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cc DW. C 11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

SOCIAL SECURITY REVIEW

file on B/UP

The figures in the note by officials (Mr Godber's letter of 26 April) were not available to MISC 111. It is clearly essential that we take them fully into account before reaching decisions on these important matters.

2. Let me start by narrowing the remaining area of difference between Norman Fowler and myself. Over the whole range of the Social Security Reviews, it concerns solely the question of SERPS. And there is, moreover, agreement that SERPS cannot simply be left as it is: it would impose an intolerable burden of public expenditure and national insurance contributions in the next century

3. The prior question, then, is whether - in the light of the figures - we wish to abolish SERPS in April 1987, with the consequence decided by MISC 111 that there should be compulsory private provision (option (1)), or whether we would do better to keep a quasi-SERPS, but in drastically modified form (option (4)), as the Inquiry into Provision for Retirement itself concluded.

4. The attractions of option (1) are clear. It is a much more fundamental and radical course (although, by the same token, much more controversial), and would lead to greater savings in the next century. But the option (4) savings, although smaller, would still be eminently worthwhile, and would in my judgement reduce the cost of SERPS to a level that we would then be able to afford.

5. On the existing basis, the cost of SERPS peaks at £22 billion a year in the 2030s. Modified SERPS reduces this cost to just over a third, so that the peak cost in the 2030s becomes £8 billion. The main differences between SERPS and modified SERPS are set out in an Annex to this minute.

6. So much for the next century. It is important that we have regard to it. But it is also prudent to consider the effects of what we are doing in the present century. And here, inevitably ~~initially~~ we find that option (1) is considerably more burdensome than option (4). In the calculations that follow, which are drawn entirely from the agreed note by officials, I focus on 1987-88, since it is both the first year of the new arrangements and the last year of the present Parliament; but the agreed figures show that the position in 1988-89 is even worse, and in general there will be a continuing heavy burden.

7. In 1987-88 then, the changes agreed in MISC 111 (SERPS apart) produce modest but much-needed public expenditure savings of £300 million and a total reduction in the PSBR of £800 million. Option (4) secures these gains. Under option (1), however, the whole of the public expenditure savings is wiped out and replaced by a public expenditure increase of £200 million - a net deterioration of £500 million. As it is, we are going to need all the savings we can get. The PSBR reduction of £800 million is similarly transformed into a PSBR increase of £200 million - a net deterioration of £1,000 million. Looking at the fiscal prospect for 1987-88, I simply do not see how we can safely contemplate a worsening on this scale.

8. But the public expenditure and PSBR position is only part of the 1987-88 picture. Overall the figures show no net increase in private employers' costs. But this masks the fact that there are substantial winners and losers. Contracted-out firms lose over £½ billion; the contracted-in gain the same amount. There will be a net reduction in employees' take-home pay of £300 million, again masking substantial numbers of winners and losers. Finally, option (1) imposes an additional burden on the self-employed of £600 million.

9. All in all then, my considered opinion is that to embark on option (1) in April 1987 would be more than a banana-skin: it would be evidence of an electoral death wish.

10. Finally, it may be helpful to look again at option (2) - the abolition of SERPS in April 1987, but with private provision in its place on a voluntary basis, the proposal that

Norman originally put to MISC 111 and I supported - as compared with options (1) and (4). The figures for 1987-88 can be summarised as follows:-

	£million OPTION 1	OPTION 2	OPTION 4
Private sector employers	no net effect	+700 gain	no effect
All employees	-300 loss	+300 gain	no effect
Self-employed	-600 loss	-200 loss	no effect
PSBR	-1000 loss	-800 loss	no effect
TOTAL BURDEN	1900	no net effect	no effect

The contrast between the 3 options is striking and speaks for itself.

11. Although option (2) would clearly be preferable to option (1), I am persuaded that, all things considered (including political considerations not covered in the minute), the best course is option (4).

12. Option (1), by contrast, for all its bold radical appeal, which I fully appreciate, emerges in the figures before us as financially prohibitive and politically disastrous.

13. I am copying this minute to Willie Whitelaw, Norman Fowler, John Wakeham and Sir Robert Armstrong.

Margaret O'Mara

N.L.

29 April 1985

(approved by the Chancellor and signed in his absence)

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ANNEX

Extract from Vol 2

of Draft Green Paper

2.1.44 We have considered whether it might be possible to modify SERPS to meet the arguments against it while avoiding outright abolition. One possibility would be to retain its basic structure, including provision for contracting-out, but to reduce its future costs by (i) basing additional pension rights on a lifetime's average earnings, rather than on the best 20 years; (ii) scaling down the additional pension to give an eighth, rather than a quarter, replacement of earnings above, say £155 a week (the average for a male manual worker); (iii) making contracted-out pension schemes responsible for inflation proofing of guaranteed minimum pensions, up to a maximum of the lower of the retail price index or 5 per cent a year.

2.1.45 This is in many ways an attractive option. It would reduce the cost of SERPS by over £13 billion by 2033/4 and would achieve a greater degree of redistribution than the present scheme. It would also make savings where they can best be made afforded without creating new needs - on the pensions of higher earners.