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MS 5/9

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

5 September 1983

Miss Janet Lewis-Jones
Private Secretary to the
Lord President of the Council

Dear Janet,

MAKING THE PRINCIPAL CIVIL SERVICE PENSION SCHEME CONTRIBUTORY

The Chancellor will shortly be circulating a paper to Cabinet on public sector pensions policy for discussion at the meeting on 15 September. It will include a proposal that the Principal Civil Service Scheme should be made contributory, although the Chancellor is only seeking a decision in principle at this stage.

Since the subject may come up at the Cabinet meeting, your Minister may wish to see copies of the recent correspondence on the subject which I enclose.

I am copying this letter to David Heyhoe (Lord Privy Seal's Office) and John Lyon (NIO). I am also sending copies, without the enclosures, to the Private Secretaries of Cabinet Ministers who have already seen the correspondence.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

SEP 1983



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

11 August 1983

Brett Bonner Esq
Private Secretary to the
Secretary of State for Employment

J 12/8

Dear Brett,

MAKING THE PRINCIPAL CIVIL SERVICE PENSION SCHEME
CONTRIBUTORY

In the debate on the Scott Report on 22 October last year, the Minister of State, Treasury, said that the Government was attracted to the proposal in the Megaw Report on the Determination of Non-Industrial Civil Service Pay (Cmd 8590) that the Principal Civil Service Pension Scheme (PCSPS) should be put on to a contributory basis. I am enclosing a paper by the Official Group on the Megaw Report (MISC 84) which contains proposals on how such a change might be brought about. As you will see, it seeks authority only for the opening of negotiations on methods and leaves aside the important question of what the right employee contribution level should be.

The Chancellor does not believe that the question of the appropriate level of contribution to the PCSPS can be considered in isolation from other public service schemes for which the Government has responsibility. He will therefore shortly be putting proposals to Cabinet on how to carry forward the Manifesto commitment to a continuation of price protection of public sector pensioners "on the basis of realistic pension contributions". But he thinks that it should be possible to discuss with the unions the principle and the means of turning the PCSPS contributory in advance of decisions on the level of contribution, provided it is recognised that such decisions are still necessary.

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The Chancellor would therefore like now to confirm the Government's commitment in principle to a contributory scheme and to authorise the opening of negotiations with the Civil Service unions. He understands that the unions themselves are expecting such an initiative. Thus, unless he hears from colleagues to the contrary by 24 August, he proposes to ask officials here to proceed in conjunction with officials of other Departments as appropriate.

I am copying this letter to the Private Secretaries to other members of MISC 83 and to Michael Scholar (No 10), David Staff (Lord Chancellor's Department), Roger Bone (FCO), Hugh Taylor (Home Office), Stephen Williams (DES), Derek Hill (NIO), Caroline Brookes, (D/Energy), John Wilson (Scottish Office), Judy Roberts (Welsh Office), Roger Bright (DOE), Caroline Varley (DTI), Alex Galloway (Chancellor of the Duchy's Office), Andrew Melville (D/Transport), David Dawson (MAFF) and Richard Hatfield (Cabinet Office).

Your sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

CCNO

From: THE PRIVATE SECRETARY

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MBPM

MUS 2/9

HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

30 August 1983

Dear Margaret,

MAKING THE PRINCIPAL CIVIL SERVICE PENSION SCHEME CONTRIBUTORY

The Home Secretary has seen your letter of 11 August to Brett Bonner, setting out the Chancellor's proposals for negotiations with the civil service union on how the PCSPC could be made contributory.

He sees no objection to discussions being opened with the trade unions on the modalities, but he is concerned that, in preparing for these negotiations full account should be taken of the position of prison officers under the PCSPS and the problems which could arise for them under a contributory scheme. There will need to be close liaison between the Treasury and the Home Office Prison Department on this matter.

In view of the Home Secretary's responsibilities for the pension schemes for the police and fire services, he welcomes the Chancellor's view that the appropriate level of contribution by civil servants should not be considered in isolation from other public service sector schemes for which the Government has responsibility. You will recall that contribution rates in the police and firemen's pension schemes were recently increased significantly.

Copies of this letter go to Brett Bonner and the other recipients of your letter.

