MJ

PART 2

Confidential Filing

Inflation Proofed Pensions.
Inquiry into the Value of Pensions.

ECONOMIC POLICY

Part 1 : January 1980

Part 2 : November 1980

* Additional copies of Scott Report in folder in Box.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~8.12.80~~							
~~19.12.80~~							
~~22.12.80~~							
~~13.1.81~~							
~~28-1-81~~							
~~29.1.81~~							
~~5-2-81~~							
~~9.2.81~~							
~~12.2.81~~							
~~4-3-81~~							
~~6.3.81~~							
~~10.3.81~~							
~~13.3.81~~							
4-6-81							
— ends —							

PART 2 ends:-

4.6.81

PART 3 begins:-

10.7.81

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C(81) 3	09/01/81
CC(81) 2nd Meeting, Item 4	15/01/81
H(81) 40	03/06/81

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed OWayland Date 29 March 2011

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Cmnd. 8147
Inquiry into the Value of Pensions
Published by HMSO, February 1981

Signed OMWayland Date 29 March 2011

PREM Records Team

CONFIDENTIAL

cc: Mr. Hoskyns
Mr. Wolfson
Mr. Duguid
~~Mr. Lankester~~ Econ Pol

MR. WALTERS

Indexed Pensions

Thank you for sending me a copy of your note of today's date to the CPS about indexed pensions. I have read it with interest, particularly on the proposal for buying out. You and others here may wish to be brought up to date on the work that is going on at official level (in VP Committee) following up the Scott Report.

We have now just about completed an interim report for the Ministers (the Chancellor and the Lord President in the first instance) which should go to them this weekend. It seeks approval of Ministers for the examination in greater detail of a restricted range of options, taken from the very wide number of possibilities available. Our favoured options are:-

a) A straight increase in contributions, probably coupled in the case of the Civil Service and Armed Forces with a move to a formally contributory scheme (like nearly all other public sector schemes). We are suggesting that contributions could be levied at a rate of 10% or so, compared with the present rate of 8% in the Civil Service and 5 - 7% in most other public services.

b) Restricting the indexation financed by the Government or employer to the average private sector practice in any one year. As a variant on this it might be possible to finance the difference between everyday private sector practice and full inflation-proofing by a pay-as-you-go contribution from employees.

c) Restricting pensions increase by a cut-off point which might be expressed either as an absolute percentage figure, a proportion of inflation, or a proportion of inflation above a threshold.

/ d) .....

CONFIDENTIAL

d) Discretionary power, for use in exceptional circumstances and within a pre-determined limit, to increase pensions by less than the rate of inflation.

Buying out is not considered in any depth in our paper, becuase the terms of reference of the group are restricted to the issues raised by the Scott Report. But there is nothing to prevent buying out being considered at the point of which our report is taken by Ministers. The mechanism would be for Ministers to ask the group to include it among the options for further study.

There has ~~to~~ been some discussion within this office of the benefits of using word processors. Those interested might like to know that the 73 paragraph, rather complicated and extremely dull report being provided by the group was put on a word processor sometime ago, as a result of which it has been possible to incorporate an endless number of drafting changes very quickly, and to churn out beautifully typed revised drafts with no difficulty. For this kind of task, the merits of a word processor are clear.

J. M. M. VEREKER

4 June 1981

Weekend box

AIMS OF INDUSTRY

The free enterprise organisation

FREEDOM NEEDS FREE ENTERPRISE

FOR RELEASE: 00.01 hours, Thursday, May 7, 1981

R 7/5

CALL FOR GOVERNMENT
TO AVERT
PENSIONS DISASTER

Britain has a time bomb ticking away, threatening to blow up in our faces, says a new study out today. If the bomb - index-linked pensions guaranteed to the public sector - goes off, the result could be financial catastrophe.

The danger lies in the Government approving the totally unsatisfactory report on civil service pensions produced by the Scott Committee. And also the contrasting treatment of different sectors of the community, suggests Alfred Sherman, director of studies at the Centre for Policy Studies.

In "The Scott Report - Pension Time Bomb"*, published by Aims of Industry, the free enterprise organisation, he calls on the Government to look again at the whole "golden chains" system of perks and pensions. He recommends the abolition of index-linked State sector pensions. "There is nothing to stop civil servants from having an occupational scheme providing it is not out of line with private sector arrangements" (p.14).

m.f.

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* "The Scott Report - Pension Time Bomb", by Alfred Sherman (Aims of Industry, 40 Doughty Street, London WC1N 2LF), 60p.

40 Doughty Street, London WC1N 2LF Tel: 01-405 5195

Mr Sherman says that, if any lesson is to be learned from the Scott Report, it is that when governments shuffle off their decision-making responsibilities to committees matters are only made worse (p.15).

He points out that unless the public sector is radically reduced, inflation will continue to escalate. Six attempted "cures" since 1949 have been short lived. Securing State employment and subsidy has become an aim in itself (p.2).

The attempt by those who live off the State to pay themselves generous inflation-proofed pensions - creating further inflation and general stagnation - is an example of our present social malaise.

A basic question for the Government, Mr Sherman argues, is: how high a proportion of the labour force could we afford for activities which produced neither tradeable goods or services, nor ones essential to society? (pp.3-4).

Sir Bernard Scott and his members of the "great and good" were asked a question about the future values of different inflation proofing and relative job security. But, says Mr Sherman, the only honest answer the committee or anyone else could give was: We do not know. The answer depended on imponderables - developments in every country, in all potential customers and competitors, in trade-groupings, on possible invaders (pp 4-5).

Mr Sherman charges the Government Actury with making calculations based on Utopian assumptions, that inflation after 1980 would average 7% and the return on investment would on average exceed inflation by 3% a year. That was a far better performance than actually occurs (p.5).

Of the suggested possibility of indexed bonds to cover pension liabilities, he says: "Had government bonds been issued in the past with returns comparable to the Government Actury's assumptions, an accumulative obligation of several hundred millions yearly would have been incurred". The Public Sector Borrowing Requirement might have been doubled just to make good those bonds (p.8).

m.f.

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m.f.

People without inflation-proofed pensions or salaries, or security of employment, might feel piqued, the Scott Report admitted. Yet it offered only the hope that "one day they too may enter the Kingdom of Heaven by the back-door, or, if not, then perhaps the Kingdom may eventually run down anyway" (p.11).

To try to offset even a quarter of the fall in value of private pensions caused by inflation could bankrupt many firms.

The real message should be that it is impossible to cost inflation-proofed pensions. Nor should some groups enjoy inflation proofing at the expense of the more productive section of the population. "It is impossible to guarantee everyone inflation proofing without the most complete fraud," Mr Sherman declares (p.13).

- End -

Enclosure: "The Scott Report - Pension Time Bomb".

Note to Editors: The National Association of Pension Funds annual pensions survey, covering more than 50% of occupational pensions, showed only 2% of private schemes "guaranteeing" to keep pensions in line with inflation compared with 68% of public sector schemes.

Further information: Malcolm Hoppe 01 405 5195
Michael Ivens 01 405 5195
Alfred Sherman 01 828 1176

From: T A ...

Econ Pol

CIVIL SERVICE DEPARTMENT

WHITEHALL LONDON SW1A 2AZ

Telephone Direct line 01 273 5360

Switchboard 01 273 3000

cc -

Mrs Brown
Mr Saunders - on file
Parly Clerk - for No 10 Records

N Smallman Esq MA LLB
Chairman
New Towns' Chief Officers Association
Peterborough Development Corporation
Touthill Close
City Road
Peterborough
PE1 1UJ

24 March 1981

12

7/4

The Prime Minister has asked me to reply to your further letter of 9 March about the publication of this year's PRU Reports.

2. As you know, the Government's view is that the Civil Service pay settlement this year should be based on cash limits, reflecting what the country as a whole can afford, and not on pay research. Ministers therefore decided that for the 1981 settlement, the proper course would be to suspend the Civil Service Pay Agreement and the Pay Research procedures governed by it. As the Agreement was suspended, the Pay Research Unit decided that it would not be appropriate to publish the 1981 PRU reports. The documents have not therefore been delivered to either the Official or Union Sides. This decision was, as you may know, challenged by the Council of Civil Service Unions in the High Court, but their case was dismissed. The reasons for the decision were set out fully in the course of those proceedings and in the Government's view they remain valid.

3. The Government recognises that civil servants are concerned about the way in which their pay will be settled in the future. The present pay research arrangements were set up some 25 years ago and in some respects have come to lack public confidence. Both the Government and the Union Side have said that they wish to see changes in the system. The Lord President of the Council told the Civil Service Unions on 23 February that the Government intend to review the arrangements for determining the pay of non-industrial civil servants, with the object of establishing as soon as practicable an ordered and agreed system which takes account of all relevant factors and which will command the widest possible acceptance. Talks have already been held and the Government hopes that further work and discussions will lead to the establishment of satisfactory new arrangements for determining Civil Service pay.

T A A Hart

JS

Ecan Pol

10 DOWNING STREET

From the Private Secretary

13 March 1981

I enclose yet another letter from the New Towns Chief Officers Association. You will see that Mr. Smallman is dissatisfied with the reply which you sent to him on the Prime Minister's behalf on 3 March. I should be grateful if you would arrange for a reply to be sent to Mr. Smallman's latest letter on the Prime Minister's behalf, letting us have a copy for our records in due course. I am sure it would help if your reply could be sent to him more quickly than the last.

TPL

CS

Jim Buckley, Esq.,
Lord President's Office.

HS

13 March 1981

I am writing on behalf of the Prime Minister to acknowledge your further letter of 9 March. This is receiving attention and a reply will be sent to you as soon as possible.

T.P. LANKESTER

Neville Smallman, Esq.

cc Mr. Lankester
Mr. Wolfson
Mr. Hoskyns
Mr. Duguid

P

MR. VEREKER

1. The cost of an indexed pension at a zero real rate of return can be found roughly as follows.

Assume: 40 years working
12 years retirement
3 years lump sum

Pension is 2/3rds average lifetime nominal salary (it is about one half the highest terminal salary).

Then $(15 \times \frac{2}{3}) \div 40$ is the fraction of the salary that, each year, must be put aside for pension $\simeq$ 25%.

However we have to add on widows benefit and dependent children etc. (as well as payments for administration) so I get a minimum of 30%. Now if real earnings increase at circa 1½-2½ per cent per annum, then the cost will be considerably higher - since pension is based on terminal real salary. My 40 per cent gives some allowance for this factor but only at the lower range. Thus I am fairly sure that, with 2 per cent growth in real wages, 40 per cent is not a silly figure - certainly not much too high.

2. The differences between these elementary calculations and those in the Scott Report are due to the fact that Scott did not report the cost of a pension. It reported in table 4 page 34 only the cost difference between the Civil Service pension and the so-called "analogue" in the private sector. I think that if you calculate, even with Scott assumptions, the cost of a Civil Service pension, you will not be all that far from my rough approximation of 30-40%. But I have not done the rather extensive arithmetic involved.

3. On the point about "buying-out", I doubt if we can put a figure on it since there is no market - and I would not like to guess what values should be placed on such unprecedented deals.

4. On "amending existing rights" I thought that politically the problem was that indexed pensions in the Civil Service were so much

better than analogues. In which case my suggestion is sensible. But I may be quite wrong about the political problem.

5. Finally, I did not follow your arguments on paragraph 2 of page 2. You say "increasing the cost will do nothing to reduce immobility". It seems to me that it will, <u>cet par</u>. But perhaps I have misinterpreted you.

6. I agree that it is not yet in a form suitable for P.M.

AW

11 March 1981

R H

Econ Pol

cc:- J Buckley, CSD

10 March, 1981

The Prime Minister has asked me to thank you for your letter of 21 February about the Scott Inquiry. She has asked me to assure you that the representations made by the Alliance will be taken fully into account before any decisions on the Report are taken.

T. P. LANKESTER

M E Yates, Esq

1PS

The New Towns Chief Officers Association

an affiliate of the Association of First Division Civil Servants

Your Ref

Our Ref: L/NS

Date: 9 March 1981

The Rt. Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
Whitehall
London
SW1A 2AZ

R10

Dear Prime Minister

PUBLIC SERVICE PENSIONS

I have now received a reply to my letter to you of 15 January - from Mr. Hart of the Civil Service Department. A copy is enclosed for your information.

In referring the letter to that Department you no doubt intended that I should have a reply to the matters I had put to you. But you will see that in fact I have not.

Subsequent to my last letter the content of the Scott Report became public knowledge. But the fact that it confirmed that public service pension arrangements are adequately taken account of in salary determination is not the issue.

The issue concerns the commissioning of the report, not its findings.

As Civil Service Salaries are paid by the public it is right that the public should be satisfied that determinations are made on proper and relevant criteria. In this respect the Government has two equal responsibilities - to the public to demonstrate that the salaries it pays to its employees are so determined, and to its employees to so demonstrate.

Pension arrangements are one, but only one, of the factors taken under consideration by the pay research unit. The commissioning of the Scott report indicated an acknowledgement by the Government that there was room for doubt about the adequacy of the value placed on pension arrangements and, by necessary implication, about the results of the work of the pay research unit.

Chairman
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D E Bath B.Soc.Sc., Dip.T.P., M.R.T.P.I.
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A J Adams F.C.A., I.P.F.A.
Warrington Development Corporation
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Tel (0925) 51144

As matters now stand one pay factor has been independently confirmed. As regards the other factors either they, too, are in doubt or they are not.

If they are in doubt a further independent report should be commissioned and published in the same way as the Scott Report. If they are not in doubt the Government should say so. To do or say nothing would be at best unfair to the Government's employees to whom the Government now clearly owes it to publish the results of the most recent pay research exercise regardless of whether the Government decides it has the resources necessary to implement it or not.

Because the Association I am privileged to chair plays no direct negotiating roll, I feel I can properly invite you to consider this question: whatever salary settlement is now to be made for the Civil Service it will inevitably fall far below the level impartially recommended and justified by the pay research unit whose report has so far been withheld. Assuming the absence of any material doubt about the aptness of the other criteria employed, is it not right and fair that the public should be informed, by the publication of that report, of the full extent of the forfeit which the Government is expecting its own employees to make.

The Government may well, as Mr. Hart says, be mindful of the need to ensure that issues relating to the public service are fairly and fully presented - a rather facile statement, if I may say so with respect. Some evidence of that would be welcome, preferably in the way I have suggested.

And having now twice written and having received responses which have not addressed themselves to the matters put, may I respectfully express the hope that on this occasion I may be favoured with a relevant reply.

Yours sincerely

Neville Smallman

NEVILLE SMALLMAN
CHAIRMAN

Civil Service Department
Whitehall London SW1A 2AZ

01-273 4400

From the Private Secretary

Nick Sanders
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

9 March 1981

Dear Nick,

Thank you for your letter of 24 February enclosing one which the Prime Minister has received from Mr M E Yates, the Honorary General Secretary of the Civil Service Pensioners' Alliance. As requested I attach a draft Private Secretary reply.

Yours sincerely,

Jim Buckley.

J BUCKLEY

DRAFT LETTER FROM PS/PRIME MINISTER TO:

M E Yates Esq
Hon General Secretary
Civil Service Pensioners' Alliance
55 Morley Road
Chaddesden
DERBY DE2 4QU

The Prime Minister has asked me to thank you for your letter of 21 February about the Scott Inquiry. She has asked me to assure you that the representations made by the Alliance will be taken fully into account before any decisions on the Report are taken.

CONFIDENTIAL

cc Mr. Lankester
Mr. Wolfson
Mr. Hoskyns
Mr. Duguid

MR. WALTERS

Econ Pol.

The Value of Indexed Pensions

Thank you for sending me a copy of your minute of 5 March, enclosing a draft minute for the Prime Minister about indexed pensions.

I entirely take the point about the desirability of the extension of the market for indexed gilts, as the basis for providing a fully costed indexed pension scheme.

But I am less happy about some of your other conclusions, which seem not clearly to follow from the preceding argument. You say that the cost of a fully indexed two-thirds pension is about 30-40% of salary, because Scott assumed a 3% real rate of return, whereas a zero real yield is a better estimate of the market rate. Scott himself did not estimate the effect on the "deduction" of a zero real rate of return, but in table 4 on page 34 of the report he increases the deduction by 1% for each 1% reduction in the rate of return, so it is fair to assume that he would have calculated a 7% deduction for a zero rate of return. Adding to that the other contributions identified in table 3 on page 25, which together amount to 3.7%, we have an estimated cost of 10.7%. How do you reach so much higher a figure?

Second, you concluded that buying out existing pension rights would be unattractive in the foreseeable future, but it is not clear why. Is it because to do so would be unreasonably high? Can we put a figure on it? Third, you say that we could amend rather than abolish the existing rights, perhaps by making Government pensions keep pace with analogued pensions. Are you here arguing in favour of the cut-off technique, whereby the pensions increase would be limited to a fixed percentage, or a fixed proportion of inflation? If so, why is this more politically acceptable than abolishing the existing right to index linking?

/I do

CONFIDENTIAL

I do have some doubts about minuting the Prime Minister with all this. As a subject it contains so many related sub-issues that it is not really yet in a fit state for political decision; that I think is why Ministers have referred the Scott committee report to an official group, which is just starting its work now. I am the No.10 representative on this group, and you may like to see the first paper circulated by the Chairman, which I now attach. It is an attempt to order the work of the group in such a way as to provide for the major issues of principle to be put to Ministers within a month or so, with the possibility of a White Paper before the Summer Recess. If you have any comments on the paper, or any views that you would like me to feed into the work of the committee, I should be glad to have them (the first meeting is on Budget Day, and I shall probably not be able to attend, but in fact most of the work is going to be done in an informal sub-group, of which I shall also be a member, because the main group is so large as to be unwieldy).

Subject to the views which others may have, my own approach is roughly as follows. Ministers have two aims in looking at indexed pensions: they want to cut down the cost in terms of public expenditure, and they want to reduce the disparity between the public and private sectors which they believe leads to restricted interchange. The two ways of approaching indexed pensions are to increase the cost, or to reduce the benefits. Increasing the cost does nothing to reduce immobility, and also poses difficulties in the absence of pay comparability, which removes the basis for calculating the cost. Therefore we need to find some way of limiting the benefits, and in particular of limiting the benefits received by existing pensioners, rather than by existing contributors in the future, since it is existing pensioners who have paid least in real terms and who represent the current public expenditure burden. We should therefore move quickly to put a ceiling on the annual increases by one of the techniques discussed in Scott. We could keep the principle of indexation if we stick to the fiction that we believe the Government's policies will ensure that inflation seldom if ever exceeds 10% and set the annual ceiling at 10%. We could then

/encourage

encourage private sector schemes to close the gap with the public sector on the basis of the indexed financial assets which you have discussed.

J.

6 March 1981

cc - Parliamentary Clerk

CIVIL SERVICE DEPARTMENT
WHITEHALL LONDON SWIA 2AZ
Telephone Direct line 01 273 5360
Switchboard 01 273 3000

Neville Smallman Esq MA LlB
Chairman
The New Towns Chief Officers Association
Peterborough Development Corporation
Touthill Close
City Road
Peterborough PE1 1UJ

3 March 1981

TL 7/4

The Prime Minister has asked me to thank you for your further letter of 15 January about public service pensions, and to reply on her behalf.

2. As I understand it, your point is that the Scott Report, by concentrating on public service pensions, may lead to an unbalanced and ill-informed public discussion of the total remuneration of public servants. I hope that, having now seen the report, you will agree that this is not the case. The Report, which is written against a background of pay comparability (and particularly the civil service pay research mechanism) makes it clear that pensions are only a part of public service remuneration. It offers a thoughtful analysis of this very difficult issue and brings out a number of important factual points which have sometimes been misrepresented in public discussion.

3. The Report shows, for example, that 40 per cent of employees in occupational pension schemes (virtually all in the public sector) can expect to receive index-linked benefits. Only one in eight of these are civil servants; others include the armed forces, policemen, doctors, dentists, nurses, teachers, MPs, and the judiciary, miners, postmen, railmen and so on. It also emphasises that the pension contribution paid by civil servants is getting on for twice the average contribution paid in comparable outside work. The contributions paid by other public servants for similar benefits can be related to this.

4. I can assure you that the Goverment is fully mindful of the need to ensure that issues relating to the public service are fairly and fully

/presented.

presented. The Scott Report has already contributed to a more balanced discussion of public service pensions and it will continue to be a valuable source of information and analysis. In presenting the Report to Parliament the Prime Minister said that the Government wished to take full account of the reactions to the Committee's findings. That process of public consultation is now taking place and I have no doubt that any formal observations which your Association may wish to put forward would be welcome.

Yours sincerely,

T.A.A. Hart

T A A HART

File

DSJ

bc: HMT
CSD
Econ Pol

10 DOWNING STREET

From the Private Secretary

3 March 1981

The Prime Minister has asked me to thank you for your letter of 1 March about the Scott Inquiry. She has asked me to assure you that your representations will be taken fully into account before any decisions on the Report are taken.

T. P. LANKESTER

G. H. Massey, Esq.

PPS - CF

cc: CSD
5/3 AMT

The National Federation of Post Office and Civil Service Pensioners

(Member of the Public Service Pensioners' Council and the Civil Service Pensioners' Joint Consultative Committee)

General Secretary
G. H. MASSEY
14 Larch Road,
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Tel. 0272-566306

Asst. Secretary
J. F. HETZEL, T.D. M.B.I.M.
The Uplands,
[redacted]
12 Brookside Road,
Old Bedhampton,
Havant,
Hants. PO9 3JL
Tel. 0705-454666

The Rt.Hon.Mrs Margaret Thatcher MP.,
The Prime Minister,
10 Downing Street,
LONDON SW1A 2AA

1 March 1981

R3

Dear Mrs Thatcher,

THE SCOTT INQUIRY

Further to the exchange of correspondence we had in December last concerning your interview with Peter Simmonds as published in the Sunday Telegraph 7 December 1980, I note that on the publication of the report of the Scott Inquiry you replied to a Parliamentary Question to the effect that the Government will take account of the reactions to the Report's analysis and findings before coming to any decision.

As explained in my letter to you dated 15 December, I can only speak for Post Office pensioners and in so doing, I am very much aware of the views of the Civil Service Pensioners' Alliance and the Public Service Pensioners' Council because we work together for the common good of pensioners.

In general, we welcome the general conclusions of the Report especially :-

1. That it is a highly desirable social objective that the standard of living of those in retirement should be protected.

2. That the considerable inequalities between pensions in the public and private sectors should be harmonised by improving the position in the latter.

3. That there is a clear recognition that many of the criticisms made of the present arrangements have been based either upon ignorance of the ~~facts~~ facts, or because of the extremely high valuations which some of the critics have suggested.

4. That in considering pension schemes, short term considerations should not prejudice the long term interests of such pensioners, especially in a period of high inflation and the associated highly charged atmosphere.

5. That the assumptions made by the Government Actuary have been upheld by the Inquiry.

May I say that any change to the existing Public Service Pension agreements because

of

because of short term expediencies would be completely unjustified. Neither should there be any imposition of any cut off point which you mentioned as being a possible matter for discussion on 12 February. This would be tantamount to an admission by the Government that the situation had got out of hand and being unable to control inflation. Furthermore, as I said in my letter to you 15 December, any interference in our pensions to our disadvantage will be regarded by Post Office pensioners as the unilateral breaking by government of a contractual obligation.

It is to be hoped that the analysis and findings of the Scott Inquiry are accepted by the Government with the clear understanding that there is no basis for any curtailment of existing provisions for the index-linking of pensions.

Yours sincerely,

G. H. Massey

(G.H.MASSEY)
General Secretary

cc LPO
HMT

ECON POL

10 DOWNING STREET

THE PRIME MINISTER

2 March 1981

Dear Mr. Fawcett

Thank you for your letter of 26 February.

I can assure you that your Council's representations will be taken into account before any decisions on the Report of the Scott Inquiry are taken.

(sgd) M T

G. B. Fawcett, Esq.

jfh

3

10 DOWNING STREET

PRIME MINISTER

This is a letter from the Public Service Pensioners' Council saying that they do not believe the Scott Report provides any justification for a change in the present pension arrangements. I suggest you send a short reply as per the attached, and I will send copies of their letter to the CSD and Treasury.

Good

Mr W send.

TL

27 February 1981

TL

CF ?

PUBLIC SERVICE PENSIONERS' COUNCIL

Hamilton House, Mabledon Place, London, WC1H 9BD
Telephone: 01-387 2442 Extension 130

PPS
R27

Hon. Secretary:
G B FAWCETT Esq
Hamilton House,
Mabledon Place,
London,
WC1H 9BD.

The Prime Minister
10 Downing Street
LONDON SW1

26 February 1981

Dear Prime Minister

On the publication of the report of the Scott Inquiry you advised Parliament that the Government wished to take account of the reactions to the Report's analysis and findings before coming to any decisions.

The Public Service Pensioners' Council includes all the major organisations representing the interests of retired public servants, and we trust that the Government will consider carefully the views of the Council on the Scott Report.

The conclusions of the Scott Inquiry are generally welcomed, and we certainly take the view that any pension disparities between the public and private sectors should be tackled by improving the position in the private sector. To that end we endorse the view of the Scott Committee that serious consideration shall be given to the issue of indexed bonds to cover pension liabilities.

We agree with the Scott Inquiry's conclusion that a long term view needs to be taken of pension issues, and the importance of any consideration not being prejudiced by short term expediencies. We believe that many of the criticisms made of the present arrangements have been based either upon ignorance of the true position, or upon the recent experience of high rates of inflation which do not provide a reliable guide for the future. The assumptions made by the Government Actuary are in line with those of other actuaries as the Scott Inquiry makes clear. We consider that any change to the existing arrangements resulting from reference to such short term circumstances would be completely unjustified. Equally, we believe that the imposition of any cut off point, which you referred to as a possible matter for discussion on 12 February 1981, would be taken as an admission of the Government's inability to control inflation, or manage the economy to provide a reasonable real rate of return upon investments.

Continued ..../2

In conclusion, therefore, it is our view that the analysis and findings of the Scott Inquiry provide no justification for any curtailment of existing provisions for the index linking of pensions.

Yours sincerely

G.B. Fawcett

pp G B FAWCETT
Hon. Secretary

SJB

R H

Econ PM.

BF 9/3/81

24 February, 1981

The Prime Minister has received the attached letter from the Honorary General Secretary of the Civil Service Pensioners' Alliance. I should be grateful if you could provide a draft Private Secretary reply to go from No.10 to reach us here by Monday, 9 March.

N. J. SANDERS

Jim Buckley, Esq
Lord President's Office

MFJ

23 February 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 21 February. I will place your letter before the Prime Minister and a reply will be sent to you as soon as possible.

NJS

M.E. Yates, Esq.

PPS R2312

CIVIL SERVICE PENSIONERS' ALLIANCE

Hon. General Secretary
M. E. YATES
Tel. Derby 672376
(STD 0332)

55 MORLEY ROAD,
CHADDESDEN,
DERBY DE2 4QU.

21 February 1981

The Rt. Hon. Margaret Thatcher, MP,
The Prime Minister,
10 Downing Street, London SW1

Dear Prime Minister,

Inquiry into Value of Pensions

I wrote to you on 8 December 1980 concerning the remarks attributed to you in an interview reported in the "Sunday Telegraph" of 7 December 1980 and enclosed a copy of the Alliance's evidence to the Inquiry. In your reply of 19 December 1980 you assured me that my members' views would be taken fully into account by the Government when considering the Report, and on 5 February 1981 in the House you announced that before making decisions the Government intended to take account of the reaction to the Report's analysis and findings.

The Alliance wishes it to be known that, in general, it welcomes the Report's findings and notes that, in many respects, these agree with the submissions made by the Alliance in its written evidence. There is, for example, broad acceptance that:-

(a) the disparity of treatment between the public and private sectors should be harmonised by improving the position in the private sector;

(b) civil servants pay more for their pensions than other groups and all civil servants and civil service pensioners have effectively incurred deductions on account of pension differences throughout their service;

(c) in any consideration of pension schemes it is essential not to be prejudiced by short-term considerations, especially in a period of high inflation which creates a highly charged atmosphere; and

(d) if the battle to contain inflation is successful pension inequalities will diminish to more manageable proportions.

Finding itself in accord with many of the Report's findings the Alliance hopes that the Government will also be able to accept them.

Further to (c) and (d) above I have been asked to repeat the point made in the concluding paragraph of the Alliance's evidence to the Inquiry, that interference with index-linking at the present time might well be assumed to be an acceptance that inflation had become unmanageable, and so be destructive of public confidence in the credibility of the Government's policy to combat inflation. You were reported in Hansard of 12 February 1981 as expressing the hope that the House will have time to discuss the Scott Report thoroughly, and you made reference to the Report's suggestion that the Government could provide a cut-off point for index-linking as a possible matter for discussion. The Report stated that it had been "implicitly assumed that, in the last resort, there would have to be some cut-off point". From paragraph 29 of the Report it is clear that this reference to the last resort further implies a very high rate of inflation and negative rates of investment return for a considerable period. Even to contemplate such a situation arising would, in our view, indicate a lack of belief in the efficacy of the Government's policies.

Yours sincerely

M E Yates

FILE

VLB

Econ Pol

16 February 1981

Thank you for your letter of 12 February, which I showed the Prime Minister.

She was interested to see Harold Rose's note, but surprised that he had been unable to influence the Committee more.

T P LANKESTER

A. N. Ridley, Esq.

Econ Pol Pt 3.

cLPO

10 DOWNING STREET

From the Private Secretary

12 February 1981

The Prime Minister has asked me to thank you for your letter of 26 January about public service pensions, and also for your expression of support for the Government's efforts to tackle the country's economic problems.

As you will know, the Scott Report was published last Thursday. The Government will now study its findings and consider in detail what course of action would be appropriate. In so doing, it will want to take account of reactions from all quarters, and it is useful to have the views of you and your colleagues.

T. P. LANKESTER

M.G. Jackson-Smyth, Esq.

2

Prime Minister
The Chancellor mentioned this.

TL
13/2

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000
Direct Dialling 01-233 5618

A N Ridley
Special Adviser

G.6

Tim Lankester Esq
10 Downing Street
London SW1

12 February 1981

Dear Tim,

SCOTT REPORT

I think that you (and the Prime Minister) might be interested in the attached note by Harold Rose, which casts an interesting light on its recommendations. He has told me that many of the more objectionable aspects of the final text were added very much as last minute glosses by the Chairman, in circumstances such that other members found it difficult to alter them.

Rose informs me that he will be at the IEA lunch on Monday at which the PM will be present.

You may also like to know that we are taking steps to learn as much as we can from Rose, since his guidance is clearly very relevant to the unfolding debate. I suspect that we may be able to find ways of correcting some of the "false impressions" he refers to. I will be able to tell you more on Tuesday when we have seen him.

Yours

Alan.

SCOTT COMMITTEE ON PUBLIC SECTOR PENSIONS

As I was a member of the Scott Committee I should like to correct some totally erroneous reporting by some newspapers, e.g. The Telegraph, which have said that we were recommending both the retention of indexing of public sector pensions and its extension to the private sector.

Our remit was solely the valuation of public sector pension benefits, and we made no comment at all concerning the question of principle. Part of the confusion arises from our recommendation that the Government should "seriously consider" the issue of indexed bonds against pension liabilities. We made this recommendation as a possible solution of the daunting problem of valuing indexed pensions, and our reference to the private sector was designed to help employers to assess more accurately in advance what the cost of different degrees of indexing might be.

If the market yield on indexed bonds were low, as we imagined it would be, our view - which unfortunately we did not make explicit - was that the private sector would not choose to bear the cost of indexing and that this would also be true of the public sector.

