

E(79)60

COPY NO 53

26 OCTOBER 1979

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

CIVIL SERVICE PAY RESEARCH: PENSIONS VALUATION

Memorandum by the Lord President of the Council

Introduction

1. At E(79)5th Meeting we concluded that pay research should continue. We have all questioned whether civil service pension benefits provide an unfair advantage compared with others. This paper explains how deductions for the value of civil service pensions are arrived at in pay research and goes on to propose two changes. The Government Actuary should calculate a single figure for the deduction for civil service benefits and that deduction should be submitted to a strengthened Pay Research Unit Board for audit.

What deductions are made for pensions?

2. In Pay Research the pay rates, and other benefits like pensions, of 'outside analogues' are surveyed to provide factual evidence on which civil service rates are negotiated with the unions. The analogues comprise those engaged in work comparable to civil servants' and cover both private and public sector employment in the proportions of 80% to 20%.

3. Civil servants then pay for their pensions in the following way: by two deductions from the equivalent outside pay rates, and by a direct contribution of $1\frac{1}{2}\%$ of salary by male civil servants for widows benefits. The two pay deductions are to reflect:

a. differences in pension contributions between the analogues (4.1% of salary on average) and male civil servants (1.5%);

b. differences in net pensions benefits (this was the 2.6% figure assessed by the Government Actuary for 1979).

The combined effect of these deductions and the contribution for widows benefits is about 7%, greater than the average in the private sector and well in line with other public sector employees who receive similar benefits. Civil servants comprise about 14% of public sector employees whose pensions are inflation-proofed for the most part by legislation. Further background on this and other data are given in the Annex.

What does the 2.6% cover?

4. It is commonly thought that the 2.6% is to cover the difference between full inflation-proofing in the civil service and none outside. In fact, civil service full inflation-proofing is compared with the actual pensions increases awarded, mostly under discretionary arrangements, to the private sector analogues - who have managed on average about 60% inflation-proofing - and to the public sector analogues (full inflation-proofing). The deduction also covers differences in all other pension benefits; and some aspects are better in the private sector. The Government Actuary's 2.6% is the extra amount effectively paid by civil servants for the extra benefits they receive compared with their analogues. A comparison excluding the public sector analogues would lead to a higher deduction, but also to higher pay.

How do we reassure the tax-payer?

5. Pay research is sophisticated and complex and the (present) figure of 2.6% is widely misunderstood. I propose to ask the Government Actuary to combine all the deductions of paragraph 3 into a single figure. This would make it clear that civil servants in fact pay a total of about 7% of salary for their pensions. Further, I propose that the Government Actuary should submit his report on these matters to the Pay Research Unit Board, just as the Director of the Pay Research Unit does, so that the Board in reporting to the Prime Minister can endorse or otherwise comment on the Government Actuary's recommendations. All reports would, as now, be published.

6. To ensure valid and respected comment I propose to include in the arrangements I am making to strengthen the Pay Research Unit Board the appointment of a member skilled and experienced in pensions administration (or insurance) in the private sector, who would be an actuary.

When can we make these changes?

7. The present arrangements for valuing Civil Service pensions and the composition of the PRUB are part of the Civil Service pay agreements. Any changes will have to be negotiated with the Staff Side, and they may take some time to recognise that it is in their members' interest to dispel misunderstanding and suspicions about the fairness of the pensions arrangements. If colleagues approve my proposed changes I intend to seek the earliest possible implementation but it may not prove possible to introduce all of them in time for the 1980 settlement.

Recommendations

8. I recommend that:

- the Government Actuary should provide a combined single figure to cover the value of pensions;
- the assumptions and method used be submitted to the Pay Research Unit Board for audit;
- a pensions (or insurance) expert be included on the Pay Research Unit Board.

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26 October 1979

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Pay Research: Background note on pensions

1 One half ($11\frac{1}{2}$ millions) of all employees are in pension schemes. Of these, some $5\frac{1}{2}$ millions are in public sector schemes and receive fully inflation-proofed pensions:

	Number of employees (m)	Members of pension schemes (m)
Private sector	15.8	6.1
Public sector (including 732000 civil servants)	<u>7.2</u>	<u>5.4</u>
Total employed work force	<u>23.0</u>	<u>11.5</u>

2 Public sector contributions: some examples*
(In practice all 100% inflation-proofed)

	Employee contributions (%)	
Public Teachers	6	
Services Local Government - manuals	5	
- others	6	
NHS - manuals	5	
- others	6	
Police - men	7	
- women	5	
Fire	$6\frac{3}{4}$	
MPs	6	
Armed Forces	6	
	Review body makes pay deduction	
Nationalised industries		
Gas	6	
Electricity	6	
Steel - white collar	8	
- manuals	$5\frac{1}{4}$	
Coal - white collar	$5\frac{1}{4}$ (women), 6 (men)	
- manuals	$5\frac{1}{4}$	
3 Private sector contributions and inflation-proofing: some examples*		
	Employee contributions (%)	Degree of inflation-proofing since 1974 (%)
Abbey National	$2\frac{1}{2}$	55
ICI	$2\frac{1}{4}$ on salary up to £7020, $6\frac{1}{2}$ thereafter	74
Marks and Spencer	nil	61
Shell	2.2 on salary up to £7020, 6 thereafter	73
Barclays Bank	nil	67
Reed International	5	40
Unilever	nil on salary up to £7020, 8 thereafter	69

*The basic figures given here do not, of course, cover numerous differences in the pension schemes, which affect the comparison between individual schemes, such as the length of service required to earn a full pension and what proportion of final salary that pension represents.