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DEPARTMENT OF HEALTH AND SOCIAL SECURITY

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Telephone 01-407 5522

From the Secretary of State for Social Services

Andrew Turnbull Esq
Private Secretary
10 Downing Street

26 April 1985

Dear Andrew

SOCIAL SECURITY REVIEW

I attach a note by officials which sets out the figures requested in your letter of 24 April.

A supplementary note, providing additional information - eg on the effect on contracted-in and contracted-out pension schemes - will follow as soon as possible on Monday.

Copies go to Rachel Lomax, Janet Lewis-Jones, Murdo Maclean and Richard Hatfield.

Yours
Sincerely

S A Godber
Private Secretary

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SOCIAL SECURITY REVIEW: PENSIONS: NOTE BY OFFICIALS

This note, and the attached tables, set out the costs of four options for changing the State Earnings Related Pension Scheme.

OPTIONS

1. Replace SERPS with new minimum pension requirement in April 1987.
2. End SERPS in 1987 without replacement; private provision on voluntary basis:
 - a) no employer's contribution required to personal pension;
 - b) 2 per cent employers contribution required to personal pension.
3. Defer Option 1 to April 1990.
4. Modify SERPS from April 1987 to reduce emerging benefit costs: base additional pension on lifetime's average earnings and reduce accrual rate on higher earnings. Limit indexation and require contracted-out scheme payment to same limit.

ASSUMPTIONSOption 1National Insurance (NI) contributions

- self-employed to pay full rate of higher contributions which follow from end of SERPS; alternative would be higher Class 1 rates for employees;
- no change in NI fund balance, as calculated on present basis which takes one year with another;
- Treasury supplement kept at expected amount if SERPS had continued - this implies an increase in the proportionate rate of supplement;
- lower and upper earnings limits rise in line with prices until 1987/88 and then linked to earnings;
- reduced rates for low paid of 3, 5 and 7 per cent, as set out in proposals before MISC 111. This maintains broad relativity with post-Budget structure.

Minimum pension requirements

- 4 per cent contribution, of which 2 per cent paid by employer - assume in practice all employers pay only 2 per cent for newly covered workers. This is about the minimum contribution needed to reduce reliance on supplementary pension;

- all employees and self-employed covered except those earning under £35.50 per week - the lower limit for NI contributions - and in their current job for less than six months. Part-timers are included;
- allow for increase in employed workforce in line with Treasury assumptions and linked increase in people already saving through pension schemes;
- average earnings for newly covered employees £105 per week at 1985/86 levels; £125 per week for self-employed.

Tax

- assumed contribution of existing tax relief on contributions and pension investments;
- effective rate of relief on contributions:

employee 25%	private sector employers 30%)	full effect delayed in line with tax payments
	self-employed 25%)	

Receipts

- 90 per cent of minimum pension contributions (for employed and self-employed) paid in year for which due, 10 per cent in following year;
- all NI contributions for employees paid in year for which due; 90 per cent of employer's NIC paid in year due, 10 per cent in following year; 40 per cent self-employed NIC paid in year for which due, 50 per cent following year, 10 per cent in year after.

Public sector and personal pensions

- employees not covered now by pension scheme brought in at minimum contributions level.

Option 2

NI contributions and tax as Option 1.

Personal pensions

- a) take-up rising 100,000 a year 1987/88 to 1993/94 if no employer's contribution required (average contribution 4 per cent of earnings);
- b) take-up rising 200,000 a year if employer's contribution of 2 per cent required (employee contribution average 2 per cent - total 4 per cent).

Note

There is no reliable basis for these estimates. They are out of a total field of 7 million. In practice, the different impact of each is likely to be negligible.

Option 3

As Option 1

Option 4

As if SERPS had continued, except for contracted-out NIC rebate staying at present level, instead of falling from 1987. Increase in occupational cover (and so tax relief) expected because of simpler contracting-out test and lower SERPS pensions. To be footnoted: no reliable assumptions about numbers possible, but less than under Option 2.

Note

Options 1 and 2 do not take account of the fact that, as matters now stand, the contracted-out rebate will fall from 1988 as a result of the quinquennial review provided for in the Social Security Pensions Act 1975. The effect will be a reduction in the full Class 1 rates and a rise for the self-employed.

