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Ref. A09457

PRIME MINISTER

PAY AND CASH LIMITS

This note seeks briefly to summarise the main features of the pay scene and prospects at the outset of your Administration. In the light of your Manifesto it is largely concerned with pay in the public sector.

Pay determination machinery

2. You have inherited five formal pieces of pay determination machinery. They are:-

- (a) The Civil Service Pay Research Unit and Pay Research Board.
- (b) The new Standing Commission on Pay Comparability.
- (c) The Armed Forces Review Body.
- (d) The Doctors and Dentists Review Body.
- (e) The Top Salaries Review Body.

3. The first three of these base their recommendations on "comparability" (i. e. the systematic assessment of the going 'rate for the job'). The last two are influenced by comparability but their recommendations, e. g. on doctors or Members of Parliament, also have a judgmental content. The PRU and the three Review Bodies have a long history and well-established procedures and techniques. The Standing Commission is new and reflected a decision by the previous Government to allow a substantial extension of the comparability principle into pay determination in the public service in its widest sense, i. e. in all of the public sector excluding only trading bodies like the nationalised industries. Although new, the Standing Commission already has a number of remits to fulfil extending from local authority manual workers to nurses. You will wish to consider at an early stage whether to accept the continuation of these various pieces of machinery and in particular whether to seek to cut back on the Standing Commission or to continue to leave it available to any public service group in the non-trading public sector where both sides agree to call on its services.

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4. The previous Government had already begun the process of seeking to establish an annual economic assessment with the TUC and the CBI to inform future wage bargaining. You are committed to a rather similar idea in your Manifesto. If progress is to be made an early start is needed. The idea has long been advocated by the CBI and you should find a ready acceptance by them. The TUC, on the other hand, may seek to claim that the understandings they had reached with the previous Government were specific to that Government and that all bets are off. Such an attitude is however more likely in relation to their commitment to achieve a reduction in the rate of inflation to below 5 per cent by 1981 (where the TUC would in practice have found it very difficult to agree on the specific implications of honouring that commitment) than to taking part in a joint assessment of the economic outlook. The trouble of course is that no economic assessment can be divorced from policy on taxation and public expenditure, where views are influenced more by political judgment than by cold analysis, so that a tripartite agreed analysis is probably not attainable. Nevertheless the process of education is valuable in itself as is the impact of discussion on expectations. German experience is particularly relevant here. You will need to arrange for early thought to be given on the best way of proceeding.

Early public sector cases which will require Government decision

5. Large parts of the public services and the nationalised industries have already concluded their pay negotiations for this year but there are a number of outstanding issues and negotiations still to be settled. The most important of these are likely to be:-

- (a) Armed Forces. You are committed to increase the pay of the Armed Forces. The Review Body's recent report giving their recommended full rates of pay for 1st April 1979 is available and its implementation need cause no difficulty in itself. There would however be some problems of overlap given that the pay of senior serving officers is handled by the TSRB rather than the AFRB. Without special action for them inverse pay differentials would result from the full and immediate implementation of AFRB report, e. g. Brigadiers would be paid more than Major Generals.

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- (b) Doctors and Dentists. Like the Armed Forces the Doctors and Dentists Review Body (DDRBR) produced a report last year which showed that very substantial pay increases were needed to bring the Doctors' and Dentists' pay up to date following the period of pay restraint. The then Government agreed that these increases should be paid in stages - 10 per cent last year, half the balance on 1st April this year and the remainder on 1st April next year - with both this year's and next year's stages being updated to current levels. The DDRBR report on what those current levels should be on 1st April 1979 is now to hand. The presentation is complicated because the report also deals with the new contract for senior medical staff. Early decisions will also be needed on:-
- (i) Whether this year's updating is acceptable to the Government.
  - (ii) Whether the cost of introducing the new contracts is acceptable to the Government.
  - (iii) Whether, like the Armed Forces, the outstanding payment due next year should be brought forward to this so that the acknowledged anomaly is fully corrected at the outset of this Parliament. So far as I am aware, the doctors have not yet argued for this but it would be surprising if they did not press for parity of treatment.
- (c) The "top salaries" groups. The Top Salaries Review Body covers a wide range of senior public appointments ranging from Members of Parliament and Ministers to senior civil servants, senior officers in the Armed Forces, judges and the Chairmen and Board members of nationalised industries. These groups, too (with the exception of MPs and Ministers), had a report last year recommending substantial increases in pay as a catching up operation. The then Government accepted the proposals in principle subject to staging over this year and next but with an important difference as compared with doctors and soldiers. This was that the Government expressly deferred a decision on whether the recommended

