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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

CIVIL SERVICE PAY RESEARCH

Memorandum by the Lord President of the Council

1. This paper considers the position of the Civil Service non-industrial pay research system in the light of our wider economic objectives.

The point at issue

2. The principle on which pay research has operated since its inception in 1956 is that Civil Service pay should be based on "fair comparison with the current remuneration of outside staffs employed on broadly comparable work taking account of differences in other conditions of service". The note at Annex A describes how the system works in practice, and the arrangements that have been made to introduce greater openness about its procedures and to demonstrate its independence. The main point at issue is whether pay research should be continued and, if so, how it should be modified to meet our wider objectives.

3. We require a system which enables the Government to recruit and retain the staff it needs and which is as demonstrably fair as possible to civil servants and tax payers alike. Alternatives to pay research would either prevent Civil Service pay from responding to differential movements in the outside market for different types of staff, or would increase the scope for argument by the unions by relaxing the disciplines of the pay research system, which is based on detailed job for job comparisons.

4. The graph at Annex B illustrates how Civil Service pay has moved over a period of years in line with or rather below general movements in outside earnings. Larger increases in particular years are indicated when the normal cycle has been too long or has been interrupted and there is consequently a large element of catching up. The average increase this year was contained within 25% by the discipline of the system when 30% or more was indicated by the movement in the general indices of outside pay movements. To move away from pay research would give the unions the opportunity to pray in aid such general indicators whenever it suited them.

5. The militant elements in the unions would like to see an end to pay research which they regard as a restriction on their negotiating freedom. They would prefer to test their industrial muscle in an annual punch up. The influence of these elements has been strengthened by the events of last winter. In my view we should avoid playing into the hands of the militants, which would be the effect of repudiating pay research. To restore the morale of the moderates we need to assure them that we intend to treat the Civil Service fairly, and not interfere arbitrarily in the normal operation of the pay system. The main difficulties with pay research arise when it shows percentage increases in particular years markedly out of line with the going rate elsewhere but if it is allowed to operate annually there is no reason to expect it to throw up exceptionally large increases or to give rise to inflationary expectations elsewhere.

6. There is no practical alternative to pay research which does not carry worse risk of inflationary settlements. A number of changes could, however, be made with advantage to the way pay research operates.

Pensions

7. There is wide concern that index-linked pensions give civil servants and other public sector workers an advantage which cannot be obtained by many in the private sector. If index-linking is to continue it is essential that full account is taken and is seen to be taken of this benefit when pay is determined. In the case of the Civil Service, a pay deduction is made on the basis of an independent assessment by the Government Actuary. A note by him on his published report is at Annex C. The public presentation of this aspect of pay research would be much improved if the Government Actuary's report was reviewed authoritatively by some independent representative of the wider public interest. Since the pensions issue cannot be wholly separated from the question of pay, I suggest that the Pay Research Unit Board (suitably strengthened) might perform this role.

Independence

8. Generally there is a need to strengthen the visible independence of the system. I should like to see

- a. significant strengthening of the independent membership of the PRU Board, including giving the Chairman the right to exclude the non-voting members from the management and union sides where he thought it appropriate to do so;

- b. the appointment of an outsider as the next Director of the Unit. (The present Director is due to retire in 1981).

No-strike agreement

9. In principle, I should like to see a no-strike agreement in the Civil Service. The unions will not, however, readily surrender their most powerful weapon. The price they would seek to extract might well be much too high. At the very least they would want unqualified guarantees about future implementation of pay research and recourse to arbitration. However Civil Service pay is fixed, we would need to retain some right to override the normal pay system for reasons of overriding national importance. If however we decide to go for no-strike agreements more generally, I will certainly wish to pursue the possibilities in the Civil Service.

Cash Limits

10. We said in our Manifesto that pay research would have to be reconciled with cash limits in consultation with the unions. The Chancellor has prepared a separate paper on the general question. In the case of the Civil Service the issue is whether the assumption on pay in cash limits governs the outcome of the pay negotiations or vice versa. I see no way of reconciling pay research or, for that matter, arbitration with an arbitrary pay assumption made ahead of the pay negotiations. In my view the right approach is to incorporate a nil assumption for Civil Service pay increases when the cash limits are published, and decide after the settlement how far the limits need to be revised. This would keep all our options open for as long as possible. The alternative of fixing a limit without reference to pay research would make much more difficult the task of restoring Civil Service morale and would unite the staff behind their unions in a major confrontation with the Government.

Conclusion

11. I invite my colleagues to endorse the analysis in this paper, and to agree that:

- a. pay research should be retained;
- b. we should aim to bring about the changes set out in paragraphs 7 and 8 above after discussions as necessary with the Civil Service unions.

