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*Prime Minister*

Qa 05025

To: MR LANKESTER ✓

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From: J R IBBS

Public Sector Pay Policy

1. The Prime Minister may like to know that the CPRS has a number of reservations on the Chancellor's proposals of 15 May, particularly in relation to the public services (central and local Government and NHS).

2. Of course, we agree with the Chancellor that pay settlements in the current round have been uncomfortably high. But we do not believe that the main problem rests with the public services. Had it not been for 'catching-up' for past phasing, the current round public service settlements averaging  $14\frac{1}{2}$  per cent could have been presented as a favourable outcome.

3. The Chancellor's preferred course is to impose tight cash limits as a means of reducing settlements in the public services but to retain the institutional structure of comparability as one (limited) factor in the process of pay determination.

4. The CPRS sees a number of difficulties in this course:

(i) It seems most unlikely that the status of, e.g. pay research and the Review Bodies could be changed by negotiation.

(ii) The changes would therefore have to be imposed. This could lead to confrontation, not only with the Civil Service but with such groups as the Armed Forces, the Doctors and Dentists, MPs, Judges, Nurses and the Police.

(iii) The policy would be seen as discriminatory. The comparability institutions would be producing the material for 'fair comparisons' and the Government would be seen to be disregarding it. Presentationally this would give the Government the worst of both worlds.

(iv) A discriminatory policy carries with it all the seeds of a future 'catching-up' problem, like that which has bedevilled the present round.

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5. In short the CPRS does not believe that this approach would be tenable, or that it would be accepted as some form of 'middle ground'.

6. The Chancellor's fallback proposal is to abolish comparability altogether. In the view of the CPRS this could be a very 'high risk' policy:

(i) Negotiations would be seen in conflict terms by all the groups referred to in paragraph 4(ii) above. The potential disruption is immense.

(ii) Comparability would not, of course, be excluded from the pay negotiations. Each group would make its own (favourable) comparisons. Every sectional interest would pay in aid special factors in support of their own case.

(iii) It cannot be assumed that the Government could win against some of the groups involved; or that the settlements would be lower than if comparability were retained. Some of the public sector unions are already having second thoughts about comparability because they think they could improve their position in a trial of strength.

(iv) If cash limits were set, and breached, this would greatly damage the credibility of the cash limit system itself.

7. The CPRS therefore believes that Ministers should consider the alternatives very carefully before discarding or 'dethroning' comparability. A preferable solution might be to consider three groups:

(a) where no market exists (e.g. nurses and those covered by the Review Bodies), the CPRS believes that comparability is likely to remain the best answer;

(b) where sufficient of a market exists to justify collective bargaining, this should be the preferred solution, even though some groups were covered by Clegg last year (e.g. local authority and NHS manuals);

(c) a middle range between (a) and (b) for which the market is the preferred solution but for which an occasional reference to an expert and independent body may be useful (e.g. ambulancemen might be in this category);



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8. Where comparability is retained, efforts should be made to:

(i) Seek to improve the standard of the comparability exercise, e.g. in relation to labour market conditions, the representativeness of analogues, efficiency and job security;

(ii) make sure that comparability is better defended and better understood. In particular it is important to explain the effect of lags on the pattern of private and public sector settlements.

9. Whichever course Ministers choose, however, the CPRS agrees very strongly with the Chancellor that there is a need for an intensive effort to influence expectations. This requires further work with which we should like to be associated. It is also for consideration whether there is a case for seeking to influence the direction of bank lending so that the present squeeze - already apparently having some effect on settlements in manufacturing industry - might be extended more widely, notably to service industries where settlements are still very high.

10. The Chancellor in his paper does not specify the extent to which cash limits might be used to bring the level of settlements below the comparable rate. Ministers may like to note the following orders of magnitude:

- a 5 per cent difference in the wage bill of the public services is worth around £1bn. on the PSBR
- a 5 per cent difference changes the average level of national earnings by some one percent and the RPI scarcely at all.

11. By contrast, the impact on inflation of settlements in the public trading sector is far greater, and the problem of control much more intractable. The CPRS agrees with the Chancellor, however, that there is no alternative to pressing ahead on broadly the same lines as this year. In addition, notwithstanding the desirability of an arm's length relationship, Ministers should exert as much pressure as possible on the Boards to adopt a tough stance.

12. I am sending a copy of this minute to Sir Robert Armstrong.

16 May 1980