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PRIME MINISTER

Index Linked Pensions: Follow up to the Scott Report
(C(81)58)

BACKGROUND

At their meeting on 15 July the Ministerial Committee on Economic Strategy asked the Chancellor of the Exchequer and the then Lord President of the Council to arrange for officials to report to them by the end of September, and to make recommendations as soon as possible thereafter, for changes in the arrangements for public sector index linked pensions (E(81)24th Meeting). Officials were to work on the assumption that changes would apply to all public sector groups and that the options to be further examined should include the possibilities of changes in benefits as well as in contributions. The Committee wished any legislative changes to be made in the present Parliamentary Session on the grounds that it would be impracticable to introduce legislation to give effect to changes shortly before the next election.

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2. Officials reported on 7 October. Their report is attached as Annex A to the Chancellor of the Exchequer's memorandum C(81)58 of 7 December. Officials have analysed the options and, while they do not make recommendations, they regard action on contributions as practicable but see considerable difficulties in action on benefits, particularly if applied to past service. The Chancellor of the Exchequer would like to act on both fronts: be recommends firmly in favour of changes in the arrangements for contributions; on benefits he suggests that there might be full inflation proofing up to, say, 7 per cent with discretion to go further, and that these arrangements should apply to benefits for past as well as for future

service. The Chancellor of the Duchy of Lancaster, in her minute of 8 December, recommends action on contributions only and argues against treating civil servants more harshly than other public service groups.

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3. The legislation necessary to bring about changes in contributions and benefits would apply to those public service groups listed in Annex B at the back of C(81)58, ie the civil service, armed forces, teachers, local government, police and fire service and also to the judiciary, to Members of Parliament and Ministers. It is proposed that the civil service scheme should be made fully contributory. No action is proposed for nationalised industries but consideration is to be given to amending the tax law so as to bring benefits under nationalised industry and private sector schemes in line with the proposed limits for the public services.

Pledges

4. The Cabinet will wish to consider what weight to give to the statements made during the 1979 General Election campaign. These were summarised in the Annex to E(81)78 which was before the Ministerial Commitee on Economic

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Strategy in July; for convenience a copy is attached to this brief. The statements seem to point to the possibility of changes in contributions but not in benefits.

MAIN ISSUES

5. The main issues for considerations are as follows:

a. whether action should be taken on contributions, or benefits, or on both;

b. if action is taken on contributions, whether this should take the form of a specific extra contribution for pensions increase and if so, how this should be determined for the civil service and the other public service groups;

c. if action is taken on benefits, whether this should take the form of making increases above a certain level discretionary and, if so;

i. what the level should be;

ii. what special treatment, if any, should be given to those who have purchased "added years" or who have "transferred in" service;

d. whether it is sufficient to leave nationalised industry schemes to be dealt with by possible amendment of the tax law;

e. whether it is feasible to go ahead with legislation in the current session.

Contributions

6. The report by officials considers two possible options for action on contributions. Option A is a straight increase in public service contributions to a unified level of 9 or 10 per cent. The Chancellor of the Exchequer agrees that this should be rejected on the grounds that there is no objective way of establishing that this is the right level of contribution. Instead he recommends Option B under which, in addition to the basic pension contribution, a special charge would be levied based on a calculation of the extent to which indexed public service pensions exceeded indexation in a number of private sector schemes which would be chosen for comparison. The special charge has been estimated at about 2½ per cent. Most public service groups (eg the local government workers, teachers and NHS staff) pay 6 per cent. Under the new proposals they would pay 8½ per cent.

7. There is however a difficulty in the case of the Civil Service where there is already a notional pension contribution of 8½ per cent taken

into account in the old pay arrangements. The Chancellor of the Exchequer argues nevertheless that the new additional charge of $2\frac{1}{2}$ per cent should be levied throughout the public services; and that Civil Service pay should not be adjusted upwards to compensate for this, or at any rate not by the full $2\frac{1}{2}$ per cent. In her minute of 8 December the Chancellor of the Duchy of Lancaster argues that civil servants should not be singled out to bear an unfair proportion of the extra contribution. It is in any event proposed in the officials' report and in the Chancellor of the Exchequer's paper that the civil service pension scheme should become fully contributory. This should help to put an end to much of the public criticism of civil service pensions. The Chancellor of the Duchy of Lancaster therefore proposes that in making this change the Government should face up to the fact that male civil servants already in effect pay something like the $8\frac{1}{2}$ per cent required and should not impose a further special charge.

