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PRIME MINISTER

Future Arrangements for Pay in the Public Services
(E(81) 12, 16 and 18)

BACKGROUND

When the Committee discussed public service pay in October last (E(80) 37th Meeting, Item 4) the Chancellor was asked to arrange for an interdepartmental group of officials to consider the options for determining pay in the Civil Service and other public services in the longer term, and to report. In the event, although the paper by Treasury officials (much too long as it is) attached to the Chancellor's memorandum (E(81) 12) has been discussed with other Departments, it is the work of the Treasury alone. Other Departments are not committed to it, though in practice I do not think there would be much dispute about the analysis in the Treasury paper: the differences would arise on the conclusions to be drawn from the analysis.

2. There are two major issues:-

- (i) The role of comparability in determining pay in the public services.
- (ii) How to reconcile the discipline of cash limits with the need to retain some freedom of manoeuvre in pay negotiations.

Comparability

3. In public service pay bargaining, comparability is like nature: you can expel it with a pitchfork, but in the end it always comes back. This is inevitable, because people in the public services (like everybody else) will always be looking to keep up with their particular Joneses, even if there are no formal arrangements for basing pay on "fair comparisons". But it is also logical: in the long run the public services will not be able to recruit and retain the people they need if they are not paying enough by comparison with other employers of similar people. Because mobility in large parts of the public services is sticky, the results of failure to pay enough to recruit in sufficient quality and quantity may not show up, in terms of damage to

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efficiency, for quite a long time; and then it will take a long time and be very expensive to redress the balance. In these circumstances "comparability" is a kind of short-cut, short-term substitute for the disciplines of the market, to provide a rough and ready yardstick to ensure adequate recruitment.

4. The highly mechanistic system of fair comparisons based on pay research for non-industrial civil servants looked good when inflation was moving at very low rates and it was necessary to do "fair comparison" exercises only once every four or five years. Pay bargaining was then focussed on "interpretation" of the pay research evidence, and the Priestley system offered a basis for settling Civil Service pay which both was felt to be and was fair, and one which kept the subject out of politics. The defects of the system become much more obvious when inflation is moving at high levels and pay has to be adjusted every year. A highly mechanistic system can then become an instrument of circularity and even an engine of inflation.

5. So the problem is to discover a system of pay determination which:-

- (a) allows pay comparisons to be taken into account but not to dominate the system or exclude other considerations;
- (b) is accepted by the employees concerned as a fair basis for settling their pay, and thus
- (c) takes as much of the politics as possible out of the whole business of determining public service pay.

6. The Review Body system is one way of achieving this. But that is a system for settling pay without direct bargaining between employers and employees, and as such unlikely to be acceptable to the public service unions as a system for deciding the pay of other groups of public servants than those to whom it now applies. They will want to stay in the business of negotiating pay.

Cash Limits

7. The Treasury paper concludes that cash limits should be set in advance of negotiations on a realistic basis and then held to in the bargaining process. That reflects the Chancellor of the Exchequer's view that cash limits should be used to influence and should not merely reflect pay settlements.

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8. The difficulty about this is that in practice, so long as the pay factor has to be published, it very narrowly restricts the room for bargaining on pay. Once the pay factor is announced - particularly for the Civil Service, where pay and procurement are on separate votes - the pay factor introduces a considerable rigidity into pay bargaining. It becomes a ceiling for management and a floor, or "entitlement", for unions, and thus in effect a norm, and a challenge to the unions to break it. We may get away with it, more or less, this year; but we cannot expect to do so every year. We need a system in which the cash constraint is real, and is accepted by the unions as a reality, but we do not have to define it, with the degree of precision entailed by a declared pay factor for cash limits, in advance of pay negotiations.

The Conflict in the Committee

9. The Chancellor of the Exchequer is saying, in effect, "let us have constrained bargaining: a system which allows us to take comparability (and other factors) into account but in which in the end the cash limit rules." This is easier to postulate as an aim than to achieve in practice.

10. The Lord President, in his paper (E(81) 16), voices the alternative view. He rejects the Treasury approach as unrealistic and argues instead for a "workable formal agreement" with the staff to determine pay "backed by arbitration". He now accepts that the pay research system has gathered too many barnacles to be saved by tinkering: he therefore envisages a new system, to be agreed with the staff after and in the light of a major review by a "new ad hoc body ... under an authoritative chairman with wide industrial experience". The review would consider "in the light of experience and changed conditions the extent to which the principles laid down by the Priestley Royal Commission in 1955 now need to be modified or supplemented; the data which should be collected as the basis for negotiations; and the way in which the data should be used". The Lord President believes that, apart from its other merits, the announcement of such a review would materially help him in the present pay negotiations with the non-industrial Civil Service and perhaps in next year's negotiations as well (he envisages the work of the review taking perhaps

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18 months) . His paper is silent about the implications for cash limits: but he must envisage a sufficient degree of flexibility to allow for the outcomes of whatever system is agreed.

11. The CPRS note (E(81) 18) attempts to clarify the issues. Broadly speaking it backs the Lord President's judgment that "constrained bargaining" is impracticable and suggests that, if Ministers also accept this view, then the real question is how the present system should be reviewed - by a Royal Commission (on the analogy of the Priestley Commission), an ad hoc external inquiry, or an in-house study by the CSD.

