SAVING TELEGRAM

BY BAG

CONFIDENTIAL

FM FCO

TO UKDEL IMF/IBRD WASHINGTON

TELNO [1] SAVING OF [30] APRIL 1986

LONG TERM TRENDS IN SOCIAL EXPENDITURE

1. POINTS TO RAISE WITH STAFF

1. Presentation of paper is poor: too descriptive instead of analytical, and too lengthy. As published paper will attract widespread interest, suggest staff revise it to provide a briefer paper with a cheaper framework, less tables, and expanding policy section on lines of para 13 of our brief telegram.

DRAFTING COMMENTS TO RAISE WITH STAFF

2. Pages 53-4

References to June 1985 Green Paper proposals to phase out SERPS, have been overtaken by more recent proposals to modify it, set out in December 1985 White Paper on reform of social security. Accordingly suggest following revised paragraph on UK pensions:

> "The United Kingdom has perhaps been taking the most radical look at its pension system in the light of the long term cost implications of SERPS. Its reform strategy has recently been outlined in a policy document. 1/ The more expensive elements of SERPS are to be modified: SERPS pensions are to be based on lifetime earnings rather than the best twenty years, and calculated on 20 per cent of earnings rather than 25 per cent. Spouse's rights to inherit SERPS entitlements have been reduced, and greater responsibility has been placed on occupational pension schemes for inflation - proofing guaranteed minimum pension. Financial incentives are to be introduced for firms setting up occupational schemes and individuals taking out personal pensions. The UK Government estimates that the annual cost of SERPS will be nearly halved from £25.5 billion to around £13 billion by 2033."

1. United Kingdom, Reform of Social Security: Programme for Action (Cmnd 9691).

3. P56 Relative Price Effects

Paper might try to explain what factors have contributed, in what measure, to the relative price effect observed in the most of the countries in this Scrutiny, and why this effect has not been observed in either France or Canada? There is a confusion in this paragraph between increases in expenditure which are due to a relative increase in unit costs (an RPE), and those which are attributable to increases in the level of provision. Third party insurance and fee-for-service are associated more with the latter than the former, except insofar as each weakens the resistance to increasing labour costs - which is in any case dealt with as a separate issue.

4. The result that France did not experience a significant RPE over this period sits rather uneasily with footnote 2 on p57.

5. p57 Growth in real benefits and demographic changes

Footnote 1 to this page is insufficient to explain the simple transfer of OECD's figure of a 6.5%/3% growth in real benefits as a measure net of demographic effects. In the IMF work "net of demographic effects" seems to mean: additional to changes in benefit levels due to changes in the age composition of the population. The OECD benefits figure however, includes effects of a changing age composition. As the figures earlier in this extract (p55) suggest that the impact of changing age structure is highly significant it might be expected to account for a substantial proportion of the 6.5%/3% increase in real benefits quoted here.

6. What deviations are concealed within the average figures used here and hence what policy conclusions might be drawn about what an acceptable rate of benefit growth might be.

7. What are "coverage effects"? (page 57, para 1, line 7).

8. Page 66

The discussion of policy implications is flawed by a failure to marry up 3(a) (p66) within the subsequent discussion on cost containment. It would be helpful, for example, to know what Japan regards as "excessive treatment" (p67) and how Japanese action compared with the "restraint in the volume

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of services" in Germany. The fact that the volume of services is under pressure in these countries is important and impinges directly on ethical, efficiency and equity issues. Given these measures in Germany and Japan, could staff explain comment in para 2, p69 on the UK cash limits: that they will only succeed if efficiency gains prevent reductions in service.

9. The last sentence of the second paragraph on page 69 could be re-drafted to put the efficiency point more positively, ie, "In effect, cash limits provide an incentive constantly to search for improvements in efficiency - otherwise new services can only be introduced at the cost of cutting back existing services".

10. The second footnote on page 69 should be deleted - cash limits apply only to HCHC current expenditure, and the £1.7 billion figure quoted cannot be substantiated.

COMMENTS ON UK STUDY - BACKGROUND

11. We have followed general points based on UK paper, as these bring out the limitations of the cross-country study of social expenditure.

12. UK paper tends to confirm the view already expressed that the objectives of the IMF's work on social expenditure are not very well defined. This is reflected in the fact that the UK study never really gets beyond the point of presenting the outcomes of alternative scenarios which in themselves are of limited interest. Insufficient effort is made to explain the meaning or rationale of the assumptions used in these alternative scenarios or to indicate which set of assumptions corresponds to the most likely outcome.

13. Beyond the use of common demographic and economic growth assumptions, there does not appear to be any obvious consistency in the analysis of the three main expenditure programmes covered in the UK study (social security, health and education). For example, the section on health includes relative price effects, but these hardly feature at all in the section on education.

14. Resolutely deterministic approach adopted throughout the study means that a number of important issues are pushed aside without real discussion, for example the extent to which certain influences on expenditure such as medical advance in the case of health care are truly exogenous, and - more generally - the role and scope of policy choice. There is

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also no discussion of the possibilities for achieving productivity gains in the provision of public services.

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