CABINET

OLD-AGE PENSIONS

MEMORANDUM BY THE SECRETARY OF STATE FOR THE HOME DEPARTMENT AND LORD PRIVY SEAL

In pursuance of the Cabinet's discussion of pensions policy on 14th May (C.C. (57) 40th Conclusions, Minute 3) the Committee on National Insurance were asked to formulate detailed proposals for the amendment of the National Insurance Scheme with a view to introducing legislation early in the 1957-58 session of Parliament.

2. The background to the task of the Committee is two-fold. First, the existing National Insurance Scheme is becoming progressively less well designed to meet the conditions of to-day. The level of pension which can be supported on the basis of a universal flat-rate contribution is widely regarded as insufficient for the needs of higher paid workers, who are liable, in the absence of supplementary provision, to suffer a severe drop in their standard of living when they retire. Moreover, approximately one-third of the working population is already covered by occupational pensions schemes, providing some supplement to National Insurance pensions; but many of those who do not enjoy this advantage might wish to be enabled to do so. Second, the emerging deficit in the National Insurance Fund gives cause for concern. On the basis of existing levels of contribution and benefits, the annual Exchequer liability to the National Insurance Fund is expected to increase from about £95 millions in the current year to about £345 millions by 1966 and about £515 millions by 1979 (assuming 4 per cent, unemployment after 1960) or to about £270 millions by 1966 and £438 millions by 1979 (assuming that the current rate of unemployment remains unchanged throughout).

3. We have also had in mind the wider economic aspects. An increase in the income of retired people means an immediate transfer of economic resources from the working population to those who have retired, and unless the working population are prepared to restrain their demands on the economy any sudden and substantial increase in pension is inevitably inflationary. If, moreover, as seems to be the case, the working population at present see no great obligation on themselves to accept the need for a transfer of a significant part of their consumption to retired people, there would be further serious dangers of inflation in any scheme which involved a compulsory and substantial increase in the amount which employers and employees were required to contribute. Severely increased contributions by employees generally would almost certainly stimulate wage claims beyond what was likely to be claimed in the ordinary course; and increased contributions by employers would certainly lead directly to price increases. Our most important task as a Government is to bring inflation under control, and in considering future pensions policy we must, therefore, at all costs avoid courses which would be likely to exacerbate inflation.

4. The National Insurance scheme covers not only pensions, but also sickness and unemployment benefit and certain other benefits. Hitherto all have been kept in line, and we have assumed that any increase in pensions will involve an increase in other benefits also. The plans examined below provide accordingly.
Objectives of Policy

5. The Committee have considered the policy to be pursued against the foregoing background. We have examined many alternative proposals and the common mean of our advice is set out below. The plan will, however, require further examination in a number of respects and no member of the Committee is committed to it in the meantime.

6. The objectives of the Government’s future policy should in our view be these:

(a) to introduce an early improvement in the present rates of basic pensions;
(b) to reduce so far as is practicable the burden on the Exchequer which will result from the emerging deficit in the National Insurance Fund;
(c) to make such progress as is possible towards a system of pensions above the basic level, and related to earnings, but without stimulating inflation and endangering the economy;
(d) to ensure that any changes in the statutory requirements relating to the provision of pensions allow the greatest possible scope to the private sector.

All these objectives are important; but we must be careful that, in seeking to secure any one of them, we do not imperil the others.

Basic Provision

7. The Committee consider that the first priority must be to increase the present rates of National Insurance benefits. An increase in the present pension of 40s. for a single person by about 5s. would be necessary by next spring in order to protect the value of these benefits as established in 1955, but it may well be desirable to go beyond this and improve the real value of the present basic pension beyond any standard hitherto adopted. If so, the increase could be by 10s. for a single person, giving a pension of 50s., and by 15s. for a married couple, giving a pension of 80s. This should enable us, without undue trouble, to get rid of the tobacco concession, which we should all like to do.