12. If the object is to gain time, a Royal Commission or an external inquiry will achieve that, though possibly at the cost of recommendations which would not be very convenient for the Government. If Ministers can define the objectives with sufficient precision, there would be much to be said for an in-house study which could be kept under control.

13. In addition to considering the long term problems, Ministers are also being asked, by the Lord President and the Secretary of State for Social Services, to be allowed to raise their pay offers to the non-industrial Civil Service and the National Health Service from 6 to 7 per cent. Mr. Jenkin makes it clear that he is also asking for a corresponding adjustment in the pay factor for his cash limit. Lord Soames's letter is silent on this, but I gather that he would be content to leave his cash limit at 6 per cent and "see how we get on": hoping that by a combination of tight budgeting and underspend it will in the end be possible to live within a 6 per cent cash limit, but making it clear that it may be necessary to reopen the cash limit later in the year, if there are some pay votes which cannot be held within the 6 per cent.

14. The Chancellor is likely to say that he would be content to see the pay offers go up to 7 per cent, provided that the pay factor for cash limits stays at 6 per cent. He will argue strongly for this. If the sense of the Committee goes against him, he will say that he must have time to consider the implications for public expenditure and come back to his colleagues: he may say that he can see no alternative to reducing the price factor from 11 to 10 per cent.

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15. Ministers have throughout recognised that, once the local authorities settled for $7\frac{1}{2}$ per cent, it was unlikely that it would be possible to settle the Civil Service and the NHS for 6 per cent. They will therefore be inclined to give the Lord President and the Secretary of State for Social Services authority to go up to 7 per cent. I suggest that you should try to avoid spending any time at this meeting discussing the implications for cash limits: unless the Committee agrees that the pay factor should remain unchanged at 6 per cent - which would be much the best outcome but is not likely to be acceptable to Mr. Jenkin - the best course would be to ask the Chancellor to consider the implications for cash limits, in consultation with the Lord President and the Secretary of State for Social Services, and to circulate a note for discussion next week in Cabinet (it is there, rather than in E, that the question should be considered).

16. The Secretary of State for Social Services also raises a separate but important point relevant to his negotiations (but not to those of the Lord President). This is whether the Government should pick up the NHS management side's suggestion that the present settlement with the ancillaries should run for 15 months to April 1982, thus aligning their negotiating timetable with that of the nurses, doctors, non-industrial civil servants, armed forces and so on. If this could be achieved without extra cost it would have a number of advantages (aligning the pay and financial years, reducing the scope for leapfrogging, and adding a further element - a lump sum of £50 to £75 - to the present settlement, which some staff could find attractive). Against this the lump sum would presumably have to be paid now, ^{and} the spread of "synchrony" in the public services may not be a wholly unmixed blessing in the longer term. A common settlement date for the public services is one thing; a common pay negotiation, if it ever came to that, might be quite another. Nevertheless, the question has been raised, and requires a decision.

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HANDLING

17. You may find it convenient to divide the discussion into two parts: the current negotiations for the non-industrial Civil Service and the NHS; and the longer term perspective. In this case you would want to ask the Lord President and the Secretary of State for Social Services to make their proposals for the present negotiations, and then explore how far your colleagues are prepared to go to meet them. Are they prepared to authorise them to go up to 7, or in the last resort to 7½ per cent to get a settlement? If so, is it accepted that the pay factor for cash limits stays at 6 per cent? If not, you will want to ask the Chancellor to consider the implications, in consultation with the Lord President and the Secretary of State for Social Services, and to report to Cabinet next week.

18. The Lord President will also argue that the degree of give he needs to reach a settlement now will be conditioned by the outcome of the Committee's discussion on longer term arrangements. This degree of overlap is unavoidable, and you may want to reserve final conclusions on negotiating authority to the end of the whole discussion.

19. You will also need to decide whether to authorise the Secretary of State for Social Services to offer the NHS ancillaries a settlement running to 1st April 1982.

20. You will then want to call on the Chancellor of the Exchequer, the Lord President and Mr. Ibbs to introduce their papers. In the ensuing discussion you will want to seek answers to the following key questions:-

- (a) Do colleagues prefer the approach of the Chancellor of the Exchequer or that of the Lord President?
- (b) If they prefer the Chancellor's approach, have they any modifications to suggest? It is possible, for example, that some colleagues will argue strongly that, even if cash limits are set in advance, they should not be published, because this puts the credibility of the system on the line, sets a floor for the unions, and reveals the Government's maximum negotiating position from the outset.

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- (c) If colleagues prefer the Lord President's approach, do they have a preference as between the three kinds of review set out in paragraph 9 of the CPRS paper? What are the implications for cash limits - or is that a question that can be left on one side until the Cabinet discusses the Treasury's proposals for changing the system of controlling public expenditure?

CONCLUSIONS

21. You will want to record separately decisions on the immediate negotiating stance to be adopted with the non-industrial Civil Service and the NHS, and the longer term arrangements for Civil Service (and NHS) pay determination. On the former you may also want to record a request to the Chancellor to consider the implications for cash limits and to report back to the Cabinet next week. On the longer term arrangements you will want to commission a paper from the Lord President discussing the detailed application of the decisions taken; a paper from the Secretary of State for Social Services adapting the decisions to the circumstances of the NHS; and a paper from the Chancellor of the Exchequer setting out the implications of the decisions for the operation of the cash limits system.

REA

(Robert Armstrong)

11th February 1981