We were also much tougher towards estimating the present value of public sector indexing than some newspapers have said. As against the Government Actuary's estimate that a "deduction" of 3.8 per cent be made from Civil Service salaries to allow for the difference between Civil Service and "analogue" pension benefits, our view was that the figure lay somewhere between 3 and 8½ per cent, plus an extra margin to reflect our recommendation that public sector bodies be excluded from the "analogue" sample. This might make the range 3½ - 10½ per cent. If Mrs Thatcher believed it was right to take a tough view, our Report would justify as much as a further 6 - 6½ per cent deduction from existing Civil Service salaries.

I suspect that the problem of reporting stems mainly from the tone of the "pieties" about protecting pensioners which the Report expressed, but I would defend the argument that pensioners are the innocent victims of inflation for which other groups are responsible.

HBR

HBR
11.2.81

LORD PRESIDENT OF THE COUNCIL

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

From the Private Secretary

10 February 1981

Tim Lankester
Private Secretary
10 Downing Street
LONDON SW1

11/2

PS att

Dear Tim,

John Wiggins passed to me the letter of 26 January which the Prime Minister received from Mr Jackson-Smyth and Mr Warren of a Home Office branch of the IPCS. I attach a ... draft reply for the Prime Minister to send.

Yours sincerely,

Jim Buckley.

J BUCKLEY

DRAFT LETTER FROM THE PRIME MINISTER TO:

M G Jackson-Smyth Esq
Cruelty to Animals Inspectorate
Home Office
50 Queen Anne's Gate
LONDON SW1H 9AT

The PM has asked me to thank you

~~Thank you~~ for your letter of 26 January ~~on behalf of your IPCS colleagues~~ about public service pensions, and ~~Thank yo~~u also for your expression of support for the Government's efforts to tackle the country's economic problems.

As you will know, the Scott Report was published last Thursday. ~~The Report offers an interesting analysis of a very difficult issue.~~ The Government will now ~~We now need to~~ study its findings ~~in some depth~~ and ~~to~~ consider in detail what course of action would ~~now~~ be appropriate. In so doing, it will ~~we shall~~ want to take account of reactions from all quarters, and it is useful to have the views of you and your colleagues.

Econ Pol

Foreign and Commonwealth Office

London SW1A 2AH

9 February 1981

CONFIDENTIAL

Sir Robert Armstrong KCB CVO
Cabinet Office
Whitehall
London SW1A 2AS

Dear Robert,

SCOTT INQUIRY ON THE VALUE OF PENSIONS

1. You sent Michael Palliser a copy of your letter of 29 January to Ian Bancroft. As Michael is away, I am replying on his behalf.

2. Given our particular Diplomatic Service interest, we should like to nominate John Goulden, Head of Personnel Services Department (Curtis Green Building, Victoria Embankment, SW1A 2JD) as our representative. It may well be that for much of the time it would be sufficient for him to receive papers and only attend meetings if issues of particular relevance to us arise. But we should like him to be able to attend as he sees fit, and particularly the first meeting.

Yours ever

Teddy

Edward Youde

cc: Sir Ian Bancroft, GCB. Civil Service Department.
Sir Douglas Wass, GCB. HM Treasury.
✓C A Whitmore Esq, No 10.
Sir Peter Preston, KCB. ODA

Econ Pol.

SCOTT INQUIRY INTO THE VALUE OF PENSIONS

The Report of the Committee of Inquiry into the Value of Pensions (the Scott Report) is published today (Cmnd 8147).

Answering a Parliamentary Question from Michael Neubert, MP, the Prime Minister said:

> "On 22 May 1980, I announced the establishment of an Inquiry under the Chairmanship of Sir Bernard Scott into this question (Vol. 985, Cols. 285-286). I received the report of the Committee of Inquiry on 19 December and I am today publishing it as a Command Paper. I should like to thank Sir Bernard Scott and his colleagues for their thoughtful analysis of the difficult issues involved. Before making any decisions on this problem, the Government will take account of the reactions to the Report's analysis and findings."

10 Downing Street
Whitehall SW1 Tel: 01-930 4433
5 February 1981

NOTE TO EDITORS:

Press enquiries on the Report generally should be addressed to the Treasury Press Office: 01-233 3415.

Queries on the actuarial aspects will be taken by the Government Actuary's Department: 01-242 6828 (Ext 210, Mrs Cain).

Inquiry into the Value of Pensions
Treasury Chambers
Parliament Street, London SW1P 3AG
Telephone Direct Line 01-233
Switchboard 01-233 3000

Not for publication, broadcast or use on club tapes before 16.00 hours on Thursday 5 February 1981

PLEASE NOTE EMBARGO

THE FOLLOWING PRESS RELEASE HAS BEEN ISSUED BY THE INQUIRY

The Prime Minister presented to Parliament on 5 February 1981 the Report of the Inquiry into the Value of Pensions - the Scott Report - Cmnd 8147.

The Inquiry had been asked to consider, and advise on, the value of index-linked pensions and job security, so that appropriate account could be taken of these factors in determining pay and other conditions of service in the public sector.

The main points from the Report are as follows.

General

(a) It is a highly desirable social objective that the standard of living of those in retirement should be protected. This is clearly recognised in countries like France and West Germany where the benefits enjoyed by pensioners are superior to those of this country and the benefits of index-linking are extended alike to both public and private sectors.

(b) In the United Kingdom the feeling of injustice so widely held in the private sector must be recognised. But if the battle to contain inflation is successful then the present considerable inequalities between pensions in the public and private sectors will diminish to more manageable proportions. Even so, it should not be forgotten that good pensions have to be earned and paid for during working life.

(c) Improvements can be made in current public sector arrangements for taking account of the value of differences in pensions, including differences in inflation protection, in determining pay. The Inquiry does not, however, accept many of the extremely high valuations which some critics have suggested.

(d) The general principles underlying the Inquiry's findings are applicable to all areas of the public sector where pay is determined by reference to comparability exercises. Pay negotiators in other areas of the public sector ought to draw on these findings to assess whether proper account is currently being taken of differences in pensions in their areas.

Analogues

(e) The Inquiry has no reason to doubt the suitability of the comparable jobs (the 'analogues') drawn from the private sector for comparison purposes, but it believes that the present practice of drawing a proportion of the analogues from the public sector can effectively create a circular argument. The effect of excluding the public sector analogues from the comparisons would be, in the case of the non-industrial Civil Service for example, to make a small increase in the effective pension contribution from employees. The basic pay rates would also alter.

Assumptions

(f) Private sector employees cannot on any terms acquire a pension that has a guarantee of inflation-proofing. However, the Government Actuary has assumed that the public sector's guarantee would not always be met, since, in extreme circumstances, Government and Parliament would intervene. This is a view the Inquiry shares.

(g) The prime disadvantage borne by private sector employees stems from the uncertainty of the inflation rate. This should be taken into account in the calculations. The Inquiry commissioned a study of this problem and the approach adopted is of considerable interest and merits serious consideration as part of any future comparison.

(h) The difficulties of arriving at agreed assumptions would be reduced if indexed bonds were available on the market. Such securities would be of considerable assistance to those who wished to provide for a greater degree of inflation protection of pensions and would enable inflation protection to be extended to the self-employed, who at present are in the worst case of all. The Inquiry suggests that the Government should now look seriously at the case for issuing indexed bonds to cover pension liabilities.

(i) Critical to the valuation of an index-linked pension is the assumption concerning the real rate of return on investments over the next forty or more years (that is, the difference between the gross rate of return on assets and the corresponding rate of inflation). Another important assumption concerns the extent to which the analogue pension schemes will be able to provide increases in pensions and how these increases will be related to the levels of inflation. The effect of the new State earnings-related pension is also relevant, being particularly significant for those on average earnings or less.

Valuation

(j) The Inquiry concludes that it should suggest a range of assumptions which is reasonably consistent with the nature of the public sector guarantee and the more likely prospects for the economy, bearing in mind the hope of lower inflation rates than those recently experienced.

(k) This range means that, for example, for the non-industrial Civil Service the total effective employee contribution would lie between 7 and 13½ per cent of pensionable pay. The current contribution is 7.9 per cent and is nearly double the direct contribution paid by analogue employees. The top of the range represents three times that figure.
These statistics relate only to the non-industrial Civil Service and only to an assessment made in the context of a comparability exercise. Nevertheless, they are indicative of the effects of applying the Inquiry's general principles, wherever appropriate, elsewhere in the public sector.

The Government Actuary's role

(l) The Inquiry sees no reason to take from the Government Actuary the task of assessing differences in pension benefits. However, the present degree of scrutiny of comparability exercises should be extended to cover the pensions aspects, including the Government Actuary's assessments. The problems involved in pensions assessments should be more widely discussed, bringing in not only actuarial but also economic and commercial opinion.

Job Security

(m) The Inquiry was no more able to come forward with suggestions for valuing job security than was the Clegg Commission.

5 February 1981

PRESS ENQUIRIES TO: PRESS OFFICE, H.M. TREASURY - 01-233 3415

NOTES FOR EDITORS

TERMS OF REFERENCE

1. The setting up of the Inquiry was announced to the House of Commons by the Prime Minister on 22 May, 1980. The terms of reference were:

"Having regard to the need to ensure that full account is taken in all areas of the public sector, whether by contributions or salary abatement, of the value of inflation-proofing of occupational pensions, and of relative job security; taking due account of arrangements in the private sector:

(a) to consider the assumptions and methods used by the Government Actuary where he assesses the value of differences in inflation-proofing of occupational pensions;

(b) to consider the relative degree of security in the full inflation-proofing enjoyed by public sector employees compared with those in the private sector, and the additional value to be placed upon it;

(c) to consider how to assess the relative job security enjoyed by employees in the private and public sectors;

(d) to report their findings and suggest what valuations or methods of valuation would be appropriate to take account of these factors in determining pay and other conditions of service."

2. In announcing the Inquiry the Prime Minister said that it would be for

"the Government and other public sector authorities to decide, in the light of the advice given, whether and what changes in present arrangements would be desirable. Any such changes would of course have to be considered by the managements and unions and staff associations concerned".

MEMBERSHIP

3. The members of the Inquiry were as follows.

(a) Sir Bernard Scott, CBE, TD, (Chairman of the Inquiry) is Deputy Chairman of Lloyds Bank Ltd and Vice Chairman of Lloyds Bank International. He is a Director of Boots and Thomas Tilling and President of the Society of Motor Manufacturers and Traders. He was formerly Chairman of Lucas Industries Ltd, a member of the CBI Council from 1974 to 1976, the British Overseas Trade Board from 1973 and 1977, and President of the Birmingham Chamber of Commerce from 1972 to 1973.

(b) Sir Alex Jarratt, CB, is Chairman and Chief Executive of Reed International Ltd and Deputy Chairman of Midland Bank Ltd. He is a non-executive Director of Imperial Chemical Industries Ltd and the Supervisory Board of Thyssen-Bornemisza.

(c) Mr Gavin Laird is a Member of the TUC General Council, a Member of the Executive Council of the AUEW, a Member of the Iron and Steel Training Board, a part-time Director of BNOC and a Member of the BBC Consultative Group on Industrial and Economic Affairs. From 1976 to 1979 he was on the TUC General Purposes Committee.

(d) Mr Robert Macdonald, MA, FFA, is General Manager and Actuary and also Director of the Scottish Mutual Assurance Society. From 1977 to 1979 he was President of the Faculty of Actuaries.

(e) Professor Harold Rose is Group Economic Adviser to Barclays Bank and Esmee Fairbairn Visiting Professor of Finance at the London Business School. He has served on the Research Panel of the Wilson Committee on the Functioning of Financial Institutions and is a Special Adviser to the Treasury and Civil Service Committee of the House of Commons.

BACKGROUND

Pension arrangements

4. Statutory inflation-proofing is provided for all members of pensions schemes in the public services; these include, among others, local government employees, civil servants, teachers, National Health Service employees, the armed forces, the police, the fire service, and Members of Parliament. Approaching two-thirds of the employees in the nationalised industries' and public corporations' pension schemes are in pension schemes the rules of which provide for inflation-proofed pensions. However, some of these schemes do provide that the full pensions increases may not be granted if the fund cannot afford them, unless the employer agrees to meet the extra costs, and others provide for reviews of the pensions increase arrangements. In total, some 5 million public sector employees are members of occupational pension schemes which provide inflation-proofed pensions. A further half million such employees are in schemes which, in practice, have provided inflation-proofing, although the rules of the scheme only make provision for discretionary pensions increases.

5. In the private sector, guaranteed full inflation protection is virtually unobtainable because private sector employers and pension funds cannot be sure that resources will be available to pay such benefits and are not prepared to accept the risk which giving a guarantee of this sort would entail. Typically, the most that is guaranteed is a fixed percentage increase, usually of the order of 3 to 5 per cent; beyond this the level of inflation-protection is at the discretion of the pension fund trustees or the employer.

6. The new State earnings-related pension, the full effects of which will be felt only by people retiring after 1998, will reduce to some extent the present differences between public and private sector pensions. The State will then bear a much greater part of the burden of providing pensions and protecting them against inflation than it has in the past. This will be particularly significant for those who, when employed, were on average earnings or less, since the State pension, taken with the Guaranteed Minimum Pension where appropriate, will provide pensions of 40 per cent or more of pre-retirement earnings, and this amount will be fully protected against inflation. However, during the transitional period, and even after that for those with above average earnings and those who are self-employed (since the earnings-related pension does not apply to them), there could continue to be a substantial difference between public and private sector pensions.

Taking account of differences in pensions

7. The Government Actuary makes detailed assessments of the value of differences in pension schemes for:

(a) the non-industrial Civil Service;

(b) the industrial Civil Service;

(c) employees whose jobs are examined by various Review Bodies (for example the armed forces, doctors and dentists, and people with 'top' salaries); and

(d) staff belonging to a number of bodies whose pay is determined by reference to Civil Service and other public service rates.

The Government Actuary has also calculated adjustments for staff groups which were considered by the Clegg Commission, for example, teachers, nurses and midwives, and local authority manual workers.

8. The assessment is made by comparing the pension contributions and benefits of the group under study with those which apply in comparable jobs (the 'analogues'). Comparisons of pension contributions have not proved controversial. The comparison of pension benefits, on the other hand, has aroused considerable controversy. The value of the benefits available under the pension schemes being compared is expressed in the form of a 'normal contribution rate' which is the theoretical percentage of salary required to be paid (from employee and

employer combined) throughout service in respect of a new entrant at age 25 to secure all his benefits.

9. In making the assessment a number of assumptions have to be made about the future. The principal assumptions which the Government Actuary made in his 1980 Review for the non-industrial Civil Service were that over the long-term:

(a) the rate of inflation will average 7 per cent per annum;

(b) the return on investments (which includes capital appreciation as well as income) will on average exceed the rate of inflation by 3 per cent per annum (giving a return of about 10 per cent per annum);

(c) the return on investments will on average exceed increases in the general level of earnings by 1½ per cent per annum (giving increases in the general level of earnings of about 8½ per cent per annum); and

(d) increases in analogue pensions in payment will be at about the same proportion of the inflation rate as in the recent past; this amounts to assuming that, over the long-term, protection will be given against 62 per cent of the rate of inflation for the analogues schemes as a whole (50 to 55 per cent if only the private sector analogues are considered).

The non-industrial Civil Service

10. A feature of the arrangements for taking account of differences in pensions for the non-industrial Civil Service is the 'Deduction'. The 'Deduction' is often wrongly assumed to represent either the total cost to a civil servant of his pension or the full value of inflation-proofing a pension. In fact, it is neither: it represents only part of the total adjustment to Civil Service pay and is intended to measure the difference between benefits payable under the Civil Service and analogue schemes.

11. The total effective contribution by non-industrial civil servants towards their pensions is made up of three elements:

(a) first, there is a reduction which primarily reflects the difference between the pension contributions paid from gross pay by civil servants and analogue employees;

(b) second, comes the 'Deduction' which is a percentage reduction in what remains after the first reduction; it reflects the difference between the pension benefits under the various schemes and was 3.8 per cent in 1980; the Inquiry has suggested that a figure in the range 3 to 8½ per cent can be considered reasonable; the gross pay figure is then what is left after the first and second reductions; and

(c) third, is a contribution from gross pay for family benefits.

Civil servants effectively pay towards their pensions an amount equal to 7.9 per cent of their gross pay (nearly twice the average analogue employee's contribution from gross pay). Also their pensionable pay is lower than that of the average analogue because of the reductions made in arriving at their gross pay.

Evidence

12. The Inquiry took evidence from over 200 organisations and individuals, including the Government Actuary, the CBI, the TUC, public sector unions and pensioners organisations, and professional pensions advisers.

Publication information

13. The "Report of the Inquiry into the Value of Pensions" has been published by HMSO as Cmnd 8147, price £3.90.

1. ~~PL~~
& GR

2. ~~MAP~~

3. ~~GR~~

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

2 February 1981

J. Buckley, Esq.,
Private Secretary
Lord President of the
Council's Office

Dear Jim,

.... I attach a letter to the Prime Minister from a Home Office IPCS branch about civil service pensions. Since the CSD is responsible for policy on this subject, you kindly agreed to arrange for No.10 to have an appropriate draft reply.

Perhaps Tim Lankester, to whom I am copying this letter, would bear in mind that letters about civil service pensions will for the most part more readily fall to the CSD than the Treasury.

Yours ever

John Wiggins

A.J. WIGGINS

TL

R27

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THE INSTITUTION OF PROFESSIONAL CIVIL SERVANTS

CRUELTY TO ANIMALS INSPECTORATE
HOME OFFICE
50 Queen Anne's Gate
London SW1H 9AT

26 January 1981

The Rt Hon Mrs Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Dear Mrs Thatcher

We have heard that you have received many letters expressing concern over the inflation proofing of public service pensions which is not awarded to the same extent to pensioners in the private sector. The purpose of the recently commissioned enquiry by Sir Bernard Scott is, we understand, to assess the amount of the contribution (or pay abatement) that is required to secure a pension relevant to the earnings concerned. We regard a pension as earnings, the payment of which is deferred until retirement, and in this sense their purchasing power in retirement should be no less than it was at the time the money was earned, whatever the circumstances. Pensions differ from ordinary savings in that the latter can be effected, applied and withdrawn as,, how and when the individual wishes.

A point that we do feel to be relevant to the protection of the value of public service pensions especially is that a public service pensioner retired with an adequate pension has a number of years of useful working life left to which he could devote his energies to some other field of community service where the question of remuneration may be a minor one for him/her, or may not arise at all as in the case of voluntary service. We are aware of your recently expressed appreciation of the value of voluntary services. Without the assurance of the maintained value of his/her pension such a person may be tempted to take up other pursuits that may pay better, merely to be relieved of the nagging worry of penury later on. If this were the case the community may be deprived of services that it needs but could not afford to purchase at full commercial salary rates. What is equally important is that the retired public servant by his training and experience is better qualified than most to render such services. It would be a pity not to have such a source of expertise available. In conclusion we would say that we appreciate the problems confronting the country and the efforts being made to solve them. As a working group we will continue to play our part towards achieving these ends but would be dismayed if the lot of our retired colleagues were to worsen because of any diminution in the value of the benefits for which they have worked.

Yours truly

M. Jackson-Smyth.

M G Jackson-Smyth BA MB BCh
Chairman

Alan G. Warren Secretary

A G Warren BSc Dr Med Vet (Zurich)
MRCVS M I Biol

cc J. Vereker

CONFIDENTIAL

Prime Minister 2

cc Mr Ingham

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

THE SCOTT REPORT

Cabinet on 15 January invited the Lord President of the Council and myself:

a. to arrange for the Report of the Scott Inquiry into the value of pensions to be printed as a command paper with the aim of presentation to Parliament around the end of January; and

b. to circulate to the Cabinet a note of guidance on the line which Ministers should take in response to questions on the Report.

2. The Report will be presented to Parliament as a command paper on Thursday, 5 February. I attach the note of guidance which we were asked to prepare.

3. I am copying this minute to members of the Cabinet and Sir Robert Armstrong.

(G.H.)

2 February 1981

CONFIDENTIAL

The Scott Report of an Inquiry in the value of pensions

NOTE OF GUIDANCE

The Scott Report does not give an easy answer to the problems of occupational pensions in the public and private sectors. It offers an interesting analysis of the value of pensions, seeks to refute some of the fundamental criticisms, and makes suggestions for the future which are complex and have far-reaching implications. The Government needs time to examine these suggestions and to consider public reaction, before deciding what future arrangements could be made. It will particularly welcome views from the private pensions industry.

Background

2. When, in 1970, Parliament legislated systematic arrangements to protect the value of official pensions against inflation, this was done with the agreement of all parties. It was seen as no more than turning into a regular and certain arrangement what had already been done in repeated ad hoc pensions increase legislation, and no objections were raised.

3. The reason why private pension arrangements have not been able to maintain values of pensions is that we have lived through a decade and more of very rapid inflation and very poor rates of return on investment - one of the worst experiences on record and one very far from being foreseen ten years or so ago.

Inflation The Real Problem

4. The pensions problem is a striking example of the economic and social evils of inflation, which are why the Government has set the defeat of inflation at the heart of its economic strategy. But we cannot simply leave the pensions problem to be solved by better times in future.

Abolition Of Inflation-Proofing

5. One possible answer - an apparently simple one - would be the abolition of inflation-proofing of public sector pensions. But there are objections to be considered:

/- to do this would

- to do this would mean that the Government as an employer was tearing up obligations accepted in good faith and taken as a condition of service by an enormous range of employees - not just civil servants, but the armed forces, police, teachers, nurses, doctors, miners and many others in nationalised industries, local authority employees, judges, Members of Parliament, in all over half of the total number of occupational pensions now being paid;

- it would not directly improve the condition of private sector pensioners, nor that of the self-employed, even though it removed one cause of resentment for them;

- and there is the question how far one can go against what the Scott Report describes as a highly desirable social objective that the living standards of those in retirement should be protected: an objective reflected in State pension schemes and the arrangements for them to which the Government has so far been committed.

Limitation Of Inflation-Proofing

6. There may well be a stronger case for putting some limit on the amount of protection which can be guaranteed when economic developments are severely unfavourable and consequently intolerable disparities begin to appear. The treatment of existing pensioners and future pensioners might need to be considered separately. These are questions which the Government will certainly be considering.

Improvement Of Private Pension Schemes

7. The Report raises also the question whether the arrangements for private pensions should be improved. But an important factor here is whether any such improvement could be afforded - and, if so, how it could be effected. The Report suggests that Government could help by providing index-linked bonds as a new investment instrument which could be attractive to pensions managers. This raises very wide questions of flows of funds in financial markets and the scale and methods of financing of Government borrowing, which need a good deal of further study.

/Contributions By Public Sector Employees

Contributions By Public Sector Employees

8. Finally, the Scott Report provides important, although not very precise, guidance to enable the Government to reassess the varying present arrangements for public sector employees to contribute to their own pensions. Part of the resentment felt by many people about inflation-proofed pensions is the belief that they are financed too much by taxpayers and too little by the beneficiaries themselves. In fact, some public sector employees already made contributions from salary at higher levels than those generally made in the private sector and some rates of contribution or abatements of salary have been increased in recent years to reflect the extra value of protected pensions in a period of inflation. But the question remains whether the existing contributions for all adequately reflect the value, now that recent experience has shown how great that value can in practice be. Public resentment extends to the way in which inflation-proofing has been extended to the nationalised industries. A change in that sector - and perhaps not only there - could involve controversial legislation.

Job Security

9. It is a great pity that the Inquiry was not able to reach a conclusion on this problem, which is of great topical interest.

General

10. The general line should be to avoid any sense of commitment to moving in a particular direction. The Government wants to encourage public reaction while it studies implications of the various kinds of action which could be taken. It needs to be emphasised that the implications of virtually any course are very different. It will of course be necessary for the Government to give some kind of steer fairly soon, but initially the aim should be to clarify and focus opinion, rather than to force it in particular directions.

C.A. Whitmore, Esq.

CABINET OFFICE

With the compliments of
Sir Robert Armstrong KCB, CVO
Secretary of the Cabinet

70 Whitehall, London SW1A 2AS
Telephone: 01-233 8319

Econ Pol

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref: A04102 29th January 1981

CC Mr Vereker

Scott Inquiry on the Value of Pensions

When the Cabinet considered the Scott report on the value of public sector pensions it was decided that there should be an official study of the issues raised by the report. This study will be undertaken by an official Cabinet Committee under Treasury chairmanship with joint Secretaries from CSD, Treasury and Cabinet Office.

The Treasury have nominated Peter Dixon (Under Secretary) as Chairman, and I should now be grateful for nominations for Departmental representatives (generally at Under Secretary level). A large membership seems inevitable because so many Departments have an interest, through their sponsorship role for particular public services or for nationalised industries, and must be given the right to attend. Those whose Departmental interest is limited may be content to receive papers and attend only as the particular topic for consideration requires.

I am copying this letter to all those on the attached list, and should be grateful for early replies, indicating whether the Department wishes to be represented on the Committee and, if so, nominating a representative; or whether the Department is content to receive papers and, if so, nominating a contact point for that purpose.

ROBERT ARMSTRONG

Sir Ian Bancroft, GCB

A04102 copied to:

E.A. Johnston, Esq., CB	Government Actuary's Department
J.R. Ibbs, Esq.	CPRS
Sir John Garlick, KCB	DOE
Sir Kenneth Barnes, KCB	Employment
Sir Patrick Nairne, KCB, MC	DHSS
Sir Frank Cooper, GCB, CMG	MOD
Sir Peter Carey, KCB	Industry
Sir James Hamilton, KCB, MBE	DES
Sir Brian Cubbon, KCB	Home Office
Sir Kenneth Clucas, KCB	Trade
Sir Peter Baldwin, KCB	Transport
Sir William Fraser, KCB	Scottish Office
T.P. Hughes, Esq., CB	Welsh Office
Sir Kenneth Stowe, KCB, CVO	NIO
Sir Donald Maitland, GCMG, OBE	Energy
Sir Wilfrid Bourne, KCB	Lord Chancellor's Department
James Nursaw, Esq.	Law Officers' Department
Sir Michael Palliser, GCMG	FCO
Sir Brian Hayes, KCB	MAFF
C.A. Whitmore, Esq.	No. 10) for information
Sir Douglas Wass, GCB	Treasury)

CONFIDENTIAL

cc CDL
LPO
CO

MS

Econ Pol

10 DOWNING STREET

From the Private Secretary

29 January 1981

Publication of Scott Report

The Prime Minister has read the Chancellor's minute of 22 January. She suggests that the Report be published at 4.00 p.m. on Thursday 5 February (not before because of the debate on unemployment); and she is content with the draft Written Parliamentary Question.

I am sending a copy of this letter to Robin Birch (Office of the Chancellor of the Duchy of Lancaster), Jim Buckley (Lord President's Office) and David Wright (Cabinet Office).

T. P. LANKESTER

John Wiggins, Esq.,
H.M. Treasury

GB

CONFIDENTIAL

FILE

VLB

ECON POL

28 January 1981

I enclose a letter to the Prime Minister from the Institution of Professioaal Civil Servants, about index-linked pensions in the public service.

I should be grateful if you would arrange for a Treasury Minister to reply to this letter on the Prime Minister's bahalf, letting us have a copy for our records here in due course.

T P LANKESTER

Peter Jenkins, Esq.,
H.M. Treasury.

JG

FILE

VLB

28 January 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 26 January about index-linked pensions.

This is receiving attention and a reply will be sent to you as soon as possible.

T P LANKESTER

M. G. Jackson-Smyth, Esq.

Prime Minister

We suggest that the report be published at 4 p.m. next Thursday (after the beginning of your speech).

Yes

Content – and also with draft written PQ and Answer?

Yes

mb

TL 28/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

PUBLICATION OF SCOTT REPORT

Following the discussion at Cabinet on 15 January, I am preparing with the Lord President of the Council a draft Note of Guidance for circulation to Cabinet. I hope to send this to you very shortly, so that you can see what we have in mind before it goes to our colleagues.

2. Meanwhile, we need also to settle the precise arramgements for publication. The Report is being printed as a Command Paper, and will be ready during the first week of February. You announced the establishment of the Inquiry by Written Answer. I think it would be appropriate to adopt the same form to announce publication of the Report, particularly since our intention is to make minimal substantive comment at the time. On this basis, I offer the attached draft for you to consider.

3. As regards timing, I understand that Sir Bernard Scott, who would like to be in London and available at the time of publication, and indeed proposes to issue a Press Statement giving a brief summary of the main points of the Report, will not be available in the first two or three days of the first week in February, but will be available on and after Thursday, 5 February. If this is convenient to you, and does not clash uncomfortably with any other proposed announcements, I suggest we might go for Thursday, 5 February.

4. I am copying this letter to the Chancellor of the Duchy of Lancaster and the Lord President of the Council.

(G.H.)
27 January 1981

DRAFT QUESTION

To ask the Prime Minister whether she will make a statement about the account taken of the value of index-linked pensions in settling public sector pay and employee pension contributions.

DRAFT ANSWER

On May 22 1980, I announced the establishment of an independent inquiry under the Chairmanship of Sir Bernard Scott into this question /Vol. 985, Cols. 285-286/. I received the report of the Committee of Inquiry on 19 December and I am today publishing it as a Command Paper. I should like to thank Sir Bernard Scott and his colleagues for their thoughtful analysis of the difficult issues involved.

Before making any decisions on this problem, the Government will take account of the reactions to the Report's analysis and findings.

Agreed

MT

B/F 2 file. ELCOW POL

VK

27 January 1981

Report of The Scott Inquiry

I am replying on Clive Whitmore's behalf to your letter of 20 January.

Arrangements will be made for you to have sight of the Report of the Inquiry just before publication. The Treasury will be in touch with you about arrangements for this.

TPL

James Driscoll, Esq.

QU
TL

R27

1

THE INSTITUTION OF PROFESSIONAL CIVIL SERVANTS

CRUELTY TO ANIMALS INSPECTORATE
HOME OFFICE
50 Queen Anne's Gate
London SW1H 9AT

26 January 1981

The Rt Hon Mrs Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Dear Mrs Thatcher

We have heard that you have received many letters expressing concern over the inflation proofing of public service pensions which is not awarded to the same extent to pensioners in the private sector. The purpose of the recently commissioned enquiry by Sir Bernard Scott is, we understand, to assess the amount of the contribution (or pay abatement) that is required to secure a pension relevant to the earnings concerned. We regard a pension as earnings, the payment of which is deferred until retirement, and in this sense their purchasing power in retirement should be no less than it was at the time the money was earned, whatever the circumstances. Pensions differ from ordinary savings in that the latter can be effected, applied and withdrawn as, how and when the individual wishes.

A point that we do feel to be relevant to the protection of the value of public service pensions especially is that a public service pensioner retired with an adequate pension has a number of years of useful working life left to which he could devote his energies to some other field of community service where the question of remuneration may be a minor one for him/her, or may not arise at all as in the case of voluntary service. We are aware of your recently expressed appreciation of the value of voluntary services. Without the assurance of the maintained value of his/her pension such a person may be tempted to take up other pursuits that may pay better, merely to be relieved of the nagging worry of penury later on. If this were the case the community may be deprived of services that it needs but could not afford to purchase at full commercial salary rates. What is equally important is that the retired public servant by his training and experience is better qualified than most to render such services. It would be a pity not to have such a source of expertise available. In conclusion we would say that we appreciate the problems confronting the country and the efforts being made to solve them. As a working group we will continue to play our part towards achieving these ends but would be dismayed if the lot of our retired colleagues were to worsen because of any diminution in the value of the benefits for which they have worked.

