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Policy Unit

PRIME MINISTER

FUTURE ARRANGEMENTS FOR PAY IN THE PUBLIC SERVICES

This important issue is to be discussed at E on Thursday.

The Chancellor has suggested early discussion of the issues of principle which arise in working out any future system for public service pay. This seems to us an essential first step in such a complex matter.

We attach a paper by the Policy Unit which is intended simply to help get this thinking and discussion process started. It is not intended to provide any simple answers or recommendations.

I have copied this minute and our paper to members of E, to Robin Ibbs, and to Sir Robert Armstrong.


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FUTURE ARRANGEMENTS FOR PAY IN THE PUBLIC SERVICES1. INTRODUCTION

- 1.1 In E(81)12, the Chancellor asks for early discussion of the issues of principle which arise in the working out of any future system for public service pay. In the context of the Civil Service, the Lord President's memorandum of 6 February recommends a wide-ranging review to work out an agreed and ordered pay system; the early announcement of which should increase the chances of the Civil Service unions accepting around 6% in the coming pay round.
- 1.2 We believe that some hard thinking about the underlying principles is needed before we can give any undertakings to the unions about such a review. We need to have some idea where that review is likely to take us first. It is always the quality of the thinking (and the readiness to think about "unthinkables") at the start of such a project which determines whether or not what follows turns out to be a waste of time.
- 1.3 This paper therefore looks at some of the principles and assumptions behind the Treasury paper, and our current thinking.

2. BACKGROUND TO THE PROBLEM

- 2.1 Public services pay (that is, excluding nationalised industries) amounts to over 30% of total public expenditure. If the Government is unable to limit public service pay increases, it must either reduce employment - which may not always be possible, eg in hospitals - or else further reduce public sector investment, as Governments have done over the years.
- 2.2 Over the past 10 years, Civil Service pay has, if anything, slightly lagged the private sector equivalents - to the extent that those equivalents are known.
- 2.3 Against a background of inflation and failing incomes policies, we have seen growing trade union militancy, increasing Left-wing penetration in certain unions, declining morale and growing public

hostility towards the public servants. A great deal of Ministers' and officials' time over the years has been devoted to the problems of public service pay. Governments have frequently looked weak in dealing with strong groups in the public services and unsympathetic in dealing with weaker or more responsible ones (eg nurses).

2.4 Against this background of constant fire-fighting, it is not surprising that Government is still confused about the nature of the problem. In varying circumstances, we are pursuing several objectives which often conflict with each other: maintaining services; cutting numbers; reducing inflation; and controlling expenditure.

3. CLEARING AWAY THE CONFUSION

3.1 What are the main categories of public service, for pay purposes?

We can categorise by pay determination system, as at Annex A of the Treasury paper. Are there other ways of categorising which would be helpful? For example, can we distinguish between those parts of the public service which can be volume-constrained (when pay increases collide with cash limits) and those which can't?

3.2 Is collective bargaining in the public services a meaningful concept?

3.2.1 Trade unions were originally formed to protect members from very bad employers. Government may never be a very good employer, but how likely is it to be a bad one? Certainly it has come to be seen as a bad employer over recent years. But that may have been the result of Governments' incoherent efforts to control public expenditure and public services pay, against a background of inflation and growing trade union power. Having failed to curb trade union power, Governments have instead simply put pressure on weaker groups and reneged on promises where they were able to do so.

3.2.2 What does "collective bargaining" mean? In normal negotiations, a bargain is only struck when both sides agree. If either side is not satisfied, it can "walk away" and agree with someone else. In collective bargaining that is not the case, because the total

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population of "bargainers", on one side, bands together so that the other side has no option: there is only the union. (An analogy would be for all BL's suppliers to join together to refuse to supply BL unless BL agreed to an across-the-board 20% price increase on all the components supplied.)

