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E(80)48

COPY NO 31

3 JUNE 1980

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

CIVIL SERVICE PAY

Note by the Lord President of the Council

The Pay Research System

Civil Service pay has been settled on the basis of pay research since 1956, following the recommendations of the Priestley Royal Commission. The underlying principle is "fair comparison" with the total remuneration paid to outside employees engaged on comparable work; Civil Service rates are based on the middle of the range of outside rates. The data on outside jobs found to be closely comparable with Civil Service jobs is collected by the Pay Research Unit (PRU) and reported to the negotiating parties. The Civil Service Pay Agreement governs the way in which this data is to be used to determine Civil Service pay rates. The work of the PRU is audited by the PRU Board which publishes an annual report. In the event of disagreement between the negotiating parties, the Civil Service Arbitration Tribunal, chaired by an eminent QC, makes binding awards on the proper rates flowing from the pay research evidence.

2. The case for pay research providing it works properly may be summarised as follows:

- a. it is, by definition, a catching up process, and always follows and can never lead outside pay movements. The graph at Annex A illustrates how Civil Service pay has followed average outside earnings since 1964;
- b. it restricts negotiations to objective evidence and denies the unions the opportunity to use, for example, the RPI as a target to be beaten;

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- c. by providing a yardstick it removes from government the difficult political judgement of what to pay their own staff and ensures that outside judgements about the value of different types of work are reflected within the Civil Service;
- d. it provides for all elements of the remuneration package to be taken into account (President Carter's initiative last year on US Civil Service pay was designed to bring superannuation and leave entitlements into comparative consideration for the first time);
- e. it enables greater efficiency to be pursued in its own right without having to be paid for separately (contrast for example the reported 70% of savings from changes in postal services practices which are to go to the staff);
- f. it is buttressed by an arbitration system which makes binding awards on the rates flowing from the evidence. The present Chairman has shown a healthy regard for the sanctity of hard evidence and the constraints of the Pay Agreement and has avoided the "splitting the difference" approach popular with many arbitrators.

Anxieties and Criticisms

3. But the fact remains that the detailed operation of the system needs to be looked at afresh. The main worries to which we should address ourselves are as follows:

- a. pay research is a cosy system, shrouded in secrecy, lacking independence, and run by and for civil servants;
- b. the analogues are suspect, with too much emphasis on banks and other high payers;
- c. the arrangements for taking account of the value of pensions, job security, fringe benefits and uprating (the adjustments to analogue rates to take account of different settlement dates) are suspect;
- d. it sets a lead which private sector employers follow and thus fuels inflation;
- e. it takes no account of what the country can afford;
- f. it takes inadequate account of supply and demand factors;
- g. it does not allow adequately for differences in individual merit.

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To take these one by one:

4. Cosiness, Secrecy, Lack of Independence. The Director of the PRU and the Chairman and members of the PRU Board are appointed by the Prime Minister. They publish an annual report on the work of the PRU - the suggestions for extending the role of the Board in paragraph 4c below would be reflected in that report. Only five of the 30 or so PRU survey staff engaged on pay research are directly recruited or seconded from private sector employers. Clearly the proportion of outsiders must be increased. In particular, the post of Director of the PRU should be filled by an outsider. As far as the PRU Board is concerned, we have recently strengthened the membership through the appointment of Mr Holland (Chief General Manager of Pearl Assurance) and Mr Russell (Managing Director of UK Alcan). We now need to go for a strong replacement for the Vice Chairman, Sir Derek Rayner.

b. Suspect Analogues. Responsibility for the selection of the outside analogues now rests firmly on the Director of the PRU. In constructing the external survey fields he sets out to ensure that the selection of individual organisations closely reflects the distribution of outside staff engaged on comparable work in the different industrial and commercial sectors in the community at large. It is this that causes 20% of the analogues for the administrative grades to be drawn from Banking, Insurance and Finance. The PRU Board is examining the number and type of organisations chosen for the outside surveys. This is important and I intend to encourage them to be thorough and searching in their examination.

c. Pensions, Job Security, Fringe Benefits, Uprating.

