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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY
FUTURE ARRANGEMENTS FOR PAY IN THE PUBLIC SERVICES

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Note by the Chancellor of the Exchequer
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Since our discussions last year (E(80)27th Meeting, Item 1 and 37th Meeting, Item 4) I have been giving further thought to arrangements for determining pay in the civil service and the other public services in the longer term. I attach a paper by Treasury officials which has been discussed with officials in other Departments, although those Departments are in no way committed to it.

2. This paper explores a new approach to public service pay. It focuses chiefly on the civil service which is the area where the most elaborate system for determining pay by means of comparisons has developed. This is the natural starting point for any discussion, although it does not follow that what we decide for the civil service should set a pattern for the rest of the public services - at present there are considerable differences and I am sure that this must continue to be so.

3. For the civil service, the key question is the future role of comparability. The existing system of comparability, based on pay research, stems originally from the Priestley Report of 1955.

/The Civil Service Pay

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The Civil Service Pay Agreement commits the Government to implementing the agreed results of this research, but there is provision for withdrawal subject to six months notice and the significant fact is that for the last 15 years the results of civil service pay research have been given effect without modification only on three occasions.

4. This demonstrates clearly enough that the system is not working. The paper by officials argues that this is basically because of three changes in the situation since the Priestley Report. First, inflation has become a major national economic problem, pre-occupying every government. Secondly, the control of public expenditure has become increasingly important and cash control an important part of it. Thirdly, the assumption which lay behind the Priestley system, that the civil service could not or would not strike, is no longer correct.

5. A fourth factor is that the system of pay research no longer commands general public confidence. No doubt this could be corrected to some extent by reform of the pay research system but I am very doubtful whether this would restore confidence. There is much more tendency now to question the proposition that appropriate levels of pay can be set by the formal process of job comparison. That system was designed more to achieve fairness for civil servants than to simulate the market. Many people now believe that the process of determining pay should include some assessment of the market value of the personnel who are employed, and the Treasury paper suggests that it should be possible to develop a technique for doing this using data for the supply of and demand for given types of personnel.

6. But perhaps the main features of the Priestley system which we must question is the principle of automaticity: that the Government should be committed in advance to implement the results of pay research. This is at the heart of the Priestley system, although, as I have said, full implementation has been the exception

/rather than the

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rather than the rule in recent years. The principle of automaticity implies that Governments must accept that the cost of the civil service will be determined for them by processes which they do not control. I believe we can no longer accept this and that we must firmly re-assert the right and duty of the Government to determine what it will spend year by year on the civil service and on other public services too, making its own judgement - crucial and fundamental - as to how much taxpayers' money can be spent on the provision of each service.

7. This does not mean, of course, that decisions about public service pay can be taken purely arbitrarily or without constraint. My strong view is that in the long term it will never be possible for the remuneration of public employees - taking account of every element - to diverge very widely from the remuneration of people doing similar work in the rest of the economy. It is very important that we should be realistic about this. But it is quite another matter to continue a system in which we are, at any rate in principle, committed in advance.

8. It follows that if we are to make a break with the existing system (which would mean abandoning the existing Civil Service Pay Agreement) we cannot replace it with a formal system of a different kind. The new arrangements will have to be more fluid and leave more room for judgement and negotiation. They should be arrangements which give some weight to processes of comparison between civil service jobs and those elsewhere so that the outcome of the negotiations is viable and realistic. But comparability should not automatically determine the outcome.

9. The paper suggests that at least in the civil service we should try to move towards a different system which it describes as "constrained bargaining" (I do not necessarily endorse the language). Pay would be determined by negotiations within cash limits which would be realistically set taking account of any evidence of over-

/shooting or undershooting

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shooting or undershooting in pay in the preceding year. Some data on comparability and on market value could be produced as an agreed input to the negotiations but would commit no one.

10. Before we try to work out in any detail how such a system would work and what changes, if any, should be made in the pay arrangements for other public servants, I suggest that we should discuss the issues of principle which arise. We must decide on our approach to this question very soon, so that we can begin to plan for the 1981-82 pay round.

| | |
|------------------------|--------------------------|
| Ministers | £10,000 |
| Senior and FE teachers | £20,000 |
| University teachers | £37,000 |
| 1st Auxiliary workers | £11,000 |
| Wages | (G.H.) £10,000 |
| H.M. Treasury | £7,000 |
| 29 January 1981 | |
| Doctors and Dentists | £28,000 |
| Judges | £10,000 |
| Armed Forces | £20,000 |
| Firemen (G.H.) | £5,000 |
| EUSS groups | statistically negligible |

2. Annex A describes the arrangements at present in force for determining the pay of each of these groups. It is clear that the arrangements vary widely. The Government needs to consider a comprehensive approach to public service pay, but this cannot be complete uniformly.