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pay rates should be updated in 1979 and 1980 to take account of developments since the main report was produced in early 1978. The TSRB has however now reported on what it believes the updating should be for 1979. The Government therefore needs to decide whether it will accept the proposals for updating included in the latest TSRB report. You may also care to note that, as with the Armed Forces, there can be problems in Civil Service pay structures arising from the fact that grades up to Assistant Secretary are handled through PRU and more senior officials through the TSRB. The particular problem here is that the TSRB's latest report recommends salaries for Under Secretaries below those which PRU evidence suggests for Assistant Secretaries. This has happened before and has been met by cutting back on Assistant Secretaries' pay. But a conscious decision will be needed.

- (d) Members of Parliament and Ministers. The TSRB report on the pay of MPs and Ministers is in a different category because it is the first report on their pay for many years. The Government will therefore need to decide ab initio:-
- (i) Whether it accepts the recommendations of the report.
  - (ii) Whether it is prepared to implement them at once or to provide some form of staging for implementation over a future period.

In handling all of these cases, other than the Armed Forces, you and your colleagues will need to balance the case for getting rid of old anomalies quickly (including the political case that any increase for the higher paid arouses opposition and that staging therefore prolongs the presentational agony) against the immediate cost of full implementation and the repercussions on other groups, e.g. the police, the nurses, the non-industrial Civil Service, who have accepted varying degrees of staging for their outstanding claims.

- (e) Local Authority non-manual employees. The local authorities' white-collar (APTCS) grades, largely represented by NALGO, are due for a pay settlement on 1st July. Although they have traditionally sought to strike their own bargains without reference to "comparability" (and may have done rather better from this than they would on a strict "fair

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comparisons" basis) they may well this time press for "comparability" and a reference to the Standing Commission. The problem with local authority pay settlements is of course that they involve an underlying battle between Government and local authorities about who should pay the cost. On recent form the local authorities will only make an offer when they have a Government assurance that Rate Support Grant will be forthcoming because otherwise the cost of any settlement above what is already allowed in RSG falls on the rates. This question is part of the wider issue of the control of public expenditure by local authorities and the drain on central Government resources represented by the RSG to which your Government may want to give a good deal of attention in the public expenditure review.

- (f) Teachers. Negotiations on teachers' pay continued up to a late stage in the election campaign and were then deferred at the Government's request until the election was out of the way. The basic issue dividing the two sides was that of the terms of reference for any comparability study.

*Mej*  
*Speed*  
The teachers saw the purpose of a new study as up-dating the Houghton report (which was particularly generous to teachers) and wanted terms of reference framed accordingly. The management side (including the Government) wanted an honest comparability study done with full weight given to the non-pay terms and conditions of teachers' service. If the negotiations do not lead to agreement the teachers enjoy a statutory fall-back right to arbitration which they have so far been reluctant to exercise. Negotiations will have to be resumed very quickly now that the election is over.

- (g) Post Office. At a very late stage in the election campaign Post Office employees rejected by ballot the terms of a pay offer made to them in negotiation. The negotiations must therefore be resumed at an early date. The Government will need to decide what guidance if any should be given to the Post Office.