Yours truly

M. Jackson-Smyth.

M G Jackson-Smyth BA MB BCh
Chairman

Alan G. Warren. Secretary
A G Warren BSc Dr Med Vet (Zurich)
MRCVS M I Biol

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

26 January 1981

T. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

Geoffrey Littler had a word with you about the reply which should be given to the letter to Clive Whitmore of 20 January from Jim Driscoll, asking for a sight of the Report of the Scott Inquiry before it is generally released, for the benefit of the Nationalised Industries' Chairmen's Group.

I suggest you reply to Driscoll on the lines of the attached draft letter. We will arrange to provide the promised copy of the Report a few hours in advance of publication, and Littler will have a word with Driscoll about the arrangements for this.

Yours ever,

Richard Tolkien

R.I. TOLKIEN

DRAFT

Write to: James Driscoll, Esq.,
Director,
Nationalised Industries' Chairmen's Group,
PO Box 403,
33, Grosvenor Place,
LONDON, SW1X 7JG.

REPORT OF THE SCOTT INQUIRY

~~Thank you for your letter~~ of 20 January. // Arrangements will be made for you to have sight of the Report of the Inquiry just before publication. The Treasury will be in touch with you about arrangements for this.

[T. LANKESTER]

I am ~~writing on~~ replying on Clive Whitmore's behalf to your letter

23 Janaury 1981
Policy Unit

PRIME MINISTER

INDEX-LINKED PENSIONS

I was talking to David Young yesterday, and he mentioned to me that he had discovered by chance that Crown Agents run a fully funded index-linked pension scheme for its employees. The contributions total 35% of pay roll - he is not sure how much of this is paid by the employee and how much by Crown Agents themselves.

He understands that Crown Agents do not extend this scheme to new recruits!

Crown Agents did apparently report particulars of their scheme to the Scott Enquiry.

I am copying this minute to Geoffrey Howe.

JOHN HOSKYNS

May I have details please especially about the point which is arrowed.

MT

10 DOWNING STREET

THE PRIME MINISTER

22 January 1981

Dear Mr. Graham,

Thank you for your letter of 12 January about public sector pensions.

The Scott Report will be published soon. We shall then have to consider what action needs to be taken in the light of its recommendations. Whatever happens, I entirely agree that public servants' pension contributions should be fair and seen to be fair by the public generally.

Yours sincerely

Margaret Thatcher

Ted Graham, Esq., M.P.

MFJ
cc HMT
NIO

10 DOWNING STREET

THE PRIME MINISTER

22 January 1981

Dear Mr. Kendall,

Thank you for your letter of 7 January. I am afraid I do not accept your reading of the original report in the "Sunday Telegraph" and my earlier letter to you.

I suggest it would now be best to await the publication of the Report of the Scott Inquiry, which I hope it will be possible to publish shortly.

Yours sincerely

Margaret Thatcher

W.L. Kendall, Esq.

3

10 DOWNING STREET

Prime Minister

Treasury and CSD have looked carefully at the Daily Telegraph article and at your earlier letter, and have suggested the attached draft reply.

T.

21/.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

20 January 1981

TL

N. Sanders, Esq.,
Private Secretary,
10, Downing Street

Dear Nick,

I apologise for the telephone message to you on Friday evening, asking you to stop the draft I had sent to you with my letter of 15 January for a reply from the Prime Minister to a second letter from Bill Kendall about the Scott Enquiry. The reason was that the Civil Service Department suddenly pointed out that there had been two relevant articles in the 7 December Sunday Telegraph, a short piece on the front page as well as the more substantial interview article on page 19. We had based our earlier advice to you on the larger article, together with the full text of the recorded interview which you had sent to us, and wanted just to check that we had not overlooked anything of importance by missing the shorter article.

In fact the shorter article is largely repetitive. It differs slightly in wording on the points which have excited Bill Kendall, but, having examined these points carefully, we see no reason to modify the letter which the Prime Minister has already sent, or amend the draft which I sent to you on 15 January.

I understand that the Civil Service Department share this view. The proposed draft with my letter of 15 January therefore stands.

Yours ever,

Richard Tolkien.

R.I. TOLKIEN

Nationalised Industries' Chairmen's Group

Director
James Driscoll

PO Box 403
33 Grosvenor Place
London SW1X 7JG

01-235 1212

20th January, 1981.

C.A. Whitmore, Esq.,
Principal Private Secretary to
the Prime Minister,
10, Downing Street,
LONDON, S.W.1.

Dear Mr. Whitmore,

Report of the Scott Inquiry

I am writing to express the hope that it will be found possible to give the Nationalised Industries' Chairmen's Group a sight of the Report of the Scott Inquiry before it is generally released.

As you will appreciate, the Corporations' arrangements for index-linked pensions form part of the remit of the Inquiry; and since those arrangements differ considerably from those elsewhere in the public sector, it seems no unlikely that the Report will comment separately on them. It would, therefore, be helpful if the Chairmen's Group were given reasonable opportunity to prepare for the queries which it will face when the Report is published.

Possibly still more important, the Report seems likely to appear at a time when a number of Corporations will be seeking to bring their pay negotiations to a close with moderate settlements. In many cases, this involves assessing a fine balance of negotiating factors; and it would thus be especially helpful to have an advance sight of a Report which could well affect the attitudes of the Unions.

I am copying this letter to Tom Burgner at the Treasury.

Yours sincerely,

Jim Driscoll

From the Private Secretary

LORD PRESIDENT OF THE COUNCIL

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

20 January 1981

Nick Sanders Esq
10 Downing Street
LONDON
SW1

Dear Nick,

Thank you for your letter of 13 January, enclosing a copy of one from Ted Graham MP. As requested I attach a short draft reply from the Prime Minister.

Yours sincerely,

Jim Buckley.

J. BUCKLEY

DRAFT LETTER FROM THE PRIME MINISTER TO:

Ted Graham Esq MP
House of Commons
London SW1A OAA

Thank you for your letter of 12 January about public sector pensions.

The Scott Report will be published soon. We shall then have to consider what action needs to be taken in the light of its recommendations. Whatever happens, I entirely agree that public servants' pension contributions should be fair and seen to be fair by the public generally.

xPO 15/1

ec Press Office

10 DOWNING STREET

THE PRIME MINISTER

16 January 1981

Dear Mr. Fawcett,

Thank you for your letter of 6 January about the Sunday Telegraph article of 7 December 1980 concerning the Scott Inquiry.

You will, of course, be familiar with the terms of reference given to the Scott Inquiry when it was appointed. I did not suggest in the interview that the Inquiry should go further than these terms of reference but I have always considered that it would be natural and welcome that the Inquiry should indicate its views generally on index linked pensions as part of a full response to the terms of reference given to them.

The Scott Report will be published shortly, and there will be plenty of opportunity for the views of all those with an interest in this subject to be taken into account before any decisions are taken.

Yours sincerely,
Margaret Thatcher.

G. B. Fawcett, Esq.

VLB

Jul

Econ Pol

16 January 1981

The New Towns Chief Officers Association have written again, following the reply I sent using the draft offered in your letter to me of 13 January.

I should be grateful if you could arrange for a further reply to go from CSD on the Prime Minister's behalf.

M. A. PATTISON

Jim Buckley, Esq.,
Lord President's Office.

QB

Tur

16 January 1981

I am writing on behalf of the Prime Minister to thank you for your further letter of 15 January. This is receiving attention and a reply will be sent to you as soon as possible.

M. A. PATTISON

Neville Smallman, Esq.

GB

CF - yours?

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 January 1981

R 17/1
10.30am

N Sanders Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Mick,

You sent to me on 9 January for draft reply a further letter from Mr Kendall of the Civil Service Unions, dated 7 January, about the remarks on public sector pensions in the 7 December "Sunday Telegraph" interview with the Prime Minister.

It seems that Mr Kendall is misreading the original article, or the Prime Minister's earlier reply, or both. But further argument would not be fruitful. We have consulted the Civil Service Department at official level, and agreed with them the general line of the ... attached reply.

I am copying my letter and enclosure to Jim Buckley.

Yours ever,

Richard Tolkien

R I TOLKIEN
Private Secretary

DRAFT

Write to: W.L. Kendall, Esq.,
Secretary General,
Council of Civil Service Unions,
19, Rochester Row,
LONDON, SW1P 1LB.

SCOTT INQUIRY

Thank you for your letter of 7 January. I am afraid I do not accept your reading of the original report in the "Sunday Telegraph" and my earlier letter to you.

I suggest it would now be best to await the publication of the Report of the Scott Inquiry, which I hope it will be possible to publish shortly.

(MARGARET THATCHER)

The New Towns Chief Officers Association

an affiliate of the Association of First Division Civil Servants

Your Ref:

Our Ref: L/NS

Date: 15 January 1981

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
WHITEHALL
London

OPS

Dear Prime Minister

PUBLIC SERVICE PENSIONS

I am obliged for Mr Pattison's letter of 13 January - but it does not relate to the issue put in my letter of 23 December.

You have very properly called for a report on the value of the public service pension arrangements and the adequacy of allowance consequently made in determining public sector pay. And there is little doubt that at least some parts of that report will be made or become public knowledge.

The subject matter of that report covers one factor only of those factors taken into account in pay negotiations and in pay research activities. If the adequacy of the addition for pension value is in doubt, it is difficult to see why the same doubts should not exist in respect of deductions for fringe benefit values.

The point I am seeking to make is that the public concern of which you speak is already based on inadequate, incomplete and to some extent inaccurate information. The report for which you have called will add to the imbalance of information.

It would be wholly unfair to the public service if the conclusions of that report were made public in the context of current public concern unless at least the results of the most recent pay research exercise were also made public.

.../2

Chairman
Neville Smallman M.A.LL.B.
Peterborough Development Corporation
Touthill Close
City Road
Peterborough PE1 1UJ
Tel (0733) 68931

Secretary
D E Bath B.Soc.Sc., Dip.T.P., M.R.T.P.I.
Peterborough Development Corporation
Touthill Close
City Road
Peterborough PE1 1UJ
Tel (0733) 68931

Treasurer
A J Adams F.C.A., I.P.F.A.
Warrington Development Corporation
New Town House
Buttermarket Street
Warrington WA1 2LF
Tel (0925) 51144

The Government has a responsibility to public service employees to ensure that issues affecting conditions of service are fairly and fully presented. Many of us in the public service have seen reason to doubt whether the Government accepts that they have such a responsibility. This doubt can only be removed in the way I have suggested and I would welcome an assurance that the appropriate steps will be taken.

Yours faithfully

Neville Smallman

NEVILLE SMALLMAN

CONFIDENTIAL

Ref. A03983

PRIME MINISTER

Inflation-proofed Pensions

(C(81) 3)

BACKGROUND

The decision to set up the Scott inquiry into inflation-proofed public sector pensions was taken by the Ministerial Committee on Economic Strategy at its meeting on 20th February last year (E(80) 7th Meeting, Item 1). In summing up the Committee's discussion at that meeting you said:

"The Committee agreed that the most fruitful approach, in the short term at any rate, would be to preserve index-linking of public service pensions but to increase the contributions required from those in work".

2. In arriving at its decision the Committee was influenced by the specific commitments to preserve index-linked public service pensions which had been given in the course of the Election campaign, by the number of beneficiaries involved - over 5 million public sector workers currently entitled to index-linked pensions and approaching 2½ million index-linked public sector pensions actually in payment - and by the view that the "contributions route" appeared to offer quicker and easier benefits to the Exchequer than any measure of deindexation.

3. It is also relevant that very large numbers of private sector employees are - though they may be only dimly aware of the fact - at an early stage in the process of building up an entitlement to earnings-related index-linked pensions under the terms of the Social Security Act 1975 - a process which will be complete by 1998. As this process goes forward, the index-linking of pension benefits will come to be seen less as a difference between the public and private sectors than as a difference between the employed person and the self-employed (and to a lesser extent between the higher and lower paid in private employment).

4. The terms of reference of the Scott inquiry (reproduced in their report) required the Committee to look at two aspects of public sector pensions:

(a) the assumptions and methods used by the Government Actuary;

CONFIDENTIAL

(b) the additional value to be placed on the relative value of security in the full inflation-proofing enjoyed by public sector employees compared with those in the private sector;

and, in addition, to advise on how to assess the relative job security enjoyed by employees in the private and public sectors.

5. The Scott Committee have not been able to set a definite arithmetic valuation upon the security provided by guaranteed inflation-proofing, such as could be carried through into the processes of wage determination. They have instead worked over the methodology for establishing the right level of contribution for an inflation-proofed pension, and have established, in the case of the Civil Service pensions scheme, a range within which they think the answer will fall (from rather less than the present deduction to about 5 percentage points above that deduction). They make it clear that the particular point in the range which may be chosen is critically dependent on the assumptions used to operate the scheme, in particular those about the future course of inflation and the future real rate of return on investment (the lower the real rate of return is assumed to be, the larger the contribution required).

6. On the substance of the issue, there will be a number of very difficult issues for the Government to consider, following the Scott report:

(a) What real rate of return on investment should be assumed for calculating the deduction to be made from "true rates" for civil servants in respect of pension contribution?

(b) Should the same real rate of return be assumed for other public service and public sector pension schemes, including those that are contributory?

(c) Should there be greater standardisation of pension contributions within the public sector, or between the public sector and the private sector? It is relevant here that the deduction from "true rates" in respect of pension contributions for civil servants is already among the highest of the contributions required from other public service employees (and higher than the average rate in the private sector). A combination of standardisation with increased contributions for inflation-proofing could involve considerable increases in contribution rates in other public service schemes - and a complex set of negotiations and alterations to legislation and to pensions schemes.

(d) As Scott emphasises in his report, the deduction to be made from Civil Service pay on account of pension benefits including inflation-proofing represents the difference between Civil Service pension benefits and those of their analogues within the Pay Research system; this being so the calculation of the deduction depends critically on the continuance of the PRU system itself. Is the paper right in assuming that the suspension of pay research makes it impracticable to make progress with the process of adjustment suggested by the Scott Committee in the current pay round? What are the implications for the future of pay research, and for the future of Civil Service superannuation arrangements?

7. All these problems are for future consideration. The present paper addresses itself largely to procedural questions:

(1) When should the Scott report be published?

(2) What should the Government say on publication?

(3) What arrangements should be made to carry the work further?

8. Presumably the Cabinet will agree to publication as early as convenient - about the end of January.

9. Paragraph 15 of the paper suggests a series of initial comments. They do not go very far, and it may be for consideration whether it would make better sense at this stage for the Government to say nothing of substance at this stage, so as to give time to see how Parliamentary and public reaction develops in the light of the report.

10. As to the arrangements to be made for further considering these matters and for arriving at conclusions, the paper by the Chancellor and the Lord President suggests:

(a) the possibility of a study by the Treasury and Civil Service Select Committee, and

(b) urgent studies within Government of the handling of increases in contributions (and the separate Scott recommendation of the provision of index-linked bonds to private pension funds).

11. A study by a Select Committee would spend much time going over the same ground that the Scott Committee have already traversed; but it could be a means by which Parliamentary opinion could be helped to focus on the issues of substance.

12. As to studies within Government, they will involve all Departments responsible for public services or public sector organisations. It would be possible to use the new Committees on pay in the public services, but this subject is distinct and I believe that it would be better not to try to put the slightly longer-term pensions problems alongside the shorter-term problems of pay management. I should therefore propose the establishment of a Committee of officials, under Treasury chairmanship, to report to the Ministerial Committee on Economic Strategy.

13. There are two other issues of substance: the valuation of relative job security, and the issue of index-linked bonds.

14. On the issue of valuing relative job security, the CSD will maintain that job security is one of the "unquantifiables" for which they already obtain credit in the negotiations on Civil Service pay and which they would hope to continue to bring into the reckoning in the future. If the Cabinet want to pursue the issue further, you might ask the Lord President of the Council to put in a paper for future consideration.

15. On index-linked bonds you could say to the Cabinet that this is not a new proposal, and is one which has to be considered in the context of wider questions of market management. It therefore falls within the Chancellor of the Exchequer's responsibilities for monetary policy and market management.

HANDLING

16. You will want to ask the Chancellor of the Exchequer and the Lord President (in that order) to introduce their paper, and then open up the discussion to colleagues, with special reference to the following points:

(a) The most urgent task will be to seek agreement on the line to be taken by the Government when the report of the Scott Committee is published. For this purpose you may like to take your colleagues through the sub-paragraphs of paragraph 15 of the paper, and to discover whether there is a basis for agreement on these lines, or whether it is best to go for a totally non-committal stance.

(b) You will want to judge, in the light of the discussion, whether it is realistic to publish the report at the end of this month or whether, with a little more time, the Cabinet might wish and be able to agree a more positive public stance.

(c) You will want to get a view on the desirability or otherwise of involving a Parliamentary Select Committee in the next stage of the operation (see paragraph 11 above).

(d) You may like to indicate how you propose to arrange for the ongoing work within Government (see paragraph 12 above).

RtA

ROBERT ARMSTRONG

14th January, 1981

PRESIDENT OF THE COUNCIL

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

13 January 1981

From the Private Secretary

Mike Pattison Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

Dear Mike,

Thank you for your letter of 5 January enclosing one to the Prime Minister from Mr Neville Smallman, Chairman of the New Towns Chief Officers Association, about public service pensions. As requested I enclose a draft Private Secretary reply.

Yours sincerely,

Jim Buckley.

J BUCKLEY

DRAFT LETTER FROM MR PATTISON TO:

Neville Smallman Esq M.A.I.L.B
Chairman
The New Towns Chief Officers Association
Peterborough Development Corporation
Touthill Close
City Road
PETERBOROUGH PE1 1UJ

Type for MAP.

The Prime Minister has asked me to reply to your letter of 23 December about public service pensions.

The Government does of course appreciate the feelings of those who are in receipt of index linked pensions but we must recognise that there is some public concern about these arrangements. Since their introduction inflation has continued at a high level and the cost has proved considerable. Moreover, many other pensioners are not protected against inflation to the same degree.

Recently, serious doubts have been raised as to whether adequate allowance is made for the value of present pension arrangements in settling public sector pay. As you know the Government therefore set up an inquiry into that question and is considering carefully the inquiry's report. Naturally, the Government will take account of all the views that have been expressed on this important matter.

C.F.
To keep with other similar ones?

File X6
cc Lord President
Ecard

10 DOWNING STREET

From the Private Secretary

13 January 1981

The Prime Minister has asked me to reply to your letter of 23 December about public service pensions.

The Government does of course appreciate the feelings of those who are in receipt of index linked pensions but we must recognise that there is some public concern about these arrangements. Since their introduction inflation has continued at a high level and the cost has proved considerable. Moreover, many other pensioners are not protected against inflation to the same degree.

Recently, serious doubts have been raised as to whether adequate allowance is made for the value of present pension arrangements in settling public sector pay. As you know the Government therefore set up an inquiry into that question and is considering carefully the inquiry's report. Naturally, the Government will take account of all the views that have been expressed on this important matter.

M. A. PATTISON

Neville Smallman, Esq., MA., LL.B.

KB

R H

Mr. T. GRAHAM

(Public Sector pensions)

13 January, 1981

I attach a copy of a letter the Prime Minister has received from Ted Graham, MP. I should be grateful if you could suggest a very short draft reply, which ideally should go before the Scott Report is published.

May we please have something from you by Thursday, 22 January?

N. J. SANDERS

J Buckley, Esq
Lord President's Office

13 January, 1981

The Prime Minister has asked me to thank you for your letter of 12 January. This is receiving attention and you will be sent a reply as soon as possible.

N. J. SANDERS

Ted Graham, Esq, MP

From Ted Graham, M.P.

CCJG
1311

HOUSE OF COMMONS
LONDON SWIA OAA

12th January, 1981.

Rt. Hon. Margaret Thatcher, M.P.
Prime Minister,
10 Downing Street,
Whitehall,
S.W.1.

R13/1

Dear Prime Minister,

<u>Public Sector Pensions.</u>

I know that you like many others will be looking forward to the day when the Independent Enquiry into the cost of Index Linked Pensions in the public sector (The Scott Enquiry) is published so that we can give consideration to its recommendations.

The Enfield branch of the National Association of Local Government Officers recently invited me to discuss this issue with them, and arising from that meeting I am now writing to say that I hope very much that before any hasty action is taken on any recommendations, that the Government will reflect on the present situation which in my view is equitable and fair.

Public Service Pensions have been increased on account of inflation to a greater or lesser degree for the past 40 years, and by reason of long standing practice this has become an established condition of service. Public servants have accepted employment totally devoid of any of the perks in the Private Sector, such as: company cars, low interest mortgages, low cost travel, free holidays etc., Moreover the majority of public servants pay a contribution at 6 - 6¼% for their pension benefits as against the average contribution rate in private schemes of 4½%.

I earnestly suggest that if consideration is to be given to the cost to the Exchequer of maintaining the present index linked basis, it be resolved not by abolishing the index linking but producing a more equitable mean of payment for it which, of course, could include an increase in payment by public servants.

Yours sincerely,

Ted Graham

RH
File

10 DOWNING STREET

THE PRIME MINISTER

12 January 1981

Dear Sir Alex.

I am writing to thank you for all your work on the Inquiry into the Value of Pensions. I know how much must have been involved in completing so full a report so quickly, and I am most grateful to you all for undertaking the inquiry. I have read the report with great interest.

Yours sincerely

Margaret Thatcher

Sir Alex Jarratt, CB

JS

RH

7.6

10 DOWNING STREET

THE PRIME MINISTER

12 January 1981

Dear Mr. Laird.

I am writing to thank you for all your work on the Inquiry into the Value of Pensions. I know how much must have been involved in completing so full a report so quickly, and I am most grateful to you all for undertaking the inquiry. I have read the report with great interest.

Yours sincerely

Margaret Thatcher

G Laird, Esq

JS

RH
7/6

10 DOWNING STREET

THE PRIME MINISTER

12 January 1981

Dear Mr. Macdonald,

I am writing to thank you for all your work on the Inquiry into the Value of Pensions. I know how much must have been involved in completing so full a report so quickly, and I am most grateful to you all for undertaking the inquiry. I have read the report with great interest.

Yours sincerely

Margaret Thatcher

Robert E Macdonald, Esq FFA

JS

10 DOWNING STREET

PRIME MINISTER

You said you wanted to write to each of the members of the Scott Inquiry. We have therefore revised the previous letter to Sir Bernard himself.

I now attach five letters for you to sign.

MS

9 January, 1981

RH

26

10 DOWNING STREET

THE PRIME MINISTER

12 January 1981

Dear Professor Rose.

I am writing to thank you for all your work on the Inquiry into the Value of Pensions. I know how much must have been involved in completing so full a report so quickly, and I am most grateful to you all for undertaking the inquiry. I have read the report with great interest.

Yours sincerely

Margaret Thatcher

Professor Harold B Rose

JS

RH

file

10 DOWNING STREET

THE PRIME MINISTER

12 January 1981

Dear Sir Bernard.

I am writing to thank you for the report of your Inquiry into the Value of Pensions which you sent me shortly before Christmas.

I am most grateful to you and all your colleagues for undertaking the inquiry. I know how hard you must have worked to complete so full a report as quickly as you did. I have read it with great interest.

Yours sincerely

Margaret Thatcher

Sir Bernard Scott, CBE TD
Flat 148A
3 Whitehall Court
SW1A 2EL

JS

CONFIDENTIAL

COPY NO. 42

INQUIRY INTO THE VALUE OF PENSIONS

REPORT

of an Inquiry into the value of differences in the inflation protection of occupational pensions and the value of relative job security for the purposes of determining public sector pay and other conditions of service.

Chairman: Sir Bernard Scott, CBE, TD.

CONFIDENTIAL

CONFIDENTIAL

COPY NO.

INQUIRY INTO THE VALUE OF PENSIONS

REPORT

of an Inquiry into the value of differences in the inflation protection of occupational pensions and the value of relative job security for the purposes of determining public sector pay and other conditions of service.

Chairman: Sir Bernard Scott, CBE, TD.

CONFIDENTIAL

Treasury Chambers
Parliament Street
London SW1P 3AG

TO: The Prime Minister,
The Rt Hon Margaret Thatcher, MP

19 December 1980

On 22 May 1980 you announced to the House of Commons the setting up of an independent Inquiry to consider, and advise on, the value of index-linked pensions and job security.

You appointed us to be the members of the Inquiry and gave us the following terms of reference:

"Having regard to the need to ensure that full account is taken in all areas of the public sector, whether by contributions or salary abatement, of the value of inflation-proofing of occupational pensions, and of relative job security; taking due account of arrangements in the private sector:

(a) to consider the assumptions and methods used by the Government Actuary where he assesses the value of differences in inflation-proofing of occupational pensions;

(b) to consider the relative degree of security in the full inflation-proofing enjoyed by public sector employees compared with those in the private sector, and the additional value to be placed upon it;

(c) to consider how to assess the relative job security enjoyed by employees in the private and public sectors;

(d) to report their findings and suggest what valuations or methods of valuation would be appropriate to take account of these factors in determining pay and other conditions of service."

We now have the honour to submit to you our Report.

Sir Bernard Scott, CBE, TD (Chairman)
Sir Alex Jarratt, CB
Gavin H Laird
Robert E Macdonald, FFA
Professor Harold B Rose

CONTENTS

CONFIDENTIAL

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PREFACE

1. Our appointment was announced to the House of Commons by the Prime Minister on 22 May 1980 and we held our first meeting on 4 July 1980. We realised at the outset that the Government wished us to try to report swiftly so that account could be taken of our findings in the current round of pay negotiations in the public sector wherever possible. We were anxious to meet this time-table. We realised that in the time available we would be unable to make a detailed study of all aspects of the matters upon which we were required to report and we concluded, therefore, that we should concentrate on the general principles involved. It was not for us to try to determine the precise arrangements which should apply to any given case; this would be for the parties to the individual negotiations.

2. At an early stage, we decided that we should encourage representative organisations and members of the public to give their views. This necessarily meant that we had to extend the time-scale for our work, but many of the problems at which we were looking had been given an airing before and we were confident that the majority of those with an interest in these topics would be able to give us their views with only relatively short notice. We decided to concentrate on taking evidence in the form of written submissions since this would allow us to deal with a large number of representations in a relatively short period. We have received over 200 representations, more than 30 of these from bodies representing employees or employers. We decided to take oral evidence from only a few representative bodies and individuals. In the main, our purpose in doing this was to follow up some detailed points which had been made in written evidence which we believed it would be easier to pursue orally than in writing. The individuals and organisations listed in Appendix 1 gave evidence. We are very grateful to all those who took the trouble to write to us or who gave oral evidence.

3. We have decided not to have printed and published the evidence which was submitted to us. However, some people may wish to read parts of the written representations and we therefore propose to make many of these available for inspection at the Public Record Office at Kew.

4. In total we held 18 meetings. The evidence submitted to us suggested a number of possible lines of enquiry. We also followed up ideas of our own, seeking advice from specific bodies or individuals. We express our thanks to Professor R A Brealey and Dr S D Hodges of the London Business School for the work which they did for us on the problems of valuing pension security and to the many people from whom we sought and received advice either formally or informally.

5. The contribution that has been made to our work by our Secretary, Peter Farmer, has been of the highest value and he has not spared himself in the monumental task of studying all the documents and composing innumerable digests and drafts for us to consider. No Inquiry could have been better served by its Secretary. We gratefully acknowledge the contribution which our consultant, Leslie Martin FIA, has made to our work with his considerable experience of the pensions aspects in our terms of reference. We also record our appreciation of the work of our Assistant Secretary, Theresa Pollock, of our support staff, Joyce Osborn and Maria Gani, and of the Treasury typists, Committee Section and Word Processing Unit.

SUMMARY AND CONCLUSIONS

Pensions

General considerations

6. It is a highly desirable social objective that the standard of living of those in retirement should be protected. This is clearly recognised in countries like France and West Germany where the benefits enjoyed by pensioners are superior to those of this country and the benefits of index-linking are extended alike to both public and private sectors. In the United Kingdom, however, the full cost of protecting pensioners has yet to be recognised and fully shouldered during working life. We believe that there may be helpful lessons to be drawn from our work for private sector pensions and their financing, as well as for the public sector.

7. In this country, there is no doubt that the occupational pension schemes of the vast majority of public sector employees are superior to the schemes in which nearly all private sector employees find themselves. In particular an assurance of full inflation protection is a feature common to a very high proportion of public sector schemes which only a handful of private sector schemes can match (and even these have strong connections with the public sector). Some 5 million employees, virtually all of them in the public sector, are members of occupational pension schemes which provide inflation-proofed pensions. This represents over 40 per cent of the total number of employees in occupational pension schemes and over 20 per cent of all employees. A further ½ million employees in public sector schemes which do not give a formal commitment to full inflation protection have, in practice, been fully protected against inflation.

8. The new State earnings-related pension, the full effects of which will be felt only by people retiring after 1998, will reduce to some extent the present differences between public and private sector pensions. The State will then bear a much greater part of the burden of providing pensions and protecting them against inflation than it has in the past. This will be particularly significant for those who, when employed, were on average earnings or less, since the State

pension, taken with the Guaranteed Minimum Pension where appropriate, will provide pensions of 40 per cent or more of pre-retirement earnings, and this amount will be fully protected against inflation. However, during the transitional period, and even after that for those with above average earnings and those who are self-employed (since the earnings-related pension does not apply to them), there could continue to be a substantial difference between public and private sector pensions.

Current arrangements

9. We have received much criticism of the inequities of differences between public and private sector schemes so far as inflation-proofing is concerned. The value of this advantage is clearly deeply felt in the private sector when high rates of inflation are experienced. One way of dealing with this is to try to ensure that those who do have better pensions pay a fair price for their advantage. The archetypal method is that used for the non-industrial Civil Service. The present arrangements are not properly understood by many people, primarily because the assessment of the value of differences in pensions for the Civil Service is part of the wider arrangements for taking into account other factors relevant in determining pay. This is the comparability system which resulted from the work of the Royal Commission on the Civil Service (the Priestley Commission) in 1955. This system has been suspended for the 1981 pay negotiating process.

10. We would stress that the particular figures for adjustments to Civil Service pay to reflect differences in pensions which we discuss in this Report were derived from their pay comparability process and it would be wrong to apply these figures to pay rates which were determined by any other means.

11. The general principles underlying our findings are applicable not only to the non-industrial Civil Service but also to all areas of the public sector where pay is determined by reference to comparability exercises. Moreover, in areas of the public sector where comparability exercises are not used, the pay negotiators ought to draw on our findings to assess whether proper account is currently being taken of differences in pensions in their arrangements.

12. Briefly, the Civil Service comparability exercise compares Civil Service jobs with similar jobs in a wide range of large and medium sized organisations in

both public and private sectors. In the study for the 1980 pay award, more than 600 job surveys were made providing data on comparable jobs, known as the analogues. All available information about the pay rates and other conditions of service of the analogues, such as the provisions of the associated occupational pension schemes, was sought. By comparing the Civil Service rates and conditions of service with this information the estimated total remuneration package (pay and other benefits) of civil servants was adjusted to match the estimated total remuneration package of the average of their analogues. These adjustments included allowances, reflected in the gross pay of civil servants, to take account of the differences between the contributions and benefits applicable to their pension scheme and those of the average of the analogue schemes.

13. The adjustments to take account of the differences between the Civil Service pension scheme and the analogue schemes effectively mean that civil servants pay a sizeable contribution towards their pensions, but, because the main part of this contribution is made in the form of a reduction in gross pay, this is not often realised. The effective contribution by civil servants, at around 8 per cent of pensionable pay, is getting on for twice the average direct contribution by employees in the analogue schemes.

