

PO-CH/NL/0204

PART C

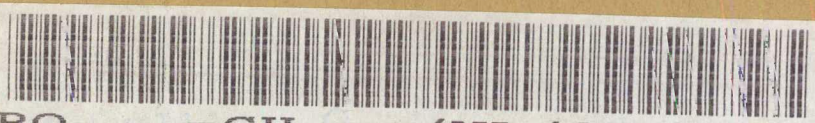
PART C

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Lawson

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PO -CH /NL/0204



PART C

CHANCELLOR'S PAPERS ON  
GENERAL PAY ISSUES

PO -CH /NL/0204

PART C

Begin. 25/1/88

DD: 25 years

Ends: 31/3/88 (CONTINUED)

8/9/98

FROM: A P HEFFORD

DATE: 25 January 1988

PS/CHANCELLOR

PS/CHIEF SECRETARY

PS/PAYMASTER GENERAL

PS/SIR P MIDDLETON

PS/SIR T BURNS

MR ANSON

DAME ANNE MUELLER

MR KEMP

MR MONCK

MR KELLY

MR ODLING-SMEE

MR R I G ALLEN

MR GILHOOLY

MRS BROWN

MR CHIVERS

MR PICKFORD

MR TRUMAN

MR PRATT

MR FELLGETT

MR PRICE

MR CORRY

MR BELL

MR GRAHAM

MRS HARROP

## PAY SUMMARY NOTE

This note updates that circulated on 22 September. As many major negotiations are about to begin, this note will, in future, be issued on a monthly basis.

A.P. Hefford.

A P HEFFORD

I PUBLIC SERVICES

1987 - 88 Round

Settled:

Police Federated Ranks - 7.75%

Settled:

Fire Service - 7.3%

Settled:

Local Authority Manual Workers - 10.7%

Teachers:

Evidence presented to Interim Advisory Committee on school teachers' pay. Three largest unions have incorporated claims for a 16% increase in their evidence. IAC due to report to Education Secretary by 31 March.

FE Teachers:

A 16.9% package staged over 2 years agreed by negotiators but not ratified by NJC. Includes outstanding increase for 1987.

NHS Review Bodies:

Government evidence to be presented shortly.

Other Review Bodies:

TSRB evidence submitted. AFPRB evidence due to be submitted by end-January.

Civil Service:

Results of IRSF ballot on long term pay and grading package similar to IPCS deal show narrow majority in favour of acceptance. CSU

executive (merged 1 January with SCPS to form NUCPS) accepted offer of new unified grading and pay structure for 17,000 support staff (messengers etc). Both deals mean pay 1988 settled for about 1/3 of non-industrial civil servants.

## II PUBLIC TRADING

### British Coal:

BC offered NACODS 3.25% later 4.28%. Rejected in ballot by large majority. Further meeting took place 22 January: ballot for industrial action widely expected.

### Water Service:

Unions submitted claim for large unspecified increase at meeting on 21 January. No offers yet.

## III PRIVATE SECTOR

### Agricultural Wages Board:

Large claim expected from TGWU for £140 pw minimum rate and 35 hour week; first meeting 8 March.

### Barclays Bank:

Bank offered 2 year deal of 6.25% + £100 in 1988 and 5.25% in 1989. Barclays union accepted: BIFU to ballot.

### Ford Motor Co:

"Final" offer of 3 year deal worth 6.5% from November 1987 plus further cost of living rises in 1988 and 1989. Rejected by unions: industrial action likely.

### Vauxhall Motors:

2 year deal of 4.5% in each year plus "versatility supplement" for efficient working practices, likely to be accepted.

British Airways:

First year of privatised company. All groups offered 5% from January 1988 and 5.5% from January 1989. Includes understanding on flexibility. Nothing further is known.

OTHER INFORMATION

Average earnings whole economy increasing at  $8\frac{1}{4}\%$  (underlying rate) to November ( $8\frac{1}{4}\%$  in manufacturing). Unit wage costs in manufacturing up 1.6 % 3 months to November 1987 on year earlier.

RPI 3.7% in 12 months to December 1987.

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CH/EXCHEQUER	
REC.	26 JAN 1988 ✓ 2/1
ACTION	CST
COPIES TO	

QUEEN ANNE'S GATE LONDON SW1H 9AT

25 January 1988

Dear Nigel,

E(PSP)88 FIRST MEETING - MINUTES

I am sorry to have to write to you as Chairman of E(PSP) about the minutes of the important meeting held on 18 January.

Your summing up of this meeting was admirably fair. I do not, however, feel that the record of that summing up now circulated gives its full flavour. In particular there were two points which are not reflected in the record. First, while the Sub Committee certainly reaffirmed its wish to see a move from up-rating police pay in line with earnings elsewhere in the economy to a new formula based on settlements elsewhere, it did not go so far as to say that it was essential that negotiations on this should take place in the PNB in time for the new arrangement to be adopted for the 1988 police pay settlement. Rather it was agreed, in my view, that the OME Survey should be examined by the Sub Committee before a decision was taken on how to use it, so that the right balance could be struck on our objectives on pay and on allowances. Every effort should therefore be made to ensure that the results of the survey of settlements were produced in time to allow that.

In making this point, I do not seek to renege on the Committee's reaffirmation of the conclusions reached at its previous meeting. Rather I recall making the point, and recall it being accepted in your summing up, that the Sub Committee would need to consider carefully the balance of political as well as other factors involved, in the light of the outcome of the survey, before deciding the precise balance we should seek to strike in our pursuit of the PNB negotiations.

Secondly, I also recall making the point, which was accepted at the time, that the monitoring of the negotiations to be undertaken by the Official Committee on Public Sector Pay (PSP(O)) should pay due respect to the existing negotiating machinery. The PNB exists within a statutory framework, and the monitoring to be undertaken by officials must observe this. Again, the minutes as circulated do not reflect this point.

I do not like to quarrel with the record of meetings - indeed I cannot recall having previously done so in this way. But I do ask that the two points I have made be borne in mind as we pursue these matters in future, and that they be recorded in whatever way you consider sensible as forming part of the backcloth to our future discussions.

I am copying this letter only to Mr Monger in the Cabinet Office.

*(over)*  
*Douglas,*

The Rt Hon Nigel Lawson, MP

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Reference No E 0499

CHANCELLOR OF THE EXCHEQUER

E(PSP)(88)1st Meeting - Minutes

The Home Secretary wrote to you yesterday about the minutes of this meeting.

2. He challenges the minutes on two points in your summing-up.

3. First, he says it is wrong to attribute to you the statement that 'it was essential that negotiations on this [the new pay uprating formula] should take place in the PNB in time for the new arrangement to be adopted for the 1988 police pay settlement'.

But both Mr Wells and I have it clearly recorded in our detailed notes that you said exactly that. It also seems to me that to concede the point now to the Home Secretary would undermine the conclusion, first reached at E(PSP) on 25 November and confirmed at the last meeting, that the pay uprating formula should be changed. The Home Secretary's suggestions that the Survey should be examined before a decision is taken as to how to use it, and that the Sub-Committee would need to consider the balance of 'political' and other factors involved show that he still hopes that the change in the formula will not in the event be pressed.

X | 4. Secondly, the Home Secretary says that it was agreed that the work of PSP(O) should 'pay due respect to the existing negotiating machinery'. Our notes record that the Home Secretary did indeed say this, but not that you assented to it. It could not therefore be recorded in the summing-up. It is not entirely clear what the words mean but they are clearly intended to weaken PSP(O)'s monitoring role, and indeed the Government's role generally in the negotiations.

*Ch/Content with draft?*

*Wells - the subject of Mr Wells's draft is a little more than X. I have made a point.*

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5. I should report that the first meeting of the inter-departmental group took place yesterday. The Department of Employment estimated that the Survey would not be available until early July. We might shave a month off this timetable but we are unlikely to do more. The Home Office told us that the full official side would meet during February to discuss its strategy in the negotiations and then set up joint working parties with the Staff Side. The Home Office accepted that if we did not raise the pay formula question at that stage we could later be accused by the Staff Side and the rest of the official side of having misled them as to our intentions. It may therefore become necessary to grasp the nettle of raising the issue of principle before the Survey is complete. We are exploring this urgently and the Treasury will probably report to you. Meanwhile, it shows the risk of accepting amendments tending, as the Home Secretary says, to the view that the Government should not decide its strategy on uprating until the Survey is ready.

6. I attach a possible draft reply which seeks to strike a friendly note without yielding any points of substance.

G W MONGER

Cabinet Office  
26 January 1988



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pl type  
for ch  
to send

(M)

Draft letter for Chancellor of the Exchequer  
to send to the Home Secretary

E(PSP)(88)1st Meeting - minutes

Thank you for your letter of 25 January.

I have looked carefully at the minutes in the light of the points you have made, but I believe that they give a true and fair record of my summing up. In particular, it is my recollection that we agreed that it was essential for negotiations on a new pay formula to take place in time for the 1988 police pay settlement.

I agree with you of course that we shall need to take account of political as well as other factors in our approach to the negotiations and that ~~we must~~ <sup>PSP(O) will not be</sup> ~~we must~~ always bear in mind the nature of the existing negotiating machinery. And I have taken note of your views on the points at issue. We shall no doubt need fairly soon to discuss the whole question further in E(PSP).

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[in all our work, including that of PSP(O); we must

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*amp*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

27 January 1988

The Rt Hon Douglas Hurd MP  
Secretary of State for the Home Office  
50 Queen Anne's Gate  
London SW1H 9AT

*Stan Anglin*

Thank you for your letter of 25 January.

I have looked carefully at the minutes in the light of the points you have made, but I believe that they give a true and fair record of my summing up. In particular, it is my recollection that we agreed that it was essential for negotiations on a new pay formula to take place in time for the 1988 police pay settlement.

I agree with you of course that we shall need to take account of political as well as other factors in our approach to the negotiations and that in all our work, including that of PSP(O), we must bear in mind the nature of the existing negotiating machinery. And I have taken note of your views on the points at issue. We shall no doubt need fairly soon to discuss the whole question further in E(PSP).

*Nigel Lawson*

NIGEL LAWSON

PERSONAL AND CONFIDENTIAL  
Until 11.30am on Thursday 18 February  
thereafter CONFIDENTIAL

~~4549~~ 5207  
useful - reason no markets.

FROM: P L PATTERSON  
DATE: 17 February 1988

1. MR PICKFORD  
2. CHANCELLOR (+1 for No 10)

cc  
Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Monck  
Mr Scholar  
Mr Odling-Smee  
Mr Sedgwick  
Mr R I G Allen

Mr Hibberd  
Mr MacAuslan  
Mr Bush  
Mr Dyer  
Mr Hudson  
Mr O'Brien  
Mr Cropper  
Mr Tyrie  
Mr Call  
HB/001

Another large fall in unemployment,  
but attention is likely to focus  
on the rise in underlying earnings -  
for the third month in succession.

split  
17/2

### COMBINED RELEASE OF LABOUR MARKET STATISTICS ON 18 FEBRUARY

#### Summary Statistics (seasonally adjusted GB unless otherwise stated)

	Thousands	Level	Change on previous period	Change on previous year
<u>Unemployment (UK)</u>				
Total (excl. school leavers) January		2,563	-51	-549
Total (not seasonally adjusted) January: 'Headline Total'		2,722	+26	-575
<u>Vacancies (UK) January</u>		250	-7	+38
<u>Employed labour force 1987Q3</u>		24,506	+75	+453
<u>Manufacturing employment December</u>		5,035	-5	-55
			<u>Percentage change on previous year</u>	
<u>Index of average earnings, December</u>				
Whole economy, underlying (actual)			8½	(8.6)
Manufacturing, underlying (actual)			8¼	(8.4)
Service industries, underlying (actual)			8¾	(9.1)
<u>Wage and salary costs per unit of output</u>				
Whole economy 1987Q3			3.3*	
Manufacturing 1987Q4			2.0	
<u>Output per head</u>				
Whole economy 1987Q3			3.5*	
Manufacturing 1987Q4			6.3	

\* No change from previously published figures.

ASSESSMENT AND COMMENT

2. The unemployment statistics this month are consistent with a continuing downward trend of around 50,000 a month. DE's briefing line is that the number of participants in the traditional employment and training schemes has hardly changed over the last year, at a time when unemployment has fallen rapidly. [NOT FOR USE: DE's assessment is that these measures are declining slightly, and that the other administrative measures are now well established and thus not contributing to the monthly reduction in the count. The strength of the economy must therefore account for the whole of the fall in unemployment in recent months. Supporting evidence for this is that the downward trend in male unemployment has increased while the decline in female unemployment has slowed in recent months, since DE think that Restart and availability testing have had a disproportionate effect on women.]

3. A full analysis of the January figures for youth and long-term unemployment is not yet available. [NOT FOR USE: Preliminary estimates suggest that there has been a further sharp fall in long-term unemployment over the past three months, giving a record fall of the order of 230,000 over the past year.] The full January figures are expected to be published next week.

4. Employment figures were revised with publication of the 1987 Labour Force Survey (LFS) results on Tuesday 16 February, and they are covered in an earlier briefing note. The only new figures in the release of labour market statistics are for the number of manufacturing employees in December, which further support the view that the downward trend is levelling off. The stock of vacancies fell in January for the second month running, following nine consecutive months of increase, but remain at a high level, some 18 per cent up on a year earlier. [NOT FOR USE: DE again say that this series is distorted by the activities of Jobcentre staff, but are at a loss to explain fully recent movements in either the stock of vacancies or the component inflow and outflow series.] Inflows fell back in January but evidence from the IFF survey (carried out in January for the 'Training for Employment' White Paper) suggests that the vacancy position is consistent with a buoyant labour market.

5. The provisional estimate of the underlying increase in whole economy average earnings in the year to December has risen by  $\frac{1}{4}$  per cent to  $8\frac{1}{2}$  per cent. This is the third consecutive monthly increase of  $\frac{1}{4}$  percentage point. The rise mainly reflects a further increase in the underlying growth of earnings in the services sector which DE say, largely on the basis of anecdotal evidence, is due to high overtime in the pre-Christmas period and end-year bonus payments. The rise in whole economy earnings is unexpected and is certain to be badly received among financial commentators. [NOT FOR USE: End-year bonuses (as

distinct from more regular bonus payments throughout the year) seem to have been particularly high in 1987. For the economy as a whole, December bonus payments were over 15 per cent higher than a year earlier. Nearly three quarters of this is in manufacturing and a quarter in the services sector; bonuses in the financial sector were in aggregate below the level of a year earlier. Overtime working in manufacturing continues to add to underlying earnings growth - 1 per cent to the manufacturing figure and  $\frac{3}{4}$  per cent to that for the whole economy. DE statisticians offer little hope that the December figure is erratically high. Indeed with a number of settlements, many in the service sector, coming up in the next few months, they warn of the possibility of a further rise towards  $8\frac{3}{4}$  per cent in February.] It is difficult to point to any special factors behind the rise between November and December. In his statement, the Secretary of State for Employment is likely to refer more generally to the recent acceleration in underlying earnings being a result of strong demand growth in the economy which is pushing up overtime and bonus payments.

### THE FIGURES IN DETAIL

#### Unemployment

5. Seasonally-adjusted adult unemployment (excluding school leavers) fell by a further 51,000 in January to 2.563 million (9.2 per cent of the working population). The fall over the last six months has averaged a record 52,000 a month.
6. The 'headline' total rose by 26,000 to 2.722 million, 9.8 per cent of the working population. There was a rise of 27,000 among adult claimants and a fall of 1,000 among school leavers.
7. The stock of vacancies at Jobcentres (seasonally adjusted) fell in January by 7,000 to 249,500, but remains 18 per cent higher than a year earlier.
8. Points of interest:
  - (a) Seasonally adjusted total at lowest level for  $5\frac{3}{4}$  years (since April 1982).
  - (b) Seasonally adjusted total has fallen for eighteen months in succession since July 1986, by 647,000 in total. [Note that routine revisions to seasonal adjustment factors have moved the unemployment peak from June to July 1986 and that unemployment has therefore been falling for only eighteen months, the same as was quoted last month.]

- (c) Fallen by 549,000 over past year, largest twelve-month fall since similar records began; fall over last six months also a record.
- (d) Fall in 'headline' total of 575,000 compared with year ago, also largest on record.
- (e) School leaver unemployment (under 18s), at 63,000 in January, was 26,000 (or 30 per cent) lower than a year ago and lowest January total since 1980.
- (f) Rate of fall of unemployment among men accelerating, while that among women slowing. Over past three months average fall of 11,000 a month among women (down from 19,000 in previous three months) and 39,000 a month among men (up from 34,000 in previous three months).
- (g) Unemployment continues to fall in all regions. Over the past twelve months the unemployment rate has fallen most in the West Midlands, Wales, the North West and the North, closely followed by other regions. Over the past six months, the unemployment rate has fallen by between 0.9 and 1.3 points in all regions, including Scotland and Northern Ireland.
- (h) UK unemployment rate fallen more in past year than in any other major industrialised country. Now also true of any OECD country. Latest figures (national definitions) show fall in UK rate of 2.1 percentage points over past year, compared with fall of 1.0 in US, fall of 0.1 in Japan and rise of 0.1 in Germany.
- (i) Revisions have been made to the working population figures to take account of the LFS results. The denominator used to calculate recent unemployment rates has thereby been updated to June 1987, and the effect of this revision is to reduce the national rate by about 0.1 percentage point.
- (j) Seasonal influences on the unadjusted headline total in February are normally downward.

### Employment

9. The only new employment figures this month are for the number of employees in manufacturing industries in December. The widespread revisions to the employment statistics, to take account of the 1987 Labour Force Survey results, were published on Tuesday 16 February. You received separate briefing on these.

10. The number of employees in employment in manufacturing is estimated to have fallen by 5,000 between November and December. Monthly figures are erratic, but in recent months there has been an appreciable slowdown, and possibly a levelling off, in the downward trend in the number of manufacturing jobs. In the six months to December manufacturing employment fell by an average of 4,000 a month.

### Other features

11. The provisional estimate of the underlying increase in whole economy average earnings in the year to December has risen to  $8\frac{1}{2}$  per cent from  $8\frac{1}{4}$  per cent in November. This is the third consecutive monthly increase of  $\frac{1}{4}$  of a percentage point. For manufacturing industries the figure remains unchanged from November at  $8\frac{1}{4}$  per cent, but in service industries it has risen further, by  $\frac{1}{4}$  per cent to  $8\frac{3}{4}$  per cent. This series has risen from  $7\frac{1}{4}$  to  $8\frac{3}{4}$  per cent in the past four months, reflecting high overtime and bonus payments as well as two substantial settlements covering nearly  $1\frac{1}{2}$  million employees (or 10 per cent of the service sector's employment) - the second stage of the teachers' agreement in October and the local authority manuals' settlement in November. The high level of overtime working in manufacturing (see below) also continues to raise underlying earnings growth.

12. The level of overtime working in manufacturing in December, at 13.42 million hours a week, remains at a high level following its sharp increase in October. The average of 13.6 million hours a week in 1987Q4 is the highest level since the start of the decade and well above the average level of 12.4 million hours in the first 9 months of 1987.

13. Output per head in manufacturing in 1987Q4 was 6.3 per cent higher than a year earlier, reflecting an increase in output of  $5\frac{1}{2}$  per cent and a 1 per cent fall in employment. Unit wage and salary costs rose by 2.0 per cent over the same period.

### MANUFACTURING : Percentage increase on year earlier

	Average earnings	Output per head	Wages and salaries per unit of output
1987Q1	7.8	7.0	0.8
Q2	7.7	6.7	0.8
Q3	8.5	7.7	0.8
Q4	8.4	6.3	2.0

14. There are no revisions this month to the figures for whole economy productivity and unit wage costs.

*Peter Patterson*

PETER L PATTERSON





Thanks. Office  
Jupp  
shown  
CBI.

Treasury Chambers, Parliament Street, SW1P 3AG

01-930 1234

Ch/ You will be getting a note on the level of settlements asap. The gist of it will be:

Unofficial, unpublished figures collected by DEMP from monitoring private sector settlements suggest average 5 1/2 per cent so far this pay round (since September) against an average of 5 1/4 last pay round.

CBI publish figures, which show slow upward creep in manufacturing

April 87	5.2
Oct 87	5.3
Nov 87	5.7

over



Treasury Chambers, Parliament Street, SW1P 3AG

01-930 1234

but services figures not so helpful:

86	Q4	5.1%
87	Q1	5.6%
	Q2	6.4%
	Q3	7.1%
	Q4	7.0%

mpw

CONFIDENTIAL



FROM: MISS M P WALLACE

DATE: 18 February 1988

MR PATTERSON

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Monck  
Mr R I G Allen  
Mr Hibberd  
Mr MacAuslan  
Mr Pickford  
Mr Price  
Mr Tyrie  
Mr Call

**COMBINED RELEASE OF LABOUR MARKET STATISTICS ON 18 FEBRUARY**

The Chancellor was most grateful for your minute of 17 February. He has commented that the rise in earnings has a great deal to do with increased overtime. He has asked whether we know what has been happening to the trend of wage settlements. If this looks better, this would be useful in reassuring the markets.

2. I have discussed this with Mr Price, who has agreed to provide a note on this point.

A handwritten signature in dark ink, appearing to read 'M.P. Wallace'.

MOIRA WALLACE

FROM: S PRICE  
DATE: 18 FEBRUARY 1988

CHANCELLOR OF THE EXCHEQUER

cc : PS/Chief Secretary  
Sir Peter Middleton  
Sir Terence Burns  
Mr Sedgwick  
Mr Hibberd  
Mr Patterson  
Mr de Berker

*Thank you. Copy to 187.  
get the settlements  
public sector  
Mr Patterson  
X*

AVERAGE EARNINGS AND SETTLEMENTS

You asked for evidence to support the view that the recent rise in the underlying rate of increase in average earnings from 8½ per cent in November to 8¾ per cent in December 1987 was not due to a rise in settlements.

2. DE state that the ¼ per cent rise is due mainly to higher levels of bonus payments and overtime working in December 1987 compared to the previous year, especially in the services sector.

3. This interpretation looks right in view of the high level of demand and growth in the economy. Overtime figures are not available for services, but overtime per operative in manufacturing was at a record level in October, and was still very high in December. 1987 is expected to be another year of high profits growth throughout the economy, so it is also natural that end of year bonuses should be high.

4. Settlements have not been increasing at anything like average earnings, except in some parts of the public sector. Private sector settlements monitored by DE (for internal purposes only - not to be used) show that the cumulative level of settlements in the current round is a little up on the last round, as shown in table 1. I attach a chart showing how settlements have moved from month to month. As the current round is at an early stage, it would be wrong to read too much into the figures for any particular month. Nevertheless, they seem to show that the upward trend discernible from January 1987 is continuing, although not at a dramatic rate.

