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~~cc W/S~~
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(Cabinet office) 2



Treasury Chambers, Parliament Street, SW1P 3AG

D Norgrove Esq
Private Secretary
10 Downing Street
London
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27 September 1985

Dear David

SOCIAL SECURITY REVIEWS AND THE SURVEY

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— Following the Chief Secretary's talk last Wednesday with the Prime Minister, I attach as agreed a background note on the position on social security expenditure. At the Chief Secretary's request, I have added a short covering note summarising what he believes are the main issues.

Yours
Richard

R J BROADBENT
Private Secretary

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SOCIAL SECURITY EXPENDITURE

In this year's Survey, there are demand led additional bids for social security expenditure of:

	(£ million)		
	1986-87	1987-88	1988-89
	+ 1525	+ 1740	+ 2060

These bids represent a large element of the overall problem we face on the Survey.

2 Over the past year, various measures have been agreed which would help offset these bids. In particular:

i) <u>1984 PES Measures</u> : the measures implemented after last years Survey produce additional savings in 1986-87 (and in the later years but offset in those years by the cost of Family Credit).	1986-87	1987-88	1988-89
	- 118	-	-
ii) <u>Reviews</u> : savings agreed in MISC III (some PSBR, some public expenditure)	- 150	- 800	- 1000
iii) <u>Uprating</u> : savings agreed after the Reviews from moving the uprating date	- 164	- 285	- 305

3 The Chief Secretary regards these savings as an important first step in reducing the additional bids. Depending on how much of the Review savings score as public expenditure, this year's additional bids could be reduced by these earlier commitments to:

	+ 1085	+ 1094	+ 1192
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But, as explained below, the Secretary of State's proposals lead to higher additional bids of

	+ 1200	+ 1600	+ 1800
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Difference	+ 115	+ 506	+ 608
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4 This difference arises because, despite the scale of his additional bids, the Secretary of State is arguing that the previously agreed measures require him to produce lower savings than those set out in paragraph 2. The key points are:

i) PES Measures: in 1986-87 he has suggested the £118 million flowing from measures agreed last year should count towards fulfilling the later agreement to bring forward £150 million of Review savings into 1986-87;

ii) Reviews: in 1987-88 and 1988-89, he has suggested that some measures agreed in last year's Survey should be counted as Review measures. £184 million and £190 million respectively is at stake,

iii) Uprating: in 1987-88 and 1988-89, he has suggested that the savings from moving the uprating should count towards fulfilling the earlier agreed Review savings target.

5 The Secretary of State has also increased the cost of his Family Credit scheme, adding net additional costs in the two later years of £55 million and £39 million.

6 The attached note sets out the position in more detail including the extent to which these numbers represent PSBR as opposed to public expenditure savings.

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Commentary on key aspects as at 24 September 1985

(All figures are fm cash and based on DHSS estimates liable to adjustment)

Review Savings

1. Following the spring meetings of MISC 111, and Cabinet discussions in early May of the Review conclusions, Mr Fowler agreed to deliver PSBR savings of 800 in 1987-88 and 1000 in 1988-89 through "structural" changes in social security. (A large slice of these savings would take the form of reduced help, through Housing Benefit, with claimants rates. This amounts to a lower rebate of a tax - ie less revenue foregone - rather than reduced government spending.)

2. Subsequently, in discussions concluded by a meeting chaired by the Prime Minister on 22 May, Mr Fowler was asked to deliver savings of at least 150 in 1986-87, by early implementation of Review measures from the July 1986 uprating date.

3. So, noting the uncertainty over the definition of the 1986-87 figure, the PSBR savings to be secured from the Reviews, in the light of decisions since April are:

1986-87	1987-88	1988-89
at least 150	800	1000

A 23 May letter from Mr Fowler's office explained the kind of measures he had in mind to deliver savings of at least 150 in 1986-87. No details were given of the measures to be taken to deliver the 800 and 1000.

Savings from changing timing of upratings

4. The Prime Minister's meeting of 22 May agreed that, despite the big public expenditure savings available (£570m in 1986-87) if there were no uprating of benefits between November 1985 and April 1987, there should be an interim uprating effective in July 1986. This yields smaller savings (and it was in this context that Mr Fowler was asked to bring forward some Review measures to secure savings of at least £150m in 1986-87).

5. The public expenditure savings estimated to flow from breaking step to April upratings via a July 1986 interim uprating are highly uncertain. They depend crucially on the seasonal pattern of increases in the RPI, which cannot be

precisely predicted. They are currently estimated as follows:

1986-87	1987-88	1988-89
164	285	305

1984 PESC measures

6. In MISC 106 discussions in the autumn of 1984, Mr Fowler agreed to find a package of measures which would deliver total savings rising from 218 in 1985-86 to 735 in 1987-88. In a 25 October 1984 letter to the Lord President, he said one source of these savings would be:

"...measures of which the details will have to be settled later in the light of the priorities which emerge from my programme of reviews. The precise amount to be found "on account" will depend on what I can get from [elsewhere]."

7. The package of measures eventually adopted to deliver the PESC 1984 targets was a wide ranging one, which included some measures (eg the June 1985 announcement of an uprating of Child Benefit to only £7 from November 1985) consistent with the priorities emerging from the Reviews. Except for a last minute (14 June) decision to announce that the Housing Benefit rates taper was to rise from 9 to 13 per cent, the measures were however quite different from those indicated in the 23 May letter from Mr Fowler's Office as the possibilities he had under consideration to secure, subsequently, the saving of at least 150 in 1986-87.

