E.R.

19A

SECRET

1 March 1985

PRIME MINISTER

BENEFITS

We need to get MISC 111 back on the road because there are big prizes at stake.

- £2 billion of savings.

- Simplifying the benefit system to save staff and meet the widespread criticism that it is ramshackle, inefficient, and impossibly complicated.

- Reduce unemployment by increasing the gap between what you get in and out of work.

- Expose people to the costs of local government and improve the operation of the housing market by getting rid of 100% housing benefit - an idea originally launched by the Unit last year.

The political appeal of the reviews is that they enable us to harness support for the latter three objectives to achieve the overriding objective of saving money. We have, throughout, made it clear to Norman Fowler that he will only get agreement to his changes in the benefit system if they show big savings. My note to you of 1 February (Annex A) set out the Policy Unit shopping list before the first meeting of MISC 111.

The first £1 billion

The first £1 billion of savings can come from supplementary benefit and housing benefit as the figures below show:

Housing Benefit	£m
70% rent and rate taper	260
90% maximum rate rebate	150
90% maximum rent rebate	400
Supplementary Benefit	
Cutting out special and additional payments	250

Not up-rating HB and SB this year could save us money as well. But it's an advance payment on the £1 billion shown above rather than a substitute as:

- A full year's saving from not uprating SB & HB is only around £400 million. In particular, not uprating the

E.R.

SECRET

HB needs allowance saves you very little if there's still 100% support for people on SB.

- After you have cut a benefit all the political pressure is then to restore the abatement. If you have cut the rates first, following it up with a restructuring, makes it more difficult for the spenders to identify the benefit rates which need to be restored.

- You lose the wider prizes of, for example, exposing everyone to at least 10% of rent and rates, and cutting out SB special payments, which also save big money (about £500 million and £150 million respectively). And we want to cut SB rates for the young able-bodied in particular.

- If we are too greedy and try to get more than £1 billion out of HB and SB, the losers will be politically unsustainable.

The second £1 billion

The second £1 billion needs to come from Child Benefit. The options which we set out last Autumn are:

(a) Simply cut the basic rate of CB. Every 10p off the current rate of £6.85 saves almost £60 million. After allowing for offsets, a £5 CB saves about £1 billion.

(b) Means test child benefit. The Treasury proposal saves £1½ billion by a 50% taper for anyone above average earnings. But means testing is an administrative nightmare; there are lots of middle class losers (remember student grants); and the poverty trap is worsened.

(c) A combination of (a) and (b). Keep the current basic rate of child benefit for the first child and then provide a means tested support for subsequent children. Alternatively restrict Child Benefit to under 5s to save about £2½ billion. This would help middle class families who feel the expense when the wife has her first child and stops work.

I recommend (a) or (c). There is a big risk that means-testing on its own just won't be feasible.

It is important to go for a bold reform which provides such large savings that the benefit losers are also big tax gainers. In particular, the Chancellor must be prepared to contemplate some means whereby the tax system recognises the cost of children by, for example, a family tax allowance payable to any couple with children. His proposals for fully transferable allowances will help.

E.R.

SECRET

Improving the benefit system

You are worried that some of Norman Fowler's structural reforms are an excuse for shirking the tough decisions on benefit levels. Annex B shows the real merits of some of his proposals.

David Willetts

DAVID WILLETTS

Annex A

PRIME MINISTER 1 February 1985

SOCIAL SECURITY REVIEWS

We broadly support Norman Fowler's proposals. They have attractive political themes: rewarding individual thrift, cutting the number of benefits, simplifying and reducing means tests, encouraging people to get jobs. But you will want to press him on three key questions at MISC 111.

Will we save money?

There is no point in going through these major reforms - however sensible in their own right - unless we can cut spending. The whole appeal of these wide-ranging reviews is that they provide an opportunity to save money without just looking like a cuts exercise. A shopping list of savings is attached at Annex A. It omits two even bigger money-spinners:

- **Child Benefit.** This costs us over £4 billion. But unless the Chancellor can allow for the cost of children in the tax system (eg by a Family Tax Allowance) it is probably not politically feasible to save money here.

