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Prime Minister

Agree to the Chancellor

circulating this paper to E, so

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that there would

be a discussion

PRIME MINISTER

I agree that there should be a discussion. There will be some difficulties - I believe in getting the Chancellor's views endorsed.

about whether to announce these decisions

in May/June?

INDEX-LINKED PENSIONS

When we last discussed this on 25 February you decided against an announcement in my Budget Statement and suggested that we might consider the possibility of an announcement in the late summer or autumn, which would be least inconvenient on the pay front. You thought it would be useful to expose all the arguments in a published document, perhaps a Green Paper: it might also be necessary to arrange for a debate in Parliament later on.

2. Since then, pressure has continued from many of our supporters to give a early indication of our conclusions. Francis Pym recently wrote to me to say that, in his judgement, there was no prospect of avoiding a fairly early Parliamentary debate. The new leader of the House will be under growing pressure to arrange this, which is likely to increase in the coming weeks, especially as we approach the time for decisions on MPs' pay and allowances.

3. Against this background I do not think we can now hope to postpone any indication of our views until the autumn. A debate with no clear indication of our intentions would be badly received by our supporters, both in the House and in the country. Similarly, if we published an inconclusive Green Paper, we should earn no credit with the opponents of index-linking, while, because of the continued uncertainty, causing widespread concern to the pensioners and public service unions. There are, therefore, in my view good political arguments for resolving this question once and for all well

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before the run-up to an Election. I have discussed this with Janet Young, who has also encountered considerable pressure around the country for an early Government decision. This comes not only from those opposed to index-linking but from others who are anxious to see an end to the present uncertainty.

4. The best timing for a debate would be towards the end of May or early June - after decisions on the civil service pay arbitration and before the report of the Megaw Inquiry. This could still run into difficulties over the teachers' or nurses' pay negotiations, if they had not been settled by then, but it would be difficult to hold off the pressures much beyond mid-June. The debate would, I think, need to be preceded by an oral statement giving an indication of our conclusions in fairly broad terms. This could be backed by a written document, placed in the Library of the House, explaining the proposals in greater detail.

5. Beyond that, we are firmly committed to consult the various interests on any proposed changes and we could, as you had in mind, undertake this during the summer - perhaps on the basis of a White Paper or formal consultation document. We could decide which in the light of the debate. This timetable would pave the way for final decisions in the autumn as you suggested, and on the assumption (which we may wish to reconsider) that no place can now be found in the 1982-83 legislative programme, it would lead either to legislation early in the 1983-84 session (with a view to implementation in the course of 1984), or to a firm Manifesto commitment for action early in the next Parliament. We need not close the options on this question for some time.

6. In conclusion, therefore, the strong pressure for a Parliamentary debate does, I believe, mean that we must now give some fairly early indication of our proposals. We cannot hope to delay - this till the autumn and the best time for a debate would be at the end of May or early June. The

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debate could be preceded by a statement in fairly general terms, and followed by a consultative exercise through the summer. We could emphasise that while we had made proposals in general terms, we were still open to receive representations, and we need not, therefore, be committed to final decisions until the autumn.

.....
7. I should like to put these suggestions to our Cabinet colleagues and I attach at Annex A a revised draft of the paper I showed you in February. The substance remains the same, but the sections on timing and presentation have been revised to reflect the proposals in this minute. A draft of the proposed statement is of Annex B.

8. I am sending copies of this to John Biffen, Janet Young and Michael Jopling, and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'G.H.'.

(G.H.)

8 April 1982

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DRAFT PAPER FOR CABINET

INDEX-LINKED PENSIONS

Introduction

It is now 14 months since the publication of the Scott Report and we are coming under increasing and understandable pressure to announce our conclusions. At Cabinet on 10th 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 (described in these papers as the lower tier) a new special charge (the upper tier) 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 practices. And it must be right in principle.

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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

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 2½ 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, with an upward adjustment to pay to compensate for the lower tier contribution. The effect would be financially neutral. 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 yet entered into contracts to pay additional voluntary contributions but be waived for those with contracts existing at the date of

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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> per cent	
	<u>Existing</u>	<u>Proposed</u>
Teachers)		
Local Government)	5 manual	7½ manual
NHS)	6 non-manual	8½ non-manual
Other bodies)		
Civil Service	Total effective contribution approximately 8 (equivalent to 8½ per cent in a contributory scheme)*	7½ manual 8½ non-manual
MPs	6	8½
Police, fire and) prison services)	6½ - 8	10-13 depending on negotiations
Judiciary	3 or 4	5½ or 6½, 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.

* reflecting the fact that pensions would be slightly larger being based on higher gross pay.

