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Prime Minister

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PRIME MINISTER

POLICY UNIT

CABINET: PUBLIC SECTOR PENSIONS

The Chancellor has slightly recast the paper you saw earlier, in the light of your feeling that it would be wrong to take action on both contributions and benefits: but he still clearly prefers that course, with a 7 per cent upper limit on indexation. Janet Young's note sets out the case against action on benefits. We think she is right.

Looked at on its own merits (i.e. disregarding what is expected or desired by public servants, or by the public at large) we are clear that the best course of action is Course B - an increase in contributions so that there is a special element directly related to the cost of indexation. This produces the most benefits in public expenditure terms (up to £600m a year, depending how much is offset in higher pay); requires the least controversial legislation; and would be widely seen as fair, even by public servants, because it is based on the principle that people would be paying what the scheme actually costs.

The Chancellor suggests (paragraph 13 of his paper) that Civil/Servants should also pay the proposed 2½ per cent special charge for index-linking, even though they are alone among public service groups in already paying fully (paragraph 29 of the report).

Janet Young says it would be wrong to single out civil servants in this way. Again, we think she is right. Apart from the immediate effect it would have on pay bargaining, it would be

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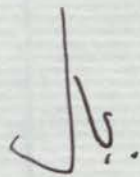
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widely regarded as unfair. The broader political implications of how we deal with public service pensions are set out in John Hoskyns' note.

Adding to increased contributions Course C - the imposition of an upper limit on indexation - produces little or no additional public expenditure benefit, since if you do Course B public servants pay exactly for the benefits they receive; requires more controversial legislation; and risks challenge in the European Court of Human Rights, because those who have contributed in the expectation of inflation-proofed pensions would be denied what they have paid for.

So we conclude that Course B is the right course, and that action on benefits as well isn't worth the problems it would cause. If colleagues see the balance of political factors differently, and feel it necessary to take action on benefits, we strongly recommend, in place of Course C, going to Course D - a discretionary power to increase pensions by less than the rate of inflation. That would be slightly less provocative to public servants, and would retain maximum flexibility for the Government. But it would still arouse widespread opposition.



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9 December, 1981

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