CS

Civil Service Department
Whitehall
LONDON SW1A 2AZ

5 July 1979

THE PAY RESEARCH SYSTEM

1. The pay research system was adopted following the report of the Priestley Royal Commission in 1956. The report recommended that the primary principle in determining Civil Service pay should be fair comparisons with the remuneration of outside staff engaged on comparable work, taking account of differences in conditions of service. It is the task of the Pay Research Unit (PRU) to collect the facts about outside pay and conditions for similar work based on detailed job for job comparisons. The Unit is independent of both management and unions; it does not make recommendations about Civil Service pay but merely reports the facts to the negotiating parties. This year for example it submitted 481 reports on the main groups in the pay system. Just under 550,000 civil servants are affected by pay research of whom about two-thirds are directly included in the pay research programme.

2. After the reports have been received by the negotiators, the information they contain is processed according to precise rules in the Civil Service Pay Agreements. Adjustments are made to each outside rate to take account of quantifiable differences in conditions of service including pensions contributions, fringe benefits and London Weighting. Negotiations then centre on the median of the adjusted rates, at which stage unquantifiable differences are taken into account and weight is given to factors such as relative job security and accountability.

CHANGES MADE TO PAY RESEARCH IN 1977

3. Following a searching review a number of changes were made to the pay research system, after negotiation with the unions, as the price for its restoration for the April 1979 settlement. A greater independent element was introduced with the establishment of the Pay Research Unit Board to oversee the activities of the Unit. The composition of the Board is as follows:

Chairman:	Lord Shepherd	
Deputy Chairman:	Sir Derek Rayner	
Other independent voting members:	Professor Rodney Crossley	
	Mr Lief Mills	
	Baroness Pike	
Non-voting members:	Mr F G Burrett	} CSD
	Mr J E Pestell	
	Mr W L Kendall	} NSS
	Mr P L Avery	

Director of the PRU ex officio

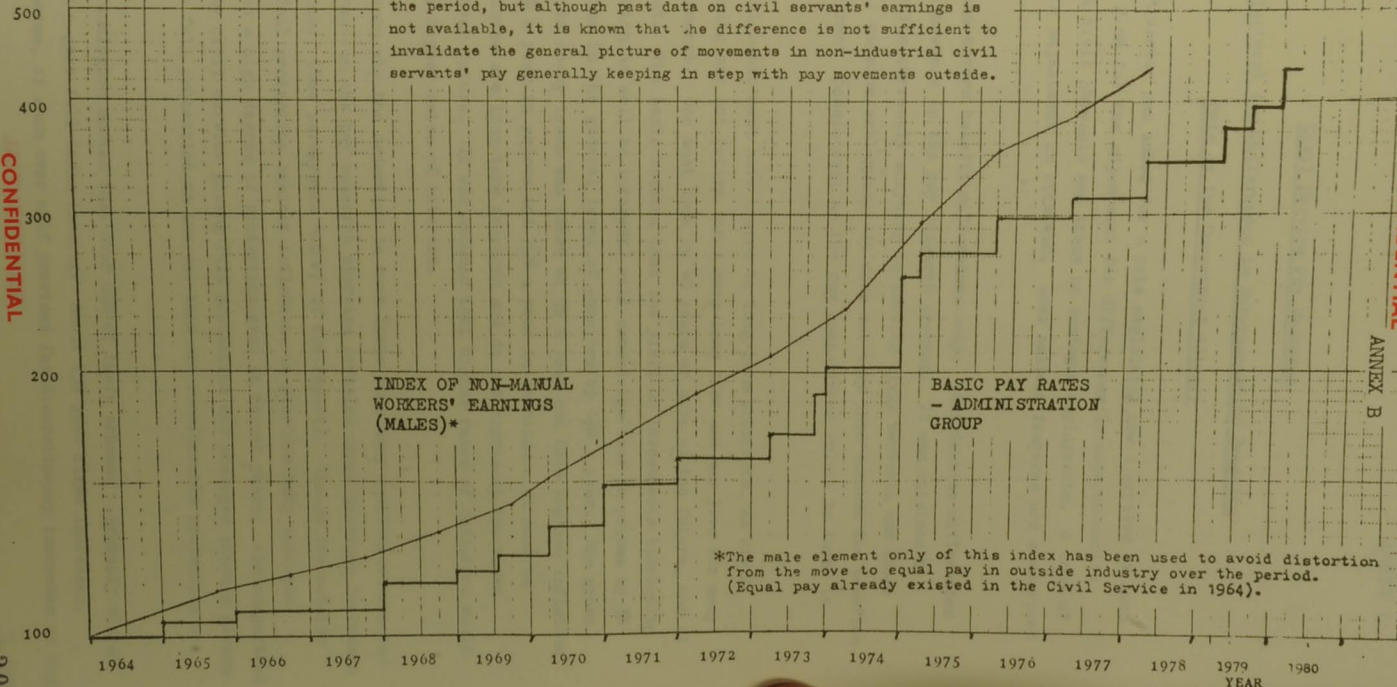
The Board has published its first annual report on the work of the Unit, as it was agreed it should in the interests of greater openness about the system.

