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POLICY GROUP ON PUBLIC SERVICE PAY AND PENSIONS

REPORT

As a result of the 1971 Pensions Increase Act, 900,000 pensioners (ex-civil servants, teachers, firemen, policemen, local government and Health Service employees, and MPs) receive increases each December to compensate for changes in the RPI. In addition since 1971 the Armed Forces and the Nationalised Industries (including a further 900,000 pensions) have sought in many areas to give the same increase, though they are not covered by the Act. The rules of some nationalised industries have been changed so as to reflect automatically in their benefits increases under the Pensions Increase Act 1971. Other organisations have purposely retained their own discretion in this matter: this year the National Coal Board, for example, gave a full increase to the mine workers' pension fund, but a maximum of £6 p.w. for staff pensions. The number of people working in all these categories amounts to 6½ million persons, a quarter of the working population, and the greater part of these now look forward to inflation-proof pensions.

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The Case for Inflation-proof Pensions

It is a fair and sensible way to protect pensioners from the ravages of inflation which they cannot themselves influence.

2. The State retirement pension is in effect inflation-proofed as successive governments have given annual * increases to compensate for the cost of living. Indeed recent increases have cumulatively exceeded this. The law now states that the basic State retirement pension must be reviewed in line with prices or earnings, whichever of the two is likely to be of benefit to the pensioner (Social Security Act 1973, as amended by S.5 of the National Insurance Act 1974).

3. We are advised by the Civil Service Department that European countries, America, Canada, and Japan all inflation-proof public sector pensions.

4. The 1971 Act ended the series of long annual negotiations at which it had become increasingly difficult for the employers to resist claims for indexation usually argued emotionally on the grounds of 'fairness to our old folk'. It also laid to rest the claims for parity in pensions - i.e. the increase of pensions in payment to the level that new pensioners receive, which are higher since the salary for the same job has gone up over the years. (It is important to appreciate that the public sector pension increases are price-indexed not salary-indexed).

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* Exceptionally two increases were granted in 1975.

The Case against Inflation-proof Pensions

1. We cannot afford them. They will become an increasingly massive burden on the Treasury, the size of which is not yet appreciated. This is a case of political priorities, and it can be assumed that the 1.8 million pensioners who benefit, and the 6½ million workers who expect to benefit will place this fairly high on their list of priorities.

2. The Private Sector funds cannot afford to inflation-proof.

3. Public servants are put in a highly privileged and insulated position. Therefore the public sector has a much greater attraction in recruitment of people than the private sector. Much of the antagonism towards public sector pension increases centres on this, as well as the feeling that the loose management of the public sector is a major contributory factor in the high rate of inflation.

The Problem this Year

The increase in public service pensions in December 1975 was 26% (to compensate for cost of living changes to June 1975) and it cost about £180m., though this will be taxable in the recipients' hands. The sheer size of it shocked many people, and it intensified the campaign against the bureaucracy, particularly the resentment that many people feel towards the protected position which the civil servants have created for themselves. The increase in December 1976 will also be substantial since it will represent the RPI from June 1975 - June 1976; and when it is paid in December it is possible that it could be well in excess of the going rate of inflation, so one can anticipate a similar reaction. Furthermore, if the next December increase is say in the region of 15-20%, it is likely to exceed the going level of wage settlements by a substantial amount. This in itself may lead the Government to find ways that don't require legislation to iron out anomalies that would arise (e.g. if a Civil Servant retires with a pension of £[illegible],000 p.a. in the first period of wage restraint, he will get a lower pension than someone who retired a year earlier, but who has had a pension increase at a rate higher than the intervening salary increase).

A Policy for the Opposition

We have examined several possible courses of action, and we have whittled these down to four:

1. Do nothing

There are obvious advantages in this. No Opposition need feel naked without a policy for public sector pensions which is nowhere near the centre of the political stage.

However we must recognise the strong feelings in the private sector that the public sector is "getting away with it".