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OPTION 1: REPLACE SERPS WITH MINIMUM PENSION REQUIREMENT IN APRIL 1987

A: OVERALL IMPACT

(£ bn)	1987/88	1988/89
<u>Public Expenditure</u>		
- savings agreed by MISC 111	-0.3	-0.5
- higher public sector employers' NICs	+0.4	+0.4
- higher public sector pension contributions	+0.1	+0.1
Total public expenditure	<u>+0.2</u>	<u>nil</u>
<u>Revenue</u>		
- lower <u>rate</u> rebates	+0.5	+0.5
- tax relief on contributions	-0.2	-0.3
- NICs: private sector	-0.8	-0.6
public sector	+0.4	+0.4
- higher public sector pension contributions	+0.1	+0.1
Total Revenue	<u>nil</u>	<u>+0.1</u>
Total PSBR	<u>+0.2</u>	-0.1

N.I.C.
Tax.
Compulsory Contributions

OPTION 1: REPLACE SERPS WITH MINIMUM PENSION REQUIREMENT
IN APRIL 1987

B: IMPACT ON PRIVATE SECTOR

(£bn)	1987-88	1988-89
<u>Effects on private sector employers' costs</u>		
Extra NICs	-0.7	-0.8
Contributions to private schemes	+0.7	+0.8
Gross increase in employers' costs	0.0	0.0
Less tax relief	0.0	0.0
Net increase in employers' costs	0.0	0.0
<i>1/2 b.</i>		
<u>Effects on private and public employees</u>		
Extra NICs	-0.3	-0.3
Contributions to private schemes	+0.8	+0.9
Gross increase	+0.5	+0.6
Less tax relief	-0.2	-0.2
Net increase (ie reduction in take-home pay)	+0.3	+0.4
<u>Effect on self-employed</u>		
Extra NICs	+0.2	+0.5
Contributions to private schemes	+0.4	+0.5
Gross increase	+0.6	+1.0
Less tax relief	0.0	-0.1
Net increase	+0.6	+0.9

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OPTION 2: END SERPS IN APRIL 1987 - PRIVATE PROVISION ON
VOLUNTARY BASIS

A: OVERALL IMPACT

(£bn)	1987/88	1988/89
<u>Public Expenditure</u>		
- savings agreed by MISC 111	-0.3	-0.5
- higher public sector employers' NICs	+0.4	+0.4
Total public expenditure	<u>+0.1</u>	<u>-0.1</u>
<u>Revenue</u>		
- lower rate rebates	+0.5	+0.5
- tax relief on contributions	negligible	negligible
- NICs: private sector	-0.8	-0.6
public sector	+0.4	+0.4
Total Revenue	<u>+0.1</u>	<u>+0.3</u>
Total PSBR	nil	-0.4

OPTION 2: END SERPS IN APRIL 1987 - PRIVATE PROVISION
ON VOLUNTARY BASIS

B: IMPACT ON PRIVATE SECTOR

(£bn)	1987-88	1988-89
<u>Effects on private sector employers' costs</u>		
Extra NICs	-0.7	-0.8
Contributions to private schemes	negligible	negligible
Gross increase in employers' costs	-0.7	-0.8
Less tax relief	nil	+0.1
Net increase in employers' costs	-0.7	-0.7
<u>Effects on private and public employees</u>		
Extra NICs	-0.3	-0.3
Contributions to private schemes	negligible	+0.1
Gross increase	-0.3	-0.2
Less tax relief	negligible	negligible
Net increase (ie reduction in take-home pay)	-0.3	-0.2
<u>Effect on self-employed</u>		
Extra NICs	+0.2	+0.5
Contributions to private schemes	nil	nil
Gross increase	+0.2	+0.5
Less tax relief	negligible	-0.1
Net increase	+0.2	+0.4

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OPTIONS 3 AND 4

OPTION 3: DEFER OPTION 1 TO APRIL 1990

OPTION 4: MODIFY SERPS FROM APRIL 1987 TO REDUCE EMERGING
BENEFIT COSTS

(£bn)	1987/88	1988/89
<u>Public Expenditure</u>		
- savings agreed by MISC 111	-0.3	-0.5
<u>Revenue</u>		
- lower rate rebates	+0.5	+0.5
- tax relief on contributions	negligible	negligible
Total Revenue	<u>+0.5</u>	<u>+0.5</u>
Total PSBR	-0.8	-1.0



