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cc JV

Prime Minister

Treasury Chambers, Parliament Street, SW1P 3AG For tomorrow's
01-233 3000 meeting with the
Chancellor. Do you
agree the paper be
circulated for Cabinet
on 4 March?
ms 24/2

PRIME MINISTER

INDEX-LINKED PENSIONS

It is now a year since the Scott Report on index-linked pensions was published, and it is becoming increasingly difficult to justify the delay in announcing the Government's views on it. Cabinet, on 10 December last, commissioned further work on the application to particular groups of our preferred scheme. I have now received this in the form of reports from the Official Committees on the Value of Pensions (VP) and on Public Service Pay (PSP(O) - copies are with your Policy Unit. I believe it is important to press on with an early announcement. Specifically, I would see advantage in including an announcement in my Budget Statement on 9 March. The absence of any announcement on this subject was one of the points specifically criticised about by Budget Statement last year.

2. Clearly there are difficult questions, which you and the Cabinet will wish to consider, about the timing both of an announcement and of the date of implementation. My own view is that this subject is likely to become more rather than less contentious with the passage of time and that, for the reasons given in the draft Cabinet paper enclosed, the best course is to press ahead as quickly as possible. I should therefore like to circulate this Cabinet paper on Thursday of this week for consideration on 4 March, so that the option of an announcement in my Budget Statement can be considered. I should be grateful if we could have a word about this when we meet tomorrow.

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MANAGEMENT IN CONFIDENCE



3. I am sending a copy of this minute and enclosures to Sir Robert Armstrong.

Peter Jenkins

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(G.H.)

February 1982

(Approved by the Chancellor of the Exchequer and signed in his absence).

CONQUEROR

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DRAFT PAPER FOR CABINET

INDEX-LINKED PENSIONS

Introduction

It is now 12 months since the publication of the Scott Report and we are coming under increasing and understandable pressure to announce our conclusions. At Cabinet on 9th December (CC(81)40th Meeting, Item 4), we agreed in principle not to legislate to remove or reduce the inflation-proofing of public service pensions. Instead, we asked for further work on a new system of employee contributions. Essentially, public servants would pay, in addition to their present contributions, a new special charge towards the current cost of index-linking. We accepted that the scheme could not extend directly to the nationalised industries because of the legislative difficulty of bringing their contribution rates within Government control.

The Official Report

2. Officials have now completed this further work and their report is at Annex A. It is detailed, but that is inevitable given its scope and the complex legal and financial structures involved.

I am satisfied that the basic concept of our preferred option is sound; and that the technical difficulties can be overcome. There is, indeed, considerable attraction (except for the people affected) in a course in which public servants would be seen to pay for the additional cost of full index-linking, as compared with private sector practice. And it must be right in principle.

3. The report distinguishes between the services where full pensions are earned over 40 years ("normal accrual") and those where pensions are earned more quickly and are payable from an earlier age ("fast accrual"). Fast accrual is much more valuable and the benefit of index-linking is correspondingly greater. I endorse the general view of officials that these better benefits should be paid for at a ^{somewhat} higher rate. But we must also recognise that the advantages of earlier retirement stem partly from the fitness requirements of the jobs concerned - in the police, fire and prison services, for example, and the armed forces.

Points for decision

4. On the main issues posed in paras 4-6 of the official report and para 4 of the Chairman's note, my views are as follows:-

a. Police, Fire and Prison Services - lower tier contributions

I would accept the Official Committee's recommendation that the lower-tier contributions for these services should in principle be increased. I doubt whether in practice it is realistic to aim at a single, uniform, contribution and it will probably be unavoidable that we negotiate rates tailored to the circumstances of each service. We should, however, aim to ensure that the treatment of the various services is consistent and avoid unnecessarily fine distinctions between them. (Similar considerations apply to the NHS Mental Health Officers.)

b. Calculation of the special charge (the upper tier)

Though it will complicate the scheme, I agree that the special charge should be calculated separately for the normal and fast accrual services. If there were a single charge for all, those in the normal schemes would claim that they were being required to subsidise the more costly inflation-proofing of the others. However, for the fast accrual schemes, the combined impact of increases in both tiers would be very severe. We may need to modify the higher special charge on the grounds that earlier retirement is imposed in these services.

c. The Armed Forces. It is desirable in principle that the scheme should have the widest possible coverage and that the Armed Forces should not appear to be getting specially favoured treatment. This argues for including them. On the other hand, the present pension deduction for the Armed Forces - increased last year to 11 per cent (equivalent to 13 or 14 per cent in a contributory scheme) - is unlikely to be criticised as inadequate. And although the method of calculation is different, the result is in line with what is proposed for the other fast accrual services. A change would require major adjustments to the Armed Forces pay and pension arrangements. On the balance of these arguments I would suggest that the Armed Forces should be excluded from the new scheme - at least for the time being.

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5. For the normal accrual services - civil service, NHS, teachers and local government - I agree that the lower-tier contribution should be 5 per cent (manuals) and 6 per cent (non-manuals) with a uniform special charge estimated at $2\frac{1}{4}$ per cent.