- Only meet 80% of the **housing costs** of people on Supplementary Benefit. This gets us large savings, and

E.R.

helps remind everyone of the costs of extravagant local authorities. But there will be more paperwork and some hard cases.

Benefit expenditure also tends to spring expensive and unpredictable leaks as claimants devise new ways of getting money, such as booming SB mortgage interest expenditure. Sweeping away Supplementary Benefit special payments, and restricting the scope of Housing Benefit, should help stop those leaks in future.

Will we save staff?

I also attach a shopping list, at Annex B, showing how we could save several thousand civil servants. The administrative costs of minor benefits, death grant and maternity grant, are now approaching the cost of the actual benefits. There are very useful staff savings here.

Are the reforms practical?

Norman Fowler is aware of the need to implement these changes carefully and efficiently. That is unfortunately why we won't get savings until 1987. You could press him for a timetable for implementation. This will ensure there is a feasible framework, as well as providing us with a benchmark against which to measure performance.

DAVID WILLETTS

E.R.

ANNEX A.2

BENEFIT SAVINGS BY 1987-88: A SHOPPING LIST

Supplementary Benefit special payments abolished	£150m
Supplementary Benefit for under-25s tightened up	£75m
Mortgage interest out of SB for first 6 months	£50m
Steepening Housing Benefit taper for rents	£150m
Housing Benefit rate rebates curtailed (helps PSBR, but not public expenditure)	£350m
Abolish One-Parent Benefit	£70m
Abolish Death Grant	£15m
Abolish Maternity Grant	£15m

E.R.

ANNEX A.3

STAFF SAVINGS BY 1987-88: A SHOPPING LIST

SERPS abolished	-300 (at least)
Supplementary Benefit reform	-2,500
Housing Benefit reform	-500
Abolition of Death Grant, Maternity Grant and Maternity Allowance	-1,000
Computerisation	-1,500

Annex B

YOUR WORRIES ABOUT THE BENEFIT REFORMS

The new Capital Disregard extends the scope of SB

At the moment if you have savings of over £3,000 you are excluded from Supplementary Benefit. Norman Fowler is proposing that a taper above that point with a final cut-off of £6,000. Its brings 20,000 extra people within SB at a cost of about £20 million. That is why you are worried. But:

- Overall, Norman Fowler's proposals take 250,000 people out of SB and save £250 million. He is tightening up SB whilst finding room to meet the widespread backbench complaint that the current cliff-edge unfairly penalises thrift.

- There is no capital disregard in HB at the moment. If HB is based on SB rules and the new capital disregard applied then we save £45 million in HB. So overall we save about £25 million taking HB and SB together.

The new earnings disregard also extends the scope of SB

Any earnings above £4 per week are deducted £1 for £1 from SB.

E.R.

Norman Fowler is proposing a more generous disregard of £15 per week, at a cost of £20 million. But he is restricting it to people who have been unemployed for over a year. This is a pretty cheap way of scoring the political bull point of helping the unemployed to stay in contact with the labour market. It's a pretty tough package and it needs some positive features.

The discretionary social aid scheme is unworkable.

We currently spend more than £200 million a year on one-off special payments for supplementary benefit claimants. Expenditure has quadrupled from £50 million in 1980 and the number of payments has doubled. 3,000 staff are needed to administer the complicated rules. It is one of the main areas where the benefit budget is rising unchecked and where claimants' unions exploit the complicated rules so that a judgement in Inverness is applied in Bristol.

Norman Fowler wants to get rid of all the rules and replace it with a discretionary cash-limited budget, largely using loans not grants, totalling £50 million. You are right that there is a risk that his scheme will slowly expand until it reaches the same sorry state as the current scheme. But we will start off with a saving of over £100 million and a major simplification in the supplementary benefit rules. It's better than what we've got at present.

