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PRIME MINISTER

copied to:- Civil Service: Pay + Pensions: Pt 2.

Public Sector Pay Policy

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The meeting will have before it three papers - one by the Chancellor on public sector pay policy, circulated under cover of a letter to Mr. Lankester of 15th May; one by the Minister of State, Civil Service Department, circulated under cover of a letter to Mr. Lankester dated 16th May and dealing with the Pay Research System; and a report by officials on the next pay round, which you commissioned as background material and which I sent to you under cover of my minute of 15th May. You also have a minute, dated 16th May, - and not copied to colleagues - from the Lord President firmly plumping for the continuation of Pay Research in settling Civil Service Pay.

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Civil Service May 79 Pay + Pensions.

2. The Chancellor's paper is very much his own work and represents his own conclusions following a more detailed study of the options prepared by officials. This fuller report has not been circulated.

3. You might also like to bear in mind Mr. Hoskyns's recent report to you on the history of the BSC pay negotiations.

4. Discussion should centre on the Chancellor's paper as covering the wider ground, with Mr. Channon's paper as the second focus. The issues are very complex, not only in themselves but in their link with a range of other problems - e.g. nationalised industry EFLs - which are under separate consideration. They also impinge on, though the Chancellor's paper barely acknowledges this, nationalised industry prices. This discussion is therefore likely to be the first of several: in the nature of a Second Reading debate whose main purpose is to identify questions which need to be studied in greater detail before matters can be brought to the Cabinet.



5. One respect in which the Chancellor's paper is too summary is that it arrives at broad conclusions without considering all the practical details and constraints which in practice can determine the choice of policy options.

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6. To take an obvious example, the Government's commitment to the Armed Forces is quite specific. It is to "bring their pay up to full comparability with their civilian counterparts immediately and keep it there" (Manifesto, Page 29). The Chancellor's proposal - paragraph 9(c) of his paper - is to "dethrone comparability so that it survived as only one limited consideration in pay determination. The Government would take it into account in negotiations but would not be bound by the results". This paper does not make it clear that his proposal would mean reneging on the promise to the Armed Forces.

7. Similarly the Government has very specific commitments to the Police and the Fire Service which go beyond comparability to index-linking. It is not enough to say, as the Chancellor does in paragraph 12(d) that "Some sort of special treatment may still be appropriate for the Police and the Firemen". What special treatment? And can the Government defend and maintain it against those who do not get special treatment? Colleagues need specific suggestions so that they can come to a political judgment.

8. Ministers will need to assess whether, if the Chancellor's proposals were accepted, the end result would be an improvement on the present position. It is all very well to say that we must set a cash limit - as the Chancellor does in paragraph 5 - below the levels of 1979-80 for Central and Local Government and then assume that they can be made to stick. But it takes two to make a bargain, and if that bargain is not struck by disciplined comparability it risks being struck by force. This may be a perfectly acceptable route for the Government to follow; but before embarking on it the Government needs to have thoroughly assessed the cost of the struggle, the chances of success and the penalties of failure (notably the breaking of the cash limit system). The essential message of John Hoskyns's piece on the British Steel negotiations was that the Government took some critical decisions in advance without fully realising their consequences and was lucky to emerge as the apparent winners - and that even then, greater thought in preparation could have led to a cheaper result more quickly. The report by officials on the prospects for the next pay

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round carries, in its final paragraph, the same message. As the penultimate sentence puts it, "the common thread in these groups is that in each case it is prior decisions by Government, whether on pay-bargaining machinery or EFLs or cash limits, which will determine the climate in which decisions on industrial action will be taken". If the Government does decide that economic circumstances require a determined effort to "dethrone comparability" and to achieve a step-change downward in public service pay, it needs a worked-out strategy which extends not only forwards, to the chances of success and the penalties of failure, but also back to these critical prior decisions - so that they can be taken in the clear knowledge of the likely consequences.