3. We assume that, with few exceptions (such as the armed forces, pay and conditions of service will continue to be settled by negotiation between representatives of employers and employees. The question is what ground rules, if any, should govern the negotiations, and how their conduct and results should be brought to bear.

FUTURE ARRANGEMENTS FOR PAY IN THE PUBLIC SERVICES

This note discusses the future approach to pay in the public services. For this purpose, the public services comprise the following.

| Group | Approx. nos. (full time equivalents) |
|---|--------------------------------------|
| Civil Service Non-Industrials | 500,000 |
| Civil Service Industrials | 166,000 |
| APT&C grades (essentially LA non-manuals: administrative) | 5-600,000 |
| LA Manuals | 650,000 |
| School and FE teachers | 500,000 |
| University teachers | 37,000 |
| NHS Ancillary workers | 213,000 |
| Nurses | 410,000 |
| Ambulancemen | 17,000 |
| Doctors and Dentists | 100,000 |
| Police | 130,000 |
| Armed Forces | 330,000 |
| Firemen (E&W) | 36,000 |
| TSRB groups | statistically negligible |

- Annex A describes the arrangements at present in force for determining the pay of each of these groups. It is clear that the arrangements vary widely. The Government needs to consider a comprehensive approach to public service pay; but this cannot be complete uniformity.
- We assume that, with few exceptions (such as the Armed Forces), pay and conditions of service will continue to be settled by negotiation between representatives of employers and employees. The question is what ground rules, if any, should govern the negotiations, and how wider economic considerations can best be brought to bear.

Background

4. History is important. Historically, 4 main types of approach to pay determination have developed.

(a) Since the Priestley Report of 1955 the Civil Service (up to Assistant Secretary level) has had a formal system of comparing rates of pay with rates for similar jobs elsewhere. Although there is some room for negotiation about the definition of similar jobs and the interpretation of the data, and other factors such as internal relativities may be taken into account, the system in principle produces fairly precise and well-defined pay comparisons. It was originally based on the assumption that civil servants could not or would not strike and that market factors could not easily be applied to the pay of most grades in a career service; the aim should therefore be to set up an objective method, avoiding disputes and confrontation but producing fair and satisfactory pay levels. However, in recent times, under the pressure of inflation and the efforts of Governments to grapple with it, the system has repeatedly been superseded.

(b) Certain groups, notably the firemen and police have arrangements providing a more generalised type of comparability through links with the growth of earnings in the economy at large. In practice, the Armed Forces have received similar treatment (see also (d) below). The grounds for this are, as to some extent with the Civil Service, that the groups provide essential services and cannot or should not strike.

(c) For the rest of the public services, there have been no clear principles for determining pay. Both sides have been free in negotiation to adduce any facts they considered relevant. Negotiations have been supplemented, from time to time, by ad hoc enquiries, such as the Clegg enquiries of 1979-80; and although comparability has played a part, both in the negotiations and in the enquiries, it has never been systematised.

(d) Finally, Review Bodies have been established for certain senior or sensitive groups or groups which have no, or restricted, ability to negotiate. The terms of reference of the Review Bodies are very broad and make no special reference to comparability. In practice, however, comparability has influenced the Review Bodies to a greater or lesser extent. The system has not worked well under the pressures of inflation and the efforts of Governments to beat it. Review Body recommendations

often
have been overridden.

5. In short, there is no single or comprehensive set of principles or type of machinery for determining pay in the public services, and there never has been one. This paper considers whether such a set of principles should be developed and, if so, how it could be made to influence the behaviour of negotiators in the public services. It does not consider the separate question whether the principles should be formally announced. Nor does it consider the future of Pay Review Bodies, since these raise some separate and special questions.

Changes in the situation

6. The circumstances in which public service pay is decided have changed, especially over the last 10 or 15 years, in three important ways.

7. First, inflation has become the major national economic problem; and every Government in recent times has been much concerned with fighting inflation. This has meant that Government has frequently intervened in the determination of pay, by suppressing the operation of formal systems of pay comparison (in the last 15 years, the results of Civil Service pay research have been given effect without modification on only 3 occasions), by overriding the recommendations of Review Bodies, or by imposing formal incomes policies.

8. Secondly, the change to a system of cash control as opposed to volume control for public expenditure has affected the situation considerably. Under the old system, which continued until cash limits were introduced in 1976, cash provision for pay could readily be adjusted to accommodate the cost of pay agreements or Review Body recommendations. The need to control public spending in cash terms and to limit the burden on the PSBR led to the introduction of cash limits. It is now necessary to consider pay from an expenditure point of view. This could lead to a conflict between cash control and pay determination. Such conflict is likely to be most acute, particularly in the short run, where there is a commitment to some form of comparability (paragraphs 4 (a) and (b) above). However, it must be assumed that cash control over expenditure on pay will continue and will affect all parts of the public services.

