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P.0190

PRIME MINISTER

INFLATION-PROOFED PENSIONS

(Minutes to you from the Chancellor of the Exchequer dated 10 January and from the Minister of State, Civil Service Department dated 11 January)

BACKGROUND

*see
Cm 102 (Pub Ex)
P.7* { When the Cabinet discussed public expenditure on 13 December 1979 (CC(79) 25th Conclusions, Minute 6) a good deal of attention focussed on the malign effect of the Retail Price Index (RPI) on public expenditure generally. Although no conclusions were reached there was a widespread view that all index-linked expenditure, including social security benefits and public sector pensions, ought to be looked at again. However, in the discussion the Chancellor indicated, and he had discussed this view with you before the meeting, that attention on public sector pensions might more fruitfully be concentrated on the contributions made by employees rather than by seeking to remove index-linking as such. Following this thought his minute to you of 10 January suggests that, in order to get results usable in this spring's pay negotiations with the non-industrial Civil Service, there should be a quick and subjective review by a small group of people of distinction, authority and experience who would be asked to establish a principle to be used in evaluating inflation-proofed pensions in public sector pay negotiations. By way of illustration he suggests a group comprising Lord Boyd-Carpenter, Alex Jarrett (Chairman of Reed International and an ex-Civil Servant) and R E Holland (Chief General Manager of Pearl Assurance). In his minute of 11 January Mr Channon supports this approach.

2. I understand that the Secretary of State for Employment* is likely also to concur with the Chancellor's general proposition though he will have points to make about the membership of any group and will want to return to the

*in the form
P.*
*Minute of 14 January now received

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parallel problem of evaluating job security (which is currently being looked at in general terms by the Clegg Commission).

3. This area is of course a political minefield because, while index-linked pensions give rise to a good deal of criticism, they are enjoyed as a statutory right by large numbers of public employees ($5\frac{1}{2}$ million of them, according to the Lord President's memorandum of 26 October last to E Committee (E(79) 60)) and are seen by them as a protection against the employer depressing the real value of his pension commitments. Apart from the large number of public sector employees involved it is relevant also that all state retirement pensions are index-linked as is the earnings-related supplement which enables all non "contracted-out" employees to build up a higher pension entitlement under the national scheme. Most of the working population, therefore, have a direct interest in the principle of index-linking. Moreover, as the Chancellor pointed out in Cabinet, the public sector beneficiaries include "emotive" groups like nurses and members of the armed forces. And they also include many of the most articulate members of society. It was no doubt this consideration which led the Chancellor to prefer to tackle the contributions rather than the pensions end of this particular equation.

4. Your colleagues may or may not want to take a decision now on whether they accept the principle of index-linked pensions as such - and thus concentrate wholly on the adequacy of contributions - or whether they prefer to keep all their options open. Even if they feel that political realism points to the former course, however, they may nevertheless see advantage in keeping options open for the time being as a pressure point when negotiating higher contributions from Government employees.

5. However that might be, the Chancellor's minute is concerned with contributions and must be judged in that light. It has two weaknesses:-

a. The objective of the inquiry as described in paragraph 2 is "to establish a principle which is capable of being adapted to the variety of different [public sector] cases" which should then be "applied as widely as possible". But in paragraph 8 the inquiry is seen as "applying its subjective judgement and stating, without

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any pretence at precise mathematical accuracy, a broadly reasonable figure to reflect value". These objectives are not necessarily compatible.

b. It is short of facts, in a situation where these can constrain Government action.

6. If the inquiry is to be asked to advise on principles it risks being an unguided missile. Thus an obvious principle might be that the contributions of staff to their pensions should adequately and consistently reflect the value to them of those pensions. But there are wide differences within present public sector pension schemes in the value for money which contributors obtain. I understand, for example, that the Armed Forces Pay Review Body reflects pension rights in its awards by broadly following Civil Service practice. But because they are paid at an earlier age, armed forces' pensions have a significantly higher total value than do Civil Service pensions. The effect of this principle might therefore be that the contribution to be exacted from the armed forces, and possibly the police, to reflect pension rights would be considerably higher than at present.

7. An inquiry directed to principle could well suggest that, for clarity, Civil Service pay rates should be struck before, not after, allowing for the value of pensions and payment made for pensions by the staff from current earnings. Such an arrangement would reflect current private sector, and some public sector, practice and would have presentational advantages. It would however lead to a substantial once for all increase in the Government's apparent pay bill - an outcome which the Chancellor might not welcome. It would also raise questions about the size of the Government's own contribution to the pensions of its employees (at present thought by the CSD to be roughly on a par with private sector practice - at about 10 per cent of the wages bill) and might lead to pressure for the establishment of a pensions fund. This need not be an unwelcome development in itself but could have substantial implications in the Chancellor's field.

8. Given the wide disparity between staff contributions to pensions in the public sector (see Annex A to E(79) 60) it is unlikely that the inquiry would

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be able to come up with a subjective valuation of index-linking as such - and indeed to do so would run into precisely those problems of professional competence to which the Chancellor draws attention in paragraph 9 of his minute. There is however one element of the value of index-linking which could be susceptible to value judgements - the value of the "guarantee" as opposed to the "best endeavours" basis of many private sector schemes. But even here there are snags: the staff could argue that, as no Government can bind its successor and Parliament is free to change the law, the "guarantee" is less solid than it appears; and the present pay agreement with the non-industrial Civil Service requires the value of pensions to be actuarially calculated and the staff have the right to go to arbitration (subject only to a Government veto on grounds of "policy") if they do not like the deduction proposed. In the case of teachers, of course, the veto can only be exercised by joint resolution of both Houses of Parliament.

9. The Committee will come to its own view but, given the complexities of public sector pensions generally it is arguable that quick and easy solutions are not available. The alternative would be to launch a full-scale inquiry either in-house as a preliminary to further decisions or externally through a Royal Commission or a Select Committee. Any such inquiry would however preclude action being taken in time to influence the pay negotiations, or Review Body reports, due this spring.

HANDLING

10. You will want to ask the Chancellor of the Exchequer to introduce the subject and then call for contributions from the Minister of State, Civil Service Department and the Secretary of State for Employment. You might then, I suggest, seek to direct the Committee's attention to four questions:-

a. Do they accept that index-linked pensions in the public sector should be retained and attention concentrated on ensuring that staff contribute adequately to the cost of the pensions?

b. Is the Chancellor's suggested quick inquiry an adequate response to the problem?

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If so

- c. /what membership would they wish to see and what guidance can be given on drafting the terms of reference?
- d. If not do they favour a major inquiry and if so in what form?

CONCLUSIONS

11. Very much subject to discussion, the conclusions of the meeting might be:-

- i. [That the Committee accept that the principle of index-linked public sector pensions will have to be retained] and immediate attention concentrated on the size of the contributions made by staff; and either
- ii. that the proposals made in the Chancellor's minute of 10 January should be accepted and the Chancellor invited to consult further with colleagues on membership and terms of reference ; or
- iii. that the Chancellor be invited to bring forward proposals for a wide-ranging inquiry by [a Royal Commission] [a Select Committee of the House] into public sector pension schemes generally; or
- iv. to invite the Chancellor to commission an 'in-house' study of public sector pension schemes and the implications of change as a preliminary to further consideration of the issues by the Committee.



P Le CHEMINANT

Cabinet Office
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