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Cash limits

6. Cash limits are central to your approach to the control of public expenditure, and indirectly of pay levels in the public sector. There are however two points to be made:-

- (a) The degree of control exerciseable through cash limits varies depending on the particular part of the public sector in question. The key distinction is whether the Government itself is the sole paymaster or one among several. In central Government and the NHS the Government is the sole source of finance. If you set cash limits here, and stick to them, excessive pay increases (over and above those for which you have allowed in setting the cash limits in the first place) will inevitably and necessarily result in a reduction in the number of staff employed or the volume of goods and services bought. In the case of the local authorities, 61 per cent of expenditure in England and Wales is met by the RSG and 68½ per cent in Scotland. A decision to set a cash limit on the amount of RSG provided, therefore, puts the burden of adjustment, whether through rates, charges, alterations in balances or the volume and quality of service provided, on the local authority concerned. In the case of the nationalised industries, the proportion of Government finance provided to them varies from industry to industry. The balancing factors are prices, employment, investment and the quality of service. Moreover, with the nationalised industries, the nature of the "cash limit" varies. In some it will be a limit on their borrowing from the National Loan Fund. (Though the British Gas Corporation, for example, is a net repayer of Government borrowing.) In others it will relate to specific subsidies (e.g. those to British Rail and some of the payments to the National Coal Board). In yet others it will relate to deficit financing, whether described as borrowing or not (e.g. British Steel). This does not mean to say that the concept of cash limits is inappropriate to these industries. But it does mean that the financial arrangements with each will need to be tailored to its particular circumstances.

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(b) Cash limits are not a painless instrument of financial control. In central Government, for example, the application of a cash limit to a Department can have three quite separate and distinct effects:-

(i) It intensifies the search to cut out waste in administration. And it must be true that in any organisation as large as the Civil Service there will be waste in some areas. The real problem is to carry through the detailed and searching enquiries needed to bring waste to light. There is of course already a substantial apparatus of staff inspectors etc. who carry out detailed surveys but the real problem is to motivate the line managers. Many are cost-conscious and do their not inconsiderable best to economise. But top management is generally too involved with policy and the needs of Ministers to get deeply involved and it is, unfortunately, very rare indeed to find a Minister who takes a personal interest or is willing to devote time to the detailed, and in personal political terms unrewarding, work required. You have I know your own ideas about how the 'war on waste' should be conducted.

(ii) It intensifies the search to find ways in which the objectives of policy could be achieved by less expensive means (the Treasury have expenditure on housing in their sights as an example here). Success here depends on a lively and imaginative input by

*No - because they were well rep. with list & took for list of items*

Ministers (the Programmes, Analysis and Review arrangements - PAR - have tended to wither precisely because Ministers react against the disturbance and interference with their own parishes which can result). The possibilities are nonetheless worth systematic identification.

(iii) Finally, it causes Departmental Ministers to rethink their priorities so as to identify the functions they are prepared to drop in the interests of economy. Politically this is the hardest of all. (Every expenditure and every policy has its own lobby.) And of course it is here that Departmental Ministers most hesitate

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to act because they are at the receiving end of the pressure groups' attentions. But no serious programme of cuts in public expenditure and no serious intent to hold to cash limits can succeed without a realistic assessment of priorities. Again you will need to decide whether some external 'input' would help Departmental Ministers.

7. Of course central Government expenditure is most subject to your control.

But many substantial sums of public money are spent through the local authorities and the NHS in both of which, by common consent, there is a good deal of 'waste'. Local authority expenditure is particularly difficult to control - and attempts to do so will lead into very difficult areas of relationships with independent-minded and elected authorities. The prize however could be substantial. The NHS is in an intermediate position. It is wholly funded by Government but enjoys a good deal of autonomy and is riddled with difficult characters (especially the professionals) besides being a political minefield. You will want the responsible Ministers to turn in quick and thoughtful reports on the possibilities.