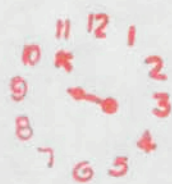
Yours sincerely
Hugh Taylor

H H TAYLOR

Miss M O'Mara

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1 - SEP 1983





miss (v)

*It seems inevitable
that the general
principles will
have to be discussed*

With the Compliments of
the Private Secretary to
the Minister of State

in Cabinet

before this

*particular aspect
can be agreed*

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House

Elephant and Castle

London, S.E.1.

WJ
20/8



DEPARTMENT OF HEALTH AND SOCIAL SECURITY
 Alexander Fleming House, Elephant & Castle, London SE1 6BY
 Telephone 01-407 5522

From the Minister for Health

Miss Margaret O'Mara
 Private Secretary to
 The Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 London
 SW1P 3AG

25th August 1983

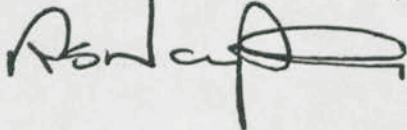
Dear Margaret,

MAKING THE PCSPS CONTRIBUTORY

In the absence of Mr Fowler, the proposal in your letter of 11 August has been considered by Mr Clarke and Dr Boyson. I have to let you know that both feel this matter needs some collective consideration by Ministers before discussions are opened up with the Civil Service unions. We are of course concerned here from a number of points of view: the implications for other parts of the public sector (in our case, the NHS); the implications for civil service industrial relations; and the implications for the mounting debate on reform of the occupational pensions sector and the problem of the early leaver.

The circulated paper concentrates on the civil service problem: but your letter accepts that this cannot be studied in isolation from other public sector schemes. Ministers do of course understand that the immediate proposal is to open discussion only on "modalities" and structure, and not get into the key issues of effects on contribution and pay. But it seems to them that Ministers should have an opportunity to consider the Government's stance on these issues before discussions are opened up with the unions. The whole issue could have important implications for the NHS and seems likely to have consequences for the Government's approach to wider public sector pay issues which ought to be explored further.

I am copying this to the recipients of your letter.

yours sincerely


ROBIN NAYSMITH
 Private Secretary

26 AUG 1985

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5 6 7 8 9



CABINET OFFICE

From the Minister of State

Lord Gowrie

MANAGEMENT AND PERSONNEL OFFICE

Old Admiralty Building

Whitehall

London SW1A 2AZ

Telephone 01-273 4400

Miss M O'Mara
PS/Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

22 August 1983

Dear Margaret,

MAKING THE PRINCIPAL CIVIL SERVICE PENSION SCHEME CONTRIBUTORY

We have now seen a copy of your letter of ^{MCS?} 11 August to the Private Secretary to the Secretary of State for Employment about the Civil Service Pension Scheme.

Lord Gowrie very much welcomes the Chancellor's proposal to confirm the Government's commitment in principle to a contributory pension scheme and to authorise the opening of negotiations with the Civil Service unions on the terms described. Not only is the reform desirable in itself but, as the Chancellor indicates, it is the way in to much wider reform of pension contributions across the public services - to the potential benefit of the Exchequer.

Two further points. First, the Cabinet Office (MPO) is committed to seeking abolition of the compensation payable to civil servants dismissed on grounds of inefficiency. As such payments are made through the mechanism of the PCSPS, change requires either agreement with the unions or primary legislation. It is inconceivable that the unions would agree to the necessary changes in isolation but they might well be brought to accept them in the context of a broader reform of the PCSPS as a whole. We would wish to seize the opportunity of the new negotiations to achieve this particular objective among others.

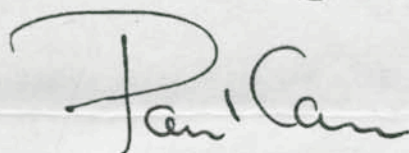
The second point is simply to record that the Cabinet Office (MPO) - given its responsibilities among other matters, for retirement and redundancy policy across the Service - has a considerable and direct interest in the policy issues discussed in the MISC 84 paper and in the proposed negotiations with the unions. This interest

/would be best

would be best reflected if our officials could be associated with, and as necessary take part in, those negotiations.

I am copying this letter to the recipients of yours.

Yours sincerely,

A handwritten signature in cursive script that reads "P L Cann". The signature is written in dark ink and is positioned below the typed name.

