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cc Mr. Hoskyns
Mr. Walters

PRIME MINISTER

Cabinet 29 April: Index linked pensions

The Chancellor's paper C(82)14 is almost identical to the paper he sought your authority to circulate before the Budget, and which you said should be delayed because of the possible effect on the pay round of his proposed announcement. The principal change he has made is to keep, in paragraph 14, a much more open mind on the timetable for legislation - before, he had said there was a strong case for going for implementation by 31 March 1983. Nonetheless, he proposes to announce that the new scheme "should come into effect in the course of 1984" (Annex C), and I believe that our objections to that still stand:

(i) Pay implications

The Chancellor is of course right to say that the whole scheme is designed to answer the charge that public servants pay too little for index linking, so that we cannot concede automatic pay increases to meet the new charge. But, as the report of the Official Group on Public Service Pay makes clear, seeking increased contributions will inevitably complicate pay bargaining across the board; and, in the case of the civil servants, will widely be regarded as totally unjustified, because civil servants believe that their pay is already reduced by the full 8¼% proposed (although since the suspension of pay research that reduction has been only notional). So all the groups affected will argue for offsetting pay increases: to some extent that is bound to result in higher pay settlements than would otherwise have been the case. And the proposed 2¼% special charge will be much harder to lose in pay bargaining in low single figures than it would have been with settlements running over 20%.

(ii) Technicalities

The method recommended by the Chancellor, on the basis of the Official Group's work, is probably the best available in this highly technical area. It is certainly the one which will be most easily saleable as fair, because of the clear relationship it establishes between the benefits of indexation and payment for

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it; and I am sure it is right to make the "fast accrual" services pay more. But the arguments for excluding the Armed Forces are unconvincing. As paragraph 27 of the Official Report makes clear, that is bound to increase the resistance of other groups to the Government's proposals, and leave the Armed Forces open to the criticism, however unjustified, that they are still receiving non-contributory pensions. The Armed Forces should be included.

(iii) Consultation

Your reaction to the Chancellor's earlier proposal was that it would be best to publish a Report, possibly in the form of a Green Paper, exposing all the facts and complexities, with a view to a wide-ranging public debate over the Summer. The Chancellor's proposed oral statement goes very much further than that, by indicating firm decisions on the part of the Government as to action on increased contributions and a firm timetable leading up to legislation coming into effect in 1984. So he would be setting out specific proposals, not starting a consultative process. Given that this is a most unlikely candidate for pre-election legislation - John Hoskyns drew your attention earlier to the large numbers of voters involved - that risks getting the worst of all worlds: the fear of higher contributions will put greater pressure on pay, but the benefits of increased contributions would not be achieved in the present Parliament.

(iv) Nationalised industries

Ministers agreed in December that officials should work on the assumption that the scheme would not extend to the nationalised industries, and the reasons for that decision still stand: it would be virtually impossible to implement any proposals. But this remains highly unsatisfactory, because in the public sector as a whole it is the nationalised industries whose pay settlements bear least relation to job security, market factors and affordability, and it is the public services where we have greatest success in holding pay down. From that point of view, increasing pension contributions in the public services but not the nationalised industries is a move in the wrong direction.

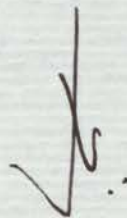
(v) Public Perception

Public and media perception is not at present running at all strongly on index linked pensions, principally because of the improved prospects for inflation. Resentment of index linking is a product of inflation itself. The fact that inflation from next year on should be firmly settled into single figures is a factor to take into account in deciding whether it is necessary to grasp this nettle at all.

Conclusion

So I recommend you stay with your original proposal, and:

- (i) Endorse as the Government's preference the detailed scheme proposed (paragraph 15c of the Chancellor's paper), but with the inclusion of the Armed Forces; but
- (ii) Amend the Chancellor's proposed statement to replace references to Government decisions and proposals by preferences subject to the outcome of consultation; and
- (iii) Delete from the Chancellor's proposed statement the suggested timetable, and indicate instead an intention to publish a consultative document in the summer, on the basis of which the Government would subsequently decide whether legislation was justified.



John Vereker

26 April 1982