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This approach seems very sensible. The value of an index-linked <sup>pension</sup> must be a very subjective judgement, and not something just amenable to actuarial assessment.

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Mr Channon seems to be content - you might like to confirm this with him tomorrow. Assuming he is content,

PRIME MINISTER

INFLATION-PROOFED PENSIONS

agree?

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Our discussion in Cabinet before Christmas led us away <sup>10/1</sup> from ideas of limiting or removing the benefit of inflation-proofing of public sector occupational pensions, and towards adequate (larger than at present) "contributions" from potential beneficiaries.

2. There has grown up a wide range of contributions or salary abatements in different parts of the public sector in respect of pensions benefits which are all inflation-proofed, resting on a variety of past agreements and negotiations. There can be no single and simple way of dealing with them all. What I think we could aim to do, however, is to establish a principle which is capable of being adapted to the variety of different cases, and then see that it is applied as widely as possible.

3. Attempts at objective valuation of inflation-proofed pensions - of the kind which have in recent years been made for the non-industrial civil service by the Government Actuary - are widely believed to be inadequate. They involve contentious assumptions about long-term future developments of prices, earnings and rates of return on investment, and they cannot reflect the subjective value of security enjoyed by the beneficiary of full inflation-proofing. The problem - which is in some respects similar to the problem of evaluating job security - inevitably involves subjective judgement.

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4. To get at this we shall need a new breakthrough. If we are to affect 1980 settlements, we shall need it quickly - some of the most important public service groups operate, like the non-industrial Civil Service, on April settlements. It will not be easy.

5. One approach might be simply to try to negotiate an adjustment for the Civil Service and other major groups. But I think this would be weak. We would have no authority for the attempt other than our unilateral assertion; we would have to tackle the problem quite separately for each negotiation, with the risk of different outcomes, or ending up with the lowest common factor.

6. It seems to me, therefore, that we have to look for some outside judgment. The question is whether we can find a sufficient outside authority, and one which could do the work in time. I do not think we could ask the Clegg Commission to tackle this - their style would involve prolonged factual enquiry and taking of evidence, and an additional task would cut across their already tight timetable for handling references on teachers. I wondered whether there might be any possibility of using the House of Commons Select Committee which looked into the subject some time ago (in the previous Parliament); but I suspect that they also would feel the need to undertake a prolonged enquiry.

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7. I have concluded - with reluctance and rather to my own surprise - that our best hope may lie in trying to find some new group of people - hopefully of distinction, of authority and of experience - whose considered opinion would be likely to command acceptance among reasonable people. They would have to be chosen and appointed specially for this purpose.



8. It remains a question whether the task could be carried out without a heavy or prolonged burden of work, which must be avoided if it is to be done within a month or so. In principle, I believe it should be possible. There would be need for some inspection of evidence - actual levels of benefits achieved under private sector pension schemes and actual levels of contributions or notional salary reductions. Fortunately, material of this kind should be available from the current work being done by the Government Actuary. The task of the group would essentially be that of applying its subjective judgment and stating, without any pretence at precise mathematical accuracy, a broadly reasonable figure to reflect value. The terms of reference would need to make clear that the advice was needed quickly, and that it was judgment, rather than searching analysis, which was needed.

9. As regards membership, the short time-scale suggests that we need not be debarred from approaching people who have busy jobs already. We would need a lay chairman, at least one acceptable active business representative, and it would be useful to have somebody from the pensions/insurance industry. (I think we should avoid a professional actuary in that capacity, because of the difficulties that might create in relations with the Government Actuary.) As an illustration, a well-balanced trio could be: Lord Boyd-Carpenter, (Alex Jarratt) (Chairman of Reed International) and R.E. Holland (Chief General Manager of Pearl Assurance).

10. I cannot be certain that an approach on these lines would work. But I can see no other way of getting at a significant effect on the forthcoming 1980 public service settlements in time. Even getting the judgment from the right group of people could be difficult. Having got it, we would still face the task of making it apply in the various negotiations, but I would hope that we could expect some public support for doing so and, if we were able to launch the

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process successfully in one or two negotiations, it would become progressively easier to extend it across the whole public sector. A good deal of money is potentially involved. One per cent on the non-industrial Civil Service pay bill would be over £30 million; but there are many other large blocks of public sector staff - about ten times the number involved in the nominal Civil Service - who should also be affected sooner or later.

11. I should add that I have not given up entirely the thought of de-indexation of the pension benefits themselves. I am satisfied that the outcome of our discussion before Christmas was right for the time being. But if efforts to get a more satisfactory "payment" for the benefits of inflation-proofing fail, I believe we would need to look again at de-indexation. This is a consideration which could be brought in to the discussion during negotiation with unions and staff associations in the light of any helpful recommendation from the kind of outside group I am proposing.

12. I believe that Paul Channon agrees that it would be sensible to try the course I have suggested. This would, of course, replace for the Civil Service our earlier proposal to put the pensions and job security issues to the Pay Research Unit Board (which seems to have foundered on Staff Side opposition). If you share our view, he and I will arrange to put to you considered terms of reference and a list of possible names.

13. I am copying this to other members of Cabinet and to Paul Channon.

G.H.

(G.H.)

January 1980

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