

020

8 cc/W



Prime Minister
We are meeting you at
1400 on Monday to discuss
this before this 11 on Tuesday.

P 01721

DRS
11/10.

PRIME MINISTER

REPORT ON THE REVIEW OF SOCIAL SECURITY
(MISC 111(85))14 - Flag A

BACKGROUND

1. This is the first opportunity that Ministers collectively have had to consider the social security reform package in the light of comments received on the Green Paper published in June. The Social Services Secretary now proposes a number of changes to the original package agreed at Cabinet on 2 and 9 May. He also sets out a new timetable for legislation and implementation.

Green Paper Proposals

2. The Secretary of State's original proposal fell into the following main parts:

(a) PENSIONS: The State Earnings Related Pensions Scheme (SERPS) would be phased out and replaced with compulsory private provision through occupational, industry or personal schemes with a minimum contribution of 2 per cent each by employers and employees by the end of the transitional period. Broadly those who did not contribute to SERPS would not be covered by the new compulsory requirement. In particular the position of the self-employed would be unchanged. The low-paid and unemployed would not contribute.

(b) INCOME SUPPORT SCHEME: The supplementary benefit scheme would be replaced by a system of income support. This would eliminate the present complex system of differing rates and additional payments and in its place introduce a much simpler system under which the level of benefit would depend only on



SECRET

age with premia for families with children, single parents, pensioners and long term sick and disabled. There would no longer be extra entitlements - for example, for heating - related to detailed assessment of individual circumstances and assistance would not be available with mortgage interest payments during the first 6 months on benefit. There would, however, be a social fund fall-back scheme for emergencies and special needs operated within a budget with no legal entitlement or detailed rules. The level of disregard for both capital and earnings would be increased to encourage the incentive for self help.

(c) A FAMILY CREDIT scheme for low-income working families with children would replace family income supplement. This new scheme would be based on the same structure as the new income support scheme so that those in and out of work would be treated consistently. The aim would be to alleviate the poverty and unemployment traps. Family credit would be paid in the wage packet to the principal wage earner as an offset to tax and national insurance. No change would be made in universal child benefit but it would be subject to less frequent uprating.

(d) HOUSING BENEFIT (HB): Major simplifications were proposed. Benefit would be provided on the same income test as the income support scheme to ensure consistent treatment for people in and out of work. It would be reduced as income rose, through a single taper instead of, as at present, six different tapers for rent and rates and different types of claimant. The same rules for capital disregard would apply as for the income support scheme. Powers would be taken to fix percentages of rebate for both rent and rates with the maximum assistance for rent being set at 100 per cent but that for rates at 80 per cent, so that households would not be insulated from the effect of rate increases. The intention of this very important change is to improve the accountability of local government in line with the proposals being taken forward in E(LF), and it



SECRET

accounts for a large share of the savings expected from the package. A reserve power would also be taken to enable rents eligible for HB to be capped in any individual local authority area in which rents were being raised unreasonably because the bill was being met by housing benefit. The direct subsidy to local authorities by specific grant would also be limited to 80 per cent of benefit cost so as to give local authorities a greater incentive to control costs.

(e) MISCELLANEOUS: Death and maternity grant would be replaced by help out the social fund. The maternity allowance would be concentrated on working expectant mothers who would have a choice over the period it could be drawn. A new lump sum of £1,000 would be paid to widows instead of the present weekly widows' allowance paid for 6 months. Weekly benefit would be focussed on widows with children and older widows without children.

(f) The UPRATING of benefits would be brought forward from November to April. The first April uprating would be April 1987, with an interim uprating in July 1986.

(g) Improvements would be made in the management of the social security system to improve efficiency and effectiveness in its operation.

Consultation Reactions

3. The Secretary of State reports that comment on the Green Paper contains a good deal of support for the objectives in pension reform - to reduce the cost of SERPS, to expand occupational provision, and to increase choice through the option of personal pensions. But there is also widespread concern about the means proposed. Employers and the pensions world, including the large insurance companies, believe the proposal on pensions will lead to higher administrative and wage costs for employers and that a pension contribution of 4 per cent will be too low to secure employees in adequate pension when they retire. They

SECRET

therefore support modification of SERPS rather than outright abolition on the basis that this would reduce the risk of pensions again becoming a "political football" and that employers would find change within the existing structure easier to cope with than a radical disruption of existing arrangements.

