

CONFIDENTIAL

P 03156

PRIME MINISTER

*We cannot go back
on our commitments previously*

EXCHEQUER CONTRIBUTIONS TO BR AND NFC PENSION FUNDS

E(A)(88)31

*given & accepted in
good faith - not*

DECISIONS

1. Mr Channon seeks agreement in principle that the Government should legislate to reduce its contributions to the pension funds of British Rail (BR) and the National Freight Corporation (NFC). This would be controversial, not least because of commitments which Ministers gave during the passage of the Transport Act 1980. Mr Fowler in particular is concerned on this point. You will wish to reach a decision in principle on whether Exchequer contributions should be reduced despite the commitments.

2. If this is agreed, the handling will need careful consideration. Legislation would not be possible until 1989-90 at the earliest. An early announcement would merely give BR and NFC, and the unions, a chance to mount a campaign to get the decision reversed. On the other hand, the Government will need to make its position clear before the NFC's public flotation around the turn of the year. Mr Channon therefore proposes to open confidential discussions with NFC to try and do a deal, while saying nothing about the position on BR for the time being. He would then consult colleagues further about announcements on both BR and NFC. You will wish to decide whether this is the best approach.

BACKGROUND

3. In 1974 the Labour Government decided that BR would be unable to finance a pension deficit of some £800 million, and the Exchequer should pay it off over ten years. Similar assistance was given to NFC for employees transferred to it from BR. Following



criticism by the Public Accounts Committee that those payments were in advance of need, the Government decided in 1980 to change its contribution onto a pay-as-required basis.

4. At the time of the 1980 Transport Act, Mr Fowler as Minister for Transport made clear in Parliament, and to BR and the rail unions, that the Government regarded the basis of contributions established by that Act to be a once-and-for-all settlement. He did so at a time when the chance of a substantial surplus was regarded as negligible, whilst great importance was attached to protecting the Government from an open ended commitment to fund BR and NFC pensions, whatever the performance of their fund managers. The junior Minister responsible for the 1980 Act (Mr Clarke) said in Committee "I accept that if the funded proportion outperforms the obligation under the unfunded proportion, there will be a surplus which does not go to the Treasury but would probably go to the improvement of benefits". By the time of NFC's privatisation in 1982, statements about continuing the payments to NFC were made, but of a more guarded nature (eg: it is our present intention ...).

5. The amounts payable by Government under the 1980 Act were fixed by actuarial valuation. In the case of BR, which has two main pension funds plus nine minor ones, the Government currently contributes £89 million per annum to its schemes. This amount is expected to increase in the period up to 2000 and then tail off gradually, perhaps coming to an end around 2050. Mr Channon's preferred option is for Government to continue contributing £37 million to certain closed pension schemes relating to pre-1975 service which are unfunded, and to transfer responsibility for the remainder to BR. This would produce a public expenditure saving of £31 million on schemes which are now in surplus.

6. In the case of the NFC, the Government contributes £6 million a year to three schemes under the 1980 Act. This was left unchanged when the NFC was privatised in 1982, the only privatisa-



tion to date in which the Government has accepted a continuing commitment to fund pension scheme deficiencies. The contribution falls into two parts.

- £4.5 million into two schemes which are now in surplus (the latest estimate of this surplus is £190 million). Although NFC would not need to continue these payments if Government funding ceased, they would be unable to benefit from a pensions holiday to the extent of the reduced Government funding. Government withdrawal could therefore affect their profit and loss account to the same extent as if they were required to continue paying the £4.5 million;

- £1.5 million to a largely unfunded scheme, which is still in deficit. Mr Channon proposes that the Government might agree to continue this contribution. NFC would need to take it over if the Government payment ceased.

In addition, under separate legislation Mr Channon has discretion to refund to NFC the cost of rail and tube concessions for employees transferred to NFC from BR. This currently costs £2 million per year. Mr Channon proposes to include travel concessions in his negotiations with NFC.

7. Taking all Mr Channon's proposals together, the saving in public expenditure might be £30-40 million a year.

ISSUES

8. The first issue is whether the Sub-Committee agrees in principle that the Government should reduce its contributions to these pension funds. The principal arguments for reducing the Government's contribution are:

a. the £30-40 million of public expenditure cannot now be justified on pension schemes which are now in surplus. The original justification for the expenditure has entirely disappeared;



b. circumstances have changed. It is quite reasonable to review commitments made 8 years ago, in the light of the substantial growth in the value of pension funds over this period. No one could have foreseen the enormous improvement in the pension funds which have taken place since 1980;

c. action on NFC is justified, given its current financial strength. Action on BR is justified, given the need to put its operations on a normal commercial basis.

9. The main arguments for retaining the present levels of contribution are:

a. clear commitments were given by the Government in 1980. It will not be easy to go back on these, particularly when private shareholders in NFC would be disadvantaged. Mr Fowler expressed concern about going back on the 1980 commitment in a letter to Mr Channon of 9 March. He specifically requested a discussion at E(A). By contrast, we understand that Mr Clarke is relatively relaxed, and believes that the issues should be addressed on their current merits.

b. there could be an impact on future privatisations out of proportion to the £6.5 million per annum savings from NFC, if potential investors came to believe that Government assurances given in privatisation prospectuses are of little value. Mr Ridley made this point in a letter of 15 March to Mr Channon.

c. local authorities could claim that such an action by the Government gave them a precedent for evading some of their own pension obligations. Mr Ridley made this point too in his letter of 15 March;

10. The second issue is whether Mr Channon's proposal to open confidential negotiations with NFC is the best way of taking the decision forward (if approved). Mr Channon envisages that a deal with NFC might take the form of Government continuing to contribute



to non-funded schemes (£1.5m per annum) but stopping its contributions to funded schemes (£4.5m per annum). The Chief Secretary may suggest that any continued contribution could be commuted into a lump sum, to end Government involvement. Mr Channon may be concerned that this would mean paying in advance of need. If the proposal for confidential negotiations is approved, you may wish to ask Mr Channon and the Chief Secretary to pursue this bilaterally. You might also wish to ask Mr Channon what he would say if news of the negotiations with NFC were to leak.

HANDLING

11. You may wish to ask the Secretary of State for Transport to introduce his Memorandum. The Chief Secretary, Treasury could be asked to comment first. The Secretary of State for Employment, followed by the Chancellor of the Duchy of Lancaster, as the Ministers involved in the 1980 settlement, may wish to comment next. The Secretary of State for the Environment may suggest that there are consequences for the future privatisation programme, and for local authorities. You may wish to ask the Lord President of the Council, the Lord Privy Seal or the Parliamentary Secretary, Treasury whether they would expect any significant difficulty in passing the necessary legislation through Parliament.

R.T.J.W.

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