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From the Private Secretary

30 April 1985

Dear Steve,

SOCIAL SECURITY REVIEWS: PENSIONS

The Prime Minister held a meeting yesterday evening to discuss the future of pension provision. Present were your Secretary of State, the Lord President, the Chancellor of the Exchequer, the Chief Secretary, the Chief Whip and the Minister for Social Services. Also present were Mr. Gregson, Mr. Redwood and Mr. Willetts. The meeting had before it a note by officials attached to your letter to me of 26 April setting out agreed costings of the various options, plus an addendum of 29 April; a minute by your Secretary of State of 26 April; and a minute by the Chancellor of 29 April.

The Prime Minister said the meeting had to consider the options for the future of pension provision, and the agenda for this week's meeting of Cabinet. Time for the latter was short as she and other colleagues had to leave at noon for the Economic Summit. In addition to the standard items and the Social Security Reviews, Cabinet would be discussing gas privatisation and the revision of the Legislative Programme.

The Chancellor said the future liability represented by SERPS as presently constituted could not be sustained and had to be ended. His preference was for SERPS to be abolished, with voluntary provision for private pensions. If that could not be achieved, he recommended adoption of a modified SERPS which would reduce its costs by about two-thirds.

He was, however, extremely concerned about a proposal to abolish SERPS and replace it by compulsory pension provision. This had several disadvantages. First, it wiped out the £0.8 billion saving to be achieved by other measures in the Reviews and in 1987-88 produced a small PSBR cost. The Social Security Reviews as a whole would therefore make no contribution to reducing the pressures on public expenditure and the PSBR. Unlike other measures enlarging the PSBR, this one would not benefit other income groups. Secondly, if the change were made in 1987-88 it would produce adverse effects on the net income of very large numbers of people and companies. While, in the aggregate, employers' net position would be unchanged, those contracted out would lose £0.5 billion at the expense of those contracted in. Employees as a whole would lose £0.3 billion, again with large losses for the contracted out. The loss per week could be as much as £2.65p. The self-employed would lose £0.6 billion in 1987-88 and £0.9 billion in 1988-89. These changes could be extremely unpopular, especially as people would perceive themselves as paying more in return for the same or less. It would be dangerous for the Government to undertake this in pursuit of benefits in the twenty-first century. Modification of SERPS would reduce the liabilities in the next century without incurring these major costs in the immediate future.

Against this it was argued that the Government could not secure support for its proposals, on the backbenches or in the country, if it simply removed SERPS and put nothing in its place. Abolition and replacement by compulsory private provision would achieve a shift from public to private sector provision of pensions. This would give a ~~sense~~ of financial independence to many people and would be a major political prize for which the costs to the PSBR were not out of proportion. With the exception of the self-employed, the pattern of gains and losses was sustainable. Opinion surveys showed that people valued a private pension very highly. In addition, their pension contributions would attract tax relief.

It was further argued that modified SERPS would itself involve many unpopular measures. Women in particular would accumulate much lower pension rights and provision for widows would be reduced. It would expose the Government to an auction of election promises, but still within the same pensions framework. The Opposition would pledge itself to restore the lost benefits and would present the Government in a negative light. Modification of SERPS or abolition without a compulsory replacement would be inconsistent with the "twin pillar" theme of the Green Paper.

It was agreed that the position of the self-employed should be looked at again. They would in any case be paying additional NICs as a result of the abolition of SERPS and for them the burden of compulsory contributions would be too much. Many self-employed people wished to invest their savings in their own businesses, rather than be required, via the financial institutions, to invest in other people's businesses.

It was suggested that SERPS could be abolished on the understanding that compulsion would only be introduced if take-up of voluntary pension provision proved inadequate. It was felt, however, that voluntary provision would be unlikely to develop in these circumstances.

In discussion it was noted that the addition to private sector savings, which could amount to around £1.9 billion, would make it possible to finance a higher PSBR for a given level of interest rates, though it would be unwise to expand the PSBR before demand for additional Government debt had been demonstrated.

The Secretary of State for Social Services said he was anxious to issue a Green Paper by 22 May at the latest. To delay beyond the Whitsun Recess could cause the Government to lose the initiative. The Green Paper could clash with the statement of next year's uprating. He would very much prefer to consider the Social Security Reviews in their entirety at this week's Cabinet, though he recognised that it might not be possible to complete discussion at one sitting given the other items on the agenda. He was investigating the problems of the timetable should decisions on parts of the Reviews be held over until the following week.

The Chancellor said that, given the importance of the decisions facing Cabinet, colleagues should be aware of the implications for business costs, the take-home pay of employees and the self-employed and for the PSBR, of the proposals which were being put before them.

Summing up the discussion, the Prime Minister said that difference in perception about the political attractions about the various options remained. Nevertheless the Social Security Reviews should be put on the agenda as planned though it was likely that it would not prove possible to complete discussion of all the issues in one sitting. The press should be briefed on this possibility. The presentation of the Social Security Reviews should go ahead as planned at 0845 for half an hour. The standard items would then be considered as quickly as possible. They would be followed by discussion of gas privatisation and revision of the Legislative Programme. Following that, Cabinet should start discussion of the Reviews and make as much progress as it could before she and other colleagues had to leave for Bonn. The Secretary of State for Social Services should investigate the timing constraints on publication and should agree with the Treasury revised costings for a scheme which excluded the self-employed from compulsory pension provision.

I am copying this letter to Janet Lewis-Jones (Lord President's Office), Rachel Lomax (HM Treasury), Richard Broadbent (Chief Secretary's Office), Murdo Maclean (Chief Whip's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely

Andrew Turnbull

(ANDREW TURNBULL)

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