The private sector

14. Virtually no private sector scheme guarantees to provide inflation-proofed pensions. But private sector schemes vary considerably in the degree of inflation protection which, in practice, they do provide. We do not have comprehensive information about the practice in all the private sector schemes; but the information gathered for the purposes of the Civil Service comparability exercise in 1980 shows that some private sector schemes have largely compensated pensioners for the effects of inflation even in the more recent difficult economic circumstances. Other private pension schemes used in the comparability exercise have done less well. On average the private sector pension schemes in the exercise have provided 50 to 55 per cent protection against inflation over the last five years or so. However the private sector schemes in the Civil Service comparability exercise are not intended to be representative of the generality of private sector pension schemes, and such information as is available to us suggests that the former have given far better protection against inflation.

Choice of analogues

15. A question which naturally arises in a comparability exercise is which analogues to use in the comparison, for the choice can significantly affect the results. So far as pensions are concerned, there is wide variation in schemes between the public and private sectors and within the private sector itself.

16. The principal criterion for selecting analogues for the Civil Service, as set out by the Priestley Commission, was that they should be jobs which can be considered comparable to the job being studied. Public sector comparability exercises draw analogues from both the private and public sectors.

17. We believe that the inclusion of analogues drawn from the public sector can effectively create a circular argument, in that public sector employers have largely looked at each other's pay rates and conditions of service in setting their own. So far as the pensions element in the exercises is concerned, the inclusion of public sector analogues results in too little weight being given to the advantages which the inflation-proofing of pensions gives to the public sector over the private sector. If the public sector analogues had been excluded from this part of the Civil Service calculations, all the other analogues being the same as before, then the assessment of the value of the difference in pension benefits would have been somewhat higher. Against this, the adjustment for the value of the difference in pension contributions would have been lower. The net effect would have been a small increase in the effective contribution from civil servants.

18. We have no reason to doubt the suitability of the analogues drawn from the private sector but we do believe that analogues should not be drawn from the public sector. It would be illogical to exclude public sector analogues from only the pensions part of the calculations; they would have to be excluded from the whole of the comparability exercise. This would alter the basic pay rates from which the pension adjustments are made.

The assessment of the difference in pension benefits

19. The assessment of the value of the difference in pension benefits for the comparability exercise for the non-industrial Civil Service is made by the Government Actuary. In his 1980 Review he had to make various assumptions, the principal ones being that over the long-term:

(a) the rate of inflation will average 7 per cent per annum;

(b) the return on investments (which includes capital appreciation as well as income) will on average exceed the rate of inflation by 3 per cent per annum (giving a return of about 10 per cent per annum);

(c) the return on investments will on average exceed increases in the general level of earnings by 1½ per cent per annum (giving increases in the general level of earnings of about 8½ per cent per annum); and

(d) increases in analogue pensions in payment will be at about the same proportion of the inflation rate as in the recent past; this amounts to assuming that, over the long-term, protection will be given against 62 per cent of the rate of inflation for the analogue schemes as a whole (50 to 55 per cent if only the private sector analogues are considered).

20. Some of these assumptions are inter-related and others are entirely speculative. For example, the rate of return likely to be received in the future on pension fund assets and the expected rate of inflation are both important assumptions but they tend to move in the same direction. It is, however, the difference between them, which we have for convenience described as the real rate of return on investments, which is critical to the valuation of an index-linked pension. Another important assumption concerns the extent to which the analogue pension schemes will in the future be able to provide increases in pensions and how these increases will be related to the levels of inflation. In the light of recent experience, this must be highly problematical.

21. While it was of interest for various purposes to examine the sensitivity of the valuation results to changes in the individual assumptions, it has to be borne in mind that a change in any one assumption is unlikely to occur in practice without consequent changes in the others. Many of the critics of the Government Actuary's assumptions took little account of this.

Guaranteed pensions increases

22. We believe that the inflation-proofing of the vast majority of public sector pensions confers on the employees concerned a considerable advantage over the employees of the analogue schemes. The advantage is greater over most

employees in the private sector outside the analogues: their protection against inflation has been relatively small. The advantage over the self-employed and those who are not members of occupational pension schemes is even more marked.

23. The Government Actuary effectively assumed that the degree of inflation-protection in the analogue schemes would remain at the recent level of about 62 per cent (50 to 55 per cent if only the private sector analogues are considered) which implies that pensions under the analogue schemes (in excess of the Guaranteed Minimum Pension, where appropriate) would be expected to lose somewhat more than 20 per cent of their real value over a period of 10 years. We believe that this disadvantage might well be diminished if the Government Actuary's other assumptions were actually realised. He also took into account the effects of the State pension scheme.

Valuation

24. The Government Actuary's assumption of an average inflation rate of 7 per cent over the next forty years or more is obviously one in regard to which there are many and varied opinions. The problem facing private sector employees is more the uncertainty of the inflation rate than its level. If inflation were to be held steady at any figure, and a sufficient real rate of return on investments were available, private pension funds could, at an appropriate price, offer a high degree of inflation protection. The prime disadvantage borne by private sector employees stems from the uncertainty of the inflation rate and this should be taken into account in the calculations.

25. We asked Professor R A Brealey and Dr S D Hodges of the London Business School to examine this problem of uncertainty.

26. They made a hypothetical comparison between portfolios required to come closest to providing, on the one hand, full inflation protection and, on the other, the 62 per cent inflation protection for the analogues used in the comparability exercise. They deduced that the rates of return on such portfolios could be used in order to value the advantage of full inflation protection.

27. They came forward with a 'Deduction' substantially in excess of the 1980 figure for the non-industrial Civil Service. We believe their assumption of

negative real rates of return to be too low in the light of our own assessment of the future. But we believe that Brealey and Hodges' novel approach is of considerable interest and merits serious consideration.

28. The difficulties of arriving at agreed assumptions about the future would be reduced if long-term bonds indexed to inflation were available on the market. The possible issue of indexed bonds was fully discussed in the Report of the Committee to Review the Functioning of Financial Institutions (the Wilson Committee). That Committee was evenly divided and made no recommendation. If indexed bonds were available for pension funds, the problems raised by the uncertainty of the inflation rate and of the likely real rate of return on investments would to some extent be reduced. The return on indexed bonds would reflect the value which people placed on full protection against inflation. The valuation of fully indexed pensions would be appropriately carried out on the basis of a rate of interest equal to the expected long-term real rate of return on indexed bonds. If fears about the level of the inflation rate remained material the pension benefits of only partially indexed schemes might then be valued at a somewhat higher rate of return to compensate for the additional element of uncertainty involved. We would suggest that the Government should now look seriously at the case for issuing indexed bonds to cover pension liabilities.

29. The Government Actuary assumed a real rate of return on investments of 3 per cent per annum. This figure is in line with those employed in the valuation of many private sector pension funds, but such funds are not required to provide for a guarantee of full inflation protection. Different assumptions can significantly affect the calculations. If inflation were expected to fall to very low levels and to be accompanied by a satisfactory real return on investments, the 'Deduction' from Civil Service pay to allow for the difference in pension benefits would be smaller than at present. Equally, if these assumptions were reversed, as a result of continuing serious economic circumstances, the 'Deduction' would need to be very high indeed. In our assessment we have implicitly assumed that, in the last resort, there would have to be some cut-off point.

30. We feel almost bound to postulate a positive real rate of return, but we do not believe it appropriate to assume a figure in excess of 3 per cent per annum over the long-term. We have concluded that we should suggest a range which we

regard as reasonably consistent with the nature of the public sector guarantee and the more likely prospects for the economy, bearing in mind the hope of lower inflation rates than those recently experienced. This range means that for the non-industrial Civil Service the appropriate 'Deduction' to take account of the difference in pension benefits may be taken as lying between 3 and 8½ per cent. The 'Deduction' assessed in 1980 was 3.8 per cent. The total effective employee contribution corresponding to this range would lie between about 7 per cent and 13½ per cent of pensionable pay. The figure for 1980 was 7.9 per cent. If the public sector analogues were excluded from the comparison, as we believe they should be, there would be a small increase in these figures.

31. The figures which we have quoted relate only to the assessment for the non-industrial Civil Service and only to a 'Deduction' calculated in the context of a comparability exercise. Nevertheless, they are indicative of the sort of effects which we would expect to see if the principles which we have been discussing were applied, wherever appropriate, elsewhere in the public sector.

The Government Actuary's role

32. The Expenditure Committee of the House of Commons in 1977 referred to the "awesome responsibility" laid on the shoulders of the Government Actuary. The public accountability of those holding public office is an important feature of our democratic system and it is important to ensure that criticisms are dealt with properly. The simplest way of doing this is to provide some form of scrutiny. The Government Actuary himself suggested that the present degree of scrutiny of comparability exercises be extended to cover the pensions aspects of these exercises. He also said that he would like to be able to make greater use of the professional actuarial bodies as a forum for discussion of the sort of problems involved. We support both these proposals and we suggest that the discussions go wider and include both economic and commercial opinion.

Job security

33. We were also asked "to consider how to assess the relative job security enjoyed by employees in the private and public sectors". The evidence produced to us on this topic was largely subjective. Those within the public sector thought that there was little difference between themselves and their counterparts in the private sector. The opposite opinion was held by those in the private sector.

Certainly recent reductions in the size of most public services have not matched the number of redundancies and widespread short-time working in such large parts of the private sector as manufacturing industry and in some of the nationalised industries. For a comparability study one difficulty is getting appropriate data to make a proper comparison and ensuring that one is comparing like with like, which means looking at the analogues rather than the generality of outside employments. Even this would still leave the difficult problem of valuing differences in job security.

34. The Standing Commission on Pay Comparability (the Clegg Commission) was asked to consider job security but was unable to come forward with any evaluation; nor were we.

The overall picture

35. We were asked to examine the methods and assumptions for taking account of the value of pensions in determining pay in the public sector. 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.

36. This Inquiry has been conducted in a highly-charged atmosphere during a period of high inflation. If the battle to contain inflation is successful then the present considerable inequalities between pensions will diminish to more manageable proportions. In any case, it is basic to any consideration of pension schemes that a long view, that is not only a working life but an increasing retirement span, has to be taken into account and it is incumbent on us all not to be prejudiced by short-term considerations.

37. The comparability exercise is complex and obscures the reality as to what civil servants contribute for their excellent pension arrangements; for example in 1980 they 'paid' around twice as much as their opposite numbers in the private sector analogues.

38. It would be an advantage if, in future, the pension element of the comparison were better publicised.

39. We have not been able to place a precise value on the guarantee of inflation-proofing that is a central feature of the problem we have examined; nor do we believe that the Government Actuary has been able to do so. Moreover, it cannot be assumed that the guarantee would always be met since, in our view, in extreme circumstances, Government and Parliament would intervene. We have, however, offered a range within which, short of such extreme circumstances, a value can be established from time to time in accordance with the most likely prospects for the economy.

40. In our work, we have been able to promote two approaches that, following more thorough examination, could help in making a valuation. The first was the idea developed for us by Brealey and Hodges to set a possible value on the uncertainty of inflation in the future. Second, we believe that if Government or other indexed bonds were made available these could help in valuing public sector pensions. They would also greatly help the private sector - including the self-employed who are in the worst case of all - to provide more reliable protection and to cost this more realistically.

41. In our work, if we have been forcibly reminded that the main objective of public policy must be to beat inflation, we have also been reminded of the serious concern that pensions over a high proportion of the private sector are not good enough. This is so even allowing for the State scheme which comes into full effect in 1998.

42. In the meantime, it is a fact that the private sector employee cannot acquire a pension that has a guarantee of inflation-proofing on any terms. And thus, and especially during this present period of recession and economic stringency, the feeling of injustice so widely held in the private sector must be recognised.

43. The figures we have looked at suggesting what the cost of pensions will amount to in the year 2000 - a short 20 years ahead - are dramatic in their magnitude. It may also come as something of a shock to see that at the upper end of our range of valuations an analogue scheme providing no more than the current degree of inflation protection would today require a funding rate (total

contribution by the employer and the employee) as high as 24 per cent of salary.

44. In short, good pensions, like anything else, have to be earned and paid for during working life; and the burden to be shouldered over the next twenty years will steadily grow.

45. If as a society we fail to face these realities we shall find that the precept expressed in our introduction, that "it is a highly desirable social objective that the standard of living of those in retirement should be protected", will be but an empty phrase.

CHAPTER 1: INTRODUCTION

Public concern

46. There has been considerable concern about the value and cost of inflation-proofed pensions in the public sector. In the 1970s inflation ran at levels for which no-one was prepared. Everyone has suffered from this to some extent but perhaps one group which has felt this more than others has been that of the pensioners. The pension schemes of the 1960s were not designed with the inflation of the 1970s in mind. Although some private sector pensioners have had their pensions increased quite considerably, very few of these pensions have kept pace with inflation. Other private sector pensioners have had quite small increases or none at all and have had to rely increasingly on the State for help. The vast majority of public sector pensioners, on the other hand, have received increases in pensions in line with inflation. It was in the light of this public concern that the Prime Minister decided to set up this Inquiry.

47. This concern was well reflected in the evidence submitted to us. The general argument against current pension arrangements was expressed along these lines: index-linked pensions in the public sector are largely financed by the tax-payer and it is grossly unfair that the private sector should be required to help provide a level of benefit which it is unable to afford for its own employees; in current economic circumstances, a burden such as this can only heighten the problems which British industry is facing; either index-linked pensions should be abolished or public sector employees should contribute in full towards the additional benefits which they receive; current methods of assessing the value of these additional benefits bear little relation to reality and take no account of the fact that full inflation protection is guaranteed rather than discretionary; these anomalies are highlighted by the inflation-proofing of the full amount of 'top' people's pensions when some private sector pensioners on more modest pensions are getting no protection against inflation at all. About half of the written evidence which we received took this line.

48. The other half supported the current arrangements, with arguments which were along these lines: pension schemes should provide for benefits to be protected against inflation; some private sector pensioners are getting a significant degree of protection against inflation and, although others are not

doing so well, the solution is to improve pensions in the private sector rather than to make public sector pensions worse; pensions should not be looked at in isolation; private sector employees often get valuable fringe benefits and are less subject to Government interference in their pay and other conditions of service; the value of public sector pensions is fully taken into account in public sector pay negotiations and in a number of cases the values used have been the result of detailed actuarial calculations which were objective and at least as reliable as those which anyone else would make; public sector employers have an obligation to existing pensioners and contributors to continue to provide the inflation-proofed pensions which they were promised.

Approach

49. We were not asked to decide what action should be taken concerning inflation-proofed pensions in the public sector. It is to be left to the Government and other public sector authorities to decide whether and what changes in present arrangements would be desirable and for any such changes to be considered by the managements and unions and staff associations concerned.

50. Our prime task was to consider methods and assumptions appropriate for assessing the value of differences in inflation protection of occupational pensions for use in public sector pay negotiations: in other words, methods for working out by how much public sector employees' pay should be adjusted to take account of the pensions to which they are entitled. This is the area in our remit which has attracted considerable public concern and we felt that it was right, in the limited time available to us, to concentrate on this area. Chapters 2 to 5 cover our findings on this topic.

51. We were also asked to consider how to assess the value of relative job security. We have found it very difficult to say anything of substance about this. Others have tried before us and have failed. What little we have to say is in Chapter 6 of this Report.

CHAPTER 2: CURRENT ARRANGEMENTS

Current pension provisions

52. The pension schemes in the public sector are described briefly in Appendix 2. The principal aspect of pensions with which we are concerned is how pensions in payment are increased. Appendix 3 shows the provisions for pensions increases which apply to the main public sector employments. Statutory inflation-proofing (in nearly all cases under the Pensions (Increase) Acts) is provided for all members of pension schemes in the public services; these include, among others, local government employees, civil servants, teachers, National Health Service employees, the armed forces, the police, the fire service, and Members of Parliament. Approaching two-thirds of the employees in the nationalised industries' and public corporations' pension schemes are in pension schemes the rules of which provide for inflation-proofed pensions. However, some of these schemes do provide that the full pensions increases may not be granted if the fund cannot afford them, unless the employer agrees to meet the extra costs, and others provide for reviews of the pensions increase arrangements. Nearly one-third of the employees in nationalised industries' and public corporations' pension schemes are in schemes which, in practice, have provided inflation-proofing, although the rules only make provision for discretionary pensions increases. Thus, the number of pension scheme members in the public sector who are in schemes which do not undertake to provide inflation-proofed pensions is comparatively small and the number in schemes which have not, in practice, provided inflation-proofing is much smaller.

53. On the other hand, in the private sector guaranteed full inflation protection is virtually unobtainable because private sector employers and pension funds cannot be sure that resources will be available to pay such benefits and are not prepared to accept the risk which giving a guarantee of this sort would entail. Typically the most that is guaranteed is a fixed percentage increase, usually of the order of 3 to 5 per cent; beyond this the level of inflation protection is at the discretion of the pension fund trustees or the employer.

54. Expenditure on retirement benefits (including lump sum payments etc) in the public sector is illustrated by Tables 1 and 2 which show for four of the main public service groups of employees the expenditure on pensions in recent years and, as a percentage of pay, the division of the cost between basic pensions and cumulative pensions increases. All four groups receive index-linked pensions. Total expenditure on retirement benefits as a proportion of the pay bill has increased over the period because of an increase in the number of pensioners and the maturing of the schemes. The effect of high rates of inflation is reflected in the distribution of the total cost of benefits between basic pension benefits and cumulative pensions increases, with the latter representing 35 to 40 per cent of the total in 1980-81 compared with around 10 to 15 per cent in 1970-71.

TABLE 1: Expenditure on retirement benefits in four public service groups

£ million

Financial year	Civil Service	Local Government	NHS	Teachers
1970-71	92	88	42	94
1971-72	109	85	50	107
1972-73	130	95	60	130
1973-74	172	114	78	143
1974-75	197	157	105	180
1975-76	295	221	143	236
1976-77	352	286	193	298
1977-78	390	354	238	367
1978-79	495	418	274	483
1979-80	580	493*	379	517
1980-81 (Estimated)	755	580	425	606

* Estimate.

55. It has been estimated that the cost of public service retirement benefits for 1980-81 will be £3.23 billion with £1.3 billion of this representing the current cost of past and present pensions increases. Comparable figures for the nationalised industries and public corporations were not readily available.

56. The total expenditure on pension benefits by both public and private sector occupational pension schemes (that is, excluding the State pension) is currently over £5 billion according to the Government Actuary's estimates. This

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TABLE 2: Expenditure on retirement benefits as a percentage of the pay bill in four public service groups showing basic benefits (including lump sums) and cumulative pensions increases

Per cent

	Civil Service			Local Government			NHS			Teachers		
	Basic	PI	Total	Basic	PI	Total	Basic	PI	Total	Basic	PI	Total
1970-71	6½	1	7½	9	1	10	5	½	5½	9½	1½	11
1971-72	6½	1½	8	6	2	8	5	½	6	8½	2	11
1972-73	7½	2	9	6½	2	8	5	1	6	7	2½	9
1973-74	8½	2½	11	5½	2	7½	5½	1	6½	6½	2½	9
1974-75	8	2½	10½	7½	2	9	5	1	6	6½	3	9½
1975-76	8½	3	11½	6	2½	8½	4	1½	5	5½	2½	8
1976-77	9	4	13	6½	2½	9½	4½	2	6½	6½	3½	10
1977-78	9	4	13	7½	3½	11	5	2	7½	7	4½	12
1978-79	10½	5½	16	8	3½	11½	5	2½	7½	8	5½	14
1979-80	11	6	17	8*	4*	12*	6½	3	9½	8½	6	14
1980-81 (Estimated)	11½	6	17½	8	4½	12½	5½	3	8½	8	6	14

* Estimate.

Note: some totals may seem not to tally because of rounding.

represents some 4 per cent of total personal income. The Government Actuary has estimated that total occupational pension benefits, at 1980 prices, may more than double by the year 2000, reaching some £13 billion.

57. This increase is based on the assumption that real incomes will rise by about 1½ per cent per annum. As the growth in pension benefits estimated by the Government Actuary represents an annual rate of increase of 4½ per cent per annum in real terms, the implication is that the share of total incomes taken by pension benefits will rise - from about 4 per cent now to nearly 7 per cent in the year 2000. This would require the working population to restrict the growth in its standard of living accordingly.

58. These projections were made on the assumption that by the year 2000 private sector schemes would protect pensions in payment against about two-thirds of the rate of increase in prices. Full protection would impose an additional cost on the working population.

Taking account of differences in pensions

59. In determining pay rates by comparison with other employments, employers and employees will wish to ensure that full account is taken of any advantages or disadvantages relating to the employment under consideration. For example, the benefits of membership of an occupational pension scheme may add considerably to a job's value and, when unexpectedly high rates of inflation are experienced, considerable importance will generally be attached to the provisions for increasing pensions in payment.

60. If public sector pay were determined simply on the basis of the employer's ability to recruit, retain and motivate employees, then there would be very little need to make precise adjustments to pay scales to allow for particular advantages and disadvantages, since market forces would ensure that the value to be attached to these things would be allowed for in some way in determining the rates of pay. But, in practice, pay negotiations will often include discussion of the value of particular benefits or conditions of service.

61. The State pension scheme is also relevant because the State and occupational schemes are complementary. Pensions under the State scheme are

index-linked to prices and the State scheme also provides for index-linking of the related elements in contracted-out occupational pension schemes. The full effects of the new State earnings-related pension will be felt only by people retiring after 1998. The State will then bear a much greater part of the burden of providing pensions and protecting them against inflation than it has in the past. This will be particularly significant for those who, when employed, were on average earnings or less, since the State pension, taken with the Guaranteed Minimum Pension where appropriate, will provide pensions of 40 per cent or more of pre-retirement earnings and this amount will be fully protected against inflation. However, during the transitional period - and even after that for those with above average earnings and those who are self-employed (since the earnings-related pension does not apply to them) - there could continue to be a substantial difference between public and private sector pensions. In Appendix 4 we give a general description of pension schemes in the United Kingdom and we briefly describe the schemes in France and West Germany in Appendix 5.

62. Essentially there are three ways in which differences in pensions may be treated in determining pay:

(a) differences in pensions may be hardly taken into account at all;

(b) differences in pensions may be taken into account but only in a fairly rough and ready way; and

(c) differences in pensions may be taken into account after a very detailed study.

63. In this Report we shall be concentrating on methods for making a detailed evaluation of differences in pensions for the purpose of determining pay. This effectively means that we shall be looking at methods used in the context of a detailed pay comparability exercise. Arrangements of this sort apply to a relatively small proportion of jobs in the public sector. We are not in a position to analyse in detail the way in which differences in pensions are taken into account in the remaining jobs in the public sector. However, because of the size of this group, those responsible for determining pay in these jobs ought to have regard to what we say about the methods used in comparability exercises to see whether there are any lessons to be learned concerning how differences in

pensions should be taken into account.

Comparability

Principles

64. The use of comparability exercises can be traced back to the Royal Commission on the Civil Service (the Priestley Commission) of 1953-1955 which recommended that the primary principle of Civil Service pay should be "fair comparison with the current remuneration of outside staffs employed on broadly comparable work, taking account of differences in other conditions of service."

65. The comparability process in the public sector usually involves surveys of, first, representative jobs within the public sector organisation being considered and, second, a sample of jobs in other organisations. In the latter survey individual jobs (the 'analogues') are often considered in a representative sample of organisations in the public and private sectors. Where possible, staff are identified in each analogue doing the same kind of work at the same level of responsibility as staff in the public sector organisation being considered. The aim is to obtain all the available information about the pay rates and all matters bearing on the total remuneration package so that a proper comparison can be made.

Employments covered

66. The Government Actuary and his Department are called upon to make most of the detailed assessments of the value of differences in pension schemes. The Government Actuary is a civil servant and is the Government's professional adviser on pensions. He makes assessments for the following groups:

(a) the non-industrial Civil Service;

(b) the industrial Civil Service;

(c) employees whose jobs are examined by various Review Bodies (for example the armed forces, doctors and dentists, and people with 'top' salaries); and

(d) staff belonging to a number of bodies whose pay is determined by reference to Civil Service and other public service rates.

67. The Government Actuary has also calculated adjustments for staff groups which were considered by the Standing Commission on Pay Comparability (the Clegg Commission), for example, teachers, nurses and midwives, and local authority manual workers. That Commission is now being wound up and it seems likely that pay for the groups which it covered will revert to negotiation without a detailed assessment of pension differences.

68. In 1979, the pay of local authority administrative, professional, technical and clerical staffs (APT & C grades) in England, Wales and Scotland was based on the results of an 'in-house' comparability study. The Government Actuary's Department was not involved.

Methods used

69. The method used in calculating the value of differences in pensions for the pay negotiations for the non-industrial Civil Service sets the pattern for the other groups, although the procedures for the latter may be less detailed. In the case of the non-industrial Civil Service, differences in pension schemes are allowed for in two stages. In the first stage, the difference between analogue employees' pension contributions and those in the Civil Service is taken into account, as are differences resulting from some of the analogue schemes not contracting-out of part of the State pension scheme as the Civil Service scheme has done. Having taken account of this and other factors, 'interim' figures are produced for pay and the median of these is found. In the second stage, the median is adjusted to take account of the remaining difference which relates to the difference in pension benefits: this adjustment, expressed as a percentage of the median, is known as the 'Deduction'.

70. The assessment of the difference in pension contributions requires little in the way of subjective judgements and has not proved controversial. We are satisfied with the current arrangements and need not discuss them further. The assessment of the difference in pension benefits, on the other hand, has aroused considerable controversy. Briefly, so far as the non-industrial Civil Service is concerned, the method is this: differences in pension benefits are assessed by working out for the Civil Service scheme and the analogue schemes the contributions as a percentage of salary which, on the assumptions made, would, on average, have to be paid into the schemes to pay for the benefits which a member can expect to receive from them.

71. Particularly important in these calculations are the assumptions regarding:

(a) the rate of inflation;

(b) the return on investments;

(c) the rate of increase in earnings; and

(d) the degree of inflation protection which will be provided for pensions in payment.

The rest of the calculation is essentially an attempt to simulate an average career and period of retirement. The Government Actuary makes assumptions about, among other things, ages of joining the pension scheme, rates of mortality, ill-health retirement and withdrawal from service for other reasons, career salary progression, the age at retirement and the proportion of members of schemes who are married. These assumptions are based on an analysis of the experience of civil servants, including the experience of retired civil servants and their dependants. Since this assessment is intended to take account of all the differences in the benefits provided by the pension schemes being considered, the method includes an attempt to take account of differences in the provisions for increasing pensions once they are in payment.

72. An illustration of how the system worked in 1980 might be helpful. It is based on data given in the Government Actuary's Report on his 1980 Review for the Civil Service. The position is shown in Table 3. For each £100 of gross pay, the average analogue pays £4.3 in occupational pension contributions and receives occupational pension scheme benefits (and for contracted-in schemes only, earnings-related State benefits) worth £12.6 (12.6 per cent of gross pay). Thus for each £100 of gross pay, his net pay is £95.7 and the total value of his 'remuneration package' of pay and pension is assessed at £108.3.

73. For each £100 of gross pay which the average analogue receives the average Civil Servant will get gross pay of £93.9. The figure is arrived at by making two reductions from the figure of £100:

(a) the first reduction, of £2.4, reflects the difference between the contributions paid from gross pay by the average analogue (£4.3) and the contribution which a male Civil Servant would pay from gross pay of £100 for family benefits (£1.5); the difference is adjusted down (by

£0.4) to take account of benefits which some of the analogues receive through being contracted-in to the State earnings-related scheme (which Civil Servants are not); and

(b) the second reduction, of £3.7, reflects the difference between the benefits of the Civil Service scheme and those of the average analogue; this amount, when expressed as a percentage of the pay figure after the first reduction, is known as the 'Deduction' and was 3.8 per cent in 1980; the derivation of this figure is explained in Appendix 6.

From gross pay of £93.9, the contribution for family benefits, averaged over male and female civil servants, is £1.3.

74. Thus, the average Civil Servant will effectively contribute £7.4 towards his pension for every £93.9 of gross pay he receives, the £7.4 being made up of:

(a) the first reduction during the pay research process of £2.4;

(b) the second reduction of £3.7; and

(c) the contribution from gross pay of £1.3.

75. The Government Actuary has calculated that for each £93.9 of gross pay the average civil servant will get pension benefits of £15.8 (equivalent to 16.8 per cent of the gross pay of £93.9), so that the remuneration package of pay and pension is £108.4. This is virtually equal to the £108.3 for the average analogue, the difference of £0.1 being solely due to roundings to one decimal place during the calculations.

TABLE 3: The system for the non-industrial Civil Service in 1980 showing the position for each £100 of gross pay of the average of the analogues

	Average of the analogues £	Non-industrial Civil Service £
Starting point in calculating Civil Service gross pay	–	100.0
First reduction in lieu of pension contribution	–	-2.4
		97.6
Second reduction in lieu of pension contribution (a 3.8% 'Deduction')	–	-3.7
GROSS PAY	100.0	93.9
Occupational pension contribution from gross pay	-4.3	-1.3
NET PAY	95.7	92.6
Pension benefits	+12.6	+15.8
TOTAL REMUNERATION PACKAGE	108.3	108.4

76. It is worth noting that the average analogue employee pays 4.3 per cent of gross pay for benefits and that civil servants effectively pay an amount equal to 7.9 per cent of their gross pay.

77. This, incidentally, may help to dispose of two misconceptions. The first is that civil servants pay nothing for their pensions. Certainly, apart from a contribution paid for family benefits, no contributions per se are paid but in lieu of contributions the gross pay rates of the Civil Service are reduced. Another misconception arises because the widely publicised 'Deduction' is often wrongly assumed to represent either the total cost to a civil servant of his pension or the full value of inflation-proofing a pension. In fact, it is neither: it represents only part of the total adjustment to Civil Service pay and is intended to measure the difference between benefits payable under the Civil Service and analogue schemes.

78. The adjustments made for the industrial Civil Service are based on essentially the same methods as are used for the non-industrial Civil Service.

The main variation is that, instead of separate calculations of the differences in contributions and benefits, a single calculation is made covering both differences.

79. For jobs covered by the Review Bodies, the types of comparison made vary from one reference to another, depending on the specific needs of each Review Body. They usually take the form of a comparison of the value of the pension scheme to individuals who have specific careers in various employments, rather than a simple comparison of scheme benefits in relation to a common average career. Given this difference, however, the basic principles on which the comparisons are made are the same as for the comparisons made for non-industrial civil servants.

80. For jobs which were covered by the Clegg Commission, comparisons were made either on a job-for-job basis or by 'factor comparisons' - a form of job evaluation. On the whole, the pensions assessments made for the Commission were based on fewer analogues than for the non-industrial Civil Service and it was recognised that the quality of the data was not generally so good. Moreover, various approximations had to be adopted in order to carry out the assessments in the time required. In other respects, the principles were the same as those for the non-industrial Civil Service.

81. The 'in-house' comparability study for local authority APT & C grades followed the general pattern of comparability exercises. In valuing the difference between pension provisions, use was made of figures which had been calculated by the Government Actuary for other comparability exercises. A detailed actuarial assessment was not made.

CHAPTER 3: THE PRIVATE SECTOR AND THE ANALOGUES

Introduction

82. Much of the criticism of the current comparability methods has been directed at the choice of analogues - the jobs selected from outside employments which are considered to be comparable with those in the public sector organisation under study. One of the criticisms is that the pension schemes of the analogues chosen are not representative of private sector pension schemes as a whole, so we begin with a survey of private sector pension schemes.

