

PRIME MINISTER

P 03581

NATIONAL INSURANCE FUND

E(A)(89) 31: Memorandum by the Secretary of State for Social Security. Also letter from him of 14 November. Minute of 22 November from the Chancellor of the Exchequer.

DECISIONS

Mr Newton says that the high uptake of personal pensions will put the National Insurance Fund into deficit in 1992-93. He proposes to avoid this by legislating this Session to abolish the payment from the Fund to the National Health Service from April 1991. The Chancellor of the Exchequer and Mr Clarke agree.

2. You will wish to consider the options:

i. abolish the NHS allocation. The main issue is whether or not it is right to abolish the contribution from the Fund to the NHS, leaving the latter to be funded entirely from taxation plus receipts from charges and income generation.

ii. temporary reduction. Mr Newton's letter of 14 November referred to the possibility of legislating to set the allocation at zero until the Fund's problems are overcome. Mr Clarke is opposed to this on presentational grounds.

iii. other measures to reduce outgoings. Mr Newton's paper lists other options which in a package combined with limited borrowing powers for the Fund would solve its problems. But the Chancellor is strongly opposed to the borrowing powers.

iv. increase National Insurance contributions. An alternative would be to increase the Fund's income from contributions. Mr Newton rejects this.

v. defer a decision. A further possibility might be to

defer a decision for a year to see how the uptake in personal pensions develops. But this might mean rushing a Bill through in the 1990-91 Session.

BACKGROUND

3. The income of the National Insurance Fund, nearly all from National Insurance contributions, is expected to be £28.5 billion this year. Most of this goes to finance National Insurance benefits but £4 billion goes to the National Health Service (NHS) and covers about 16% of NHS expenditure. Mr Newton says that because of personal pensions, the Fund as a whole will fall below the Government Actuary's minimum recommended level in 1991-92, and into deficit in 1992-3. He proposes to prevent this happening by abolishing the Fund's contribution to the NHS from April 1991, in this Session's Social Security Bill.

ISSUES

Mr Newton's proposal

4. As Mr Newton says, many people believe that the whole or a large part of their National Insurance contribution goes to the NHS as the "health stamp". It has been thought that payment for Welfare State benefits through the NICs is very effective at bringing home their cost. You may want to explore the effect on public perception of the cost of the NHS if the contribution from the NI Fund is abolished.

5. Throughout its term the Government has raised the NHS contribution. In 1979-80 it totalled only £877 million, covering under 10% of NHS costs; it now totals £4 billion and covers 16% of NHS costs. It is not clear how the Government would explain the change of course, if the contribution from the Fund were to be dropped. Given the widespread misunderstanding about the importance of the NHS contribution, you might ask whether abolishing it would be regarded as harming the NHS to meet the cost of the Fund's subsidy to private pensions.



A temporary reduction in the Fund's contributions

6. A variation on Mr Newton's proposal, set out in his letter of 14 November, would be to take power to set the Fund's contribution to the NHS at zero, but to make it clear that this would only be done until the Fund's problems had been overcome. The Government would still hold to the principle of partly financing the NHS from National Insurance contributions but would waive it for the time being.

7. Mr Clarke is opposed to this approach on presentational grounds. He believes that it would look like short-term expediency and lead to criticism that the NHS was to suffer because of subsidies for private personal pensions. But it might be argued that the same criticisms apply to complete abolition of the Fund's contributions to the NHS. You may wish to consider whether setting the Fund's contributions at zero until its problems have been overcome is an option which should be pursued.

Other measures to reduce outgoings

8. Mr Newton's paper sets out other options for helping to avoid the Fund going into deficit: see Table 1. They involve removing industrial injuries benefits from the Fund; possibly removing statutory sick pay and statutory maternity pay from the Fund; and reducing the NHS allocation rather than eliminating it. A package of such measures, combined with giving the Fund limited borrowing powers so as to allow it to fall below the minimum recommended level, could be sufficient to solve the Fund's problems. This is what Mr Newton originally proposed. The Chancellor is however strongly opposed to borrowing powers since they could be portrayed as a relaxation of financial prudence and cast doubt on the Government's fiscal stance. You may wish to agree that borrowing powers should not be taken.

The alternative of raising NICs

9. Mr Newton's proposal would mean that from April 1991 NHS spending would be financed entirely from taxation, apart from

relatively small contributions from charges and income generation. The alternative would be to raise National Insurance contributions in order to keep the National Insurance Fund in balance. Mr Newton says that a sharp increase in NIC rates would be "unattractive" and undermine the Government's record of cutting taxes and contributions. You may want to consider the case for a rise in NICs as an alternative to putting the burden on general taxation.

Defer a decision?

10. Mr Newton wants to legislate this Session to make the change from April 1991. A number of points arise:

i. could the decision be taken this time next year, with a view to legislating at the beginning of the 1990-91 Session? This would allow time to see the level of uptake of personal pensions, which is hard to predict. Table 1 shows the balance still well above the minimum level in April 1991.

ii. Mr Newton says that in 1991-2 the Fund will not go into deficit, but its balance will fall below the Government Actuary's recommended minimum level. You may want to ask about the status of this minimum level and the practical consequences of falling below it. Table 1 to the paper shows that even with no change there would be a balance of 11% in the Fund in April 1992.

iii. The options in table 1 might be used to postpone the decline in the Fund's finances and keep the balance above the Government Actuary's minimum at the end of 1991-2. You may wish to explore whether the problem could be handled in this way.

HANDLING

11. The Secretary of State for Social Security will wish to

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introduce the subject. The Secretary of State for Health will also wish to speak. (These two Secretaries of State hope to leave at about 12 o'clock for press conferences). The Chancellor of the Exchequer will be interested in any implications for taxation, and the Lord President of the Council in the implications for the Social Security Bill.

RTJ

R T J WILSON
Cabinet Office
November 22, 1989

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