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PRIME MINISTER

This letter from the Association of Independent Businesses is highly critical of the report of the Government Actuary which was submitted to the previous Government in April. This concluded that a deduction of 2.6 per cent should be made on Civil Service salaries to take account of index-linked pensions; and this 2.6 per cent was built into the PRU recommendations on which the recent Civil Service pay settlement was based.

On the face of it, the 2.6 per cent does seem insufficient. But the previous Government were unwilling to challenge the Government Actuary. I think you should probably reply to this, since ~~we~~ you are formally responsible for the Actuary - and it is an important issue. If you agree, I will get a draft reply from the CSD.

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18 May 1979

Would we also ask the Actuary how he arrived at that. Bad figure. MT.

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17th May, 1979.

The Rt.Hon. Mrs. Margaret Thatcher, M.P.,
10 Downing Street,
London S.W.1.

F18/5

Dear Prime Minister,

Inflation Proofed Pensions and the Civil Service

I write with reference to the report made by the Government Actuary to your predecessor on the subject of 'the 1979 Review of the Adjustment for Differences in Superannuation Benefits'. At its National Council Meeting yesterday, this Association accepted its Economic Committee's condemnation of the Review and endorsed certain recommendations to which I propose to return later in this letter.

We believe that Mr. Johnston has failed lamentably to fulful the objective of the 1977 Civil Service Agreement on Revised Pay Procedures to which he draws attention in Appendix 1, i.e. to ensure that pension adjustments can be demonstrated to be fair and properly based, particularly in relation to pension increase. His task has been to receive evidence from the Pay Research Unit and to exercise his professional judgement to determine the 'Deduction'. This is defined as the allowance required to reflect the extent to which superannuation benefits of Civil Servants are, on average, more valuable than those of comparable employments.

The Report explains very clearly, and with the utmost precision, the process by which the 'Deduction' is determined at 2.6%, an increase of 0.85% from the figure determined in 1974. There is, however, one glaring omission. In paragraph 6.11, the assumption is made that the Pensions (Increase) Acts will continue to provide full protection against price increases for Civil Servants, but nowhere in the assessment is any account taken of the value of this assurance. The vast majority of the analogue schemes selected by the Director of the Pay Research Unit provide either a low level of fixed increase or increases which are discretionary to the fund trustees. Our research discloses only three schemes outside the public sector where cost of living increases are guaranteed: one of these is a Trade Union and another, a company which was at one time a nationalised undertaking. The independent business sector which we represent makes most of its pension

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arrangements through life assurance companies, who find it impossible even to quote for inflation proofed pensions. The most that can be arranged at present is a funding provision for escalation at the rate of 8½% per annum which typically increases the payroll costs from 20-25% to 40-45%. In the light of these circumstances, we would have expected the Government Actuary to place a value on this almost priceless guarantee of at least 10%, making the 'Deduction' 12.6%, instead of 2.6%.

The Government Actuary reports that the analogue schemes can be expected to provide 65% inflation proofing in future. In our view, and using the evidence he has previously produced in his Fifth Survey of Occupational Pension Schemes, we feel that the analogue is very untypical of the private sector as a whole, with which, in our opinion, the comparison should be made.

Mr. Johnston has chosen to express the value of superannuation benefits at the 'new entrant to contribution rate'. This has meant his taking into account the inflation proofed nature of the earnings-related Government scheme which does not come fully into effect for another twenty years. For employees with less than twenty years to serve, the Government scheme is much less significant, a fact which is very material.

The report confirms that the 'Economic Assumptions' are of particular importance and indicates that those made imply rates of price increases of about 6% a year. Taking a forty year view, which the Government Actuary does, who knows whether he may be correct? He bases his view of the future, however, upon his assessment of the past; perhaps a dangerous thing to do in current conditions. He also takes 'account of the views of the Treasury'. In this respect, a glance through successive editions of the Investors Chronicle demonstrates that the Treasury has consistently under-estimated inflation prospects and has forecast figures which are regularly lower than those put forward by private institutions.

I trust that I have said sufficient to explain our dissatisfaction with the Report.

We are not unmindful of the history of pension inflation proofing. The measures introduced in 1971 were designed by common consent to give automatic adjustments of perhaps 2-3% per annum to a deserving section of the community. No one anticipated at that time the extent to which prices would escalate in subsequent years. The Government of the day expressed the hope that private industry would follow their example. It is significant that only public authority schemes and nationalised industries have done so. Management of private industry, from the giant G.E.C. downwards, have considered it to be commercially impossible for them to make similar provisions.

My Association would therefore ask you to consider four alternative recommendations.

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1. If on closer and more expert examination, the Government Actuary's determination is found to be correct, let the 'Deduction' of 2.6% be omitted. At the same time, remove all guarantees of continued inflation proofing, implied or otherwise. Let the adjustment be the subject of annual review by the Government in the light of what the country can afford.

2. If the present situation is to be allowed to continue, even for a short time, accept the recommendations of the Eleventh Report from the Expenditure Committee Session 1976-77 and arrange for the Government Actuary's findings to be made the subject of examination and report by consultant actuaries who confirm that they have no vested interest in the matter.

3. Let the Government confirm their previously held view that private sector schemes should provide for inflation proofing and let them re-insure the measure of risk involved which no single employer can sensibly underwrite.

4. Let the Government give emphasis to its determination to eradicate high levels of inflation by accepting liability for post retirement increases in excess of 3% per annum for all occupational pension schemes.

We believe that there is wide concern in the country about the rapidly increasing disparity between the standard of living enjoyed by public sector pensioners compared with their private sector counterparts.

We look to you, Madam Prime Minister, to provide an equitable solution to an inequitable situation.

Yours sincerely,

Philip Bayliss

P.A. BAYLISS
Chairman
National Economic Committee