5. A publicly available source of data is the CBI report on their Databank Survey of private sector settlements. The evidence here tends to confirm the picture from the DE. Settlements have increased since the end of 1986 but have tended to flatten off somewhat in the second half of 1987. Indeed, they show some signs of having fallen slightly towards the end of 1987, and these figures could be drawn to public attention.

6. There is, therefore, a case for arguing that the current high increase in average earnings is due to the buoyant level of activity in the economy and the special factors of the local authorities manual workers' award of 10.7 per cent, which entered the index in November, and the second stage of the teachers' award in October.

7. Nevertheless, it should be said the outlook over the coming pay round may be for an average level of private sector settlements as high as 6 per cent. The picture will become much clearer over the course of the next few months.

Robert Price

RP

S PRICE

Table 1: Percentage Increase in Settlement Levels Monitored by DE

	<u>1987-88 to date</u>	<u>1986-87 comparable period</u>	<u>1986-87 outturn</u>
Private Sector	5½	4¾	5¼
- manufacturing	5½	4½	4¾
- non-manufacturing	5¾	4¾	5½

NOT FOR PUBLIC USE

Table 2: CBI Databank Survey of Service Sector Settlements

<u>Date</u>	<u>Number of Settlements</u>	<u>Average Percentage Increase in Earnings</u>
1986Q4	27	5.1
1987Q1	50	5.6
Q2	116	6.4
Q3	23	7.1*
Q4	14	7.0*

\* Provisional

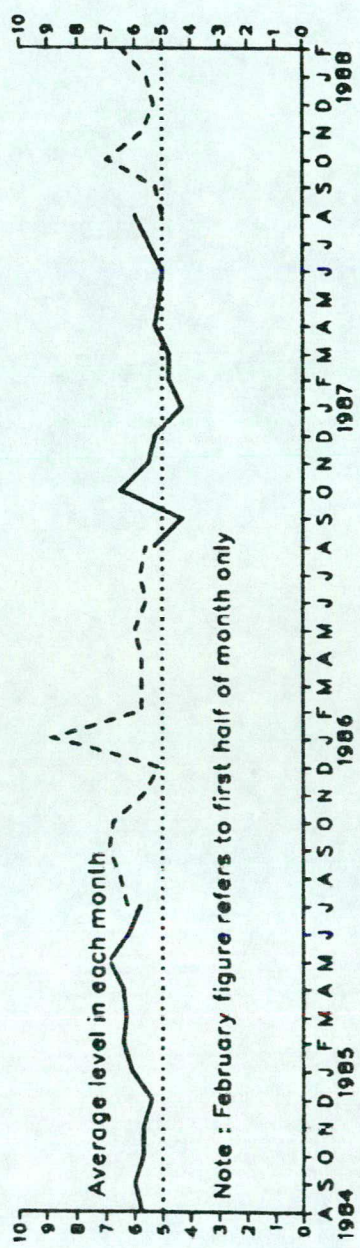
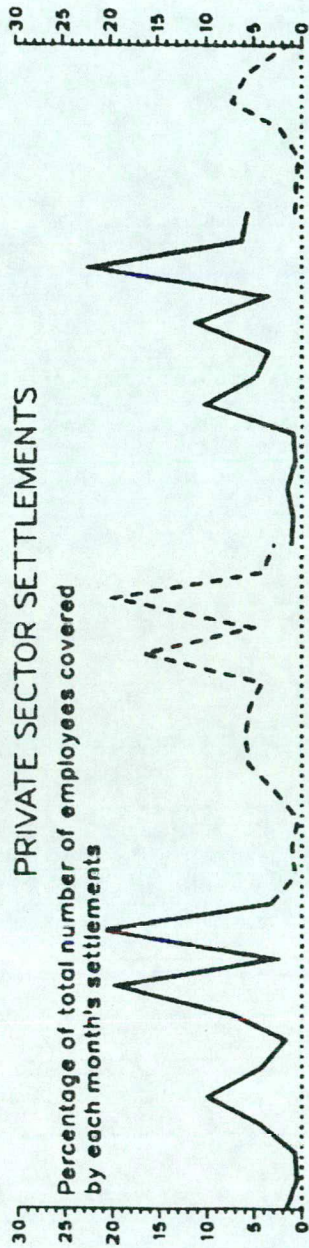
*Manufacturing - I think!*

Table 3: CBI Databank Survey of Service Sector Settlements

<u>Date</u>	<u>Number of Settlements</u>	<u>Average Percentage Increase in Earnings</u>
October 1986	74	4.6
November	79	4.8
December	56	4.8
January 1987	259	5.2
February	53	4.6
March	52	4.4
April	229	5.2
May	79	5.4
June	92	5.7
July	130	5.8
August	29	6.1
September	27	5.7*
October	49	5.3*
November	30	5.7*

\* Provisional

CONFIDENTIAL  
PRIVATE SECTOR SETTLEMENTS



Note : February figure refers to first half of month only

- 1984-1985 PAY ROUND
- - - 1985-1986 PAY ROUND
- · · 1986-1987 PAY ROUND
- · - 1987-1988 PAY ROUND

CONFIDENTIAL



FROM: MISS M P WALLACE

DATE: 18 February 1988

MR PATTERSON

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Monck  
Mr R I G Allen  
Mr Hibberd  
Mr MacAuslan  
Mr Pickford  
Mr Price  
Mr Tyrie  
Mr Call

**COMBINED RELEASE OF LABOUR MARKET STATISTICS ON 18 FEBRUARY**

The Chancellor was most grateful for your minute of 17 February. He has commented that the rise in earnings has a great deal to do with increased overtime. He has asked whether we know what has been happening to the trend of wage settlements. If this looks better, this would be useful in reassuring the markets.

2. I have discussed this with Mr Price, who has agreed to provide a note on this point.

A handwritten signature in dark ink, appearing to read 'mpw'.

MOIRA WALLACE





BF 26/2

FROM: A C S Allan

DATE: 19 February 1988

MR PRICE

cc PS/Chief Secretary  
PS/Paymaster General\*  
Sir P Middleton  
Sir T Burns  
Dame A Mueller\*  
Mr C W Kelly\*  
Mr Sedgwick  
Mr R I G Allen\*  
Mr Pickford\*  
Mr Gilhooly\*  
Mr Hibberd  
Mr Patterson  
Mr de Berker

\*With Mr Price's minute

**AVERAGE EARNINGS AND SETTLEMENTS**

The Chancellor was most grateful for your minute of 18 February. He thinks it is important that we get the settlements picture into the public arena, in particular the line you suggest in your paragraph 5, to the effect that CBI surveys suggest that settlements have increased since the end of 1986, but have tended to flatten off in the second half of 1987, even falling slightly in the last months.

2. He therefore wishes to write to Mr Fowler, copied to the Prime Minister and others, saying he feels it is unhelpful to concentrate too much attention on the earnings figures, which ~~are~~ inflated by overtime and bonus payments. This is a point often made by employers, who do not recognise the figures, and feel they produce an unhelpful climate where many employees feel disgruntled because their settlements are well below what they assume others in the economy are getting. The letter could then bring out your points about the trends in settlements.



3. I should be grateful for a draft, in consultation with Pay divisions, and routed through Sir T Burns.

ACSA

A C S ALLAN

CONFIDENTIAL

*Handwritten signature and scribbles*

FROM: ANNE MUELLER  
DATE: 22 FEBRUARY 1988

MR PRICE

cc: PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
Sir Peter Middleton  
Sir Terence Burns  
Mr C W Kelly o/r  
Mr Sedgwick  
Mr R I G Allen  
Mr Pickford  
Mr Gilhooly  
Mr Hibberd  
Mr Patterson  
Mr de Berker

*Alex*

**AVERAGE EARNINGS AND SETTLEMENTS**

I have just seen your minute of 18 February together with Mr Allan's of 19 February. When I saw the CBI last week they expressed some concern that their latest figures of settlements were rising again particularly in the service sector. A note of our meeting is attached.

2. I suggest that it would be worth checking direct with the CBI on the latest position before submitting the draft letter for the Chancellor to send to Mr Fowler.

*am*

ANNE MUELLER

CONFIDENTIAL

FROM: M H WHEATLEY  
DATE: 18 FEBRUARY 1988

NOTE FOR THE RECORD

MEETING WITH CBI ON PAY: TUESDAY 16 FEBRUARY 1988

Present:	<del>Dame Anne Mueller</del>	Mr Price	)
	Mr Macauslan	Mr Lindop	)
	Mr de Berker	Mr Cahill	) CBI
		Mr Sentance	)

Mr Price said that it was useful to meet informally from time to time to exchange views, given the links in the labour market between public and private sector pay, which remained important though not as pronounced as in earlier years. He outlined the current situation: the average level of settlements had fallen back slightly in the last quarter of 1987 (although earnings were running at a higher rate). However he told Dame Anne Mueller in confidence that the CBI was concerned that their latest evidence showed settlements to be rising to over 6% in manufacturing industry and higher in the service sector. The CBI would wish to balance attention given to this by stressing unit labour costs and improvements in productivity and performance; it had ample evidence that companies expected improvements in this area to continue. Companies also felt that the difference between the level of settlements and the rise in earnings could largely be accounted for by benefits gained by the companies; and that they were now using pay settlements in a proactive way to achieve changes which were desirable managerially.

2. Dame Anne Mueller raised a number of questions:

(i) despite the sharp fall in inflation in recent years, why did the increase in earnings in the UK remain stubbornly high compared with competitors? Mr Price said that despite some improvements in the last two years more needed to be done to overcome labour market rigidities. Mr Cahill added that many companies perceived a problem of inadequate labour supply; this was particularly acute in the South East where the service sector was concentrated. Concepts of "fairness" also remained remarkably persistent;

(ii) productivity improvements are achieved by individuals. Should not the CBI be reviewing the continued prevalence of collective bargaining on an industry-wide or company-wide scale and monitoring systems of individual reward? Mr Lindop said that there had been some change since 1979. Insofar as companies continued to adhere to industry-wide agreements, they were only used as a basic set of arrangements to be fleshed out by local arrangements. Mr Price said that companies were increasingly moving towards local bargaining, but the CBI did not wish to encourage this process to accelerate dramatically; companies often lacked the expertise necessary to carry out this process successfully. There was widespread interest in performance pay systems but concern that the PRP regulations were too

rigid (the CBI was carrying out a survey on this). Some organisations no longer offered a cost-of-living increase, insisting that any increase be on the basis of individual performance and marketability;

(iii) had the CBI carried out any comparative analysis of bargaining arrangements in the UK and abroad? Mr Cahill said that a concept of "fairness" was still prevalent among employers and employees in the UK to a far greater extent than other countries. Employers felt that they were morally obliged to reward staff for productivity improvements. In other countries there was a much greater sense of shared purpose - "cohesion" - among employers;

(iv) had Mr Clarke's speech last year encouraging employers to move away from rigid national pay rates been useful? Mr Price said that while the CBI itself had moved away from exhortation, clear statements of policy by Ministers were helpful. However, while Mr Clarke's actual words, about a "move away" from rigid national rates were right, the presentation of his remarks to the press, implying that current arrangements should immediately be abandoned, had been unfortunate.


3. Mr Macauslan asked whether companies were devoting more attention to training. Mr Price said that companies were on the whole only just beginning to realise the importance of training, in the face of growing skills shortages. The CBI was trying to persuade companies (but often to little effect) that training was an alternative to increasing pay rates, and would be offering a training presentation along the lines of its pay presentation. Mr Macauslan asked how far improvements in productivity had genuinely been stimulated by pay settlements, rather than merely used as a justification for them. Mr Price said that companies believed that more positive use was being made of pay settlements. Evidence from the CBI's pay database also suggested an increasing stress on performance in settlements.

4. Mr de Berker asked what evidence was available on service sector productivity. Mr Cahill said that it was difficult to measure. There were signs that companies were moving towards a greater individualisation of reward, with a stress on objective-setting and appraisal, to achieve the quality and competitiveness which were essential in the service sector.

*MHM*

M H WHEATLEY  
PS/DAME ANNE MUELLER

cc: Mr Monck  
Mr Burgner  
Mr Kelly  
Mr Chivers  
Mr Gilhooly  
Mr G Jordan  
Mr Macauslan  
Mr Truman  
Mr de Berker

FROM:  A P HEFFORD

DATE: 22 February 1988

**PS/CHANCELLOR**

PS/CHIEF SECRETARY

PS/PAYMASTER GENERAL

PS/SIR P MIDDLETON

PS/SIR T BURNS

MR ANSON

DAME ANNE MUELLER

MR KEMP

MR MONCK

MR KELLY

MR ODLING-SMEE

MR SEDGWICK

MR R I G ALLEN

MR GILHOOLY

MR HIBBERD

MRS BROWN

MR CHIVERS

MR PICKFORD

MR TRUMAN

MR RICHARDSON

MR FELLGETT

MR PRICE

MR CORRY

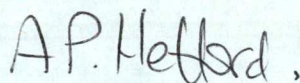
MR BELL

MR GRAHAM

MRS HARROP

**PAY SUMMARY NOTE**

This note updates that circulated on 25 January.



A P HEFFORD

## 1987-88 PAY ROUND

I. PUBLIC SERVICES

Settled: Police 7.75%, Firemen 7.3% LA Manuals 10.6% Civil Service IRSF grades 6.5% (first year).

Teachers: (England and Wales NAS/UWT claim 15%, AMMA claim 15%, PAT about 5%, Head teachers claim 20%. IAC due to report on 31 March on how £300m for teachers (worth c.4¼%) should be distributed. Deadline now passed for responses to Green Paper on long-term arrangements for teachers' pay. (Scotland) unions claim 8½-9% - no response from employers.

Civil Service: IRSF voted in favour of long term deal. CPSA claim £25 pw plus 35 hr working week NUCPS (formerly CSU and SCPS) 15% claim for EO-SEO grades.

Review Bodies: TSRB, DDRB, NPRB evidence submitted. AFPRB evidence due to be submitted shortly.

LA Builders: Large unspecified claim. Employers offer of £10 pw (6½% on earnings) rejected. Matter now with ACAS-arbitrators appointed.

II PUBLIC TRADING

Coalmining: NACODS rejected BC 4.28% offer (worth 3.75% on earnings). Matter now with National Reference Tribunal (NRT).

Water: Craftsmen claim for large but unspecified increases. Manuals ditto.

Electricity: Unions claim "well in excess of RPI"

UKAEA: Industrials claim large unspecified increase plus reduced working week. No response from employers yet.

Shipbuilding: Staff and Manuals large unspecified increase claimed.

III PRIVATE SECTOR

Agricultural Wages Board: Union claim of £140 pw minimum rate (40% increase) and reduced working week.

Ford: Following strike action new 2 year deal of 14% with no strings (7% in each year guaranteed) accepted at ballot. Returned to work 22 February.

Vauxhall: 2 year offer of 4.5% in each year (worth 14-15% on earnings over 2 years). Accepted at Ellesmere Port but not at Luton where ballot however not in favour of industrial action.

- Various Wages Councils have awarded increases ranging from 5.24% to 8.11% on minimum rates.

OTHER INFORMATION

Average earnings (whole economy) December increasing 8½% underlying rate, 8¼% in manufacturing. Unit wage costs in manufacturing rose 2.0% in 3 months to December 1987 (over same period in 1986).

RPI 3.3% in 12 months to January 1988. TPI 1.4% to January 1988.

DIARY AT 22.2.88

- 22 February: Water-employers due to respond to manuals claim.
- 3 March: Electricity Council's response to Manuals claim expected.
- 8 March: Agricultural Wages Board meet to consider Union's claim.
- 25 March: RPI, TPI for February.





*mp*

CH/EXCHEQUER	
REC.	25 FEB 1988 <i>25/2</i>
ACTION	CST
COPIES TO	

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-273 5817

Switchboard 01-273 3000 GTN Code 273  
Facsimile 01-273 5465 Telex 915564

The Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

*Friday 24*

*Dear John*

**POLICY PAY REVIEW**

In your letter of 17 February to Douglas Hurd, you raise questions about the timing of the survey of pay settlements and its relationship to this year's PNB negotiations.

For my part I see advantage in our having time to consider the results of the survey in E(PSP) before they are formally introduced into the negotiations, though I recognise that to be effective this cannot be left until the eleventh hour. This means that we really must press the OME to produce the results in good time and certainly well before their present forecast of early July.

There are of course a number of constraints and I do not underestimate the task. The whole business of designing the survey, selecting the sampling frame, issuing questionnaires and then following through all takes time, and must be done properly if the subsequent analysis and end-results are to have credibility with the local authority members of the Official Side, let alone the Staff Side. For the same reason, the period covered by the survey must also coincide as closely as possible with the average earnings index period used at present. Since the latter is the May figure, published in July, I think we have accepted that the settlement survey cannot realistically cover a period earlier than the year to end-April 1988.

CONFIDENTIAL



Despite this very tight timetable I would nevertheless hope that we could have results to hand as early as possible in June and that the PNB Official Side, having commissioned the survey, will exert all its influence to that end.

Meanwhile officials in my Department will go on working up the paper on police earnings circulated with Douglas Hurd's letter of 15 February, in consultation with Treasury and Home Office officials.

I am copying this letter to the recipients of yours.

A handwritten signature in black ink, appearing to read "Norman Fowler". The signature is written in a cursive style with a large initial "N" and "F".

NORMAN FOWLER

CONFIDENTIAL

CONFIDENTIAL

mjp

1. MR GILHOOLY *26*  
 2. CHIEF SECRETARY *26/2*

FROM J DE BERKER  
 DATE 26 FEBRUARY 1988

cc Chancellor  
 Paymaster General  
 Sir P Middleton  
 Dame Anne Mueller  
 Mr Anson  
 Mr Hayden-Phillips  
 Mr Kelly  
 Mr Gilmore  
 Mr Hawtin  
 Mr Turnbull  
 Mr Gilhooly  
 Mrs Case  
 Mr Potter  
 Mr White  
 Mr Revolta  
 Mr Brook  
 Mr Westwater  
 Mr Cropper

*Para 14 of this report -*  
*WBS*

#### POLICE PAY REVIEW

Mr Hurd's letter of the 15 February attached a paper on how the application of the Edmund-Davies formula has affected police pay. The paper has been prepared by officials at the Department of Employment in consultation with ourselves and the Home Office. It is still an early draft but you may wish to express views on how it should be developed.

2. At E(PSP) it was decided that the Government would need to be able to put forward persuasive evidence that the existing up-rating formula had resulted in excessive settlements for the police, and that this should be prepared by officials. The data are poor and open to a variety of interpretations. It is the accumulation of different bits of evidence pointing in the same direction, rather than a single knockdown argument, which makes the case. In our view the paper is too narrowly focussed and needs to make the bull points more clearly.

3. The paper is aimed at the Official Side of the PNB, but we understand that the meeting on the 23 February almost rejected the possibility of changing the Edmund-Davies uprating formula

from an earnings basis to a settlements basis, and it was only with great difficulty that representatives from the Home Departments were able to keep the possibility open. The Home Secretary should be writing shortly reporting on the meeting, but it is arguable what effect further evidence would have on the Official Side of the PNB.

4. The Official Side of the PNB leaks like a sieve - the Police Review is an impressively reliable source of information on their transactions. Anything the Government sends to the Official Side is likely to be selectively leaked so the case we make should be made with one eye to a wider audience.

#### Changes we would like to see

5. The paper needs to be written in a more accessible style. It still shows signs of being a technical paper written by specialists.

6. The paper also needs a full blooded attack on the Edmund-Davies formula. The authors have not done this on the grounds that the Prime Minister has said that we should respect the broad framework of Edmund-Davies, so it is perverse to try and discredit it. Nonetheless, without receding from that, it is important to make it clear why the present situation is unsatisfactory and needs to be modified.

7. A wider approach would allow the paper to say something about recruitment and retention: there is no longer a problem except perhaps for retaining experienced officers in London. It should also be possible to say something about police overtime. This has varied over the years but on the whole it has gone down. A true comparison would also look at earnings excluding overtime, and the paper should cover this.

8. The paper says very little about allowances on the grounds that it is unreasonable to attack pay because allowances are too high, especially if allowances are already been tackled as a separate issue. But the allowance situation is worth bringing

out in its own right. The rates of allowance have risen faster than pay rates, and the amount paid in allowances has increased as a proportion of the paybill over the years.

### The paper paragraph by paragraph

#### Introduction

9. Paras 1 and 2 set out the approach taken in the paper. This is all right as far as it goes but it is too narrowly focussed.

#### Average earnings comparison

10. Paras 3 and 4 should be read on conjunction with the tables at Annex I and Annex II. The presentation would be better if the tables were incorporated in the text. The numbers also differ slightly from those we have seen earlier. We will take this up at official level.

11. The text shows how police earnings have moved compared with earnings in the economy as a whole. The point of difficulty is that in the 1985 settlement the Edmund-Davies formula was moved from the actual increase in average earnings to the underlying increase. This gave a once and for all saving of about 1½ per cent. <sup>Sub does not affect the working of the formula</sup> Since then, the relative earnings of the police appear to have fallen back and opponents will argue that this shows that the formula has already been effectively modified. In Annex I they will point to the fall in the relative earnings of police constables in 1986 and 1987, and in Annex II they will point to the low increase in police earnings compared with that for full time adults in 1985/86 and 1986-87. The counter-argument, which is made in the paper, is that there were severe data problems in 1986. This does not account for the 1987 figures. In fact what happened was that overtime fell between 1986 and 1987, and the increase in police earnings excluding overtime was marginally greater than the increase in earnings in the economy as a whole. Misleadingly the figures in the text include overtime.

12. Para 5 is an opaque caveat designed to ward off criticism that the presentation of the figures is mendacious. Under the

Edmund-Davies formula the police pay settlement in September is based on the increase in earnings in the twelve months to the previous May. This lag means that in a period when earnings growth is falling the police settlement is always higher than the average settlement for the current wage round. In a period of rising earnings growth this process goes into reverse. But if settlements fall from a peak of around 20 per cent in 1980 and then stabilise at between 7½ and 8½ per cent - the experience since 1983 - the police will be left permanently ahead. Opponents will argue that this is consistent with the broad framework of Edmund-Davies, but it is certainly arguable whether this was what was intended when the formula was introduced.

13. Para 6 says far too little about police allowances and fails to make the point that they are an important and rising part of police pay. The percentage increase in allowances per man between 1979/78 and 1985/86 is puzzling since it is virtually identical to the increase in a constable's earnings over the same period. We will query this since we understand that the cost of allowances as a proportion of the total paybill has risen from about 10 per cent in 1978 to around 15 per cent now.