9. Thirdly, workers in many parts of the public service are much more ready

to strike. Moreover, the distinction between staff with the types of pay system described in paragraph 4(a) and (b) and staff with the type of system described in paragraph 4(c) does not correspond to a distinction between those who cannot and those who can strike. Civil servants, for example, can and do strike, whereas it is in practice very difficult for NHS nurses to do so. Moreover, many of the services in which strikes would be most damaging fall outside the public services in the public trading sector.

Objectives for public service pay

10. Against this background, it may be useful to try to set out the objectives which should govern public service pay before considering possible systems of pay determination. Briefly, the objectives seem to be as follows:

- (i) to attract and retain, as economically as possible, an adequate number and standard of personnel to enable the employer to provide a level of service which is acceptable to the community and at a cost which is also acceptable;
- (ii) to influence pay behaviour in the rest of the economy in a non-inflationary way;
- (iii) to act as a good employer and to be fair to employees in the public service;
- (iv) to achieve a broadly stable system, rather than one which fluctuates between low settlements and 'catching-up', and which leads to frequent confrontation.

The role of comparability

11. What do these aims suggest as regards the role of comparability (whether in the sense of formal systems of pay comparison, or more broadly) against the background set out in paragraph 4 to 9 above? The first aim can be taken as meaning that the proper market price, no more and no less, should be paid for

the skills which are needed in the public services. It can be argued that comparability is, in fact, a proxy for the market, in the sense that it is unlikely that total remuneration for similar work in public and private sectors can diverge very widely without unacceptable effects on recruitment and retention. However, in practice, comparability has tended to enshrine historical pay relativities, to lay heavy emphasis on ideas of fairness, and to take less account of such factors as changes in the relative attractiveness of working in the public sectors or changes in relative productivity. Historical relativities and concepts of fairness cannot be ignored; but it may well be that they have played too great a part in public service pay determination over the last quarter century as compared with other aims.

12. In particular, it is necessary to take account of the market. It is a broad objective of economic policy to make markets work more efficiently. In the market for public service labour this implies adjusting pay to take account of market forces. If there were excess supply of a particular type of public service labour there would be a presumption that its pay should grow less rapidly than pay elsewhere for a year or two, so that labour was encouraged to move. A large differential, let alone a growing one, could not normally be maintained, at least for any significant period of time. But a small differential, if maintained would have an important cumulative impact on the allocation of labour.

13. It may be helpful to illustrate these points in the particular case of the Civil Service, which has the most highly developed and formal system of pay comparisons. On the one hand -

(a) the apparent precision of the results to emerge from the pay research process is somewhat spurious. The selection of analogues, particularly at more senior levels, usually involves a considerable element of judgement, and can rarely be subjected to the objective test of whether there is an interchange of the personnel concerned.

(b) There is room for wide difference of opinion about the value of non-salary benefits, and in particular of such intangible benefits as security of employment. It seems intuitively likely that the value put on such benefits will change with economic and other circumstances; but in practice the system tends to regard them as constant. This, with the point at (a) above has led to a lack of confidence among commentators and

the general public in the fairness and objectivity of the system.

(c) The system takes no explicit account of supply and demand.

On the other hand -

(d) Even if it is thought that (a) and (b) above suggest the need for a step change in the existing relativity between civil service pay rates and pay elsewhere, it is unrealistic to suppose that pay in the Civil Service can indefinitely grow more slowly than the pay of comparable groups elsewhere.

(e) As a matter of negotiating and managerial realities, it is necessary to take account of movements in pay in other similar occupations. However important it is to subject civil service pay to the discipline of supply and demand, data on supply and demand simply do not permit the fine tuning that would be required for a fundamental review of relative pay rates on the occasion of each pay settlement.

14. Taking these considerations together, one might draw the following conclusions.

(1) Formal systems of pay comparisons, even where they can be applied, should play less part in the future than in the past. Something more flexible is essential. In most of the public services, or course, they cannot be used at all, because the public sector is itself the dominant employer.

(2) There may well be a need for a step change in relative pay rates in parts of the public service in order to take account of current economic circumstances.

(3) Once appropriate relativities have been established, both formal pay comparisons, where applicable, and more general comparisons with pay movements in the economy at large will have a considerable bearing on pay settlements in the public services.

(4) Such comparisons must, however, take greater account than in the past of market forces. Paragraphs 15 to 18 below make some suggestions in this area.