Looking ahead

8. Given your Manifesto commitments, your administration will escape the treadmill of private sector cases which took up so much of the time of your predecessors. You will however still have an inescapable responsibility for pay in the public services. The main issues to which you may wish to direct attention are:-

(a) Do you confirm that 'comparability' (properly carried out) is the key to establishing public service pay?

(b) If so can improvements be made in the machinery and techniques for carrying it out? In particular do you want to work towards the merging of the present five Boards, Commissions, etc? And what can be done to improve the methods used to determine true comparisons? This is an area in which you might like to commission an early report by officials to serve as the basis for Ministerial discussions.



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Conclusion

9. There are a number of specific decisions which you will have to take quickly, mainly relating to specific pay cases; you will need to launch quickly a national debate on the economic outlook and this involves deciding how, where and with whom the debate is to be conducted; you will need to begin the process of settling cash limits for 1980-81 and to settle the level of RSG, before the summer Recess; and you will need to begin quickly a searching examination of public expenditure, including in that examination a search for areas where, and the techniques whereby, waste can be eliminated, new and cheaper ways found of achieving agreed objectives, and priorities established so that functions can be jettisoned to lighten the ship. In all of this you will inevitably get drawn into questions of pricing, investment and employment policies for the nationalised industries, the whole difficult area of local authority expenditure, efficiency and finance, and the question of charges for services at present free or higher charges for services at present provided too cheaply. At the same time you will be concerned with redressing the balance in pay bargaining by the various means outlined in your Manifesto and you may find that you have to go on to consider more fundamental questions like the structure and organisation of the British trade union movement. And you will want to think through the machinery for public service pay determination.

10. The handling of these issues within Government will depend partly on the decisions you have yet to take about the Committee structure and possibly wider machinery of Government issues. Nevertheless it is clear that at an early stage you will want to give a series of remits to Ministers or Ministerial Committees to produce papers and proposals on the sorts of issues touched on in this note.

You may also want to precede the issuing of specific remits by a general discussion in Cabinet. If you wish we could readily produce an annotated agenda for you to circulate to your colleagues.

Yes please  
mt.

*John*  
4/5  
(John Hunt)

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b.c: Mr. Stowe  
Mr. Wolfson  
Mr. Ridley  
Mr. Ryder

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Economic Policy

File



10 DOWNING STREET

From the Private Secretary

MR. VILE

PAY AND CASH LIMITS

The Prime Minister has now read Sir John Hunt's brief of 4 May on the above subject. She has made the following comments:

- (i) On teachers' pay, she thinks the previous Administration were quite right to oppose the teachers' request that their comparability study should be no more than an up-date of Houghton. She thinks the previous Administration were quite right to insist on "an honest comparability study done with full weight given to the non-pay terms and conditions of teachers service".
- (ii) On PAR, she has commented that the PAR studies were well nigh useless and took up a lot of time.
- (iii) On paragraph 7, the Prime Minister agrees that it would be highly desirable to conduct early reviews of local authority expenditure and NHS expenditure with a view to identifying - and getting rid of - waste. I will be commissioning reports from DOE and DHSS respectively on these; but no doubt Sir Derek Rayner will also have an important role to play here.
- (iv) On comparability, the Prime Minister cannot confirm that comparability is the key to establishing public service pay. (She has of course already commented on this - see my note of 6 May.)

See separate files under Local Govt & Nat Health.

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/The Prime Minister

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The Prime Minister agrees with Sir John Hunt's conclusion - that Ministers or Ministerial Committees will need to be asked at an early stage to produce papers and proposals on the various issues touched on in the brief, but she would first like to have a general discussion in Cabinet, and with this in mind she would be grateful for an annotated agenda which could be circulated to colleagues.

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P.S.

As regards the reports from DOE and DHSS ( (iii) above) I would be grateful if you would let me have drafts of the commissioning letters for me to send.

8 May 1979

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