8. Such an increase would require a substantial increase in contributions. The total combined contribution by employers and employees is at present 13s. 7d. for men (of which the employee pays 7s. 5d.). This covers pensions and other insurance benefits, industrial injuries, and the National Health Service contribution of 1s. 8d. A strictly actuarial increase in the contribution to cover an increase in benefits to 50s. (single) and 80s. (married) would be 2s. 9d., giving a total combined contribution of 15s. 4d. (employee’s share 8s. 10d.). If, however, the contribution were to provide a substantial offset to the emerging deficit in the National Insurance Fund—which will be enlarged by an increase in benefits—then a further increase in contributions would be desirable, and an appropriate level might be 18s. 4d. (employee’s share 9s. 10d.). But if such an increase in benefits were to be followed shortly by the introduction of a new graduated system, such as is described below, in place of the present flat-rate system, it might not be necessary during the interim period to provide so great an offset to the emerging cost, and the increased contribution might be about 17s. 6d. (employee’s share 9s. 5d.), rather than 18s. 4d.

We have not however as yet been able to consider in detail the financial implications of these various levels of contributions.

Graduated Pensions

9. Over and above any decision to increase the basic pension rate we have considered what further steps are desirable to make some progress towards a system of pensions related to earnings.

The scheme which we have considered, which is described in greater detail in the Appendix, would provide for graduated contributions of 8 per cent. of earnings (4 per cent. by the employer and 4 per cent. by the employee) in respect of earnings up to £750 a year, and a 2 per cent. contribution from the Exchequer of earnings up to £8 a week. These contributions would replace the flat-rate contribution. The scheme is based on the assumption that the flat-rate benefit for existing beneficiaries would be raised to 50s. (single) and 80s. (married) on its introduction even if that had not already been done. A flat-rate pension of 50s. (single) and 80s. (married) would be retained under the new scheme for all employees.
whose average earnings amounted to £8 a week or less. Contributors whose average earnings after the scheme's introduction exceeded £8 per week would receive additional benefits, which would vary according to age of the entry into the scheme. For men between eighteen and thirty when they entered the scheme the weekly addition per pound of earnings over £8 would be 5s.; for older workers the rate would be less; until for men of fifty to sixty-four the weekly addition would be 2s. per pound of earnings over £8. Under this plan, the contribution payable by a man earning £8 a week would be 6s. 6d., by a man earning £12 a week 9s. 7d., and by a man earning £15 or more a week 12s. These figures compare with the contribution of 9s. 6d. which would be paid by all men under a flat-rate scheme with a total contribution of 17s. 6d.

10. Many variations would be possible under this scheme, and there are a number of consequential features which have yet to be examined in detail; for example, it would be for consideration whether or not other benefits, such as those for unemployment and sickness (which would be increased to the 50s. (80s.) level) should have a graduated addition also.

11. The main financial advantage of this scheme lies in the automatic increases in the income from contributions which would follow increases in earnings, whether these were due to inflation or to a rise in the real national income. In so far as they were due to inflation, the additional income would probably have to be spent on preserving the value of benefits already in payment, and might not suffice for that purpose. So far as inflation is concerned, therefore, the scheme would be partially, though not wholly, self-financing. Increases due to rises in real earnings, on the other hand, would provide a growing offset to the emerging cost; and on reasonable assumptions about growth of the national product the scheme might show a considerable surplus within ten years, although some of the surplus might be needed to finance increases in benefits due to inflation. In so far as any prospective surplus remained, it would be available either for increasing benefits in real terms, or for reducing contributions, or for fortifying the Budget. (On the same assumptions about growth of the national product the surplus would continue to grow after ten years, but figures so far ahead are very speculative.) It is clear that the scheme offers substantial advantages from the Exchequer point of view, even allowing for the fact that it involves automatic increases in the Exchequer supplement as national income increases.

12. The earliest date on which it would be practicable to introduce a graduated scheme, if the necessary legislation were passed during the 1957–58 session, would be April, 1960, because it involves a complete change in the methods of collection and enforcement of National Insurance contributions. It is therefore possible that this scheme (which would be on the point of coming into existence) and any rival proposals put forward by the Opposition might become an issue at the next Election.

13. One criticism which can be levelled at the proposed scheme is that it may to some extent intrude upon the private sector. How far it might do so is perhaps uncertain; and this aspect would need to be further discussed with representatives of the life insurance industry. If it becomes clear that the graduated scheme would be generally regarded as having very damaging effects on the development of insurance provision through the private sector, it may be that such a scheme would not be acceptable unless workers participating in approved occupational pension schemes—both existing schemes and, if possible, schemes introduced in the future—were allowed to contract out of the graduated element in the benefits of the national scheme. An additional advantage seen in such arrangements would be that transferability of pension rights could be prescribed as a condition of approval for occupational pension schemes. But the effect of these proposed modifications on the finances of the scheme might be serious, and these questions, as well as those referred to in paragraph 10 above, require further consideration.

