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Social Services.

SECRETARY OF STATE FOR SOCIAL SERVICES

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
ALEXANDER FLEMING HOUSE
ELEPHANT AND CASTLE LONDON SE1 6BY
TELEPHONE 01-407 5522 EXT

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Prime Minister

You may care to glance at the Gov^t Actuary's conclusions.

MCS 12/7

The Rt Hon William Whitelaw CH MC MP
Secretary of State for The Home Department
Home Office
50 Queen Anne's Gate
London
SW1

9 July 1982

Dear Willie.

QUINQUENNIAL REVIEW OF SOCIAL SECURITY FINANCE

I am writing to seek your agreement, as Chairman of the Home Affairs Committee, to the way in which I propose to handle the Government Actuary's report on his quinquennial review of the National Insurance Fund.

The background is this. S.137 of the Social Security Act 1975 requires the Government Actuary to carry out a review of the National Insurance Fund each five years. The object is "to determine the extent to which the level at which the National Insurance Fund stands from year to year may be expected in the longer term to bear a proper relation to demands in respect of payments of benefits". The review is therefore restricted to benefits payable out of the National Insurance Fund - which are about two thirds of all social security payments. The report is made to me and I must lay a copy before Parliament.

The Government Actuary has now reported. A summary of the report's conclusions is at the back of the attached draft PQ and press notice. With your agreement, I propose to arrange for the report to be laid and published on or about 21 July - the exact date to be settled in the light of the timing of the debates on the various benefit uprating orders.

My officials have been considering with officials from the Treasury and the Government Actuary's Department how we should respond to the report when it is published. They have advised that we should take a neutral stance - simply welcoming the report, promising to study it carefully and inviting comments from those concerned.

I am sure this is the sensible approach. Roughly three quarters of the Fund goes to pay retirement pensions. We ought not to appear to be calling into question the pension rights building up under the Social Security Pensions Act 1975, an Act which has our backing when we were in opposition, before we have had a chance to study the report. If at this stage we did suggest that we might possibly cut back on pension benefits we could only alarm contributors and pensioners alike.

E.R.

On the other hand, we must be seen to be taking seriously any report on national insurance finances, given the substantial proportion (about one sixth) of public expenditure that this represents. Accordingly, I propose to welcome the report and make it clear that we shall be studying it carefully in the light of the general response to it. I attach a draft Question and Answer and press notice on this basis.

I understand that Geoffrey Howe is content that I should proceed with the publication of the report on the general lines I propose. I should be glad if you could let me know if you too are content.

I am copying this to the Prime Minister, to other members of H Committee, to Patrick Jenkin and to Sir Robert Armstrong.

Yours ever
Norman

NORMAN FOWLER

ANNEX 1

DRAFT PRESS NOTICE

REVIEW OF SOCIAL SECURITY FINANCE

Norman Fowler, Secretary of State for Social Services, today laid in the House of Commons a report by the Government Actuary on the operation of the Social Security Acts between 6 April 1975 and 5 April 1980 as required by Section 137 of the Social Security Act 1975. Mr Fowler said:

"I welcome this report, which looks at the experience of the early years of the new pension scheme, and provides a detailed analysis of possible future contributory benefit costs, on a variety of assumptions.

Pension costs are much the largest element in the overall costs. The Government must keep under careful review the developing costs of the social security system as a whole, including in particular the possibility of increasing costs for contributors. Equally we must keep under review the effectiveness of that system in meeting its underlying objectives, and must do so in the context of our wider social and economic policies. This report will be a valuable contribution to that process.

We shall now be studying in detail all the implications of this report, but, in view of the importance of pensions and their complicated, long-term nature, it is likely to be some time before we reach any conclusions. To assist in this, I shall be inviting all those concerned, including the Select Committee on Social Services, the Social Security Advisory Committee, the Occupational Pensions Board, both sides of industry and the pension organisations to let me have their views and comments by the end of the year."

2. Mr Fowler announced the publication of the report in reply to a written Parliamentary Question from [ ]. A copy of the Answer is attached.

3. Also attached is a summary of the conclusions reached by the Government Actuary.

4. Comments should be sent to [B2, DHSS].

DRAFT PQ

SOCIAL SECURITY FINANCES

To ask the Secretary of State for Social Services if he has yet received a report by the Government Actuary on the operation of the Social Security Acts since 1975.

