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PRIME MINISTER

MINISTERIAL GROUP ON SOCIAL SECURITY:  
Meeting on 31 October  
Flag A - (MISC 111(85)15 and MISC 111(85)16)- Flag B.

## BACKGROUND

The main purpose of this meeting is to consider Mr Fowler's revised proposals on SERPS. You will recall that at the Group's meeting on 15 October Mr Fowler made an initial report on the reactions he had received, and suggested ways in which the Green Paper should be adjusted. In particular, he proposed that SERPS should be modified, rather than abolished, and that the main implementation date for the social security reforms should be April 1988 rather than April 1987. The Group did not finally agree either of these proposals but asked Mr Fowler to do more work on both of them.

2. He is now reporting back on this, and it is most important that if at all possible the Group take clear decisions on pensions policy tomorrow so that preparation of the legislation can go ahead at full speed. (Indeed the issues are so technical and complex that if you do not reach at least broad decisions tomorrow there must be a risk of not being able to get that part of the legislation drafted and through Parliament in the 1985-86 Session). The Group will also be able to take note of the overall position on timing, though Mr Fowler's list of candidates for implementation earlier than 1988 is currently under discussion in the Star Chamber and should not be discussed in detail in MISC 111 at this stage (see further paragraphs 5 to 8 below).

## MAIN ISSUES

Pensions

3. Mr Fowler's paper MISC 111(85)15 recognises that the twin policy



aims on pensions must be to reduce the cost, and attractiveness, of SERPS, and to make contracting out (and especially personal pensions) a more attractive option. At the last meeting the Group were not convinced that the balance of the alternative package Mr Fowler then proposed was right. It still left SERPS looking too attractive, and personal pensions not attractive enough. And the treatment then proposed for the benefits under SERPS meant that savings had to be found by transferring a substantial amount of the cost of inflation-proofing to the private sector which affects the PSBR through the contracted-out rebate.

4. Mr Fowler's new package, agreed with the Chancellor of the Exchequer, is addressed to all these problems.

(a) SERPS

The previous proposals included basing SERPS on average life-time earnings (instead of the best 20 years, as in the existing scheme), and reducing the proportion of a pension inherited by the surviving spouse to 50 per cent (from the existing 100 per cent). These proposals are retained, but it is now proposed that the rate of the pension should be reduced to 20 per cent of the relevant earnings, so that what is now proposed is 20 per cent of average life-time earnings instead of the existing 25 per cent of the best 20 years.

The reduction in the rate to 20 per cent, which applies equally to the calculation of guaranteed minimum pensions under contracted-out schemes, means that the cost of inflation proofing up to 3 per cent can now be moved on to contracted-out schemes without requiring any increase in the rebate.

(b) Encouraging Contracting-out

The proposed reduction in the rate of SERPS pensions, described above, also makes room for a special bonus of 2 per cent on the contracted-out rebate (see paragraph 7 of MISC(85)15). This bonus is the key new proposal that Mr Fowler is making

to encourage contracting-out. It would apply to the new occupational schemes and personal pension holders, and would run for 5 years. This is a simple, clear and visible way of meeting the Group's wish to make contracting-out more attractive, though it should be noted that there is no way of ensuring that employers put the extra money into pensions rather than anything else.

The remaining elements of Mr Fowler's package are not substantially changed from those he put to the Group at the last meeting, when they seemed generally welcome. The most positive proposal is doubtless that every employee should have a right to opt for a contracted-out personal pension. However, whatever declaratory rights of this kind are conferred, the relative attractiveness of buying one's own pension or relying on the State scheme will be dictated by the specific measures discussed above.