E. R.

The changes in supplementary benefit and housing benefit clobber the elderly.

The elderly get over half of all benefit expenditure:

- Out of the 7 million households getting housing benefit, over 3 million are headed by an elderly person.

- There is an average 25% premium over other groups for pensions in SB. Over a third of old people getting SB also save money.

- The basic pension has risen by 8% more than the rate of inflation since 1979, accounting for half the £2½ billion increase in benefits as a result of policy decisions.

So pensioners do lose out from the changes. But we keep to the pledges on the basic pension and supplementary pension. If we can't have pensioner losers it's difficult to reform either HB or SB.

The housing benefit reform repeats the mistake of the unification of housing benefit in 1980.

Sweeping away the complicated system of tapers and needs allowances is a big prize. Using the supplementary benefit

E.R.

means tests instead, and with a sharp 70% taper for rent and rates, gives us a simpler and more economical system. It also means that savings in supplementary benefit gear up into savings on housing benefit as well. Provided that we press Norman Fowler to fix rates of housing benefit lower than 100% for all, this could be a major contribution to improving local government as well as saving benefit expenditure.

<u>Why invent the Family Credit?</u>

<u>If</u> Norman Fowler can save us big money then there is a case for accepting his Family Credit proposal:

- It costs a net £70 million after abolishing Family Income Supplement. Compared with raising tax allowances it is a very cheap way of, in effect, taking poor people out of tax.

- It only goes to the working poor. It balances cuts in SB for the unemployed as a means of increasing the gap between those in and out of work.

- Delivering the benefit through the pay packet using PAYE and NIC tables may be administratively neat. It helps employers' to hold down pay rates and there is no harm in trying out employers' reactions in a Green Paper.

Reforms won't save money.

The crucial condition for agreement to Mr Fowler's reforms is that he saves money. He can have his structural changes and save staff and improve the system provided he can also deliver big savings. That has been the deal all along and he can't shirk it.

GOVERNMENT TO STAND FIRM ON PENSIONS

36

By VALERIE ELLIOTT Political Staff

THE Government is expected to stand firm on its commitment to the State earnings-related pension scheme in its forthcoming review of the social security system.

But it is thought likely to offer new incentives to employers and workers to bring in their own occupational and private pension schemes in an attempt to shift the pensions burden into the private sector.

The Government believes that more and more people will decide to contract out of State earnings-related pensions if they can be offered attractive concessions.

But meanwhile the Government would stick by its assurance to pay the earnings-related pension to those contracted wish to take up any incentives on offer.

The full details are expected in the Government Green Paper consultative document on the overhaul of the security system in 9pril aor May.

Particularly concerned

The Government is particularly concerned as to how it can finance the state earnings-related pension scheme in the future and believes encouragement to employers to establish occupational pensions in their firms or for workers to take out their own private schemes will considerably reduce the load.

There are some 11,400,000 people at present contracted into the State earnings-related scheme, which began in 1978.

The full burden on the State will become evident in 1998 when those in the scheme will have completed 20 years' work, on which their pensions will be based.

It is believed that if something is not done to switch the burden to the private sector, those in work at the end of the century and in the next century will have to pay huge National Insurance contributions to finance earnings-related pensions.

Ministers are no doubt optimistic that such a move as they contemplate will work, and they have probably been heartened by the growth and popularity of occupational pension schemes.

For of the 11,600,000 people in the country currently enrolled in an occupational pension scheme some 10,300,000 opted out of the State scheme for an employer-initiated one.

The 1,300,000 others are in occupational pension schemes serving as a top-up to the State earnings-related scheme.

The move would also reinforce the consensus which has existed on pensions policy and would vindicate Mr Fowler, Social Services Secretary, on his commitment to pensions.

