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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

COMPARABILITY AND CASH LIMITS

Note by the Chancellor of the Exchequer

Following our discussions about "dethroning" comparability, we need to consider further how to handle cash limits for public service pay.

The Future of Comparability

2. The key to this is the Civil Service. Although this represents only a fairly small proportion of the total public service, it has the most formal and long-running system of comparability. If we can get the approach right here, it should be easier to deal with other cases in the public service, including those covered by the Review Bodies. We shall, however, need to review the position on nurses, in the light of our recent decision in Cabinet that future arrangements for determining their pay should be considered. Though there may be some scope for

breaking up the big public service groups into smaller units for pay negotiating purposes, scope for the short term at least is limited. We are clearly going to have to face up to the prospect of handling pay claims made on the basis of various forms of comparability and inconsistent with the levels of cash limits we shall need to set.

3. Reconciling Civil Service pay increases with cash limits was not easy for this year, and will be even more difficult in 1981-82. Some quite large parts of the Civil Service pay bill are housed in cash limit blocks which do not include significant other expenditure. The scope for offsetting volume adjustment (by reduction of numbers below planned levels) will be very much narrowed for 1981-82 if, as I intend, the Estimates provision already takes into account already planned reductions in the size of the Civil Service. Finally it would be damaging to repeat the tactic of compensation for the cost of a high pay increase by deferring the date of implementation. Thus the allowance for pay increases built into whatever cash limits are decided for next year will be an even tighter constraint than this year in effectively determining the actual pay increases which can subsequently be negotiated.

4. The figure we shall want to choose for the cash limit will probably be considerably below the figure likely to emerge from normal pay research. So comparability in any form will probably be irreconcilable with cash limits for the Civil Service for 1981-82. In such circumstances, cash limits will have to prevail. This raises the questions:

(i) whether it would be sensible to take the initiative and suspend comparability now, at least for the coming year, and if so

(ii) whether to announce this decision now or leave it until nearer the time for pay negotiations.

5. A practical argument for an early announcement is that

six months' notice should be given for the suspension of the Civil Service Pay Agreement. This would call for an announcement by 1 October. There are arguments for making an announcement still sooner. There seems to be a certain momentum towards lower figures in the private sector. The announcement on TSRB salaries has probably had a beneficial effect, creating lower expectations. There is a clamour from the private sector for the public sector to set a good example for the next pay round. Suspending pay research could have a very helpful influence on the climate.

6. There is also a great deal of feeling against comparability, largely occasioned by the work of the Clegg Commission. E Committee has already agreed to wind up the Commission and there would be advantage in an announcement before the Recess following publication of the Commission's General Report. This would inevitably lead to questions about the future of comparability more generally, which argues for tying in with it a statement about the suspension of pay research. We should make it clear in the announcement that this does not imply any intention to discriminate against the Civil Service as compared with the rest of the public services - which means saying something about the rest.

7. But we have to consider not only the next year but the slightly longer term as well. I have not suggested that we should abandon comparability entirely. In the longer term it will probably be impossible to get away from comparisons as part of the basis for determining pay in the Civil Service in particular, and in much of the public service area as well. A policy of using the public sector to drag down the general level of pay settlements would not be sustainable over any substantial period. Even for the coming year, we do not want to find that at the end of the round the public sector has received pay settlements substantially lower than the rest of the community.

8. Of course, we cannot know in advance what the general level is going to be. We have to take a view on what we can reasonably

hope and expect will be happening in the economy as a whole, and bias it a bit towards the optimistic. But to go further than this is to invite trouble. Even if the policy could be made to stick for one year the risks for later years would be increased. All this must affect the character of any announcement we make now.

The Options

9. Broadly the options seem to be:-

(a) To suspend the Civil Service Pay Agreement and the operation of pay research (the PRU could be put on to a care-and-maintenance basis) and say nothing more. This would imply that pay would be settled annually in the light of what we judged could be afforded.

(b) To suspend the Agreement and pay research, but at the same time indicate that the Government accepts that comparability should continue to play a part in the determination of public service pay; that the present arrangements for pay research are unsatisfactory and need overhauling; and that we will be considering new and improved arrangements for making comparisons and discussing them with the unions.

(c) As at (b) above, but adding something more about the kind of future system which we have in mind.

10. I do not think (a) is to be recommended. It would play into the hands of militants and it would probably lead to an immediate demand from the unions that they should participate in decisions about the level of the pay element in cash limits, which is where the crucial decisions would lie.

11. On the other hand, (c) would require decisions now about the future policy and this may be difficult. So (b) seems the best course. Even so I think it would be advisable before

making any announcement at least to have some preliminary idea of what the future system will be. There seem to be broadly four approaches - though I think it would be premature to discuss them in any detail:

(i) A year of suspension followed by a re-instatement of pay research on an annual basis, but modified to take account of its well-known shortcomings. If the reform of the comparability arrangements really produced rather different results, this might work out well. If not, the one year's suspension could be followed by another catching-up process in the following year.

