capital disregards more generous, financing this by offsetting cuts in SB. You rightly pointed out that increasing the disregards extends the scope of SB. On the other hand, it seems good politics to meet widespread political pressure here. The improved earnings disregard for the long-term unemployed helps keep them in touch with the jobs market. And there could be an ingenious twist. The disregards for Housing Benefit are currently much more generous. If we align the two benefits on the new SB arrangements, we actually save more on Housing Benefit than we spend on SB. Overall, we save around £35m.

There is also scope for saving more money within the new structure by reducing benefit rates for people under 25. This will encourage them to seek work.

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Family Income Supplement. Your scepticism about this proposal is well understood, and I think widely shared by many of your colleagues. We had explained earlier to Norman Fowler privately that this was the most difficult and contentious of all his proposals, and that no-one wanted to see a Review, designed to curb the social security system, come up with a major benefit which in its turn would create a big lobby group. But remember that it is targetted on people at work. The aim is to increase the gap between what you get on benefit if you are unemployed and what you receive from low paid work. It is in effect a neat way of raising tax allowances for poor families. Together with toughening up supplementary benefit and increasing tax thresholds it will help with the "why work?" problem.

Conclusion

Above all, we need to shift the rhetoric in this debate. Now that the average person on Supplementary Benefit receives the same amount in real terms as somebody on average earnings after the War, we do need to think about persuading the public that the kind of world we want is one in which the numbers of people gaining eligibility for benefits falls year after year rather than rises. To do this, it requires some tough decisions on benefit eligibility; and, more importantly, a successful package of measures to get the jobs market going again as a matter of considerable urgency.

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A Second Reading debate for the first meeting was most helpful. It gives you a clear idea of the way in which the arguments are likely to run in the important next two Sessions which will take the detailed decisions.

There seemed fairly general agreement that reductions in public spending are required as a result of this exercise. There was natural concern about how many losers there would be, and about the balance between the advantages of cost reduction and the political disadvantages of losers. But there is no alchemy whereby we can save money without losers. That is why we need reforms in the system as well. It makes a cost cutting package politically easier to sell.

There seemed general agreement on getting rid of SERPS, reducing Housing Benefit, more caution about consolidating Supplementary Benefit, and outright scepticism concerning the proposals for the family.

We have asked DHSS to send over a table of changes and savings, and suggested to Treasury they come in firmly for some major reductions.

We can then minute you on the cost/policy balance.

David Willetts

JOHN REDWOOD/DAVID WILLETTS

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Telephone 01-407 5522

From the Secretary of State for Social Services

Andrew Turnbull Esq
Private Secretary
10 Downing Street

12 February 1985

Dear Andrew,

MISC 111

My Secretary of State has asked me to send, for the advance information of the Prime Minister and the Chancellor, a copy of the tables which he proposes to present at the meeting of MISC 111 tomorrow.

I should add that the figures are intended to broadly illustrate the kind of savings which could be achieved under the proposals which have been put forward. It is not suggested that the Committee need take a final view on all the specific details which underpin them, but my Secretary of State was anxious to provide indications of the kind of financial and other implications of his proposals.

I am copying this letter and enclosures to Margaret O'Mara (HMT).

Yours sincerely,

Stephen

S H F HICKEY
Private Secretary

SUPPLEMENTARY BENEFIT: ILLUSTRATIVE COSTINGS

A. EXPENDITURE

(i) Current scheme £6,370m(ii) Changes proposed

Savings

New income support scheme	- £ 140 m
Single payments (replaced in part by social aid)	- £ 100 m
Mortgage (no payment for first six months)	- £ 60 m
	-£ 300 m

Costs

Capital (£3000 disregard, tariff up to £6000 then cut off - but introduction of same rule into housing benefit produces <u>savings</u> of £45 m)	+ £ 20 m
Earnings (higher disregard for couples after 1 year)	+ £ 30 m
	- £ 250 m

Net saving

Transitional protection to prevent <u>cash</u> losses in 1987-88	+ £ 175 m
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Other potential reductions in supplementary benefit budget (offset by increases in other programmes)

16-17 year olds	- £ 250 m
Students (including housing benefit savings)	- £ 100 m

B. CASELOAD

(i) Current scheme

4.2 million households

(ii) Under proposed arrangements

New income support scheme - 250,000

In addition exclusion of 16-17 year olds and students would reduce caseload by over 300,000

C. GAINS AND LOSSES (NUMBER OF HOUSEHOLDS IN THOUSANDS)

<u>Gains</u>	over £5 a week	230
	£2-5 a week	485
	Under £2 a week	535
<u>No change</u>		330
<u>Losses</u>	Under £2 a week	985
	£2-£5 a week	935
	Over £5 a week	250

HOUSING BENEFIT: ILLUSTRATIVE COSTINGS

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A. Expenditure (£ million)	Current scheme	Change from current scheme under:	
		Separate assessment (tapers 50% on rents, 21% on rates)	Combined assessment taper 70%
Total	4210	- 90	- 260
of which renters	3780	- 30	- 70
owner-occupiers	430	- 60	- 190
B. Caseload (No. of households (rate rebates))			
Total	7.7m	- 1.1m	- 1.6m
of which renters	5.1m	- 0.5m	- 0.3m
owner-occupiers	2.6m	- 0.6m	- 1.3m
C. Gains and Losses (No. of households in thousands)			
Gains - over £5 a week		175	150
£2 to 5 a week		430	375
Under £2 a week		1200	625
No change		3300	3300
Losses - Under £2 a week		2300	2150
£2 to £5 a week		575	1200
Over £5 a week		240	300
D. Expenditure effects of less than 100% assistance with rates *			
Option A 90 per cent		- 170	- 150
Expenditure on supplementary benefit households		- 75	- 75
Expenditure on other households		- 95	- 75
Option B 80 per cent		- 340	- 300
Expenditure on supplementary benefit households		- 155	- 155
Expenditure on other households		- 185	- 145

*These savings are additional to those in A above.

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MISC III

SUPPLEMENTARY AND HOUSING BENEFIT: ILLUSTRATIVE COSTINGS

The tables attached provide illustrations of the broad costs and savings, and the numbers of gainers and losers, which could result under the proposals for supplementary benefit and housing benefit described in paper MISC III(85)4.

13 February 1985

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SUPPLEMENTARY BENEFIT: ILLUSTRATIVE COSTINGS

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