Private sector pension schemes

83. The practice of providing retirement benefits for staff employees began to spread during the immediate post-war period, but the benefits were often modest and related to the average salary earned throughout an employee's service. Interest rates were low and benefits related to final salary were much more expensive than many employers could contemplate. As interest rates rose, however, and the higher rates were employed in pension calculations, the cost of providing pensions reduced rapidly and the estimates for final salary pensions became more in line with what many employers had been paying for more modest benefits. With increasing consciousness of inflation in the economy, final salary pension benefits had great attractions and the 1960s saw the widespread introduction of final salary pension schemes, embracing not only staff but also works employees.

84. The fact that the higher levels of interest rates were a consequence of the higher rates of inflation was, of course, recognised, but the implications for pension fund financing were not taken into account by many of those concerned with pensions. It was certainly the practice to incorporate assumptions as to increases in the general level of salaries when ascertaining the cost of a final salary pension scheme but it was not the practice to make any provision for the uplift of pensions. Nor indeed would any such provision have been acceptable, since it would have increased the cost to the same level as had been rejected in the low interest period of the 1950s.

85. There is no statutory requirement to provide occupational pension schemes in this country. Until recently the idea that pensions ought to be increased to allow for inflation was recognised by very few employers. Moreover, for many years the efforts of trade unions were concentrated on negotiating pay with little regard to pension arrangements. In the background the Inland Revenue was actively discouraging any hint of 'over-funding'.

86. In the 1970s, the high rates of inflation then being experienced brought home very clearly the unsatisfactory nature of pensions which were fixed in money terms. The level of benefits, having been set on the assumption of high rates of interest, could not be increased without the provision of additional finance from the employer. Even by the end of the decade a common response to the erosion of a pension's value was the introduction of fixed contractual rates of increase in pensions, usually of the order of only 3 to 5 per cent.

87. The circumstances giving rise to the contrast, in a period of high inflation rates, between the experience of private and public sector pensioners, are perfectly clear. It is not possible for any private sector scheme, however generously funded, to guarantee that its pensions will be inflation-proofed, since there are, at present, no assets available to match such a liability. But it should be able to make a good attempt.

88. Suppose, for example, that the funding rate of a scheme is calculated on the assumption that only a 3 per cent rate of interest will be received. Inflation is at the rate of 15 per cent and long-term interest rates in the market are 13 per cent. The 'real' rate of interest earned is -2 per cent so the fund cannot provide pensions increases in line with inflation, but nevertheless there is a substantial surplus arising from the 10 per cent difference between the 3 per cent assumption and the 13 per cent earned, which will permit reasonably large pensions increases to be paid without the necessity for further finance.

89. If, on the other hand, it had been assumed that the interest rate would be 10 per cent, a small surplus on pensions would have emerged permitting only a token increase in pensions.

90. The first example is of a scheme which is making a reasonable attempt to provide 'real' pensions and might be regarded as a typical analogue. The second

example is more representative of the private sector as a whole.

91. The previous paragraphs provide an unduly simplistic outline of the arithmetic, but it is significant that the funding cost of the first scheme might be in excess of 20 per cent of salaries whereas that of the second might be half of that. Employers faced with pension costs of between 20 and 30 per cent of their pay bill would recognise that they must either reduce the level of their pension promises or pass on the cost to their customers or their employees.

92. It is relevant to note that retiring employees, given the alternative of a pension of fixed amount or a reduced pension which would be increased at a fixed rate each year, tend to select the higher initial amount. Employers unable to finance increased pension costs may thus have difficulty in negotiating lower initial pensions funded with the aim of preserving their real value.

93. The development of pensions which maintain their real value can only occur gradually in the private sector: if it were to happen at once it would add to inflationary pressures. Nevertheless, we believe there is a growing awareness of the need to finance 'real' pensions, and, as greater numbers of pensioners benefit from this, the present 'two-nations' attitude will die away.

Choice of analogues

94. With the enormous variety and range of pension benefits available in the private sector, the selection of jobs to be used as analogues in a comparability exercise can significantly affect the results. The choice of the analogues is a highly developed process in which the nature of the pension benefits provided has no influence: the choice is concerned with the sort of work which the employees do. Jobs in a wide range of organisations are selected. The process for the non-industrial Civil Service is described briefly in the Government Actuary's Report on his 1980 Review and in greater detail in the 1980 Report of the Civil Service Pay Research Unit.

95. We have received much evidence and comment to the effect that those analogues which are drawn from the private sector have not provided a proper comparison and have not been representative. None of the witnesses who expressed this view was able to suggest a more satisfactory method for providing

a comparison. For example, to be able to identify comparable jobs, the firms involved must operate developed systems of personnel management. This effectively rules out many small companies. Only about 20 per cent of the Civil Service analogues in 1980 were drawn from companies with less than 2,000 employees, and even such a criterion as this would hardly serve as a definition of a small company. However, it is a mistake to assume that the analogues should be representative of the whole private sector. They should be representative of the jobs in the private sector which most closely resemble those in the public sector organisation under study: that is the only comparison which is relevant. We have no reason to doubt the suitability of the private sector analogues currently selected.

96. So far, the analogues have not been drawn exclusively from the private sector. The Priestley Commission of 1953-55 recommended that the pay of the Civil Service be determined by comparison with other employments and that, for a proper comparison, those employments ought to include other public sector employments. In 1980, about 20 per cent of the 600 or so analogues were drawn from the public sector. In 1955, the inclusion of public sector analogues was unexceptionable, but in present times, with the greater use of comparability exercises and with public sector employers largely looking at each other's pay rates and conditions of service in setting their own, there is a serious risk of creating a circular argument.

97. In his 1980 Review, the Government Actuary concluded that a 'Deduction' of 3.8 per cent ought to be made in setting pay in the non-industrial Civil Service to allow for the differences between the pension benefits of the Civil Service and the analogues. If the public sector analogues had been excluded from the calculation, the 'Deduction' for benefit differences would have been increased to 4.6 per cent. As against this, the adjustment to allow for the difference in contributions would have been lower. The overall effect would have been a small increase in the effective pension contribution paid by the non-industrial Civil Service. This, however, refers only to the pension calculation. It would be illogical to exclude the public sector analogues only from the pension calculation; they would have to be excluded from the whole comparability exercise. This would have some effect on the calculation of the basic pay rates, although in which direction we have not been able to ascertain in the time available. Whatever the final outcome, we believe that the analogues used in comparability exercises should be drawn solely from the private sector.

CHAPTER 4 : VALUATION

Introduction

98. In assessing the differences in benefits between private and public sector pension schemes it is necessary to take into account all the provisions of public sector pension schemes and to compare these with the schemes of the analogue employments. The leading example of the approach is that used by the Government Actuary in making an assessment for the non-industrial Civil Service. This is set out in some detail in "The 1980 Review of the Adjustment for Differences in Superannuation Benefits: Report by the Government Actuary". We have confined our attention to the arrangements for the non-industrial Civil Service because it is the archetype, but we stress that our comments apply in principle to the arrangements used for other public sector groups also.

99. The methods and bases employed, supplemented by written and oral explanations provided by the Government Actuary, have been examined in detail and compared with the practice of other members of the actuarial profession. In addition, we have examined another approach to valuation suggested to us as being useful for this particular purpose.

The assumptions

General

100. In conducting a valuation of the expected cash flows involved in any pension scheme it is necessary to make extensive assumptions concerning various influences which will take effect over the long-term future. This is especially so for the methods employed by the Government Actuary, in particular his use of the 'normal contribution rate' to determine the differences between the private and the public sectors. The normal contribution rate is the theoretical percentage of salary required to be paid throughout service in respect of a new entrant at age 25 to secure all his benefits. In consequence, one of the assumptions, item (d) below, only begins to operate after forty years. The principal assumptions which the Government Actuary made in his 1980 Review for the non-industrial Civil Service were that over the long-term:

(a) the rate of inflation will average 7 per cent per annum;

(b) the return on investments (which includes capital appreciation as well as income) will on average exceed the rate of inflation by 3 per cent per annum (giving a return of about 10 per cent per annum);

(c) the return on investments will on average exceed increases in the general level of earnings by 1½ per cent per annum (giving increases in the general level of earnings of about 8½ per cent per annum); and

(d) increases in analogue pensions in payment will be at about the same proportion of the inflation rate as in the recent past; this amounts to assuming that, over the long-term, protection will be given against 62 per cent of the rate of inflation for the analogue schemes as a whole (50 to 55 per cent if only the private sector analogues are considered).

101. Of the assumptions listed, the most controversial feature was item (b), the real rate of return on investments, that is, the difference between the gross rate of return which might be expected to be earned on assets in the future and the corresponding rate of inflation. This is perhaps the key assumption. The assumption concerning the actual level of inflation is important too, as it influences the relative value of the analogues' benefits. There is little rational basis for its prediction and sudden changes in inflation are likely to be accompanied by counter movements in the degree of inflation protection given to analogue pensions.

102. The real rate of return on investments assumed by the Government Actuary was 3 per cent per annum, and his valuation of the Civil Service scheme, expressed as a normal contribution rate, was 16.8 per cent of salary. These figures were the subject of criticism from many quarters. As an indication of the sensitivity of the funding rate to the real rate of return assumed, it may be recorded that if, for example, the assumed real rate of return were altered from +3 per cent to -1 per cent per annum and the other assumptions were unaltered, the valuation would bring out a funding rate of 46.6 per cent of salary. Some of those critics whose calculations produced results of this order paid little regard to whether the assumptions underlying their calculations were reasonable assumptions; and, furthermore, of those others who did, some failed to consider the corresponding effect on the valuation of the benefits of the analogues.

103. It must, therefore, be emphasised again that the purpose of these calculations is to evaluate the difference between the benefits of the public sector scheme concerned and those of the analogues. An example of the necessity for saying this arose from the evidence submitted to us by the Centre for Policy Studies. After what appeared to be a most competent analysis of the valuation process, the Centre employed a real return assumption of +1 per cent and arrived at a funding rate for the Civil Service scheme of 27.11 per cent, which corresponds reasonably well to the rate calculated for us at the same interest rate by the Government Actuary's Department of 27.9 per cent. The Centre's Report records that they did not have the data to enable them to make the corresponding adjustment in the valuation of the benefits of the analogues. They nevertheless arrived at a 'Deduction' of 11.7 per cent to reflect the difference between the benefits (the Government Actuary's figure in the 1980 Review was 3.8 per cent) and released to the Press a Report which

> "demonstrates that the cost of index-linked pensions to public employees has been seriously under-estimated..., thereby throwing heavy and unjustified burdens onto future taxpayers and ratepayers."

We did not regard this as a helpful contribution to public understanding of the problem. If corresponding adjustments had been made to the analogue valuation, the 'Deduction' would have increased from 3.8 per cent to about 6 per cent provided the other assumptions in the calculations remained unchanged.

104. In Table 4 below we have estimated in broad terms the effect of changing one of the Government Actuary's assumptions in the 1980 Review for the non-industrial Civil Service whilst leaving all other assumptions the same. It should be noted that, as all the assumptions are inter-related, it is unlikely to be reasonable to suggest that one can be changed without others changing also. The effect is shown in terms of the 'Deduction' for the non-industrial Civil Service. It should be noted that this is only part of the total effective pension contribution from civil servants: further details are given in paragraphs 72 to 76.

TABLE 4: Effect on the 'Deduction' (for the difference in pension benefits) of changes in the principal assumptions

(See note in paragraph 104)

Nature of change in one of the long-term assumptions		'Deduction'
No change		3.8%
Inflation: instead of 7% pa, averaging		
(a)	6%	3½%
(b)	8%	4¼%
Real rate of return: instead of 3% pa, averaging		
(a)	1% pa	6%
(b)	2% pa	5%
Increase in real earnings: instead of 1½% pa, averaging		
(a)	1% pa	3½%
(b)	2% pa	4%
Inflation protection for analogues: instead of 62%, averaging		
(a)	52% of inflation rate	4¼%
(b)	72% of inflation rate	3¼%

The principles involved

105. Assumptions such as those made by the Government Actuary are generally familiar in actuarial practice, but there is one feature which is not. It would be most unusual for the actuary of a pension fund in the private sector to be required to evaluate a benefit linked to inflation both before and after retirement (although this is common in the nationalised industries). For some funds, the actuary's efforts may be directed to enabling them to pay pensions increases of the same order as the rate of inflation, but a rule guaranteeing an index-linked benefit introduces a new dimension. Some of those who gave evidence to us described this guarantee as invaluable or even as having infinite value.

106. No one can suggest, with confidence, what levels of inflation or return on investment will be experienced in the next forty years or so, although some levels are, no doubt, more likely than others. In deciding on figures to use in these calculations it is necessary to derive a suitably weighted average. Very

high levels of inflation may be very unlikely but they would be associated with a very high value of inflation-proofed pensions. It is impossible to say what the outcome would be. The Government Actuary stated that in the calculations which he had made there is an underlying assumption that, if economic circumstances deteriorated to the extent that extreme rates of inflation were to continue over a long period, some action would be taken to narrow the gap between inflation-proofed and other pensions. Effectively the probability distribution of future rates of inflation has been cut off at the upper end so that some form of assessment becomes possible.

107. Similar restrictions are implied in other methods of valuation which have been suggested.

108. So far we have considered methods of approach to the problem based entirely on actuarial conventions. We are dealing, however, with the difference between private sector and public sector schemes. The former are all funded and conventional methods are therefore entirely appropriate. Some of the public sector schemes, however, are financed on a pay-as-you-go basis and any assumptions made, therefore, as to the rates of return to be earned in future on assets are entirely hypothetical. In the circumstances it is possible that a somewhat different approach might be useful to take account of the very uncertainty of the future. In particular it is necessary to ask what value might be placed on the protection which most public sector pensioners at present receive against the uncertainty of the inflation rate.

109. In normal pension fund practice, the effect of uncertainty is dealt with, in the last resort, by alterations in pension benefits or contributions if investment experience proves to be markedly different from that assumed. Therefore, no specific account is taken of the possible range of variation in the rate of return other than in the selection of the rate itself. An approach to take account of uncertainty was developed by Professor R A Brealey and Dr S D Hodges of the London Business School. Their method stems from a modern investment theory which has been widely discussed but is still subject to controversy. According to this theory, if two assets have the same expected future cash flows, but different degrees of uncertainty surrounding these expectations, the asset with the higher risk will carry the lower price in the present. That is to say, it will have to

provide a higher expected rate of return to compensate purchasers for the additional element of risk involved. The fundamental reason for this is that most people are risk-averse, that is, they seek compensation for uncertainty. The rate of return on relatively risky securities, like ordinary shares, has tended to be well above that on riskless securities.

110. Taking this a step further, if different pension schemes offer benefits carrying different degrees of uncertainty, for example with respect to the effect of inflation, they might be valued at different rates of interest, with relatively high-risk benefits being valued at a relatively high discount rate, which would lead to a lower value being placed on them. The next problem is to determine what those rates should be.

111. The study by Brealey and Hodges (which is described in more detail in Appendix 7) used the basic assumptions of the Government Actuary concerning salaries and inflation but also made an allowance for the possible variability of inflation. This allowance was derived from the United Kingdom's experience over the past fifty years, but with more weight being given to that over the past ten. They then estimated what mixture of securities would be needed each year to provide the pension benefits of the non-industrial Civil Service scheme with the minimum degree of uncertainty, given the assumed variability of the inflation rate. The choice of investment portfolios was derived from a model using the way in which, in the past, the returns on different types of security - Treasury bills, long-term gilt-edged securities and ordinary shares - have tended to react to changes in the inflation rate.

112. On this basis, Brealey and Hodges concluded that the average real return on such portfolios would actually be negative and would be as low as -0.9 per cent. They carried out a similar study for the analogue schemes, which were assumed to provide 62 per cent indexation and for which they derived a figure of -0.3 per cent for the valuation of the retirement benefits.

113. Their figures led to a difference between the contribution rates of the Civil Service and analogue schemes of 10.7 per cent of salary. This would have required a 'Deduction' of 7.2 per cent as against the Government Actuary's 1980 'Deduction' of 3.8 per cent. About 1 percentage point of the gap between the

Government Actuary's figure and that of the Brealey and Hodges study reflects the difference between the real rates of return as applied to the Civil Service and analogue schemes respectively; the remaining and larger part of the gap reflects the generally low level of real rates of return emerging from the study.

114. The Brealey and Hodges study was intended to be illustrative rather than to provide an answer to the problem of valuation. Its rates of return are derived from past experience and do not claim to be a forecast or assumptions concerning the future.

115. However, the approach is of considerable interest and merits serious consideration as part of any future comparison of public and private sector schemes.

Indexed bonds

116. The difficulties of arriving at agreed assumptions about the future would be reduced if long-term bonds indexed to inflation were available on the market. Pension funds require protection against inflation of their members' salaries during working life and mainly against price inflation after retirement. No protection could ever be obtained against the inflation of members' salaries, although the Government is prepared to cover the inflation of national average earnings for employees who leave a job while in a scheme contracted-out of the State earnings-related scheme. Protection against price inflation is probably what is most commonly regarded as being provided by indexed bonds.

117. If such bonds were available the difficulty of valuing the element of the inflation-proofing guarantee in public sector schemes would then become that of making an assumption as to the weighted average rate of return likely to be earned on indexed bonds in the long-term future; the difficulty of dealing with the analogues would become that of assessing the extent to which the private sector could afford to fund schemes on the basis of such a long-term rate of return. These are similar to the problems involved in the present calculations.

118. The general case for and against the issue of indexed securities - by private as well as by public sector bodies - was discussed in the Report of the Committee to Review the Functioning of Financial Institutions (the Wilson Committee),

Cmnd 7937. That Committee was evenly divided and made no recommendation. The existence of an indexed bond traded on a free market would be of considerable assistance to employers, who could obtain a much clearer indication of the expected costs of various levels of inflation-proofed benefits. The existence of indexed bonds would also enable inflation protection to be extended to the pension arrangements of the self-employed and those not covered by occupational schemes. Even then, it is unlikely that private sector schemes could guarantee to pay inflation-proofed pensions, because these schemes must also protect themselves against unexpected surges in the salaries of their members. It should be noted that the inflation-proofing of public sector pension benefits is tantamount to making a series of issues of such bonds restricted to a privileged class and on terms which have not been subjected to the financial disciplines of the market place. We would suggest that the Government should now look seriously at the case for issuing indexed bonds to cover pension liabilities.

119. Before proceeding to draw conclusions, there are other points which need to be considered.

Other points

120. Mention has already been made of the Government Actuary's expression of the value of the benefits in the form of a funding rate applicable to an entrant at age 25, described in his Review as the 'normal contribution rate'. The use of this contribution rate was criticised as producing a clear under-estimate of the cost, which, in the view of some, should be based on a valuation of the future benefits and contributions of all present employees. In a private sector pension scheme where there is a fund of assets, an actuarial valuation can be carried out from time to time and the funding rate recalculated. In the case of a pay-as-you-go scheme, such as that of the Civil Service, there is no fund of assets. Ingenious suggestions were advanced for arriving at a suitable valuation result which would ensure that no additional burden would be placed on the taxpayer by reason of the age of the members or the inadequacy of any past contribution. Methods of this type can only secure very rough justice unless they are taken to the extreme of charging a separate rate for each age of member varying according to duration of service.

121. Just as it is important to go to some length to ensure equity for the taxpayer, it is equally important to try to ensure equity for the members. The first detailed calculations in connection with pensions comparability were carried out in the mid-1960s, and were formally codified in the 1974 Civil Service Pay Agreement. These, however, were the formal manifestations of a process which appears to have operated more generally before this under the general pay comparability arrangements introduced in the Civil Service following the Priestley Report of 1955, and perhaps even before that time. We have no alternative but to assume, therefore, that a suitable differential was already established between salaries in the private and public sectors and that every public sector employee has effectively incurred a deduction on account of pension differences from the date of his entry into service. If employees are now required to pay on the basis of a regularly up-dated estimate of the normal contribution, the requirements of comparability should be satisfied.

122. Many suggestions have been made to deal with the gap between public and private sector pensions and also to by-pass the vexed problems of valuation. They include placing a maximum on the percentage increase in pension which should be allowed in any one year, expressed as an absolute figure such as 20 per cent, or as a multiple of the inflation assumption incorporated in the calculation, or giving increases related to the rate of return on investments in a given year. Another suggestion was that pension increases due to a rate of inflation in excess of an agreed maximum should be directly charged, to the extent of the excess, to current employees. This is equivalent to charging a mixture of a funded contribution rate and a pay-as-you-go emerging cost. Methods such as these are superficially attractive but they all suffer from the fundamental objection that they are inequitable to many employees. This is particularly true of the last method, to which younger employees in the public sector would be entitled to make strong objections.

123. The purpose of all these suggestions is to ensure that pensioners retain no more than their fair share of the national product. In some circumstances, as has happened before, the standard of living of the whole community might have to be reduced. If any section of the community had its standards guaranteed, therefore, the standards of the rest would have to be correspondingly lower. This could then be expected to lead to measures which would have the effect of

preventing incomes moving up with prices. It would be inequitable if this were prevented from happening to pensions also.

124. It is however no part of our remit to recommend changes in the pension scheme rules of the public sector, but in our assessment of the valuation of pension benefits we have implicitly assumed that, in the last resort, there would have to be some cut-off point. Without such an assumption, a valuation of inflation-proofed benefits is, in our view, indeterminate.

Conclusion

125. In considering the numerous expressions of opinion on the question of valuation, there are many assumptions about the future which can be regarded as within a range of 'reasonableness' in the light of the professional views from many disciplines as to how a mixed economy such as ours seems likely to develop in the future. There are also assumptions which fall outside that range and would be unlikely to be employed by practitioners for valuation purposes.

126. If inflation were expected to fall to very low levels and to be accompanied by a satisfactory real return on investments, the 'Deduction' from Civil Service pay to allow for the difference in pension benefits would be smaller than at present. Equally, if these assumptions were reversed, as a result of continuing serious economic circumstances, the 'Deduction' would need to be very high indeed.

127. It is difficult to put precise limits to the range of 'reasonable' assumptions regarding the real rate of return on investments. In the light of the importance in a free economy of the supply of capital, one is almost bound to postulate a positive real rate of return. Bearing in mind, however, the relative power of capital and labour, we do not believe it appropriate to assume a figure in excess of 3 per cent over the long-term. A large proportion of the critics of the Government Actuary's present assumptions based their views on the real rates experienced currently or in the last 10 years. Such experience is not necessarily relevant. The last decade has been a period of unusual disturbance in the operation of our economy. We incline to the view that it would be reasonable to adopt a real rate of return of zero as the lower limit on our range.

128. We have concluded that we should suggest a range which we regard as reasonably consistent with the nature of the public sector guarantee and the more likely prospects for the economy, bearing in mind the hope of lower inflation rates than those recently experienced. At the more optimistic end of the range, we have assumed a real rate of return of 3 per cent per annum coupled with an average rate of inflation rather lower than 7 per cent and with a degree of protection against inflation for the analogue schemes somewhat higher than that assumed by the Government Actuary in 1980. At the other end of the range, we have assumed a real rate of return of zero accompanied by a degree of inflation protection for the analogues somewhat lower than the Government Actuary assumed. On these assumptions, the appropriate 'Deduction' for the non-industrial Civil Service to take account of the difference in pension benefits may be taken as lying between 3 and 8½ per cent. The 'Deduction' assessed in 1980 was 3.8 per cent.

129. As has already been explained in paragraphs 72 to 76, the 'Deduction' does not represent the total effective employee contribution for pensions. The total effective employee contribution corresponding to the range mentioned above would lie between about 7 per cent and 13½ per cent of pensionable pay. The figure for 1980 was 7.9 per cent.

130. Our figures are based on the same analogues as were used in the 1980 Review: the public sector analogues have not been excluded. If they were, as we have recommended, there would be a small increase in our figures but we do not know what the effect would be on the basic pay rates.

131. The assumptions at the lower end of the range would imply funding rates, that is, 'normal contribution rates' (for employer and employee combined), of the order of 17 per cent for the Civil Service benefits and 13 per cent for the analogue benefits. (The figures derived by the Government Actuary in 1980 were 16.8 per cent and 12.2 per cent, respectively.) The corresponding figures based on the assumptions at the top end of the range would be about 36 per cent for the Civil Service and 24 per cent for the analogue benefits.

132. The figures which we have quoted relate only to the assessment for the non-industrial Civil Service and only to a 'Deduction' calculated in the context of

a comparability exercise. Nevertheless, they are indicative of the sort of effects which we would expect to see if the principles which we have been discussing were applied, wherever appropriate, in the public sector.

CHAPTER 5: THE ROLE OF THE GOVERNMENT ACTUARY

133. Referring to the Government Actuary's role in making pensions assessments, the Expenditure Committee of the House of Commons in 1977 said:

> "one man ultimately has this awesome responsibility and has hardly any chance of getting it right, which is no criticism of the Government Actuary but is a criticism of a system which sets him an impossible task".

134. The problem here is really one of public confidence. Whilst we believe that the Government Actuary goes about his tasks in an entirely proper way, it is only right, in view of the wide implications of his work, that the public should seek safeguards to ensure that the job is being done properly. We see no reason to take the task of assessing differences in pension benefits away from the care of the Government Actuary; indeed the calculations require specialised knowledge which is not available to other actuaries. It is, however, important that there should be some suitable means of independent scrutiny of these calculations.

135. The Government Actuary has himself said that he would welcome greater outside scrutiny of his work. He intends to continue to publish reports on which the informed public, and actuaries in particular, can comment. He has also made two further suggestions. First, the present degree of scrutiny of the comparability exercises could be extended to cover more aspects of the exercises so that the data and the assumptions being made can be more easily interpreted in the light of the use to which they are ultimately to be put. Second, he has said that he would like to be able to make greater use of the professional actuarial bodies as a forum for discussion of the problems involved.

136. Other people have suggested that some sort of independent body should determine what assumptions should be made in the calculations. We have some sympathy with this view but in practice such an arrangement might create problems rather than resolve them. Instead, we suggest that the scrutiny of comparability exercises should include the pensions aspects. Further, we support the Government Actuary's suggestion for discussions and suggest that these should involve not only actuarial opinion but economic and commercial opinion as well.

CHAPTER 6: JOB SECURITY

137. We were also asked "to consider how to assess the relative job security enjoyed by employees in the private and public sectors". The evidence produced to us on this topic was largely subjective. Those within the public sector thought that there was little difference between themselves and their counterparts in the private sector. The opposite opinion was held by those in the private sector. Certainly recent reductions in the size of most public services have not matched the number of redundancies and widespread short-time working in such large parts of the private sector as manufacturing industry and in some of the nationalised industries. For a comparability study one difficulty is getting appropriate data to make a proper comparison and ensuring that one is comparing like with like, which means looking at the analogues rather than the generality of outside employments. Even this would still leave the difficult problem of valuing differences in job security.

138. The Standing Commission on Pay Comparability (the Clegg Commission) was asked to consider job security but was unable to come forward with any evaluation; nor were we.

APPENDIX 1: ORGANISATIONS AND INDIVIDUALS SUBMITTING EVIDENCE

Abbott, R W CBE FIA
Ablett, W J
Adams, Mrs M
Allender, A G
Association of Consulting Actuaries
Association of County Councils
Association of Independent Businesses
Association of Local Authority Chief Executives
Astbury, Mrs Y M

Bacon, Mrs M
Bailey, B H
Bandey, D
Bankes-Jones, R M
Barnes, C H W
Barr, N A
Barratt, D H
Barratt, Mrs P M
Boyle, R C
Bragg, S L
Brealey, Professor R A
Brimblecombe, R E FIA
British Institute of Management
British Insurance Brokers' Association
British Medical Association
British Railways Board
Broadhurst, Ms V A
Brown, C T
Browne, H E
Brunet, E FIA
Butler, W

Cawthorne, F C
Centre for Policy Studies
Chandler, T J
Chaplin, G B FFA
*Civil Service Department
*Civil Service Pay Research Unit
Civil Service Pensioners' Alliance
Clark, A G
Clark, W E
Clay, J P
*Confederation of British Industry
Confederation of Health Service Employees
Cooke, R M
Cooper, I W
Corry, J A CBE
*Council of Civil Service Unions
Council of Her Majesty's Circuit Judges

Crews, Mrs V M
Crown Agents
Crump, H T
Culshaw, Mrs L
Curd, Flight Lieutenant B R

Davies, W D
Davis, J G G
Deeley, F C
Defence, Ministry of
Dennis, R A FIA
Dent, C W
Dorlay, J S
Dowle, R V
Dunlop Holdings Limited
Dyer, S

Edgeley, C R
Educational Institute of Scotland
Elkins, Miss P G
Engineering Employers' Federation
Escolme, A R FIA
Ettie, P F F

Faraday, M A
Fellows, D E FIA
Fire Brigades Union
Fisher, The Hon F F MC
Forestal International Limited
Foster, Councillor H
Foster, T B
Furse, A W

Geach, C D
General Electric Company Limited
Gibb, J R FFA
Gillon, H W FFA
*Government Actuary
Graham, R W
Grand Metropolitan Limited
Greater London Council Staff Association
Green, J R
Green, S J FIA
Grey, D

Hall, E B
Hall, E M
Harding, G F
Harris, E C and Partners
Harris, L E
Harvey, Brigadier M G CBE MC
Henley, N F
*Heywood, Geoffrey MBE JP FIA FFA
Hodges, Dr S D
*Holbrook, J P FIA

Holmes, W
Holmestead, F
Holt, F J
Hymans, J C D ERD FFA AIA

Incomes Data Services
Institute of Actuaries

Joseph Rowntree Memorial Trust

Kane, T
Kennedy-Bell, M C
Kershaw, R
Kibble, O A
Kingston, W
Knell, G G

Lands Tribunal
Langton, V C
Lauener, R G FFA
Lingard, H R
Low, C W F FFA
Lowden, R
Lyburn, A U FFA
Lyon, C S S FIA

Mackenzie, A D
Macleod, J M FIA
Mansell, L
Marshall, Lieutenant Commander A J D
Martin Paterson Associates Limited
McCall, Sir Patrick
McCallum, D
McLeish, D J D FFA
Metropolitan Pensions Association Limited
Miles, D H FIA
Mitchell, Mrs B
Mitchelmore, S W T
Moore, Professor P G FIA
Morris, S J
Mottram, J

National and Local Government Officers Association
National Association of Fire Brigade Pensioners
National Association of Pension Funds
National Association of Probation Officers
National Association of School Masters and Union of Women Teachers
National Federation of Post Office and Civil Service Pensioners
National Union of Teachers
Nationalised Industries' Chairmen's Group
Neill, A FFA FIA
Neville, J R
New Zealand-United Kingdom Chamber of Commerce and Industry
Nicholson J M
Northern Ireland Resident Magistrates' Association
Nottage, R

Officers' Pensions Society Limited

Palmer, Mrs J
Pecak, E
Pick, R A
Pilch, M
Pingstone, G W
Police Representative Organisations
Policy Studies Institute
Pollard, L H
Pratt, L
Price Harris Partnership
Public Service Pensioners' Council

Rae, Miss B
Raithby, C B
*Rayner, Sir Derek
Reynolds, Dr E R S
Richardson, Dr D
Richmond, J W A
Roberts, Dr A F
Roberts, G
Rogers, E F FIA
Royal College of Nursing

Sherwood, A P
Sketch, J E
Skinner, J H
Skipworth, E J
Society of Pension Consultants
Spencer, P J
Stark, A R
Stivelman, H J
Stretch, K L

Tagg, Councillor C W
Tampin, A V
Taylor, F S
Thatcher, A R CB
Thompson, D P
Tildesley, D H
*Trades Union Congress
Transport and General Workers Union
Treasury, Her Majesty's
Tunbridge, Flight Lieutenant P
Turner, P

United Kingdom Steering Committee on Local Government Superannuation

Vale, M A W

Wagstaff, J S
Watson, J
Webster, Mrs G B
Wheeler, G R OBE MM
Whitehead, R P

Whitmore, Miss M C
Whittet, Dr T D CBE
Wilkie, A D FFA FIA
Williams, A L
Williams, G
Willis Faber Limited
Wilson, E G OBE
Wilson, W E
Wood, Mrs B
Wood, Mrs C
Woodrow, J

Yale, W H

(* Indicates that oral evidence was given)

APPENDIX 2: PUBLIC SECTOR PENSION SCHEMES

1. The following account of the rules of public sector pension schemes is intended to describe the main provisions of those schemes. This note by no means describes all the provisions and should not be taken as an authoritative statement of the rules of any particular public sector scheme.

