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PRIME MINISTER

Index-Linked Pensions

(C(82)14)

BACKGROUND

At its meeting on 10 December 1981 (CC(81)40th conclusions, minute 4), Cabinet decided that there should be no change in the index-linking of benefits conferred by public sector pension schemes, and invited the Chancellor of the Exchequer to arrange for further studies to be made of the detailed effects on different public service groups of changes in the present system of pension contributions.

2. The memorandum, and the detailed report by the Official Committee on the Value of Pensions (VP) attached to it, take as their starting point the 'two-tier' system of contributions previously discussed by Cabinet. Under this, the generality of public servants would continue to pay a 'lower-tier' contribution of 5 per cent for manual workers and 6 per cent for non-manuals; a new 'upper-tier' contribution, based on the year-by-year cost of the pensions increase element of public service pensions, would be levied in addition. This would be of the order of 2 $\frac{1}{4}$ per cent of pensionable pay; the exact amount will probably need to be studied further.

3. The other main features of the Chancellor's proposals are as follows:

a. for the police, fire and prison services which have a lower retiring age, the existing lower-tier contribution will need to be increased and the new upper-tier contribution ought to be set at a higher rate; however the combined effect of these extra charges may be too severe and they may have to be modified;



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b. the armed forces are to be excluded for the time being on the grounds that the existing notional contribution is adequate and that the necessary adjustments to the armed forces pay and pension arrangements could not be justified;

c. the judiciary should be dealt with by asking the Top Salaries Review Body to review the arrangements under which they take account of pensions in assessing judicial pay, (in his letter of 22 April the Lord Chancellor has pointed out that the judiciary, like the civil service and the armed forces, pay a notional contribution for their pensions);

d. the civil service pensions scheme should be made fully contributory with an offsetting adjustment to pay to compensate for the lower-tier contribution; in the case of the upper-tier any claim for offset will be resisted as far as possible in accordance with e. below;

e. there should be no assumption that pay will be adjusted to offset the special charge;

f. while the scheme cannot apply directly to the nationalised industries, each industry should be invited to review its level of employee contributions in the light of the charges proposed for the public services;

g. the next steps should be an early announcement on the lines of the draft at Annex C, followed by a Parliamentary debate in late May/early June, consultations in the summer, and final decisions in the autumn leading either to legislation (probably not before the 1983/84 session) or a Manifesto commitment for action nearly in the next Parliament.

MAIN ISSUES

General

4. The most important issue is whether Ministers feel that the Chancellor's general approach to the issue of index-linked pensions is feasible, justifiable, and politically advantageous.

Feasibility & Justification

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5. The following difficulties may be identified in discussion:

← a. the proposals are not fully comprehensive and consistent; in particular:

they do not apply to the nationalised industries;

the armed forces have to be left out, partly on the grounds that their notional contribution for index-linking is adequate although this can be argued equally well for certain other groups such as the civil service;

the principle of paying the true cost of pensions is not to be applied with full rigour to those groups (police, fire and prisons) who are at present most markedly undercharged for their pensions;

in making the civil service scheme contributory, the 6 per cent lower-tier notional contribution is to be accepted as justifying automatic offset by increased pay but not the existing 2 per cent notional charge for index-linking;

b. the proposals will be difficult to negotiate and, as the report by the Official Committee on Public Service Pay concluded (Annex B to C(82)14), "increased contributions are in practice likely to be compensated, at least in part, by corresponding increases in pay";

← c. although the proposals may arouse opposition among some of the groups affected, they may not satisfy that sector of public and Parliamentary opinion which is hostile to index-linked public service pensions, particularly if increases in contributions are, and are seen to be, offset by increased pay.

6. If Ministers are unconvinced by the Chancellor's general approach, there is no easy alternative. The Cabinet rejected action on benefits at its



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meeting on 10 December 1981, not least because of statements made before the 1979 Election. It will also no doubt be argued that the Government cannot continue for much longer to resist a Parliamentary debate on index-linked pensions, and that it would be difficult in such a debate to give no clear indication of the Government's intentions. At the last Cabinet discussion some Ministers felt that the best way of holding the position would be to publish a Green Paper setting out all the facts in relation to pensions in the public sector, demonstrating both the extent to which certain groups were already contributing towards the cost of their pensions and the complexities and difficulties involved in various courses of action, and inviting comments. This might help to postpone the time when the Government had to take up a clear position until inflation was in single figures and the issue of index-linked pensions was to that extent less emotive and contentious. There must however be some doubt as to whether such tactics would work.

More detailed issues

7. If Ministers approve the Chancellor's general ^{approach} ~~approval~~ it will be necessary to go through the specific proposals about the treatment of particular groups, the implications for pay negotiations, and the proposed next steps summarised in paragraph 3 a. to g. above.

8. The precise timing of any announcement will need careful consideration in relation to public service pay negotiations in the current round. It is difficult to forecast how long it will be before a settlement is reached in the National Health Service. The hearing on the arbitration for schoolteachers in England and Wales is unlikely to take place until well into May. The local authority white-collar workers and the industrial civil service have settlements which are not effective until 1 July.

HANDLING

9. After the Chancellor of the Exchequer has introduced the paper you will wish to invite comments particularly from Ministers responsible for various public services, the Home Secretary (police, fire and prisons), the Secretary

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of State for Defence (armed forces), the Secretary of State for Education and Science (teachers), the Secretary of State for the Environment (local authority employees) and the Secretary of State for Social Services (National Health Service). The Lord Privy Seal will have comments about the effect of the proposals on the Civil Service. The Secretary of State for Employment may have some general comments. The Lord President and the Chancellor of the Duchy of Lancaster will have views on the Parliamentary and political implications.

CONCLUSIONS

10. You will wish to reach conclusions on the following points:

- i. whether the Chancellor's general approach of introducing a new special charge of around 2 $\frac{1}{4}$ per cent for index-linking is broadly acceptable;
- ii. whether the lower-tier contributions for the police, fire and prison services should be increased, and there should be a higher special charge, subject to possible modification in the light of overall impact;
- iii. whether the armed forces should be excluded for the time being;
- iv. whether the scheme should cover all other public services including the judiciary and, indirectly, the universities and other public service bodies mainly financed from Government funds;
- v. whether the Civil Service scheme should become fully contributory;
- vi. whether there should be no assumption that adjustments will be made to pay to offset the special charges;
- vii. whether the nationalised industries should each be invited to review its own level of employee contributions in the light of the changes proposed for the public services;



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viii. whether there should be an early announcement on the lines of the draft statement at Annex C, and, if so, when;

ix. whether there should be a Parliamentary debate, consultations in the summer, and final decisions in the autumn;

x. whether the options of legislation during this Parliament or a Manifesto commitment for action in the next Parliament should be left open at this stage.

ROBERT ARMSTRONG

19 May 1982

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