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Ref. A01204

PRIME MINISTER

Inflation-Proofed Occupational Pensions

(E(80) 4)

BACKGROUND

When E (not Cabinet as the Chancellor's paper says) discussed inflation-proofed occupational pensions on 15th January they took no decisions but asked the Chancellor to explain his proposals in more detail and, as an aid to thought, to include also draft terms of reference for the "wise men". It was clear that most colleagues saw considerable political difficulty in tackling inflation-proofing as such, and were attracted by the Chancellor's suggestion that attention should be concentrated on increasing the contribution which staff make to the cost of their pensions.

2. The problem in the Civil Service is that there are elaborate arrangements, built into the basic pay agreements, for determining the value of Civil Service pensions and comparing them with the value of pensions paid to the analogues used as the basis of "fair comparisons". These arrangements involve actuarial calculations by the Government Actuary, and both sides are in effect committed to honour the result of his calculations. The course of the discussion then, and indeed the Chancellor's paper now, sought to avoid this complication by arguing that the "right" to index-linking had a "subjective" value above that within the scope of the Government Actuary's arithmetic, and that a monetary value could properly be set on this for the purpose of pay negotiations. The suggestion of the "wise men" was designed to provide a mechanism by which this subjective element could be valued.

3. The terms of reference proposed by the Chancellor, and annexed to his paper, cover this point in (b). They also add, at (a), a review of the assumptions and methods used by the Government Actuary in assessing the value of full inflation-proofing in public sector pensions and the 60 per cent inflation-proofing achieved on average in the private sector analogue schemes.

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They also include, at (c), a request to the "wise men" to consider how to assess, also for pay negotiation purposes, the value to staff of the higher job security attaching to public sector work.

4. The essential questions for Ministers are:-

- (a) Whether they accept that index-linking of public sector pensions as such is politically untouchable, and that attention should therefore be concentrated on contributions. If so, a willingness to say this at a suitable point would help the saleability of the general proposition to the employees concerned.
- (b) Whether they accept the form and membership of the inquiry as suggested in paragraph 10 of the Chancellor's paper.
- (c) Whether they accept the proposed terms of reference. It would be as well here to consider each of the three elements in turn. Thus:-

(i) The Government Actuary's assumptions and methods.

1:2 The advantage of the Actuary agreeing to use tougher assumptions would be that the results would carry through automatically into Civil Service pay under the terms of the pay agreements. But the Government Actuary is a professional, doing a professional job, and the Inquiry will need to walk delicately, given especially that it is, as proposed, a non-expert body.

(ii) The value of the guarantee. This is the central object of the exercise and on the face of it could yield useful results. But the Civil Service unions are likely to argue that they have no real guarantee of index linkage - being dependent on the whim of Parliament - and, if asked to pay, could well ask, as a quid pro quo, for the guarantee to be strengthened. If there is no real prospect of going back on inflation-proofing - and Governments of both Parties have been aware of the difficulty of doing so - then strengthening the guarantee might not in reality be a high price to pay. The Committee could usefully ask the Chancellor and the Civil Service Department, in parallel

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with the present operation, to consider what form an improved guarantee might take (e. g. could it be written into contracts of service?).

(iii) Job security. Assessment here could well require a good deal of research because the concept of placing a value on job security is unfamiliar. The Committee will want to be clear whether they are asking the "wise men" to suggest methods of assessment or whether they are seeking an early view on monetary value. The former is compatible with a quick operation - because the bulk of the work will be left to be done by someone else at a later stage - but the latter is not, especially if the results are liable to be challenged at arbitration, as they certainly would be if disadvantageous to the staff.

(d) Whether they accept the view in paragraph 12 of the Chancellor's paper that even the limited task for the "wise men" is probably too much to be tackled in time for this year's Civil Service pay negotiations (which effectively start in February) and should therefore be seen as a lead-in to subsequent negotiations either with the non-industrial Civil Service next year or with other parts of the public service this year.

(e) Whether, if there is now more time, they would prefer to consider a more fundamental examination of the problems than that envisaged by the "wise men" - perhaps by way of a Royal Commission.

HANDLING

5. You will want to ask the Chancellor to introduce his paper and then have the views of the Secretary of State for Employment (who saw the Chancellor's paper in draft and does not dissent from it) and the Minister of State, Civil Service Department before opening the discussion more widely.

CONCLUSIONS

6. You will want to record conclusions on:-

(i) Whether the Government is prepared to say that it accepts the continuation of index-linking for public service pensions and proposes to concentrate on getting adequate payment (or deduction from pay) for them from staff in service;

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- (ii) the membership of the new group;
- (iii) the terms of reference of the new group.

7. If the Committee now preferred a more wide-ranging inquiry - perhaps by way of a Royal Commission, you would need to invite the Chancellor, in consultation with the Secretary of State for Employment and the Minister of State, Civil Service Department, to produce specific proposals.

RA

(Robert Armstrong)

22nd January, 1980