Market factors

15. It is necessary to have information about the excess supply of or demand for each type of labour when taking account of market factors. This information would take various forms. For non-career services, it should consist of basic data about number of vacancies in relation to applicants, and number of resignations in relation to total jobs ("quit rates"). For career services where there is very little movement in and out except for initial recruitment and final retirement (eg higher grades of the civil service), a careful analysis of the availability of sufficient numbers of appropriate quality recruits at existing pay levels is required. Many categories are intermediate between these two extremes. Doctors, for example, can and do find jobs in the private sector and abroad, and so information relating to mid-career vacancies, applications and quit rates is relevant, as well as studies of initial recruitment (in this case, medical school admissions).

16. There are a number of important features of the use of market factors in determining public service pay. First, unlike under a rigid comparability system, there is even in theory no precise formula into which objective data can be fed to produce figures for public service pay. Although, in principle, studies, primarily econometric, could suggest what levels of pay would be appropriate to clear observed market disequilibria, such studies are usually open to different interpretations. More importantly, a view has to be taken about the speed at which it is desirable to clear disequilibria. These are properly the subject of negotiations, and depend on the relative weights given to fairness and market factors. They cannot be determined a priori by reference to the facts. The data can indicate the direction of the change in pay relative to that elsewhere, and perhaps give an idea of whether the required change is large or small: they will not generate precise numbers.

17. Secondly, the data on excess supply and demand do not necessarily have to be collected by the central government or an independent body. In most cases it will be enough if the information is available to the managers of the relevant public service and both sides of the negotiations. Preliminary tentative enquiries suggest that some of the managers do already have the relevant information, while in other cases it might be necessary for them to start keeping their records in a different way. However, at the beginning when the Government is trying to persuade people (employers, employees and the general public) of the need to take account of market factors, it will probably be necessary for the Government to collect together and publish relevant information for

a variety of groups, or ask an independent body to do so on the Government's behalf. There are precedents for this kind of exercise. Some of the review bodies and ad hoc enquiries have paid attention to demand and supply factors. The Government has also itself undertaken occasional enquiries, a recent example being that into doctors (Medical Manpower Steering Group Report, August 1980).

18. Thirdly, for many categories of labour, especially where there are career services, it is not necessary to collect detailed information every year. Supply and demand respond fairly slowly to relative pay, and efficiency probably will not suffer significantly if pay is adjusted appropriately only every few years.

Possible systems of pay determination

19. If the broad conclusions of the preceding sections of this paper are accepted, it is necessary to consider what methods of pay determination would best give them effect. As noted in paragraph 3 above, we assume that pay and conditions of service will, with few exceptions, continue to be settled by negotiation. The following paragraphs are therefore directed to the framework within which bargaining takes place, and the ways in which Government can influence the system where it is not itself the employer.

(a) Systematised pay comparisons

20. It would be possible to revert to this system for the non-industrial Civil Service after the current suspension, but meanwhile to secure changes in the methods of pay research so as to make the system less vulnerable to criticism and to achieve some general reduction in the level of at least some Civil Service salaries compared with the private sector (possibly, in part, as a result of the recommendations in the Scott Report on pensions), but then to continue as before.

21. However, the argument so far in this paper suggests some cogent reasons for not proceeding in this way.

(i) The system purports to produce, within narrow margins, an objectively 'right' result, which, however, takes little or no account of the Government's general economic policy or its ability to pay. The Government then has to choose between either accepting that a largely external process will determine the pay of its staff or overriding what appears to be an

entitlement established by some impartial process. It is essential to the system that the results emerging from pay research should normally be applied. It is likely that while inflation continues to be a major problem the Government would frequently have to override the system.

(ii) The techniques of pay research no longer command universal support.

(iii) If it is thought right to introduce some assessment of market value into the process, this cannot be reconciled with a formal system of pay comparisons.

(b) Bargaining within arbitrarily-determined cash limits

22. In theory, the Government might continue to proceed as this year by fixing cash limits for the various parts of the public services on the basis of its own judgement of what the taxpayer and the country can afford, without reference to market value or pay movements elsewhere in the economy, and insisting that all public service employees settle within the constraints of the limits. (This does not, of course mean that each individual pay settlement must conform to the pay increase assumed for the cash limit). We do not believe that this is a realistic long-term policy. It would generate serious friction with both employers and employees in the public services; and the increasing disparities between pay in the public and private sectors which it would create would rapidly lead to overwhelming difficulties of recruitment.

(c) Constrained bargaining

23. The most promising approach therefore seems to be to move towards systems in which data relating to earnings in comparable employment are collected in cases where this is appropriate, and also data relating to market value and supply and demand. Both types of data should be accepted by employers and employees as relevant, but not as yielding binding results. The Government could itself collect such data where it was the employer (or it could hand the task over to an outside agency, or to a Pay Research Unit with new terms of reference). Such an approach might fit easily for the Civil Service, with its background of disciplined comparability. But it might fit less well in the NHS, and even less in local government, both because of the difficulty of collecting data for groups (eg nurses, doctors, teachers) without obvious comparators, and because the bargaining traditions and institutional arrangements are not geared to this approach. Even if the employers did deploy all the data, there could be no

guarantee that the employees would accept it as relevant. If it were pursued, the Office of Manpower Economics or some other organisation, could collect the data, at least initially, for other parts of the public service, as they did for the Clegg Commission (see also paragraph 17 above).