(c) Savings and transitional questions

The savings from modifying SERPS in these ways are about £10 billion in 2033, which is beyond the target of £9.5 billion that you set at the last meeting and should be an adequate demonstration of the government's determination to tackle the emerging cost of SERPS. There is, however, an important transitional and potentially controversial point embedded in these costings to which I should draw your attention. It is to do with the rights built up before 1988 by people retiring after the end of the century. (If they retire before the end of the century they will continue to enjoy full SERPS benefits on Green Paper lines). In the context of the abolition proposals then being advanced the Green Paper said that "all those who have already contributed to SERPS will also have their accrued rights preserved until they retire". It will doubtless be argued that people contributing to SERPS between 1978 and 1988 should have their full entitlement for those years when they retire in the

Period 5%

Out: Penn.



next century. The problem about this is that the entitlements presently earned at a rate of 1.25 per cent a year are designed as part of a system that works on the "20 best years" approach. To preserve the entitlements literally conferred by the present legislation for years up to 1988 and then to switch to a lower rate applied to average life-time earnings would lead to very generous pensions for that group when they eventually retired. Honouring literal pre 1988 entitlements is estimated to cost £4.2 billion in 2033. A cost of that order would seriously prejudice the whole exercise and the only sensible way to deal with the matter is as Mr Fowler describes at the end of paragraph 3 of MISC(85)15. Nevertheless, although the government's case on this is a logical and persuasive one that Mr Fowler should be able to present effectively, the language of the Green Paper seems bound to lead to accusations of broken promises, and very great care will be needed in its presentation.

(d) Public Service Pension Schemes

The papers before the Group do not mention this, but you should know that there is a very important issue here, which the Chancellor of the Exchequer is briefed to raise. Put briefly, there would be significant public expenditure implications if the new right to a personal pension led to many people in public service pension schemes contracting-out and if public service employers were pressured into contributing at a higher rate than the normal rebate. It is important that this gets resolved before Cabinet considers the White Paper, since the Defence and Education Secretaries are both much concerned with this. The Chancellor will propose that he will pursue the matter with Mr Fowler outside the meeting: that is clearly the best way to proceed, but it is important that they report back to MISC 111 on 20 November.

(e) Consultations with Industry

Mr Fowler has met the CBI representatives of the pensions



industry. They have emphasised that more than simply modifying SERPS will be required to encourage a significant shift to contracting out. They consider the rules and administrative arrangements governing contracting out would need to be made simple and an incentive provided. The Social Services Secretary believes as a result of these talks that there will be support for modifying SERPS but reservations about the requirement to inflation proof GMPs and some resistance to giving everyone the right to a minimum pension. No new arguments to support this view were advanced and Mr Fowler considers that the Government should not be deflected by these reservations from what is a central plank in the pensions reform package.

#### Other Social Security Green Paper Proposals

5. Mr Fowler has not so far set out for the Group his proposals on the non-pensions aspect of the Green Paper. This means that the Group have not so far been able to take a view on the reform package as a whole. We know, however, that in a number of cases Mr Fowler is proposing changes from the measures set out in the Green Paper in order to reduce the number of losers and make the proposals more presentationally acceptable. We do not yet have details, but the Treasury believe that the new proposals on Family Credit and Income Support are markedly more generous than those in the Green Paper and would add substantially to the costs of the reform.

6. The position is complicated by the Star Chamber. In order to complete its assessment of the scope for savings, the Star Chamber has had to make assumptions about the social security figures and an agreement was in fact reached with Mr Fowler this morning which, though not eliminating the additional bids entirely, would deliver large reductions and largely meet the Star Chamber's own targets (for example, Mr Fowler has now accepted a reduction of £600 million in the bid for the third year). But the Lord President has been particularly careful to preserve

your position and that of MISC 111. Accordingly, the Lord President proposed, and Mr Fowler agreed, that the figures for the third year (1988-89) should be marked as provisional in the autumn statement and subject to the final outcome of the social security review, so that any further changes decided by MISC 111 or the Cabinet can be reflected in the detailed figures that will appear in next Spring's Public Expenditure White Paper.

7. Some of the reductions agreed by Mr Fowler with the Star Chamber involve bringing forward selected review measures to April 1987 (as was originally intended). These are included in an entirely consistent with the list of measures to be brought forward that are set out in paragraph 4 of MISC 111(85)16. I suggest, therefore, that you do not at this meeting seek to discuss these but simply note that some of them have been taken into account in the Star Chamber and that MISC 111 will need to return to them at its next meeting.

