



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

A handwritten signature in blue ink, appearing to be 'M. S.', located to the right of the recipient's name.

INDEX-LINKED PENSIONS

We discussed recently Alan Walters' suggestion that membership of index-linked pension schemes should be optional. I said that, while there were always attractions in principle in flexible arrangements, they were outweighed in this case by the practical difficulties.

2. Clearly, somebody who opted out of the pension scheme would expect to be fully compensated in the form of higher pay. We should be pressed for the compensation to reflect not only his contribution as employee, but also the employer's contribution, on the grounds that it was just as much part of his remuneration, albeit deferred. If that were accepted, the pay increase for public servants opting out of their pension schemes could be some 15-20 per cent. On that basis, we could expect a great many people to opt out, particularly younger people. There would be a high public expenditure cost immediately, but the savings on pensions would not materialise for several decades.

3. There are other problems. For example, those who opted out of their occupational scheme would have to be contracted in to the State scheme, leading ultimately to higher expenditure from the National Insurance Fund. And many of those who opted out early in their careers would want to change their minds later. Generally



speaking, people's perceptions of the importance of pensions are directly related to their age. The main factor in determining the proportions who opted out would probably be the age composition of the workforce.

4. An alternative version would be to allow opting out of index-linking alone, which would raise a different set of problems. We would have no way of ensuring that future governments (stretching well into the next century) would in practice resist political pressure to increase the pensions of those who opted out of index-linking. If inflation were high, they might well be given ex gratia increases in some form, as happened before the present legislation. So the taxpayer could end up paying a good deal of the cost without benefiting from the contributions; and those who had paid contributions for index-linking throughout their careers would feel aggrieved, and would probably start demanding refunds.

5. A further practical problem is that our preferred scheme is in fact a levy to ensure that, beyond whatever is the current private sector practice, every penny of the cost of index-linking will be automatically paid not by the taxpayer but by the employees in the schemes concerned. This means that it could hardly behave as a price in the conventional sense, reacting to supply and demand, because whatever the take-up it is difficult to see a convincing argument for levying more than 100 per cent.

6. These are all real difficulties, and I doubt whether we would gain much credit by including this suggestion in our response to the Scott Report. It might

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well encourage strong union pressures in favour of these or other similar options, which we would then wish to resist. I should therefore prefer not to pursue it.

7. A copy of this minute goes to Alan Walters, to whom Adam Ridley has mentioned my concerns.

G.H.

(G.H.)

19 May 1982



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