#### Police rankings in the earnings league

14. Paras 7 and 8 deal with the ranking of police in the earnings league and should be read in conjunction with the table in Annex 3. This shows that since 1979 police constables have risen in the earnings league every year except for falls in 1981 and 1986 caused by the data problems referred to in the text. The paper does not analyse why this has happened. In our view it is because the police get an above average settlement every year. Most occupations get good settlements in some years and poorer settlements in others which pull them back in the earnings league. The logical consequence of the Edmund-Davies formula is that eventually the police will continue to move further and further up the earnings league. The Annex does not show the 1987 earnings league - it would be useful to do this especially if it demonstrated that the police have made up the ground "lost" through

data problems in 1986.

#### Comparative pay scales

15. Paras 9 and 10 should be read in conjunction with Annex 4 which compares the pay scales of constables with those of other public sector employees. This shows that the police have done well, and they have done even better if allowances are included (but the paper is silent on this). Given the current sensitivity over nurses you may wish to consider whether they should be included in this comparison which is bound to become public. On reflection, our view is that nurses are probably best left out of anything sent to the PNB, at least before the Review Body decisions are made and announced.

16. Finally, the whole paper rests too heavily on increases since 1978 thus including the "catching up" increases which took place in 1978 and 1979. This produces very large increases in police earnings but makes it harder to discern the effects of the formula.

#### Handling

17. Subject to your comments we propose to try and get the changes we have suggested incorporated in the paper and clear the final version with you. As to timing, we will press ahead as fast as possible so that the lack of a paper does not prejudice any decision to raise the issue of the Edmund-Davies formula with the PNE.

18. HE are content.

*J de Berker*

J DE BERKER

FROM: SIMON PRICE  
DATE: 29 FEBRUARY 1988

- 1. MR HIBBERD *Jim Hibberd 29/2*
- 2. SIR TERENCE BURNS *29/2*
- 3. CHANCELLOR OF THE EXCHEQUER

cc : PS/Chief Secretary  
PS/Paymaster General  
Sir Peter Middleton  
Dame A Mueller  
Mr C W Kelly  
Mr Sedgwick  
Mr R I G Allen  
Mr Pickford  
Mr Gilhooly  
Mr Hibberd  
Mr Patersson  
Mr de Berker

*Ch/ content to write as drafted? (You should be aware that Mr Fowler's concern is manifesting itself in*

**AVERAGE EARNINGS AND SETTLEMENTS**

*a different way - see whacking paper on pay sheet in which we await advice mon 2/3*

As requested, I attach a draft letter to Mr Fowler arguing that the current level of settlements (as opposed to earnings) should be given more prominence in public presentation.

2. By way of background, tables 1 to 3 summarise the latest data from the CBI (from the February Pay Report) and DE settlement figures (which are not published). The new data confirm the picture given in my minute of 18 February. The size of private sector settlements has fallen in the last quarter of 1987, although these figures cover a period that traditionally has relatively few settlements. They are quite volatile, and we cannot yet confidently claim to detect a firm trend.

3. Despite the fall in the size of private sector settlements, the impact of past rises will increasingly be felt in the average earnings figures as the low settlements of a year ago are replaced by higher current settlements. Arithmetically, were settlements now to remain constant at their fourth quarter level, their average level over the past year (which affects current average earnings) would continue to rise for a further nine months.

4. Another point worth stressing is that public sector settlements are much higher, as table 1 shows. It is the high public sector figure of 10 per cent that gives a whole economy average settlements figure of 8 per cent for the round so far. At present, this is primarily due to the local authorities manual workers' award. But few, if any, of the forthcoming recommendations from the public sector Review Bodies are likely to be low enough to significantly reduce the whole economy average level of settlements below last year's outturn.



5. The size of settlements may also rise from the fourth quarter level. Very high profits growth in 1987 (ICC's profits were 25 per cent up on a year earlier), continued buoyant demand, and falling unemployment could lead to higher settlements, despite the current lower than expected levels of retail price inflation. The CBI staff have told us informally that they, too, are concerned about developments. They feel the outcome at Fords, even if justified there, will undoubtedly make it more difficult to maintain low settlements. Furthermore, although very few negotiators have so far settled in 1988, settlements that have been concluded suggest a 6 per cent figure in manufacturing, even without including the Fords settlement. DE officials take a similar view. Given the very small number of settlements actually concluded, however, it is still possible for the first quarter number to turn out lower than 6 per cent.

6. We are assuming that private sector settlements will average 6 per cent over the current round, compared to 5½ per cent in the 1986-87 round. These higher settlements will tend to keep earnings growth relatively high over the coming year at a time when we think that overtime will ease somewhat, making a negative contribution to earnings growth.

7. However, there is still likely to remain a significant gap between private sector settlements and earnings. The attached draft letter emphasises this point in a way that should present few or no hostages to fortune if private sector settlements do, as seems likely, turn up.

*Simon Price*

S PRICE

Table 1: Percentage Increase in Settlement Levels Monitored by DE

NOT FOR PUBLIC USE

	<u>1987-88 to date</u>	<u>1986-87 comparable period</u>	<u>1986-87 outturn</u>
Whole economy	8	6	6
Private Sector	5½	4¾	5½
- manufacturing	5½	4½	4¾
- non-manufacturing	5¾	4¾	5½
Public sector	10	7¼	6¾
- trading	-	7½	5
- non-trading	10	7¼	7

Table 2: CBI Databank Survey of Service Sector Settlements

<u>Date</u>	<u>Average Percentage Increase<sup>(1)</sup></u>
1986Q4	5.1
1987Q1	5.6
Q2	6.4 (6.2)
Q3	6.9*
Q4	6.7*(6.8)*

\* Provisional

(1) Half year average in parentheses

Table 3: CBI Databank Survey of Manufacturing Sector Settlements

<u>Date</u>	<u>Average Percentage Increase</u> <sup>(1)</sup>
1986 October	4.6
November	4.8 (4.8)
December	4.8
1987 January	5.2
February	4.6 (5.0)
March	4.4
April	5.2
May	5.4 (5.4)
June	5.7
July	5.8
August	6.1 (5.8)*
September	5.8*
October	5.3*
November	5.9*(5.5)*
December	5.5*

\* Provisional

(1) Quarterly average in parentheses

*polyre final*

## DRAFT LETTER TO NORMAN FOWLER

The growth of whole economy underlying average earnings rose from 7½ per cent in September to 8½ per cent in December. These figures have excited increasing public interest, comment and concern. ~~They have been interpreted by some commentators as an indication of overheating in the economy, and as a forewarning of a significant upturn in inflation.~~ There is a danger that many groups will seek to achieve increases in pay that they regard as equivalent to or better than the recent published increase in earnings. With the economy going well and profits strong, some employers may feel that large increases are warranted.

2. I believe it may be misleading to concentrate too much attention, in our public presentation, on the earnings figures. They are <sup>inflated</sup> ~~affected~~ by overtime and bonus payments which, ~~after all,~~ are rewards for extra effort and performance, but may be of a temporary nature. Many employers simply do not recognise the figures. They feel they produce an unhelpful climate. Employees may feel disgruntled because their settlements (confused with earnings) are well below what they assume others in the economy are getting. ~~The latest data from the CBI shows that settlements have not, in fact, been rising in the same way as the increase in earnings growth.~~ The following figures <sup>for ~~set~~ pay settlements</sup> are from the CBI Databank Pay Report.

CBI Survey of Private Sector Settlements  
Average Percentage Increase

Date	Manufacturing	Services	Actual Underlying Private Sector earnings
1986 Q4	4.8	5.1	8
1987 Q1	5.0	5.6	7½
Q2	5.4	6.4	8
Q3	5.8	6.9	8
Q4	5.5	6.7	8½

3. While there has been an increase in both sectors since the end of 1986, settlements have flattened off in the second half of 1987, and indeed have fallen in the last quarter. Even if settlements were to rise somewhat in the early part of 1988, possibly following the very bad precedent set at Fords, they would almost certainly be <sup>significant</sup> below the recent increase in earnings.

4. There is no room for complacency here, but it would be <sup>it would</sup> useful ~~for the rather more encouraging figures for settlements to be given~~ <sup>of very much less danger, and probably more payments, if the</sup> ~~much~~ more public attention.

*it would*  
*write in future*



FROM: A C S Allan  
DATE: 19 February 1988

MR PRICE

cc PS/Chief Secretary  
PS/Paymaster General\*  
Sir P Middleton  
Sir T Burns  
Dame A Mueller\*  
Mr C W Kelly\*  
Mr Sedgwick  
Mr R I G Allen\*  
Mr Pickford\*  
Mr Gilhooly\*  
Mr Hibberd  
Mr Patterson  
Mr de Berker

\*With Mr Price's minute

#### **AVERAGE EARNINGS AND SETTLEMENTS**

The Chancellor was most grateful for your minute of 18 February. He thinks it is important that we get the settlements picture into the public arena, in particular the line you suggest in your paragraph 5, to the effect that CBI surveys suggest that settlements have increased since the end of 1986, but have tended to flatten off in the second half of 1987, even falling slightly in the last months.

2. He therefore wishes to write to Mr Fowler, copied to the Prime Minister and others, saying he feels it is unhelpful to concentrate too much attention on the earnings figures, which ~~are~~ inflated by overtime and bonus payments. This is a point often made by employers, who do not recognise the figures, and feel they produce an unhelpful climate where many employees feel disgruntled because their settlements are well below what they assume others in the economy are getting. The letter could then bring out your points about the trends in settlements.



3. I should be grateful for a draft, in consultation with Pay divisions, and routed through Sir T Burns.

ACSA

A C S ALLAN



Caxton House Tothill Street London SW1 9NF  
5803  
Telephone Direct Line 01-243.....  
Switchboard 01-243 3000

CH/EXCHEQUER	
REC.	29 FEB 1988 29/2
ACTION	MR GILHOOLY
COPIES TO	PM & DAHEANUELOP MR KELLY SIR PMIDDLETON SIR T. BUANS.

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

*Nigel*

*February 24<sup>th</sup>*  
*(1) advise of... (2) counts: ...*  
*(1) Mr F ... still on ...*  
*(2) Mr X (@ ...), Govt's ...*

PAY

I have been wanting to follow up with you our mutual concerns about the rising trend of earnings growth and the harm this could do to our progress in the economy and to prospects for jobs.

I very much share your own approach to dealing with pay issues and I should like us to build on that together. In the public sector, where we are now experiencing mounting pressures, a practical step should be to ensure that Ministers collectively have time to give proper consideration to offers before they are made. A good example is the case of British Rail pay, where I intervened last week, and where the plan had been to authorise settlement in excess of 7 per cent. We must ensure that the Government machinery which exists to pick up issues of such obvious importance is properly used and, if possible, improved upon. In that context I would see merit in raising the profile of the officials committee on public sector pay which shadows E(PSP), rather in the manner of current involvement in the police pay issues.

We also cannot avoid taking a view about private sector pay settlements. Too many employers take too short-term a view of their interests on pay, as they do with training, and seem

*Conclude ...*  
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*some ...*  
*pay ...*  
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*actual ...*

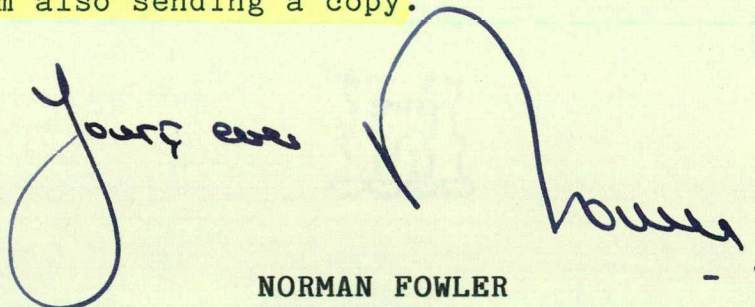




unwilling to break with the habits of the past. They have yet to adapt sufficiently to the new freedoms we have provided in our employment and industrial relations legislation. I found the latest CBI presentation, which I believe you also saw, rather too complacent. They emphasised the importance of pay and productivity for competitiveness but did not seem to appreciate the direct links between pay and jobs. I am sure we must go on publicly arguing the case that high pay rates and increases are damaging in themselves because of the effects on the use of labour and on output, profits and investment.

To support this argument, we also need to establish more firmly our overall strategy for pay, which recognises the prime responsibility of employers and employees but also brings together the many positive moves we are making ourselves, including in the whole area of competition policy.

... My officials have prepared the enclosed draft paper setting out how our approach to the pay problem has evolved and suggesting ways in which we can now carry it forward. I would appreciate your comments on the paper and those of John Major, to whom I am also sending a copy.

  
NORMAN FOWLER

CONFIDENTIAL

A STRATEGY

FOR PAY

Department of Employment

February 1988

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A STRATEGY FOR PAY

Chapter 1

BRITAIN'S PAY PROBLEM

- 1.1 For the last quarter of a century Britain has had a pay problem. Over most of this period earnings rose much faster than in other major industrial countries but productivity grew more slowly and our international competitiveness declined. Looked at another way our earnings growth was far in excess of the growth of output, so that most of it disappeared in higher inflation.
- 1.2 It is not easy to explain why earnings growth has not moderated more over the last few years. Since 1979 the government has pursued a restrictive monetary policy, along with measures to increase the competitiveness of product and labour markets at a time of very high unemployment. Before then it would have been assumed that the combination of such factors would lead inevitably to lower earnings.
- 1.3 The growth of earnings has an impact on employment and unemployment in two ways. Firstly, for any level of output, a lower rate of earnings growth will increase the demand for labour either by encouraging employers to substitute labour for capital or through an expansion of (lower paid) jobs. Secondly, if wage increases outpace productivity growth, and our labour costs rise faster than in other countries, the decline in competitiveness means that we will sell fewer goods abroad and import more.
- 1.4 Approaches to the pay question have on occasion seemed ambivalent. Some have argued for lower settlements as a means of encouraging the demand for labour and restoring balance in the labour market. Others suggest that higher wage increases are acceptable provided they are matched by productivity. In reality these are really two sides of the same coin: the objective should be to maintain pay at a level that protects existing jobs and promotes new jobs. This is made clear by the Government's often repeated view that employers should pay what they can afford and what is necessary to recruit, retain and motivate their employees.

The facts

- 1.5 Our recent history is one of persistently higher earnings growth than that of other industrialised nations.

Average growth of earnings in manufacturing - percent

	UK	Total OECD
1973-79	16.6	11.6
1979-86	11.0	7.7

- 1.6 And because we have also experienced lower productivity growth than other countries we have also suffered from a much faster rate of increase in unit labour costs.

Average growth of unit labour costs in manufacturing - percent

	UK	Total OECD
1973-79	15.8	8.3
1979-86	7.0	4.3

- 1.7 Against this background of higher earnings and unit labour cost increases it is not surprising that our employment performance has been much less successful than it could have been.
- 1.8 Turning to the more recent years since the economic recovery began in 1981/82 the most noteworthy feature is that the decline in earnings growth in manufacturing halted at around 7 $\frac{3}{4}$ %, and average earnings in this sector are now rising at 8 $\frac{1}{4}$ % a year (8 $\frac{1}{2}$ % in the whole economy) even though inflation has continued down to below 4%. In other countries by contrast, the fall in earnings growth has continued, and the latest average for OECD countries is only 5%.
- 1.9 More encouragingly, in the last 12 months our rate of increase of labour costs has declined sharply. But this is due entirely to a large increase in productivity which is unlikely to be sustained. Unless our rate of earnings growth can be reduced, our unit labour costs will soon start to rise again faster than in other countries.

Factors influencing the growth rate of earnings

- 1.10 In a competitive labour market, the growth rate of wages should be mainly influenced by labour market pressures - the balance of demand and supply. But the most surprising feature of the period since 1979 is the limited influence of high unemployment in moderating earnings growth.
- 1.11 A host of different factors can exert an influence on the growth of earnings and it is hardly possible to state with confidence which will be the most significant in any given set of circumstances. This paper does not attempt to analyse all these factors and their relative importance. But those which are most frequently quoted by wage negotiators and analysts include the cost of living; comparability; profitability; relationships between "insiders" and "outsiders"; and unemployment. We refer to each of these briefly.
- 1.12 To start with, the parties to wage negotiations appear to have an almost universal and deeply held conviction that wage increases should at least compensate for previous rises in the cost of living. This then sets the floor on which further increases may be built.
- 1.13 Comparability claims are also widely accepted as justified by management as well as employees. They are based on the belief that there is a rate for the job irrespective of other considerations and that equity requires that pay increases in one firm or industry should be matched by others. Apart from being "fair" the attraction for management is that comparability can appear to reduce their manpower problems.
- 1.14 The influence of profitability is generally in one direction: pay increases tend to rise with higher profits but are not necessarily depressed when profits decline. Unions not unnaturally quote profits where they support a high claim, and managements' believe that employees should share in the rewards of higher profits.
- 1.15 Recent economic studies indicate that pay increases are also influenced by the characteristics of employers' own internal labour markets. Many employers prefer to reward existing employees highly, to maintain motivation and productivity, and contain the overall pay bill by

shedding labour. Their employees are able to push for higher wages because of the specific skills they acquire. In such cases high unemployment in the external labour market has little relevance for the individual firm.

- 1.16 The effect of unemployment on the rate of earnings growth needs careful analysis. Economic studies suggest that this is stable over time but is perhaps surprisingly small. The explanation seems to be that an increase in the rate of unemployment has a larger moderating effect on wage increases than a continuing high level of unemployment. The period when settlements moderated most was 1980/82, when unemployment rose rapidly.
- 1.17 Two other factors, benefit levels and skill shortages, are potentially important. Unemployment and supplementary benefit payments must be expected to lead to higher rates of pay than would otherwise be the case, especially at the bottom end of the wages structure, though here again, economic studies suggest that the effect of current benefit levels on wages is not large. The effect of skill shortages in putting upwards pressure on wages will be especially large in a period when the economy is expanding.

## Chapter 2

GOVERNMENT APPROACHES TO DATE

- 2.1 In 1979 the Government ended the orthodoxy of most of the previous 20 years which embodied direct intervention in private sector wage bargaining. In particular incomes policies were rejected on the grounds that they did not reduce the long run rate of wages growth, but did introduce job destroying distortions in the labour market.
- 2.2 Instead the government introduced a new economic and financial strategy based primarily on control of the money supply. After 1982, when it was clear that the rate of earnings growth had stopped falling, Ministers widened their approach. Monetarism remained of paramount importance but was now supported by a greater emphasis on exhortation to negotiators. In the last few years the emphasis has widened further to embrace more explicitly the reform of pay bargaining, while relying still on the method of exhortation within a continuing monetarist framework.

Monetarism

- 2.3 The Government stance in 1979 was that controlling the money supply would be sufficient to ensure a low rate of inflation, and that employers should bargain in the light of their own circumstances.
- 2.4 The Manifesto of that year set out the position the Government would take:

"Pay bargaining in the private sector should be left to the company and workers concerned. At the end of the day, no one should or can protect them from the results of the agreements they make".

"Different considerations apply to some extent to the public sector. In the great public corporations, pay bargaining should be governed, as in private ones, by what each can afford. There can be no question of subsidising excessive pay deals".



"Pay bargaining in central and local governments and other services such as health and education, must take place within the limits of what the tax payer and rate payer can afford. It is conducted under a variety of arrangements, some long standing, such as pay research. In consultation with the unions, we will reconcile these with the cash limits used to control public spending and seek to conclude non-strike agreements in a few essential services. Bargaining must also be put on a sounder economic footing, so that public sector wage settlements take full account of supply and demand and differences between regions, manning levels, job security and pension arrangements."

- 2.5 The Government's main role was to establish the fiscal and public expenditure policies necessary to ensure control over the money supply. However it was recognised that the speed and ease with which this approach could defeat inflation also depended upon the competitiveness of product and labour markets. Measures were introduced to increase competition. These included de-regulation and privatisation; comprehensive reforms to industrial relations practices; wages council reform; and the ending of the fair Wages Resolution and Schedule 11 of the 1975 Employment Protection Act. These policies were an attempt to reduce monopoly power on both sides of industry, so that pay and employment determination should reflect competitive conditions.
- 2.6 Public sector negotiations demanded special treatment. Unlike the private sector, complete disengagement was not possible nor was it sought. Where the Government is itself the employer this was primarily because of its concern about public expenditure. But the Government also sought to influence public sector wages more generally by means of cash limits, external financing limits and the stipulation of a pay factor in permitted expenditures.
- 2.7 At first the policy seemed to succeed in reducing price and wage inflation. And in the private sector the rate of earnings growth fell from 19% in 1979/80 to 10% in 1981/82. But the price of this success was a very sharp rise in unemployment as tight monetary conditions resulted in reduced domestic profitability and international competitiveness.

2.8 In any case after 1982/83 the decline in earnings growth stopped. In the last 5 years, average earnings in the private sector have risen on average by about  $8\frac{1}{4}$ - $8\frac{1}{2}$ % a year and in the public sector by about 7% a year. And public sector earnings growth has recently accelerated, to  $8\frac{1}{4}$ % in December 1987. Why this has happened is a complex question but possible explanations are that:

- inflexible wage bargaining was not able to respond to changes in labour market conditions;
- once the growth rate of unemployment levelled off, workers were less willing to accept a further fall in wage increases;
- employers were prepared to offer incentives to motivate and encourage greater performance and productivity;
- employers were also anxious to avoid costly industrial action, especially when output started to pick up; and
- the increasing proportion of long term unemployed had little effect on the labour market and hence pay.

#### Exhortation

2.9 The failure of earnings to fall after 1982 showed that macroeconomic policies could control inflation but would not have an immediate effect on the labour market: accordingly the emphasis shifted to include exhortation about the need for lower pay increases. Ministerial speeches now advised private sector employers to seek lower settlements in the interest of jobs. During 1982 and 1983 Norman Tebbit, as Employment Secretary, made the case repeatedly. In August 1982 for example he told the Scottish EEF "there is a crucial and unbreakable link between pay and jobs ..... I hope negotiations in your industry and more generally will understand this; will remember it; and act on it".

2.10 Exhortation highlighted Government concern about pay but did not reduce the rate of earnings growth. This was not surprising. Employers will always act to further their own interests as they perceive them: to promote the efficiency and competitiveness of their undertakings in order to raise profitability. Aggregate levels of unemployment are not seen as the responsibility of employers and therefore not a matter to be raised in pay negotiations. The gap between employers' concerns and national needs is shown by the failure of successive CBI initiatives to encourage employers to seek to negotiate lower settlements. A major difficulty is that individual employers and employees are not readily persuaded of the relevance to themselves of the argument that it is necessary to accept pay restraint in return for more jobs.

#### Reform of collective bargaining

2.11 As earnings growth continued high, Ministers widened the argument to include the need to reform collective bargaining.

2.12 The proposition is that current arrangements are too inflexible, and unresponsive to market forces and the circumstances of the individual employer. Ministers have therefore begun to advocate radical reforms to collective bargaining machinery, the intention being to weaken practices which prevent market forces from operating and to strengthen those which allow wage changes to respond more quickly.