(d) Unconstrained bargaining

24. Finally, it would be possible to have a system in which either side could adduce whatever arguments it considered relevant and advantageous: indeed, this is the system which has traditionally been used in most public services. It avoids any appearance of an automatic process generating results independently of the Government's general policies or ability to pay. On the other hand, it increases the risk of confrontation; it does not demonstrate that the Government wishes to reduce the importance of comparability in pay determination; and it does not produce results which can be publicly defended by reference to objective evidence, interpreted in the light of the Government's policies and ability to pay, and which therefore have a reasonable chance of being acceptable to public and Parliamentary opinion.

25. We therefore consider the approach described in paragraph 23 above to be the most promising. If this general approach were adopted, its application to each major area of public service pay would have to be considered separately. In many cases eg. local authorities and much of the NHS, there might be little need for change from current practice so far as data are concerned. Where data are collected to provide a basis for negotiations, they might be still more useful and effective if they were published. Publication would both help influence public opinion in the right direction and reduce or remove the widespread suspicion with which both pay research and other comparability exercises are regarded.

Localised Bargaining

26. Although this paper is essentially concerned with national negotiations, the arguments in it suggest that local bargaining should ideally play a larger part than in the past. It is, for example, a matter of common observation that it is much easier to recruit adequate numbers of suitable staff for many Civil Service grades in the provinces than in London. This strongly suggests that the rates of pay offered in the provinces are unnecessarily high. The same is probably true in other public services: they all offer some form of

London Weighting, for example, though this is seldom or never pitched at a level which equalises recruitment in London and the provinces; nor, of course, does it deal with variations in the structure of the labour market outside London.

27. Any large scale move towards localised bargaining would be difficult to negotiate with the unions, and could create managerial problems, at least at more senior levels, if it made it difficult to move staff around the country. However, it seems well worth trying to secure some move, at least at more junior levels, in this direction.

28. The system of constrained bargaining described in paragraph 23 would have to be dovetailed with the system of expenditure control. This is for two main reasons, which are discussed in more detail in paragraphs 29-31 below.

(a) Consideration of what the country can afford must be brought to bear on the process of pay determination.

(b) But the expenditure control system will break down if it attempts to hold pay at levels which are unrealistic in relation to the market for any great length of time. It must therefore be based on a realistic assessment of the results likely to emerge from the (reformed) pay determination process.

Expenditure Control

29. As we have argued above, pay determination must in future be seen always in the context of expenditure control. We assume that the Government will want to maintain the system of cash limits as a method of control. Two important points follow:-

(a) When the cash limits are originally fixed, the important criterion is what can be afforded in total for each service. This, of course, involves a judgement which must be made in the light of many factors, including political commitments, as well as expectations of cost. But since pay is such an important element in the cost, and therefore in the judgement of what can be afforded levels of pay must be constrained by the judgements which go into the setting of cash limits.

(b) Once cash limits have been set, they should be respected. This does not have to be a totally infrangible rule: there should be some scope

for decisions to vary the limits as a result of special developments; but if this were carried very far, the system would cease to serve its purpose.

30. It follows from this that we should avoid arrangements in which both the amount and the implementation of an increase in pay are determined independently of the relevant cash limit and without regard to funds actually or potentially available. The Government should not put itself into a position in which it commits itself to implement arbitration awards, review bodies recommendations or pay research without leaving room for the interests of financial management to be taken fully into account whether through processes of negotiation or through judgement by Ministers.

31. A general difficulty which arises both in setting and in operating cash limits is that the freedom of manoeuvre for management in adjusting expenditure plans to ensure that cash limits are met is in practice very variable. Three particular kinds of situations may be noted:-

(i) Minimum flexibility is found where the expenditure covered by the cash limit is entirely or almost entirely devoted to pay. There must always be some scope for adjustment of numbers employed during the year, but this is usually constrained, at the most, to a very few percentage points. If, additionally, an attempt is made in advance to set targets for economy in numbers, the system quickly becomes over-determined and little flexibility remains.

(ii) A middle position is where cash limits cover wide varieties of expenditure; in particular instances there may be severe pressures all round, but in principle and as a general rule, the ability to adjust several kinds of expenditure makes for an increase in flexibility.

(iii) Maximum flexibility arises in such cases as local authority expenditure where the cash limit applies firmly to a major source of funds, but there is scope for some variation of the total funds available, by recourse to other sources.