P L CANN
Assistant Private Secretary

Lab of Civil Service & Pay + Pensions

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22 AUG 1968

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Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213.....6400.....

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Margaret O'Mara
 Private Secretary to
 the Chancellor of the Exchequer
 HM Treasury
 Great George Street
 LONDON SW1

19 August 1983

Dear Margaret

MAKING THE PRINCIPAL CIVIL SERVICE PENSION SCHEME CONTRIBUTORY

Thank you for your letter of 11 August. My Secretary of State is away next week and will not be able to consider these issues fully by 24 August. Moreover he believes that the question of whether to move to a contributory scheme, and if so how, cannot be readily separated from questions about how the scheme is to be costed and about whether effective pension contributions should be increased. He would therefore prefer to consider the issues raised in your letter when he has had an opportunity to see the Chancellor's forthcoming proposals, which we understand are likely to be discussed in Cabinet on 15 September, about public sector pension policy generally.

He appreciates that this approach may mean that it will not be possible to start discussions with the Civil Service unions until after 15 September. But he believes that this delay would bring with it the important compensating advantage that the Government's broad policy on how the scheme is to be costed and on contribution levels will have been established in advance. In his view these issues are bound to be raised by the unions very quickly.

I am copying this letter to the Private Secretaries to other members of MISC 83 and to Michael Scholar (No 10), David Staff (Lord Chancellor's Department), Roger Bone (FCO), Hugh Taylor (Home Office), Stephen Williams (DES), Derek Hill (NIO), Caroline Brookes (D/Energy), John Wilson (Scottish Office), Judy Roberts (Welsh Office), Roger Bright (DOE), Caroline Varley (DTI), Alex Galloway (Chancellor of the Duchy's Office), Andrew Melville (D/Transport), David Dawson (MAFF) and Richard Hatfield (Cabinet Office).

Yours sincerely
Brett Bonner

BRETT BONNER
 Private Secretary

Civil Service
Pay P+13

2 - AUG 1983

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MAKING THE PRINCIPAL CIVIL SERVICE
PENSION SCHEME CONTRIBUTORY

Note by the Chairman

Among its other recommendations the Megaw Committee concluded that

a provided this can be introduced at no additional cost to public funds, the basis by which civil servants contribute to their pensions should be one whereby a direct contribution is made from the pay actually received to cover the whole of the employee's share of pension costs. Both the employee's and employer's share should be publicly declared;

b the Government should make its decision on the appropriate pension contribution rates with the help of an assessment by the Government Actuary on the rate which would be needed in a funded scheme to support civil service benefits.

2 There is of course a long background to this issue (going back at least to the Scott Report and embracing both Ministerial consideration of the work of the Official Committee on the Valuation of Pensions (VP) and the decisions to increase the pension contributions by the police and fire services). The Government's initial position on the Megaw recommendation was expressed to the House of Commons on 22 October 1982 by the Minister of State Treasury Mr Hayhoe who said that the Government were "attracted by the proposal to make the civil service scheme contributory"; that "few would dissent from the proposition that public service pension schemes should be based upon fair contributions from those concerned. In this context the cost of pensions increase must be included as well as the cost of basic pension"; and that "there would be no question of uncovenanted benefits or windfall gains going to civil servants as a

result of a change to a contributory scheme".

3 The Conservative Party Manifesto stated

"In the next Parliament we shall continue to protect retirement pensions and other linked long-term benefits against rising prices. Public sector pensioners will also continue to be protected on the basis of realistic pension contributions".

4 The attached report by the Official Group on the Megaw Report (MISC 84) seeks Ministerial authority for the opening of discussions with the civil service trade unions about the modalities of making the Principal Civil Service Pension Scheme contributory. The discussions will be unlikely to come to a conclusion about the "realistic" level of contribution and any associated offsetting pay increases for many months. As is common with reports of this kind the departments who took part in its preparation have fully reserved the position of their Ministers.

E P KEMP

HM Treasury

6 July 1983

MAKING THE PRINCIPAL CIVIL SERVICE
PENSION SCHEME CONTRIBUTORY

This paper considers the next steps in pursuing the suggestion in the Megaw Report (para 19 of the Summary of Recommendations) that

"Provided this can be introduced at no additional cost to public funds, the basis by which civil servants contribute to their pensions should be one whereby a direct contribution is made from the pay actually received to cover the whole of the employee's share of pension costs. Both employee's and the employer's share should be publicly declared."

