CONFIDENTIAL

Prime Minister

Do you wish to raise this at one of your regular meetings with the Chancellor?

Or do you prefer not to intervene?

MLS 27/11

Yes - I agree with John's views see paper attached.

MR. SCHOLAR

cc: Mr. Hoskyns

PUBLIC SECTOR PENSIONS

I have been keeping you informed of the progress of the work of the official group which has been following up the remit from E last summer to produce further details of the four possible courses of action, and the developments at Ministerial level between the Treasury and the erstwhile CSD. The Chancellor has now, I understand, decided on the recommendation he wishes to put to his colleagues; and although the time has still not yet come when we have to put all these rather detailed papers to the Prime Minister, there is an important procedural point.

The minimum necessary background is as follows: the official group has identified four possible courses of action, which are summarised in the Annex to this note. The first two, (a) and (b), involve an increase in contributions from employees; the second two, (c) and (d), involve a limitation on the indexation. The official group refrained from recommending as between the contribution route or the benefit route, while pointing out that the financial arguments pointed clearly towards increased contributions, and that there would be a risk of losing a case under the European Convention on Human Rights if the indexation benefits for which existing pensioners had paid were withheld. Before the abolition of the CSD, Lady Young proposed to the Chancellor that the Government go for course (b), i.e. an increase in contributions.

I understand that, following discussion among Treasury Ministers and officials, the Chancellor has now decided to put round a paper to E - which the Cabinet Office now tell me may be taken on 10 December - recommending that the Government take action on both contributions, in the form of course (b), and on benefits, in the form of a 7% upper limit with discretion to go higher if the Government so wish.

/ I am not

I am not here concerned with the merits of the Chancellor's proposal, although when the time comes, and when I have had a chance to consult others concerned within No. 10, I should certainly advise strongly against this proposition. My present concern is that, having sat through the discussions in the official group, I know that a recommendation along these lines will be strongly opposed by the Chancellor's colleagues representing other public service groups, as well as (if he accepts Departmental advice) Mr. Tebbit. Colleagues will certainly want to argue that there is an element of unfairness, as well as an absence of benefit in public expenditure terms, in restricting the benefits if you have already taken steps to ensure that those benefits have been properly paid for. John Hoskyns will also wish to advise the Prime Minister on the political desirability of a course of action which, while possibly generally commending itself to those who do not work in the public services, will certainly strongly antagonise the roughly 5 million employees in the public sector who are members of occupational pension schemes providing inflation-proofed pensions, and their spouses.

I think, therefore, that it is highly desirable that the Chancellor clear his lines with the Prime Minister before putting his proposals to E. You may feel that the right course of action would be to draw the Prime Minister's attention to this issue and suggest that she have a word with the Chancellor at her next meeting with him.

J.

24 November 1981

ANNEX

POSSIBLE COURSES OF ACTION IN RESPECT OF PUBLIC SECTOR PENSIONS, IN ACCORDANCE WITH THE CONCLUSION OF E COMMITTEE ON 15 JULY

(a) Course A: An increase in employee pension contributions from their typical level of 5-7% in the public services to something significantly higher.

(b) Course B: A partial switch to "pay-as-you-go" contributions, under which members of index-linked schemes would pay a separate special charge directly related to the emerging cost of pensions increase.

(c) Course C: The imposition, in one form or another, of an upper limit on post-award increases in pensions.

(d) Course D: A discretionary power to increase pensions by less than the rate of inflation.