4. On HB, in addition to the expected opposition to the proposition that all householders should pay 20 per cent of rates and that central government subsidy be limited to 80 per cent, there have been strong representations from local authorities that the timescale for implementation is too short and could lead to a repeat of the problems experienced in 1983 when HB was introduced. Finally there have been representations about the severity of the effects of some proposals on individuals or groups of individuals.

Proposed Modifications

5. In the light of this reaction the Secretary of State now proposes the following main modifications.

(a) PENSIONS: This is the main change to the original package. Mr Fowler proposes to retain SERPS, but to modify it. His detailed proposals are at Annex A of the Memorandum. The effect is to reduce the emerging costs; to simplify contracting-out arrangements and extend them; and to encourage the spread of occupational pension schemes, by limiting exclusions and by stimulating industry-wide schemes and measures to extend personal pensions. This last proposal would involve giving everyone the right to opt for a personal pension. Personal pensions would be contracted-out, with minimum age-related contributions paid by DHSS to the scheme of the employee's choice as a national insurance contribution rebate.

(b) INCOME SUPPORT: Mr Fowler proposes implementing these proposals broadly as intended except that there would be no budget limit on the payments out of the social fund for maternity

*Mr Unwin prepared this brief before seeing the paper, unavoidably.
(b), (c) and (d) here are not discussed in detail in the paper.*

SECRET



SECRET

and funerals. Negotiations are also still continuing with the building societies over his proposal not to pay mortgage interest for the first 6 months during which an individual receives income support.

*Summer
is it?
with new
high in
payments*

(c) FAMILY CREDIT: Mr Fowler proposes that family credit should be assessed on 5 weeks earnings not 13 weeks as originally proposed. He believes this will be more flexible and less trouble for employers.

why?

(d) HOUSING BENEFIT: Mr Fowler proposes to return to an earlier proposal to separate assessment and tapers for rent and rates; the tapers would be 55 per cent on rents and 25 per cent on rates. He considers this is necessary to avoid disproportionate losses for owner-occupiers - especially pensioners. He also suggests that some concession may have to be made to local authorities on the proposal to limit direct subsidy to HB to 80 per cent, while keeping incentives to economy through the power to set the level of subsidy annually. He considers a concession may also need to be made on local authorities transitional costs. Finally, he proposes the continuation of special local relief schemes for war pensioners.

(e) TIMING OF IMPLEMENTATION: The other major change proposed is to defer implementation of the main proposals until April 1988 to accommodate slippage in the preparation of the Social Security Bill as a result of the pension changes and to allow local authorities and businesses a longer time-scale for preparation of implementation. Mr Fowler believes that local authorities will simply not be willing or able to implement the new HB system before April 1988.

6. Mr Fowler does not make clear in any detail in his paper the financial and distributional consequences of his new proposals compared with those approved by MISC 111 in June and embodied in the Green Paper. I understand from the Treasury, however, that the combined effect of the

*But see Annex B
of Mr Fowler's paper.*



SECRET

changes in the measures themselves (notably to the Family Credit and Income Support schemes) and the change in timing will be to add substantially to both public expenditure and the PSBR in both 1987-88 and 1988-89. There is, however, no agreement between the Treasury and DHSS on the precise numbers; the current argument between them relates to bids over the Survey baseline rather than to the difference between the costs of these new proposals and those in the Green Paper. So far as distribution is concerned, the changes will obviously reduce the number of expected losers from the Green Paper package. Again, we have no agreed details, but I believe the overall number of losers could be reduced by around 1 million, of whom over three-quarters would be pensioners.

MAIN ISSUES

7. The problems of timing and of harmonisation with other current proposals are as difficult as the substantive policy issues. In particular, there is a complex interaction with the local government finance studies in E(LF), and you will be concerned to ensure that the present meeting does not pre-empt any of the room for manoeuvre in the Star Chamber for holding down social security expenditure. (There is also an interaction with the proposed Green Paper on personal taxation, though this is less clearly discernible at present).