2 At the moment civil servants do not make any explicit contribution towards their pensions apart from the $1\frac{1}{2}$ per cent deduction for widows and any payments they make for added years. However, as the Scott Report pointed out, civil servants have been making an "effective contribution" of around 8 per cent of pensionable pay as a result of the pay comparability system which was in operation until 1980. In the debate on 22 October 1982 the Minister of State, Mr Hayhoe, said that much of the earlier misapprehension about civil servants not paying for their pensions had abated as a result of the two reports. He said that nevertheless misunderstandings were almost bound to continue and the Government were therefore attracted by the proposal to make the scheme contributory. Members from all sides of the House generally supported the suggestion, and at a subsequent meeting of the Joint Official and Trade Union Side Committee on Superannuation the Trade Union Side raised no objections in principle.

3 The next step, on the assumption that Ministers agree will be to open discussions with the trade unions on the basis of proposals by the Government, and in the following paragraphs, we suggest how this should be done. Since the principal object is to make the system more overt, we would not be proposing any large scale reform of the level of benefits.

At the end of the day, if a contributory scheme were introduced, the method of financing would be changed, but the individual civil servant ought not to notice much difference. We would not want to propose changes which would interfere with the planned computerisation of the pension awarding process which is at present in train, or incur large scale extra administrative costs. On the contrary we should take the opportunity of introducing simplification where possible, with a view to making the whole system less costly and more efficient.

4 Legislative Powers

Section 1 of the Superannuation Act 1972 empowers the Treasury to "make, maintain, and administer schemes (whether contributory or not)". No further legislation is therefore required to set up a contributory scheme. It could be done by making a scheme amending the existing PCSPS which would then be laid before Parliament under the negative resolution procedure.

5 There are however a small number of civil servants (about 2,200) who have legally enforceable contracts of employment entitling them to rates of pay determined by wages boards or linked to outside analogues who, in the main, are not covered by occupational pension schemes. Because the current rates of pay of these people do not take account of the superannuation cover they enjoy, it might not be legally possible, without their individual consent, to increase their pay to the extent necessary to ensure that contributions could be paid without loss of take-home pay. With this exception, which could be put right when a suitable legislative opportunity occurred, perhaps in a Miscellaneous Provisions Bill, we see no need for general legislation on the PCSPS, and would hope that the basis of the contributory scheme could be agreed with the trade unions, and introduced as an uncontentious matter.

6 Method of Measurement

Most private sector pension schemes, and some in the public sector, are funded. Actuaries determine the amount of money that would be required to meet the liability for future benefits and recommend the rate of contribution which is necessary to achieve this. The split of the contribution rate between employer and employee is then a matter for negotiation. From time to time, usually at intervals of 3 to 5 years, new actuarial assessments are made to ensure that the fund is still solvent. Contribution

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and benefit levels may then have to be reconsidered but, in practice, deficits have normally been financed by increased employer contributions.

7 As far as the PCSPS is concerned, although a funded scheme is the obvious way of making the whole system overt, we recommend strongly against it. One of the principal reasons for funding pensions in the private sector is to ensure security for the superannuation of employees against the bankruptcy of their firm, a point which does not arise with the Government's own employees. To fund existing liabilities would involve an enormous addition to defined public expenditure and cause a major upheaval in capital markets. The unions are likely to press for a funded scheme for they could then demand a formal share of control as trustees and play a part in investment policy, but we propose to refuse this. We propose that the civil service scheme should remain non-funded.

8 Megaw assumed (20 of the Summary) that the Government would make its decision on the appropriate pension contribution rates with the help of an assessment by the Government Actuary of the new entrant rate which would be needed in a funded scheme to support civil service benefits. In assessing the total costs of the scheme under such an arrangement, the Government Actuary would include the costs of index-linking as well as all the other superannuation benefits available under the scheme. This would give similar results to a funded scheme without the difficulties of a real fund.

9 Megaw also recommends (Recommendations 21 and 22) the GA should be required to consult the profession on his assumptions and to submit his arguments and calculations to the scrutiny of the Pay Information Board, and we agree that this should be done, as a further help to making the whole matter more overt.

