



Treasury Chambers, Parliament Street, SW1P 3AG

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PRIME MINISTER

CCBG
Prime Minister!
Only Mr Tebbit has
yet commented, in support
of the Chancellor. Agree
the Chancellor's proposals,
subject to colleagues?

D. H.
20/6.

PUBLIC SECTOR PENSIONS: REALISTIC CONTRIBUTIONS

You will recall our commitment in the 1983 Manifesto that, "In the next Parliament, we shall continue to protect retirement pensions ... against rising prices. Public sector pensioners will also continue to be protected on the basis of realistic contributions".

After considering a report by officials in 1984, E(PSP) concluded that any move to increase employees' contributions, if combined with offsetting pay increases, risked misunderstanding and controversy for no financial benefit; and not to concede offsetting pay increases would encounter strong employee resistance at a time when the pay climate was already difficult. We therefore decided to await the conclusions of Norman Fowler's review of retirement provision before making any final decision, and I minuted you to this effect on 27 July 1984.

With the introduction of Norman's Social Security Bill, I have looked again at the question of realistic contributions, and consulted colleagues responsible for public sector schemes. Having examined the options fully we are all agreed that we should not take further action now to increase employee contributions.

Developments in the past few years in both the level of inflation and pay and pensions for public sector employees have transformed the scene. The main sources of the concern which lay behind the Manifesto statement were the open-endedness of the commitment to indexation and the belief that the employees' share of the cost of this was insufficient. These issues are much less pressing today. Action has already been taken, between 1981 and 1984, to increase employees' contributions to the police, firemen, and MPs' schemes,



and the allowance for effective pension contributions made by the Review Body in setting armed forces' pay was also increased in 1981. Differences between public and private sector schemes in the extent of protection offered against inflation have narrowed.

More fundamentally, our success in establishing sustained lower rates of inflation has reduced the apparent benefits of indexation.

We have been pretty successful in controlling public sector pay, at least so far as central Government is concerned, and we must clearly not let up. Taking into account all relevant factors, including superannuation benefits, the 'overall remuneration package' is generally appropriate to the need to recruit, retain and motivate the necessary staff. Provided our pay negotiations take proper account of the value to the employee of index-linked pension benefits, I do not believe we need to proceed further down the very difficult path of seeking actually to increase employee contributions. The aim is to ensure that the overall remuneration package represents value for money for the taxpayer, in relation to the services provided.

Subject to your views on the substance, we also need to consider handling. There is always liable to be interest in a Manifesto commitment. But my own view is that we should not go out of our way to make an announcement. If pressed, we can emphasise that the Government have, in the light of the Manifesto, always taken account of the value of pensions, and aimed at an appropriate overall package.

The approach I suggest is not affected by my proposals, announced in the Budget, for the treatment of pension fund surpluses. There are, however, related questions to be considered about the financing of some public service schemes and the treatment of surpluses, and I have asked John MacGregor to pursue these with colleagues. But none of these affects the line I propose on employee contributions.

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I am copying this to Cabinet colleagues.

NL

NIGEL LAWSON