6. I would endorse the other recommendations in para 4 of the Report. In particular, I see it as an integral part of the proposals that the Civil Service scheme should become fully contributory. I would propose to enter into consultation with the Civil Service unions on the precise amendments needed to the pension scheme avoiding, so far as possible, "windfall" benefits for those about to retire. Arrangements equivalent to the special charge must clearly apply in the universities and other public service bodies mainly financed from public funds. It would also be right to invite the Top Salaries Review Body to review, in the light of the proposed changes, the arrangements under which they take account of pensions in assessing judicial pay.

7. I shall consider further the effect of the increases in contributions on the Inland Revenue limit that employee contributions should not exceed 15 per cent of pay in schemes qualifying for tax relief. My present view is that this limit should continue to apply to those who have not yet entered into contracts to pay additional voluntary contributions but be waived for those with contracts existing at the date of announcement, to the extent - and only to the extent - that the new arrangements would take them over the limit.

8. The special charge as estimated in the official report must be regarded as provisional, pending a proper review before implementation. However, the most likely overall effect of these proposals can be summarised as follows:-

<u>Total Contributions</u>		
	<u>Existing</u>	per cent <u>Proposed</u>
Teachers	} 5 manual 6 non-manual	} 7 $\frac{1}{4}$ manual 8 $\frac{1}{4}$ non-manual
Local Government		
NHS		
Other bodies		
Civil Service	Total effective contribution approximately 8	7 $\frac{1}{4}$ manual 8 $\frac{1}{4}$ non-manual
MPs	6	8 $\frac{1}{4}$
Police, fire and prison services	} 6 $\frac{3}{4}$ - 8	} 10-13 depending on negotiations
Judiciary	3 or 4	5 $\frac{1}{4}$ or 6 $\frac{1}{4}$, plus TSRB pay adjustment
Armed Forces	Continued pay adjustment equivalent to 13 or 14 per cent in a contributory scheme.	

The gross public expenditure savings of these changes - that is, the additional income from employee contributions, assuming no offset in higher pay - would be about £535 million a year.

Implications for pay

9. The key question for decision is whether - sometime in 1983 or 1984 - we are going to insist that public servants should pay more for index-linked pensions. To impose a higher contribution would not be easy at any time. It will be particularly difficult now when most public servants are being asked to accept increases in pay which are below the increase in the cost of living. We must, therefore, expect our proposals to be vigorously resisted by the unions, even if the basic shape of the scheme is a fair one.

10. The Official Committee on Public Service Pay have pointed out (Annex B) that the introduction of the special charge will lead to claims of varying strengths for compensatory adjustments to pay. However, the whole scheme is designed to answer the charge that public servants pay too little for index-linking. Its purpose would be lost if we conceded automatic pay increases to meet the new charge - as would the savings in public expenditure. In my view, we should say there can be no assumption that pay will be increased to offset the special charge. We should then resist claims for offsets so far as possible.

11. These difficulties are, of course, inherent in any proposal to increase the contributions for index-linking over the next two years. The problem will not go away; and my judgement is that public concern about index-linking will increase if we are successful in holding down pay while pensions increase in line with prices. If we are to meet this concern, the only alternative to a genuine increase in contributions would be to cease full index-linking. We have rejected that course for other reasons. It might, however, help to secure the acceptance of the special charge if we pointed to this alternative during the process of consultation.

Announcement and implementation

12. The Official Committee on Public Service Pay have recommended against an announcement before the completion of the remaining public service pay negotiations - the Civil Service, the NHS and schoolteachers - and it is clearly

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important not to prejudice their outcome. On the other hand, the matter has dragged on for over a year and we are now being pressed for a response to Scott. My Budget Statement last year was criticised for not dealing with it. I believe we should now act as quickly as possible and I should like to give some general indication in this year's Statement of what we have in mind. A decision will be welcome to many of our supporters, while an announcement that we do not for the moment intend to remove index-linked may slightly improve the climate on pay.

13. Before implementing this scheme we are committed to consult those affected and we need legislation taking power to impose the special charge. The earliest date for implementation would be the first pay settlement for each service after 31 March 1983, which would require a bill to be introduced very early next session, and on the Statute Book well ahead of that date. The alternative would be implementation from 31 August 1983, which would allow more time for legislation, but which would be criticised by those who already argue we have been dragging our feet, and would bring the process nearer to the likely date of the election. I can appreciate the timetable problems, but I believe nonetheless there is a strong case for going for the earlier date.

Recommendations

14. I ask my colleagues to agree, therefore:-

- i. that I should announce in my Budget Statement our intention to consult with interested parties on the introduction of a two-tier system of contributions on the general lines of our preferred option, with a view to legislation next session and implementation in each service at the first pay settlement after March 1983;

- ii. that the normal accrual schemes should be treated as proposed in paragraph 5 above and pay a special charge of around $2\frac{1}{4}$ per cent;

- iii. that for the police, fire and prison services, contributions for pension benefits should be reviewed as proposed in para 4a above; that the special charge should be set at a higher rate; but that the overall impact of these changes may need to be modified (para 4b).

- iv. that the scheme should exclude the Armed Forces, but that it should embrace all the other public services, including the judiciary and, indirectly, the universities and other public service bodies mainly financed from Government funds;

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- v. that the civil service scheme should become fully contributory and that the other recommendations in paragraph 4 of the official report should be accepted;

- vi. that there should be no assumption that adjustments will be made to pay to offset the special charge; and

- vii. that while the scheme cannot apply directly to the nationalised industries we should invite each industry to review its own level of employee contributions in the light of the changes proposed for the public services.

24 FEB 1962



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