10 No final decision need be taken at this stage on the method of measuring the costs of the scheme, but we are attracted to the Megaw proposal as a straightforward and economical method, and one which would permit decisions to be taken from time to time on appropriate changes in contribution rates when these were needed to reflect changing circumstances. Although (as mentioned in para 6) the private sector find it difficult to change benefit levels or employee contribution rates, it would be desirable for the PCSPS to take the lead in introducing this practice and for it to be extended to other public service schemes in due course.

11 The choice of a method of measurement does not, of course, imply any decision on methods of financing or on how these should be divided. The Megaw method, would if adopted, concentrate attention on the total costs of benefits, rather than on the index-linked element as such. This would be in line with the Government's policy statement in the debate on 22 October which was widely welcomed

"Much of the public concern about public sector pensions is focused on the cost of index linking and there is understandable resentment at any additional burden upon taxpayers as a result. Few would dissent from the proposition that public sector pension schemes should be based upon fair contributions from those concerned. In this context, the cost of pension increases must be included as well as the cost of the basic pension."

12 In 1981 and early in 1982 Ministers considered the possibility of introducing a special charge for members of public sector schemes to cover the additional cost of pensions increase as compared with uprating arrangements in the private sector. Employee contributions could, however, be assessed to cover both basic benefits and pensions increase costs. Both costs were included in the costs of the police, fire service and Armed Forces schemes, on the basis of which the higher contribution levels for these fast accrual schemes have been determined. Final decisions on the method by which employees contribute towards the cost of pensions increase do not need to be taken at the moment but, in order that discussions with the civil service unions can make progress, it is necessary to make an assumption about how the benefits of the civil service scheme should be measured. We propose that the Government should adopt as a working assumption that the PCSPS should be costed on a basis that includes the cost of pensions increase in the way assumed by the Megaw Report.

13 Non Superannuation Benefits

At the moment, for the sake of convenience, civil service redundancy terms and provision for injury benefits are included in the PCSPS. These payments which are the financial responsibility of the employer raise different issues from superannuation, and it would help the general objective of reducing the scope for misunderstanding if they were to be treated separately in the new arrangements. We recommend that this should be done.

14 Financial Effects

The present scheme is a "terminal salary" scheme with benefits based on length of reckonable service and pensionable pay at the time of leaving. A contributory scheme would be similar but with contributions levied on pensionable pay throughout reckonable service. Since however existing civil servants are deemed to have received reduced rates of pay in the past to take account of the non-contributory nature of the scheme, gross pay will need to be increased before contributions can be levied. If nothing further were done, pensionable pay would therefore be higher and ipso facto attract increased benefits. This would obviously be wrong, and the Minister of State made it clear in the debate that there could be no question of uncovenanted benefits or windfall gains going to civil servants as a result of the change in the method of financing. The object therefore is to devise a package which will ensure either that benefits as a whole are not increased or that any increase in benefits is paid for by increased employee contributions. In practice it is difficult to measure the Exchequer effects precisely, given that the effects of changes are spread over several decades, but the objective should be to ensure that in the early years there will be no increased expenditure (A substantial inflow is much more likely). Furthermore the position of individual members of the scheme is bound to be substantially different from what it would otherwise have been, even if the changes as a whole are broadly neutral.

15 The crucial question will be how the costs should be divided between employer and employee. At present because the information on the 'effective contribution' is several years out of date we no longer have a way of determining precisely what the present employee contribution is. There is of course no objective "right" level of employee contributions. Some comparison with private sector practice will obviously have to feature in any negotiation. This varies considerably from scheme to scheme and over time. In 1975, the average ratio of employee to employer contributions in private sector schemes was about 1 to 3 but, by 1979, it was nearer 1 to 4. Levels of benefits and particularly the availability of pensions increases should be taken into account and there should be no presumption that the civil service should adopt the private sector average. The unions could be made to face up to the fact that there is a choice to be made between the levels of income civil servants wish to enjoy whilst at work and the benefits they want after retirement.