9. There are two other points which might be made:-

- (a) The first graph attached to the Chancellor's paper, while designed for a different purpose, shows that throughout the seventies local authority non-manual employees did rather better in relation to their private sector counterparts than did non-manual Government employees. But over this period, and within the constraints of pay policy when applicable, local government employees bargained for their pay while those of central Government relied on comparability. While only a rough comparison, this does not support the notion that free collective bargaining will give a lower result in cash terms than comparability. The graph at Annex C of Mr. Channon's paper makes the same point even more forcibly. We think of pay research as an engine of inflation; but we do not know what result an alternative would produce, and it is likely that Civil Service pay may have gone up by less than it might otherwise have done under a system in which the Civil Service unions, with their ability to disrupt the flow of Government revenues, the flow of benefits to the sick, the old and the needy and the vital role they play in supporting the Armed Forces, were tempted to exert the potential strength of their bargaining position.
- (b) There are some important differences between a Government (or public service management) bargaining with its own employees and a private employer

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bargaining with his. One is that Government cannot go out of business. When the dust has settled Government has to go on: it still needs to collect taxes, pay benefits, defend the realm, nurse the sick, and so on. Another is that in carrying out these tasks, the Government has no alternative source of labour to that it already employs. There is no separate pool of Tax Inspectors, Post Office engineers, nurses or whatever to replace the existing staff. At the end of the day a bargain has to be struck with the existing group of employees.

10. I am not seeking to suggest that the Government can do nothing but accept the status quo. But I do think that the Chancellor's present paper is not an adequate basis on which to take decisions. A lot more work is needed before that point is reached. You could usefully commission further papers on:-

- (a) An analysis of the results of comparability where it has been applied to public service pay over a period with the results of pay for similar groups determined by other methods, so that the results of a change in the system can be assessed, at least in terms of historical experience.
- (b) A set of scenarios for the coming 12 months for pay, cash limits and manning in the main public service groups (Civil Service, local government and NHS) which would seek to explore the magnitudes of the numbers underlying the Chancellor's concern and the future choices for Ministers.
- (c) A similar set of scenarios seeking to establish the costs, results and likely course of pay disputes in the public sector as a whole (including nationalised industries) as a guide to colleagues in deciding whether, and if so which, pay negotiations they would be prepared to push to the point of outright confrontation.
- (d) Very important: A timetable of the critical dates on cash limits, EFLs and so on. This would be useful, not only for its own sake, but as a means of enabling Ministers to decide whether any alterations in the critical dates would enable them to exercise better control of events.

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11. Of course colleagues may be prepared to say now that they accept Mr. Channon's - and the Lord President's - arguments. This would clear a major uncertainty out of the way. But the Chancellor for one may jib at losing the weapon of cash limits entirely in settling Civil Service pay next year, and unless he is isolated it might be better to let all of the issues wait for decisions until all of the work has been done and further discussion taken place.

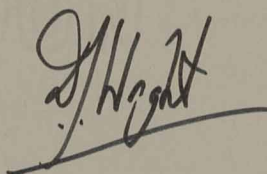
12. In order to get this work carried out - in the great secrecy which would be necessary - you might care to entrust it to a small group of senior officials from the Departments principally concerned led perhaps by the Cabinet Office.

HANDLING

13. You will want to invite the Chancellor to speak first followed perhaps by Mr. Channon, Mr. Ibbs, Mr. Prior and then other colleagues at choice. In introducing the subject it would probably be enough to say that the occasion was essentially one for a Second Reading debate, as a basis for putting further more detailed work in hand; and that it will be necessary for the group to meet again on one or more occasions before conclusions can be put to colleagues.

CONCLUSIONS

14. Subject to the course of the discussion, you will wish to commission whatever further work seems appropriate.



(Robert Armstrong)

*(Approved by Sr. R Armstrong
and signed on his behalf)*

15th May 1980