In November, 1983, he told the Commons: "My aim in setting up an inquiry (into Pensions) is not to call into question the fundamental pensions structure that was established in the 1970s with all-party agreement and in which I was a party."

1. Mr Bowtell
2. Mr Walmsley
3. Mr Montagu
4. Mr Moyes
5. ...

THE TIMES

Opposition to tax on pension funds

11

From the Chairman of the Legal & General Group Plc

Sir, Your leader on "Budget boldness" (February 22) is marred by one very serious illogicality. You suggest that as part of a package of tax reform taxation should be levied on the investment income of pension funds.

As noted by the Meade committee in 1978 the current tax position of pensions is virtually ideal in itself, with tax relief on contributions, and investment income, and tax payments deferred until the actual receipt of pensions. That this way of saving has fiscal advantages does not derive from the improper tax treatment of pensions but from the inappropriate treatment of other forms of saving – implicitly recognised by your reference to "the shambles" of Britain's system of capital taxation. To condone a tax on pension fund income is to impose a further distortion on the system.

To depict such a development as part of a programme of "radical reform" is intellectually untenable. It may be good politics – or it may be bad politics. It has, however, nothing to do with "reform". The raising of tax income by a charge on the investment income of pension funds has no justification in terms of economic efficiency or in terms of the much-used and misunderstood objective of "fiscal neutrality". It would clearly represent what might be best described as "fiscal opportunism".

Finally, there is no foundation whatsoever for your statement that such a tax is one for which "the industry is already half-prepared". The innuendo in this statement is clearly that for "prepared" we should read "accepts". Nothing is further from the truth either as far as "the industry" is concerned or employers or, most important of all, the millions of current and future pensioners.

Yours faithfully,
JAMES BALL, Chairman,
Legal & General Group Plc,
Temple Court,
11 Queen Victoria Street, EC4.
February 26.

THE TIMES

Earnings related pensions to stay

36

By Anthony Bevins

The government review of the social security system is expected to safeguard the earnings-related state pension scheme while boosting the attractions of occupational and other schemes in a determined effort to shift a greater portion of the pensions burden into the private sector.

Work on the social security Green Paper is said to have slipped by as much as one month, with publication now scheduled for April or May, but it was said yesterday that the weekly Cabinet committee meetings, chaired by the Prime Minister, had been remarkably free of disagreement.

It would appear that one of the keenest difficulties has been the threat, raised by non-attributable Treasury sources, to tax pension funds or lump-sum payments.

But it was authoritatively stated yesterday that that threat could now be discounted because of the deterrent effect that it would have on the Green Paper proposal to make occupational and private pension schemes more attractive.

About 12.7 million people are now wholly or partially contracted into the earnings-related state scheme under which full pensions will become payable in 1998. The 1975 scheme proposes to double the pension for a man on average earnings from the present 20 per cent to about 40 per cent of previous earnings in 1998.

But diversionary action has been forced on ministers by the sheer scale of the costs.

With the number of pensioners due to increase from the present 10 million to 12.6 million by 2025, the cost to the Exchequer of an unchanged pension regime would treble at least, from £5,000 million to about £17,500 million at 1984-85 prices, over the 20 years from 2005.

The Green Paper, which will pave the way for legislation in the next session of Parliament, is expected to offer employers and employees extra incentives for starting alternative pension arrangements in order to build on the 75 per cent of working men who already belong to such schemes.

Letters, page 11

TRIEVAL SERVICE DATE

Keep

16 FEB 1985

EARNINGS-LINK PENSIONS FACE ECONOMY AXE

2

By DAVID FLETCHER Health Services Correspondent

A PACKAGE of sweeping reforms in social security benefits is to be announced by the Government in a Green Paper shortly after Easter. They will not only simplify the complex web of 30 existing benefits, but will cut the £40 billion cost of benefits now consuming nearly one-third of all public expenditure.

