PRIME MINISTER

Agree proposed course of action

SCOTT REPORT

Attached is the Scott Inquiry Report which - as I told you - is, on the face of it, disappointing.

The crucial recommendation is to be found in paragraph 30 - namely, that the appropriate "deduction" for inflation-proofing should be somewhere between 3 and 8½ per cent, compared with the "deduction" of 3.8 per cent this year, (The "deduction" is the amount that is deducted from Civil Service salaries to account for the difference between the full inflation-proofing of Civil Service pensions and the 62 per cent inflation-proofing provided to the PRU analogue groups). The recommended range suffers from being neither very specific - the Committee are in effect turning over the task of deciding the exact amount to the Government - and from being a good deal lower at the upper end than many critics of the system had argued for. The reasons for the large range are given in paragraph 128: they essentially concern the assumptions that are needed to be made for the real rate of return on investment, the expected rate of inflation, and the degree of protection against inflation that analogues can expect in years to come.

Nonetheless, if the Government were to decide to go for the upper end of the range in one go, that would be a significant move and pretty controversial at a time when we have suspended PRU. It would be argued that the Government could not at the same time throw out comparability on pay, but apply strict comparability on the pension deduction. For example, it would be very hard to impose a 6 per cent settlement less the additional amount for the "deduction": the resultant figure would come out at just under 1½ per cent. If we wanted to go for a larger "deduction" than 3.8 per cent for presentational and other reasons, we would probably have to start from a higher gross figure than 6 per cent and bring it back to a net figure of around 6 per cent by applying the larger "deduction".

All this will obviously have to be looked at very carefully.

/Other

Other points in the Report:-

(i) It recommends that other employees in the public sector should be removed from the analogues both for salaries and pensions: this would reduce the extent of inflation-proofing for analogue schemes from 62 at present to 50-55 per cent.

(ii) It suggests that the difficulties of arriving at agreed assumptions about the future would be reduced if indexed-linked bonds were available to the pension funds. We have considered many other reasons for issuing such bonds; this is a new one. The argument here is that the return on indexed bonds, as measured by their market value, would reflect the value which people placed on full protection against inflation.

(iii) It suggests that the Government Actuary should in future have wider discussions with outside bodies before making his recommendations.

(iv) It was unable to reach any conclusions on the value of job security.

(v) Paragraph 35 says - "We believe that improvements in current arrangements can be made, but we do not accept many of the extremely high values that have been quoted in criticism of the system."

Handling

The next step is for the Treasury and CSD to put a paper to E, or possibly straight to Cabinet, very early in the New Year. Then, as soon as we have decided on our response to the Report, it would be published. Can I assume that you are content with this?

19 December 1980

cc: Mr. Ingham
Mr. Vereker
Mr. Wolfson
Mr. Hoskyns

Charlotte Stevens
Duty Clerk
for TPL
20 December 1980