(ii) A year of suspension followed by a new regime in which pay research on a modified basis would produce data, but the management would retain flexibility on the extent to which its results influenced the subsequent pay negotiations. This is akin to the ideas of the Clegg Commission in Chaper 7 of their General Report.

(iii) A system in which job-for-job comparisons were done only at intervals of longer than one year - say every three years. Since we have just come through a phase of catching up, the next year for full comparisons might be 1983. In the immediate years, pay could be settled either by a cash limit system or by "free collective bargaining" or by something on the lines of (iv) below. Once again there would be a risk that the comparison years would produce a sharp increase because of catching-up, but this would depend on how severe the regime was in the interim years and on whether the reform of the system of comparisons (which would be part of this policy also) led to more moderate figures or not.

(iv) An arrangement for "topping-up" settlements based on cash limits. Civil Service pay would be determined by the pay element in cash limits fixed the previous autumn and coming into force in April. But there would be a safety valve in case this resulted in Civil Service pay falling substantially behind the private sector. It would offer some assurance to the unions that they would not lose out seriously, but would avoid both retrospection and leading. The topping-up element could be negotiated on an ad hoc basis or according to a formula linked to the movement in private sector earnings, after making allowance for earnings drift. This is akin to the proposal contained in the CPRS paper E(80)54.

12. These ideas will need to be considered more fully, and it may be that other possibilities will emerge. I suggest that we ask officials to examine the alternatives further so that we can look at them again in the early autumn.

Clegg

13. We agreed at E(80) 22nd meeting on 26 June that the Clegg Commission should be wound up as soon as its present references were completed. As indicated above, these are arguments for an early announcement, and, since it will raise more general questions about comparability, there is advantage in combining this announcement with that on the future of comparability.

The Review Bodies

14. These are the only other permanent bodies which play a part in comparability and we should need to make our position on these clear if we made an announcement on Civil Service pay research. We agreed at E(80) 22nd meeting on 26 June that the proposals in the paper on the membership and terms of reference of the 3 pay review bodies, which was attached to the note by the Lord President of the Council, E(80)59, should be considered after the Cabinet had discussed the two current reports from the TSRB.

15. In my view, our conclusions on those reports do not in any way invalidate that paper. I have considered, for example, abolishing TSRB now that we have taken nationalised industry chairmen and board members out of its remit. But our strategy is to dethrone comparability. The inevitable logic of this is to retain the Review Bodies and a fact-finding capacity in the Office of Manpower Economics, which may in due course form the nucleus of some more rationalised machinery as suggested in my earlier paper E(80)46.

16. I doubt the advisability of changing the Review Bodies' terms of reference, both for the reasons in paragraph 5 of E(80)59, and because spelling out the need to take account of economic factors would undoubtedly lead to pressure to specify other factors also - in particular the role of comparability. We shall, of course, want to be very careful in any new appointments to the Bodies. But our main influence must be in our evidence to the Review Bodies and in our right to refuse to accept a Review Body's recommendation if we consider that it has given insufficient weight to economic considerations (although in the case of the Armed Forces, the commitments we have given mean that we are bound to honour the AFPRB recommendations).

17. I therefore suggest that, when we announce our decisions on pay research and Clegg, we should make clear that we intend to ensure that pay levels of groups covered by the Review Bodies are fixed at levels which take wider economic considerations into account.

Other Public Service Settlements

18. (i) Police

We have agreed to maintain indexation of police pay for their settlement which will be announced in early August. But I would hope some element of market forces could be introduced into the level of settlements in future years now that the recruitment picture is beginning to improve.

(ii) Firemen

There have been some signs that the local authorities are thinking of breaking the index linking of firemen's pay, and we should use any opportunities to encourage this.

Fixing the Pay Element in Cash Limits

19. An announcement that comparability was to be suspended would lead immediately to pressure for an indication of how the Civil Service (and other public sector) pay was to be settled next year; and in particular what figures for pay increases in the public sector we had in mind. In any case, it may be difficult to arrive at conclusions on the points discussed in paragraph 11 above without coming at least to some provisional view on this question.

Timing of Decisions and Announcements

20. For operational reasons, the basis on which cash limits are fixed has to be decided towards the end of October. If it were later, we could not get the RSG settled in time for the necessary Order, nor construct the Estimates in time for presentation to Parliament. This year, special arrangements were made for delayed decision and presentation of a central Vote covering pay increases for the Civil Service; but for next year I should like to treat the Civil Service in the same way as all other public sector pay. The decision whether to announce the pay element in that particular cash limit in November or later can, however, be left open for the time being.

21. The local authority manuals settlement date is 4 November, but negotiations on this commonly finish after that date, with a restrospective decision. For other parts of the public services, an early November timing also fits. NHS ancillaries settle in December.