8. I suggest that your general objective at this meeting should be to achieve a strategic political overview of all the Social Services Secretary's new proposals, against which he can take work on the White Paper and Bill forward. But in view of the necessary lead-time in preparing this highly technical legislation (on which drafting will now have to start again from scratch), it would be desirable for the Group to take provisional decisions in principle now on the pensions element of the package, especially on the basic question of the abolition of SERPS.

Pensions

9. The pensions questions do not raise significant public expenditure



SECRET

issues for many years, though they have short-term organisational and administrative implications in both the public and private sectors. As Mr Fowler's paper explains, the proposal to abolish SERPS has clearly elicited a quite unexpectedly hostile response not just from the Government's political opponents but from most quarters representing the interests that would be involved in operating the new regime. In the light of this, members of the Group may see advantage in moving quickly away from the plan to abolish SERPS before the Government are committed to it any more deeply, and a decision in principle not to proceed with the abolition of SERPS may well readily emerge.

10. Even if that decision in principle is acceptable, however, it does not necessarily follow that Mr Fowler's proposals are a viable alternative to abolition. There are basically three issues here:

Any answer?
(i) Do the new proposals do enough to tackle the huge cost of SERPS in the next century, to which the Green Paper has drawn so much attention?

(ii) Can the proposals be plausibly presented as being significantly different from the ones that the Green Paper summarily rejected?

(iii) What kind of response will the new proposals get from those who will have to administer them, especially employers and the pensions industry?

Other Social Security Policy Proposals

11. Although the changes that Mr Fowler is proposing to the rest of the Green Paper package are not as drastic as his new proposals on SERPS, most of the adjustments being canvassed are designed to get broader acceptance for them and would cost money (see paragraph 6 above). As you know, the social security net additional bids are the highest the Star Chamber will need to consider (£1.2 bn, £1.1bn, and £1.9 bn in the three Survey years respectively) and, as indicated above,



SECRET

there is a complex and unresolved argument between DHSS and the Treasury about the proper scoring of the savings agreed in MISC 111 when the Green Paper was being worked up. The current proposals also need to be examined more deeply than time has so far allowed, simply to test the costings. Against that background, you will not wish the Group to get drawn into details or to do anything that would reduce the pressure for savings that can be brought to bear in the Star Chamber. Within these constraints, however, it will be valuable to get the general sense of the Group's views on the overall balance of the package that is emerging.

Timing

12. The implementation date foreshadowed in the Green Paper was April 1987. That would have meant getting Royal Assent by the beginning of July 1986 (in order to leave time for making a number of regulations and commissioning much preparatory work), and second reading before Christmas 1985. Mr Fowler now proposes a start date of April 1988 which would enable second reading to be postponed until, say, the end of next January. It would also presumably make it unnecessary to rush out the White Paper as soon as early or mid-November, as Mr Fowler still proposes. That would provide another month before second reading in which to produce the local government finance Green Paper. It may be, however, that despite the difficulties described by Mr Fowler you would not wish to contemplate a later start than April 1987 on other grounds. And, in any event, you will not want at this stage to authorise a final decision to delay implementation, because the start date is an integral part of the sums that will be before the Star Chamber. The public expenditure and PSBR implications of the start date will need further analysis along with most of the figuring in the paper.

*A copy
way of
meeting
the
election.*

13. The meeting also enables you and colleagues to take note of the wider implications for the legislative programme. Introduction in January should be manageable if the date of Royal Assent ceases to be dictated by the requirement of an April 1987 start, but anything later than that would present great difficulties in getting the Bill through



SECRET

both Houses. The worst conceivable scenario would be attempting to legislate for the whole plan of the review (ie including pensions) with a late introduction and still aiming for a 1987 start. If, however, you still wish to aim at an April 1987 start, a possibility that might be worth considering is to press forward now with a Bill covering the non pensions proposals, leaving pensions to a separate later Bill following a period of further consultation on the practical details of implementation.

Interaction with Local Government Finance Proposals

The other departments do not know it has been done.

It should be available on Monday.