Mr Fowler, Social Services Secretary, has drawn up the outlines after conferring for 10 days at the Wilton Park conference centre, Sussex, with other social security Ministers and members of the review teams appointed last year to examine welfare benefits.

The package will now be put to the rest of the Government, and the shape of the Green Paper will only emerge after discussions in Cabinet.

The most controversial measure under discussion is abolition of the State earnings-related pension scheme at an estimated saving of £20 billion, at present prices, by the year 2030.

The scheme was introduced by the Labour government in 1978 and will pay employees, in addition to the basic state pension, an extra pension related to their best 20 earning years.

It will not reach maturity until the turn of the century when Ministers fear it will become increasingly costly to finance.

Boom in pensioners

This is because the number of contributors — those in work paying National Insurance — will rise only marginally from 21 million now to 22 million in 2025.

But the number of pensioners claiming the higher payments will jump from 9 million to well over 12 million over the same period.

Any Cabinet decision to abolish the scheme will provoke a furious reaction from the Labour party and from the unions, although the 950,000 people who are already benefiting from the scheme will continue to receive their pensions.

If the scheme is abolished it will be up to individuals to enter an occupational scheme or make private arrangements.

If they choose to use their spare cash in other ways it will be on the understanding that when they come to retire their only entitlement will be the basic state pension.

Mr Fowler would like to see some of the savings used from abolition of earnings-related pensions used to improve other parts of the social security system, but it is not yet clear whether he will win Treasury acceptance of this ideal.

A number of other changes in social security payments are also being put to the Cabinet. The one known to command Mrs Thatcher's sympathy is withdrawal of supplementary benefit from 16 to 18 year olds.

They will then be left with the choice of remaining at school or taking up a place on a Government training scheme.

The Cabinet is also thought likely to approve a simplification of the supplementary benefit scheme by withdrawing special payments for items such as heating, diet, furniture and laundry.

The benefit would also be restructured so that different rates are paid to different groups like single parents, couples, the disabled and pensioners.

More for poor

More controversial are proposed changes in the £6·85 a week child benefit at present received by all 7 million parents, irrespective of need.

The solution most likely to be favoured by the Cabinet is that the amount will be increased for poor families but the benefit will gradually reduce as income increases so that better-off parents receive nothing.

Changes are also expected to be agreed in housing benefit, one of the most costly benefits and one which is received by some recipients earning as much as £10,000 a year.

Daily Mail COMMENT

Time to think again on pensions

6

EVERYBODY would like a fat pension when they retire.

The State earnings-related scheme originally brought in by Mrs Barbara Castle but with all party support aims to do just that.

Why then does her present successor as Social Services Secretary, Mr Norman Fowler, want to meddle with it?

Apparently because it is starting to pile up a commitment which the country will not be able to afford.

This is partly because he doubts whether the economy will grow at the 1½ per cent. per year necessary to pay for it.

That argument seems needlessly pessimistic for a Government bent on radical economic reform and should not on its own be decisive.

But what is more disturbing and seems to be beyond dispute is that in about 20 years the number of pensioners will start rising out of all proportion to those at work and the burden on the latter may become intolerable.

As yet, only comparatively few benefit from the scheme and any change will not affect them.

Regarding the rest, it should not be difficult to fit existing contributions into private self-financing schemes.

So there is a common-sense case for such a change.

All the same, it would be much more palatable if it were combined with legislation making all occupational pension rights transferable so that contributors may, without penalty, move from job to job.

Daily Telegraph

MEDIASCAN LIMITED
INFORMATION RETRIEVAL SERVICE

DATE 18 APR 1985

PAY—LINKED PENSIONS TO BE SCRAPPED

Painful Whitehall curbs ahead

THE Government has decided to scrap the State Earnings-Related Pensions Scheme. Under proposed legislation the task of providing pensions geared to pay will be left to private schemes and companies, with the State providing "safety net" basic pensions.