2.13 Two particular reforms have already been implemented: a drastic reduction in the scope and powers of wages councils and the scheme to encourage profit related pay through tax incentives. Others being argued for include moving away from national bargaining, job evaluated payment systems, the annual pay round and the going rate. In their place collective bargaining arrangements for settling pay should ensure that pay negotiations reflect local labour market conditions, affordability, performance and merit.

2.14 There has been no suggestion of statutory intervention to implement these changes. Implementation still relies mainly on exhortation, leaving private employers to take their own initiatives. Ministers have also demonstrated that the Government as an employer is moving in this direction. This part of the approach, which is now prominent and still evolving, is discussed in more detail in Chapter 3.

THE REFORM OF PAY BARGAINING

3.1 The previous two chapters have briefly surveyed the experience of the last 8 years leading to the current emphasis on reform of collective bargaining. This Chapter addresses key questions posed by such reforms and assesses their possible effects.

Reforming national bargaining

3.2 National bargaining is said to give higher wage increases than are justified because it:

- fails to take account of the circumstances of individual firms
- takes insufficient account of differences in local labour market conditions
- encourages comparability and going rate concepts
- removes from individual employers a direct link between pay and jobs (thus partly explaining their belief that pay is unimportant for job creation).

3.3 All this adds unnecessarily to costs. Moreover, to the extent that national bargaining is inflationary, it follows that there will be fewer jobs.

3.4 On the other hand, employers argue that national bargaining has the advantages that it:

- prevents leap frogging and therefore produces lower rates of earnings growth
- only affects minimum rates and acts as a wages floor
- brings stability to the industry and prevents uneconomic wage cutting.

- 3.5 In discussing the pros and cons, we need to distinguish between multi employer national bargaining (mainly private sector) and single employer national bargaining (mainly public sector).
- 3.6 Evidence from industry studies indicate that multi-employer national bargaining has contributed to excessive earnings increases. Even in industries where the national minimum rate acts as a floor, and does not directly affect earnings levels, a percentage change in the minimum rate feeds through into a similar percentage change in industry earnings. But the effect of national minimum rates on actual earnings levels may be greater. In 1982 an estimated 30% of males covered by private sector national agreements were paid basic rates of 10% or less above the nationally negotiated minimum rates. An increase in their national minimum rate is likely to feed through as an increase in their actual earnings as well.
- 3.7 Moreover, national bargaining has probably contributed to the relatively small variations in geographical earnings. Table 1 (overleaf) gives information on hourly earnings (excluding overtime) by region for adults from the 1987 New Earnings Survey. It shows that apart from Greater London, and to a lesser extent the rest of the South East, average earnings in the other regions are tightly bunched. There is no clear relationship between high unemployment and low earnings. Further, there is little evidence that relative regional earnings are changing in a way that would enhance employment.
- 3.8 Nevertheless, the demise of national pay bargaining would not necessarily make for lower increases in earnings, at least in the short term. The results would depend on the circumstances of individual industries and local labour markets. In that context it is well to remember that decentralised wage negotiations require more management time and expertise and will be more costly and time-consuming; and they will only allow local factors to have an effect if other aspects of the labour market also approximate to competitive conditions. In certain areas strong unions may be able to pick off local employers one by one.

Table 1

Regional variations in average hourly earnings (excluding overtime) for full-time adult workers (1987 New Earnings Survey) and unemployment rates. Index numbers.

REGION	MANUALS		NON-MANUALS		UNEMPLOYMENT
	MALE	FEMALE	MALE	FEMALE	RATE
GB	100	100	100	100	100
LONDON	112.1	115.7	122.7	123.4	82.1
SOUTH EAST (exc London)	99.2	112.1	100.7	98.4	63.2
EAST ANGLIA	96.9	96.5	89.0	88.1	71.7
SOUTH WEST	94.6	94.5	93.0	92.8	85.8
WEST MIDS	98.3	99.1	90.4	94.2	114.2
EAST MIDS	97.3	95.5	88.8	90.8	93.4
YORKS & HUMBERSIDE	98.1	95.2	88.7	89.6	117.0
NORTH WEST	100.1	99.9	93.2	93.6	130.2
NORTH	102.8	97.9	89.0	92.9	143.4
WALES	99.2	97.1	88.6	93.1	127.4
SCOTLAND	97.5	97.6	96.7	94.6	133.0

Note Ratios of unemployment rates are based on the seasonally adjusted unemployment rates excluding school-leavers.

3.9 With these caveats the conclusion must be that employers who are party to private sector agreements should be encouraged to question seriously the desirability of their continuing to subscribe to them. Employers can of course usually leave a national agreement if they wish. Their attitudes are not static but respond to changing labour market circumstances. A number of traditional agreements have been ended or are already in decline.

3.10 Introducing more geographical variations within single employer national bargaining may be more acceptable to unions, and less costly to employers, than abandoning national bargaining, while achieving most of the objectives of greater flexibility. But many employers may see the benefits to be derived from greater geographical variation in pay rates as being outweighed by the costs of introducing and operating a decentralised system. These include:

- extra administration costs
- greater potential for more frequent local disputes
- the need to obtain local labour market data to make informed judgements about appropriate local pay rates
- greater difficulty in transferring employees between areas.

3.11 Such difficulties are not however insurmountable, and in the public services and elsewhere there is scope for greater geographical variation within the framework of existing national bargaining arrangements.

3.12 Any discussion of national bargaining cannot ignore the position of Wages Councils, where bargaining arrangements mirror those of nationalised agreements in that they establish a national rate. This subject is being considered separately.

Comparability

- 3.13 The importance of comparability arises from two features of collective bargaining in Britain: the attachment of negotiators to the concept of fairness and the extensive use of job evaluation. It stands to be criticised because it imports into many pay negotiations external comparison unrelated either to market forces or to performance and ability to pay. It helps to generate inflation and destroy jobs.
- 3.14 The idea of fairness in pay rates is deeply influential among employers and employees alike. One interpretation is that employees doing similar jobs should be paid similar rates. However in recent years the idea has spread from pay levels to include pay increases. Many employees believe fairness requires that pay increases should at least keep in line with the rate of inflation or with settlements in the economy as a whole.
- 3.15 Employers are also attached to comparability - more so than employees according to a recent CBI paper. The appeal of fairness to employers may be less obvious but it probably stems from two factors: firstly, a feeling that they should not treat employees harshly and secondly, the fear that unless they pay the rate for the job all the familiar problems of personal management will arise.
- 3.16 The use of job evaluation exercises frequently opens the way for comparability - based pay structures. Job evaluation systems frequently perform a useful function in ranking a range of jobs within an organisation. What is unacceptable are attempts to equate dissimilar jobs in different organisations and apply pay rates drawn from cross-employer salary surveys. It is scarcely meaningful for example to compare the job of a bank manager with that of a schoolteacher: even less illuminating are attempts to equate salaries when the two jobs are found in different parts of the labour-market.
- 3.17 Payment systems based upon comparability - either formally through job evaluation or informally by negotiations - need to be re-examined. The objective should be to weaken the role of comparability and strengthen the importance attached to labour market conditions, affordability and the need to recruit, retain and motivate staff.



3.18 However, it will not be possible to eliminate comparability and job evaluation completely from pay negotiations, at least in the foreseeable future:

- employers cannot afford to ignore the going rate for labour of particular skills in taking on and keeping contented workers;
- the EEC Equal Pay and Equal Treatment directives oblige us to have machinery for ensuring equal pay for work of equal value. It is thus impossible to avoid job evaluation within establishments completely.

#### The annual pay round and the going rate

3.19 These are sometimes thought of as recent practices introducing an inflationary bias into wage bargaining. But the concept of annual settlements, if not the annual pay round, has a long history. The average interval between settlements over the whole of the period 1950-75 was just over 12 months.

3.20 It is unclear whether annual settlements of themselves encourage higher settlements and earnings growth. Evidence from the small number of 2 or 3 year deals is limited though the the second and third stages may exceed predicted inflation when the rate is falling. But an advantage of longer term deals is that if price inflation unexpectedly rises the effect on wages is delayed. With annual settlements an unexpected rise in price inflation more quickly feeds through in higher rates of earnings growth.

3.21 The going rate of increase also has a long pedigree rooted in ideas of fairness and comparability. By going rate is meant the general perception of the average national level of settlements.

3.22 The concept of the norm during incomes policy periods appeared to narrow the distribution of settlements forming the going rate. Whereas previously the going rate had been expressed as a range, incomes policy tended to narrow this or reduce it to a single figure. However during the last few years the range of settlement levels forming the going rate seems to have widened again, so that it now imposes less of a straitjacket on employers.

3.23 Going rate concepts may reduce the average rate of earnings growth if they deter employees from pressing for the highest increase affordable and making leap-frogging claims. It is impracticable to expect employers to disregard the going rate completely because they all need to know what their competitors are paying for the same type of labour. But they should regard it only as one of a number of factors to consider alongside affordability, performance and merit.

3.24 Changing payment systems, with greater emphasis on the importance of performance, merit and profitability may tend to reduce the influence of annual pay negotiations, and the effect of the going rate will have less influence on the level and growth of earnings.

Performance, merit and profitability-based pay systems

3.25 The 1987 NES shows that 41% of male manual and 31% of female manual workers receive some form of payment by results, which accounts for 7½% of average earnings for manual workers. Moreover the NES data excludes periodic payments from bonuses and profit related schemes so that the actual incidence of performance and profitability schemes is larger than they indicate.

3.26 Performance and merit pay should be distinguished from pay related to profitability. The former depends upon the performance and skill of an individual in his job while the latter relates to the performance of the company as a whole. There is obviously a much closer relationship between motivation and incentives in the case of performance and merit pay than with profit-related pay. The individual worker can see the relationship between his own effort and additional earnings but in a company-wide profit related pay scheme the connection is often tenuous.

3.27 Performance and merit-related pay are now being incorporated as elements of the pay structures of many companies, though none seem to envisage that pay could be based entirely on these factors. Employers look for a sensible and ordered system of rewards to support their hierarchy of jobs. Pay increases must also be allowed to reflect other factors such as demand and supply in the local labour market. Performance should be one important consideration along with others that are relevant.

- 3.28 There is no reason why a scheme linking an element of reward for individual employee performance should not be accommodated within payment systems. Many pay systems have a range of different pay rates within grades and the introduction of merit or performance yardsticks can be used to help determine the individuals' position within that range without disturbing the wider pay structure.
- 3.29 Performance and merit pay may increase flexibility and help to create a climate favourable to change and higher productivity and output. These are all major benefits. It is less clear whether they help towards a fall in average earnings levels. If performance and merit pay additions are placed on top of the normal settlement then average earnings will rise. This is the experience of many productivity or payment by result schemes.
- 3.30 The relationship between individual effort and company profits is fairly remote, so the effect of profit-sharing schemes on incentives, motivation and efficiency is less than in individual performance based schemes. Whether they result in lower earnings growth depends upon the characteristics of the schemes. Where profit sharing payments are paid on top of annual pay increases they may actually increase the rate of earnings growth. For example, in both ICI and the clearing banks which have well established profit sharing schemes, the level of annual pay settlements usually compares favourably with those of other firms in their industries and are generally above the overall average for the private sector.
- 3.31 The profit related pay schemes the Chancellor is encouraging through tax incentives are conceptually quite different. Their distinctive feature is that a profit related pay element will be introduced at the expense of part of existing pay or future pay increases. In a period of rising profits the increase in average earnings may be higher than otherwise, but if profits are falling pay increases may be lower than with conventional bargaining arrangements. Profit related pay, by encouraging greater wage flexibility may help to safeguard jobs in a period of falling profits.

- 32 Profit-related pay has some further advantages. It undermines multi-employer national bargaining, since individual schemes can not apply wider than a single employer. It can also undermine the concept of the going rate because where PRP forms part of a settlement it will be difficult for others to see what the percentage wage rise will actually be.
- 3.33 While performance, merit and profit related pay systems will encourage adaptability, higher productivity and greater efficiency, the evidence from existing schemes is that they may not necessarily reduce the rate of earnings growth. If they are to make an effective contribution to that employees will have to show a greater willingness to accept lower basic pay settlements in return for greater rewards from performance and profit sharing schemes.

Will reforming pay bargaining moderate earnings growth?

- 3.34 As this discussion has shown there must be uncertainty about the effect of the proposed reforms on the level of pay increases. Much depends upon the circumstances of individual industries and firms and conditions prevailing when changes are introduced.
- 3.35 What can be said is that the reforms already made - wages councils and profit-related pay - and those being advocated will increase pay bargaining flexibility. Admittedly in the short run the effect on earnings growth may not be wholly beneficial. For example, the break up of national bargaining may lead to an initial round of leap-frogging settlements. But in the long run it will encourage pay settlements more in line with what can be afforded and with labour market conditions. Over time this should result in lower rates of earnings growth.

## Chapter 4

INCREASED COMPETITION IN THE PRODUCT AND LABOUR MARKETS

4.1 This paper concentrates on pay bargaining and the ways in which bargaining arrangements could be reformed to bring about greater labour market flexibility and lower pay increases. But a complete strategy for pay must also recognise that pay bargaining arrangements and negotiations are influenced by the general conditions prevailing in product and labour markets. If these markets are not working effectively it is unlikely that competitive forces can have a dominant influence on pay bargaining.

4.2 Increased competition in the product and labour markets should help to moderate wages growth by putting pressure on employers to reduce costs and to cease passing on pay rises in higher prices. The Government has pursued a range of policies to increase competition, including privatisation, contracting out services particularly local authorities, deregulation and trade union legislation. These measures take time to achieve their effects. Meanwhile more could be done to realise the full benefit for inflation and efficiency gains from increased competition. Working together with a reformed collective bargaining system this should enable labour market pressures to have a moderating impact on wages.

4.3 In addition to measures already introduced to sharpen product market competition others could be considered including:

- breaking up public and private sector monopolies eg coal, steel, electricity, water, telecommunications and gas
- fostering new and small enterprises
- further reducing regulations and statutory requirements on businesses
- re-introducing Sunday trading legislation

- using the public sector's power as a consumer to stimulate competition eg, competitive tendering.
- making more active use of existing competition, restrictive practices and fair trading legislation.
- increasing competition though international trade

4.4 Further measures to increase labour market competition include:

- removing restrictive labour practices
- removing anti-competition agreements eg among the professions.
- further reducing the impact of wages councils.

These are currently being considered in the context of the Government's competition policy.

4.5 Other measures which would indirectly increase labour market competition are :

- increasing labour mobility through reducing housing constraints by deregulating the private rented sector
- reducing the incidence of the poverty and unemployment traps
- more training aimed specifically at skill shortages

4.6 Introducing radical reforms will not be easy, and will meet with strong opposition from vested interests. But they are well worth pursuing. The extent of the impact of increased product and labour market competition on average rates of earnings growth is uncertain but should be positive. Moreover, such reforms are not solely directed at achieving a lower rate of earnings growth; they would also promote labour flexibility more generally with all the benefits to the economy that would bring.

## Chapter 5

PUBLIC SERVICES PAY

5.1 The special problem of public services pay is to develop a system which meets the needs of the taxpayer, employers and employees. Pay levels should take account of:

- what taxpayers are prepared to afford
- what employers need to pay to recruit, retain and motivate employees, and therefore of necessity what employees regard as fair.

5.2 These objectives are not easily reconciled. The market pressure of affordability is weaker than on private sector employers because Governments have the option of raising more money through higher taxes or increased borrowing. For many occupations the public service is the major employer so that a market rate cannot be easily established.

5.3 In the past this dilemma was partly solved by incorporating into public service pay an element of comparability. This ensured that over the long run employees regarded their salaries as fair and recruitment and retention problems could be avoided. But the weakness of comparability was that it led to a loss of control over public expenditure. The present Government has attempted to assert the primacy of public expenditure control and affordability as the main influences on public service pay, while being prepared to retain an element of comparability in line with the findings of the Megaw Committee.

5.4 But the extent to which control over public service pay negotiations could be re-established depends upon bargaining arrangements. In public services these are of three different types\*

- review bodies or index linking arrangements
- free negotiations covering local authority groups
- free negotiations covering central government groups.

\*Public Service arrangements are described in more detail in Annex 2.

5.5 Government control over the first is severely limited. Both the review bodies and index linking arrangements place a greater emphasis on comparability than on recruitment and retention needs and affordability. Central government control over local authority negotiations used to be effective but in recent years has weakened though steps are being taken to establish control e.g. with teachers. The central government groups - civil servants and NHS staff - have experienced the full rigours of the Government's emphasis on affordability and have experienced far lower settlements than others as a result:

5.6 Between 1980/81 and 1986/87 the cumulative rise in the level of settlements was:

56% - for private sector groups

78% - for public service review bodies and index linked groups

58% - for local authority freely negotiating groups

46% - for central government freely negotiating groups

5.7 Government policy has undoubtedly been successful in restraining pay increases for some public service groups but there is now intense pressure for 'catching up'. Previously such pressure has achieved results. Already school teachers and university teachers have received large increases to recover much of their ground. But other groups - mainly in central government - have achieved less and substantial pressures remain.

5.8 The main question over the next few years is whether these pressures can continue to be resisted in the face of recruitment and retention problems and growing evidence of a willingness to take industrial action. If not, how can the government arrange an orderly measure of catching up without risking a general pay explosion?



5.9 There are three ways of dealing with catching up pressures

- Resistance. If successful this would contain costs and set a good example. Major disadvantages are the likely significant short run costs of industrial action, and long run manpower problems leading to a fall in the quality of service.
- Market solution. This would continue the present policy of emphasising affordability and the requirement to control public expenditure. Implicit in this approach is the acceptance from time to time of a need for upward adjustments to the relative pay of certain groups, usually because of recruitment and retention pressures. But the aim would be to deal with them when and where they arose in a targeted manner, thereby avoiding general public service 'catching up' and keeping the overall pay bill cost down.
- Institutional Reform. This assumes that a public service "catching-up" is inevitable but that, within the present framework of piecemeal pay setting arrangements, will occur in a chaotic manner leading to industrial relations problems. Institutional reform would aim to provide for a more controlled process. One possibility would be a new Public Services Commission to cover all public service employees. This would rationalise the present variety of methods of determining public service pay within a framework that takes an overall view of public service employees and their relation with the rest of the economy. However, such institutional reform of the kind suggested would be inconsistent with the existing thrust of Government policy towards pay determination.

CONCLUSIONS: FURTHER ACTION BY GOVERNMENT

- 6.1 Britain's problem of excessively high earnings growth is serious and so far unsolved. After levelling off at  $7\frac{1}{2}\%$  a year the growth rate in the whole economy has now begun to creep up again, to  $8\frac{1}{2}\%$ . And the recent improvements in manufacturing productivity - and hence unit wage costs - are attributable to special factors that cannot be expected to continue at the same strength.
- 6.2 The objective remains to reduce earnings growth to a level that can be afforded by higher output and productivity, and more truly reflects market forces. But the entrenched attitudes of wage bargainers, especially their attachment to cost of living increases and comparability, still contribute to wage rigidity. Bargaining structures are often inefficient. These and other factors continue to push up earnings, reduce competitiveness and ultimately cost jobs.
- 6.3 The Government's approach to the pay problem has evolved over the years since 1979 and the emphasis has varied with time. But it has remained a consistent part of the overall economic strategy directed at the central tasks of reducing inflation, loosening up markets and bargaining arrangements, and encouraging a more dynamic and profitable economy, able to support higher earnings and more jobs.
- 6.4 One method of exerting a direct Government influence that is not recommended would be a return to some kind of formal incomes policy like those of the 1960s and 1970s. Though these had initial success in reducing earnings growth this could not be maintained and the policies had other, serious, drawbacks. They encouraged union militancy and industrial action, and increased distortions in the labour market. And above all, because the policies were more tightly enforced for the public sector, they gave rise to serious problems of industrial unrest and expensive catching up awards once they were relaxed.

- 6.5 For these reasons there is now little support anywhere for that sort of general Government intervention though the incomes policy idea still has its advocates at a time when earnings growth and unemployment both remain excessive. Most prominent is Professor Layard whose tax-based plan to restrain the growth of pay can be seen as complementary to the Chancellor's use of the tax system to influence bargaining.
- 6.6 In essence, Layard's main suggestion is that firms would pay a tax proportional to the excess growth of hourly earnings above a national norm. This is consistent with maintaining a market-based approach to pay bargaining and avoids some of the problems of a conventional incomes policy. For example, free collective bargaining would continue; relativities would be adjusted as the parties determined rather than by an old-style pay body; the tax would be levied on earnings, not settlements; and profit-sharing schemes would be exempt. But there are important disadvantages. Among others, the plan would create labour market distortions, and penalise firms which deserved encouragement - for example, those needing to pay more to recruit skilled labour and those wishing to restructure their payment systems to motivate staff and reward performance and merit. It would also be difficult to adapt to the public sector.
- 6.7 Another method to be considered if only to be rejected is that of legislation for example to make collective agreements legally binding or to outlaw national collective agreements as restrictive practices. The first of these is really irrelevant to the pay problem. The likely effect would be that trade unions would demand a higher price for entering into new collective agreements or for retaining existing ones. And it is quite uncertain whether this would be offset by better productivity arising from greater industrial peace.
- 6.8 As to moving against national agreements, the theoretical advantages would indeed be to increase labour market flexibility and competitiveness, promoting lower wage increases and hence more jobs. But the drawbacks are considerable such that E (CP) decided last July against pursuing the idea. The Government would be intervening directly in pay bargaining quite contrary to a central tenet of its policy consistently applied since coming to office. Employers as well as unions would totally oppose any attempt to outlaw arrangements they support and use voluntarily. Finally there would be numerous practical

difficulties of enforcement. The major exception to this is whether wages councils should be further reformed or abolished as an example to wage bargainers of the Government's commitment to more flexible negotiating arrangements.

### Elements of a strategy

6.9 While the most promising way forward is therefore to persevere with developing the Government established approach, it can at the same time be given a sharper definition by clarifying the different ways in which a Government strategy can operate. A major, attainable, objective remains the promotion of greater flexibility in the whole system of collective bargaining. This involves eroding the influence of those institutional factors making for rigidity, such as national agreements, (whether industry or company-wide) and the annual pay round; and reducing the hold of such influences as the cost of living and comparability on bargaining attitudes. In their place the emphasis should be much more on responsiveness to market forces; performance and merit; and affordability.

6.10 The Government can pursue this objective in two main ways:

- exerting a direct influence on pay where appropriate - effectively in the public services - setting an example to the private sector in the process;
- continuing with further action to increase competition in product and labour markets which should have a crucially significant indirect impact on pay.

Thirdly, Government influence on negotiators through argument and exhortation might be more effectively focussed.

