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PRIME MINISTER

## SOCIAL SECURITY REVIEW: SERPS

Officials have prepared a separate note on the costs of and practical issues involved in passing out SERPS on the basis we agreed last Wednesday. It might be helpful for colleagues to have my assessment of the position we have now reached.

Cost of SERPS

Projections forward are obviously difficult. But there are some estimates on which we can be virtually certain - notably that the number of pensioners is set to rise substantially. This rise is:

- 1985	9.98 million pensioners
2005	10.1 million pensioners
2015	11.1 million pensioners
2025	12.3 million pensioners
- 2035	12.5 million pensioners.

At the same time projections by the Government Actuary's Department shows that the number of contributors remain about the same. Thus the ratio of contributors to pensioners worsens:

1985	2.3
2015	2.0
2025	1.8

There is no doubt that expenditure on pensions is set to rise significantly. The only question is by how much. The eventual additional cost of SERPS is £23 billion a year - making total pension spending £45 billion a year (on prices upratings) and £66 billion a year (on earnings).

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If we take no action on SERPS the results will be:

- (1) Costs will increase and the contributions of the working population will inevitably increase with them. Taxes will stay up.
- (2) Public spending will be pre-empted - at a time when demands from the elderly will mean more pressure for spending on the health service and personal social services. There will be consequences for all other programmes.
- (3) There will be no improvement in personal occupational pension cover. The trend to more pension benefits provided by the State will continue.

#### Replacement of SERPS

In our recent discussions of the MISC 111 proposal on SERPS, we have identified some problems which need to be overcome, but our objective remains the same. It is to end a system of State provision which will put intolerable burdens on public expenditure and National Insurance in the next century. But there is also the wider objective of giving people a personal stake in the economy on their future through their own pension investment. That is the political prize.

Our concerns have been about the short-term cost of building up new private savings, and the need to prevent those nearing retirement facing a sudden reduction in their pension expectations. I think the transitional arrangements we have now devised meet those concerns. In summary I now propose

- for men now aged 50 and women aged 45 SERPS would continue until their retirement, ie nobody retiring this century would be affected;
- for all other employees SERPS would go over three years from April 1987 and a minimum private contribution requirement would be brought in: 1% each for employers and employees in 1987/88; 1½% in 1988/89; 2% in 1989/90 and beyond;

- National Insurance contributions would be changed to match: those staying fully in SERPS and their employers would each pay an average of 2% more than the rest. For those no longer in SERPS contracting out would be phased out over two years.

The cost implications of this proposal seem to me to be satisfactory:

- we save less in the early years but still achieve almost all the savings originally envisaged when SERPS would have been at its most expensive in the next century;
- the initial impact is less: only an extra £600 million of pension savings in the first year; and just £100 million on the PSBR;
- a net reduction on average of 0.2% in take-home pay and a net increase of only 0.3% in private sector employment costs in the first year;
- even by 1989/90 these net effects are small.

The implications for individuals are also much less worrying. Nobody retiring this century will be affected. As our Gallup Poll showed it is the over-50 age group which is most concerned about pension expectations. For those now just under 50, there will be a reduction in pension expectations if they make only the minimum 4% contribution but they have fifteen years to make additional provision above the minimum if they wish. In general, the position of the younger age groups is satisfactory even at the minimum level. I believe a scheme of this would meet the concern that we should provide an adequate replacement system if SERPS is to go.

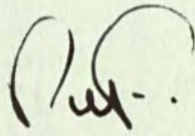
The officials' note covers the questions raised at our last meeting about the compulsory arrangements. I would only add the following general points. First, we are not establishing a compulsory scheme as such. We are putting in place a framework of minimum requirements. This will be consistent with our current legislation

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on transferability and will not worsen the problems of those changing jobs. I certainly see no need for any complex administrative machinery. Indeed, the new arrangements will make the whole concept of personal pensions much easier to realise. That will in turn ease the problems of small employers who do not wish to set up their own schemes.

Second, I believe the minimum standards we set must be seen to do more than simply keep people off supplementary benefit. We will be expected to show that they provide a reasonable replacement for SERPS. For that reason I would want coverage to be as wide as possible and I would not want to reduce the contribution requirement below 4% - 2% each for employers and employees.

Overall the proposals should be seen in the context of what we are already doing to reform the pension system. In the current Social Security Bill we have already given members of schemes transfer rights; protection for early leavers; and better information about their schemes. We have already announced our intention to develop personal pensions. These steps can be seen as a natural foundation for what I now propose.

A handwritten signature in dark ink, appearing to be 'P. G.', is written above a long horizontal line that extends to the right.

6 May 1985

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