"Excess" savings emerging from 1984 PESC

8. The measures adopted to meet 1984 PESC decisions yielded "excess" savings in 1986-87 and later years. (The measures had to deliver the required 1985-86 savings but were implemented only part way through that year and so had a bigger effect in a full year.) The amounts concerned are:

1986-87	1987-88	1988-89
118	150	171

9. The figures for the later years reflect almost entirely savings flowing from the decision to hold the November 1985 Child Benefit uprating to only £7. Treasury and DHSS Ministers agreed that for those years the extra savings should be set against the expected extra cost of Family Credit (see para 11 below for current figuring on this).

10. As for the 118 in 1986-87, the then Chief Secretary wrote to Mr Fowler on 13 June explaining that he proposed to credit this sum against the big additional

bids already emerging on the social security programme for that year. (The Prime Minister's 22 May meeting had been told that these were already over £1 billion.)

Financing the Family Credit scheme

11. In the spring the additional cost of the Family Credit scheme (over and above FIS which it replaces) was costed at 135 in 1987-88 and 140 in 1988-89. But Mr Fowler now reportedly seeks 205 and 210. So, compared with the excess savings which arose from 1984 PESC, a net additional public expenditure cost arises in each year:

	1987-88	1988-89
cost of Family Credit	205	210
<u>1984 excess savings</u>	<u>-150</u>	<u>-171</u>
net additional cost arising	55	39

Mr Fowler's position

12. Mr Fowler's position seems to be broadly as follows:

- (i) the estimating savings arising from changing the timing of upratings should properly be regarded as structural changes in the system resulting from the Reviews. They should thus score, in 1987-88 and 1988-89 at least, as part of the Review savings of 800 and 1000 rather than as additional to those figures.
- (ii) things done to achieve the 1984 PESC targets which he regards as having been within the spirit of the Reviews should similarly be reckoned towards his Review savings targets. Mr Fowler suggests that 184 and 190 of the due savings can be accounted for in this way.
- (iii) for 1986-87, the 118 of "excess savings" from 1984 PESC should now be regarded as accounting for all but 32 of the further 150 which he was asked to find on 22 May through early implementation of Review measures.

Treasury position

13. The Treasury does not accept Mr Fowler's approach on any of these three issues:

- (i) the 1987-88 and 1988-89 uprating timing savings reflect decisions taken well after Cabinet endorsed the 800 and 1000 savings to be secured through Review measures. (They are, moreover, highly uncertain, depending on the exact month by month profile of the RPI.) So they should be secured in addition to the Review savings. Mr Fowler has already accepted in correspondence that this is the position for the 1986-87 timing savings.
- (ii) the effects of measures adopted to meet 1984 PESC targets were reflected in the Cmnd 9428 social security figures, published well before Ministerial discussion of the Reviews. And the reasonable commonsense interpretation is that the savings decisions apply from the Cmnd 9428 figures (ie the 1985 Survey baseline).
- (iii) as Mr Rees made clear in June, the reasonable way to treat the 118 of 1986-87 excess savings from 1984 PESC is as a partial (but relatively very small) offset to the big demand-determined bids on social security. The 150 of additional savings agreed on 22 May is an entirely separate issue (as the 23 May letter from Mr Fowler's Office seemed to recognise).

In addition:

- (iv) the Treasury believes that any significant additional net cost now sought on Family Credit (para 11 above) should be brought into the Review arithmetic.

14. There are several smaller issues on the Survey and Review figuring not yet settled. (For example, Mr Fowler seeks to score certain administrative savings, emerging from some individual Review measures, towards the 800 and 1000. But this is not acceptable when substantial bids for temporary additions to administrative costs are expected.)

15. Overall, the Treasury view is that the main adjustments necessary to remove overstatements from Mr Fowler's Review arithmetic are:

	1986-87	1987-88	1988-89
savings from changing uprating timing wrongly scored		285	305
1984 PESC measures already in Survey baseline		184	190
1986-87 excess savings to be set against demand determined bids	118		
measures needed to offset cost of Family Credit		55	39
<u>totals</u>	<u>118</u>	<u>524</u>	<u>534</u>

16. On this basis, and taking account of some other adjustments, the Treasury assesses the true savings which Mr Fowler is offering under the Reviews as:

(savings = -)	1986-87	1987-88	1988-89
public spending	-32	+135	+29
PSBR	-32	-290	-411
compared with agreed targets for PSBR savings of:	-150 ("at least")	-800	-1000

So, in round terms, the PSBR savings fall short of those due by over 100 in 1986-87, 500 in 1987-88 and nearly 600 in 1988-89.

19. The reasons for not delivering the full Review savings seem to lie largely in higher rates of benefit envisaged for income support (particularly for the elderly) and more generous arrangements for Family Credit.

Survey position

20. The total bids for extra social security spending are currently estimated at:

1986-87	1987-88	1988-89
1525	1740	2060

These figures are net of expected benefit savings (rising to 30 a year) from deployment of extra anti-fraud staff. They allow for certain additional running costs bids, agreed by the Treasury.

21. Additional demand-determined estimating increases could emerge before the Autumn Statement. And substantial further bids on running costs, for a temporary increase to secure successful implementation of the Reviews from 1987, are expected.

22. On the basis of Mr Fowler's present position on Review and other savings, the net over-runs on the social security programme would be:

excess over baseline, £ billions

1986-87	1987-88	1988-89
1.2	1.6	1.8

23. Even after securing the Review and other agreed prior savings in full the over-runs would be:

1.085	1.094	1.192
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These figures assume that the full public expenditure savings from the Reviews would amount to:

.150	.300	.500
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24. The Chief Secretary is seeking option cuts rising from .15 in 1986-87, to .35 in 1987-88, and to .55 in 1988-89.

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H M TREASURY

28 September 1985