22. For the nationalised industries, we have agreed that EFLs should be announced at about the same time, i.e. early November. But before this there will have to be discussions with the managements which will begin with proposals by the management, including proposals as to pay assumptions, on which discussions will begin in September. It will therefore be necessary to have at least a provisional view about appropriate levels (although these may vary from one case to another with the nationalised industries, within limits) in September.

Basis of Cash Limits

23. It may well be necessary for the pay element in cash limits next year to be somewhat lower than the non-pay element. This is consistent with our view that a fall in real earnings should occur in both the public sector and the private sector over the coming year. This discrepancy will have to be acknowledged publicly and defended.

24. The pay elements in cash limits for all parts of the public service do not necessarily have to be the same. But there will no doubt be a general assumption that they will be based on the same reasoning and wider or seemingly random variations would be hard to defend. I think that the right approach would be to have a central figure, but we can leave open for the moment the possibility of variation from it in cases where there are special reasons for this, eg market factors.

25. There is one loophole I propose to block up. In the past staging has offered a way of avoiding the full financial discipline of cash limits. Staging reduces the immediate cost of a settlement. If offers a way of keeping the cost within the cash limit for the current year by deferring part of the cost to the following year.

26. Under past procedures, cash limits for the following year have been calculated in a way that provided whatever money was needed to meet the full cost of past awards, including any element of the cost deferred by staging. For this reason the 1980-81 cash limits provide for an increase between 1979-80 and 1980-81 of about 25% in the Civil Service paybill, despite the

fact that they provide only 14% for new pay awards in 1980-81.

27. I propose that in future we should calculate the provision for pay increases in cash limits in terms of an addition to the average pay rates over the twelve months preceding the settlement date, not the final pay rates. We can consider over the next few months how we apply this approach to particular groups which have had staged settlements during the present year, but this change in approach is necessary to ensure that the effect of our policy is not circumvented by staging.

The Level of the Pay Element in Cash Limits

28. Assuming that we are agreed that we should now form a provisional view on the level of the pay element in cash limits, we need to consider what the level should be.

29. In my paper on 'Influencing National Pay Behaviour' (E(80)66) I suggested that we should point to the need for a relationship between pay settlements and money growth in the economy generally if unemployment is not to rise. Though there clearly cannot be any mechanical relationship between money growth and public service pay in any particular year, to choose a figure which was higher than the middle of the target for money supply growth might give the impression

that the Government was not serious about these targets. This reasoning leads one towards 9 per cent (although, of course, a new target range, centred on 8 per cent, will come into force at about the time when the Civil Service settlement is due). Figures of this kind would also be consistent with statements which the Prime Minister and I have made that cash limits for pay for next year must be significantly lower than last years. The recent decision on 9.6 per cent for MPs also helps to point towards single figures. This is one side of the argument.

30. But on the other hand we cannot ignore the question of realism. Whilst we must aim for settlement as low as we realistically can , a great deal of damage would be done if the figure we chose turned out not to be realistic and the policy could not be made to stick. Pay settlements of 9 per cent may turn out to be well below the rate of inflation over the twelve months ending about next Spring and might also be substantially below the average rate of increase of earnings in the private sector.

31. In the end, our decision on this is not something which can be settled by doing much more analytical work or figuring. It is very much a matter of judgement. The most I can suggest at this stage is that the pay element in public service cash limits for 1981-82 should probably be in single figures, subject to reassessment of the realism of this in the Autumn.

Staff Relations

32. Inevitably an announcement of the suspension of pay research will not be taken easily by the staff and the unions. I therefore think it important that we should all personally make a determined effort to get across the reasons for our decision to our own staff and employees of the public services for which we are responsible. This may be tedious and time-consuming: but it is the only way in which we

can hope to achieve acceptance of what we shall be asking for - a real fall in living standards for our own employees. If we leave it to the professional managements, we shall never overcome the inevitably hostile union responses.

Conclusions

33. I seek the agreement of the Committee that:-

a) An announcement should be made before the end of this month that:

i) the Civil Service Pay Agreement and pay research are being suspended and the Government will be considering future arrangements for comparability, which it accepts should continue to play a part in the determination of Civil Service pay (paragraph 6b above);

ii) the Clegg Commission is to be abolished;

iii) The Review Bodies (armed forces, doctors and dentists and top salaries) will continue in being since they are not merely instruments of comparability; but that the Government expects them to take account of general economic considerations in making their recommendations and will itself take account of them in arriving at decisions on their recommendations.

b) Officials should examine further the options for the future of comparability as set out in paragraph 11 and report in the early autumn.

c) We should take our final decisions on the pay element in cash limits for the public services as well as pay assumptions in EFLs for the nationalised industries at the beginning of November (and

announce them to the extent that may be decided then).

d) Cash limit arrangements should be adjusted so as to avoid groups deferring the full cost of settlements by means of staging.

e) Provisionally, the pay element should be in single figures, though this should be reviewed for its realism in the Autumn.

f) Ministers should follow up the announcement with meetings with staff to explain the reasons for the decisions.

G.H.

H.M. TREASURY
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