Public services

2. Although there are variations between the various public service pension schemes, they all conform to the same general pattern, with the exception of the armed forces' pension scheme. They are final-salary schemes, in that benefits are usually based on pay either in the last year of service or in the best year of the last 3 years. Usually pensionable pay is defined as basic pay plus permanent emoluments and excludes such items as overtime. Any deduction from pay or pension to take account of national insurance benefits is minimal.

3. On retirement at or after reaching age 60, the pension is one-eightieth of final pay per year of reckonable service and there is a lump sum of three times the pension. For certain special classes, however, such as policemen, firemen, prison officers and nurses, the pension age may be 50 or 55. For policemen, firemen and prison officers, service in excess of 20 years counts at double its actual length.

4. On retirement on grounds of ill-health after at least 5 years service, immediate benefits are paid as for age retirement but the actual service may be enhanced in calculating the amount of the pension and the lump sum.

5. If a male employee dies, either in service or after retirement on pension, leaving a widow, she receives a pension payable at half the rate of pension which her husband was receiving or which he would have received had he retired on grounds of ill-health immediately before his death. The widows' benefit is payable at a higher rate for the first three months of widowhood and there are additions for dependent children. Widows' pensions cease on remarriage before age 60. If there are dependent children but there is no widow, orphans' pensions are payable. For all employees, a lump sum is payable on death in service which

is the greater of one year's pay or the lump sum that would have been payable on ill-health retirement.

6. In all cases of withdrawal from service a transfer value may be paid under the public sector transfer arrangements to any scheme which will accept it. If no transfer value is paid, benefits depend on the length of service. If the employee has served for at least 5 years he or she will be granted a preserved pension and lump sum coming into payment at age 60 and calculated as though retirement on age grounds had taken place at the date of withdrawal. Entitlement to widows' benefits is also preserved. If the employee has served less than 5 years and no transfer value has been paid then, generally speaking, the employee's contributions will be returned with interest, but this does not apply to the Civil Service scheme where instead a small gratuity is paid if the service has been between 2 and 5 years.

7. All benefits, including widows' pensions, deferred pensions and lump sums, are protected against inflation under the Pensions (Increase) Acts, but except in special cases increases are not paid until the pensioner has reached the age of 55.

8. The Civil Service schemes have special contribution arrangements which are described in the body of this Report. Most of the other schemes are contributory, the contribution usually being 5 or 6 per cent of pay.

9. The scheme for the armed forces has many of the features described above, but also a number of special features designed to reflect the diverse ages at which many officers and service men retire. Benefits are not strictly in proportion to the length of service, and amounts of pension are based on the rank attained and not directly related to final pay. The scheme is non-contributory.

10. All the schemes are contracted-out of the earnings-related part of the State scheme.

Nationalised industries and public corporations

11. In most cases the pension schemes of the nationalised industries and public corporations are not very different from those of the public services, but they are rather more varied. The main differences are:

(a) in some cases the definition of final salary for benefit purposes is the average pay for the best consecutive 3 years in the last 13, often with provision for the amount used in the calculations to be up-rated in line with the cost of living to the date of retirement;

(b) benefits are often based on actual PAYE earnings;

(c) about half the schemes allow for national insurance pensions, usually by ignoring a specified amount of earnings in calculating both contributions and benefits;

(d) the normal retirement age is usually 65 for men and 60 for women, although in some schemes it is 60 for both sexes and may be lower for special classes;

(e) the lump sums on death in service are often larger than in the public service schemes; and

(f) almost all the schemes are contributory with rates of employee contribution ranging from 2 to 9½ per cent of pensionable pay, the most usual figures being in the range 6 to 8 per cent.

12. There are also differences as regards pensions increases. A high proportion of nationalised industry pension schemes provide in their rules for inflation-proofed pensions, though there may be provision for full protection to be withdrawn in some circumstances. Most of the remainder have in practice provided inflation-proofing although their rules only make provision for discretionary pensions increases.

APPENDIX 3: MAIN PUBLIC SECTOR EMPLOYMENTS AND THE PROVISIONS FOR INCREASING THEIR PENSIONS

1. The following tables show some of the main public sector employments (generally speaking those with 10,000 or more employees). They cover about 6½ million of the 7½ million public sector jobs. So far as possible the numbers are in terms of whole-time equivalents. Some of the figures are more up-to-date then others. It should be noted that not all employees are members of the employers' pension schemes.

2. The notes column shows cases where detailed assessments of the value of differences in pensions have been made in determining pay. The meanings of the symbols used are explained below.

AFPRB -	report made by the Review Body on Armed Forces Pay
C -	recent pay comparability study
Clegg -	recent study by the Standing Commission on Pay Comparability (Clegg Commission)
DDRB -	report made by the Review Body on Doctors' and Dentists' Remuneration
E -	evidence of outside remuneration has been used in the past
P -	under the pay agreement a report is made by the Civil Service Pay Research Unit; the agreement has been suspended for the 1981 settlement
TSRB -	report made by the Top Salaries Review Body.

TABLE 5: Main employments in the public services

Group	Approximate number of employees	Provisions for pensions increases	Notes
Parliament			
Ministers etc	106	Inflation-proofed by statute	TSRB
Members of Parliament	635	"	TSRB
Judiciary	920	"	TSRB
Armed Forces			
Senior Officers	200	"	TSRB
Other officers and other ranks	320,000	"	AFPRB
Civil Service			
Higher Civil Service	950	"	TSRB
Non-industrial grades	542,000	"	P
Industrial grades	154,000	"	E
National Health Service			
Administrative, clerical and secretarial grades, including top designated grades	121,000	"	
Ambulancemen	17,000	"	Clegg
Ancillary staff	210,000	"	Clegg
Doctors and dentists etc	90,000	"	DDRB
Medical laboratory scientific officers	16,000	"	
Maintenance workers:			
- electrical, engineering and plumbers	13,000	"	
- building operatives	10,000	"	
Nurses and midwives	425,000	"	Clegg
Professions supplementary to medicine	25,000	"	Clegg

Group	Approximate number of employees	Provisions for pensions increases	Notes
Local Authority Groups			
Administrative, professional, technical and clerical staffs (APT&C)	543,000	"	C
Craftsmen	105,000	Inflation-proofed by statute	Clegg
Firemen	39,000	"	
GLC/ILEA APT&C grades	19,000	"	
Manual workers	1,100,000	"	Clegg
Municipal buses: platform, non-craft, and maintenance	18,000	"	
London Transport	60,000	Inflation-proofed under the rules of the scheme	
Education			
Teachers	595,000	Inflation-proofed by statute	Clegg
University academic staff	43,000	Inflation-proofed under the rules of the scheme	Clegg
University clerical staff	20,000	various	Clegg
University manual workers	18,000	various	Clegg
University technicians	18,000	various	Clegg
Police	135,000	Inflation-proofed by statute	

TABLE 6: Main employments in the nationalised industries and public corporations

Group	Approximate number of employees	Provisions for pensions increases
Chairmen and Board members	300	Various
British Aerospace	77,000	Fixed percentage increase or increase in cost of living whichever is lower, although there may be further provision for discretionary increases up to the cost of living
British Airways Board	54,000	Inflation-proofed under the rules of the scheme
BBC	28,000	Fixed percentage increase or increase in cost of living whichever is lower, although there may be further provision for discretionary increases up to the cost of living
British Gas Corporation	104,000	Inflation-proofed in practice but this is discretionary
British Nuclear Fuels Limited	15,000	Inflation-proofed under the rules of the scheme
British Railways	240,000	Some inflation-proofed under the rules of the scheme. Some inflation-proofed in practice, but this is discretionary
British Shipbuilders	70,000	Various
British Steel Corporation	140,000	Inflation-proofed under the rules of the scheme
Electricity Council	158,000	Inflation-proofed in practice but this is discretionary
National Bus Company	57,000	Inflation-proofed under the rules of the scheme

Group	Approximate number of employees	Provisions for pensions increases
National Coal Board	310,000	Inflation-proofed in practice but this is discretionary
National Freight Corporation	35,000	Some inflation-proofed under the rules of the scheme. Some inflation-proofed in practice, but this is discretionary
Post Office	422,000	Inflation-proofed under the rules of the scheme
South of Scotland Electricity Board	13,000	"
UKAEA	14,000	"
Water Authorities	65,000	Inflation-proofed by statute

APPENDIX 4: GENERAL DESCRIPTION OF PENSION SCHEMES IN THE UNITED KINGDOM

1. In the United Kingdom, pensions are provided by two main sources: occupational pension schemes and the State.

Occupational pension schemes

2. The Government Actuary has estimated that in 1979 some 11.8 million employees were members of occupational pension schemes. This figure represented about one half of the total number of employees. Of the 11.8 million, 5.6 million were estimated to be in the public sector (representing 75 per cent of all employees in the public sector) and 6.2 million in the private sector (representing about 40 per cent of all employees in the private sector). The number of occupational pensions in payment in 1979 was approaching 4 million, about 60 per cent of these being public sector pensions. The total expenditure of occupational pension schemes is currently over £5 billion a year.

3. Some interesting information about pension funds and pension funding, including a projection of occupational pension schemes to the end of the century, is contained in a paper submitted by the Government Actuary to the Committee to Review the Functioning of Financial Institutions - the Wilson Committee. It was published as Appendix 5 to the Committee's Report (Cmnd 7937).

4. On the assumptions made for that paper, the number of occupational pensions may be approaching 5½ million by the year 2000, with public sector pensions accounting for 55 to 60 per cent of the total. The total expenditure of occupational pension schemes in that year may be about £13 billion, at 1980 price levels, with about £8 billion relating to the public sector and about £5 billion relating to the private sector.

5. An occupational pension scheme normally forms part of an employee's conditions of service, and, subject to certain rights of limitation, an employer undertakes that, through his occupational pension scheme, his employees or their dependants will receive certain payments. In part the employee may have contributed to these payments himself, but usually the major part of the cost will

have been financed by contributions from the employer. Effectively the value of the difference between the benefits which are received and the contributions which the employee makes represents an addition to the employee's remuneration. It is not surprising, therefore, that the scales of benefits to be provided under an occupational pension scheme and the division of the cost of providing these benefits between the employer and the employee are increasingly becoming a matter for negotiation.

6. Some of the main ways in which the benefits from occupational pension schemes can vary are set out below:

(a) the level of the basic pension may depend on a 'final' salary based on pay in the last year or years of work, or in selected years of work, or may, though this is rare, relate directly to the contributions made and the interest earned on them;

(b) where the level of pension depends on 'final' salary and the number of years worked then there may be differences in the fraction which is used in calculating the pension;

(c) the age at which a retirement pension is payable may vary;

(d) some schemes may offer a pension and a lump sum payment; others may offer only one of these or allow part of a pension to be given up in return for a lump sum;

(e) there may be pensions for widows and other dependants, and lump sums payable if an employee dies while in service;

(f) the benefits payable if an employee withdraws from the pension scheme before the normal retirement age is reached may vary; and

(g) different provisions may be made for increasing pensions in payment.

7. As well as differences due to different levels of benefits, occupational pension schemes differ because of the levels of contribution required from employees and the way in which these contributions are paid. Sometimes the employee's contribution is 'invisible' in that the contribution is not made from gross pay, but instead the gross level of pay may be lower than it would otherwise be in lieu of a direct contribution. Sometimes there is a mixture of these two methods of contributing, for example where an additional benefit can be bought.

8. The rates of contributions in the private sector vary considerably but the average is probably between 4 and 6 per cent of gross salary. There is also a wide variation in the contributions made by private sector employers but the average is probably between 7 and 12 per cent of an employee's salary.

9. Another factor which causes differences in pension schemes is the method by which they are financed. Most occupational pensions schemes are 'funded'. A fund is built up from the contributions paid in together with income earned on the scheme's investments and this fund is available to meet expenditure on pensions and other benefits. But some schemes operate on a pay-as-you-go principle: no attempt is made to accumulate reserves and pensions are essentially paid out of current income. This method of financing is practically unknown in the private sector, where, in the interests of security, funding in advance is more desirable, but it is adopted by a number of schemes in the public sector, where no such problems of security arise. In the public sector there is sometimes a further variation: the 'notional fund'. Here a record is kept of what the size of the fund would be if it really existed, but no actual fund is maintained and contributions and benefits are instead paid into or drawn out of current revenue.

The State scheme

10. All employees must contribute to and can expect to benefit from the State pension scheme. Employers also contribute. Amendments to the scheme came into effect in 1978 and it is convenient to refer to the arrangements before and after the changes as the old and new arrangements respectively.

11. The State pension can be made up of three main elements, and which a pensioner qualifies for depends on whether he contributed under the old or new arrangements. There are other additions, such as invalidity and age addition, but these need not concern us here. The three main elements are:

(a) a basic pension, currently set at £27.15 per week for a single person; payment of this in full depends on a pensioner's record of contributions over his working life under both old and new arrangements;

(b) an additional earnings-related pension under the new arrangements which is only paid to pensioners who have paid Class I National Insurance contributions as employees since April 1978 on earnings between a lower earnings limit (which the Government proposes should be £27 per week from April 1981) and an upper earnings limit (which the Government proposes should be £200 per week); to get the maximum benefit, contributions must have been paid for at least 20 years after April 1978; the self-employed cannot qualify for this element; and

(c) a graduated pension based on contributions paid between 1961 and 1975 under the old arrangements.

12. If an employer operates a pension scheme which can meet certain requirements then he can apply to contract his employees out of the State scheme's additional earnings-related pension described at (b) above. Both the employer and his employees then pay lower contributions to the State scheme but the contracted-out occupational pension scheme must provide the employees with at least a guaranteed minimum pension (GMP), which on retirement broadly matches the additional pension which they would have earned from the State scheme. The GMP is fixed at the level calculated on retirement however, and, so that employees get the same treatment as they would have received if they had not been contracted-out, the State pays the difference between the indexed additional pension which would have been payable and the fixed GMP; thus the cost of inflation-proofing the GMP is borne by the State scheme. The responsibility for protecting the remainder of the occupational pension remains with the occupational pension scheme.

13. The following table gives an indication of the total State pension and GMP payable to a pensioner, expressed as a percentage of pre-retirement earnings. It shows, for a range of pre-retirement earnings, the position of a person retiring in 1978 and a person retiring in 1998. It is assumed that the basic pension and the lower and upper earnings limits will continue to be about the same proportion of average full-time male earnings as at present. Any graduated pension payable (which cannot exceed about £3 per week at present levels) is excluded from the table. All the amounts are inflation-proofed by the State.

TABLE 7: Effects of the new State scheme arrangements

Pre-retirement earnings as proportion of average full-time male earnings	State pension and GMP as percentage of pre-retirement earnings for retirement in:	
	1978	1998
½	40	55
1	20	40
1½	13	35
2	10	26
3	7	17
4	5	13

14. If it is assumed that the aim of occupational pension schemes is to make up the total inflation-proofed pension income to two-thirds of pre-retirement earnings, then it can be seen that the State will bear a much greater part of the burden for people retiring in 1998 or later than it did in 1978. This will be particularly significant for those who, when employed, were on average earnings or less, since the State pension and the GMP will provide over 60 per cent of total pension income. This will be fully protected against inflation by the State, leaving only a relatively small amount to be protected by occupational pension schemes. The State will also have taken on increased responsibility for the pensions of people on higher earnings but these pensioners will still have to look to their occupational pension schemes for protection of a relatively large amount of their total pension income.

APPENDIX 5: PENSION SCHEMES IN FRANCE AND WEST GERMANY

1. The following note gives no more than an outline of the pension schemes in France and West Germany.

France

2. In France, there is a State scheme intended to provide a pension of about 50 per cent of average earnings over the last 10 years (revalued up to retirement age as in the British earnings-related scheme) calculated on earnings up to a ceiling which is revised annually (currently Frs. 60,120). Further contributions are paid to industry-wide pension schemes set up under the supervision of two organisations, ARRCO and AGIRC, run by representatives of the employers and unions. ARRCO covers manual workers and lower paid salaried employees, while AGIRC covers managers and specialists.

3. Pensions are calculated on the basis of points. These reflect the percentage contribution, and the ratio of the earnings on which contributions are paid to a reference salary based on average earnings levels at the time contributions are paid. As the reference salary increases the points are revalued. Each year a value is put on a pension point and a pensioner is paid an amount equal to the value of his total points. The intention is that, as contributions will rise as average earnings increase, the value of a point will keep pace with inflation both before and after retirement.

4. The overall effect is that pensions for long service employees would normally range from about 65 to 70 per cent of their revalued average earnings for lower paid employees down to about 55 to 60 per cent of their revalued average earnings for managers and specialists.

5. The stability of the system depends on the ratio of the number of pensioners to the number of contributors. The State scheme's position is largely determined by the past demographic history of France and appears fairly secure, at least till the end of the century. The ARRCO and AGIRC schemes have, however, expanded fairly rapidly and hence the ratio of pensioners to contributors until now has been much smaller than it would be in a stable state.

This has led to the schemes providing benefits more generous than could be afforded on a long-term basis. It has already been necessary to increase contribution percentages without any increase in the real value of the benefits provided, and it seems likely that further increases in contributions will be required unless the real value of pension points is going to be allowed to fall.

West Germany

6. The State scheme in West Germany forms a much larger part of the total pension provision than in the United Kingdom. Pensions range up to about 60 per cent of revalued average earnings up to a ceiling which is revised each year, and which amounts in 1980 to DM 50,400 a year. Until recently, revaluation has been in line with increases in average earnings based on the average figure for the three preceding years, but the system has been under financial strain and specially reduced index increases are being applied during the years 1979-81.

7. Employers operate supplementary schemes to augment the State pension. There is a State scheme of insurance for schemes' book reserves against the risk of bankruptcy. Indexation of pensions is not guaranteed, but there is a requirement on employers to review the level of pensions triennially in the light of the needs of pensioners and the state of the company's finances. It is not yet clear how this will operate in practice. At the first review it was usually found that increases in the State pension had reduced the need for indexation of the supplementary pensions and the Federal Courts normally regarded an increase representing 50 per cent of the rise in the cost of living as adequate protection. The reduction in the rate of State scheme increases from 1979 onwards may lead the Courts to require larger increases in supplementary pensions.

Public servants

8. In neither country are the arrangements described above applied to the Civil Service and other public servants. It is understood that their pensions are normally linked to the pay of the current occupants of the posts which the pensioners previously occupied.

APPENDIX 6: DERIVATION OF THE 'DEDUCTION'

1. The Government Actuary in his 1980 Report gave the value of the pension of a civil servant as 16.8 per cent of his pay and that of the average analogue pension as 12.2 per cent of analogue pay. The difference between these figures is 4.6 per cent and it needs to be explained how this was converted into a 'Deduction' of 3.8 per cent.

2. The purpose of the adjustments to analogue pay is to ensure that the package of pay (less pension contributions) and pension is the same for the civil servant and the analogue. Looking first at the analogue, for each £100 of gross pay, the analogue pays £4.3 in pension contributions and earns pension benefits worth £12.2. An addition of £0.4 also has to be made for extra State scheme benefits to those not contracted-out. Thus the package of pay and pensions is £100 - £4.3 + £12.2 + £0.4, or £108.3 per £100 of analogue pay.

3. Turning to the civil servant, the analogue pay is first reduced by £2.4 to take account of:

(a) the difference between the average analogue contribution of 4.3 per cent of pay and the male civil servant's 1.5 per cent; and

(b) the extra State benefits to those not contracted-out.

The resulting £97.6 has to be further reduced to such a sum as with the addition of 15.4 per cent (a pension worth 16.8 per cent of Civil Service pay less a 1.4 per cent average contribution for family benefits) will produce the same total package of £108.3. This means that Civil Service pay should be £108.3 divided by 1.154, which is £93.85. Hence the £97.6 resulting from the first adjustment needs to be reduced by £3.75, which is 3.8 per cent of £97.6. This 3.8 per cent is the 'Deduction'.

4. Similar principles apply in deriving a 'Deduction' corresponding to any other values which may have been calculated for Civil Service and analogue pensions.

APPENDIX 7: AN APPROACH TO ALLOWING FOR UNCERTAINTY IN VALUING PENSION SCHEMES

Note by Professor R A Brealey and Dr S D Hodges

Introduction

1. This note is a synopsis of our report "The Value of Superannuation Benefits in the Civil Service and Comparable Private Employment". The purpose of the report was to estimate how allowance for uncertainty might affect estimates of the value of the Civil Service and private sector pension schemes.

Why risk matters

2. In order to measure how much a pension plan contributes to an individual's remuneration, we calculated the present value of his expected benefits and the present value of his expected salary receipts. We then expressed the present value of these benefits as a percentage of the present value of salary. We called this the "contribution rate".

3. In order to calculate present values we need a discount rate. The appropriate discount rate is the return that individuals could expect to earn from an equally risky investment in the capital market. Thus, in order to measure the present value of pension benefits, we needed to estimate:

(a) the riskiness of these benefits; and

(b) the expected return on an investment with equivalent risk.

As an index-proofed pension is less risky than a non-indexed pension, indexed benefits should be discounted at a lower rate than non-indexed benefits.

Simplified schemes

4. As we did not have access to full details of the Civil Service and analogue pension schemes, our estimates were based on simplified versions of these schemes. Our first step was to check that our simplified versions were likely to be reasonable approximations to the actual schemes. We did this by estimating contribution rates for the schemes using estimates of discount rate, inflation

rate etc similar to those used by the Government Actuary in 1980. We also made estimates of the effect of different degrees of inflation-protection. We compared our estimates with the figures quoted by the Government Actuary. The results are shown below.

TABLE 8: Validation of estimates using simplified versions of the schemes

	Contribution rates as percentage of pensionable pay	
	Government Actuary's figures	Our estimates using simplified versions of the schemes
Current assumptions:		
Civil Service	16.8	16.5
Average of analogues	12.2	12.2
Difference	4.6	4.3
No index-linking:		
Civil Service	11.1	11.0
Average of analogues	9.2	9.2
Difference	1.9	1.8
Full index-linking:		
Civil Service	16.8	16.5
Average of analogues	14.5	14.7
Difference	2.3	1.8

5. These results suggest that we are unlikely to have induced major errors in our estimates by using simplified versions of the schemes.

Sensitivity analysis

6. Next, we conducted a simple sensitivity analysis on the above estimates. In other words, we changed just one of our initial assumptions slightly while holding all else constant and recorded the effect on the estimated contribution. We found that contribution rates (and to a lesser extent the difference between the two sets of contribution rates) are quite sensitive to minor changes in the inflation rate, the retirement age and the degree of inflation protection and, most of all, in the discount rate.

Choice of discount rate

7. Having established that the choice of discount rate can make a large

difference to our estimate of the value of these pension schemes we then tried to determine what rate of discount should be used.

8. The important thing about the discount rate is that it should depend on the riskiness of the cash flows. In the case of an index-linked pension scheme, these cash flows are proportional to those on an index-linked bond. Therefore, they should be discounted at the yield which we would expect to receive from such a bond.

9. When an actuary assesses whether a pension fund is adequately funded, he considers the return that may reasonably be expected from the pension fund. This is an appropriate measure if we wish to estimate whether the fund can be expected to meet its obligations on "best guess" assumptions about the future; but it is not the appropriate measure for determining the value of a pension on which there is no risk of default. Just as we do not measure the value of a gilt-edged security with a certain cash flow in money terms by discounting its cash flows at the expected rate of return on a pension fund portfolio, so we cannot measure the value of an index-linked investment with a cash flow deemed to be certain in real terms (the Civil Service pension) by discounting its benefits at the expected return on the pension fund portfolio. Putting the matter in another way, we can say that the question of how people might value the element of certainty of a fully-indexed pension can be answered in principle by saying what would be the return on an indexed default-free bond. The more highly people valued certainty, the lower, ceteris paribus, would be its required rate of return.

10. Our problem, therefore, was to estimate the real return that investors would require from an index-linked bond. We had two obvious clues. The SAYE (Third Issue) is widely held on a real return of approximately zero. Also Treasury Bills, which are risk-free in nominal terms, have, over long periods, provided an average real return of zero. Since we suspect that individuals would prefer even more to hold securities that are risk-free in real terms, a competitive yield on index-linked bonds may be somewhat less than this figure.

<u>The simulation model</u>

11. As a check on this, we needed first to estimate the range of possible cash flows that can happen. To do this we continued to make the same assumptions

about Civil Service and analogue pension schemes as before except that the inflation rate was assumed to be uncertain around the assumed average of 7 per cent. To measure what could happen to inflation over a 75 year period (ie from age 25 to age 100), we made use of a simulation model developed by Hodges and Cooper. This required us to specify the expected inflation rate, the variability of the inflation rate and the extent to which high or low inflation rates tend to persist. The model then provided us with 100 possible scenarios of inflation over a 75 year period. We used the Government Actuary's "expected" inflation rate of 7 per cent and drew on post-war experience to postulate the variability of inflation about this figure. The principal inputs for the simulation model are summarised in Annex A.

12. Our simulation provided us with estimates of the expected real salary and real pension benefits for the civil servant and private sector employee. We then used the simulation model to create, for each year, a portfolio of existing securities that replicates as near as possible an index-linked bond, or more precisely one that gives the same expected cash flow each year as the Civil Service pension scheme with the minimum amount of uncertainty. Then we calculated the expected real return on the portfolio. The procedure is described in more detail in Annex B. The real discount rate that we obtained using this procedure was -0.9 per cent a year.

13. As the benefits from the analogue schemes are not fully inflation protected it is reasonable to discount these benefits at a slightly higher rate. For simplicity we assumed that these benefits were 62 per cent index-linked, but it is important to note that this assumption may result in some over valuing of the benefits, since the expected degree of inflation protection for the analogues is not guaranteed. Once again we estimated the discount rate by estimating the expected return on a portfolio of existing securities that would provide returns similar to those of a partially indexed pension. Our estimates suggested that investors would be prepared to hold a 62 per cent index-linked bond on a real yield of -0.3 per cent. That is, they would require an additional real return of 0.6 per cent per annum to compensate them for the extra uncertainty of a 62 per cent indexed bond.

Estimated contribution rate

14. We used these real discount rates of -0.9 per cent and -0.3 per cent to calculate the present value of the benefit stream and the salary stream. Civil Service salaries and pension benefits were discounted at a real rate of -0.9 per cent. Benefits for private sector employees were discounted back to retirement age at a real rate of -0.3 per cent and from retirement age to age 25 at a real rate of -0.9 per cent (because salaries are assumed, in effect, to be fully indexed in the Government Actuary's calculations). The contribution rate can be expressed as the ratio of these two present values. The results are shown below.

TABLE 9: Derivation of contribution rates on our suggested basis

	Civil Service	Analogue
Present value per £1 initial salary of:		
Benefits	£ 44.93	£ 39.89
Salary	£ 107.66	£ 128.67
Contribution rate	41.7%	31.0%

15. Our estimates of the contribution rates for both schemes are substantially higher than those of the Government Actuary and so is our estimate of the difference in contribution rates: 10.7 per cent versus 4.6 per cent. But we point out that this difference may be a slight under-estimate, for we have assumed a definite figure for the extent of indexing in the analogue schemes. We have not attempted to allow for the uncertainty of this figure itself, the effect of which would depend largely on whether it was expected to move in the same direction as inflation itself or not.

Summary

16. Our principal conclusions are as follows:

(a) estimates of the value of the Civil Service and analogue pension schemes are very sensitive to estimates of the discount rate, expected inflation rate, retirement age and the degree of inflation protection; we should, therefore, not expect to be able to make precise estimates of value;

(b) in estimating the value of the pension scheme, cash flows should be discounted at a rate that reflects the riskiness of these cash flows; the discount rate should not depend on the mix of investments actually chosen by the funds;

(c) for a fully-indexed scheme, the appropriate discount rate is the yield that would obtain on an indexed bond;

(d) our best estimate of the real discount rate is -0.9 per cent for a fully index-linked investment and -0.3 per cent for a 62 per cent index-linked investment; and

(e) on these assumptions, our best estimate of the difference between the value of the Civil Service and analogue pension schemes, as a proportion of salary, is 10.7 per cent; the figure compares with the Government Actuary's estimate of 4.6 per cent.

Reference: I Cooper and S Hodges "A Portfolio Simulation Model for UK Pension Funds"; London Business School, 1979.

Annex A: Input parameters for simulation model

1. Long-run expected inflation = 7 per cent
2. Standard deviation of annual inflation = 6.4 per cent
3. Long-run average bill rate = 7 per cent
4. Expected interest rate on long-term gilts = 9.25 per cent
5. Standard deviation of interest rate on long-term gilts = 2 per cent
6. Expected equity return = 13 per cent
7. Standard deviation of equity return = 16 per cent
8. Next year's expected inflation = 7 per cent
9. Current bill yield = 7 per cent
10. Current interest rate on long-term gilts = 9.25 per cent
11. Current standard deviation of equity return = 16 per cent

NB Current values were set equal to long-term values in order to value benefit streams when economy is in long-run equilibrium.

Annex B: Estimates of the discount rate

1. We initially estimated discount rates for each of years 5, 10, 15 ... 75 (corresponding to ages 30 through 100). For each year the estimation procedure was as follows:

(a) we used the simulation model to generate 100 possible scenarios of salaries or pension benefits;

(b) we also used the model to generate 100 possible future values for each of the following investments:

(i) a diversified equity portfolio;

(ii) Treasury bills;

(iii) a fund that is invested continuously in long gilts; and

(iv) a fund that maintains a balanced investment in equities, Treasury bills and long gilts;

(c) we then estimated what combination of the four investments (including both long and short positions) would best replicate the salaries or pension benefits; these investments were chosen so that:

(i) their expected future value is identical to the future salary or pension benefits; and

(ii) the variation in the real shortfall or excess is minimized; and

(d) the discount rate for that year's cash flow is then equal to the expected return on the portfolio of investments.

2. In general, our estimates suggested that one can best replicate the cash flow from an index-linked pension scheme by a mixture of long-term borrowing and a large investment in short-term fixed interest investments. The implied real discount rates varied between -0.3 per cent and -1.5 per cent for a fully index-linked cash flow and between zero and -0.4 per cent for a 62 per cent index-linked flow. Rather than use different discount rates for individual years we took the average rates of -0.9 per cent for any fully index-linked cash flow and -0.3 per cent for any 62 per cent linked cash flow.

vb

9 January 1981

I am writing on behalf of the Prime Minister to acknowledge your letter of 7 January. This is receiving attention and a reply will be sent to you as soon as possible.