14. This brief is unable to take account of the analysis you have requested from the Treasury, which is coming forward separately. (A further synoptic analysis may also be needed in due course in respect of the personal taxation proposals). However, whatever that analysis may show on the way the two packages affect individuals and households, it is clear that there will be one difficult organisational and institutional problem. This is thrown up by the HB changes, on the one hand, and a new "residents' charge", on the other. The thrust of the social security measures would be to streamline HB and push a large number of households off local authorities' HB case loads (while collecting at least 20 per cent towards rates from all householders). The effect of the "residents' charge", however, will be to bring non-householders into what was previously the rate paying net and make them eligible for rebates if they have a low income. Over a million people could be so affected. The problem here is therefore not just one of public presentation. There must be a doubt about the willingness of local authorities to co-operate in a radical upheaval of housing benefit in the knowledge that the "residents' charge" proposals, with further radical effects, were programmed for early implementation thereafter. (There could be problems, too, if the local authorities were told to implement the two sets of proposals simultaneously, though that would appear possible only if the local government finance reform was legislated in the 1986-87 session and implemented in April 1988). There is no complete resolution of this point, assuming that a "residents' charge" remains near the heart of the local government finance review,



SECRET

and streamlining HB is one of the central themes of the social security reform. But there will clearly need to be a very careful scrutiny of the substance, timing and presentation of the DOE Green Paper proposals as they bear on this issue, and on the effects on individuals and households. Indeed, you may think that it would be prudent to commission a further study of the overall distributional effects before final decisions on the proposed White and Green Papers are taken. If necessary, the Cabinet Office could be asked to arrange this with the help of the Treasury and the other relevant departments.

Yes, but better not to mention Treasury and the other relevant departments. Study to other colleagues.

Future processing

15. In practice the Star Chamber (which includes most of the main Ministers concerned) will have to take on some of the role of MISC 111 when it considers the social security programme. Thereafter it will be necessary to take stock of the overall balance and presentation of the review as it emerges from the Star Chamber, and a time is being kept open for this on 28 October. (We currently envisage a MISC 111 meeting then but you may want to reconsider that in the light of progress and, perhaps, convene a smaller group). Ultimately the White Paper giving the promised illustrative figures of effects on individuals and households will need to go to Cabinet before the social security bill is published. You do not need to settle the precise timing of that at the moment; if the implementation date is to be April 1988, publication, as suggested above, could be a little later than mid-December. By the time the White Paper goes to Cabinet further progress should have been made on the main outstanding issues on local government finance. We have arranged for the Lord President to chair a meeting of E(LF) on 4 November; and a further meeting under your chairmanship on 12 November.

HANDLING

16. Time will be short and most members of the group will want to speak on each main point. You may think it best to take the meeting in 3 sections, inviting the Social Services Secretary to open each section by speaking to his paper, as follows:



SECRET

(i) Pensions

(a) arguments for not abolishing SERPS

(b) Main features of what is now being proposed instead.

(ii) Other policy changes from the Green Paper, other than timing.

(iii) Deferral until April 1988.

OK

17. On (i)(b) you will want to make it clear that the Group cannot take a final decision, and that the Social Services Secretary will need to have further discussion with the Chancellor of the Exchequer.

18. On (ii) and (iii) you will want to explain that this is the first chance to take stock of the response to the Green Paper in the round, and that you do not wish the Group to do more than express broad views for the Star Chamber to bear in mind in considering the public expenditure implications.

CONCLUSIONS

19. You will want the Group:-

1. To take a provisional decision whether the non-abolition of SERPS is acceptable.

2. To express interim views on the Social Services Secretary's new proposals on pensions and to remit further consideration of them for bilateral discussion between the Social Services Secretary and the Chancellor of the Exchequer.

3. To express interim views on the other proposed policy changes from the Green Paper and to note that further consideration of the financial implications will proceed in the Star Chamber.



SECRET

4. To express interim views on the implementation date (and legislative timetable) and to note that final decisions must also await the outcome of the discussions in the Star Chamber.

5. To note the connection between the White Paper that must precede the social security bill and the development of proposals on local government finance and possibly to commission a report from the Cabinet Office on their combined distributional effects for consideration before final decisions are taken on the social security White Paper and the local government finance Green Paper.

J B UNWIN

11 October 1985
Cabinet Office