These are all matters covered by the Civil Service Pay Agreement. At present the Board's remit stops with its oversight of the Unit's data collection. The Chairman of the Board believes that it should be empowered to comment on how this data should be used in the negotiations. Examples of what he has in mind are relative job security, and the principles underlying the quantification of fringe benefits and uprating. I think this is right and that we should insist that the Board should undertake these tasks as a matter of priority.

d. Leads the Private Sector. Pay Research is based on rates already being paid for comparable work. It can never lead. The Factual graph at Annex A demonstrates this and conversely it does not support the theory that holding back Civil Service pay has a restraining influence on outside earnings.

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e. What the Country Can Afford. Civil Service pay rates should reflect the values determined by the market for different skills. If we set our faces against this it will inevitably lead to lower standards, reduced efficiency and greater industrial unrest. Total manpower costs are based on both numbers and pay. If we accept that we must pay the market rate for the job, it is on numbers that we must act to reduce the cost of the Civil Service. We are already embarked on such a programme.

f. Supply and Demand. Pay research must reflect the market so that the Civil Service responds to supply and demand considerations. At present this is done on a national basis but, following E Committee discussion in February, my department has been examining the question of introducing regional variations in Civil Service pay rates. It looks as if there might be an administratively simple way of doing this by applying the regional variations shown in the New Earnings Survey to the national rates produced by pay research. I am pursuing this further.

g. Individual Merit. We have asked the PRU to study outside practice on merit pay and they are due to report at the end of the year. I shall be preparing a preliminary report on this and on "range pay" for the Higher Civil Service before the Summer Recess. I hope we will find scope for improvement here.

5. To summarise, I recommend the following action to improve pay research:

a. increase the independence of the Pay Research Unit by taking early steps to appoint the next Director from outside the Civil Service and to increase the proportion of outside survey officers (paragraph 4a);

b. further reinforce the PRU Board by appointing a strong successor to Sir Derek Rayner as Vice Chairman (paragraph 4a);

c. urge the Board to pursue effectively its examination of the PRU's choice of analogues (paragraph 4b);

d. empower the PRU Board to examine and report as a matter of priority on the principles underlying the use made of the data produced by the PRU (paragraph 4c);

e. pursue further the question of introducing regional variations to the national rates produced by pay research (paragraph 4f);

f. seek improvements in the arrangements for encouraging and rewarding individual merit at all levels of the Service. (paragraph 4g).

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The unions would need to be consulted, and those changes which require amendments to the Pay Agreement would need to be negotiated.

Conclusions

6. There are 3 options for dealing with Civil Service pay:

a. scrap pay research and impose an arbitrary cash limit;

b. fudge in some way, as we did this year, cash limits and pay research;

c. improve the pay research system and set cash limits to reflect the hardest bargain we could negotiate on the pay research evidence.

7. All these options are difficult. Option a. will almost certainly mean an annual confrontation about the cash limit. This is just what the militants want. We would, I believe, face extensive industrial action in areas which could be very damaging to us - computers, revenue collection, customs, immigration, courts, prisons, defence and we might even end up paying more than under pay research. Arbitration would have to be denied as clearly we could not allow the Arbitration Tribunal to determine the Government's cash limit.

8. Option b. is no better. It could only be achieved by reducing numbers and/or staging. As to numbers, we have already set out publicly our aim for a smaller Civil Service during the lifetime of this Parliament. I do not believe we could sensibly cut more, in an arbitrary way, than has already been decided. Nor do I see how we could easily convince our supporters or the public if we tried to take credit for a figure of staff savings which we have already announced. Clearly, we could not hope to negotiate the improvement to pay research which I have in mind if we chose this option. So no way can option b. be a lasting system. We could of course stage a settlement. But if there was a substantial amount of staging we must still face the possibility of industrial action. Indeed in 1979 the lengthy and tiresome industrial action was mainly over staging. What is more, we would simply be shelving the problem until next year. We are already accused, because of the last Government's staging of the 1979-80 settlement, of paying the Civil Service 25% more this year. So I dislike option b. most of all.

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9. I am driven, therefore, to option c. The improvements to pay research I am recommending would provide us with a defensible system. It would have to be an agreed system. The union leaders would almost certainly object to some of the changes and we might very well have to appeal over their heads to the staff. We should have to leave them in no doubt that early improvements to the system are essential if it is to be allowed to continue. We should have to be prepared to say in return that we would then honour the new system. We should insist on receiving staff co-operation in the measures we shall be pursuing over the next 4 years to improve efficiency, eliminate waste and bring down the cost and size of the Service.

