

PRIME MINISTER

7 September 1984

SOCIAL BENEFITS

Norman Fowler's Inquiry teams are busy considering:

- Pensions
- Benefits for children and young people
- Supplementary Benefit
- Housing Benefit

There are four key themes they should pursue.

Save money so we can cut taxes

We want to cut expenditure on benefits so as to finance the Chancellor's strategy of raising tax allowances. The Institute of Fiscal Studies estimates that only 54 per cent of the benefits we pay are strictly necessary to bring incomes to the Supplementary Benefit subsistence level. We can save money by focussing benefits on the poor.

Prosperous voters like their benefits, but there are strong arguments for action:

- i. It is these better off tax-paying recipients of benefit who cause churning. We want clear water between benefits and taxation.

ii. The money these people lose in benefits will come back to them through higher tax allowances. And without these savings, we doubt whether the Chancellor will be able to ease the tax burden significantly.

iii. If the middle classes are divorced from the benefit system, they cease to lobby so volubly for ever-higher benefits. It is perhaps the main reason why President Reagan has had so much more success in cutting back on social benefit expenditure than we have. That is why the poverty lobby believes so strongly in universal benefits going to all.

Simplifying the system

The DHSS absorbs 80,000 staff and spends £1.5 billion on administering the benefit system. There are many competing means tests.

- We get rid of competing systems in housing benefit - and the cost rose

We could cut down the total number of benefits by getting rid of the anachronistic ones which do little good at high cost. Death grant and maternity grant each pay out about £20 million a year, and cost as much again to administer.

We could also cut back on the number of means tests by having broader, cruder means tests for a smaller number of basic benefits. The ultimate prize would be one basic means test for Supplementary Benefit, Housing Benefit, and

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possibly a means-related Child Benefit. This way, saving money by focussing on the poor goes hand in hand with cutting back on complexity and cost of administration.

Create pressures for sensible spending

The benefit system still assumes people can't run a family budget. The DHSS in effect meets the bill which the claimant presents, both with special payments under Supplementary Benefit, and also rent and rates for poorer recipients of Housing Benefit. This is wrong:

- It is not a way to encourage the housekeeping skills which help to keep people out of poverty.

- It encourages spivs and racketeers to charge high prices to claimants, and then get the bills paid by the DHSS. Payments for board and lodging under Supplementary Benefit have risen from £200 million in 1982 to £360 million in 1983.

Fixed payments to the claimants could encourage more responsibility, and would put downward pressure on the prices they pay.

Poverty and unemployment traps

Once the state is committed to maintaining a basic standard

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of living, then a poverty trap is very likely. This happens either because benefits are withdrawn via a means test or, if they are universal, they cost so much that high marginal tax rates are needed to finance them. But there is a choice between a quick, nasty trap, taking benefits away rapidly in a narrow area of income distribution; or a slower, gentler trap, taking benefits away more gradually, but extending into a broader area.

The current system gives a pretty severe narrow trap, where income is not heavily concentrated. The best way of easing it is to increase tax thresholds.

The Government has succeeded in reducing the unemployment trap - the ratio between income out work and in work - by taxing Unemployment Benefit and ending the earnings-related supplement. But the evidence suggests that too many young people are still caught in the trap. Less generous Supplementary Benefit for them would help.

Root-and-branch reforms

Several different blueprints for root-and-branch reform have been produced in evidence for Norman Fowler's Inquiry. The main types are summarised in the Annex. They focus exclusively on one principle - universal benefits, or means-testing, or better contributory benefits - and abandon the present compromise between all three approaches.

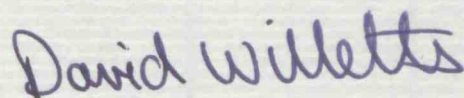
Of the three approaches, means-testing is the best. But rather than distant utopian schemes, we need practical and politically defensible steps which enable us to save money in the short term so as to take people out of tax. Different approaches to the reform of particular areas of benefit are set out below.

Conclusion

The attached Annexes apply these principles to the main benefits. It would be helpful to have your guidance on our suggestions so that we can prepare for the Seminar on 4 October.



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DAVID WILLETTS

THREE TYPES OF BENEFIT REFORMUniversal (Basic Income Guarantee, Negative Income Tax)

- Pro : Easy to administer
 : Eases acute poverty and unemployment trap problems
- Con : Expensive
 : Socialisation of income; state is both giver and taker - ie churning

Contributory (Back to Beveridge)

- Pro : People know what they are paying for; *- also No - they do it.*
 : Focusses on contingencies that cause poverty
- Con : Expensive
 : Non-contributors then press for similar benefits
 : Inflexible as new contingencies arise - eg one-parent families

Means test

- Pro : Focusses on poor, so saves money
 : Middle-class voters cease to have an interest in high benefits
- Con : Administratively complex
 : Political problems with losers
 : Tapers may worsen poverty and unemployment traps