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8. Further work will have to be done on some groups. Manual workers currently pay 1 per cent less than non-manuals and it is for consideration whether their increased contribution should be $7\frac{1}{2}$ per cent rather than $8\frac{1}{2}$ per cent. The various uniformed services - armed forces, police, fire and prison officers - have better basic pension benefits reflecting their lower retiring age. The armed forces currently pay 11 per cent through a reduction in gross pay; the police and firemen contribute 7 and $6\frac{3}{4}$ per cent respectively and prison officers the same as civil servants. It is for discussion whether, apart from the armed forces, the special payment for these groups should be $3\frac{1}{2}$ rather than $2\frac{1}{2}$ per cent to reflect the better benefits.

9. The Chancellor of the Exchequer estimates that the annual savings from his proposals on contributions might be of the order of £300 million to £600 million a year. In practice net savings would depend on the extent, if any, to which benefits were reduced and so contributions were less. For all groups there will be arguments over the extent to which pay should be adjusted

to reflect the new contribution arrangements which are likely to be introduced from April 1983. Consultation over these arrangements could well colour attitudes in the 1982 pay round and will play a significant part in the 1983 round, particularly for any groups which are being asked both to accept a relatively low pay settlement and to pay higher contributions than previously.

Benefits

10. The Chancellor of the Exchequer points out that at the root of the problem is the guarantee of index linking in public sector schemes and the virtual absence of such guarantees in the private sector schemes; he judges that the problems of private sector funding of benefits will increase. He accordingly invites the Cabinet to consider the possibility of providing for full inflation proofing of public service schemes up to, say, 7 per cent with discretion to go further. Each 1 per cent abated would save about £30 million gross a year. But to get these savings it would be necessary to apply a scheme to benefits for past as well as for future service.

11. There are a number of difficulties about this proposal which the Chancellor of the Exchequer does not fully bring out in his paper. The Chancellor of the Duchy of Lancaster refers to some of them in her minute to you of 8 December. The Cabinet will wish to consider the following points:

i. The Attorney General has advised that, while civil servants have no contractual right to pension increases, there is a risk of a successful case against the Government under the European Convention on Human Rights; and that special consideration should be given to the moral claim of those who have purchased added years at a price which includes an element for index-linking of benefits and those who have transferred previous pension entitlements into the scheme on a basis which reflects index-linking (see the letter at Annex E to the report by officials).

ii. Whatever the strict legal obligation the figures in Annex B to C(81)58 suggest that around 7 million people could be complaining of loss of "rights" and of disappointed expectations if benefits were limited in public service schemes, and some 3 million more if nationalised industry schemes were affected.

iii. It would be argued that when in opposition the Government appeared to undertake to preserve benefits, though not necessarily the present contribution arrangements - see the Annex to this brief.

12. The Cabinet will need to weigh these points against the Chancellor's argument - which those people not benefiting from public sector schemes would no doubt support - that index-linking for public servants is unfair and must be tackled now before it gets worse. In looking at this the Cabinet will need to judge the extent to which higher contributions would offer an effective answer to these criticisms.

Application to the Nationalised Industries and other public corporations

13. The Chancellor of the Exchequer accepts that the legislation, on either contributions or benefits, should not apply to the nationalised industries, but hopes that they can be persuaded to come into line with the public services. Any attempt to legislate on contributions by nationalised industry employees would mean that the Government was involving itself in the settlement of the terms and conditions of service of nationalised industry workers and would offer no safeguard against the possibility that the nationalised industries would concede offsetting pay increases or other pension benefits. If there were to be a change in the arrangements for public service contributions it would, therefore, be left to the nationalised industries to take account of this, as they saw fit, in deciding on their own

arrangements.

14. Changes in public service benefits would apply automatically to a number of nationalised industry schemes which are currently linked with the public service pension increase system; there is, however, nothing to stop these schemes from creating a new link with the Retail Price Index. To deal with benefits it is suggested that the better course would be to operate through the tax system and restrict tax relief by withdrawing Inland Revenue approval from schemes which permitted pension increases to exceed what was provided by public service schemes. This change would also affect the private sector and a transitional period of several years would be required in which schemes could amend their rules. It is explained in more detail in paragraphs 85-94 of the report by officials.

15. In short, members of nationalised industry pension schemes would be likely to be treated less rigorously than those of public service schemes; though the extent to which this were so would depend on the attitutdes of the individual boards and on what they could negotiate with their employees.

Consultation and legislation

16. The Chancellor of the Exchequer recommends the introduction of legislation in 1982 to take effect in 1983-84, or sooner if practicable. He advises that the main recommendations could not be included in the Finance Bill and that separate legislation will be needed; this would be short but probably contentious. The Cabinet will wish him to give fuller guidance on how he sees the timetable.

