30

SECRET

Ref. A02357

PRIME MINISTER

Public Sector Pay

(E(80) 46, 48, 49, 53, 54, 55, 56)

BACKGROUND

There are four new papers for E Committee's resumed discussion on Public Sector Pay. E(80) 55 by the CPRS summarises the main issues and questions, with cross references to the other papers. It is supplemented by E(80) 56 which is a factual background paper by officials. The CPRS's second paper (E(80) 54) develops their own proposal for a regime of interim awards with the final settlements linked to private sector analogues in the 1980-81 pay round. The paper by the Lord President of the Council (E(80) 53) supplements his earlier paper E(80) 48 by setting out in more detail his proposals for improvements to the pay research system.

2. There is now a formidable mass of paper before the Committee. I suggest that you guide them through it by using the CPRS's main issues paper (E(80) 55) as an annotated agenda, and that you take it sector by sector starting with the Civil Service. You can then pick up points in the other main papers by the Lord President (E(80) 48 and 53) and by the Chancellor of the Exchequer (E(80) 46) as you go along.

3. It will almost certainly be necessary to have a further discussion at a later meeting. While there is no reason to treat each part of the public sector alike, the Committee will wish to look at the package as a whole and to be satisfied that any differences are defensible. This will also give the Secretary of State for Employment an opportunity to give his views; he is in the USA this week and will be represented by Lord Gowrie. The main constraint on timing is that, if any of the new initiatives for dealing with Civil Service pay are to be adopted, there will have to be negotiations with the staff side which should start in July.

SECRET

HANDLING

4. If you agree with this approach to handling the discussion, you might open the meeting yourself by outlining it to the Committee. You can also inform them that there will be a "second reading" discussion of the TSRB report on the higher Civil Service etc. at Cabinet on Thursday followed by a further discussion, also in Cabinet, to take decisions on both reports once the report on MPs is available.

The Civil Service (paragraphs 7(a) and (b) of E(80) 55)

5. The settlement date of the non-industrial Civil Service is in April and that of the industrials in July - i.e. the latter have yet to settle for the present round; but the approach to them is essentially the same. The CPRS in paragraph 7(a) of their paper summarise the three possible approaches under discussion:-

(i) The Lord President (E(80) 48 and 53) recommends cash limits reflecting the hardest bargain which can be negotiated on the basis of improved pay research systems.

(ii) The Chancellor of the Exchequer in E(80) 46 wants pay research to be dethroned and primacy given to cash limits.

(iii) The CPRS (in E(80) 49 and 54) propose that, to deal with the lag problems, there should be interim increases in the next round, to be topped up later in the round by further increases to match actual increases in private sector analogues in the year 1980-81 (there are timing problems here: the pay increase for non-industrials is due on 1st April 1981, and that for industrials on 1st July 1981: the topping up increases paid might need to be paid later than 1st July 1981, which is the date suggested by the CPRS).

6. For this part of the discussion you might ask the Lord President to speak first on his proposal and then turn to Mr. Ibbs. The Chancellor of the Exchequer might then comment on the two other proposals as well as his own.

7. The fundamental question in looking at the first two possibilities is what is the likely gap between the cash limits of 13 per cent or less which the Chancellor wants to set and what might be the hardest bargain which could be

driven on the basis of revised pay research as proposed by the Lord President. There is great uncertainty on this. The note by the Treasury - paragraph 5 and Annex II of E(80) 56 - suggests that by the end of 1980 the year on year increase in earnings might be 16-22 per cent and by April 1981 12-18 per cent. It is on the basis of this that the CPRS suggest that the range might be 15-20 per cent. You may wish to press the Chancellor to give the Committee firmer guidance on this because without it Ministers are to a degree arguing in the dark. But if the probability is that even with hard bargaining the likely outcome will leave a gap between cash limits and pay settlement which cannot be bridged by further staff cuts, increased pension contributions etc., the choice boils down to raising the cash limit (before or after the event) to allow for something more than 13 per cent or setting it at 13 per cent and then risking industrial disputes which could be highly costly to the public sector borrowing requirement. (Annex III, Section 8, of E(80) 56 gives a short assessment of the possible effects of industrial action in the Civil Service). In looking at this the Committee will wish to bear in mind that the possibilities for bridging any gap by staff cuts are likely to be much more limited in the current round because the cash limit will from the outset take account of the substantial staff cuts which will be implemented in the coming year as the first stage of the exercise to bring numbers down to 630,000.