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Implications for pay

10. The key question for decision is whether in this Parliament 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 at a time when most public servants are being asked to accept increases in pay which are near or 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.

11. 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. So too 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.

12. 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, during the process of consultation, we pointed to this as the alternative.

Announcement and implementation

13. The Official Committee on Public Service Pay have recommended against an announcement before the completion of the remaining public service pay settlements - the Civil Service, the NHS and schoolteachers - and it is clearly important not to prejudice their outcome. On the other hand, the matter has now run on for well over a year and we are being widely criticised for dragging our feet. There are, in my view, good political arguments for resolving this thorny question once-and-for-all, well before the run up to an election. In particular, the former Leader of the House has faced growing pressure in the House to arrange a fairly early Parliamentary debate and, in his judgement, there is no prospect that this can be avoided.

14. The best timing for a debate would be towards the end of May or early June, after decisions on the Civil Service pay arbitration and before the report of the Megaw Inquiry. This could still run us into difficulties over the teachers' or nurses' pay negotiations, if they had not been settled by then, but it would be difficult to hold off the pressures much beyond mid-June. A debate with no clear indication of our intentions would be badly received by our supporters, both in the House and in the country. It would therefore need to

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be preceded by an Oral Statement giving an indication of our conclusions in fairly broad terms. (A possible draft is at Annex C.) This could be backed by a written document, placed in the Library of the House, explaining the proposals in greater detail.

15. Beyond that, we are firmly committed to consult the various interests on any proposed changes and we could undertake this during the summer - perhaps on the basis of a White Paper or formal consultation document. We could make it clear that while we had made proposals in general terms, we were still open to representations, and we need not, therefore, be committed to final decisions until the autumn. On the assumption (which we may wish to re-consider) that no place can now be found in the 1982-83 legislative programme, this timetable could lead either to legislation early in the 1983-84 session (with a view to implementation in the course of 1984), or to a firm Manifesto commitment for action early in the next Parliament. We need not close the options on this for some time.

Recommendations

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

a. that in readiness for a Parliamentary debate in late May or early June, I should announce our intention to introduce a two-tier system of contributions on the general lines of our preferred options (see the draft statement at Annex C);

b. that in the light of the debate we should consult interested bodies with a view to reaching final decisions this autumn;

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- c. on the detail of the scheme,
- i. 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;
 - ii. 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);
 - iii. 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;
 - iv. that the civil service scheme should become fully contributory and that the other recommendations in paragraph 4 of the official report should be accepted;
 - v. that there should be no assumption that adjustments will be made to pay to offset the special charge; and
- d. 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.
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Draft Oral Statement

The Government has completed its review of the arrangements for increasing public service pensions in the light of the Scott Report and I should like to announce our broad conclusions and proposals for change.

2. First, we have decided that the right course is to seek adequate contributions from public service employee for their pension benefits rather than to seek to reduce the real value of those benefits. This decision is fully in line with the approach to these matters which we put forward at the last election. The principle underlying our proposals will be that public service employees, rather than the taxpayer, should bear the full cost of the extra benefits they enjoy as compared to private sector practice.

3. For the Civil Service we would propose to replace the present mixture of salary reductions and widow's contributions by a fully contributory scheme. Contributions to the other public service schemes will be reviewed. In addition to these changes, a special charge will be levied on all employees, in schemes covered by the Pensions (Increase) Act. It will be set at the level necessary to recover in full the extra cost of index-linking in excess of average private sector practice.

4. This new charge is provisionally estimated to be about 2½ per cent of pay for most public servants and about 3 per cent for members of schemes in which full pensions accrue

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over less than 40 years, such as the police, fire and prison services. As a result most non-manual public servants will pay a pension contribution of at least 8½ per cent of salary. Members of the armed forces pay for their pensions under separate arrangements based on the recommendation of the Review Body on Armed Forces Pay; their contributions were increased to an adequate level last year and they will be excluded from our proposals. Subject to the necessary legislation receiving the approval of Parliament, we intend that the new scheme should come into effect in the course of 1984.

5. My rt. hon. friend, the Leader of the House, will be arranging for a full debate in the fairly near future. To assist in this, I shall be placing in the Library of the House a background document setting out our proposals in rather greater detail. Following the debate we shall, as we have promised, consult fully on our proposals with organisations representing public service employers, employees and pensioners, with a view to reaching final decisions later this year.

6. Finally, the House would, I know, wish me to express our thanks to Sir Bernard Scott and his Committee for the informative report which they produced last year. Although our proposals go beyond the issues set out in the Scott Committee's terms of reference, their report was a useful starting point for the Government's own review. It has helped to improve the quality of public discussion on this very difficult question.