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16 We presume that the Government's objective will be to set the contribution rate at as high a level at least as it was assessed under pay research, and probably higher. Purely for illustration, since these questions do not have to be decided for some time, if we take the cost of the present scheme as 20 per cent of salary, of which $1\frac{1}{2}$ per cent is already met by employees directly through their contributions, the Exchequer would be all square if the employee contribution were raised to $8\frac{1}{2}$ per cent and pay increased by about 6 per cent. (The figure of $8\frac{1}{2}$ per cent is chosen as the "effective contribution" under the old pay research, and the figure of 20 per cent is the Government Actuary's Department rough estimate of the current cost of the scheme, bearing in mind the recent fall in the expected real rate of return on investments.) Such an outcome would however imply a reduction in the take-home pay of civil servants of about 1 per cent which could be represented as an additional contribution towards the 6 per cent increase in benefits which the increase in gross pay would entail.

17 In theory it ought to be possible to separate the questions of pension contributions and corresponding pay increases on the one hand from the more general questions of annual pay determination on the other. However in practice the two are bound to come together in negotiation, and it is probably right that they should. This question too is for later.

18 Other Changes

Although the general objective is not to alter the essentials of the scheme, we should take the opportunity of the change to include a number of lesser reforms intended to improve the scheme as a whole and reduce costs.

19 We should for example try to remove the present differences between the treatment of men and women civil servants which will probably, in any case, have to be removed within a few years as a result of changes in the general law. We would require men and women to pay the same percentage rate of contributions and provide widowers' pensions on the same basis as those now provided for widows. Given that women generally live longer than men, widowers' pensions would be unlikely to be a costly addition, but they would be included as part of the extra costs to be taken into account in assessing the contribution rates. We should not assume that a proposal to treat men and women civil servants equally in this respect will necessarily be welcome to the Trade Union Side.

20 We should also seek to simplify the present calculation of "pensionable pay" to bring it as far into line as possible with actual pay. This will involve going through all the allowances and other emoluments which are at present additional to basic pay, including London Weighting and officially provided accommodation and uniforms, and determining how far they should continue to be pensionable. Here again any changes would be reflected in the final calculation of the costs of the scheme and of the required contribution levels.

21 The Trade Union Side have a number of claims which could also be drawn into the negotiation, although in theory they could be kept separate. They include

a a move to pensions based on 1/60th of pensionable pay with an option to commute instead of the present 1/80th pension with lump sum;

b an improvement in the death-in-service benefit which at present is lower than the generality of outside schemes.

The presumption would be that the additional costs of any such improvements to the general level of benefits, if they were to be agreed, should fall entirely on the employee contribution, but we would try to convince the unions that the move to a contributory scheme should not be complicated unnecessarily by including such major changes in the process.

Integration with the State Scheme

22 The civil service scheme is contracted out of the earnings-related additional component element of the State scheme and members do not therefore receive dual benefits under both schemes for the same periods of service. Many schemes in the private sector also have a pension benefit formula which incorporates an adjustment to allow for the fact that retired members will receive the basic or flat-rate State retirement pension. Such an adjustment was included in the civil service and other public service schemes when universal national insurance pension arrangements were introduced in 1948 but the adjustment was not modified to keep pace with subsequent increases in the basic State pension. As a result public service pensions fell to be reduced by only a small part of the basic State pension and even this reduced level of adjustment was dropped in respect of service after April 1980.

23 It would be possible to suggest that PCSPS benefits should again be adjusted to take account of current and future level of the basic State pension implying that contributions would then be lower than would otherwise be the case. This raises however very large questions about the right total income which ought to be provided for the retired and it has important economic and financial implications. Moreover it is a general question which is of concern to all ^{public service} occupational schemes. To raise it in the context of a move to a contributory PCSPS would complicate the issue unmanageably. We should however ensure that nothing is done which might prejudice future decisions on this complex topic.

A Separate Scheme for Industrial Civil Servants

24 The provision of superannuation benefits for industrial civil servants raises different problems from those of non-industrials. There is a case for moving to two schemes, and we recommend that this should be explored with the unions in the context of a move to a contributory scheme.

25 An Annual Report?

Much of the difficulty in recent years has arisen from lack of readily accessible information about the PCSPS and how it is financed. We think it would be useful each year to bring the facts together in an annual report which would give Parliament, the trade unions, and the public, the statistics on levels of benefits, numbers of beneficiaries, costs, contributions and other matters at present scattered in various documents. This report would supplement the information given in Estimates and elsewhere and would not by itself be a formal part of the parliamentary control machinery. In practice it would be akin to a report by trustees on the operation of a pension scheme.