BENEFITS FOR CHILDREN

In 1983-84, about £3.7 billion of Child Benefit went to the under-16s. Various other minor benefits - such as Family Income Supplement and child support elements in Supplementary Benefit and Housing Benefit - together added another £1 billion. There are four different ways of cutting back:

1. Tax Child Benefit. This boils down to cutting it by 30 per cent for most people, though it would not affect the very poorest who are out of tax, and would fall most heavily on higher-rate taxpayers. It would be administratively simpler just to cut it by 30 per cent. That looks politically unacceptable.
2. Abolish Child Benefit and convert it back into a Child Tax Allowance. This is an attractive way of taking people out of tax and reducing churning. But the old Child Tax Allowance was abolished partly so as to save Revenue manpower. Also we would have to provide benefit support for poor families below the tax threshold.
3. Means-test Child Benefit. Child Benefit would be reallocated so that more went to the poor and less to the better off. But if the average family loses, it will not be

very popular; and if not, then there won't be much extra money to direct towards the poor. It could worsen the poverty trap and create another administratively expensive means test without eliminating any.

4. Limiting the benefit to a narrower group. This might be a better way of saving money than cutting everyone's Child Benefit. We could just pay it for the under-5s, for example, arguing that it compensated women for loss of income when working was most difficult. The counter argument is that the costs of children rise, and it should therefore cover older children as well.

We recommend combining these approaches:

- Save money so as to raise existing tax allowances, given the difficulties of reintroducing Child Tax Allowance.
- Focus benefits on the poor to save money. This means-tested child payment might also incorporate other child-related benefit payments.
- As there are particular problems, even for prosperous families, if the wife has to give up work to look after young children, we could retain a non-means-tested benefit for the under-5s.

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A package along these lines would have something for everybody. Variations on it could be analysed. The main problem, as with any reform in this area, will be the losers.

SUPPLEMENTARY BENEFIT

One in eight of the population now depends on Supplementary Benefit. As it goes to the very poorest, it is difficult to achieve significant savings in the actual benefit payments. But we see considerable scope for simplification so as to save on administrative costs (currently 14p for every £1 of benefit).

First, at the moment it is structured in three tiers - basic payments, regular additional requirements, and one-off payments for special needs. As much as possible should be consolidated into the basic rate. This gives greater individual responsibility for the household budget, is simpler, and reduces the risk of fraud. Too many people are still having basic items of household equipment "stolen" or "broken" and getting a replacement paid for by the DHSS.

Another distinction which could be lost is between short rates for temporary claimants, and higher rates for longer-term claimants. This has now become a way of diverting assistance towards pensioners who do relatively better out of Supplementary Benefit than any other group.

The savings and earnings disregards also need to be looked at. If you earn more than £4 a week, £1 of Supplementary Benefit is deducted for every extra £1 of earnings. This is

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a major discouragement to part-time work. Working a few hours a week can keep up morale, maintain the habit of work and, indeed, people often learn about job opportunities at the workplace. So we would prefer a withdrawal rate of, say, 50 per cent, though obviously this would have a public expenditure cost.

One area for offsetting savings would be benefit payments to 16-18 year olds. It seems right that parents rather than the state should normally take responsibility for young people, unless they have clearly become independent (through being orphaned or leaving home and marrying, for example). The benefit system at the moment is too ready to treat them as fully independent.

Simplification is the main requirement for the Supplementary Benefit Review.

ANNEX D

HOUSING BENEFIT

This is where we are most likely to encounter immediate political difficulties. Large cuts in the social security budget are needed in this year's public expenditure round just to get it back to the baseline, and the Treasury regard Housing Benefit as the best candidate. It would be very difficult to implement cuts whilst the review team is still sitting, and there is a risk that at least one member will resign.

65 per cent of council tenants now get Housing Benefit. The increases in council house rents over the past few years to bring them up to economic levels have led to a shift in public expenditure from the DoE housing programme subsidising rents to the DHSS Housing Benefit programme meeting the cost of unsubsidised rents. This seems to defeat the object of the exercise.

There is another problem with Housing Benefit: it meets rent and rate bills passively. So the private tenant has much less of an incentive to shop around, and is protected from the costs of extravagant councils (an issue we are looking at for the Local Government Seminar). Housing Benefit also acts as an anti-regional policy, because we pay out more in prosperous areas of the country where housing costs are high, and so subsidise the higher costs of employing labour

in those areas.

All this points to trying to achieve savings on Housing Benefit either by reducing the rate of Benefit, or by meeting an assumed standard cost of rents or rates. The objection to this is that as our housing market is so inflexible it will be difficult for people to shop around for cheaper accommodation. But we have got to start somewhere. Indeed, these changes to Housing Benefit would be another way of increasing pressures for liberalising the UK housing market in other ways.