### Direct Influence on Pay

6.11 Government control is effectively limited to the pay of only a relatively small proportion of public sector workers - civil servants and NHS non-review body staff. However, the Government can also exert an influence on the pay of a much wider range of public sector employees. It is tempting to act to suppress pay in these areas both to

save public expenditure and to set an example to the private sector. But this would be to ignore longer term manpower and industrial relations costs and would provide no reason why private employers should follow suit.

6.12 The more sophisticated approach is for the Government to negotiate or in other ways promote more flexible pay arrangements based on the now established principles that pay should reflect what is needed to recruit, retain and motivate the particular staff in question, subject to what can be afforded. While some element of comparability in determining civil (and public) service pay can never be entirely excluded (as recognised by Megaw and reflected by the IPCS and IRSF deals and proposals to other unions) its influence should be accepted as subordinate.

6.13 Further steps in this direction would include:

- seeking to change the current index linked arrangements for the police and fire service. These are examples of the worst type of crude comparability arrangements, paying no regard to affordability and labour market pressures:
- challenging the review bodies on affordability and recruitment and retention needs. At the moment these factors do not appear to play a prominent part in their considerations despite Government evidence emphasising their importance. This could be highlighted in evidence to the Review Bodies and in the Government's response to unsatisfactory recommendations.
- continuing with efforts to introduce performance and merit pay and geographical variations in the civil service and more generally in the public services.

#### Indirect Influences

6.14 The main examples of what is in mind here are measures to increase competition in labour and product markets. Chapter 4 has suggested several that could be taken in addition to those already in train. The relevance of labour market competition for pay is unquestioned. But product market competition has perhaps not received the attention it

deserves as a mechanism for exerting downwards pressure on pay as employers are forced to become more efficient and cost-effective. This acts as a vital countervailing force to those pressures that tend to push pay inexorably upwards. Though the suggested measures will take time to work through, the ultimate effect could only be to make for a healthier economy with the possibilities of more expansion and jobs.

6.15 Other possibilities to be considered further could be the effects on pay of taxation incentives and benefit levels. Taxation incentives could be extended to further encourage negotiators to have more regard to profitability and performance. There may well be scope for developing initiatives like the Chancellor's profit-related pay scheme. Further adjustments to national insurance contributions to favour lower-paid jobs might also be considered.

6.16 The influence of benefit levels on movements in pay has not been addressed in this paper. Arguments are sometimes put forward from common sense, backed by experience in the USA and other countries, that a more stringent benefit regime would induce unemployed people to find and take jobs at lower pay, thereby exerting downwards pressure on earnings levels generally. Apart from the social and political consequences, evidence from economic studies on the likely effects is unclear and it may be that some further work on this should be done.

#### Better Focussed Exhortation

6.17 If the Government can make headway with these various initiatives, particularly in making public sector pay more market-oriented, that itself will provide a convincing example to other negotiators of what can be done.

6.18 At the same time, the present policy of exhortation could be made much more effective, both in content and method. Exhortation is more than simply an appeal. It can be defined broadly as encompassing education, encouragement and persuasion, again with the prime objective of shifting employers' perceptions towards the needs of their markets. So the message is more sophisticated than that aggregate earnings growth should somehow be lowered for the general good. Rather, it aims to show up specific faults in pay determination arrangements and processes and propose remedies. Employers (and even unions) should at the least be

brought to question seriously the advantages to themselves of existing arrangements making for rigidity. Also worth emphasising are the greater freedoms now available as a result of de-regulation - like the repeal of schedule 11 of the 1975 Employment Protection Act - and the potential of incentives under the profit-related pay scheme.

- 6.19 Methods of exhortation should be worked out in a more systematic way than hitherto. There is scope for commissioning a properly co-ordinated programme involving Ministers in the relevant Departments and using all available vehicles - in speeches, seminars, conferences and private meetings. Content and method should be sensitively targetted and adapted to the specific interests of different groups, including professionals, and "opinion-formers" as well as wider general audiences and readerships.

#### Conclusion

- 6.20 The strength of this suggested approach to a Government strategy for pay is that it remains four-square within the existing economic and financial framework of policy while building upon past experience in a number of specific ways. It is therefore consistent, coherent and has real content. Moreover many - though by no means all - employers appear to be receptive as they now take their own initiatives, for example, to reform bargaining arrangements. But a note of caution is in order. The strategy requires a determined effort by Government and officials to reform public sector pay in face of various vested interests, while in the private sector, the approach is necessarily one for the long haul. A well-sustained campaign of example and exhortation, supplemented by suitable incentives, could have a decisive long-term influence where it matters most, but in the end responsibility for pay determination and earnings comes back to individual employers, unions and employees.

#### Issues for Consideration

- 6.21 Ministers may wish to consider the following propositions:

- (a) the general approach to pay should continue to develop along established lines, within overall Government economic policy. Direct intervention through legislation or formal incomes policy is ruled out;

- (b) in the public services a significant problem is how to deal with the build up of catching up pressures. The aim should be the maximum feasible orientation towards market solutions (such as performance and geographical pay). A key question is how far the Government is prepared to go to put all arrangements onto a consistent basis, by moving against the review bodies and indexation arrangements;
- (c) in the private sector, the parties should be pressed to question existing collective bargaining arrangements and practices, shifting to a more market - oriented approach and away from comparability. A particular question for government in the future of the wages council system - ( a review is in hand and will be available soon);
- (d) further steps should be taken to sharpen competition in both product and labour markets (as in paragraphs 4.3 and 4.4) so as to exert further downwards pressure on pay;
- (e) to reinforce policies, the Government should organise a much more systematic and focussed campaign of persuasion and exhortation, emphasising employers' new freedoms and opportunities, such as tax incentives in profit related pay, and the Government's own example as employer.

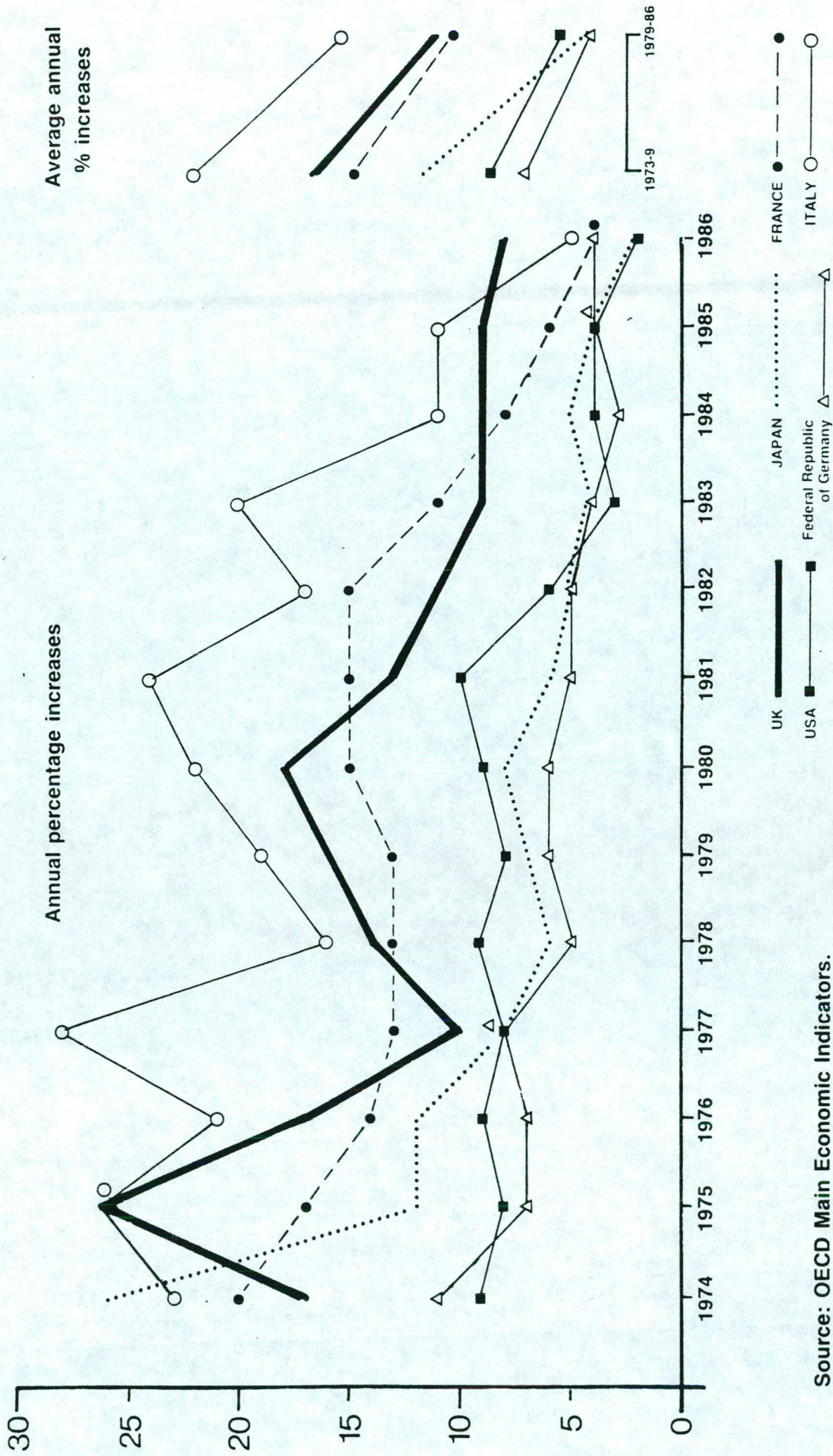
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February 1988



HOURLY EARNINGS MANUFACTURING

TABLE 1

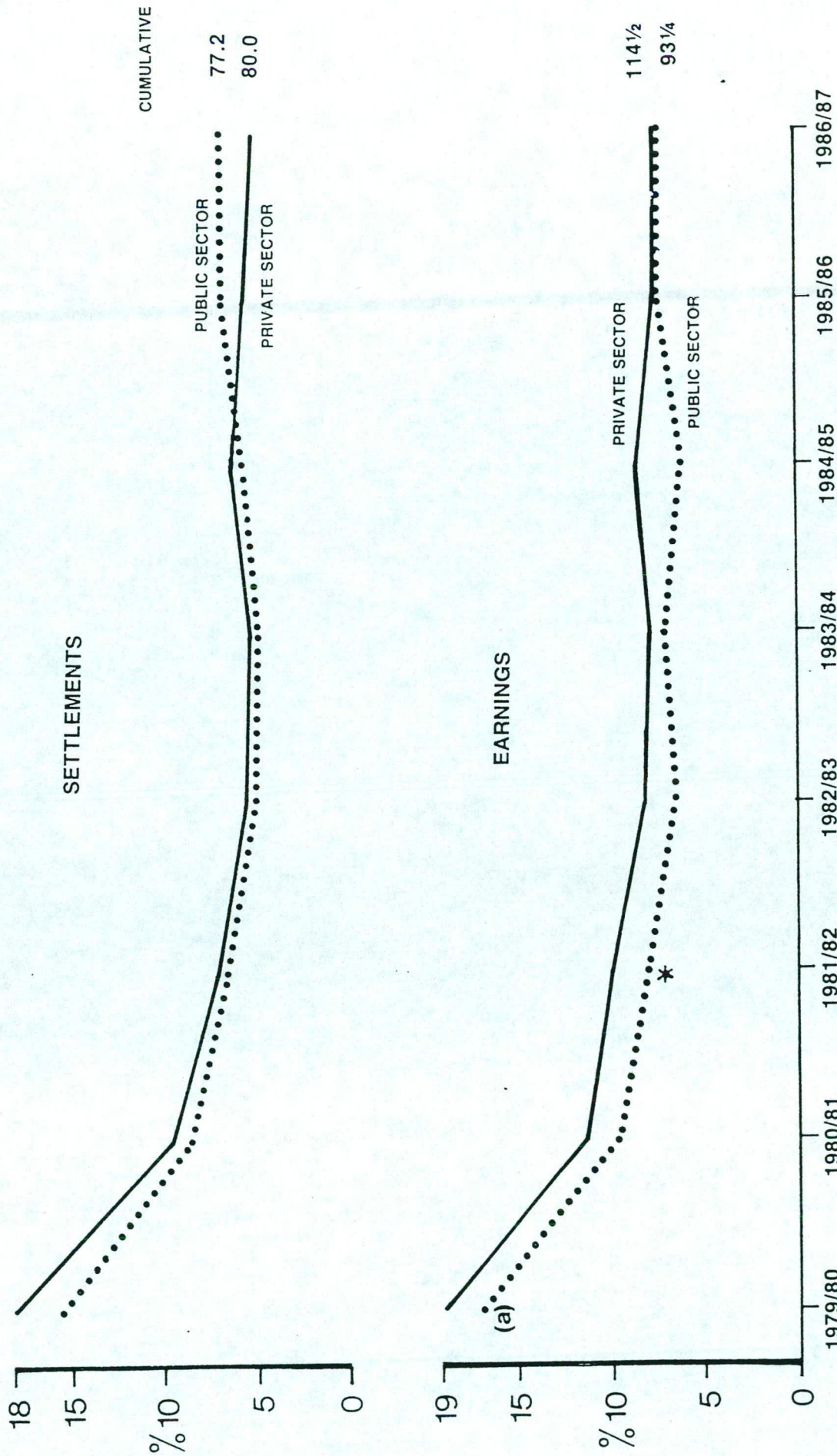


Source: OECD Main Economic Indicators.

LEVEL OF SETTLEMENTS AND GROWTH OF AVERAGE EARNINGS

TABLE 2

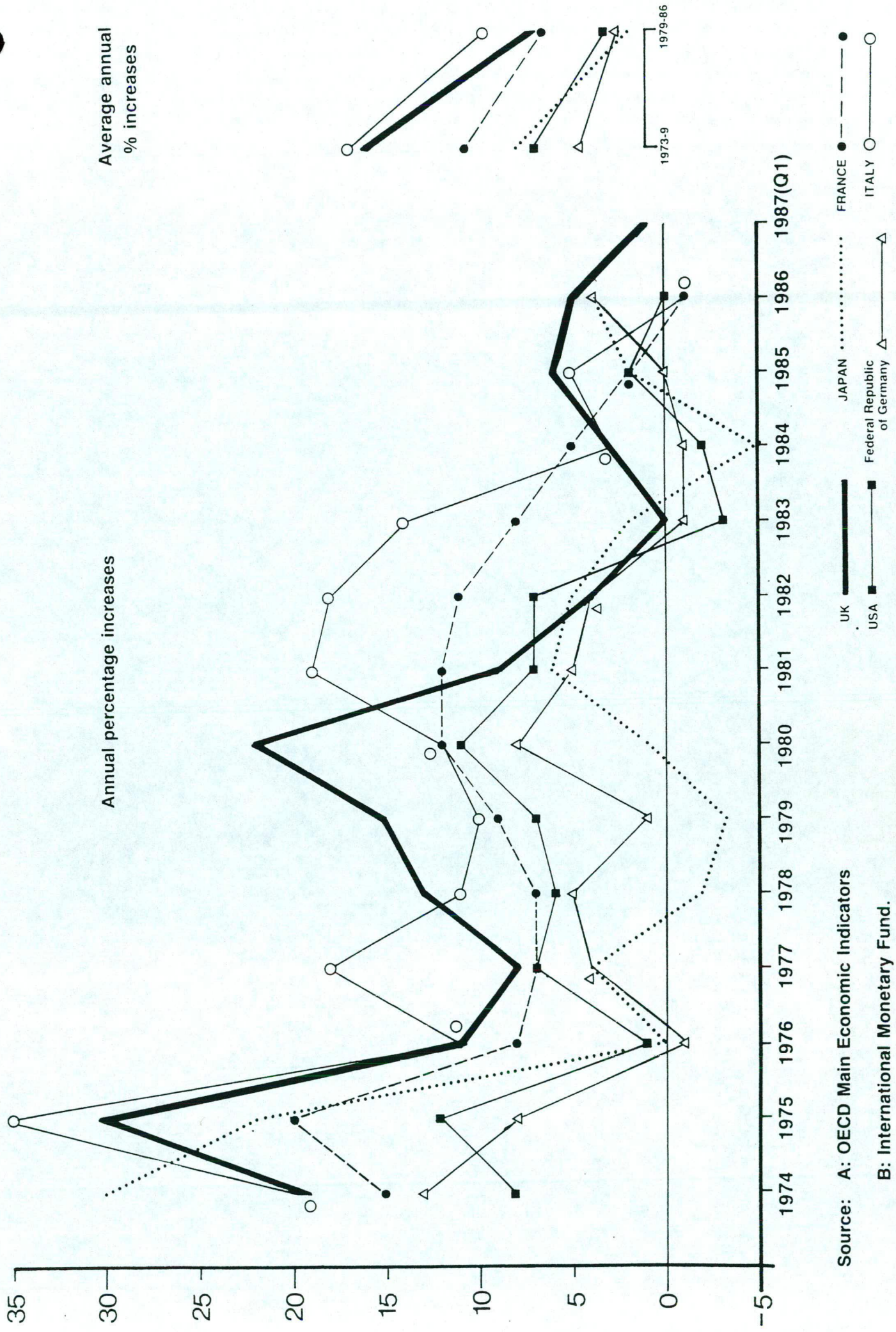
1979/80 — 1986/87



NOTE: Settlements percentages are first year costs.  
 (a) Excludes the effect of Clegg and staged civil service settlements in 1978/79 round.  
 \* Includes the effect of 7.5% increase for nurses paid in 1982/83.

WAGES AND SALARIES PER UNIT OF OUTPUT IN MANUFACTURING

TABLE 3



Source: A: OECD Main Economic Indicators

B: International Monetary Fund.

## HOURLY EARNINGS MANUFACTURING

Annual percentage increases

	UK	USA	JAPAN	Federal Republic of Germany	FRANCE	ITALY
1974	17	8	26	11	19	25
1975	26	9	12	8	17	49
1976	17	8	12	7	14	19
1977	10	9	8	8	13	26
1978	14	9	6	5	13	21
1979	16	9	7	6	13	19
1980	18	9	8	6	15	22
1981	13	10	6	5	15	22
1982	11	6	5	5	15	16
1983	9	4	4	3	11	22
1984	9	4	5	2	8	11
1985	9	4	4	4	6	11
1986	8	2	2	3	4	5
Average annual % increase						
1973-9	16.6	8.6	11.7	7.2	14.9	26.0
1979-86	11.0	5.5	4.7	4.2	10.4	15.4

Source: OECD Main Economic Indications.

## LEVEL OF SETTLEMENTS AND GROWTH OF AVERAGE EARNINGS

1979/80 - 1985/86

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	CUMULATIVE
	<b>SETTLEMENTS</b>								
WHOLE ECONOMY	16.7	8.5	6.9	5.5	5.2	5.8	6.1	6	78.8
PRIVATE SECTOR	18.0	8.8	7.0	5.7	5.4	6.1	5.6	5	80.0
-MANUFACTURING	16.5	8.7	6.3	5.3	5.4	6.0	5.6	4.7	75.1
-NON MANUFACTURING	19.2	8.8	7.6	6.0	5.3	5.1	5.6	5	81.5
PUBLIC SECTOR	15.6	8.3	6.8	5.3	5.1	5.6	6.5	6.5	77.2
-TRADING	18.5	9.3	7.3	5.6	4.9	5.5	6.1	5	80.9
-SERVICES	14.5	7.9	6.6	5.2	5.2	5.6	6.6	7	75.6
	<b>EARNINGS</b>								
WHOLE ECONOMY	(a) 18	10½	9¼*	7½	7½	7½	7½	7½	105
PRIVATE SECTOR	19	11½	10	8¼	7½	8½	7½	7½	114½
-MANUFACTURING	18½	11½	10½	8½	9	9	7½	7½	119
-NON MANUFACTURING	20	11	9	7½	6½	8	7½	7½	109
PUBLIC SECTOR	17	9½	8*	6½	7	6	7½	7½	93¼
-TRADING	21½	12	9½	7¼	7	5¼	7¼	7½	107½
-SERVICES	14½	9	7¼	6¼	7	5¼	7¼	7½	84¼

NOTE: Settlements percentages are first year costs.

(a) Excludes the effect of clegg and staged civil service settlements in 1978/79 round.

\* Includes the effect of 7.5% increase for nurses paid in 1982/83.

## WAGES AND SALARIES PER UNIT OF OUTPUT IN MANUFACTURING

Annual percentage increases

	UK	USA	JAPAN	Federal Republic of Germany	FRANCE	ITALY
Source:	<u>A</u>	<u>A</u>	<u>A</u>	<u>A</u>	<u>B</u>	<u>B</u>
1974	19	8	30	13	15	19
1975	30	12	22	8	20	35
1976	11	1	0	-1	8	11
1977	8	7	4	4	7	18
1978	13	6	-2	5	7	11
1979	15	7	-3	1	9	10
1980	22	10	3	8	12	12
1981	9	7	6	5	12	19
1982	4	7	5	4	11	17
1983	0	-3	2	-1	8	14
1984	3	-2	-5	-1	5	5
1985	6	2	2	0	3	9
1986	5	0	4	4	2	3
1987(Q1)	7	-1	n/a	5	0	5
Average annual % increases						
1973-9	15.8	7.0	7.8	4.6	10.7	16.7
1979-86	6.9	3.0	1.9	2.6	7.4	11.1

Source: A: OECD Main Economic Indicators  
 B: International Monetary Fund.

## PRODUCTIVITY IN MANUFACTURING

Annual Percentage increases

	UK	USA	JAPAN	Federal Republic of Germany	FRANCE	ITALY
1974	-2	-4	0	2	3	4
1975	-3	3	-1	1	0	-9
1976	5	6	10	10	8	12
1977	2	3	6	2	5	2
1978	1	1	8	2	5	3
1979	0	0	7	4	3	6
1980	-4	-1	8	-1	2	6
1981	4	2	3	1	3	1
1982	7	1	6	1	2	0
1983	9	8	6	5	4	1
1984	6	5	8	4	4	9
1985	3	4	7	4	3	3
1986	3	4	0	0	3	5
1987(Q1)	1	3	2	-2	4	3
Average Annual % increase						
1973-9	0.7	1.3	4.7	3.3	4.0	2.8
1979/86	3.7	3.4	5.4	2.1	2.8	4.0

Source: International Monetary Fund.

Note. These estimates have been calculated by DE from IMF data for output and employment.

