

cc J. Vockes

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Prime Minister 2

cc Mr Lyham



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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

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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:

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- 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

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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.