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From the Secretary of State for Social Services

Andrew Turnbull Esq
Private Secretary
10 Downing Street

29 April 1985

Dear Andrew

SOCIAL SECURITY REVIEW: PENSION COSTS

- file on C/UP.
Further to my letter of 26 April, I now enclose figures, agreed between DHSS and Treasury officials, showing:

- the impact of Option 1 on contracted-in and contracted-out private sector employers, and on all employees, in 1987/88 and 1988/89;
- samples of the effect of Option 1 on employers and employees at various levels of weekly earnings. (This table was annexed to my Secretary of State's minute of 29 March to the Prime Minister; it is based on current earnings levels.)

All the tables assume minimum private pension contributions of 4 per cent, split equally between employers and employees.

Copies go to Rachel Lomax, Murdo MacLean, Janet Lewis-Jones, Richard Broadbent and Richard Hatfield.

Yours

S A Godber

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Private Secretary

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OPTION 1: REPLACE SERPS WITH MINIMUM PENSION
REQUIREMENT IN APRIL 1987

1987/8 (£bn)	Contracted out	Contracted in	Total
	_____	_____	_____
<u>Effects on private sector employers costs</u>			
Extra NICs	+0.6	-1.3	-0.7
Contributions to private schemes	0.0	+0.7	+0.7
	_____	_____	_____
Gross increase in employers costs	+0.6	-0.6	0.0
Less tax relief	0.0	0.0	0.0
	_____	_____	_____
Net increase in employers costs	+0.6	-0.6	0.0
<u>Effects on private and public employees</u>			
Extra NICs	+0.5	-0.8	-0.3
Contributions to private schemes	0.0	+0.8	+0.8
	_____	_____	_____
Gross increase	+0.5	0.0	+0.5
Less tax relief	0.0	-0.2	-0.2
	_____	_____	_____
Net increase (ie reduction in take-home pay)	+0.5	-0.2	+0.3

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OPTION 1: REPLACE SERPS WITH MINIMUM PENSION
REQUIREMENT IN APRIL 1987

1988/9 (£bn)	Contracted out	Contracted in	Total
<u>Effects on private sector employers costs</u>			
Extra NICs	+0.7	-1.5	-0.8
Contributions to private schemes	0.0	+0.8	+0.8
Gross increase in employers costs	+0.7	-0.7	0.0
Less tax relief	-0.1	+0.1	0.0
Net increase in employers costs	+0.6	-0.6	0.0
<u>Effects on private and public employees</u>			
Extra NICs	+0.5	-0.8	-0.3
Contributions to private schemes	0.0	+0.9	+0.9
Gross increase	+0.5	+0.1	+0.6
Less tax relief	0.0	-0.2	-0.2
Net increase (ie reduction in take-home pay)	+0.5	-0.1	+0.4

THE EFFECT OF A MINIMUM PENSION CONTRIBUTION ON EMPLOYERS' AND EMPLOYEES' COSTS

A. WITH A MINIMUM CONTRIBUTION OF 4% OF EARNINGS (2% A SIDE)

1. EMPLOYERS

Weekly earnings £	<u>Contracted-in</u>		<u>Contracted-out (NIC only)</u>	
	1985/86 (NIC)	After change (NIC + pension cont)	1985/86	After change
50	2.50	2.50	1.91	1.50
70	4.90	4.90	3.49	3.50
100	9.00	9.00	6.36	7.00
120	10.80	10.80	7.34	8.40
150	15.68	15.75	10.98	12.75
180	18.81	18.90	12.89	15.30
200	20.90	21.00	14.16	17.00
265	27.69	27.83	18.28	22.53
500	52.25	52.50	42.84	42.50

2. EMPLOYEES

50	2.50	2.50	2.19	1.50
70	4.90	4.90	4.16	3.50
100	9.00	9.00	7.62	7.00
120	10.80	10.80	8.99	8.40
150	13.50	15.00	11.04	12.00
180	16.20	18.00	13.10	14.40
200	18.00	20.00	14.47	16.00
265	23.85	26.50	18.92	21.20
(UEL)				



29 Apr 1995

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