But more than 25,000 married women over 65 will qualify for a pension averaging £1,000 a year under an amendment which the Government intends to make to a Bill already before Parliament.

Meanwhile Cabinet ministers have been warned that painful decisions will have to be taken in this year's public spending review which is just starting.

Pensions for 25,000

By FRANCES WILLIAMS Economics Correspondent

THE Government has decided to abolish the State Earnings-Related Pension Scheme, which was introduced with all-party support in 1978.

The controversial decision will be announced in the forthcoming Green Paper report on the wide-ranging review of the social security system initiated a year ago by Mr Fowler, Social Services Secretary.

The Green Paper is due to be published early next month.

The task of providing pensions related to earnings will become the exclusive province of the private sector, with the State's role confined to providing a "safety net" basic pension.

Ministers have been worried for some time that the State earnings-related scheme (SERPS) could impose intolerable costs on future generations of taxpayers. The 1984 Green Paper on spending and taxation identified the scheme as "the major source of future pressures on social security expenditure."

SERPS, which tops up the basic pension with one based on an individual's best 20 earning years, will come to maturity at the turn of the century.

Burden on people at work

Demographic changes, however, mean that the heaviest burden on the working population will fall between the year 2015 and 2030 when a static workforce will have to support a growing number of pensioners.

The number of National Insurance contributors is expected to edge up from 21,800,000 now to 22 million in 2025, while the number of pensioners will jump from 9,300,000 to 12,600,000.

On some estimates workers could be paying a quarter of their incomes to meet the cost of State pensions in 2025, nearly double existing contributions. Abolition of SERPS could save the Government up to £20 billion a year, at present prices, by the year 2030.

Besides cost worries, however, ministers take the view that, in principle, the State should target its resources on the most needy rather than provide income-related pensions for all.

The proposed abolition of SERPS is certain to cause a major political row. The thinking behind the 1975 Labour legislation, which brought in the scheme, was to provide all workers, whether or not they belonged to an occupational scheme, with an earnings-linked pension on retirement.

The Opposition will argue that the private sector cannot adequately fill the gap for many workers, especially the low-paid, who will have to rely on an inadequate basic flat-rate pension.

The Government's own Social Security Advisory Committee argued in a report last month that SERPS should continue because it was necessary to ensure pensioners' living standards did not slip behind.

The Government's decision marks an explicit abandonment of the consensus approach to pensions enshrined in the 1975 legislation.

In November 1983, Mr Fowler told the Commons: "My aim in setting up an inquiry (into pensions) is not to call into question the fundamental pensions structure that was established in the 1970's with all-party agreement and to which I was a party."

Under the Government's proposals the existing rights of the 11,400,000 people now contracted in to the State earnings-related scheme will be protected. But after abolition, people would have to enter occupational schemes or make private arrangements to top up the basic pension.

Immediate savings on pension payments will be small, but

Continued on Back P, Col 3

PENSIONS AXE

By FRANCES WILLIAMS

Continued from Page One

the Government could reap as much as £3 billion from ending the reduced rate of National Insurance contributions paid by the 10,300,000 workers contracted out of SERPS.

This would go almost all the way towards meeting the Treasury's demand for cuts of between £2 billion and £4 billion in the £40 billion a year social security budget which it wants the Fowler reviews to deliver. Mr Fowler, however, has been battling to keep any savings to raise basic benefits.

Savings of £3 billion a year would finance an increase in the basic pension of 20·25 per cent. or enable National Insturace cotributions to be reduced by one to two per cent.

Housing benefit to be cut

The Government plans to legislate on social security in the next session of Parliament. Apart from abolition of SERPS, the Green Paper proposes large cuts in housing benefit, saving several hundred million pounds, and simplification of the supplementary benefit system, involving the sweeping away of many discretionary payments in favour of a higher basic benefit.

But the present child benefit system will be left intact. Ministers have decided that the political and practical problems of means-testing or taxation, the two canvassed options, rule out changes for the time being.