

24 February 1982

Policy Unit

PRIME MINISTER

INDEX-LINKED PENSIONS

We have seen Geoffrey's minute to you of 23 February with the draft Cabinet Paper, together with the PSP and VP papers. There are really four questions:

1. Is this a nettle we HAVE to grasp?
 - 1.1 The economic case looks powerful, with annual savings of around £½bn. As Geoffrey says, "The problem will not go away". He argues that public concern could increase if we succeed in holding pay down, while indexed pensions rise with prices. It is consistent with the Government's image - the long-term responsible approach - that we should grapple with the problem as surely as other parties would shirk it.
 - 1.2 The political implications are substantial. There are 5.4 million members of index-linked schemes in the public sector, and a presumably substantial number of potential dependants of existing scheme members. Geoffrey says that the measures he proposes would be welcome to our supporters. Of course they would. But those who would welcome them most enthusiastically are unlikely to desert us at the Election if we disappointed them on this issue. Loyal Tory supporters cannot "vote harder" than they will in any case. So the possibility of losing votes - by alienating public sector pension scheme members - seems greater than that of winning converts. So we shall have to make great efforts to persuade public sector employees that our measures are, above everything, fair.
 - 1.3 Geoffrey suggests that, in presentation, we should point to the alternative of ending index-linking altogether, and then discard it. This would be consistent with the "firm but fair" posture we have suggested in earlier minutes. A contract (ie indexed pensions) must be honoured; but the price must be fair.
 - 1.4 We conclude that the nettle does have to be grasped at some stage. So the question is when?

2. Should we leave it till the next Parliament?

2.1 At first sight, this looks attractive. But if we mean to grasp the nettle some time, it would probably be better to do it soon. If we introduce the measures in March 1983 (the earliest practicable date, Geoffrey suggests, and it would be very difficult to leave it later, with an Election likely in the autumn of 1983) we could challenge Labour and the Alliance to repeal it if they came to power. Alliance in particular probably know that index-linked pensions were a major blunder and would not wish to repeal. If they promised to do so, they would be likely to alienate far larger numbers of those who do not enjoy indexed pensions, than would be won over from those who enjoy indexation. This challenge to the other parties would be crucial, since the measures would be introduced so soon before an Election.

2.2 We doubt if it would make sense for us to delay till the next Parliament. First, there would be a good deal of scepticism amongst our supporters and the public generally about whether we would really take any action, having delayed so long. Second, many members of indexed schemes in the public sector would probably vote against us, in self defence; while it would be much easier for Labour and the Alliance to hedge about whether they would introduce such measures (much easier than it would be for them to pledge to repeal such measures once they had been introduced).

2.3 So we conclude that we have to act soon or not at all.

3. Do the colleagues grasp the pay implications?

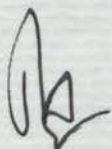
3.1 As the PSP paper says, there will inevitably be pressure for compensating pay increases. The argument will be that earlier pay awards explicitly took account of the value of indexed pensions.

3.2 It may be possible to show, for some public sector groups, that if those notional deductions had been added back in, their average pay levels would be absurdly high compared with their private sector comparators; and that therefore realistic deductions could never have been made, despite all the protestations after the event. But this would depend on the actual numbers and specific cases.

There is really no way of resolving the argument. The trade unions will say that they are being victimised and picked on unfairly. We shall be arguing that we are introducing fairness, at a time when the rest of the economy is having to face up to living within the country's means. It is unlikely, at least in the next 5 years, that we will ever find the time "convenient" for grasping this nettle, as we shall always be facing public sector pay pressures. So we really have to take it head-on and resolve to win the argument. It will help, presentationally, that MPs will have to take the Government's own medicine. Much will also depend on how "resistable" the various groups in the table at the end of Annex A of VP(82)5 are judged to be when the crunch comes.

4. If the colleagues decide to delay?

- 4.1 The colleagues may, despite all Geoffrey's arguments and their own decision in Cabinet, decide to delay this difficult issue on purely political and electoral grounds. There is a real danger of alienating very large numbers in the public sector and also getting a blow-back into pay, even before the implementation of new pension arrangements. If the colleagues decide to delay, the best way would be to make a Parliamentary announcement before the Easter Recess, indicating that they have been carefully considering the Scott Report; that it raised difficult and complex issues throughout the public sector (which is nothing less than the truth); but they have decided that it would be wrong to restrict the benefits of indexation; and that they are considering ways of ensuring that contributions fairly match those benefits; and that they would be issuing a consultative document in the summer. That document would then expose the very real difficulties, and by the time those consultations were finished, it would be too late to introduce anything into the next Parliamentary session. In view of the long delay since the Scott Report and the possibility of an Election only 18 months away, such an approach is likely to be suggested.



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