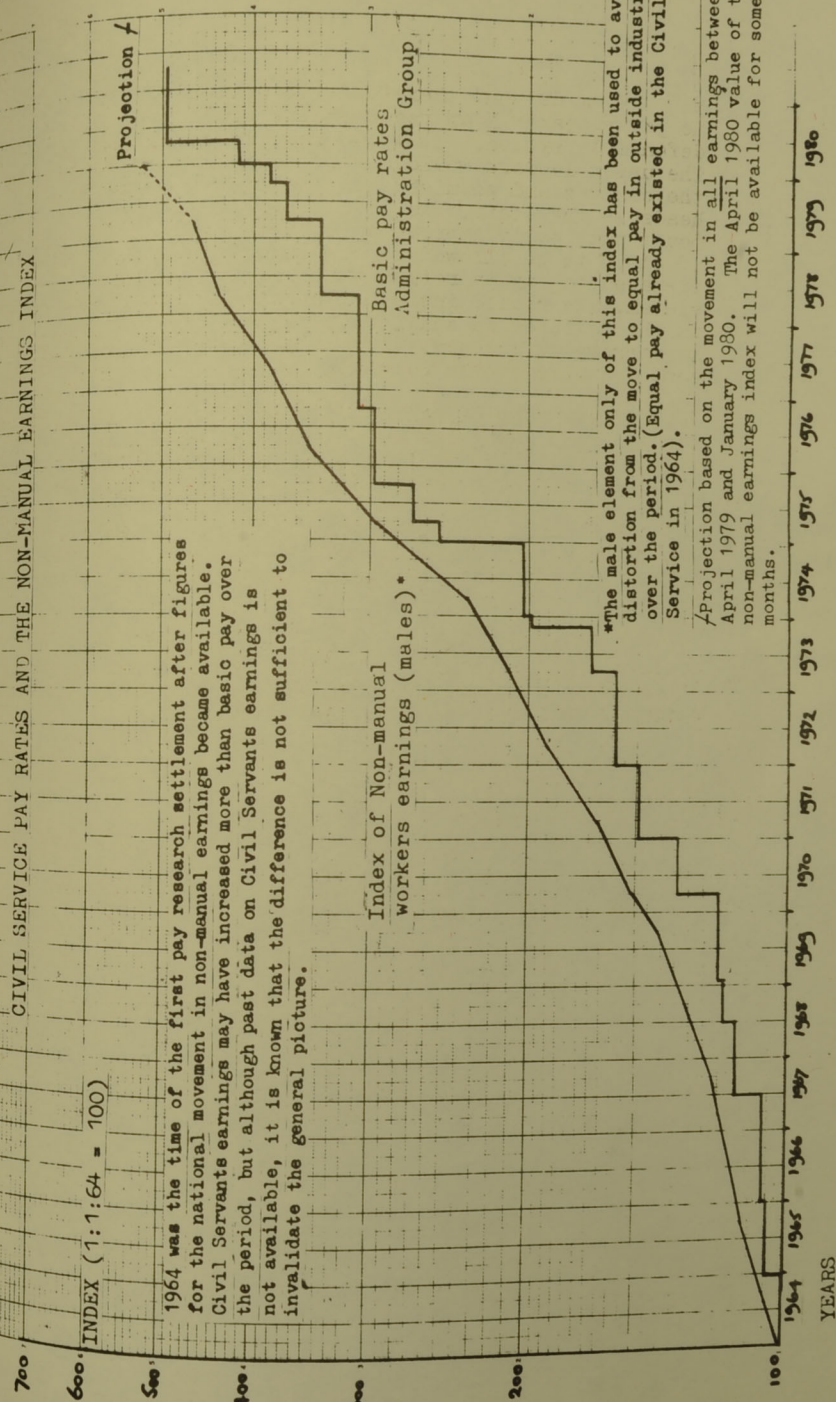
10. If we adopt a policy of depressing Civil Service pay for the next few years below what is happening outside, I think it will blow up in our faces. We could easily see a situation where, by adopting options a. or b., we depress the pay for the next 2 or 3 years facing industrial action and public inconvenience, only to find ourselves with a pay explosion a year or two ahead, possibly at the most inconvenient moment. Certainly past history points this way.

11. I have not come to these conclusions lightly. I am conscious of the real difficulties we are all facing. But it is my opinion that, of all these admittedly unattractive options, option c. is the least unattractive.

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ANNEX A

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