The problem is to reconcile the needs of the different situations in as practical a way as possible.

32. Government cannot hope for more than the occasional year to impose through

the cash limit system a restraint on pay which takes the settlement significantly below the trend of the market. This applies both to the general level of pay increase for the public services, and to particular groups. It means that, in general, the amount provided in cash limits must be as realistic as possible and, especially, that if the realistic judgement is that significant pay increases cannot be avoided or offset by reduced manpower or levels of services, then adequate funds must be provided to cover them. We do not believe that any continuing approach to public service pay can operate on a basis which every year sets pay increases below those in the rest of the economy.

33. However, even if the initial judgement attempts to be realistic, there can be no guarantee of a satisfactory match - indeed, discrepancies are certain to arise. As long as they are within the limits of flexibility in handling total manpower, this will not be inconsistent with maintaining cash limits. But, as already noted, the flexibility in many cases will be very limited.

34. It is obvious, as we have concluded above that the processes of pay determination for the public services must include negotiation. One way of resolving the potential conflicts, at least in theory, would be to conduct the negotiations before cash limits are set. The timetable for producing relevant data would be adjusted so that both sides had it beforehand. For some groups within the public services, where there is no compelling need to set cash limits until very shortly before the beginning of the financial year, this might just be possible; but for local government services, it is essential that cash limits should be known in the autumn. Some others are fixed at later points during the winter. This approach would therefore imply a succession of negotiations with unions, beginning very early in the autumn and continuing until January or February, each being preliminary to the setting of the relevant cash limit.

35. It is very doubtful whether such an approach would be workable. It is difficult to imagine unions and managements generally agreeing on future pay increases sufficiently far in advance to permit accurate planning for the financial year, which would be the objective. But apart from difficulties of this kind, it must be undesirable in principle for the Government to approach the fixing of cash limits in this way. The effect of a procedure of this kind would be to create the impression that the judgement about what can be afforded was a secondary consideration. The arguments against such a procedure are particularly strong in the case of local authority employees. If the Government had not taken any position on cash limits before negotiations with local authority

manuals and other important groups began in the autumn, the danger of excessive settlements would be much increased and the Government would be faced with the awkward decision, after the event, whether to finance them or not. This means, we think, that the idea of fixing cash limits after negotiations must be absolutely ruled out in the case of local authorities; and if so we think it must also be rejected for the rest of the public services where similar arguments apply although with less force.

Possible changes in negotiating timetable

36. The present timetable for pay negotiations in the public services has a number of drawbacks.

(a) Several key settlements (police, firemen, local authority manuals, NHS ancillaries) occur relatively early in the "pay round", from September to December or January. Although the "pay round" is generally regarded as beginning in August, the bulk of settlements in the private sector in fact occur in the first few months of the calendar year. It follows that the public service settlements tend, to quite a large extent, to set the tone of the round; and this fact increases the difficulty of the Government's choice between courting industrial action if it aims at a settlement which is low by reference to general expectations, and setting a pattern of excessive pay increases if it does not. It would be much easier if the settlements came later when there was an established pattern of private sector settlements.

(b) This difficulty is heightened by the fact that the factors for the RSG cash limit have to be announced in November, when important local authority pay negotiations are in progress or prospect.

(c) On a more technical level, the fact that the pay year for many groups of staff does not coincide with the financial year creates various difficulties: for example, the Government has to give some indication of pay factors for the next pay round; and however heavily this indication may be qualified, a good deal of - possibly unwelcome - significance is bound to be attached to it.

37. There is therefore considerable attraction in trying to concentrate public service pay settlements around the start of the financial year on 1 April. However, this can be only a long-term aim. The unions would be certain

to demand a price for accepting the change; and since the change would mainly affect services outside the control of central government, its adoption would depend on the attitude of the local authorities and others.

A possible approach

38. We can see no neat or easy way out of all the difficulties; but the key may be to consider the process of pay determination not in terms of a single year, but dynamically, taking one year with another. Once the system was in full operation, the sequence of events might be somewhat as follows:

(1) The general approach to cash limits would be settled in November, in accordance with the needs of Government financial planning generally. (It might however be possible to provide some flexibility by leaving the cash limits relating to one or two particular groups to be settled a month or so later if necessary.)

(2) To enable it to arrive at a judgement about the appropriate level for cash limits for each part of the public services, the Government would undertake, in the weeks preceding November, its own examination of available data. In principle, these would be much the same as the data which (as envisaged above) would be available as a basis for the "constrained bargaining" described in paragraph 23; but they might not be identical since the data for bargaining purposes might not be fully available until later. If so, the Government would have to proceed on the basis of data available from previous rounds of pay negotiation and any preliminary information relating to the round then beginning and forecasts of pay movements in the economy generally for the following year. It might be useful to have consultations with the employers/management as part of the input to arriving at a judgement. It is also relevant that in many services a full-scale analysis of supply and demand would not be needed in each and every year.