## PRODUCTIVITY IN MANUFACTURING

Annual Percentage increases

	UK	USA	JAPAN	Federal Republic of Germany	FRANCE	ITALY
1974	-2	-4	0	2	3	4
1975	-3	3	-1	1	0	-9
1976	5	6	10	10	8	12
1977	2	3	6	2	5	2
1978	1	1	8	2	5	3
1979	0	0	7	4	3	6
1980	-4	-1	8	-1	2	6
1981	4	2	3	1	3	1
1982	7	1	6	1	2	0
1983	9	8	6	5	4	1
1984	6	5	8	4	4	9
1985	3	4	7	4	3	3
1986	3	4	0	0	3	5
1987(Q1)	7	3	2	-2	4	3
Average Annual % increase						
1973-9	0.7	1.3	4.7	3.3	4.0	2.8
1979/86	3.7	3.4	5.4	2.1	2.8	4.0

Source: International Monetary Fund.

Note. These estimates have been calculated by DE from IMF data for output and employment.



## ARRANGEMENTS FOR DETERMINING PUBLIC SERVICE PAY

1. This note describes briefly the different arrangements used to determine pay within the public services.

### Review Bodies

2. There are four Review Bodies covering :

Top Salaries; Doctors and Dentists; Armed Forces; and Nursing Staff, Midwives, Health Visitors and Professions Allied to Medicine.

The first three were set up in 1971. The common thread was that there was an absence of negotiating machinery for these groups and there were thought to be good reasons why their pay should be determined at a distance from the Government. The Nurses Review Body was established in 1983 since it was acknowledged that normal bargaining arrangements are not appropriate for nurses who refuse to take part in industrial action.

3. The Review bodies report to the Prime Minister. The chairmen and members are appointed by the Government. The secretariat is provided by the Office of Manpower Economics.

4. Terms of reference are very general: "to advise the Prime Minister on the remuneration of.....".

5. Review bodies take written and oral evidence from interested parties, including the Government, management and representatives of the employees. Surveys of pay levels and pay movements outside the group covered are frequently undertaken, using consultants where appropriate.

6. Review bodies do not have to wait upon a specific remit from the Government to advise on pay but can offer advice whenever they choose to do so. Since their inception they have submitted an annual report, around April each year.

7. Ministers are not obliged to accept review body recommendations, but given their independence there would have to be very good reasons for refusing implementation. In practice recommendations are usually accepted, but frequently staged or implementation delayed to reduce their immediate public expenditure costs.

#### Criticisms

8. The review bodies tend to base their recommendations more on comparability arguments than on affordability and labour market pressures. For a number of years Government evidence has stressed affordability but this has been generally ignored. Recommendations tend to be expensive, in line with the growth of whole economy average earnings and way above other public service settlements. This leads to a loss of control over public expenditure for these groups.

9. On a number of occasions alternative arrangements have been considered but rejected. The merits of the review bodies are that some sort of independent body is unavoidable for the armed forces and top salaries groups, where normal bargaining arrangements cannot be introduced. For doctors and nurses it provides some guarantee that although the Government is the major employer it will not depress pay rates unfairly, especially as nurses have rejected industrial action.

Index linked Arrangements - Police and Fire ServicePolice

10. Formally, police pay is discussed in the Police Negotiating Board, a statutory body. The chairman and deputy are appointed by the Prime Minister. Management is represented by the Home Office and territorial departments having police responsibilities and local police authorities, the latter having the largest representation. The police are represented by the various staff associations. An independent element is provided by representatives of the magistrates.

11. The Police Negotiating Board (PNB) is responsible for negotiations covering pay and conditions but in practice the most expensive element in manpower costs - basic pay - is determined by index linking arrangements which have been accepted by both sides. This follows from the recommendation of the 1978 report by Lord Edmund-Davies that police pay each year should be increased in line with the growth of the whole economy index of average earnings in the 12 months to May. This was accepted by the Government and the PNB. The intention was to ensure that the relative level of police pay kept in line with earnings growth generally.

12. Index linking recognises the special circumstances of policemen who may not join a trade union and cannot go on strike. It overcomes recruitment and retention problems by offering the police a guarantee that their level of real earnings would be protected. It also means that there are no meaningful negotiations over basic salary levels, but full negotiations take place over other elements such as London Weighting, accommodation allowances and the length of the working week. If negotiations on these break down there are arrangements for arbitration.

### Criticism of index linking

13. The relative value of police pay has been maintained as recommended and has increased much faster than that of other public service groups. Police pay continues to be based on the crudest form of comparability, at a time when an absence of labour market pressures indicate that increases could be reduced. The formula also undermines control of police costs.

14. Every three years the index formula is reviewed by the PNB. For the foreseeable future the Government is committed to maintaining index linking in some form. There may however be scope for changing from the index of average earnings to a settlements index which may lead to a lower rate of growth in police pay. This will be discussed in the forthcoming review of police negotiating arrangements.

### The Fire Service

15. Firemens' pay is negotiated in a Joint National Council representing local authorities and the unions. Like the police, the JNC has agreed that basic pay increase should be based upon index linking, so that meaningful negotiations take place only over elements such as overtime payments, length of the working week and shift patterns.

16. Firemen's index linking arrangements differ from those of the police. Each year they receive a pay increase that will maintain their average level of earnings on a par with the upper quartile of the manual earnings distribution. In practice, the percentage increase required to achieve this is very similar to the percentage increase in the index of whole economy average earnings used in the police formula.

Teachers: the Interim Advisory Committee

17. Following the abolition of the Burnham Committees which negotiated teachers pay the Government has established alternative statutory arrangements in the form of an Interim Advisory Committee to advise the Secretary of State for Education about teachers pay and conditions. The Committee consists of a chairman and up to eight other members. It has its own secretariat of seconded civil servants.

18. The Committee's terms of reference allow it to respond only to a request from the Secretary of State for Education. When seeking advice from the Committee, Ministers can give directions on matters relating to pay and conditions of service which it is to examine, e.g. the overall percentage size pay increase.

19. Following a reference from the Secretary of State, the advisory committee will take evidence from all interested parties. At this stage the local authorities and the unions and/or individual teachers will be able to put forward evidence and make representations on the matters under consideration. It is not intended that the committee should act as an arbitration body but will arrive at its own independent recommendations.

20. The Secretary of State for Education is free to accept, modify or reject the advice given to him by the Committee. However, before reaching a decision on whether or not to accept recommendations, he must by statute consult the unions and local authorities to ascertain their views. If no material modification is made to the recommendations the Order implementing them is subject of the negative resolution procedure of both Houses of Parliament. But if the Secretary of State alters them, the Order requires an affirmative vote in both Houses of Parliament.

21. While in many ways the Advisory Committee can be expected to act like a review body it has a number of distinctive features. It can only respond to remits from Ministers and, moreover, Ministers can give it directives, such as the size of the pay settlement. It will have less freedom than the review bodies to go its own way.

22. Unlike the review bodies, there are statutory arrangements enabling the Secretary of State to modify or reject the Committee's recommendations. One consequence is that the statutory Parliamentary procedures may make it more difficult to modify or reject the Committees' recommendations than it is for the non-statutory review bodies.

23. Finally, the unions and local authorities are provided by statute with a role in the advisory committees' processes. This role is not one of negotiation but consultation.

24. More permanent arrangements for teachers' pay are currently under consideration by Ministers.

#### Public Services : Collective Bargaining

25. For the rest of the public services - including the Civil Service - pay and conditions are determined through collective bargaining. These take a variety of forms - National Joint Councils, National Joint Boards or Whitley Councils. But irrespective of what the arrangements are called, they all operate on essentially the same principles and basis.

26. Representatives of employers come together with employee representatives to negotiate pay and conditions. For local authority groups the employers side consists of representatives of a number of different employers' organisations, for example, the Association of District Councils, the Association of County Councils and the Metropolitan Authorities. Similarly, the employees side can contain representatives of different unions.

27. With central Government groups - the civil service and NHS - the Government is the employer, so that any change in pay or conditions must be agreed by Ministers. Government control over negotiations with these groups is much firmer than for local authority groups

28. At the moment, civil service bargaining arrangements conform to the pattern described above but recent developments indicate that this may be changing as the unions and the Treasury discuss long term pay arrangements. This would hopefully reduce the area of disagreement in annual talks. Already the IPCS have agreed long term pay arrangements, whereby the annual increase in pay will be contained within the inter-quartile range of private sector pay settlements. Similar long term arrangements are on offer to other unions.

29. Although most public service groups have arbitration arrangements as part of their formal procedures their form varies. Differences relate to whether access to arbitration is unilateral; whether arbitration awards are binding; and the status of the arbitrators. Local authority white collar staff have unilateral access to binding arbitration, but there are no formal arbitration arrangements for local authority manual workers. In the NHS, while there are no formal arbitration procedures for administrative and clerical staff, the ancillaries have arbitration arrangements requiring access by joint agreement.

30. Arbitration arrangements in the Civil Service are different again. There is a standing arbitration tribunal, with a chairman appointed by Ministers. Formally, there is unilateral access to arbitration, but the reality is that this is dependent upon Ministerial consent. In practice Ministers have refused access if it is not in the national interest.



*mwp*

FROM: MISS M P WALLACE

DATE: 3 March 1988

MR GILHOOLY

cc Paymaster General  
Sir P Middleton  
Sir T Burns  
Dame A Mueller  
Mr Kelly**MR FOWLER'S PAPER ON PAY**

The Chancellor has seen Mr Fowler's letter of 24 February, and the paper it attached. He has noted that Mr Fowler is still concentrating on earnings rather than settlements. He has also noted the proposition at (e) on page 28 that the Government should organise a more systematic campaign of exhortation, and he has commented that this would be somewhat inappropriate, since the Government's example is at the moment conspicuously bad (thanks to Review Bodies and formula awards).

2. He awaits official advice.

*mwp.*

MOIRA WALLACE



py  
W. Speller.

Ch/  
Mr Parkinson would like  
a word with you tomorrow  
about ESI<sub>2</sub> <sup>manuals'</sup> pay — existing  
offer 5%, unions want 7,  
threatening to strike,  
and Mr Parkinson thinks  
may need to make a higher  
offer now, as he sees little  
chance of settling near  
present offer. with his office

We did discuss whether he  
might be better raising this  
with CST, but he wants to see  
you (privatisation aspect eh)

We have provisionally set up a  
v. quick informal chat at 9.30 am,  
and commissioned briefing. OK? mpw



*Ry*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

3 March 1988

The Rt Hon Norman Fowler MP  
Secretary of State for Employment  
Department of Employment  
Caxton House  
Tothill Street  
LONDON  
SW1H 9NA

cc PS/Chief Secretary  
PS/Paymaster General  
Sir P Middleton  
Sir T Burns  
Dame A Mueller  
Mr C W Kelly  
Mr Sedgwick  
Mr R I G Allen  
Mr Pickford  
Mr Gilhooly  
Mr Hibberd  
Mr Patterson  
Mr de Berker

*Norman Fowler*

The growth of whole economy underlying average earnings rose from 7½ per cent in September to 8½ per cent in December. These figures have excited increasing public interest, comment and concern. There is a danger that many groups will seek to achieve increases in pay that they regard as equivalent to or better than the recent published increase in earnings. With the economy going well and profits strong, some employers may feel that large increases are warranted.

I believe it may be misleading to concentrate too much attention, in our public presentation, on the earnings figures. They are inflated by overtime and bonus payments which are rewards for extra effort and performance, but may be of a temporary nature. Many employers simply do not recognise the figures. They feel they produce an unhelpful climate. Employees may feel disgruntled because their settlements (confused with earnings) are well below what they assume others in the economy are getting. The following figures for pay settlements are from the CBI Databank Pay Report.



**CBI Survey of Private Sector Settlements  
Average Percentage Increase**

Date	Manufacturing	Services	Actual Underlying Private Sector Earnings
1986 Q4	4.8	5.1	8
1987 Q1	5.0	5.6	7½
Q2	5.4	6.4	8
Q3	5.8	6.9	8
Q4	5.5	6.7	8½

While there has been an increase in both sectors since the end of 1986, settlements have flattened off in the second half of 1987, and indeed have fallen in the last quarter. Even if settlements were to rise somewhat in the early part of 1988, possibly following the very bad precedent set at Fords, they would almost certainly be significantly below the recent increase in earnings.

There is no room for complacency here, but it would be very much less damaging, and probably more pertinent, if the figures for settlements were in future given more public attention.

**NIGEL LAWSON**



CHIEF SECRETARY

REC.	- 9 MAR 1988
ACTION	Mr De Becker
COPIES TO	Cs, AMG Sir P. Middleton, Mr Anson, Dane A Mueller, Mr Phillips, Mrs Caise Mr Crowley, Mr Luce, Mr Tomblin, Mr Mr Power, Mr Revolta Mr Brook, Mr Gilhooly Mr Crepper.

QUEEN ANNE'S GATE LONDON SW1H 9AT

8 March 1988

Dear Chief Secretary,

POLICE PAY REVIEW

Thank you for your letter of 17 February about the police pay review.

At the meeting of the Official Side of the Police Negotiating Board on 23 February, the Home Departments' representatives had serious difficulty in persuading the Official Side to keep open the option of moving away from the Edmund-Davies formula. The difficulty stemmed largely from a paper prepared by the Secretariat, purporting to summarise the conclusions of the working parties, which said that "the underlying earnings index remains the best measure of earnings movements in the economy and should remain the preferred method of determining movements in police pay generally". The survey of pay settlements which has been commissioned from the OME, was relegated in the paper to the status of a matter which the Official Side "might wish to bear in mind".

My officials pointed out that the Official Side could scarcely reach the conclusion set out in the paper until they were in possession of all the facts. They should keep their options open until they knew the outcome of the survey of pay settlements. After a bad-tempered discussion, in which the Chairman tried to bulldoze the Secretariat's wording through, followed by a close vote on an amendment proposed by the AMA to overcome the Home Departments' objections, it was agreed that the passage should be amended to read:

"The working party has reviewed the pay formula in line with paragraph 266 of the Edmund-Davies report. It has concluded at this stage that the underlying earnings index remains the best measure of earnings movements in the economy and should remain the preferred method of determining movements in police pay generally. However, the Home Office had requested a review of pay settlements and the Official Side has agreed to look at this without commitment."

This serves to keep the door open for the outcome of the survey of pay settlements to influence the Official Side's approach to this year's pay settlement, but only just. The Official Side have never really been persuaded of the need for the survey. They requested it only because my officials pressed them very hard to do so. When they know the outcome, they

The Rt Hon John Major, MP.

/over.....

CONFIDENTIAL

I should emphasise that, if we do achieve the objectives of removing the rates element of the rent allowance and of abolishing compensatory grant, the savings would be very considerable, equivalent to about 5% of the basic pay bill. This would be a substantial gain to offset against almost any conceivable pay settlement.

On all other issues, the Official Side's decisions were in line with the working parties' recommendations, which have already been reported. These were:

- (a) the starting salaries for constables are unnecessarily high;
- (b) constables below the maximum have benefited from incremental drift, so there should be a trimming of increments;
- (c) the annual settlement date should be changed from 1 September to 1 April, and the Secretariat should advise on whether the Official Side should seek a seven (7) months or a nineteen (19) months settlement this year;
- (d) the Home Office proposals for changes in the package of remuneration for police officers in London was endorsed;
- (e) the abolition of certain minor allowances (detective expenses allowance, detective duty allowance, the promotion examination allowance and the reimbursement of NHS charges) will be sought;
- (f) changes will be sought in the present specially favourable arrangements for sick leave and maternity leave.

I ought finally to report that the magazine "Police Review" has been carrying a series of embarrassing leaks of the Official Side's deliberations. The motive behind these seems to be to reveal that the Official Side is being spurred on by the Home Departments' representatives to make more draconian proposals than would otherwise be contemplated. This probably stems from a desire on the part of the local authority associations (the ACC in particular) to divert any ill-feeling arising from the review in the Government's direction. I have to say that the risk of a serious confrontation with the police service on these issues can by no means be ruled out.

I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, Sir Robin Butler and George Monger.

*Yours sincerely  
N. Janssen*

*(approved by the Home Secretary and signed in his name)*

CONFIDENTIAL



SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QJ  
01 211 6402

EXCHEQUER	
09 MAR 1988	4/3
CST	
Office	10

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

9<sup>th</sup> March 1988

*Dear Nigel,*

**ESI MANUALS' PAY**

As you know, I have been keeping John Major informed about progress with the ESI manuals' pay negotiations.

At the first substantive negotiating meeting on 3 March the Electricity Council made an offer of 5%. The Unions rejected this and said that if that was the final offer they would have to put it to a ballot with a recommendation for industrial action.

Subsequently at informal discussions between the management and the Unions the leaders of the Union side said that they were anxious to achieve a quick settlement and would therefore be prepared to accept an offer of 7% without going to a ballot. If the management persisted in their offer of 5% the Unions would go to a ballot immediately with a recommendation for rejection and industrial action. The ballot would be completed in about 3 weeks and the Unions would aim to start industrial action immediately thereafter with a view to bringing the dispute to a head quickly. In the industrial action they would expect to have the tacit but not overt support of the engineers, and would aim to create the maximum adverse financial impact on the industry by taking out the large high merit order power stations. Their objective would be to minimise the prospect of power cuts but in the Electricity Council's view this would be difficult to achieve and there is therefore a high possibility that the industrial action will quickly lead to blackouts.

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The Electricity Council would be reluctant to give way quickly to this threat but they are conscious that it will be difficult to settle at all much below 6.5% and if it goes to ballot any settlement will be concluded in a blaze of publicity. They also recognise that any industrial action could have a damaging effect on implementing our privatisation proposals. The Electricity Council have therefore asked whether in the last resort they should make an offer of 7% if they conclude they cannot negotiate less without a ballot for industrial action.

I recognise the damaging effect a settlement at this level would have both on pay negotiations within the public sector and on our stance on the level of pay settlements generally. But I also am concerned about the serious consequences that industrial action might have both through the impact on the economy of any power cuts and on progress on privatisation.

I appreciate this is a difficult time to raise this subject with you but the Unions meet on Monday to decide on the question of a ballot and industrial action, and it is clearly important we respond to the Council quickly. I would therefore like to discuss this with you in the margins of tomorrow's Cabinet.

I am not copying this letter to anyone at this stage.

A handwritten signature in dark ink, appearing to read 'James East, Cecil Parkinson'. The signature is written in a cursive, somewhat stylized hand.

CECIL PARKINSON



## CONFIDENTIAL

FROM: J de BERKER

DATE: 9 MARCH 1988

- See note  
9/3*
1. MR GILHOOLY
  2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
 Financial Secretary  
 Dame Anne Mueller  
 Mr Anson  
 Mr Monck  
 Mr C W Kelly  
 Mr Burgner  
 Mr Moore  
 Mr Gilhooly  
 Mr M Williams  
 Mr White  
 Mr Tyrie  
 Mr Call

**ESI MANUALS PAY**

We understand that Mr Parkinson will raise the issue of ESI manuals pay with you in the margins of tomorrow's Cabinet meeting. Basically the unions have rejected an offer of 5 per cent and are threatening industrial action if this is to be the final offer. However, they have indicated that they are willing to settle for 7 per cent. The Electricity Council is due to meet the unions again on Friday. Mr Parkinson will probably want you to agree to a settlement of ~~7~~ per cent because of the importance of privatisation. We advise you to make a counter proposal of 6 per cent but not to rule out a final settlement of 7 per cent.

Background

2. Mr Parkinson wrote to the Chief Secretary on 26 February seeking his consent for the Electricity Council to make an opening offer of between 4 and 5 per cent. In his reply he accepted this but asked that they should go for something at the lower end of the range and reminded Mr Parkinson that ESI negotiations should be governed by the situation in the Electricity industry alone and not by the Ford settlement, or developments in the NHS.

3. At the meeting on 3 March the unions rejected the offer of 5 per cent (top of the range) and said that if this was the final offer they would go to a ballot with a recommendation for industrial action. But informally they indicated that they would be prepared to settle for 7 per cent without a ballot.

4. The Electricity Council are due to meet the unions again on Friday, and they must decide whether to stick on 5 per cent or to improve their offer. If the unions ballot for industrial action it will take about a month before the results are known -and assuming they get the support they seek - they will probably attack the "merit order" which minimises generating costs by making the greatest use of the most economical capacity. In the first instance this will raise the industry's costs, but in due course there could be black-outs, although the risk of this will diminish as the weather improves.

#### Assessment

5. We understand that the Electricity Council are reluctant to give way to the ESI unions' demand for 7 per cent but think it would be very difficult to settle below  $6\frac{1}{2}$  per cent. Last year's settlement was 5.6 per cent, and since then the general level of settlements in the private sector has risen from about  $4\frac{3}{4}$  per cent to about  $5\frac{1}{2}$  per cent. We do not accept differentials but the unions will certainly have them in mind.

6. There is also privatisation. Industrial action may tarnish the industry's image and reduce its saleability. It will also divert the attention of top management which would otherwise be concentrating on preparing the industry for privatisation. It will also make it harder to secure the co-operation of the workforce in the industry to adapt<sup>to</sup> the inevitable changes. For these reasons we think you may eventually wish to accept a 7 per cent settlement.

CONFIDENTIAL

Line to take

7. We suggest that if Mr Parkinson asks you to accept a settlement of 7 per cent you make a counter-proposal of 6 per cent. This is:

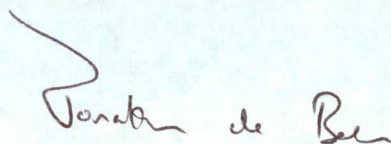
- more than last year (5.6 per cent)
- above the current level of settlements in the private sector ( $5\frac{1}{2}$  per cent)
- well above the RPI (about  $3\frac{1}{4}$  per cent) and the TPI (less than  $1\frac{1}{2}$  per cent).

If Mr Parkinson persists you can point out that the industrial relations climate is fragile, and that an excessive settlement is bound to have serious repercussions particularly in other nationalised industries, <sup>and</sup> ~~but~~ also in the economy as a whole. No case has been made on recruitment and retention grounds.

8. You will also want to ask to what extent the industry will be able to find the money from within its EFL, and whether it will still be able to meet its financial target.

9. This has been discussed with PE.

10. A speaking note is attached.



JONATHAN de BERKER

**SPEAKING NOTE : ESI MANUALS**

In the interests of a smooth privatisation settle for 7 per cent:

Excessive. Way above general level of settlements in private sector (5½ per cent). Above last year's settlement (5.6 per cent) and well above RPI (3.3 per cent) and TPI (1.4 per cent). No case has been made on recruitment and retention grounds and large settlement would have very undesirable repercussions.

If we stick at 5 per cent there will be industrial action - no realistic prospect of settling for less than 6½ per cent

Most we can possibly accept 6 per cent - more than last year and unions will think twice before industrial action if made clear we will resist. Resisting strikes an investment.