NJS

W.L. Kendall, Esq.

vb

9 January 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 5 January, which I will of course place before her.

NJS

G.H. Massey, Esq.

PEB

B/F19/1

10 DOWNING STREET

From the Private Secretary

9 January 1981

I attach a copy of a further letter about the Scott Inquiry which the Prime Minister has received from Bill Kendall. I should be grateful if you, in consultation with the CSD, could let me have a draft reply for the Prime Minister to send to Mr. Kendall, to reach us here by Monday 19 January.

I am copying this letter and its enclosure to Jim Buckley (Lord President's Office).

N. J. SANDERS

R.I. Tolkien, Esq.,
H.M. Treasury.

file VB

10 DOWNING STREET

From the Private Secretary 9 January 1981

I attach, for information, a copy of a letter the Prime Minister has received from Mr. G.H. Massey.

We have sent a brief acknowledgement from this office, and would not propose to send any further reply.

I am copying this letter and its enclosure to Jim Buckley (Lord President's Office).

N. J. SANDERS

R.I. Tolkien, Esq.,
H.M. Treasury.

CONFIDENTIAL

cc Mr. Wright
Mr. Wolfson
Mr. Walters
Mr. Hoskyns
Mr. Vereker

10 DOWNING STREET

From the Principal Private Secretary

8 January 1981

Dear John,

SCOTT INQUIRY INTO THE VALUE OF PENSIONS

The Prime Minister has seen the Chancellor of the Exchequer's minute of 5 January about the Scott Inquiry into the Value of Pensions.

She has not had time to consider the draft paper attached to the Chancellor's minute, but she agrees that it is important to give colleagues plenty of time to study both the report of the inquiry and the paper and she therefore agrees that he should circulate it, if possible in conjunction with the Lord President, in time for Cabinet to take it on 15 January.

The Prime Minister will be writing in the next day or so to Sir Bernard Scott to thank him and his colleagues for their report.

Yours ever,

Clive Whitmore.

A.J. Wiggins, Esq.,
HM Treasury.

CONFIDENTIAL

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PPS

2 PP's

COUNCIL OF CIVIL SERVICE UNIONS

19, ROCHESTER ROW · LONDON SW1P 1LB · Tel: 01-828 2727-9

Secretary General: W.L.KENDALL
Secretary: P.D.JONES
Assistant Secretaries: B.G.SUTHERLAND HELEN E.HUGHES

cc Mr Ingham

7 January 1981

R8

2

Rt. Hon. Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

PRIME MINISTER
To see. We will let you have a draft reply
MS

Dear Prime Minister,

SCOTT INQUIRY

Thank you for your letter of 19 December. I am grateful to you for your reply, which has been carefully considered by the Council of Civil Service Unions. I have to let you know, however, that we do not regard your reply as being either an adequate or acceptable response to the important issues posed in my letter of 9 December. I have been asked, therefore, to press you again on the following aspects.

First, regarding Sir Bernard Scott's appointment, we assume from your reply that you were misquoted in the "Sunday Telegraph" of 7 December. If this is so, would it not now be proper to correct the public record by seeking an appropriate disclaimer in the newspaper concerned?

Second, with regard to the Scott Inquiry's terms of reference, we note your confirmation that you have encouraged the Inquiry to exceed the terms of reference which you announced in the House of Commons on 22 May 1980. The prejudicial effect of this upon any views expressed by the Inquiry on index-linked pensions is now self-evident, and this will certainly be the view not only of all civil servants, serving and retired, but all public servants, serving and retired, as well.

Cont'd/...

In the circumstances, I must re-iterate the views expressed in my earlier letter regarding the effect upon Civil Service (and public service) morale. I hope that, as Minister for the Civil Service, you will now be able to reassure civil and public servants about the Government's attitude to their own employees, as requested in my 9 December letter.

Yours sincerely,

B Kendall

W L KENDALL

YD

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

7 January 1981

MS

Dear Robson

will request if required

Mr Heseltine was grateful for Mr Younger's letter of 11 December indicating that he was content with the decision not to make the proposed regulations which would allow part-time employees to join the local government superannuation scheme.

My Secretary of State has now decided, however, not to announce this decision until the Government have received and considered the report of the Scott Inquiry into the Value of Public Sector Pensions.

Copies of this letter go to the Private Secretaries of those Ministers who saw Mr Heseltine's letter of 28 November; to David Wright (Cabinet Office); and to Tom Lankester.

Yours sincerely

Jeff Jacobs

J JACOBS
Private Secretary

G Robson Esq

CONFIDENTIAL

cc Mr Wolfson
Prof. Walters
Mr Hoskyns

MR. WHITMORE

THE SCOTT INQUIRY INTO THE VALUE OF PENSIONS

Thank you for sending me a copy of the Chancellor's minute of 5 January, and his enclosed draft Cabinet paper. I note that it is suggested that the paper be considered in Cabinet on 15 January, and you may wish to be aware that it was agreed in the Official Committee on Public Service Pay this afternoon that a paper from the Lord President on cash limits for the non-industrial Civil Service would be put to E on 14 January. The Chancellor's paper seems to me internally contradictory in saying that on the one hand adjustments as a result of the Scott Report should be made "preferably in the current pay round for groups which have not yet settled" (paragraph 7), but that on the other hand the Government should invite public comment and possibly even suggest a study by a Parliamentary Committee (paragraph 12). I made the point this afternoon that if the Chancellor really wanted adjustments to be made in the current pay round, the Government would need to take a view on the Scott Report before it set the Civil Service cash limit, but it was generally felt that there was in fact no chance of making any adjustment until the next pay round. Nonetheless, I warned the Official Committee that the Prime Minister had not yet responded to the Chancellor's draft paper, and that her agreement not to make adjustments during the current pay round should not be assumed.

It would in fact be technically possible to make some adjustment, in accordance with the Scott Report, to pay in the current pay round without affecting the Civil Service cash limit, but only through the rather dubious mechanism of notionally increasing the award - perhaps to take account of the absence of PRU-and then to decrease it back to the cash limit on account of Scott. I doubt if that would commend itself to Ministers.

(I have told the Chancellor's Office that it is misleading to refer to "a 5-6% increase in employer contributions" (para 3 (d)): what Scott proposes, at the upper end, is 5-6% more of pay, i.e. a doubling of contributions).

7 January 1980

CS Press Office

PUBLIC SERVICE PENSIONERS' COUNCIL

Hamilton House, Mabledon Place, London, WC1H 9BD

Telephone: 01-387-2442 Extension 5

Relevant pps in CF

Hon. Secretary:
FRANK J. MAXWELL,
Hamilton House,
Mabledon Place,
London,
WC1H 9BD.

6 January 1981

recd 10 (Saturday)
Rcd CF 12/1/81 (Monday)

The Rt. Hon. Margaret Thatcher, MP
The Prime Minister
10 Downing Street
London SW1

Dear Prime Minister,

I write to express our concern at the remarks attributed in the Sunday Telegraph of 7 December 1980 in respect of the Scott Inquiry.

In particular, the Scott Inquiry's terms of reference do not ask the Inquiry to deal with the principle of index linking, and we are therefore disturbed and surprised that you are reported as urging the Inquiry to go beyond its term of reference.

Yours sincerely,

G.B. Fawcett

G B FAWCETT
Honorary Secretary

10 DOWNING STREET

NEW TOWNS
Chief Officers Assn.

From the Private Secretary

5 January 1981

I enclose a letter to the Prime Minister from the New Towns Chief Officers Association, about public service conditions of service in the light of the current debate about pension rights.

I should be grateful if you could let me have a draft Private Secretary reply by 14 January.

M. A. PATTISON

Jim Buckley, Esq.,
Lord President's Office.

Ble Rb

10 DOWNING STREET

From the Private Secretary

5 January 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 23 December about Public Service pensions.

This is receiving attention and a reply will be sent to you as soon as possible.

M. A. PATTISON

Neville Smallman, Esq., M.A., LL.B.

JS

The National Federation of Post Office and Civil Service Pensioners

(Member of the Public Service Pensioners' Council and the Civil Service Pensioners' Joint Consultative Committee)

CS PPS? no

General Secretary
G. H. MASSEY
14 Larch Road,
Kingswood,
Bristol BS15 4UQ
Tel. 0272-566306

cc Mr Ingham

2

PRIME MINISTER
To see
MJS

Asst. Secretary
J. F. HETZEL, T.D. M.B.I.M.
The Uplands,
97 Andover Road,
Winchester SO22 6AX
Tel. 0962-883456

Your Ref. Our Ref

The Rt.Hon.Mrs.Margaret Thatcher MP.,

5 January 1981

R7

The Prime Minister,

10 Downing Street,

LONDON SW1A 2AA

Dear Mrs Thatcher,

THE SCOTT INQUIRY

Thank you for your letter of reply dated 19th December 1980 and I note your remarks.

I intend to publish this correspondence in full, together with the Terms of Reference of the Committee and the significant portions of the Sunday Telegraph interview, in the next issue of our journal.

I will let our 73,000 members judge the matter for themselves.

Yours sincerely,

G Massey

(G.H.MASSEY)

General Secretary

1.

Prime Minister.

TLW

6/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 January 1981

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

BF

Dear Tim

The Chancellor's minute of 5 attached January on the Scott Inquiry into the value of indexed pensions makes no reference to the further paper on an indexed bond for pension funds which the Prime Minister commissioned at the monetary seminar on 18 November. This is simply to say that the Financial Secretary has this in hand and will be letting the Prime Minister have the paper she asked for very shortly. It will take account of the Scott Inquiry.

Yours ever

Peter

P.S. JENKINS

MG

CONFIDENTIAL

Copies to: Mr Wolfson
Mr Walters
Mr Hoskyns
Mr Vereker.

Prime Minister.

Content with the Chancellor's paper and in particular with paragraphs 12 + 13?

If so, agree that he may circulate it, if possible in conjunction with Lord Soames, in time for Cabinet on 15 January?

Ready to write to Sir Bernard Scott on the lines of X| below. If so, we will let you have a letter.

KAW 6.i.81.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

Delighted to thank them warmly. But not to comment on the report itself MT

SCOTT INQUIRY INTO VALUE OF PENSIONS

Your Private Secretary's letter of 22 December suggested that I should prepare a paper on this for E Committee or Cabinet. You may feel on reflection that it will be best to go straight to Cabinet. I understand from the Secretariat that 15 January has been noted as a possible date. I would like to give colleagues a full week to study the paper and the Report of the Inquiry.

..... 2. I enclose a draft and am copying it with this letter to the Home Secretary, Lord President of the Council and Secretary of State for Employment, who are the only other Ministers who have so far had copies of the Report. I think it would be very helpful, providing our ideas coincide sufficiently, if the paper could be presented jointly by myself and the Lord President. I look forward to hearing whether he thinks this would be possible, and to receiving any comments you and others may like to offer at this stage.

X 3. It would in my view be appropriate for you warmly to thank Sir Bernard Scott and his colleagues for the expedition and care with which they have fulfilled a very difficult remit. Granted the technical and other difficulties of the subject, they have produced a well-balanced and sensible report.

GH.

(G.H.)

5 January 1981

CONFIDENTIAL

DRAFT CABINET PAPER

INFLATION-PROOFED PENSIONS

Memorandum by the Chancellor of the Exchequer

.... Attached is a confidential copy of the Report of the Scott Inquiry into the value of pensions. It should be published as soon as convenient, which might be during the last few days of January. The appropriate form would be a Command Paper. For reasons given below, I think the Government should not offer definitive comment at the time of publication, but should give an indication of its general reactions and intentions.

Main Conclusions of the Report

2. The Report deplores the inequality in pensions treatment between the public sector and the private sector, but it does not condemn the inflation-proofing of public sector pensions. On the contrary, it asserts that the protection of retirement living standards is "a highly desirable social objective", although an expensive one, needing to be paid for, and perhaps even then temporarily unsustainable in occasional circumstances of extreme inflation or other economic difficulty. In my judgement the Report gives too little emphasis to these very real difficulties.

3. The Report notes that present disparities would be much eased if inflation were overcome. Meanwhile it points towards action in the following directions:-

(a) Strengthening of private sector occupational pension schemes: it is clearly implied that both employee and employer contributions to private schemes need to be increased, and it is noted that "employee contributions" by civil servants, although not levied in that form, are currently at twice the general level of such contributions by private sector employees.

(b) Government issue of index-linked bonds: these would provide an encouraging instrument for investment by private pension funds and by private employees who are not members of pension funds; they could also help to establish means of valuing inflation protection. (The Report refers to discussion of such bonds in the Wilson Committee Report and does not itself go beyond recommending Government consideration of the idea.)

(c) Reappraisal of public sector "employee contributions": taking the Civil Service as leading example (although repeatedly insisting on the application of the principle throughout the public sector), the Report is unable to place a precise value on inflation-proofing, notes that such a value could in any case change from time to time, and offers a range of valuations.

(d) The Report endorses in their context the methods of valuation used by the Government Actuary, subject to the different approach to "economic assumptions" embodies in the Committee's own range of valuations. It refutes some of the extreme criticisms and valuations which have been suggested. For the Civil Service, the Committee's own range would point to something between no increase and a 5-6 per cent increase in "employee contributions". There is material in the Report which could in present circumstances point to the top end of the range.

In addition there are some minor recommendations on particular aspects of the arrangements for determining and showing Civil Service equivalents of employee contributions. The Report offers no help on the separate subject of the value of job security.

Public Reaction

4. The Report is awaited with lively interest. It will be a disappointment to those hoping for a simple and clear-cut solution. Those who oppose any form of index-linking of pensions will be especially disappointed, but I would expect widespread support for the proposition that retirement living standards should be protected, and the Report's reminder that better provision is made for this in France and West Germany may attract interest. On the other hand I am myself anxious that the Report does insufficient to warn about the long-term costs and consequences of any system for index-linking of pay

and pensions, for example the general dangers of allowing automatic, built-in indexation because of its effect on attitudes to inflation and on expectations.

5. Among those with particular responsibility and involvement:-

(a) Private sector pension fund operators and employers may not only be disappointed at the Report's acceptance of inflation-proofing, but seriously troubled by the clear suggestion that present inequalities should in part be redressed by improvements in private sector arrangements. On the other hand they may strongly welcome (and therefore urge on Government) the idea of Government issues of index-linked bonds. Some may also find helpful the reference to need for stronger contribution levels, including employee contributions.

(b) Public sector unions and employees may well show mixed reactions: relief that the basic entitlement is not challenged; worry over the high end of the suggested range of contributions; and determination to fight for as low an increase in contributions as possible. They are likely to point to the fact that the Report itself found that Civil Servants are already contributing twice as much as most private sector employees. (This is partly because private sector employee contributions are unrealistically low, and partly because of the greater benefits in the public sector schemes).

Government Position

6. In the light of the Report, the central question for the Government is whether or not to allow inflation-proofing of public sector pensions to continue. This depends, I believe, on whether we can develop the ideas in the Report sufficiently to reduce the present inequalities of treatment and the sense of injustice arising from them, which are at the heart of public interest and disquiet. We need to consider the practical steps this would involve and their implications.

7. First, there would have to be increases - in some cases substantial - in "employee contributions" pretty well throughout the public sector. Unless we were able to negotiate or impose adjustments towards the top of the range suggested in the Report, I would see no hope of satisfying responsible public opinion. Because of the variety and complexity among different public sector employees in starting-points, methods of determining pay, etc., the process would take some time and need careful preparation and calculation in advance. Nonetheless I consider it important that we should seek to make adjustments as soon as practicably possible, preferably in the current pay round for groups which have not yet settled. In any case, the prospect might be used to support modest pay settlements this year. It should certainly be possible to bring in most groups at the point of their 1981-82 pay settlements.

8. I cannot at present assess the financial impact, but I see no reason why it should be harmful and it would be more likely to be helpful. An adjustment of 1 per cent over public sector employees as a whole would involve an abatement of pay or extra income from contributions in the order of £500 million per year. Some would have to be funded. There would be other, though smaller, offsets if - as might well happen - the assumptions behind the adjustment also necessitated a strengthening of existing public sector pension funds. The amounts prospectively payable as pensions would, of course, not be affected by these changes.

9. Secondly, there is the question of index-linked bonds. This is an idea we have been examining, but have not so far accepted, in the context of Government financing generally. To embark on it on a large scale - and the scale implicit in the recommendations of the Report could be very large indeed - would involve changes in the patterns of financial flows and markets in our economy with advantages and disadvantages, now and in the future, which are difficult to evaluate. This is not a matter which can be settled simply as a supplementary move on pensions, important though it may be in that context. If we were to adopt the idea, there would be much to work out on methods and conditions, and some consultation with the pensions fund industry and others could be desirable. My present view is that we need not rule out adoption of the idea in some form, but we should say that it needs more study before

we give it any warmer reception. It may be of interest to see how much considered support of the idea the Report provokes, and from what quarters.

10. Finally, there is the key question of public political reaction and what the Government can do about it. We cannot expect any solution to reconcile or persuade the extreme schools of thought on this contentious subject. Our best hope is to lower the temperature of the debate and persuade a sufficient body of responsible opinion that the direction we choose is a tolerable one. The Report offers some help in improving public understanding, which is badly needed. Both Government and Parliament may be able to further this.

Recommended Line

11. I think it would be a mistake to reject the Report outright and go for a withdrawal of the various guarantees and near-guarantees of inflation-proofing of public sector pensions (not just for civil servants, but for others such as the armed forces, the miners, the nurses). The Report gives ground for introducing a cut-off point, a rather high one, if we wish. This could be presentationally helpful but does not solve the main problems. If the principle of inflation-proofing is to be retained the Report probably offers as strong a case for persuading public opinion in its favour as can be made. But acceptance of that case could well be conditional

as a minimum on our determination and ability to achieve and demonstrate significant changes in public sector "employee contributions".

12. In outline I propose that our initial comments on the Report would take the following form:

- welcome the careful and measured analysis and judgement in the Report;
- acknowledge the theoretical desirability of protection of retirement living standards for all, underlining the cost, uncertainty and difficultly;
- endorse the sense of injustice over inequalities of treatment between public and private sectors;
- reassert determination to get inflation down and keep it down, stressing this as the most important contribution Government can make;
- indicate positive interest in the approach recommended, but without complete commitment, noting that much would depend on practicability, on reaction of private pensions industry and on general public reaction;
- invite public comment; possibly suggest study by a Committee of Parliament (?Treasury and Civil Service Committee);
- indicate that, in relation to public sector arrangements if inflation-proofing continues, the Government would judge that present circumstances justified changes in "contributions" at the top of the range suggested in the Report.

Meanwhile, it would be appropriate to set in hand urgently studies within Government of the handling of increased "contributions" and the idea of index-linked bonds.

Conclusion

13. I invite my colleagues to agree:

(a) That authority be given for the Report to be printed as a Command Paper with the aim of presentation to Parliament towards the end of January.

(b) That the initial line to be taken by Government, and reflected in a statement in Parliament at the time of publication, should be as set out in paragraph 12 above.

(c) That arrangements be made for studies within Government of the practical process of adjusting "contributions" and of the idea of index-linked bonds.

Econ Pol
T/6 6/1
C.F.

File

25H

10 DOWNING STREET

From the Private Secretary

2 January 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 22 December about the inquiry under Sir Bernard Scott's Chairmanship into public service pensions.

You will of course be familiar with the terms of reference given to the Scott Inquiry when it was appointed. The Prime Minister did not suggest in her interview with the Sunday Telegraph, nor was she reported as having suggested, that the Inquiry should go further than these terms of reference. She considers, however, that it would be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them. Ministers will shortly be considering the report of the Scott Inquiry and they will take fully into account the views put to them by the Civil Service unions and other interested bodies.

MP

Thomas Williamson, Esq.

The New Towns Chief Officers Association

an affiliate of the Association of First Division Civil Servants

Your Ref:

Our Ref: L/NS

Date: 23 December 1980

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
WHITEHALL
London

R 30/12

Dear Prime Minister

PUBLIC SERVICE PENSIONS

I write on behalf of a very small number of public servants who, like many others, are concerned at the continuing, unparallelled and wholly unjustifiable assault on the principle of so-called inflation proof pensions.

The adequacy of the direct and indirect contributions which we and others make have been repeatedly confirmed and will no doubt be so again in the course of the present investigation.

We are long accustomed to the wholly irresponsible vituperation aimed at this one aspect of our conditions of service by the press and we are waiting with interest to see when our employers will take positive steps to correct the inbalance of comment.

It is no part of our approach to current circumstances to seek to argue that the public service should be immune from the effects of general economic policies. But we should not be unfairly discriminated against, or allowed to be unjustly abused.

I commend to you the proposition that publication of the results of impartial pay research over the last decade, showing how far those in the higher ranges of the service have fallen behind comparators in other employments, might go a long way to demonstrate how much and how dearly we have already paid simply to occupy employments which we, and we hope you, believe to be relevant to the needs of the community as expressed in service to the actions of Government.

.../2

Chairman
Neville Smallman M.A.LL.B.
Peterborough Development Corporation
Touthill Close
City Road
Peterborough PE1 1UJ
Tel (0733) 68931

Secretary
D E Bath B.Soc.Sc., Dip.T.P., M.R.T.P.I.
Peterborough Development Corporation
Touthill Close
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Peterborough PE1 1UJ
Tel (0733) 68931

Treasurer
A J Adams F.C.A., I.P.F.A.
Warrington Development Corporation
New Town House
Buttermarket Street
Warrington WA1 2LF
Tel (0925) 51144

Even if pension terms were not allowed for in those impartial investigations, the degree of exploitation of those who find themselves, as individuals, to be constitutionally unable to give of less than their best to those they serve, by way of consistent failure to act on the results of those investigations, is unexcusable.

To allow obsessive and exlusive attention to be given to a single aspect of our conditions of service to go unimpeached would be totally out of keeping with those traditional national qualities which are so admired and envied by others.

Yours faithfully

NEVILLE SMALLMAN
CHAIRMAN

THE INSTITUTION OF PROFESSIONAL CIVIL SERVANTS

SCOTTISH BRANCH

Section E

Room 5/71

New St Andrew's House

Edinburgh

EH1 3SZ

x30

22 December 1980

The Rt Hon Margaret Thatcher, MP
Prime Minister
10 Downing Street
LONDON

Dear Madam

SIR BERNARD SCOTT'S INQUIRY ON PUBLIC SERVICE PENSIONS

I was extremely disturbed to read reports of an interview which you gave to the "Sunday Telegraph" on 7 December. My understanding of what you were reported as saying is that a substantial part of your mail comprises letters of resentment from people who do not participate in an index linked pension scheme, and that you wish Sir Bernard Scott to go beyond his Terms of Reference to express views on the principle of index linking.

If you have been correctly reported in the "Sunday Telegraph" there is a strong inference in your comments that you have prejudged the issue ie you consider there are grounds for other people to resent public service index linked pension schemes, and that, knowing that the facts as produced by a properly constituted Inquiry reporting under its Terms of Reference would be likely to show such resentment as totally unjustified, you have given a broad hint to Sir Bernard Scott to stray beyond his remit and allow the alleged public resentment to overrule right and reason. I also note, from Institution sources, that Sir Bernard Scott did not attend the sessions of his Inquiry which heard evidence from the Civil Service Trade Union Movement.

I would have thought that as Minister for the Civil Service, our employer, you would attempt at least to achieve the objectives of your Government with respect to the Civil Service with dignity and honour, with a proper regard for the facts of the situation and with an overriding concern to see that the Civil Service and all matters affecting it, such as this Inquiry, are enabled to be conducted in an atmosphere of strictly neutral impartiality and mutual trust. That has long been the proud objective of the Civil Service and it is now in danger by this kind of situation.

For the record, approximately 64% of <u>all</u> occupational pensions in payment are index linked. Civil Servants pay 8.5% of their Pay Research based salary levels to finance the pensions of Civil Service pensioners. This is not only the highest contribution in the public sector save for the British Railways Board, but the Principal Civil Service Pension Scheme operates with an inordinately high employee: employer contribution ratio, and in any event accounts for only approximately one seventh of all pensions in public service index linked pension schemes. Whatever your views on the public sector of the economy or your attempts to control inflation, public service pensioners have served this country well and deserve to be protected against inflationary pressure on their pensions. The evidence would suggest that index linking is not as much the exclusive reserve of the Civil Service as some commentators would suggest, nor is it a benefit for which existing Civil Servants pay lightly.

I earnestly trust that you will reconsider your reported remarks and deal with this issue fairly and impartially, based on the facts alone and not on emotive misrepresentations of the public service, nor on the opinions of Sir Bernard Scott unsubstantiated by evidence which he has heard in his Inquiry properly constituted within its Terms of Reference.

Yours faithfully

Thomas Williamson

Thomas Williamson
Chairman

cc Mr Vereker
Mr Ingham
Econ Pol

10 DOWNING STREET

From the Private Secretary

22 December 1980

Scott Report on Public Sector Pensions

The Prime Minister has read the Scott Report over the weekend. In putting the report to her, I said - on the basis of a conversation I had had with Mr. Wiggins - that the next step would be for the Treasury (possibly with the CSD) to put a paper to E committee, or straight to Cabinet, very early in the New Year. Ministers would decide on the Government's response to the report, and only then would it be published.

The Prime Minister has said that she is content with these arrangements for handling.

I am sending copies of this letter to Jim Buckley (LPO) and John Wiggins (HMT).

T. P. LANKESTER

D.J. Wright, Esq.,
Cabinet Office.

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

Covering CONFIDENTIAL

Econ Pol

Inquiry into the Value of Pensions
Treasury Chambers
Parliament Street, London SW1P 3AG
Telephone Direct Line 01-233 4095.
Switchboard 01-233 3000

T P Lankester Esq
10 Downing Street

19 December 1980

Dear Lankester Tim

REPORT OF THE SCOTT INQUIRY

I attach for submission to the Prime Minister the Report of the Inquiry under Sir Bernard Scott's chairmanship.

Copies of this letter and the Report go to those on the attached circulation list.

Yours sincerely

P J. Farmer

P J FARMER

Secretary to the Inquiry

Circulation list for the Scott Report

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Bailey
Mr Kemp
Mr Kitcatt
Mr Unwin
Mrs Gilmore

Lord President of the Council
Minister of State, CSD
Sir Ian Bancroft
Sir John Herbecq
Mr F G Burrett
Mr N E A Moore
Mr R B Saunders

Secretary of State for Employment
Mr Douglas Smith

Sir Robert Armstrong (Cabinet Office)
Mr P le Cheminant

Mr Gordon Downey (CPRS)

Mr E A Johnston (Government Actuary) (3 copies)

VS
18/12

cc. LPC office.

10 DOWNING STREET

THE PRIME MINISTER

19 December 1980

Dear Mr. Massey,

Thank you for your letter of 15 December about the passage relating to the Scott Inquiry in the 7 December Sunday Telegraph report of an interview with me, and also for letting me see a copy of your letter to Mr. Farmer.

You are of course familiar with the terms of reference given to the Scott Inquiry when it was appointed. I did not suggest in the interview, nor was I reported as having suggested, that the Inquiry should go further than these terms of reference. It would however be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them.

I can assure you that when we come to consider the report of the Scott Inquiry we will take fully into account your members' views.

Yours sincerely,

(sgd) Margaret Thatcher

G.H. Massey, Esq.

BK

cc: JIMT 18/12.

cc. LPC office.

10 DOWNING STREET

THE PRIME MINISTER

19 December 1980

Dear Mr. Yates,

Thank you for your letter of 8 December about the passage relating to the Scott Inquiry in the 7 December Sunday Telegraph report of an interview with me, and also for letting me see a copy of the submission made by the Civil Service Pensioners' Alliance to the Inquiry.

You are of course familiar with the terms of reference given to the Scott Inquiry when it was appointed. I did not suggest in the interview, nor was I reported as having suggested, that the Inquiry should go further than these terms of reference. It would however be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them.

I can assure you that when we come to consider the report of the Scott Inquiry we will take fully into account your members' views.

Yours sincerely,

(sgd) Margaret Thatcher

M.E. Yates, Esq.

cc C. Anson

fle Plo

cc HM Tsy

cc. LPC office.

10 DOWNING STREET

THE PRIME MINISTER

19 December 1980

Dear Mr. Kendall.

Thank you for your letter of 9 December, referring to the Report in the Sunday Telegraph of 7 December of an interview which I had given.

I did not suggest that Sir Bernard Scott was appointed to the Inquiry into the Value of Pensions because he was not going to enjoy the benefit of an inflation-proofed pension. The members of the Inquiry were selected and appointed as having between them a wide range of experience and authority, drawn from work in industry, commerce, public service, the trade union movement, and the actuarial and economics professions.

On your second point, the terms of reference given to the Inquiry were those published, with which you are familiar. It would however be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them.

Yours sincerely

Margaret Thatcher

W. L. Kendall, Esq.

pps w. Dr. Lancaster

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 December 1980

Mike Pattison Esq.
10 Downing Street
LONDON
SW1

P.
17/12

Dear Mike,

Your letter of 12 December.

.... I attach draft replies for the Prime Minister to send to the two letters about the Scott Inquiry, both prompted by the 7 December Sunday Telegraph report of an interview with the Prime Minister.

We noticed that the first complaint in the letter from Kendall relates to a point which was not actually included in the Sunday Telegraph article. Unless there was another edition which we have missed, it seems that he must somehow have got hold of a transcript of the full interview.

We have kept both replies as short as possible. The Report of the Scott Inquiry will be with the Prime Minister in a very few day, and although it may well not be published until towards the end of January, it seems better to avoid entering into general discussion in this correspondence so close to the likely date of publication.

We have not cleared the drafts with the CSD. Perhaps Jim Buckley would let you know whether he is content, and whether he might want to add something on the last couple of paragraphs in the letter from Kendall.

Yours ever,

Peter

P.S. JENKINS
Private Secretary

DRAFT LETTER

TO: W.L. Kendall, Esq.,
Secretary General,
Council of Civil Service Unions,
19, Rochester Row,
LONDON, SW1P 1LB.

SCOTT INQUIRY

Thank you for your letter of 9 December, referring to the Report in the Sunday Telegraph of 7 December of an interview which I had given.

I did not suggest that Sir Bernard Scott was appointed to the Inquiry into the Value of Pensions because he was not going to enjoy the benefit of an inflation-proofed pension. The members of the Inquiry were selected and appointed as having between them a wide range of experience and authority, drawn from work in industry, commerce, public service, the trade union movement, and the actuarial and economics professions.

On your second point, the terms of reference given to the Inquiry were those published, with which you are familiar. I did not suggest in the interview, nor was I reported as having suggested, that the Inquiry should go further than the terms of reference. It would however be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them.

DRAFT LETTER

TO: M.E. Yates, Esq.,
Hon. General Secretary,
Civil Service Pensioners' Alliance,
55, Morley Road,
Chaddesden, Derby, DE2 4QU.

Thank you for your letter of 8 December~~,~~ about the passage relating to the Scott Inquiry in the 7 December Sunday Telegraph report of an interview with me,

You are of course familiar with the terms of reference given to the Scott Inquiry when it was appointed. I did not suggest in the interview, nor was I reported as having suggested, that the Inquiry should go further than these terms of reference. It would however be natural and welcome that the Inquiry should indicate its views generally on index-linked pensions as part of a full response to the terms of reference given to them.

and also for
~~Thank you for~~ letting me see a copy of the submission made by the Civil Service Pensioners' Alliance to the Inquiry.

I can assure you that when we come to consider the report of the Scott Inquiry we will take fully into account your members' views.