Supplementary Provision

14. If it is decided to introduce a graduated scheme on these lines, there would be no need for any additional action by the State. But if we decide to do no more than increase the flat-rate contributions and benefits, it would be necessary to consider facilitating voluntary provision. This might be done by establishing...
a statutory corporation which could provide facilities for pensions schemes which could not conveniently be provided by the Life Offices or other private means, e.g., in industries with a rapid labour turnover.

Pension Ages
15. The present pension ages are 65 (men) and 60 (women). There are strong arguments for increasing these ages; and although there are political difficulties about doing so, we think that a higher retirement age should be accepted as necessary in the long term, and the introduction of this higher age foreshadowed as early as is politically possible.

Conclusion
16. We invite our colleagues to decide: —

(a) whether the basic National Insurance pension should be increased at the earliest practicable date—(i) by 10s., or (ii) by some alternative figure; contributions being increased accordingly;

(b) to authorise the National Insurance Committee to proceed with the further examination of the scheme outlined in paragraphs 9–13 above, with special reference to the "contracting out" provision and its effects, and with a view to the preparation of the final plan.

R. A. B.

Home Office, S.W. 1.
16th July, 1957.
A GRADUATED SYSTEM OF NATIONAL INSURANCE

1. This scheme is designed to provide, in return for graduated contributions, the same range of benefits on a graduated basis as the present National Insurance and Industrial Injuries Schemes. It assumes no alteration in the conditions for the various benefits, e.g., the retirement condition, the earnings rules, the pension ages for men and women and the selective basis of widow’s benefits. Provision is made for an annual payment to the National Health Service equivalent to the product of the National Health Service contributions collected under existing legislation.

The Contributory Basis

2. Contributions would be payable as a straight percentage of earnings up to say £750 a year and collected in connection with P.A.Y.E. The percentages would be 4 from the employed person, 4 from employers, and 6½ in respect of earnings from self-employment excluding no more than £156 of such earnings by analogy with the present low income disregard.

3. The basic feature of the benefits would be a standard rate—assumed for this purpose as £2 10s. single and £4 married—which would be payable in return for contributions chargeable on earnings up to £8 a week. (This figure could be set at £6 a week for women in view of their lower earnings. This would not materially alter the broad financial picture.) Up to the standard rate, benefit would be subsidised by an Exchequer supplement, thus preserving the tripartite basis of finance. Each contributor would receive an addition (unsubsidised) to his standard benefit by virtue of his individual record of earnings in so far as they exceeded £8 a week.

4. People without earnings who are liable as non-employed under the present scheme would be charged a flat rate which would count towards standard pension rights. This has been set at 7s. 6d. Men whose earnings yield less than a 7s. 6d. contribution would be charged at a flat rate to bring the total contribution to that amount. (This rate would also be available as a voluntary rate for those now entitled to contribute voluntarily.)

5. The Exchequer would contribute as supplement, 2 per cent. of earnings up to £8 a week (perhaps £6 for women), i.e., the upper limit of earnings on which contributions were payable for the standard rate of benefit.

6. Provision would be made for increasing the percentages of 4, 6½ and 2 by ¼ per cent. at intervals of five years until they reached 5, 7½ and 3. The whole of these additions would be allocated towards the emerging deficit.

7. The National Health Service contribution would be a first charge on the whole annual income and an appropriate share of the contribution income would be allocated to expenditure on Industrial Injuries benefits. (It has been assumed that these benefits will remain on the present basis—but increased by 25 per cent.—for the time being.) After these deductions the income of the National Insurance Scheme in 1959-60 would be £962 millions. More detailed estimates are given in the attached table, together with corresponding estimates of the income at possible increased flat rates towards increased flat rate benefits.

8. The remainder of the contribution yield from earnings below £8 a week and the flat rate contributions would be allocated to the standard rate of benefit.

