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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INFLATION-PROOFED PENSIONS

Note by the Minister of State, Civil Service Department

The Chancellor of the Exchequer's Paper (E(80)16) proposes the de-indexing of public service pensions for at least two years.

2. I share the Chancellor's view that there is considerable disquiet about index-linked pensions in the public sector at a time when inflation is running at a high level, and when these benefits seem disproportionately high.

3. Nevertheless, before any decision is taken to adopt the Chancellor's proposals, I believe we must assess the likely political consequences and decide on our objectives.

Political Consequences

4. There are about 5½ million public sector employees eligible for fully indexed pensions. About 2 million pensioners already receive them. I have since Christmas received hundreds of letters from the public and Members about these pensions. The majority (¾ at least) have been from public service pensioners who were worried by press reports of possible de-indexing. Many have been active Conservatives. About 70 of our supporters in the House have forwarded similar letters to me and many are strongly opposed to de-indexing. Several have gone out of their way to write expressing their concern at the political consequences of such a change.

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5. We also gave specific pledges in Opposition not to remove index linking. At the General Election, I and many other Conservative candidates gave assurances that we would not change the index linking provisions for public sector pensions. This followed the Guidance Note issued for candidates by the Research Department (Annex A). In addition, an unequivocal assurance was given on the Prime Minister's behalf to the Officers' Pension Society in August 1978 that the Government would continue the index linking of Armed Forces pensions (Annex B). In my part of the country there are many serving and retired public servants, most of whom are our supporters. It would be particularly unfortunate just at this moment if any inkling of the Chancellor's proposals were to get out.

6. There will also be difficult questions of retrospection. Many people in the public sector, including Members of Parliament, have bought at considerable expense added years of pension service on the basis that their pensions will be index linked. Having bought the goods, they will discover that in fact they are not getting what they paid for, and will feel cheated. It is no answer to say that the contributions paid are inadequate. They paid the asking price in good faith. Even if we now think that they have a very good bargain that does not entitle us to break it. To take away pension rights retrospectively is I believe unprecedented.

7. The Chancellor proposes that full index linking should stop at the first £1,000 of any pension and be abated by up to 5 percentage points above this level. I understand the presentational point of this, and the concern by those outside about the high level of a few public sector pensions. There would, however, be nothing equitable in this particular cut-off point. Occupational pensions are surely not a handout to alleviate hardship, but are an earned entitlement determined by length of service and final pay, and differentials have been squeezed in recent years. Moreover, pensions are already taxed progressively. We should in effect be going for a further redistribution of income in retirement. This seems to be a very curious egalitarian policy for a Conservative Government to adopt. In fact, including their families, we will probably be

reducing the standard of living of over 1,000,000 people, the majority of whom are likely to be our supporters. Those who have served longest will be hardest hit. The counting of war service, for example, will put some people the wrong side of the cut off.

8. De-indexing would inevitably have a seriously damaging effect on relations with the public service unions at what is already a difficult time.

Anomalies within the Public Sector

9. The Chancellor also recommends that Nationalised Industry pensions should be exempt. This means that we would penalise retired policemen and nurses, but not, for example, retired British Gas Corporation or National Coal Board executives. Could a Conservative Government really put itself in the position of reducing the value of the pensions of the Armed Forces whilst leaving untouched those of bus drivers?

10. What would be gained by this course? Is the objective political? I understand the political advantage of removing the dislike felt by many in the private sector of index-linked pensions in the public sector. But we will be jumping out of the frying pan into the fire. Those who will be opposed to the Chancellor's proposals will be extremely annoyed, and may well be nearly as numerous as those who will be in favour of his proposals.

11. Is the objective to save public expenditure? The Chancellor estimates savings of £100 million if all pensions were treated in the same way, and £50 million if his measures were restricted to pensions over £1,000.

12. Earlier this year (E(80)4), the Chancellor proposed a study, by a small outside group, of ways to ensure that public servants pay a more adequate contribution for their pension. If such a study resulted in only 1% more being paid by those in the main public services (even excluding the nationalised industries) such a saving would exceed £200 million.

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13. I believe a study would be a more politically defensible course and could also raise more money. What I think would be out of the question, however, would be to require public sector employees to pay more for the certainties of an index-linked pension, while actually removing the certainty at the same time. I am glad therefore that the Chancellor sees the study only as an alternative to indexing though in my view it is by far the better one.