4. To achieve further independence, outsiders were also appointed to the Unit Staff. At present five of the survey officers come from outside the Civil Service, of whom two were directly recruited and three are on loan from outside firms. The latter are paid the salaries they would be receiving in their outside employment. Four technical advisers are also from outside the Service.
5. Other changes to the system included increasing the size and scope of the fields of outside organizations surveyed to include more small and medium sized undertakings and placing the responsibility for choosing fields firmly on the Director of the PRU. Provision was also made for the Government Actuary to publish a report on his assessment of the deduction for pensions benefits.

CIVIL SERVICE PAY RATES AND THE NON-MANUAL EARNINGS INDEX

The extent to which Civil Service pay appears to lag behind pay rates outside is of course affected by the starting year chosen. 1964 was the time of the first pay research settlement after figures for the national movement in non-manual earnings became available. Civil servants' earnings may have increased more than basic pay over the period, but although past data on civil servants' earnings is not available, it is known that the difference is not sufficient to invalidate the general picture of movements in non-industrial civil servants' pay generally keeping in step with pay movements outside.

INDEX NUMBERS
(1.1.64 = 100)



INDEX OF NON-MANUAL
WORKERS' EARNINGS
(MALES)*

BASIC PAY RATES
- ADMINISTRATION
GROUP

*The male element only of this index has been used to avoid distortion from the move to equal pay in outside industry over the period. (Equal pay already existed in the Civil Service in 1964).

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ANNEX B

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Civil Service Pay ResearchAdjustment for Differences in Superannuation BenefitsNote by the Government Actuary

1. The Prime Minister has asked for a note explaining how I arrived at such a low figure as 2.6% for the adjustment for differences in superannuation benefits between civil servants and those in analogue employments. A copy of my report on this adjustment is attached; some salient features are summarized below.
2. The deduction covers benefit differences only; contribution differences are dealt with elsewhere in the pay research process. It was obtained by valuing the benefits currently accruing to serving civil servants and those accruing to their outside analogues. It does not take into account the benefits being paid to current pensioners, as the pay comparisons relate to those in service now.
3. The actuarial basis must have regard to long-term prospects, as civil servants now serving may not retire for a very long time and may live for many years after retirement. One must look to 40 years or more of the future, not at the immediate past. The basis assumes that the yield on investments (including capital appreciation as well as interest) will exceed the rise in prices by 3% a year and the rise in the general level of earnings by 1½% a year. The gross rate of interest in money terms was taken at 9% a year and this implied inflation rates of about 6% a year in prices and 7½% a year in earnings. It must be emphasized that these are long-term averages and do not represent the rates expected in the near future. It was assumed that higher rates of inflation would be accompanied by higher rates of interest.
4. The main reason why the deduction is much lower than many would have expected lies in the information the pay research exercise revealed about pensions increases in analogue schemes. (See paragraphs 4.6 & 7 of the report). Though few outside schemes promise full protection against inflation, in practice many analogue schemes have given a high degree of protection even in recent years; the comparison is not between the civil service giving full protection and analogue schemes giving none, but between full protection on the one hand and considerable protection on the other.
5. Analysis of analogues showed that over 20% of their schemes - probably almost all public sector - gave full index-linking. About 25% gave fixed increases, commonly 3% per annum, of whom over half provided for discretionary increases on top.

About 45% provided for discretionary increases only, and under 10% made no provision. Schemes which gave discretionary increases covered about 60% of the rise in the cost of living on average. One-third of all analogues gave 80% protection or more.

6. Where a scheme is contracted-out, the Guaranteed Minimum Pension will receive full price protection through the State scheme. For the balance of pension over this level, it was assumed that any fixed percentage increase would continue to be given, and that, in relation to the Retail Price Index, employers would give the same discretionary increases as in the recent past. This implies that analogue pensions in excess of guaranteed minimum pensions would receive about 70% of full protection or, taking guaranteed minimum pensions into account, nearly 80% of full protection.

7. The remainder of the deduction arises from other differences between civil service and analogue benefits. Analogue schemes often have larger national insurance offsets and higher retirement ages but better death benefits than in the civil service.

Government Actuary's Department
London WC2

13 May 1979