2. Mr Norman Fowler: I have laid before the House today the report which the Government Actuary has made on the operation of the Social Security Acts between April 1975 and April 1980 in accordance with S.137 of the Social Security Act 1975. The report provides principally a detailed analysis of the possible future costs of benefits paid out of the National Insurance Fund and of the contributions that will be needed to pay for them. The Government will be considering this report very carefully before reaching any conclusions. We shall also be consulting widely with interested organisations and inviting comments by the end of this year.

SUMMARY OF CONCLUSIONS

1.1 Since April 1978 the National Insurance Fund has collected earnings-related contributions from employed contributors and in return has promised them earnings-related pensions in due course on top of the flat-rate pensions and other benefits traditionally provided. It will be about 60 years before expenditure on the new earnings-related pensions reaches its full level and meantime the contribution rates required to balance outgo are at a significantly lower level than will later prove to be necessary. The amount in the National Insurance Fund has become, and is likely to remain, no more than a modest working balance and will contribute little real income to the Fund.

1.2 On the basis of population projections in which the total population increases gradually from 54½ million in 1979 to 59 million in 2029, and ultimately becomes stationary at about 60 million, the Class 1 standard contribution rate for National Insurance Fund benefits is estimated to increase from 15.4 per cent in 1985-86 to 16.7 per cent in 2005-6 and to 21.9 per cent in 2025-26. However the new earnings-related pension scheme is then still some way from full maturity in regard to benefit expenditure and further increases of up to 2 per cent may be expected in the standard contribution rate after 2025-26. This assumes that earnings and prices increase at the same rate in future and that unemployment is at the level of 6 per cent throughout. (With unemployment at 12 per cent the contribution rate is currently about 17 per cent of earnings.)

1.3 If, as seems more likely, earnings increase at a higher rate than prices, the standard contribution rate in the long term would be 1 or 2 per cent lower if post-award increases in earnings-related pensions continued to be in line with prices but other benefits were increased in line with earnings.

1.4 If flat-rate benefits too were uprated over a long period at a lower rate than earnings, for example in line with prices or at some intermediate rate between earnings and prices, the increase in the standard contribution rate would be less steep and it might even not increase at all depending upon how big was the difference between earnings and benefit increases. In that event, the basic benefit rates would in due course become very much lower than at present compared with the level of earnings, even if the purchasing power of those benefits had been maintained or improved. (For particulars of the estimated standard contribution rates in future years see Table 14 in section 9 of the report.)

1.5 If the proportion of employed persons who are contracted out remains constant, then in the long term the effect of contracting out on the Fund is not likely to be great, contribution reductions and guaranteed minimum pensions each year being almost equal in amount and relatively small in relation to total income and total expenditure. In the short term, because the total of guaranteed minimum pensions is very small, the greater the number contracted out and paying reduced contributions the greater the standard contribution rate required from all contributors. (See Section 10 of the report.)

1.6 If fertility, which is currently below replacement level, remains below replacement level in future, then the relative numbers of pensioners and contributors will gradually become less favourable to the Fund and the standard contribution rate greater. With fertility consistently one-seventh below that necessary for replacement, for example, the contribution rate would ultimately be about one-sixth higher than with a stationary population. If there is a significantly greater increase in longevity than assumed in the present official population projections, that too would increase the contribution rate in the long term.

1.7 Over the years, the contribution reductions allowed for members of occupational pension schemes who are contracted out gradually fall as the guaranteed minimum pensions to be provided for each year's contributions fall. As a result, the reductions made in deriving the contribution rates for Classes 2, 3 and 4 from the Class 1 rates also fall, with the consequence that the Class 2, 3 and 4 rates and the Class 1 contracted-out rates increase more than proportionately to the Class 1 standard rate of contribution in future years.

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TG 21/7

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

Tim Flesher Esq
Private Secretary
10 Downing Street

20 July 1982

Dear Tim

QUINQUENNIAL REVIEW OF SOCIAL SECURITY FINANCE

I attach a copy of the Confidential - Final Revise "National Insurance Fund Long Term Financial Estimates" which is the Report by the Government Actuary on the First Quinquennial Review under Section 137 of the Social Security Act 1975.

I also attach copies of the Parliamentary answer and press notice by which we intend to announce publication tomorrow.

I am copying this letter and enclosures to Private Secretaries to Members of Cabinet and the Chief Whip.

Yours ever
Mary McVerry

MARY McVERRY (MRS)
Private Secretary

DRAFT PQ

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PRESS RELEASE

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