Housing

PRIME MINISTER'S QUESTIONS 16 DECEMBER 1980

COUNCIL HOUSE VACANCIES

Latest figures show that 100,000 council dwellings are vacant in England. Of these 23,000 have been vacant for more than a year.

2

PRIME MINISTER

I fear that you said in your Judith Chalmers interview that 100,000 council houses had been empty for more than a year. These are the figures you saw before Christmas.

MS
7/1

Nick - (1) How many were empty a year ago
(2) Figures for whole of U.K.

The National Federation of Post Office and Civil Service Pensioners

(*Member of the Public Service Pensioners' Council and the Civil Service Pensioners' Joint Consultative Committee*)

General Secretary
G. H. MASSEY
14 Larch Road,
Kingswood,
Bristol BS15 4UQ
Tel. 0272-566306

Asst. Secretary
J. F. HETZEL, T.D. M.B.I.M.
The Uplands,
97 Andover Road,
Winchester SO22 6AX
Tel. 0962-883456

15 December 1980

The Rt.Hon.Mrs.Margaret Thatcher MP.,
The Prime Minister,
10 Downing Street,
LONDON SW1A 2AA

R17/12

Dear Mrs Thatcher,

THE SCOTT INQUIRY

I was most disappointed to read your remarks relative to the Scott Inquiry into the Value of Pensions during the course of your interview with Peter Simmonds, the Political Correspondent of the Sunday Telegraph in the edition dated 7 December. Even more disappointing is the apparent absence of a subsequent official disclaimer, or a qualification, from you. I can only assume, therefore, that you are actually encouraging Sir Bernard Scott to go outside the terms of reference of the very committee that you were primarily instrumental in setting up last May. The sensationalised report headed "New threat to inflation-proof pensions" on the front page of the same edition of the Sunday Telegraph cannot have escaped your notice.

Much of the resentment against Index-linked Public Service pensions emanates from the misleading reports in the press which give the impression that the cost of such pensions is met from the Exchequer and, therefore, from public funds. Whilst I cannot speak for the generality of Public Service pensioners I can certainly speak for Post Office pensioners. I too receive letters and I must inform you that your remarks are causing much anxiety and needless worry to retired Post Office employees, many of whom have given their whole working lives to the Post Office service. My members are concerned that the actions of your government could lead to a breach of faith in that their pensions, which formed part of their conditions of service, could be at risk. As you may be unaware of the conditions obtaining in the Post Office, I am associating with this letter a copy of the letter dated 9 July I sent to Mr, Farmer in which I explained as concisely as possible the Post Office Superannuation Scheme.

I would like to remind you of the assurances that were given by members of your government prior to May 1979 (in particular that by Sir Geoffrey Howe on 22 April 1979).

I

I have no doubt that these pledges influenced many of my members to support your particular party on 3 May 1979. It would appear that some of these pledges are beginning to have a hollow ring.

I would remind you that Post Office pensioners have EARNED their index-linked pension entitlements, and that there is no question of their pensions being something for nothing. The problem of inflation is in no way the fault of pensioners, and the index-linking of Post Office pensions (like those of Public Service pensions) is a means of trying to preserve the purchasing power of pensions awarded on the date of retirement. The index-linking of our pensions is an EFFECT of inflation, not a CAUSE.

Any interference in our pensions to our disadvantage will be regarded by Post Office pensioners as the unilateral breaking by government of a contractual obligation. It is hoped that you and your government will reconsider any idea of proceeding down the slippery slope of breaking faith with former government employees.

I can assure you that the Federation and its members await your reply with keen interest.

Yours sincerely,

G Massey

(G.H.MASSEY)

General Secretary

The National Federation of Post Office and Civil Service [redacted] Pensioners

(Member of the Public Service Pensioners' Council and the Civil Service Pensioners' Joint Consultative Committee)

Asst. Secretary
J. F. HETZEL, T.D. M.B.I.M.
The Uplands,
Andover Road,
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Tel. 0962-[redacted] 883456

General Secretary
G. H. MASSEY
14 Larch Road,
Kingswood,
Bristol BS15 4UQ
Tel. 0272-566306

P.J.Farmer Esq.,
Secretary to the Inquiry,
Inquiry into the Value of Pensions.

9 July 1980

Dear Mr Farmer,

Thank you for your letter of the 1st and for your advice that we may wish to submit evidence to the Inquiry. I should perhaps explain that although we still have "Civil Service" included in our title (this being a consequential from the days when the Post Office was part of the Civil Service) I can only speak for the generality of Post Office pensioners.

1. The Historical Background of the Post Office.

Until 1 October 1969 Post Office employees were Civil Servants and from 2 October 1969 (Vesting Day) they became employees of the Post Office Corporation. It follows, therefore, that the evidence I am submitting on behalf of the Federation falls into two parts, might be somewhat protracted and perhaps not straight forward.

2. The G.P.O. as part of the Civil Service.

Prior to 2 October 1969, as Civil Servants and as part of our Conditions of Service, the Civil Service superannuation entitlements were non-contributory and we qualified for this by reasons of age, or medical retirement.

It must be emphasised that although Civil Service superannuation was non-contributory, there was a considerable element of deferred pay involved. In the processing of pay claims at the Civil Service Arbitration Tribunals it was common practice for the Post Office and Treasury witnesses to stress the non-contributory aspect of our superannuation with its deferred pay connotations of the order of 12½%. Furthermore, the Conditions of Service clearly involved a contractual obligation on the part of the employer provided the employee fulfilled the agreed conditions.

3. The Post Office Corporation.

On and from 2 October 1969 the former G.P.O. became a Public Corporation and lost its Civil Service status. The former Civil Service conditions of employment were renegotiated and the setting up of the Post Office Staff Superannuation Scheme was

perhaps

perhaps one of the most important breaks with the past.

4.The Post Office Staff Superannuation Scheme/Post Office Staff Superannuation Fund.

The Post Office Staff Superannuation Scheme (P.O.S.S.S) was set up in 1970 and came fully into operation in 1971, as a result of an agreement reached between the Post Office and the Council of Post Office Unions (acting as the central negotiating body of the Post Office unions). The instrument for implementing the scheme is the Post Office Staff Superannuation Fund (B.O.S.S.F). Full details of the Fund and its Annual Report may be obtained from :-

Mr.F.B.Davis, Secretary, The Post Office Staff Superannuation Fund, Equitable House, 47-51 King William Street, LONDON EC4R 9DD Telephone 626 4577

Briefly, the P.O.S.S.S is a CONTRIBUTORY superannuation scheme based on Post Office employees paying 6% of their pay and the Post Office, as the employer empyer, 9% . As part of the Post Office Conditions of Service the Superannuation Scheme is one of the favourable conditions stressed by the Post Office when advertising for staff.

Because the P.O.S.S.S is FUNDED (apart from the Department of Industry payments amounting to £45millions for the assumed fund of 2½% Consolidated Stock as provided in Section 47 of the Post Office Act 1969-see bottom paragraph on page 3 of the P.O.S.S.F Annual Report 1979), there is no call on public monies, or from the generality of taxation. Reference to the 1979 Annual Report will show an income from contributions of £221millions, an investment income of £148millions, and an excess of this combined income over expenditure of £131millions with the net cash resources available for investment amounting to £448millions.

The contractual nature of our conditions of employment apply with the same force in the Post Office as formerly in the Civil Service, and are incorporated in the Contract of Employment. Our pensions are fixed in relation to the final year's salary of an employee about to retire and, therefore, such a pension is, in effect, index linked throughout an employee's service.

It cannot be too strongly emphasised that the object of the Index-linking/Inflation proofing of Public Service pensions is to maintain as far as possible the purchasing power of the pension as obtaining at retirement.

Furthermore, in common with Public Service pensioners, our Post Office pensions have been index-linked as per the provisions of the 1971 Pensions Increase Act and the Social Security Pensions Act 1975. Any paring of the provisions of these Acts would constitute a breach of faith with Post Office pensioners in particular, and with Public Service pensioners in general. If these conditions are interfered with to our disadvantage, in whom can we entrust our confidence in future ?

Yours sincerely, G.H.Massey (G.H.MASSEY) General Secretary

SCOTT Inquiry

Type

Miss ... are getting X – could you chase them tomorrow pls and send to Tsy with my comps.

10 DOWNING STREET

From the Private Secretary

12 December, 1980.

Mr. Lankester
x below: is action under way? 15/12

I enclose two letters the Prime Minister has received about the Scott Inquiry. She will want to reply to both of these before the Report comes out, and I should be grateful therefore if you could let me have suitable drafts as soon as possible.

× We do not have a transcript of the relevant part of the Prime Minister's interview with the Sunday Telegraph; I will have it sent over to you on Monday.

I copying this letter and its enclosures to Jim Buckley (Civil Service Department).

T. P. LANKESTER

Peter Jenkins, Esq.,
HM Treasury.

PS: If we move onto other topics. Last one on the economy. I mean, you have given the impression that you've given - you've got what you wanted on public expenditure reductions. It is a fact that really you ...

PM: We have got reductions.

PS: You have got reductions.

PM: Well, we've got ... Yes, we've got some reductions from over-spending. When you actually look, you'll find the expenditure next year in real terms is actually above the expenditure this year.

PS: Yes, and above that for the last few ...

PM: And above that, I'm afraid, for the last year of the Labour Government. The reason is threefold. Defence expenditure is running higher, and there's a practical effect there; not only have we put more into defence but we expect it. It's running higher than we budgeted for, for the simple reason that whereas much of the equipment was out with manufacturers who did not deliver on time, they are now delivering on time and sometimes ahead of time. So the bills are coming forward into this year and next. Now, to some extent that will be self-correcting. But it puts bigger expenditure than we budgeted for into this year and bigger expenditure into next year. Secondly, your nationalised industries are needing far more expenditure than we'd ever bargained for. Indeed, as I said in the House of Commons the other day, the external finance limit for the whole of the nationalised industry sector, that is the amount which the British taxpayer is having to find, is equal to fourpence on the standard rate of income tax. £3.1 billion. Alternatively, the way is three-quarters of the income from North Sea oil, is going into nationalised industries. Now, we've got to look for much better efficiency there. The trouble is, some of them are monopolies, and, they've just been piling the extra on prices. Even they have found some constraints. People just can't go on stepping up their consumption of electricity, so they're finding that these prices don't necessarily give increased returns. People can't go on paying increased fares, so they look for alternative methods of travel. And we've made those alternative methods easier. You can now hire coaches to come up to London, under circumstances where you couldn't. The answer to those nationalised industries is to introduce competition. Always. Now, that's defence, nationalised industries, social security. That is going up. The biggest increase is on retirement pensions. There is some increase on unemployment pay. Now I do urge you to look at the precise amount. This year I think it's £1.1 billion on unemployment pay. There'll be some extra for social security on top. The old National Assistance. Next year I think it's about £1.4 billion. But those are the big increases which we've been trying to keep in check and we've had, in order to keep the total in check, to make cuts from other programmes. Because you see, if we don't keep the total in check, it places an extra burden on the private sector. And it's having to cut down far more than we are. Now, we have not in fact taken a decision on index-linking on pensions, public service pensions, which will become a bigger and bigger expenditure as years go by, unless we really get inflation right down. And that of course is our objective. The best inflation - the best index-linking is to have nil inflation. But Bernard Scott, we did put him in charge of an enquiry into index-linking, and I believe that he will report some time this month. And of course, he's a person whose not got the public sector index-linked pension.

PS: The terms of reference for him are fairly narrow ones on contribution. Does that ...

PM: Yes. I don't know what he'll come out with. They were onto contributions, but I hope they'll come out with what he thinks about index-linked pensions, because do you know, it's one of the factors about which I get a very large postbag. There really is enormous resentment on the part of people who don't have index-linked pensions have to finance those who do. There are some people, for example, who work both in the public sector and in the private sector who find they have bigger increases in their pensions in the public sector than they get from their pensions in the private sector. That doesn't surprise me at all.

PS: So, when the Government comes to consider it ...

PM: So, we'll then ... we'll come to consider it, and we'll have a look. Just see ...

PS: Not just at the contributions, but at the principle of whether ...

PM: Well, I think we shall have to look at this, because at the moment you see, one of the problems which is bedevilling us in trying to get public spending down is that so much is index-linked. Now, the more we can get inflation falling, the less the burden of index-linking will be. It's when inflation is rising as it was last year that it is a particular burden because it bears much much,more heavily on total expenditure and therefore on the amount you're having to take out of the private sector, which is a very big overhead on them. Alternatively, on the amount which you are having to borrow which puts up the interest rates which also comes back as a burden on the private sector. The message I want to get across in a way is first: we knew when we came in, it's not only that you have to have a fundamental breakthrough on inflation than merely get it down; you have to have a fundamental breakthrough on incentives and enterprise. So as one comes down, the incentive and enterprise begin to take over and begin to get your expansion going. Between those two you have to have what I would call constructive intervention - first to mitigate the harsh effects of change on the people who suffer from it. To start some of the training for the new industries, to try to see that you give some of your research and technology contracts to business to operate your public purchasing in a way which gives your new industries a good home base on which they can export. But as you get the things which as you diminish the inflation ... Oh, and the other thing, I'm sorry, to reduce the substantial number of controls which were stopping British industry from going ahead and the number of statistics and to reduce the planning, the time spent on planning applications. All of those simultaneously. Now, of course it takes a time. And the other analogy I usually give is that Michael Edwardes has been at British Leyland three years; he hasn't got that completely turned around yet. And that's one company. We're having to try to turn around the whole economy, and the whole attitudes. And it's doing several things together. At the moment the positive things aren't coming through enough and we're watching very, very anxiously. You know that the inflation is coming down. You know that there are a number of very good signs. There are far fewer days lost from strikes, than there were. There are different attitudes. The way in which industry is going out for export business is most heartening and industry deserves to be congratulated upon it. Exports are still holding up. Yes, I know the problem. They're still holding up, and they are holding up well. They really deserve to be congratulated. Some of these people going out and really selling hard. You will find good examples in the papers today. GEC, Plessey ... I was amazed to see in the papers yesterday, I could hardly ... Look in yesterday's Times. D'you know there's a spending spree in the North-East. Did you see it?

PS: I'm not surprised. It was from their redundancy money.

PM: Well, no, they also said it was the economy. But the interesting summary ... I hope you got the sort of spending redundancy payment because if they can invest it they'll get money to spend year after year. Let's look. "Spending spree grips North East". Now look - that's a very good thing you've got to get, I must say, you've got to get a much better attitude to innovation and technological change. We will get the investment but people can be sure they'll get the return on investment. We'll get it in abundance.

PS: Can I turn now ...

PM: That's an awfully big chunk, I'm not at all sure how you're going to do it. But what I'm saying is, there's lots of positive being put in, which has still got to come through, and, oh the other thing I didn't mention; I feel very strongly about the young people. Two groups of people I feel particularly strong about; the young people coming out of school and that's why they've got to get into the habit of work and it's terrible if they can't. And that's why we put so much priority into getting a job for every one of them. Began to need a job by the Christmas following the summer recess in which they leave. There is another group that one is particularly concerned about. That is the group what I call the breadwinner people. Because it must be acutely difficult for them ... it denies your self-respect if you can't support a family, and this is where we just have to look at re-training, very much with this group of people in mind. And, I say that the technological innovation and change because, the fact that Japan is doing so well is because she has welcomed innovation and change. She's got the jobs, and we've got to get them. Not by criticising her, but by doing better than her. Because you see we get so many of the inventions here.

PS: Changing now to a very topical subject, Northern Ireland, and the hunger strike. Is there anything further that the government can do to lessen the tension there, and to ...?

E.R.

Have I commissioned draft replies?

R.

PRIME MINISTER

Here are two letters, one from Bill Kendall and the other from the Civil Service Pensioners Alliance, criticising what you said about the Scott Inquiry in your Sunday Telegraph interview. I think you will have to reply to both of these, and I will get replies for you to send before the report is published.

TPL

12 December, 1980.

12 December, 1980.

I write on behalf of the Prime Minister to thank you for your letter to her of 9 December.

This is receiving attention, and a reply will be sent to you as soon as possible.

T. P. LANKESTER

W.L. Kendall, Esq.

lu

12 December, 1980.

I write on behalf of the Prime Minister to acknowledge receipt of your letter to her of 8 December.

This is receiving attention, and a reply will be sent to you as soon as possible.

T. P. LANKESTER

M.E. Yates, Esq.

COUNCIL OF CIVIL SERVICE UNIONS

19, ROCHESTER ROW · LONDON SW1P 1LB · Tel: 01-828 2727-9

Secretary General: W. L. KENDALL
Secretary: P. D. JONES
Assistant Secretaries: B. G. SUTHERLAND HELEN E. HUGHES

9 December 1980

The Rt. Hon. Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

R11

Dear Prime Minister

SCOTT INQUIRY

The Council of Civil Service Unions have noted the remarks reported in the interview which you gave to the "Sunday Telegraph" on 7 December.

The Council would wish to know please if you are accurately reported in stating that the Chairman of the Committee currently examining index-linking in the public service, Sir Bernard Scott, was appointed because he "was not going to enjoy the benefit of an inflation proofed pension". I am sure you will understand that the Council are anxious to establish whether or not Sir Bernard Scott may be regarded as impartial in this respect.

Secondly, we are interested to know if it is true that you have asked Sir Bernard Scott's Inquiry to disregard its published Terms of Reference and to comment on issues on which, so far as is known, no evidence has been either sought or adduced ie. "to go further than his precise Terms of Reference and express views on the subject of index-linking".

As I am sure you will appreciate, your comments on the accuracy, or otherwise, of what you are reported to have said will be extremely important so far as the credibility and impartiality of any report produced by the Scott Inquiry is concerned.

Cont'd/...

I am sorry to say that, as Minister for the Civil Service, your reported comments can only add to the litany of unfair and discriminatory attacks upon employees for whom you have assumed direct responsibility.

On a previous occasion when we met, you said to me that you wished the Civil Service "to work better". I can only assure you that remarks of the kind ascribed to you are totally counter-productive so far as the morale and, consequently, the efficiency of all civil servants are concerned. I must, therefore, ask you to let us know if you were inaccurately reported or, alternatively, if this is not the case, to reassure all civil servants about the attitude of the Government towards their own employees.

Yours sincerely

Secretary General

CIVIL SERVICE PENSIONERS' ALLIANCE

Hon. General Secretary
M. E. YATES
Tel. Derby 672376
(STD 0332)

55 MORLEY ROAD,
CHADDESDEN,
DERBY DE2 4QU.

8 December 1980

R10/12.

The Rt. Hon. Margaret Thatcher, MP,
The Prime Minister,
10 Downing Street,
London, SW1.

Dear Prime Minister,

I write to express the concern of my members at some of the remarks attributed to you during your interview with the Political Correspondent of the "Sunday Telegraph" and reported in that paper of yesterday's date. They find it surprising that an Inquiry set up by you under the Chairmanship of Sir Bernard Scott should be urged to go outside its terms of reference, a fact capitalised upon by the "Sunday Telegraph" under a sensationalised headline on its front page.

There may be resentment regarding index-linked pensions, particularly among those motivated by the politics of envy and among those who either refuse to recognise or do not understand the contributions made towards those pensions during years of public service, and correspondence expressing this resentment may form a large part of your postbag. Nevertheless, bearing in mind undertakings given before the election not to remove the index-linking of public service pensions (including one by Sir Geoffrey Howe on 22 April 1979), undertakings which persuaded many of our members to support your party with their votes, one would have hoped that some acknowledgement of the need to take account of such pledges would have warranted a mention in your interview.

In order to redress, if only partially, the apparent imbalance of your postbag, I have been asked to let you have a copy of the Alliance's submission to the Scott Inquiry, and to commend especially to your attention the last paragraph thereof.

Yours sincerely

M Yates

MEMORANDUM from the CIVIL SERVICE PENSIONERS' ALLIANCE

to the [redacted]

INQUIRY INTO THE VALUE OF PENSIONS

1 This memorandum is submitted on behalf of the Civil Service Pensioners' Alliance the objects of which, in accordance with its constitution, are "to improve the method of calculating all Civil Service pensions and to maintain their purchasing power, to promote the social well-being of members, and to take part in any matters which will benefit the pensioner in receipt of or qualified to receive Civil Service pensions paid from UK funds".

2 It is recognised that the Inquiry's terms of reference require determination of the value of index-linked pensions, and that the principle of index-linking as such is not involved. It is also recognised that it is for the Government to decide, in the light of the advice given by the Inquiry, whether any changes in the present arrangements for civil service pensions would be desirable. Nevertheless, bearing in mind the unfounded attacks upon the so-called privileged position of civil service pensioners and the probability that such attacks could appear in the guise of evidence submitted to the Inquiry, the Alliance has decided to submit a brief statement of its own views.

3 The Pensions (Increase) Act 1971 made provision for "inflation-proofing" public service pensions and eliminated the requirement for separate Acts of Parliament on each occasion Parliament decided that it was necessary to restore the value of pensions that had been eroded by the rising cost of living. Parliament had acknowledged that it had a duty to public service pensioners to maintain their standard of living. The Social Security Pensions Act 1975 provides for the occupational pensions of employees both in the private and public sectors to be uprated on the common basis of changes in prices levels, and public service pensions are now increased similarly to the additional component pension (occupational pension) provided by the 1975 Pensions Act. Parliamentary pensioners have the same criteria for their pensions increases.

4 In Chapter VI of its Eleventh Report, published in July 1977, on the subject of developments in the Civil Service since the Fulton Report, the Expenditure Committee of the House of Commons, whilst recognising that there had been criticism of the index-linking of pensions, held that the principle was defensible for civil servants as under the comparability principle they received less pay than individuals in the private sector for the same work. It was conceded, however, that it was difficult for the Government Actuary to assess accurately the level of adjustment which should be made to civil servants' salaries to reflect their more generous pension arrangements.

5 In para 57 of their Report the Expenditure Committee described index-linked pensions as a gamble which a working civil servant will lose if he retires into a less inflationary world than he worked in, and win if the reverse is the case; and that if the trade unions who represent working civil servants accept this gamble on behalf of their members it was difficult to say that they have not some right to do so, since it is their members who lose current pay to assure themselves of security in retirement.

6 Evidence will be submitted from other quarters giving the basis of the current deduction from the salary of civil servants for pension purposes, but the Alliance wishes to place on record the view that existing pensioners have contributed adequately in the form of deferred pay for their pensions, and that any interference with the terms of the arrangements under which they retired would be a retrospective breach of what are, in effect, contractual obligations. Where added years have been purchased, the contractual aspect is more clearly defined in the strict legal sense.

7 Much is made of the argument that as no insurance company is prepared to quote for an index-linked pension at present levels of inflation it is impossible to quantify the contribution that should be made by the individual participant. Notwithstanding tax reliefs funded private sector schemes claim that they are unable to maintain the real value of pensions. Yet in France, two organisations, comprising representatives of employers and employees, cover the whole of the private sector and are able to link benefits with movements in earnings, with administrative costs of no more than 3% of the total contributions. In the UK these costs amount to between 10% and 30% of the amount contributed.

8 Instead of criticising the index-linking of public service pensions the private sector should aim at achieving a similar standard. As a recent article in "The Times" (29 May 1980) puts it:

"There is little doubt that a disparity of treatment is bad. But we ought to harmonise policy on the most sensible practice, not the worst. In the case of pensions this must be to give everyone a guarantee of the real value of their pension. There is no reason why anyone should see the worth of their retirement income being steadily reduced. Indexation in tax allowances and in state pensions is rightly seen as honesty in government; much the same applies to contributory pensions."

9 To do otherwise than to recognise the need for maintaining public service pensions in real terms would put this country out of step with all major Western countries and with such bodies as United Nations and the EEC, where the linkage of staff pensions is either with prices, or the pay of the former post, ie parity.

10 The advantage of parity is that it avoids anomalies in the form of unsatisfactory pension peaks and troughs which occur as a consequence of any periods of pay restraint. In a debate on Service Pensions in the House on 2 May 1980 the Minister for the Civil Service, Paul Channon, MP, described parity as an ideal solution but one which, unfortunately, would be far too costly to contemplate. The choice of linkage to prices in 1971 was thought to be rational, easily implemented, and the cheaper solution. To replace this now with less favourable conditions would be an indefensible retrograde step.

11 Whenever improvements in pension conditions have been made it has been Government policy to insist on applying the so-called principle of no retrospection. If changes are made that clearly involve a worsening of pension conditions, existing pensioners denied the benefit of improvements negotiated following their retirement, would be doubly penalised if the worsened conditions were applied retrospectively.

12 During the 1979 election campaign assurances were received from the bulk of parliamentary candidates that index-linking of public service pensions would not be interfered with, although the question of the adequacy of the contributions payable by those still serving would be reviewed. Such undertakings were confirmed by Sir Geoffrey Howe in an Election Call programme on 22 April 1979 in which he assured an Alliance member that there was no intention to remove the index-linking of public service pensions.

13 For those who have given a lifetime of service to the State, and who accepted conditions of service less well remunerated than comparable work in the private sector in the expectation of adequate provision for retirement, nothing is more unsettling than a threat that the money value of their pensions may be diminished, and that of their widows may see a similar decline at an even lower level of income. It is time that this uncertainty was removed, and, in the view of the Alliance, the Government should declare unequivocally that there will be no worsening of the conditions under which existing civil service pensioners receive their pensions. The Government's declared aim is to beat inflation. In their success any problems resulting from index-linking will disappear. To interfere with index-linking might well be assumed to be an acceptance that inflation had become unmanageable and destroy public confidence in the credibility of Government policy. The Alliance prefers to have inflation under control and avoid the necessity to uprate pensions to counteract any erosion in the value of money.

Econ Pol
Inflation Proofed
Pensions
NJ50/12

with compliments

TPC
MAP
to see
PA
MS

Private Secretary to
CHANCELLOR OF THE DUCHY OF LANCASTER
68 Whitehall London SW1A 2AS
Telephone 01-233-7113

Econ Pol.

8th December 1980

MR MACLEAN

cc Mr Harris
Miss Giles
Mr Sanders

LOCAL GOVERNMENT PENSIONS

The Chancellor has seen the letter from PS/Prime Minister to PS/Secretary of State (Environment) about a possible statement or PQ on the subject of local authority part-time employees and index-linked pensions. He has commented "Yes, this should be an oral PQ". The only possible opportunity before the recess would be Wednesday 10 December when the Department of the Environment is second in Order of Questions. However, I have spoken to PS/Secretary of State (Environment) and have been told that, since of all the Cabinet colleagues asked to comment the Secretary of State's original letter, only Number Ten has yet done so, it seems unlikely that they can be ready with either a statement or an oral PQ before the recess.

Good

Paul Lawrance

PAUL LAWRANCE

FILE

CONFIDENTIAL

TMP

B/C Mr Ingham
Mr Sanders

10 DOWNING STREET

From the Private Secretary

4 December 1980

Dear David,

The Prime Minister has read your Secretary of State's letter about local authority part-time employees and index linked pensions. She does not dissent from Mr. Heseltine's view that such employees should be denied access to the local government pension scheme; but she has asked whether it would not be wise to make an oral statement in the House, or alternatively, to find an opportunity when Mr. Heseltine next has to do Oral Questions to make the announcement then.

I am sending copies of this letter to John Halliday (Home Office), Peter Shaw (Department of Education and Science), Don Brereton (Department of Health and Social Security), Geoffrey Green (Civil Service Department), Peter Jenkins (HM Treasury), Robin Birch (Office of the Chancellor of the Duchy of Lancaster), Richard Prescott (Privy Council Office) and David Wright (Cabinet Office).

RH

Tim Lankester.

D.A. Edmonds, Esq.,
Department of the Environment.

CONFIDENTIAL

Inquiry into the Value of Pensions
Treasury Chambers
Parliament Street, London SW1P 3AG
Telephone Direct Line 01-233 4095
Switchboard 01-233 3000

T P Lankester Esq
10 Downing Street

3 December 1980

Dear Lankester

THE INQUIRY'S REPORT

Sir Bernard Scott hopes that the Inquiry will be able to report to the Prime Minister between 17 and 23 December. Publication of the Report and any parliamentary statement would, therefore, have to wait until after the recess.

Yours sincerely

P J Farmer

P J FARMER
Secretary to the Inquiry

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Bailey
Mr Kemp
Mr Kitcatt
Mr Unwin
Mr Mower
The Government Actuary
Mr Burrett (CSD)

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Prime Minister

I am sure Mr Heseltine is right to deny part-time local authority employees access to index-linked pensions.

R 27.12

cc Mr Ingham

Will there not be a storm in the House? Should there be an oral statement - or a written answer when Env. is top for written answer?

cc Mr Ibbs
Mr Le Cheminant
Mr Moore
Mr Miles

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

In 1972, at the request of the local government employers and Unions, Geoffrey Rippon agreed to make regulations which would allow part-time employees in certain defined categories to elect to join the local government pension scheme. These regulations have not yet been made, and it is only now that I have had to decide whether to proceed with them.

Last July, the Association of County Councils asked me to postpone the regulations for the time being in view of the economic situation. The other Associations and the Unions have urged me to promulgate them forthwith, but I have also received a number of representations from individual local authorities, Members of Parliament and others that the regulations should not be made, and there has been some press comment to the same effect. As you know, the Government is looking at the whole issue of index-linked pensions in the context of the Scott Report. It seems wrong to extend this principle at this time.

Further, an election by an eligible employee under these regulations would have immediate financial consequences for his employer, including administrative costs. It would, in my view, be quite wrong to impose on local authorities an open-ended commitment of this nature, and I have therefore decided not to make the regulations.

I propose to announce my decision by means of a letter to the TUC General Secretary on the lines of the enclosed draft. The decision is bound to have a stormy reception, and in view of your interest in this matter, particularly since I understand you have received no representations about your corresponding draft Scottish regulations, I would welcome any comments you may wish to offer before I write.

Copies of this letter and enclosure go for information to Willie Whitelaw, Mark Carlisle, Patrick Jenkin and Paul Channon, who have responsibility for the other public service pension schemes, and to Geoffrey Howe, Norman St John Stevas, Angus Maude and Sir Robert Armstrong.

Yours ever

Michael

MICHAEL HESELTINE

The Rt Hon George Younger MP

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THE RT HON. LIONEL MURRAY, OBE. TRADES UNION CONGRESS,
CONGRESS HOUSE, GREAT RUSSELL STREET, LONDON WC1O 3LS

When I wrote to you on 19 August in reply to your letter of 24 July about the proposed regulations to allow part-time employees to join the local government superannuation scheme, I said that I hoped to be in a position to reach a final decision on these regulations fairly soon.

I am now writing to let you know that, after carefully considering all the arguments, I have decided not to make these regulations. I would not, in any event, be prepared to make the regulations until the Government has received and considered the report of the Scott inquiry into index-linked pensions in the public service. But I have also taken note of the fact that the regulations as drafted would permit any part-time employee within the defined categories to elect to become pensionable. His employer would have no right to challenge this election, and would immediately be obliged to meet the additional costs, including the administrative costs, following from it. At a time when the Government is seeking substantial savings in local government expenditure, it would not be right to impose on local authorities an open-ended commitment of this nature.

I am of course, aware that this decision will disappoint many part-time employees who have been waiting for a long time for the opportunity to enter the pension scheme. Since April 1978, however, these employees have been eligible for pensions under the State scheme, and I am not persuaded that the advantages of transferring their entitlements to the local government scheme outweight the other considerations to which I have referred.

PART 1 ends:-

ChEx to Ld Pres. 30.6.80

PART 2 begins:-

S/S Env to S/S Scotland 28.11.80

~~HMT (Pensions Inquiry) to TL 3.12.80~~