9. Seventy per cent. of the contributions over £8 would be related to the additional graduated benefits above the standard rate. The other 30 per cent. would be a contribution to the cost of the contributor’s standard benefit.

10. For pensions, the additions would be determined by the average earnings above £8 a week and would be subject to a minimum period of contribution. They would vary with the age of entry to the scheme, but to avoid the payment of trumpery amounts to the older entrants broad age bands would be adopted. Thus for an entrant aged under 30 the addition to pension could be 5s. a week for each £1 of earnings above £8 a week, making the maximum pension ultimately payable...
£2 10s. + £1 15s. (€4 5s.) for a single man and £4 + £1 15s. for a married man. The age bands and additions per £1 of earnings might be—

<table>
<thead>
<tr>
<th>Age on entry</th>
<th>Weekly addition per £1 of earnings above £8</th>
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<tbody>
<tr>
<td>18–30</td>
<td>5s.</td>
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<tr>
<td>30–40</td>
<td>4s.</td>
</tr>
<tr>
<td>40–50</td>
<td>3s.</td>
</tr>
<tr>
<td>Above 50</td>
<td>2s.</td>
</tr>
</tbody>
</table>

For women, owing to the lower pension age and the longer expectation of life, the additions would be substantially lower. Both the standard rate and the additions would be subject to a retirement condition and increments could be earned for deferring either or both portions.

11. It is estimated that expenditure on the standard rates of National Insurance benefit would be £937 millions in 1959–60. This estimate (like all those shown in the Table) allows for graduated sickness and unemployment benefits. If it is decided to graduate these short-term benefits a sum of 5s. for every £50 of earnings in excess of £400 a year in a recent financial year could be given in addition to the basic amount. Dependency increases, children’s benefits and lump-sum grants for maternity and death would not be graduated.

### Married Women

12. It is suggested that there would be no option for married women as at present. Most married women now opt out of payment but if contributions are to be related to earnings there seems no reason why the earnings of married women should escape full liability. As a result of ending the option immediate revenue would be increased and a larger number of married women than at present would build up title to at least the standard pension. Any addition over the standard rate earned by the women would be added to the joint pension for married couples.

#### Table

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<tr>
<td><strong>NET CONTRIBUTION INCOME:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Insured Persons</td>
<td>790</td>
<td>1,042</td>
<td>1,764</td>
<td>758</td>
<td>759</td>
<td>759</td>
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<tr>
<td>Exchequer</td>
<td>133</td>
<td>182</td>
<td>344</td>
<td>115</td>
<td>115</td>
<td>115</td>
</tr>
<tr>
<td>Interest</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td><strong>TOTAL INCOME</strong></td>
<td>973</td>
<td>1,274</td>
<td>2,158</td>
<td>923</td>
<td>924</td>
<td>924</td>
</tr>
<tr>
<td><strong>TOTAL EXPENDITURE</strong></td>
<td>937</td>
<td>1,160</td>
<td>1,480</td>
<td>937</td>
<td>1,063</td>
<td>1,269</td>
</tr>
<tr>
<td><strong>SURPLUS (+) OR DEFICIT (–)</strong></td>
<td>+36</td>
<td>+114</td>
<td>+678</td>
<td>–14</td>
<td>–139</td>
<td>–345</td>
</tr>
<tr>
<td><strong>CHARGE ON EXCHEQUER:</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Above the line</td>
<td>133</td>
<td>182</td>
<td>344</td>
<td>129</td>
<td>254</td>
<td>460</td>
</tr>
<tr>
<td>Overall</td>
<td>97</td>
<td>68</td>
<td>–334</td>
<td>129</td>
<td>254</td>
<td>460</td>
</tr>
</tbody>
</table>

**Notes:**

1. The figures relate only to the National Insurance Fund, i.e., net of the Industrial Injuries Fund and the National Health Service contribution.
2. The figures assume that in 1959–60 the level of earnings will be 7½ per cent. above 1957, and that thereafter the Gross National Product increases in real terms by 2½ per cent. per annum. They therefore show an automatic growth in income under the graduated scheme: under the flat-rate scheme growth in income would have to be secured by legislation accompanying an increase in benefits.
3. In neither case is the effect shown of any future increase in benefits.
4. Neither plan assumes that there will be no further inflation. But the Table does not show the effect of inflation on either benefits or contributions.