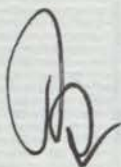


PRIME MINISTERCABINET: PUBLIC SECTOR PENSIONS: POLITICAL IMPLICATIONS

1. John Verekers' minute summarises our thinking and recommends Course B. The original 1971 Act may have been, quite literally, "an Act of insanity". However, the right posture for this Government, it seems to me, is "Indexed pensions for the public sector have proved a very heavy burden for the economy to bear. Nevertheless, a contract is a contract and it cannot be rewritten later when it proves expensive. That would be unfair and inconsistent with the Government's responsibility to its own employees. However, fair dealing means, on the other side, that inflation-proofing should be paid for, and for large numbers of public sector employees, this is not at present the case". In other words, a Government which is at present unpopular for being firm, should win as many points as it can for making very clear that it is nevertheless fair. I think it would be helpful if this general position was spelt out by you in Cabinet.
2. In political terms, the numbers are very large indeed. Annex B to Geoffrey's memorandum C(81)58, shows 5.4 million existing scheme members and 2.2 million existing pensioners (including dependants). In addition to that total of 7.6 million, there is presumably another substantial number of potential dependants of existing scheme members. So the numbers of Government employees and future voters who could - if this issue is mishandled - feel a very real sense of grievance, is very large. The Government is already criticised for appearing to denigrate its own employees, talking as if those who work in the public sector are somehow less upright than those in the private, almost wilfully damaging the morale of the Civil Service etc. Whether these criticisms are justified or not, this is how the Government is perceived. The decisions on this issue and the way those decisions are communicated to the public give us a chance to improve the perception of Government by those who work in the public sector.
3. There is an entirely different but related issue which should not properly come up in the Cabinet discussion. But, in case it does,

it is the argument that there should be complete freedom for anyone, in the private or public sector, to buy as much indexing as they like, provided they pay the market price for it. For example, unrestricted indexed gilts might be purchased by pension schemes. If the demand for these gilts for indexed pensions is high, the price will rise and the yield will fall, and thus a market price will emerge reflecting the demand for inflation-proofed pensions. In a sensible world, this would be the right way forward, but it is a more radical and long-term solution.



JOHN HOSKYNS