8. A further meeting of MISC 111 has been arranged for 20 November. It is most important that Mr Fowler should produce for that meeting a paper on the non-pensions elements of his package so that the Group can take a proper overall view of the reform. I suggest you ask him to do this. Mr Fowler ought in that paper to show clearly the differences between his new proposals and those approved by MISC 111 in the summer, together with their financial and distributional consequences. That meeting will also provide an opportunity to consider further the prospective timing of the Social Security White Paper and its relationship to the handling, substance and timing of the proposed Green Paper on Local Government Finance, on which substantial further progress should have been made by then.

#### HANDLING

9. I suggest you open the meeting by saying that the main purpose is to reach decisions on pensions, so that work can proceed on the Bill and the White Paper. You may also wish to mention that the Star Chamber has been considering some of the non-pensions aspects (you may wish to



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invite the Lord President to comment briefly on this), but that you intend to use the meeting on 20 November to take an overall view of the whole package including non-pensions matters and alongside the decisions that will by then have been taken on the local government finance studies.

10. You will then wish to invite Mr Fowler to speak to his paper on pensions. The Chancellor of the Exchequer will wish to speak next, and you will wish to invite the Trade and Industry Secretary to speak on the acceptability of the present package to the pensions industry. The Chancellor of the Duchy of Lancaster was especially concerned with the balance of the package at the last meeting and you may wish him to comment on the revised proposals from that point of view.

11. If the question of pre-1988 entitlement does not emerge naturally you may wish to ask Mr Fowler to comment particularly on how he intends to handle that aspect.

12. You will then wish to invite Mr Fowler to introduce his second paper on advance review measures and timing, though you will not want the meeting to get into a detailed discussion of the terms he suggested might be brought forward. (These are tied in with the Star Chamber and MISC 111 can take stock on 20 November). The essential point is whether the Group should now accept that April 1988 must be the realistic start date for most of the review measures, given the legislative timetable that is now emerging and the difficulties foreseen with local authorities. There now seems virtually no room for manoeuvre on this, but you will wish the Lord President and the Chief Whip to comment.


#### CONCLUSIONS

13. You will wish to ensure that:

(i) the Group takes clear decisions on Mr Fowler's latest proposals for modifying SERPS and encouraging contracting-out;

(ii) the Chancellor of the Exchequer and Mr Fowler are put on notice to report back on 20 November about public service pension schemes;

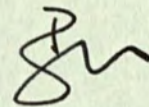




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(iii) the Group take note of the position that is developing on timing, with April 1988 being the main implementation date, and that it will consider the presentation and content of the overall package at the meeting on 20 November;

(iv) that, in particular, Mr Fowler is asked to produce for the 20 November meeting a clear account of how he proposes to adjust the Green Paper proposals on non-pensions matters, including their financial and distributional consequences.



J B UNWIN

30 October 1985  
Cabinet Office

221/10

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CONFIDENTIAL

DW  
To see  
DWR  
24/10  
From: J B UNWIN  
21 October 1985

MR LANGDON

cc Mr Wiggins  
Mr Eland  
Mr Roberts  
Mr Norgrove - No 10 (for info)

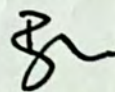
DW  
24/10/85  
SOCIAL SECURITY REVIEW

Thank you for your minute of 18 October about next steps on the social security review.

2. I agree that we should aim to concentrate at next Monday's MISC 111 meeting on the proposals for modifying SERPS and the timing. On the latter, it is important, as you say, for DHSS to be forthcoming on any proposals, either on SERPS or the rest of the overall package, that could still be introduced in advance in April 1987.

3. In the briefing we should remind the Prime Minister that Mr Fowler has still not come clean on the non-pensions part of his package. Let us consider after next Monday whether a further meeting of MISC 111 is necessary to deal with this, or whether it could be handled in correspondence before the White Paper goes to Cabinet. Subject to the outcome of MISC 120, it may be possible for Mr Fowler to reach agreement with the Treasury and with DOE on the components of the rest of the package so that they do not require further Committee discussion.

4. The briefing should also remind the Prime Minister again of the desirability of a sensible overview of the combined effects of this and the local government package before final decisions are taken. Mr Scholar at the Treasury told me at the end of last week that he did not think there would be any great problem in updating the Treasury's distributional analysis as Mr Norgrove has requested. But let us take account of where this stands later in the week.

  
J B UNWIN