3.2.3 This is the fundamental contradiction which has led successive Governments to oscillate between incomes policy and free collective bargaining (with or without attempts to reduce trade union power.) In the private sector, this sterile process works itself out in the end by helping to destroy first the marginal enterprise and eventually, if the lesson is not learned, the marginal industry. In the public services, however, that result, with its attendant lesson-learning, may never happen. Instead, there will be a volume squeeze (with cuts in service or modest de-manning by natural wastage); or higher Government borrowing or taxes; or further cuts in public sector investment.

3.3 Pay rates, comparability, manning levels, cash limits: which comes first?

3.3.1 Are cash limits meant to be an absolute constraint or not? The Treasury paper repeatedly states that they must take precedence but that they must not be set so rigidly that they cannot be amended in the light of the results of bargaining outcomes. In his memorandum of 21 January (C(81)7) the Chancellor restated the earlier E decision that "We should conduct public service pay negotiations this year within the framework set by cash limits: cash limits should determine expenditure on pay".

3.3.2 The latest Treasury paper proposes a system of "constrained bargaining". We cannot see how this would work. How could trade union negotiators have the power to push the employer up to the level of the cash limit, but the employer suddenly find the power to stop the negotiating process at that point? The employer cannot "refuse to deal", so the question arises - where does he get the powers to halt the process?

3.3.3 The underlying question is whether we are talking about genuine negotiation at all. As the Chancellor, in his 21 January minute,

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says: ". . . the Lord President and the Secretary of State for Employment take the view that the cash limit must not rule out the appearance of realistic negotiations". (Our emphasis.) Are we really talking about fictitious negotiations in which there is implicit agreement about the real cash limit; and then the appearance of negotiations so conducted as to allow the unions to appear to "win" and thus satisfy their members that they are doing a good job?

- 3.3.4 This in turn raises the whole question of pay research data. How is such data to be used? The unions may accept it as a basis from which to negotiate upwards. Will they accept it if the same data points to the need for a real reduction in pay? This problem may not have arisen while inflation was high and the money illusion survived, but it could well do once we reach Stable State, unless there is a substantial return to growth.
- 3.3.5 The proposal to make post-hoc adjustments, if public service pay falls too far behind its analogues (however defined) should reassure negotiators. But the same problem arises. Unions may welcome adjustments upwards. Will they similarly accept adjustments downwards? The two-way process would need to be made clear at the outset.
- 3.3.6 There may be a contradiction between the whole idea of pay research data (with or without post-hoc adjustments) and arm's length negotiating. Negotiating involves the best use of a bargaining position, bluff, and concealing - not revealing - your hand. Display of pay research data (like that of the cash limits sticking point) suggests that we are not really talking about negotiation at all.
- 3.3.7 Would a step change down in pay, followed by lower differentials, lead to industrial action or to a higher "quit rate"? This will presumably vary depending on seniority (eg manual workers vs. career services) and from group to group within the public services. Paragraph 15 of the Treasury paper suggests that, for career services, where there is very little movement in or out in mid career, quit rates will not give the desired information and "a careful analysis of the availability of sufficient numbers of appropriate quality recruits at existing pay levels is required

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We think both recruiting and quit rates are relevant. A zero quit rate is itself information about quit rates. If there is no movement, then we can be reasonably certain that the total package of pay and benefits is not too low. Of course, movement in and out of career services is sticky, but people do leave (eg army officers) if the differential becomes too wide.

- 3.3.8 There may be a tendency to assume that Civil Service work is so different from work elsewhere in the economy that a low quit rate is simply the evidence of this difference rather than evidence about supply and demand. But to the extent that that is true, it calls into question the whole concept of comparability, for it implies that Civil Service jobs cannot be properly compared to jobs elsewhere. In any case, we think more interchange is desirable in itself.
- 3.3.9 The difficulty with any collective pay determination system is that, if there is not enough discretion for management, the good people are paid too little, the bad people too much. The best people then leave. Could there be greater discretion for higher management, with a pot of money to vary the pay at each grade? The whole system might then become more meritocratic, even at the lower levels, as it is in an un-unionised company like IBM. Would this be a healthy development? Would the trade unions allow it?
- 3.3.10 Does the implied lifetime contract within the Civil Service make sense? Should the Civil Service follow the pattern of the armed services in which people are automatically retired (with appropriate pension) if they have not reached a certain grade by a certain age?
- 3.4 Is it possible to concentrate public service pay settlements at the start of the financial year?