26 Transitional Problems

If pay were to be increased as part of the move to a contributory scheme, civil servants retiring immediately after the date of the change would receive a windfall increase in their superannuation benefits. The contributions paid by civil servants still in service would pay for these in the long run, but it would nevertheless be wrong to allow large windfall gains to occur simply as a result of a change in the method of financing. The windfall could be obviated completely only by providing that benefits in respect of reckonable service before the changeover date should be calculated on a different basis for those payable in respect of later

service, but this would be tantamount to running two separate schemes for as long as existing civil servants remain in the service. We think that the best solution is to provide for a transitional period of say 5 years, during which the increases in pay would be treated as a compensatory allowance and absorbed into pensionable pay on a tapering scale. The extra benefits remaining would be one of the elements to be taken into account in the final calculation of the costs of the scheme and of the contribution rates. There is bound to be an element of rough justice in such a changeover but there is no way of making the transition quickly which does not involve changes to the position of individuals.

27 Inland Revenue rules limit employee contributions to 15 per cent of pay. Civil servants already contribute varying amounts towards the cost of added years and for back-service credit for widows' pensions. A contribution for basic benefits might, therefore, involve a breach of the Inland Revenue limit. But this and other transitional problems can be considered in detail in the discussions with the unions and need not be spelt out in this paper.

28 Discussions with the Trade Unions

If the policy is confirmed, then the next step would be to open discussions with the trade unions on the basis of a paper provided by the Government. The objective would be to try to separate discussions on the modalities of introducing a contributory scheme from the much more difficult questions about possible increases in gross pay and the level of employee contribution. It would not be possible, in any case, to have sensible negotiations on pay and contribution levels until all the other changes had been tentatively agreed and costed so that the pluses and minuses could all be taken into account in the final negotiation. The unions might be unwilling to negotiate on this basis, and might ask for guarantees about the future of index linking, but as the Government made clear in the debate, it is not right to separate questions about the levels of benefits from the methods of financing, and there are real choices to be made about the extent to which employees want to give up current income in the expectation of future benefits. We would seek to convince the unions that it is in their interests to move to a contributory scheme which would tend to remove the misapprehensions of recent years and make their benefits more secure.

29 Timing

If the policy is agreed, we could put a paper to the unions at once. If the unions agreed to concentrate on modalities, then it might be possible to complete discussions in time for a substantive negotiation on numbers to coincide with those on the 1985 pay settlement.

30 Effects on Other Schemes

This paper is concerned solely with the PCSPS and with Megaw since that is the remit of MISC 84 and MISC 83. However whatever is decided for the civil service will have repercussions for the other public service schemes and it is right that this should happen. As the Minister of State said on 22 October, in commending a contributory scheme, 'This will make it much easier to see the link with pay and to compare the position of civil servants with that of other groups.' Civil servants are likely to be unwilling to pay a higher level of contribution for similar benefits than members of other public service schemes. It will be necessary at some stage to link the main public service pension issues together so that the policy announced on 22 October can be taken forward on all fronts, without permitting different groups to get too far out of line with one another. Treasury Ministers will be putting forward proposals on how to do this separately if this paper is approved.

31 Summary of Recommendations

We recommend

- a that discussions should be opened with the civil service trade unions on the modalities of making the civil service pension scheme contributory;
- b the aim should be to devise a structure, but not settle the critical questions of contribution levels and pay uprating until all the other factors had been explored and costed;
- c we should try to avoid large windfall gains and losses although within the scheme as a whole the position of individuals is bound to be altered;
- d the scheme should not be funded. For the purpose of the discussions, we should adopt the Megaw assumption on the method of measurement, namely the Government Actuary's estimate of the new entrant contribution rate necessary to finance the total benefit.

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e the scheme should prepare an Annual Report which will bring together information on benefits, costs, and the split of costs between employer and employee;

f it will be necessary to coordinate progress on the PCSPS contributory scheme with the Government's plans to introduce 'fair' contributions for the other public service schemes with similar benefits, so that the policy described in Parliament on 22 October 1982 makes progress on all fronts.

HM Treasury

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↑ AUG 1967

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