(3) An important part of this process would be the consideration of exceptional cases, where pay and market improvements and particular experience of the previous round of negotiations would point to the need for higher or lower settlements for some pay groups compared with the general average. The Government would have to be prepared to differentiate in cash limits for different pay groups, allowing more for some cases than in others.

It would be important for the employers/management to know the basis for such differentiation.

(4) Another important aspect of this process would be the relationship between the cost of public services, in terms of pay, and the decision as to the quantity of those services to be provided. For example, prospective increases in the pay of a particular group at a rate very much higher than the average could lead Ministers to consider whether they wished to reduce the quantity of what threatened to become a much more expensive service. If it seemed necessary to provide, say, 10% increases for one particular large group, the Government could decide to allow, say, 7% with the deliberate intention of offsetting the inevitable pay increases by a reduction in manpower and/or level of service.

(5) Negotiations for each individual group would follow the fixing of cash limits, within the general concept of "constrained bargaining" described above. The precise arrangements for producing the information about movements of pay in comparable areas of employment and about market trends would differ from case to another. But it would be assumed, in all case, that the outcome of pay negotiations would have to be financed within the cash limits which by then would have been set. This would not rule out the possibility of rare exceptions to this rule; but, as argued above, if exceptions were anything but rare, they could undermine the system of financial control.

(6) It would be recognised that this approach could lead to situations in which data pointing to increases which could not be afforded during the year in question would have to be overridden at the time; but it would be acknowledged that such data would have to be taken strongly into account in judging the appropriate financial provision for the following year. It could indeed be helpful to the successful outcome of negotiations compatible with cash limits in a particular year if there developed some understanding that lessons learned at the time would be fully taken into account in settling cash limits for the following year.

(7) It must also be recognised that it is inherent in this approach that it will reveal the Government's views on desirable movements in relative pay. Depending on the direction of the movement, this may stir up trouble with the unions or weaken the hands of employers. But this is inevitable, unless the pay factors for cash limits are to be uniform for all services;

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and in our view such uniformity is quite unrealistic.

(8) Finally, it will be necessary to give further thought to the relationship between control of pay and control of staff numbers. If the Government fixes and publishes pay factors for cash limits and targets for staff numbers assuming the maximum feasible reductions within an acceptable standard of Service, it has virtually no flexibility in negotiation. The pay factor becomes both the starting point and finishing point of negotiations; and it is not realistic to think that this is a situation which can be maintained for very long.

The problem of transition

39. Even if it is accepted that the approach sketched out above is a desirable long-term aim, there will be serious difficulties in putting it into effect for some years. When the Government's economic and monetary policies have taken full effect, the average level of pay settlements in the private sector should be compatible with monetary stability and a sustainable level of employment. There is no reason why the average level of pay settlements in the public services should be different, though there will naturally be variations in individual services about the average to reflect market factors, expansion or decline in the size of the service, and so on.

40. It would, however, be over-optimistic to expect to reach this stable state before several years have passed. During those years, there will be serious problems.

(a) It will take a considerable time before union leaders, and their members, come to regard pay settlements in low single figures as usual, rather than the double figure settlements which have been customary for the last decade or more.

(b) At a macro-economic level, it will be necessary to effect a shift away from wages and salaries in favour of profits. In the short run, this will be, or be represented as, a "decline in living standards", which the unions are bound to resist.

(c) This resistance will be intensified in the public services if pay levels decline relative to those in the private sector, whether in order

to reduce the relative attractions of working in the public sector or in order to lead the general level of pay settlements downwards to accelerate the transition to the "stable state".

41. It is not possible to say in advance how long the transitional period will last or how, in detail, it can be coped with. Clearly the Government must continue to promote understanding of its economic aims and methods. It must also continue to impress on private sector employers the need for pay restraint (obviously, the higher the level of private sector pay settlements, the greater the Government's difficulties in imposing restraint in the public sector). Finally, it will be necessary to do everything possible to convince the public service unions that the Government's policies, including policies on pay, are not transitory expedients but permanent features of the economic landscape; and, in particular, that current pay restraint is not a passing phase, which will be followed either by a general return to double figure pay settlements or by a restoration of the relative position of the public services to the most favourable point they may have reached in the past. On the contrary, relativities will in future be unimportant except as they reflect underlying market factors.

42. For the rest, it will be a matter of making difficult judgements from time to time to balance the need to secure pay restraint in the public services against the risk of provoking such serious resistance, or such serious management difficulties, that publicly declared policies cannot be sustained.