2. Repeal the 1971 Act

We reject this. It would stir up a most emotive battle and we would be seen as anti-pensioner. It would also involve taking away many future benefits from existing workers, who believed that these were sacrosanct since they had been approved by Parliament.

A variation of this would be to stop the benefits for all new entrants into Public Sector work. This would lead over the years to a large discrepancy between pensions paid to those who benefit from the present condition and those who don't; and as the disparity increased, so would the difficulty in justifying it politically.

3. Establish a cut-off rate for increases

No increase would exceed a rate of say 10%. This recognises that no country can afford pension increases at a rate of 25% and at this level 'all bets are off'. Even if inflation continues at 15% a cut-off will in fact have to be introduced. But this would only be, we believe, a relatively minor aspect of a major economic crisis.

A variation of this would be to "taper" the increase for senior public servants. The Government may well do this, since few would speak up for the Permanent Secretaries. However, it appears to us to be fortuitously spiteful, and it adds more momentum to the reduction of differentials in rewards, which as a Party we are against.

4. Accept the principle of inflation-proofed pensions, but ensure that the present generation of public sector employees pay a full and proper contribution for these

(a) In theory, and the Civil Service would claim in practice as well, the annual salary increases take the inflation-proofed pension into account. Each year a detailed comparison for all grades of staff is made by the Pay Research Unit, which is attached to the Civil Service Department. Thousands of analogues are used in this process. When a comparable wage rate is established, 5-6% is deducted to allow for the fact that the Civil Service scheme is non-contributory. Then a deduction is made to allow for the fact that the benefits of the Civil Service scheme are better in some respects, including infaltion-proofing. The deduction last year for this was 1.75%. We are satisfied that it was totally insufficient as it did not take a realistic account of the future inflation rate; future investment returns; and future earnings increases. A leading firm of consulting actuaries has advised us that, on the assumption of salary increases of 10% per annum and a long-term investment return of 10%, the additional contribution required as a percentage of salary to produce 5% post-retirement pension increases are required, the additional salary contribution needed rises sharply from 5% to 17%. Provision for higher rates of pension increase requires even higher percentages of salary.

(NOTE: These figures apply to pension rights in respect of current service: further substantial contributions are required to provide post-retirement increases - in excess of those assumed in the current basis - in respect of pensions already accrued for service to date.)

Of course, the critical elements are the anticipated rate of inflation and the investment return that are taken into account in levying contributions required as a percentage of salary. We think that the bulk of the Civil Service are totally unaware of the difference between the deduction figure arrived at by the Government Actuary for total inflation-proofing and that which would be arrived at by independent actuaries. Therefore we consider that it is of prime importance to get these figure known and that if they are established independently they are more likely to be accepted by the public.

(b) People employed in the private sector are suspicious about this process. It looks as if Civil Servants assess their own increases in a secretive way to their own benefit. This suspicion could be removed if the wraps of secrecy were removed; if an independent element were introduced, and if Parliament had to approve. Moreover two independent surveys have recently stated that the annual salary increases for the Civil Service in recent years have substantially exceeded the movement of wages outside. This has been denied by the Civil Service Department, but once again an independent body would be better placed to carrying conviction in disputes of this sort.

(c) Legislation affecting earnings or pensions should not be considered in isolation: otherwise there could be further uncontrolled redistribution between earners and pensioners - e.g. the Remuneration Charges & Grants Act 1975 discriminates in favour of pensioners against earners. Therefore our recommendations cover the processes that determine both pay and pensions in the public sector.

We therefore recommend that:

1. The Pay Research Unit be set up as an Independent Commission.

2. It should have an Independent Chairman and a Board drawn equally from the private and public sectors. The Government Actuary should be one of its members.

3. It should report annually to Parliament, setting out its findings and the basis of its calculation of the annual wage settlement and the annual pension increase.

Some members of the Policy Group felt that the recommendations of the Commission should be debatable by Parliament and subject to amendment and approval; but we realise that this raises fundamental questions as to the responsibilities of the Legislature and the Executive, and as to the operation of the 1971 Act.

1971. - Pension & Salary

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