Cost not important

Can industry live within its EFL and keep to its financial target? Repercussions will affect all industries not just electricity.



pp

Ch/

You agreed to see Mr P again for a brief word. His office reported to me that:

- he spoke to Electricity Council again today
- they were not optimistic about 2 year deal (bound to be 7% both years - better to settle only one year, and hope for a tougher settlement next year)
- they still think it will have to be 7%, with or without a strike
- unions need new offer first thing tomorrow, or they will ballot

mpw 1073

CONFIDENTIAL

mpf

CHANCELLOR OF THE EXCHEQUER

FROM J F GILHOOLY  
DATE 9 MARCH 1988cc Chief Secretary  
Financial Secretary  
Dame Anne Mueller  
Mr Anson  
Mr Monck  
Mr C W Kelly  
Mr Burgner  
Mr Moore  
Mr M Williams  
Mr White  
Mr Tyrie  
Mr Call

Ch/ officials have provided 2  
(barely distinguishable) briefs,  
before they saw letter (now  
behind) Gilhooly thinks 6 1/2 %  
de Berker 6 %.

## ESI MANUALS' PAY

mpw

The situation described in Mr de Berker's minute below is a tricky one.

2. In terms of the ESI alone, PE's advice is that it is best to settle early, without industrial action. I would not challenge the management judgement that they can settle below the union indication of 7 per cent, but might have to go to 6 1/2 per cent (which is the level at which BR wish to settle this year after all the frills are included).

3. There are three options:

Manday:

(a) settle on Friday at around 6 1/2 per cent. From a general pay point of view this is far too high. Repercussions outside the electricity industry would be significant. But the privatisation issue points that way

(b) stand firm and let the unions ballot and if necessary go to strike action. In addition to the awkwardness this would create in the period leading to privatisation, this could lead to strike action beginning around the second week in April - not long before the announcement of the Review Body decisions. It could also encourage other unions (e.g.

in British Rail) to think that it would be worth having a go. If this were the chosen route, management should not of course raise their offer on Friday by more than a marginal amount, if at all. The principle is as usual if there is going to be a row, let it be a cheap row.

(c) the third option is to try to keep the options open. Move a significant amount on Friday, then hold open the option of a further increase timed to influence the outcome of the ballot.

4. I am not wholly persuaded that giving the management authority to go to six per cent on Friday fits any of these options. On what we are told, it will not result in a settlement (option (a) above); if Ministers decided to stand firm, it goes too far. The real argument for it is, I believe, that it might go far enough to persuade the unions that they cannot win a ballot.

#### Line to take

5. Mr Parkinson may well press very hard for authority to go to 6½ per cent or whatever it takes to get this settlement out of the way on Friday.

6. You should press him hard on the prospects of industrial action. Can the unions deliver strike action if the offer was say 6 per cent? How serious would it be?

7. The final area for judgement is if the hard line is taken, will Mr Parkinson and your other colleagues be willing to face out the action (which will have a very high profile if it leads to power cuts) for as long as it takes? Taking on a strike, and ending with an expensive settlement would be damaging both to privatisation and more generally. If you judge colleagues will not stand firm, and if it is clear that industrial action will take place, then I would be inclined to go for a settlement now,

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pressing very hard for it to be kept as close as possible to 6  
per cent.



J F GILHOOLY





FROM: MISS M P WALLACE  
DATE: 10 March 1988

MR GILHOOLY

cc PS/Chief Secretary  
PS/Paymaster General  
Sir P Middleton  
Mr Anson  
Dame Anne Mueller  
Mr Monck  
Mr C W Kelly  
Mr de Berker  
Mr DJL Moore

**ESI MANUALS' PAY**

The Chancellor spoke to Mr Parkinson twice today, following his letter of 9 March.

2. At this morning's meeting, the Chancellor suggested to Mr Parkinson that he put to the Electricity Council negotiators the idea that they should press for a two year settlement. This Mr Parkinson did. The negotiators took the view that, post-Ford, a two-year settlement would probably have to be 7 per cent in both years to find favour with the unions: in their view there was more point in settling this year, and aiming for something tougher next year. They felt that this year they would end up settling at 7 per cent, and the choice was simply whether to do so with or without a fight. At their second meeting, the Chancellor and Mr Parkinson agreed that the Electricity Council negotiators should be authorised to offer 7 per cent tomorrow morning, so long as they had an undertaking from the unions that there would then be no ballot. If the unions were determined to ballot, the offer should be 6 per cent.

A handwritten signature in dark ink, appearing to read 'mpw'.  
MOIRA WALLACE

PERSONAL AND CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

FROM: J F GILHOOLY  
DATE: 11 March 1988

cc. Chief Secretary  
Paymaster General  
Sir Peter Middleton  
Sir Terence Burns  
Dame Anne Mueller  
Mr Kelly  
Mr Odling-Smee  
Mr de Berker

Ch/Content to write as drafted? Andrew has done out (atx) one of the speeches you may have had in mind (your m.s copy on Fowler letter)

mpw 18/3

MR FOWLER'S PAPER ON "A STRATEGY FOR PAY"

1. Mr Fowler wrote to you on 24 February, enclosing a long paper called "A Strategy for Pay". His covering letter includes, additionally, some ideas about future Ministerial handling of pay issues.
2. You have already commented (Miss Wallace's note to me of 3 March). The following draws also on comments from Mr Odling-Smee.

BACKGROUND

3. I understand from DEmp that the paper is very much Mr Fowler's own initiative. It was not shown to us or other departments in draft at official level. Mr Fowler has circulated it only to you and the Chief Secretary. It is not clear whether he plans a wider circulation after he has taken your reactions on board.

THE PAPER

4. The first three chapters are mainly descriptive, setting out what has happened to pay over the last 15 years and particularly since 1979; and describing the approach the Government has taken, in particular the emphasis on reforming collective bargaining. Chapter 4 broadens the discussion to the problems of increasing competition in product and labour markets. This is followed by a chapter on Public Services Pay. The final chapter 6 makes proposals for further action by Government.

*OK as minimum*  
*2. The paper is a continuation of the work done on pay (the old paper attached) - I have used this as a basis for my own paper*  
*3. I have used this as a basis for my own paper*  
*4. I have used this as a basis for my own paper*  
*5. I have used this as a basis for my own paper*  
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*17. I have used this as a basis for my own paper*  
*18. I have used this as a basis for my own paper*  
*19. I have used this as a basis for my own paper*  
*20. I have used this as a basis for my own paper*

COMMENT

5. The paper is long and diffuse and there are points here and there which we should have to pursue with DEmp if the paper were to have a wider circulation, particularly in the economic analysis. But the broad thrust of the analysis and the policy implications is in line with ours.

6. There is a mild flirtation with Layard-type ideas; but incomes policy, and the thought of a Clegg-like commission to look at all public service deals are both rightly dismissed as inconsistent with present policy. But apart from the emphasis on exhortation, the main thrust is that we should continue on the path we are already on: in particular seeking to make labour markets more flexible, and introducing more flexibility in public service pay.

7. We would not quarrel with the conclusions in general, but there are a number which would push things in the wrong direction.

8. First the paper is too narrowly focussed on pay alone. There are gains from freeing up the labour market and greater flexibility in pay bargaining arrangements which the paper does not really address and which should be brought out. It is also, as you noted, much too focussed on average earnings as a policy target.

9. Second, while exhortation has its place, it needs to be timed and handled carefully. But the sort of concerted campaign which Mr Fowler seems to wish to launch, focussing sharply on pay, looks misguided. As you said, the timing is bad, with Review Body announcements due to be made at the end of next month. There would also be a lot to be said for having a much broader emphasis, on the need for further labour market reforms and development, building on the progress already made.

10. Third, while we would not differ generally from what is said about public service pay, the chapter on this is pretty thin on the question of how the changes can be achieved.

11. In his covering letter, Mr Fowler touches on a point to which we have ourselves been giving some thought - whether PSP(O), the officials' shadow of E(PSP), is as effective as it might be in coordinating Departments activities on pay and, ensuring coherence of approach. We are pursuing this separately. (How, I wonder)

**CONCLUSIONS**

12. DE, both Ministers and officials, have over the years taken a generally consistent line to ours on pay and Mr Fowler's paper confirms that this continues. You will wish, therefore, to give a fairly warm reply to Mr Fowler, encouraging him towards a broader approach to exhortation, but making some of the points above.

13. On handling, I suggest that you say that officials will be in touch with his to follow up some detailed points and to work up some speaking notes (with an immediate eye to what he might plan to say in the Budget debate). Inter alia this will give the opportunity to smoke out what Mr Fowler may have in mind for the future of his paper.



J F GILHOOLY

## PERSONAL AND CONFIDENTIAL

## DRAFT LETTER

FROM: Chancellor of the Exchequer  
 TO: Secretary of State for Employment

*pl type  
 final for  
 Ch to send.*

*M.*

## STRATEGY FOR PAY

Thank you for your letter of 24 February with which you enclosed a very full paper on the pay scene. I agree with the general thrust of the analysis and the conclusions too. Pay continues to cause concern. ~~But~~ <sup>And/</sup> like you I do not see that as a reason for switching track, but for intensifying the push we have already made for making labour markets work better, and introducing more flexibility in pay bargaining arrangements.

I accept, too, that exhortation <sup>may have some</sup> has a part to play, but it can, <sup>and we need to be careful about</sup> of course, be a two-edged sword ~~(unless the~~ timing and handling ~~are done carefully.)~~ We do not know, for example, what the Review Bodies may recommend and what decisions will be made on them, and at this stage in the round, we need to think carefully about high profile comments on pay. There is also the important presentational point about the dangers in concentrating too much on average earnings as opposed to settlements about which I wrote on 3 March. My instinct is that exhortation would prove more effective if it concentrated on the broader labour market points discussed in your paper, than by focussing on pay as such.

As to the paper itself, as I say, I am content with its general thrust, but there are some points, particularly on the economic

PERSONAL AND CONFIDENTIAL

analysis, which I think need further elaboration. My officials will be in touch with yours about them. They might also work up between them some speaking notes on which you and I could draw in the weeks ahead, and consider further point you raise in your covering letter about the coordination of pay issues.

I have copied this letter to John Major.

(NL)



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

3 March 1988

The Rt Hon Norman Fowler MP  
Secretary of State for Employment  
Department of Employment  
Caxton House  
Tothill Street  
LONDON  
SW1H 9NA

cc PS/Chief Secretary  
PS/Paymaster General  
Sir P Middleton  
Sir T Burns  
Dame A Mueller  
Mr C W Kelly  
Mr Sedgwick  
Mr R I G Allen  
Mr Pickford  
Mr Gilhooly  
Mr Hibberd  
Mr Patterson  
Mr de Berker

The growth of whole economy underlying average earnings rose from  $7\frac{1}{4}$  per cent in September to  $8\frac{1}{2}$  per cent in December. These figures have excited increasing public interest, comment and concern. There is a danger that many groups will seek to achieve increases in pay that they regard as equivalent to or better than the recent published increase in earnings. With the economy going well and profits strong, some employers may feel that large increases are warranted.

I believe it may be misleading to concentrate too much attention, in our public presentation, on the earnings figures. They are inflated by overtime and bonus payments which are rewards for extra effort and performance, but may be of a temporary nature. Many employers simply do not recognise the figures. They feel they produce an unhelpful climate. Employees may feel disgruntled because their settlements (confused with earnings) are well below what they assume others in the economy are getting. The following figures for pay settlements are from the CBI Databank Pay Report.



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Average Percentage Increase**

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Q3	5.8	6.9	8
Q4	5.5	6.7	8½

While there has been an increase in both sectors since the end of 1986, settlements have flattened off in the second half of 1987, and indeed have fallen in the last quarter. Even if settlements were to rise somewhat in the early part of 1988, possibly following the very bad precedent set at Fords, they would almost certainly be significantly below the recent increase in earnings.

There is no room for complacency here, but it would be very much less damaging, and probably more pertinent, if the figures for settlements were in future given more public attention.

**NIGEL LAWSON**





SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QU  
01 211 6402

CH/EXCHEQUER	
REC.	11 MAR 1988 <sup>11</sup>
ACTION	CST
COPIES TO	

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

*This accurate  
reflects on the  
agreement with the*

11<sup>th</sup> March 1988

BF 17/3  
BF 18/3  
21/3  
22/3  
23/3  
24/3  
pmp

Dear Chancellor,

**ESI MANUALS' PAY**

Thank you for finding time twice yesterday to discuss this matter. Since we met last night I have spoken again to Roger Farrance, the industrial relations director of the Electricity Council, who I know you hold in high regard. He has a first class negotiating record and has done a great deal of work behind the scenes in recent weeks.

Farrance is convinced that a settlement at 7% is inevitable this year. His considered view is that if the Council made a lower offer the unions would call a ballot with a recommendation for strike action and would then win this by a considerable majority. He has no doubt that the unions would quickly take such action, inevitably causing power cuts after a few days. The end result after a period of intense and damaging publicity would be a settlement of about 7% and maybe even a little higher. In reaching this view Farrance has been influenced this year by two special factors: the unions' reaction to the higher rate of return recently agreed with the industry and his judgement that we cannot embark on the reorganisation of the industry for privatisation, (for which we need the acquiescence of the workforce) against a background of industrial action.

Faced with a choice between an orderly settlement at 7% or the same settlement after a most damaging battle I believe that Farrance should secure a settlement now. Last night you agreed to such an offer being made provided the Council were clear that a settlement would in fact be struck without a ballot.

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*[Handwritten initials]*

I made it quite clear to Farrance this morning that an offer of 7% would have to be totally dependent on the unions' agreement not to call a ballot. Farrance has assured me that there is no question of the Council committing itself until it has secured such an agreement. They will make clear to the unions that they would open negotiations at 5.7% unless the unions could guarantee that there would be no ballot. On this basis, and in the light of our discussion, I have told Farrance to go ahead. He will have further informal discussions with the unions next week and if these are successful table a formal offer on Friday.

I do recognise that there are much wider economic considerations but as we agreed last night I think that the need to avoid disruption in the industry at this critical time outweighs these. I will be discussing with the Council the least damaging way of presenting the settlement.

The consequences of this settlement can be met within the industry's EFL.

I am copying this letter to the Prime Minister, Norman Fowler, Malcolm Rifkind, Peter Walker and Sir Robin Butler.

*Yours sincerely,*

*S. H. Hill*

PP CECIL PARKINSON

(Approved by the Secretary of State and signed in his absence)

CONFIDENTIAL



CH/EXCHEQUER
14 MAR 1988 ✓ 14/3
CST

QUEEN ANNE'S GATE LONDON SW1H 9AT

11 March 1988

Dear Chief Secretary,

#### POLICE PAY REVIEW

The Official Side of the Police Negotiating Board committee which deals with rent allowance met on 7 March and reached final agreement on the position to be taken by the Official Side in the negotiations which start on 16 March.

Most of the discussions centred on the arrangements for updating the new allowance and the need to ensure that police officers who are in receipt of rent allowance on the date when the new arrangements come into operation do not lose money.

On updating, there was some sympathy from the local authority associations with the Government's arguments for leaving it to individual police authorities to seek the Secretary of State's approval for increases in the allowance in the light of recruitment and retention problems. But the view prevailed that such a system would cause great difficulties locally for police authorities and would not stand the test of arbitration. The arbitrators would almost certainly take the view that, in the light of the longstanding arrangements for updating rent allowances biennially, there should be suitable arrangements for regular updating. The least expensive method of automatic updating seemed to be to link the new allowance to the general RPI and this was the arrangement which the Official Side agreed.

The Official Side's negotiating position may now be summarised as follows:

- (a) rent allowances in its present form should be abolished and replaced by a supplementary allowance;
- (b) the supplementary allowance to be paid to the members of each force should be calculated by treating the total amount of rent allowance paid in that force (less the rates element) as a pool and dividing it - after deduction of the money needed for the payment of personal protection - amongst the officers who are not provided with free accommodation;

/(c)

The Rt Hon John Major, MP

- (c) compensatory grant should not be paid on the new allowance;
- (d) the new allowance should not count for overtime or pensions purposes;
- (e) it should be updated annually in line with movements in the general RPI;
- (f) personal protection should be provided for officers whose rent allowance (less the rates element) plus compensatory grant on the rent element was higher than the new allowance;
- (g) personal protection should be on a mark time basis and should cease once the new allowance overtook the former amounts paid in rent allowance plus compensatory grant.

Unfortunately, a major difficulty has arisen over the timing of the implementation of all this. It had been our understanding that the target date for the introduction of the new arrangements was to be 1 April 1989 throughout the United Kingdom. The local authority representatives on the Official Side were adamant, however, that there should be three start dates linked to the date of introduction of the community charge (ie 1 April 1989 for Scotland, 1 April 1990 for England and Wales and an unspecified date for Northern Ireland, where there are no present plans to introduce the community charge).

The Official Side reasoning is that their proposals for changing the rent allowance arrangements are clearly linked to the abolition of rates. To seek to remove the rates element in England, Wales and Northern Ireland before the rates are abolished would not stand the test of arbitration and the whole of the Official Side's case could founder on this point.

The Home Departments' representatives tried very hard to persuade the Official Side to agree to a common implementation date of 1 April 1989 but failed to make any impression. They accordingly reserved the position of the three Secretaries of State for the Home Departments on this issue.

An implementation date of 1 April 1990 would mean the loss of the savings which we might have expected in 1989/90. We should try and avoid this if at all possible. Even more seriously, however, the introduction of the new arrangements in Scotland 12 months in advance of those for England and Wales would create considerable discontent in the Scottish forces, (for which the local authority associations will ensure that the Government are blamed). Moreover, the indefinite deferment of the introduction of the new arrangements in Northern Ireland (where the defects of the present rent allowance arrangements are most apparent) seems unacceptable.

This is not an easy problem to resolve. The local authority representatives on the Official Side may be right in believing that the arbitrators would be unlikely to support proposals to abolish the rates element of a police officer's remuneration before rates were themselves abolished. We might in that case risk losing the whole package because of illogicalities over the date of implementation. It seems to me, however, that the new arrangements would make sense with or without the introduction of the community charge (though that certainly helps) and that the Official Side are wrong to link the two as they are now doing.

I would be grateful for the views of colleagues on this. Meanwhile I propose to instruct my officials to continue to reserve my position with a view to leaving it open to us to provide at the end of the day for a common implementation date of 1 April 1989 throughout the United Kingdom. This is of course subject to any views which Malcolm Rifkind and Tom King may express on the matter before the next meeting of the relevant PNB Committee on 16 March.

Copies of this letter go to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, Sir Robin Butler and George Monger.

*Yours sincerely,*

*N. Sainsbury*

*(Approved by the Home Secretary in signed in his absence)*

CONFIDENTIAL



FROM: JILL RUTTER  
DATE: 14 March 1988

MR GILHOOLY

cc:  
PS/Chancellor  
PS/Paymaster General  
Mr Anson  
Sir Peter Middleton  
Dame Anne Mueller  
Mr H Phillips  
Mrs Case  
Mr C W Kelly  
Mr Turnbull  
Mr Luce  
Mr Hawtin  
Mr Potter  
Mr Revolta  
Mr Brook  
Mr de Berker  
Mr Cropper  
Mr A M White

## POLICE PAY REVIEW

Mr Gray at No. 10 spoke to me about the Home Secretary's letter of 11 March. He told me that the Home Secretary - chaperoned by Mr Wicks - had been to see the Prime Minister and had inter-alia lobbied her on Police Pay. The Prime Minister noted that she had not seen any recent papers on this subject and Mr Gray put them to her over the weekend. I agreed with Mr Gray on Friday that the basis on which he should put them to her was simply to take note that there were a lot of complex and difficult issues which were being considered both by E(PSP) and by officials. Mr Gray suggested - Mr Allan please note - that this might be a subject that the Chancellor would wish to raise with the Prime Minister in the very near future.

2 This obviously puts a premium on the rapid preparation of the ammunition paper which the Chief Secretary discussed with you and Mr de Berker 10 days or so ago.

*Jill Rutter*

JILL RUTTER  
Private Secretary

CONFIDENTIAL

FROM: J de BERKER

DATE: 15 MARCH 1988

1. MR GILHOOLY
2. CHIEF SECRETARY

cc: Chancellor  
 Paymaster General  
 Sir Peter Middleton  
 Dame Anne Mueller  
 Mr Anson  
 Mr Phillips  
 Mr Kelly  
 Mrs Case  
 Mr Hawtin  
 Mr Turnbull  
 Mr Potter  
 Mr White  
 Mr Revolta  
 Mr Brooke  
 Mr Westwater  
 Mr Cropper

Mr. Hurd is dangling the prospects of large savings on allowances if we leave the Edmund-Davies formula undisturbed. But as Mr. de Berker's submission brings out, there are no

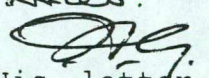
guarantees that Mr. Hurd will be able to deliver the savings or allowances.

## POLICE PAY REVIEW

You have Mr Hurd's letters of 8 and 11 March. His letter of the 8th March describes the outcome of the meeting of the full Official Side of the Police Negotiating Board (PNB) on the 23 February. The letter of 11 March describes how decisions taken on the 23 February on a replacement for rent allowance were taken forward, and the position which will be taken on this by the Official Side when negotiations begin on the 16 March.

2. In our view the key points in this correspondence are:

- there is still a possibility of moving the Edmund-Davies formula from an earnings basis to a settlements basis, but only just
- the Official Side proposals for the replacement of rent allowance are broadly along the lines favoured by the Home Office and discussed in outline in Mr Hurd's letter of 8 February. It is envisaged that it will be uprated automatically in line with the RPI. In the first instance the new scheme would produce savings equal to the rates element of the current rent allowance plus the consequential compensatory grant - equal to 3¼ per cent of the police pay bill. Ultimately this would rise to just under

15/3  


6 per cent. Mr Hurd wants to introduce the new scheme throughout the UK from 1 April 1989. The local authorities wish to delay the introduction of the new arrangements until the implementation of community charge to avoid losing at arbitration. This implies different start dates in England and Scotland and not introducing the scheme at all in Northern Ireland. The logic of Mr Hurd's position is that if he wants an earlier implementation throughout the UK date he may have to impose it.

- the Official Side have decided to try and move the settlement date from September to April. It is important that the Home Office does sufficient preparatory work on possible transition arrangements. Otherwise it could easily end up costing money.

#### **Edmund-Davies**

3. As reported in my submission of 26 February the Official Side of the PNB almost rejected the possibility of changing the Edmund-Davies uprating formula from an earnings basis to a settlements basis. You may be curious about the reference to paragraph 266 of the Edmund-Davies report in the text agreed by the PNB. This paragraph left open the possibility of either side of the negotiating body proposing variations in the uprating process in the light of future circumstances.

4. On timing, Mr Hurd reiterates his view that it would be unrealistic to ask the Official Side to propose moving the Edmund-Davies formula from an earnings basis to a settlements basis until the outcome of the survey of pay settlements is known. He considers that the survey of pay settlements is the last hope of showing that there is something fundamentally wrong with the Edmund-Davies formula. You may wish to challenge him on this. We already know on the basis of past experience that it will show that earnings have been running about 1½ per cent-2 per cent ahead of settlements. The only thing the survey will tell us is the exact difference between earnings and settlements for the period being considered.