8. The CPRS's approach (in E(80) 49) would have the effect of tying Civil Service pay increases closely to the success or failure of the private sector in its own negotiations during the 1980-81 round. The Chancellor of the Exchequer will wish to comment on the implication that the cash limits would, therefore, have to accommodate rather than to constrain the outcome. The proposal is very much directed to meeting the argument that public sector settlements should be a beneficial influence on the private sector, and at the least not a bad influence. The Lord President, however, would question whether the evidence of recent years bears out the argument that constraints on public sector pay lead to constraints on the private sector - see the graph attached to his earlier paper E(80) 48. And there must be a question mark over whether the CPRS scheme could be negotiated with, or imposed on, the unions without industrial trouble. You will want the Lord President's assessment here.

9. This is the most difficult area of the Committee's discussion and is at the heart of the arguments over comparability. (Of the 5.6 million public sector employees listed in Annex I of E(80) 56 only 1.1 million are subject to comparability and of those approximately 0.7 million are civil servants, the rest being mainly the armed forces). It may, therefore, be necessary to commission further work from the CPRS, Treasury and CSD before the Committee can reach a final conclusion.

The Armed Forces (paragraph 7c)

10. There is a Manifesto commitment to maintain armed forces' pay to levels comparable with that of their civilian counterparts. The question is whether this commitment is binding. If it is, does the cash limit have to accommodate the outcome of comparability? Or can offsetting savings be made - e.g. from elsewhere within the Defence Budget and/or by tightening the terms of reference for the Armed Forces Pay Review Body? If the armed forces are treated more generously than other public sector groups can that be defended - e.g. by recruitment arguments?

11. The Secretary of State for Defence and the Chancellor of the Exchequer will wish to speak to this. The Lord President is preparing a paper, for discussion at a later meeting, on the terms of reference of the various Pay Review Bodies.

The National Health Service (paragraph 7d)

12. NHS ancilliaries and ambulancemen settle in December and the rest in April. The cash limit effectively sets the pay. Except for doctors and dentists, there is no formal comparability.

13. Paragraph 7d sets out the three broad choices, which parallel those for the Civil Service. As with the Civil Service, there is a problem of bridging the gap between the cash limit the Chancellor might want and the minimum negotiable without disruption (see section 6 of Annex III of E(80) 56 for an assessment of the consequences of disruption). For the doctors and dentists the question is whether direct bargaining would be cheaper than continuing with the Review Body. This is the area where the question of

setting different cash limits for different groups is most pertinent because, the armed forces apart, there is less room for flexibility in spending in the NHS than in any other group. Moreover, assuming that a 14 per cent settlement for nurses is reached this year, they will want to catch up next year.

14. The Secretary of State for Social Services, the Chancellor of the Exchequer and Mr. Ibbs will wish to speak on this.

Prison officers (paragraph 7e)

15. Their pay is determined as an average of all Civil Service increases. The Home Secretary will wish to speak on the question of whether special consideration should be given to this group.

Policemen and firemen (paragraphs 8f and g)

16. Police pay is index linked and is not cash limited. The settlement date is September 1980. Firemen's pay is also indexed and is not constrained by the general local authority cash limit. The settlement date is November. The Home Secretary will comment on the case for maintaining special treatment for these groups; and the Secretary of State for the Environment on the possibility of seeking to influence local authorities on the arrangements for the firemen.

Local authorities and teachers (paragraphs 9h and i)

17. In effect the constraint is the Rate Support Grant cash limit which has to be settled by November. Subject to any points the Secretary of State for the Environment makes there is probably nothing more to be discussed at this stage. (He will be reporting next month on the option for dealing with the likely overspend in the current year).

18. For teachers, Ministers will have to decide on the current claim when the arbitration awards are available (probably the last week in July). If the Committee were disposed to pursue the longer term possibility of legislating to withdraw the right to arbitration, it would be necessary to involve the Secretary of State for Education in the discussion.

Nationalised industries (paragraph 9j)

19. The main constraints are the external financing limits. The main question is whether these should be set in November, as last year, in order to influence the pay negotiations or later. The Chancellor of the Exchequer will wish to speak on this and on his proposals in paragraphs 18-24 of E(80) 46.

20. The Committee may well endorse the Chancellor's approach here and, if so, you could invite him to supervise further work through his E(NF) sub-committee.

Clegg (paragraph 10k)

21. It would be better to defer a decision on this until the next meeting when the Secretary of State for Employment will be available.

Timing of decisions (paragraph 10h)

22. Difficult questions of timing both on cash limits and EFLs will have to be resolved at some stage. The Chancellor will need to make specific proposals when the general debate is further advanced.

