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PRIME MINISTER

## SOCIAL SECURITY REVIEW

As you requested, officials from the Departments concerned have now submitted agreed figures on the consequences of abolishing SERPS and replacing it with a new pensions structure.

Implications of the options

The main conclusion that I draw from the figures in the note by officials is that the decision we reached in MISC 111 was clearly the right one.

Nigel Lawson's minute of 23 April expressed concern about the PSBR effects and the extra employment costs which the arrangements on which we agreed in MISC 111 would involve. But we must distinguish between those which stem from abolishing SERPS - whether or not we replace it - and those which would result from requiring occupational or private pension contributions for everyone in work.

We have recognised all along that the end of SERPS would mean higher national insurance (NI) contributions for both employers and employees who are now contracted-out because of the ending of the contracted out rebate. My paper (MISC 111(85)5), which MISC 111 discussed on 13 February, made this clear; it is abolishing SERPS - not replacing it by a compulsory scheme - that accounts for the extra £400 million on public sector employers' NI contributions.

The costs of the new pension arrangements will come from the tax relief on employers' and employees' contributions. While I recognise Nigel's concern about extra tax relief, the agreed note by officials shows that the cost is likely to be £200 million in 1987/88 rather than the £1 billion that the earlier estimates suggested.



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All of us in MISC 111 recognised that the end of SERPS and its replacement by a compulsory scheme would mean higher employment costs for some people but, as the note by officials shows, the overall effect on private sector employers as a whole is nil. We felt in MISC 111 - as I still do so - that stopping SERPS while we still can, with the huge long term savings that it offers, justified the public sector and other costs. And on a minimum pension requirement for all there was no dissent from your summing up of our discussions on 13 February (MISC 111(85)2nd Meeting) when you said that "..... it would inevitably impose greater cost on the contributors and arouse controversy, but should not be postponed".

#### Why MISC 111 made its choice

We decided to replace SERPS because of its cost and complexity. We decided to replace it by a compulsory framework because it alone would achieve our objectives. In particular:

- it will ensure that everyone in work has an opportunity to build up an occupational or personal pension. It was clear during the debate on Monday, and from what has been said elsewhere, that our supporters attach great importance to what is put in place of SERPS;
- it would give everyone who had a reasonable work record enough income in retirement to lift them off dependence on supplementary benefit. We must avoid being seen as simply leaving people with inadequate provision in old age;
- the switch to funded pension provision would enrich capital markets and carry forward our aim of giving people a more direct stake in the performance of the economy;
- finally, and this is probably the most important point, it will reverse the increasingly dominant role of the State in pension provision which has developed over the last twenty-five years as higher earnings related



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pensions have been provided through the State scheme. The only effective way of reversing this trend is the route we mapped out in MISC 111.

### The other options

I do not believe that any of the other options is sustainable.

First, abolishing SERPS without putting anything in its place would leave us very vulnerable to the charge that we were simply engaged in an exercise to reduce pension rights. Coverage by occupational pension schemes has been on a virtual plateau since the 1960s. And as you will see from the tax relief figures produced by officials, it has been assumed that growth in coverage would be very slow. If it were faster, the tax relief costs would be higher. Since the loss of SERPS pension rights would not be balanced by a significant growth in private provision, we should be pressed to do more through State provision, both by our supporters and more generally. The end result would be significantly higher expenditure on the basic retirement pension or on supplementary pensions - and most likely on both. If, for example, we had to concede earnings indexation in 1987 on the basic retirement pension it would cost us a compound 1½ per cent extra or £260 million a year. The extra cost would be about £3 billion a year within ten years of 1987 with a corresponding increase in contributions.

We did consider in MISC 111 the possibility of a transitional period before making the arrangements compulsory. But for very good reasons we decided against. The fact is that if we want our proposals to have a positive impact before the next election, we must ensure that those not now building up occupational or personal pensions begin to do so at once. We know from the Gallup Poll survey how much people value their membership of an occupational pension scheme. Once they have begun to build up pension rights they will not wish to lose it. This will be a powerful political argument in our favour.



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Second, the option of deferring the ending of SERPS until the next Parliament would leave us in an extremely exposed position. As with the voluntary approach, all the emphasis in the meantime would be on the loss of pension rights without any recognition of the value of the new proposals. Once people are members of a scheme, or have taken out personal pensions, they will see the attraction of our policy. But if the new structure were not in place, we should face a barrage of expensive pension promises of the sort we have already seen from Michael Meacher, with nothing to set against them. It is not a platform on which I could recommend fighting. Moreover, the cost of SERPS would continue to grow and could be as much as 50 per cent higher if implementation had to be delayed until, say, 1990.

The third approach, which we considered but rejected in MISC 111, is to modify rather than abolish or replace SERPS. Having looked at this again, it seems to me clear that, although it will provide long term savings, it gives us the worst of both worlds. In particular:

- we should be continuing the complexities of a two-tier system and contracting-out;
- there would still be little incentive for employers to set up new schemes as is reflected in the figures on tax relief in the note by officials;
- most important of all, we should be missing the opportunity - probably the last opportunity - of giving everyone the chance of a private pension. We should have accepted for good the dominance of the State scheme - and we would have undermined one of the main thrusts of the whole review.



E.R.

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I am copying this to Willie Whitelaw, Nigel Lawson, John Wakeham  
and Sir Robert Armstrong.

26 April 1985

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