43. The difficulties will be particularly serious in 1982-83. In settling cash limits for 1981-82 the provision for pay increases has deliberately been set severely low. In addition, normal processes of pay determination have been set aside or overridden. It therefore seems inevitable that the setting of cash limits for 1982-83 in respect of the pay element will be difficult, and highly likely that some differences between groups will have to be allowed even if there are great difficulties in deciding exactly what those differences ought to be.

44. All this points to preparing the ground as carefully as possible in the period between now and next summer. If Ministers were able to agree in the next month or two on an approach to public service pay in the period after the current pay round, this would provide a basis for conditioning public opinion - and opinion among public service employers and employees - to a new approach well in advance.

Summary and conclusions

45. (a) There can be no single or comprehensive set of principles or type of machinery for determining pay in the public services.
- (b) Comparisons between the pay of public servants and similar groups in the rest of the economy are, and will continue to be, important; it is not realistic to suppose that total remuneration for similar work in the public and private sectors can diverge very widely for very long.
- (c) But the more formal systems of comparability are now less appropriate and less easy to operate because in recent years inflation has become the major national economic problem; the control of public expenditure gives much more weight to cash control; and many workers in the public services are much more ready to strike than they used to be.
- (d) It must also be recognised that public opinion has little confidence in the accuracy or objectiveness of either pay research or even of looser systems of comparability. In particular, it is necessary to take greater account of market factors and to have more, and more systematic, information about the relative balance of supply of and demand for particular type of labour in the public and private sectors.
- (e) The best long-term approach to the determination of public service pay seems to be "constrained bargaining" within realistic cash limits. In appropriate cases, this would be on the basis of data (which would have to be accepted by both employers and employees) giving appropriate weight both to earnings in comparable employment and to data relating to market value and supply and demand. Such data should be published. But such an approach may well be too formalised for some public service groups (particularly in the local authority field). Individual decisions would be needed on the precise approach for different groups in the public services.
- (f) Such a system would have to be dovetailed with the system of public expenditure control in order to ensure that considerations of what the country can afford were brought to bear on the bargaining process, and that the expenditure control system was based on realistic assumptions about pay.

- (g) Within the expenditure control system, cash limits should not normally be amended once they have been decided; but this implies that cash limits should be fixed on the basis of a considered and realistic view of trends in the relative pay of the groups concerned.
- (h) It would be undesirable to set cash limits after the outcome of the relevant pay negotiations was known. But, so far as possible, they should be decided both in the knowledge of the implications of the data to be used for the "constrained bargaining" process and in the context of what can be afforded.
- (i) It is unlikely that satisfactory results will be achieved in each and every year. It will therefore be necessary to have a process taking account of shortfalls and excesses accumulated from the previous year or years.
- (j) The transition to the new approach will be difficult, and particularly so in 1982-83. It seems desirable to decide future policy soon in order to begin conditioning public opinion - including opinion among public service employers and employees - to the new approach well in advance.

ARRANGEMENTS FOR PAY DETERMINATION IN THE PUBLIC SERVICES

This Annex describes in very summary form the arrangements for determining pay for each of the groups mentioned in paragraph 1 of the main paper.

Civil Service non-industrial:

Negotiations between Government and Civil Service trade unions are the basis of pay research. Access, in principle, to binding arbitration at the request of either party; but the Government has the right to refuse access for reasons of national policy.

Civil Service industrials:

Negotiations between Government and a committee of trade unions, mainly on the basis of a loose form of comparability.

Local authority APTC grades:

Negotiations between the Local Authorities conditions of Service Advisory Board and NALGO (plus some other trade unions). Unilateral access to binding arbitration.

Local authority manuals:

Negotiations between representatives of employers and trade unions on the National Joint Council. No specific provision for arbitration.

School teachers:

Negotiations between panels of local education authorities and teacher unions. The employers have agreed to make no offer the total cost of which is unacceptable to the Government. Unilateral access to arbitration; awards must be given effect by the Secretary of State, unless set aside by resolutions of both Houses of Parliament.

University teachers:

Two stage negotiations, first between universities and the AUT, then between

those two parties and the Government. Unilateral access to arbitration.

Doctors and dentists:

Decided by Government on advice from Review Body.

Other NHS staff:

Negotiations in various Whitley Councils between employers (subject to Government control) and trade unions.

Police:

Negotiations in the Police Negotiating Body between employers and the Police Federation. No agreement may be implemented without the authority of the Secretary of State. Negotiations are conducted on the basis of indexation by reference to the earnings index. The police are prohibited by law from striking.

Armed Forces:

Decided by Government on advice from Review Body.

Firemen:

Negotiated between local authorities and Fire Brigades Union. Since 1978, earnings have been related to the upper quartile of adult male manual workers earnings.

TSRB groups:

Decided by Government on advice from Review Body.