This familiar suggestion is raised in the Treasury paper (paragraph 37) as desirable. But it is instantly down-graded as "only a long-term aim", and it is said that the unions would demand a price for accepting the change. But why should they demand a price? Would it be demanded with menaces? What menaces

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would the law allow them to use? And in any case, what is the repeated cost of not having such a change, and could this perhaps be less than any once-and-for-all price demanded or conceded?

3.5 Experience from other countries

What lessons are there to learn about trade union organisation and pay determination systems in other countries' public services?

3.6 What will "Stable State" be like?

3.6.1 The Treasury paper (paragraph 40) identifies the very real problems which await us when inflation has been brought down. Average nominal pay expectations will have to be close to zero, especially in the public services. Some people's pay will have to be cut if there is to be a shift from wages and salaries to profits.

3.6.2 How will the public service trade unions then see their role in pay determination? So far, their task has been to ensure that pay and job numbers can go up but not down. If there is little real growth, and little inflation, what are they to do? Do we work out a fictitious bargaining ritual to allow them to save face? Do they accept that their traditional role of bargaining is over? Or are they to bargain in earnest? And if so, how is the Government (running by then a tight monetary regime with low inflation) to ensure that this doesn't simply produce an exaggerated relative price effect and thus an ever-increasing burden on the private sector?

3.6.3 In short, money illusion and inflation have helped both to cause and to absorb the militant use of trade union power in public services. Is a Stable State trade union role possible, unless other steps are taken to remove power which can no longer be absorbed in the traditional way?

4. THE OBJECTIVES OF A NEW SYSTEM

4.1 The previous section has looked briefly at some of the issues raised by the question "What is the real problem?" Until we have

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answered that question (and, as suggested earlier, there may be different answers for different parts of the public service) it is not easy to set the objectives for a new system.

- 4.2 The Treasury paper (paragraph 10) sets out four objectives which may be to some extent in conflict with each other. For example, the objective "To act as a good employer and to be fair to employees in the public service" raises many questions. What do we mean by "fair"? Does it mean the use of morally neutral economic criteria? Or does fair really mean "more"?
- 4.3 Should one of the objectives be to link the public service labour market much more closely with the national labour market, with more movement between the two, even at the higher levels? Does this raise larger questions of management practice within the Civil Service, with greater emphasis on management discretion, merit payment, early retirement etc?

5. CONCLUSION

- 5.1 We get the distinct impression (though of course our evidence is anecdotal) that the "right to manage" has been surrendered to a remarkable extent to the trade unions, in the public services in general and in the Civil Service in particular.
- 5.2 In a rational world, there would be no need for pay bargaining by trade unions in the public services. The new recruit would accept that there was no right to strike, no collective bargaining and that if he did not like the corresponding advantages of relative security and a reasonably good employer, he would seek a job elsewhere. The whole concept of trade unions in the public services, with their unique privileges and immunities and their members with indexed pensions, being ready to strike against a Government paymaster seems to us quite absurd. Like so many things, we have got used to it by degrees, and to question it now appears "immoderate".
- 5.3 It may well turn out, after careful examination, that the best thing, in fact, is to keep the pay determination arrangements confused, contradictory and vague, because it is simply not

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possible to develop a comprehensible and rational system which commands general support. But the first step is to be clear as to why sensible systems are at present unlikely to be "politically possible" and then see whether they might be made so.

- 5.4 Our initial thinking leads us to support the Lord President's recommendation of a major review which would include recruitment and retention, job security factors and, indeed, some aspects of Civil Service management and reform. But we need to spend thinking time first on the terms of reference and (after Scott) the composition of the review body.



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