Conclusions

14. I invite the Committee to:

- a. consider the potential political difficulties of de-indexing discussed in paragraphs 4 to 8;
- b. agree that, as an alternative to the de-indexing, we should go ahead with the earlier proposal to set up a small group of outside people who would be asked to assess the value of index-linked pensions (as in conclusion 8.2 of E(80)16);
- c. agree that, if b. above is not acceptable, and if de-indexing is to be proceeded with, it must apply to the nationalised industries as well as to the public services.

PC

Civil Service Department

18 February 1980

PUBLIC SECTOR PENSIONS

Question

What will a Conservative Government do about inflation-proofed public sector pensions?

Suggested Answer

The principle of automatic inflation-proofing for certain public sector pensions was first established by the Conservative Government in the Pensions (Increase) Act of 1971. For private sector employees a considerable degree of inflation-proofing is now provided not only in the state retirement pension but also in the new second pension scheme, whether state or private. We are not therefore proposing to change the index linking provisions for public sector pensions.

There is, however, a real problem about the way contributions are assessed in the public as compared with the private sector. The cost of inflation-proofing to the taxpayer has risen substantially as a result of the sharp increase in the rate of inflation. This has given rise to a real sense of grievance amongst those working in the private sector, for whom complete inflation-proofing of occupational pensions is impossible and who feel they have to pay through taxes for the inflation-proofing of others. The most important remedy is, of course, to reduce the rate of inflation as fast as possible.

We would ensure that the independent Pay Research Board is fully satisfied that the deduction which is made from public sector wage settlements for index linked pensions is realistic.

Background Note

Pension contributions are national and are not deducted from public employees' salaries. But their notional value is taken into account in determining fair relationships between public and private pay for comparable work.

Conservative Research Department,
24 Old Queen Street, London, SW1

19.4.79

FROM THE CONSERVATIVE PARTY
3rd August 1978. From the Private Office of the Leader of the Opposition.

I am replying on Mrs. Thatcher's behalf to your kind and informative letter of June 9th. I apologize for the delay in doing so, this was due to the need to consult several people including our Shadow Defence Spokesman, Sir Ian Gilmour. I am now in a position to let you know our policy on the points you raised.

1. Parity in Armed Forces' Pensions

This is a matter that we have considered very carefully. The trouble is that absolute parity, i.e. awarding pensions of equal size for similar periods of service irrespective of their dates, as you seem to suggest, would cost well over £200 million a year in the Public Sector and would have wide implications in the Private Sector. The fact is, as I am sure you appreciate, whenever new conditions of service are introduced, there must be a firm date from which they start. If all new improvements had to be extended to all those who had already retired and their dependants, it would be too costly for any government to make significant improvements at any given time. For example, there are still half a million war pensioners from the two World Wars, which indicates the cost which might be involved.

2. Index-linking of pensions

I can assure you that the Conservative Government will continue with the present arrangements.

3. Pensions for the widows of men discharged before 1st September 1950

I entirely agree it is anomalous and unfair that widows of Other Ranks who left the Services before September 1950 should not receive a pension. It is Conservative policy that a high priority should be given to providing a pension for those pre-September 1950 widows as soon as our economic circumstances permit.

4. Pensions for widows whose marriage had taken place after their husbands retirement from the Services

As you suppose, under the new second pension scheme which began in April 1978 all widows (whether or not they married after retirement age) will qualify in full for that part of their husband's entitlement which is based on contributions made after April 1978.

Your proposals could not be confined to the "post retirement widows" of the Armed Services. They would have to apply to all Public Service Schemes. While I recognise that your Association feels strongly about this matter, you will appreciate that the cost of providing pensions for all widows of men who married after their retirement would be very considerable. It would, therefore, be wrong for me to promise that this change could be made in our present economic circumstances.

5. Half pensions for widows

6. Short term pensions

Your proposals would involve making retrospective improvements introduced into the Service Pension Scheme. I would certainly like to go, at least some way, towards your proposals as soon as our economic circumstances allow. But I would not like to promise early action at this stage.

7. Taxation of war widows' pensions

I agree the present position is anomalous and I can confirm that, as our resources allow, a Conservative Government will take steps to exempt altogether the War Widows' Pension from tax.

8. War preferences

You can be assured that a Conservative Government would continue the preferences to war pensioners."

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