17. If Cabinet took decisions this week, a consultation document might be issued in January. It would be desirable to provide an opportunity for comments from the trade unions and from other public sector employers

involved, from representatives of public service pensioners and, particularly if there were to be changes in the tax regime, private sector pension interests. Given the complexity and importance of the issues involved, and the need for the groups concerned to consult among themselves, it is doubtful if this consultation period could be much less than three months. If Ministers then took another month to decide, in the light of the consultations, the final form of the legislation, the Bill could not be ready for introduction much before the end of May. The business managers will wish to comment on this, and they are likely to point out that Royal Assent could not be achieved in the present Session without formidable timetabling difficulties, particularly in the House of Lords.

18. If it were decided that legislation was no longer practicable in the present Session, an alternative would be to introduce the Bill at the beginning of the next Parliamentary Session with a view to enacting it in time for the changes to take effect in 1983-84. This would be contrary to the view of the Ministerial Committee on Economic Strategy that legislation should preferably be in the present Session. On the other hand, on either timetable, contributions would not be changed before April 1983 and benefits not before the November 1983 uprating. It would be possible to abate benefits in November 1982 only if sufficient progress were made with the legislation for the necessary arrangements to be completed in time and if the convention were broken whereby November upratings are announced at the time of the preceding budget.

19. Any changes in tax law, to encourage nationalised industry and private sector schemes to limit their benefits, would be introduced in the 1983 Finance Bill at the earliest.

HANDLING

20. When you invite the Chancellor of the Exchequer to introduce his paper you could ask him also to clarify for Cabinet how he sees the timing of consultations and of legislation. You might then ask the Chancellor of the Duchy of Lancaster to speak to her minute; and to comment on the implications for the Civil Service and for business in the House of Lords. The Lord President will wish to comment on the implications for the legislative programme: obviously the difficulties will be much less if the proposal is to introduce legislation at the beginning of the next Session.

21. Most members of Cabinet will want to give their views, but you will wish to hear in particular from those Ministers responsible for the main service groups and to have their advice on the case for changes in benefits and contributions and what such changes might mean for pay negotiations and industrial relations. In addition to the Chancellor of the Duchy of Lancaster these Ministers are the Secretaries of State for the Environment, Scotland, and Wales, for local government employees; the Secretary of State for Social Services for the NHS; the Secretary of State for Education and Science for teachers; the Secretary of State for Defence for the armed forces; the Home Secretary for the other uniformed services; the Lord President for MPs and Ministers; and the Lord Chancellor for the judiciary. Ministers sponsoring nationalised industries will also wish to comment. The Attorney General will be able to advise on legal points, and in particular on the problems of making changes in benefits applicable for past as well as future service.

22. Although Cabinet will want an indication at the outset of their discussion of the likely timetable for consultations and legislation, you might reserve decisions on that until the main policy questions have

been discussed. The main questions you will wish to cover seem to be:

a. Should action be taken, on the lines of Option B, on contributions by public service employees?

b. If so:

i. should the same special charge of $2\frac{1}{2}$ per cent be levied on all groups, or should allowance be made for the higher contribution already notionally paid by the civil service?

ii. should the Civil Service pension scheme be made fully contributory, subject to consultations with the unions?

iii. is it agreed that particular problems about manuals and the uniformed services should be left for further examination by officials, and for discussion and negotiation in the consultative period?

iv. what should be said in the consultation period on the implications of higher contributions for pay?
(The best answer may well be that this is for negotiation with each public service group taking into account the details of their present arrangements; the aim might be to avoid giving firm commitments prematurely but also to avoid giving any impression that the new pension arrangements will be used as a device for docking pay.)

c. Should action be taken on benefits as well as contributions?

d. If so,

i. should the inflation proofing be up to 7 per cent with any further increase being discretionary? and should this be subject to Parliamentary approval by order?

ii. should the new arrangements apply to past as well as future service ?

iii. should there be special arrangements for those who have purchased "added years" or have "transferred in" service?

e. Is it agreed that there should be no action taken on nationalised industry schemes, but that they should be persuaded to come into line and, if public service benefits are to be changed, should there be consultations with a view to changing the tax law so as to bite on benefits in nationalised industry and private sector schemes?

f. How long should be allowed for the consultativeperiod and when should the legislation be introduced?

g. What should be said publicly about the Government's intentions (the best course might be for either you or the Chancellor of the Exchequer to make some statement when the consultative document is published).

CONCLUSIONS

23. You will wish to sum up with reference to the questions listed above, which pick up all the points in the Chancellor of the Exchequer's paragraph 18. It will be very important to get right both the tone and the details of any consultation document and I suggest that you should ask the Chancellor of the Exchequer to clear the draft in correspondence with all members of the Cabinet.

RTA

9 December 1981

ROBERT ARMSTRONG