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bc MR VEREHOE

10 DOWNING STREET

From the Principal Private Secretary

10 September 1981

See Jim,

INQUIRY INTO CIVIL SERVICE PAY : THE "ISSUES" MEMORANDUM

The Prime Minister held a meeting this morning with the Lord President, the Chancellor of the Exchequer, the Secretary of State for Employment, the Secretary of State for Defence and the Secretary of State for Social Services to discuss evidence for the Megaw Committee. Sir Robert Armstrong and Mr Gregson were also present. The meeting had before it your letter of 3 September to Willie Rickett, enclosing a draft "issues" paper; Richard Dykes's letter of 8 September to Willie Rickett; and the Chancellor of the Exchequer's undated minute to the Prime Minister.

Affordability

The Lord President said that he thought that the main difference between him and the Chancellor of the Exchequer on the question of what was said about affordability in the memorandum was a matter of degree rather than of principle. Under the old pay system no account of what the Government could afford was taken into account when data were being collected by the pay research unit. This defect had some times led to situations where there was a wide difference between the level of pay settlement indicated by the data and what the Government could afford. It was important that whatever replaced the old system provided for affordability to be brought into the reckoning early on. But it was not the only factor but was one of several. Nor should the figure for what the Government could afford be immutable: it might well have to be changed somewhat in the light of the other factors which would have to be taken into account in any new system. He thought that these considerations could be brought out satisfactorily in the evidence for Megaw with a certain amount of redrafting of the memorandum.

The Chancellor of the Exchequer said that he agreed that affordability was not the only factor to be taken into account in the new process for determining pay and that it could not be expressed as an immutable cash limit. But his fear was that there would be a natural tendency on the part of the Megaw Committee to end up by recommending what was in effect a revamped version of the old system. Such an outcome might well lead to the Government being presented with results from the new process which it could not afford. Put slightly differently, Megaw might well design a system which produced an automatic answer which the unions would regard as an

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entitlement. To prevent the committee falling into this trap it was essential that the Government explained to them the importance of affordability and exposed to them their worries about what might result if affordability was not given its appropriate weight. This was why he had redrafted paragraphs 4, 7, and 8 of the "issues" paper.

In discussion there was general agreement that the new system must produce facts and figures which could be set alongside what the Government could afford but it should not recommend rates of pay or make a judgment in some other form about levels of pay. At what precise point the new process of pay determination should take account of affordability was a difficult question. If the affordability factor was brought into play too early, it might be exhausted quickly and then not be available for use later in the final and decisive stage of settling a pay claim. This suggested that the first sentence of the Chancellor's redrafted paragraph 8 of the memorandum went too far towards making affordability an integral part of the new process. Moreover, we should take care not to put so much emphasis on affordability that the unions simply refused to accept it as a key factor and opted for free collective bargaining. On the other hand, we did not want a new process which ignored affordability in the way the old one had done. The Government should bring out clearly in its evidence to Megaw its concerns about affordability and should invite the committee to offer a view on how and at what point in the pay determination process affordability should be taken into account.

Arbitration

The Secretary of State for Social Services said that paragraph 9(f) of the draft "issues" memorandum raised the difficult question of the future role of arbitration. There were two options. Either the Government could subscribe to a system of arbitration but retain the right to refuse to go to arbitration. Or the Government should be ready to undertake to go to arbitration but should reserve its right to invite Parliament to approve the setting aside of the arbitration award. He did not believe that the Government could seek arbitration arrangements which combined both of these options. It had to choose between them.

The Lord President said that he agreed that the Government could not have an arbitration system which gave them both options, and of the two of them he believed that sounder protection for the Government would be provided if they chose to agree to participate in an arbitration system but to reserve the right not to accept its findings.

The Prime Minister said that she was not convinced that the second option was the more favourable. It was very difficult to refuse the findings of an arbitration process. Moreover, in purely practical terms there was a real limit to the number of cases the Government could take to Parliament in order to have the arbitration

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award overturned. These arguments led her to believe that the first option might be preferable. In any case, whichever course was adopted, it was essential that the Government should have freedom to appoint the arbitrators.

In further discussion it was pointed out that it would be better presentationally for the Government to use its final override after arbitration rather than to exercise it at an earlier stage by withholding access to arbitration and to be able to say there were clear and compelling reasons why it could not accept the arbitration award and it was necessary to ask Parliament to set the arbitration findings aside. The Government's evidence to Megaw should bring out the problem of arbitration and the choice of courses which could be followed. In doing so we should be careful not to give the committee the feeling that the Government was looking to them to recommend a system which, with all the necessary camouflage, allowed the Government to settle Civil Service pay by fiat. On the other hand, it was pointed out that there was probably little risk of the committee doing that, since it would be natural for them to want to produce a system which the unions would accept. Indeed, there was a danger that if the Government gave away too much ground now, we should never be able to retrieve it.

Other Points

In further discussion the following additional points were made:-

- a) Paragraph 4(a) should also bring out that a major reason why the old system had been overridden or implemented only after delay in nine out of the last fifteen years was that in many of those years incomes policies had been in operation.
- b) The Chancellor's redraft of paragraph 4(a) should make it clear that it was not only the Government that lacked confidence in the old system but the general public too.
- c) The private sector had never really accepted the Priestley concept of parity for Civil Service pay. They had always believed that their pay should have a lead over public sector pay to take account of such factors as lower job security. As it was, the Priestley system led to circularity of pay settlements: as fast as the public sector caught up with the private sector, the private sector restored its lead and so triggered off the next round of catching up. If the new process of pay determination which would flow from Megaw took account of all the relevant factors, this should allow the private sector to maintain a lead over the public sector.

/d) There was

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- d) There was much less movement in and out of the Civil Service than there was in and out of industry and it was therefore not easy to draw valid comparisons between quit rates for the Civil Service and those for industry. On the other hand, if Civil Service pay rates got markedly out of line with those in industry, the quit rates should show this up. One reason why the Civil Service attracted relatively more high fliers than industry was that it offered not only job security but also high pay; and this too was something that needed to be brought out for Megaw.
- e) Paragraph 11(e) of the draft "issues" memorandum touched on regional pay. This was an important question for some Departments, and it was hoped that Megaw would look at it carefully.
- f) It was agreed that the penultimate sentence of paragraph 10(f) of the draft memorandum should be omitted, as suggested by the Secretary of State for Employment.
- g) Megaw was inviting individual Departments to submit evidence, and there was a clear need that Departments' responses should be co-ordinated. Arrangements for this to be done had already been made.

Next Steps

The Prime Minister said that the Cabinet Office should now revise the draft "issues" memorandum in the light of the discussion and should circulate it to those Ministers present for their approval. They should also ensure, in conjunction with the CSD, that Departments' evidence was cleared by Ministers before it was submitted to Megaw.

I am sending copies of this letter to John Kerr (HM Treasury), Richard Dykes (Department of Employment), David Omand (Ministry of Defence), Don Brereton (Department of Health and Social Services) and David Wright (Cabinet Office).

Yours ever,

Alvin L. Shuman.

Jim Buckley Esq
Lord President's Office.

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