Size of cash limits (paragraph 10m)

23. The Committee may wish to give the Chancellor guidance on whether cash limit/EFL pay assumptions should be uniform, or nearly so, throughout the public sector or whether they would prefer a more differentiated approach e.g. to accommodat the NHS.

CONCLUSIONS

24. You will wish to record conclusions on as many of these issues as possible and so narrow down the areas for discussion at the next meeting. Given the interlinking between these decisions, however, it might be prudent to think in terms of provisional decisions to be confirmed or altered as part of a total package later.

25. If further work is commissioned on, for example, the Civil Service it would help if the CPRS could be asked to co-ordinate.

26. You might ask the Lord President to circulate in time for the next meeting his paper on the possibilities for tightening the terms of reference of the Pay Review Bodies.

J. Wright

(Robert Armstrong) (approved by Sir R Armstrong and signed on his behalf)

16th June, 1980

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SECRET

29

General objective - figure. Each pay claim - scope for influence

PRIME MINISTER

Public Sector Pay Policy and Inflation

I was not at the first E meeting on public sector pay policy; but I was led by the papers and by the minutes of the discussion to wonder whether we were going about this the best way.

2. The Lord President's paper arguing for the retention of the pay research system for the Civil Service was - whether one agrees with it or not - at least an argued statement of a clear point of view, leading to a definite conclusion. The Chancellor of the Exchequer's paper, on the other hand, was less clear in its conclusion; it argued that we should "dethrone comparability" (without throwing it out of the window), but it did not provide a clear definition of how that was to be done or what would be involved in doing it. Nor did it allow for the fact that comparability is like nature: you can expel it with a pitchfork, but it always comes back. Whether it is institutionalised in the form of pay research or of traditional pay linkages, or whether it is simply a subjective element in the minds of unions and their members ("keeping up with the Joneses"), no door can keep it out. It may be possible at particular times to break particular links, but it is not possible to eliminate it in general as a potent element in the pay bargaining process.

3. The discussion so far also seems to lack numbers. It is difficult to decide how to tackle next year's problem without some numbers for the expected level and trend of inflation (as measured by the retail price index) and for the expected level and trend of wages and salaries. One has to start from the forecast relationship between pay and earnings in aggregate; one has to form a view on the extent to which one wants or needs to change that relationship (i.e. the amount by which one would like to bring down the average increase in wages and salaries); and then there is no substitute for going through the public sector settlements due next year in detail, and taking a view on what course each is likely to face and what possibilities there are for the Government to modify that course in the pursuit of its general objective.

SECRET

4. This is not to say that there should not be a public relations campaign of the kind suggested by the Chancellor. I am sure there should be. But it is also necessary to go from the general to the particular, and consider what scope there is for influencing the outcome of particular settlements. Only so can the Government decide whether it is better to try to work within the framework of existing bargaining and institutional arrangements and do the best one can in each case - which will be messy and imperfect, but probably enables the Government more readily to choose the ground on which it stands and fights - or to try to break the mould of existing bargaining and institutional arrangements - which carries greater risk of confrontation and defeat on ground not of the Government's choosing.

5. If this analysis were to be accepted, it would provide a framework for discussion of the problem. We should ask the Chancellor for his forecasts of inflation and of the rise in aggregate earnings; and we should commission a detailed review of public sector wage settlements next year (September 1980 to August 1981) in chronological order, assessing the prospects for each, and the scope for influencing the result in each case. That work, done over the next two or three weeks, would enable Ministers to give informed consideration in July to what their objectives should be, and how they should set about pursuing them.

6. There is a separate point. Reducing the rate of inflation is the Government's highest economic priority. Over the coming months the retail price index is expected to fall, as the 1979 increase in VAT drops out and the seasonal easing in food prices comes through. It is crucially important, if we can, for psychological as well as economic reasons, not to lose the opportunities which this presents to turn the tide.

7. I wonder whether it would be worth your deciding to hold a regular meeting every month for the next six months with the Chancellor of the Exchequer and the Governor of the Bank of England, at which you would review how the reduction in the rate of inflation was going, what was the current state of industrial activity and expectations, and what the Government could or should

do to encourage developments which looked promising and forestall those which looked unfavourable. This would not be a formal Cabinet Committee, but it would need to be serviced with information which could be assembled by the CPRS in consultation with the Treasury and with the Bank of England, whose information on industrial prospects and expectations is the best available.

RTA

(Robert Armstrong)

16th June 1980