## Rent Allowance

5. On rent allowance, the meeting of the 23 February decided that compensatory grant (which refunds the tax paid on rent allowance) should be abolished from 1st April 1989. The meeting on the 7th March decided that rent allowance should be abolished and replaced by a supplementary allowance broadly along the lines favoured by the Home Office. And they decided it should be automatically uprated in line with the RPI. This is better than uprating in line with pay or housing costs although automatic uprating means that it does not meet your preferred outcome of being readily adjustable for local recruitment and retention needs.

6. The proposals envisage that the amount paid in supplementary allowance will be equal to the amount currently paid in rent allowance minus the rates element. This will be divided among officers who are not provided with free accommodation. Compensatory grant will not be paid on the new allowance.

7. The committee propose that the police should lose the rates element of rent allowance and the compensatory grant upon it as soon as the new allowance is introduced. This will save about 3½ per cent of the police pay bill. But they consider that officers currently getting rent allowance should have personal protection on a mark-time basis for the housing element and the corresponding compensatory grant. Ultimately there will be further savings amounting to another 2½ per cent of the police paybill but it will take some time for that to come through. Transition arrangements of some sort are probably inevitable.

8. On timing, the local authority representatives insisted that the start date is related to the introduction of community charge. This means the introduction dates for England and Scotland will be different and it may not be introduced in Northern Ireland at all where at present there are no plans for a community charge. They have chosen this timing on the grounds that otherwise the proposals will fail at arbitration.

9. The Home Office representatives tried to persuade the Official Side to agree to a common implementation date of 1 April 1989 and reserved the position of the three Secretaries of State for the home departments on this issue.

10. Mr Hurd's view is that the new arrangements would make sense with or without the introduction of the community charge and that the Official Side are wrong to link the two in the way they are now doing. He seeks the views of colleagues on this, and in the meantime proposes to instruct his officials to continue to reserve his position with a view to providing for a implementation date of 1 April 1989 for the whole of the UK. To get his way on the implementation date he might well have to impose it, possibly after arbitration.

#### Other Issues

11. In his letter of the 8 March Mr Hurd lists the other issues on which the Official Side came to a decision. Most of these are familiar and have been raised with colleagues before. But the decision to try and move the settlement date from September to April was unexpected, and has not been discussed at E(PSP). We understand that the proposal is that the police settlement will be based on earnings in the twelve months to October with the decision being announced in December and implemented in April. Local Authorities favour this because it will be easier for them to fix their budgets for the year ahead if they know what the police settlement will be beforehand. The police settlement would occur in the middle of the wage round rather than at the beginning (September). It will increase the contrast between the police and other public service groups who have settlement dates on the 1st of April. (Notably the bulk of the non-industrial civil service; the collectively bargained NHS groups and teachers but also the Review Body groups.) On balance, the move is likely to be more unhelpful than otherwise, but at least the actual decision about the settlement would be made and announced before Christmas. Before coming to a final conclusion on whether the move should be supported or opposed, we need to know much more about the likely costs.

12. The Official Side have asked the Secretariat to advise them on whether they should seek a 7 month or 19 month settlement this year. We need to be in a position to know what we want before the negotiations start so that we can exercise effective influence over the outcome. If we go down this route, the transition arrangements will have to be looked at very carefully, and you might like to suggest to Mr Hurd that they are costed as a matter of urgency. A 7 month settlement would mean two police settlements of, say, 4% and 8% following fairly closely. A 19 month settlement would probably mean a 12% plus settlement. But there might be scope for a once-for-all modest saving.

### Leaks

13. Finally, Mr Hurd reports the leaks in the Police Review. In his view it is an attempt to divert any ill feeling arising from the current pay review in the Government's direction. Mr Hurd warns colleagues that he sees the risk of a serious confrontation with the police as a possibility.

### Line to take

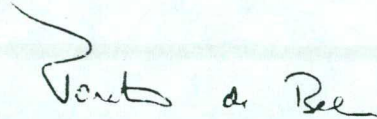
14. On Edmund-Davies point out that we already know what the survey of settlements is likely to show. Ultimately it is objectionable because it pays no attention to recruitment and retention and it is part of a process which has led to a situation where the earnings of constables in London, including overtime and allowances, can be over £20,000 a year.

15. On rent allowance you will want to support Mr Hurd's inclination to go for a 1 April 1989 as the single implementation date for the UK, and to welcome the choice of the RPI rather than earnings or housing costs as the uprating index; you may wish to point out that an automatic uprating mechanism will make it very difficult to vary the new allowance in the light of local recruitment and retention needs.

16. Finally, on the change of implementation date you may wish to suggest that work is put in hand to cost the various scenarios so that colleagues will have a clear idea of the implications. A good forum would be the PSP(O) Group.

17. A draft letter is attached. If you are content, in view of the short timescale, you may wish to ask your private office to let Mr Hurd's private office know what is said about the replacement for rent allowance.

18. HE and LG are content.

Jonathan de Berker

JONATHAN de BERKER

## CONFIDENTIAL

## DRAFT LETTER

FROM: Chief Secretary

TO: Home Secretary

Copies: Prime Minister, other members of E(PSP), Malcolm Rifkind,  
Tom King and Sir Robin Butler

## POLICE PAY REVIEW

Thank you for your letters of 8 and 11 March.

From what you say, the Official side meeting on 23 February was a difficult one, and their general approach to Edmund-Davies was disappointing although it is still possible to go back to them on this. As you know, I do not consider that we should wait until the results of the survey of settlements are available. On the basis of past experience we know that it is likely to show that the increase in earnings will be about 2 per cent higher than settlements. The survey will establish the precise difference between settlements and earnings but it will not turn up further arguments for objecting to the earnings basis of the Edmund-Davies formula. The arguments are what they have always been.

I note that the Official Side are proposing to try to move the police settlement date from September to April, and that they have asked the Secretariat to

advise them whether they should seek a seven or a nineteen month settlement. This was not a possibility discussed in E(PSP), and depending on the transition arrangements it could be expensive. There might also be undesirable repercussions for other public service groups. As a matter of urgency we must have our own costings so we are in a position to know what we want before the negotiations start. I suggest that in the first instance the PSP(O) group on police pay should consider this.

Lastly, on rent allowance, I agree the sooner its replacement is in place and we start to make savings the better. On uprating, I welcome the choice of the RPI, rather than earnings or housing costs, as the uprating index; but I still consider that you should seek to avoid an automatic mechanism as this will make it much harder to vary the allowance in later years to match local recruitment and retention needs.

I am copying this to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, and Sir Robin Butler.

CONFIDENTIAL



cc:  
 Chancellor  
 PMG  
 Sir P Middleton  
 Dame Anne Mueller  
 Mr Anson  
 Mr Hayden Phillips  
 Mr Kelly  
 Mrs Case  
 Mr Hawtin  
 Mr Turnbull  
 Mr Gilhooly  
 Mr Potter  
 Mr White  
 Mr Revolta  
 Mr Brooke  
 Mr de Berker  
 Mr Westwater  
 Mr Cropper

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Douglas Hurd CBE MP  
 Home Secretary  
 Home Office  
 50 Queen Anne's Gate  
 London  
 SW1H 9AT

15<sup>th</sup> March 1988

Dear Home Secretary,

**POLICE PAY REVIEW**

Thank you for your letters of 8 and 11 March.

From what you say, the Official Side meeting on 23 February was a difficult one, and their general approach to Edmund-Davies was disappointing although it is still possible to go back to them on this. As you know, I do not consider that we should wait until the results of the survey of settlements are available. On the basis of past experience we know that it is likely to show that the increase in earnings will be about 2 per cent higher than settlements. The survey will establish the precise difference between settlements and earnings but it will not turn up further arguments for objecting to the earnings basis of the Edmund-Davies formula. The arguments are what they have always been.

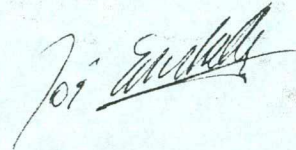
I note that the Official Side are proposing to try to move the police settlement date from September to April, and that they have asked the Secretariat to advise them whether they should seek a seven or a nineteen month settlement. This was not a possibility discussed in E(PSP), and depending on the transition arrangements it could be expensive. There might also be undesirable repercussions for other public service groups. As a matter of urgency we must have our own costings so we are in a position to know what we want before the negotiations start. I suggest that in the first instance the PSP(O) group on police pay should consider this although we may also need to convene a meeting of E(PSP) to discuss this issue.

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Lastly, on rent allowance, I agree the sooner its replacement is in place and we start to make savings the better. On uprating, I welcome the choice of the RPI, rather than earnings or housing costs, as the uprating index; but I still consider that you should seek to avoid an automatic mechanism as this will make it much harder to vary the allowance in later years to match local recruitment and retention needs.

I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, and Sir Robin Butler.

Yours sincerely



PP JOHN MAJOR

(Approved by the Chief Secretary  
and signed in his absence)





2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Douglas Hurd CBE MP  
Home Office  
50 Queen Anne's Gate  
LONDON  
SW1H 9AT

*H/1*

CH/EXCHEQUER	
REC.	17 MAR 1988
ACTION	<i>CST</i>
COPIES TO	

*16* March 1988

*Dear Douglas*

POLICE PAY REVIEW

Thank you for copying to me your letter of 11 March to John Major about the negotiations on rent allowance.

I agree strongly with your view that changes to the present rent allowance arrangements are desirable with or without the introduction of the community charge, and the two issues should not be linked. It is important that savings from the new arrangements should be achieved as soon as possible, and I support your proposal that the way should be left clear for us to provide for a common implementation date of 1 April 1989.

I am copying this letter to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, Sir Robin Butler and George Monger.

*Nicholas Ridley*

NICHOLAS RIDLEY

CONFIDENTIAL

BF 21/3

PS/CHIEF SECRETARY

FROM: J F GILHOOLY  
DATE: 15 March 1988

cc. PS/Chancellor  
PS/Paymaster General  
Mr Anson  
Sir Peter Middleton  
Dame Anne Mueller  
Mr H Phillips  
Mrs Case  
Mr C W Kelly  
Mr Turnbull  
Mr Luce  
Mr Hawtin  
Mr Potter  
Mr Revolta  
Mr Brook  
Mr de Berker  
Mr Cropper  
Mr A M White

## POLICE PAY REVIEW

1. Thank you for your minute of 14 March. This crossed with mine of the same date, which I attach below. I have made one or two minor amendments to the note, but it is basically the same as before. DE may however be able to provide further figures in the next few days. If they affect the note, I will submit a revised version.

2. HE are content.



J F GILHOOLY

CONFIDENTIAL

FROM: J F GILHOOLY  
DATE: 14 MARCH 1988

PS/CHIEF SECRETARY

cc Dame Anne Mueller  
Mr C W Kelly  
Mr Revolta  
Mr de Berker

## POLICE PAY

We discussed DE's draft paper with the Chief Secretary, and I have now had two meetings with DE and Cabinet Office officials. DE are now taking this exercise more urgently, but it is likely to be at least another week before they have sharpened up the material into a satisfactory form. 1987 figures are now becoming available, and from what the DE tell us, are unlikely to be helpful so far as comparisons of average earnings are concerned.

2. One of the problems with the DE draft paper is the prominence it gives to average earnings. These are affected by so many factors and the data are so problematical, that they obscure the workings of the Edmund-Davies formula. Changes in police overtime, in the number of new recruits (who, of course, earn less, thus depressing the average) as well as defects in the basic data make the figures an unreliable guide, and a risky basis on which to found a case.

3. With Mr de Berker's help, I have, as you asked, attempted a rather punchier presentation to pick out some key points from DE's work, especially their telling comparisons of pay rates. I have also tried to pick out the reasons why a blindly-working formula is inappropriate for any group, even the police.



J F GILHOOLY

CONFIDENTIAL

POLICE REMUNERATION

1. Under the Edmund-Davies formula, the police pay scale is uprated each year in September in line with the underlying increase in average earnings in the economy as a whole in the year to the preceding May. The Government accepts the broad Edmund-Davies framework and therefore some form of automatic uprating every year, but uprating in line with average earnings has been extremely generous.

2. With a little overtime, and including allowances, a married constable in London can earn over £20,000 a year. Fortunately this is not widely known because part of this consists of rent allowance of up to £5000 a year, and compensatory grant which refunds the tax on rent allowance. But the public are aware of police pay scales. Someone joining the police at the age of 22 starts on £10152 and in London they would also get London Allowance (£1011) and London Weighting (£945).

3. Colleagues are agreed that they would prefer to see police pay rates uprated in line with pay rates in the economy as a whole. It is a serious flaw in the present arrangements that they build into individual policemen's pay the effects of elements of drift outside. Police moving up their own pay scales benefit from incremental drift outside as well as incremental drift of their own. Police pay rates are also affected under the present arrangements by variations in the amount of overtime working in the economy, independently of the amount of overtime worked by the police.

4. The note by DE statisticians discusses the evidence on how the Edmund-Davies formula has worked since 1979.

5. As the note brings out precise estimates of the course of police average earnings vs the rest of the economy are complicated by various data difficulties, including the erroneous inclusion of rent allowance in data prior to 1986. The analysis is inevitably unsatisfactory. But overall, DE statisticians estimate that from 1980 (when the original Edmund-Davies "catching-up" recommendations

were fully in place) to 1986, police average earnings increased by 12 per cent more than average earnings as a whole.

6. Looked at another way, a police constable was in the 40th to 45th position in the earnings league in the years before Edmund-Davies; was 31st in 1980 after the "catching up" awards; and has improved his position further since then. (Movements year to year are complicated by changes in police overtime and other factors - the police have fallen back from the high point they reached due to large amounts of overtime working during the miners' strike.)

7. Average earnings are a poor proxy for pay rates which are what matters for the welfare of employees, and for recruitment and retention. Annex 4 of the DE paper shows how the pay rates of police constables have moved markedly ahead of a selection of other public service occupations, including occupations covered by Review Bodies.

8. In sum, the evidence points firmly to the fact that since 1980, when the "catching-up awards were complete, the Edmund-Davies formula has not merely kept police in step with pay outside, but has advanced them up the league.

9. Allowances have increased faster than pay.

#### THE FUTURE

10. The issue is less what has happened to police pay in the past, but what is likely to happen to it in the future. The key points are as follows.

11. First, the present formula precludes adjusting basic police pay to reflect recruitment and retention needs. As would be expected, recruitment and (with the possible exception of London) retention problems are non-existent.

12. Second, the formula builds into police basic pay rates "drift" arising outside because of greater overtime working, or the increases arising from movement up incremental scales. Increases in police overtime, and their own incremental progression is added on top.

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There is a ratchet effect built into police pay rates.

13. Third, because the formula is retrospective, police pay rates advance relative to others' when average earnings are on a downward trend and fall back when average earnings are rising. In the very long run these effects may cancel one another out. But currently average earnings are growing - around 5 per cent faster than prices, associated with exceptionally high rates of overtime working and productivity growth in the economy. Should nominal earnings growth slacken over the next few years, the police will gain a further step up the earnings league.

14. Fourth, with a mechanical formula, affordability ceases to be an issue which bears on pay. Rather than cost influencing pay, the pay formula determines the cost of employing policemen (about 65 per cent of which falls on central government).

15. Finally, the arrangements for the police run counter to the approach which we take to pay issues generally, by setting to one side questions of recruitment, retention and affordability. The arrangements undermine our stance with other groups.

16. It is factors such as these which persuaded colleagues that even if it is not possible to move away from the broad Edmund-Davies approach, an adjustment to the present formula is urgently required.



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Douglas Hurd CBE MP  
Secretary of State for the Home Department  
Home Office  
Queen Anne's Gate  
LONDON  
SW1H 9AT

17/1

	CHEQUER
	17 MAR 1988
	CST
COPIES TO	

17 March 1988

Dear Douglas,

### POLICE PAY REVIEW

Thank you for copying to me your letter of 11 March to John Major, reporting the position which the Official Side of the Police Negotiating Board propose to take on rent allowance in the negotiations which begin on 16 March, and seeking views on the difficulty which has arisen over the timing of the implementation of what is proposed.

First of all I am content with the proposals themselves as summarised in the fourth paragraph of your letter. The question of timing is certainly a difficult one and I welcome your readiness to go for a common implementation date of 1 April 1989. I accept the difficulty of abolishing the rates element of a police officer's remuneration before rates themselves are abolished in England and Wales (and Northern Ireland) but I too believe that we must go for a common implementation date of 1 April 1989 because:-

what is proposed is a package, not all of which logically flows from the abolition of domestic rates;

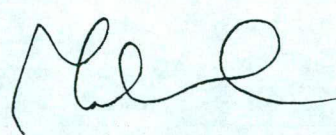
delay in implementing the proposals will give rise to loss of revenue;

if the timing of what is proposed is phased to coincide with the introduction of the community charge this will maximise the scope for the local authorities to blame the Government for the changes; and

phased implementation as proposed by the Official Side would as you recognise create considerable discontent in Scottish forces. This would not be limited to the fact that Scottish officers would regard themselves as worse off than their colleagues in other parts of the UK during 1989/90 because they will be paying the community charge (which will not be reimbursable) while other officers would have their rates reimbursed. We would also be accused of depressing the pools of money available for implementing the new allowances in those Scottish forces (representing over 80 per cent of the police service in Scotland) due to have their rent allowances reviewed in 1989/90 insofar as the pools would not reflect the increases in rent allowance which might be expected to be approved in line with increased

market values following reviews due during that period under the existing arrangements. The point here is, of course, that comparison would be made with those forces in England and Wales which, with a phased introduction, would have their rent allowances reviewed during 1989/90.

I am sending copies of this letter to the Prime Minister, other members of E(PSP), Tom King, Sir Robin Butler and George Monger.

*Yours ever,*  


**MALCOLM RIFKIND**





FROM: MISS M P WALLACE  
DATE: 21 March 1988

MR GILHOOLY

cc PS/Chief Secretary  
PS/Paymaster General  
Sir P Middleton  
Sir T Burns  
Dame Anne Mueller  
Mr Odling-Smee  
Mr Kelly  
Mr de Berker

**NR FOWLER'S PAPER ON "A STRATEGY FOR PAY"**

The Chancellor was grateful for your minute of 11 March, and has now written as drafted.

X 2. The Chancellor noted that officials here would be in touch with DE to work up some speaking notes. He thinks these could usefully draw on points he has made in speeches in the past. For example, there is the point he made in his speech to the Scottish CBI in September 1986, to the effect that for the average British firm, each percentage point extra on pay costs them four times as much as a percentage point on the cost of borrowing. He has also on occasion pointed out that excessive pay increases inject inflationary pressures into the economy which have to be neutralised in the only possible way, through higher interest rates: it follows that if pay didn't go up so fast interest rates would - ceteris paribus - be lower.

Mr ~~Johnson~~

Could you help re write X?

Mpw.

MOIRA WALLACE

I think we need pearls not only  
- pay but on geographical markets and labour markets  
generally.

Thanks  
Janet de Berker  
x 5605

27/4.



*mp*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

21 March 1988

The Rt. Hon. Norman Fowler MP  
Secretary of State for Employment  
Department of Employment  
Caxton House  
Tothill Street  
SW1

cc CST  
PMG  
Sir P Middleton  
Sir T Burns  
Dame Anne Mueller  
Mr Kelly  
Mr Odling-Smee  
Mr Gilhooly  
Mr de Berker

*Norman*

**STRATEGY FOR PAY**

Thank you for your letter of 24 February with which you enclosed a very full paper on the pay scene. I agree with the general thrust of the analysis and the conclusions too. Pay continues to cause concern. And like you I do not see that as a reason for switching track, but for intensifying the push we have already made for making labour markets work better, and introducing more flexibility in pay bargaining arrangements.

I accept, too, that exhortation may have some part to play, but it can, of course, be a two-edged sword and we need to be careful about timing and handling. We do not know, for example, what the Review Bodies may recommend and what decisions will be made on them, and at this stage in the round, we need to think carefully about high profile comments on pay. There is also the important presentational point about the dangers in concentrating too much on average earnings as opposed to settlements about which I wrote on 3 March. My instinct is that exhortation would prove more effective if it concentrated on the broader labour market points discussed in your paper, than by focussing on pay as such.

As to the paper itself, as I say, I am content with its general thrust, but there are some points, particularly on the economic analysis, which I think need further elaboration. My officials will be in touch with yours about them. They might also work up between them some speaking notes on which you and I could draw in the weeks ahead, and consider further the point you raise in your covering letter about the co-ordination of pay issues.

I have copied this letter to John Major.

*John Major*

NIGEL LAWSON

*prop*

*I'd like  
write this;  
it is now  
yet time  
to go.*



FROM: MOIRA WALLACE  
DATE: 23 March 1988

CHANCELLOR

**POLICE PAY**

We thought we ought to bring you up to date on police pay, in case you think it worth raising at the bilateral. Paul Gray tells me that he has shown the PM some of the recent papers, on the basis that E(PSP) was still hard at work on this. So far she has not intervened.

2. There are various side issues complicating the main battle, for example:

- a proposed change in settlement date from September to April, with possible expensive/embarassing transitional settlements;
- the question of when the replacement for rent allowance should be implemented (local authority representatives on the official side are pressing for different start dates in each country, in line with community charge implementation, but Mr Hurd is inclined to go for a common start date of April 1989, and we agree);
- uprating of replacement allowance (the Chief Secretary has written opposing automatic uprating, with the fallback that at the very least uprating should be by the RPI, not earnings/housing costs).

3. On the main issue, Mr Hurd's letter of 8 March reports a bad-tempered meeting of the Official Side, which only just preserved the principle that the review of pay settlements should be



considered (without commitment) before ruling out any change to Edmund-Davies. This survey is taking a long time to appear, and will not tell us much we didn't know before. The Chief Secretary's latest letter argues that we should fight the case now, on merits. Work proceeds on our own ammunition paper (most recent version attached, with Mr Gilhooly's minute of 16 March). The key points are familiar:

- present arrangements build in to individual policemen's pay effects of drift outside. So, police pay rates affected by variations in eg amount of overtime working in the economy. Logical consequence is that police will continue to move further and further up the earnings league. Married constable in London can now earn over £20,000 a year. Someone joining at 22, also in London, starts on £12,100 (compare London starting salary of civil service fast-streamer of £9,500).
- Formula does not allow basic police pay to be adjusted reflecting recruitment and retention needs. With possible exception of London, police experiencing no problems on this front.
- With mechanical formula, affordability no longer plays any role.
- High public sector settlements undermine Government's exhortations to private sector - a point made forcefully by questioners at today's TCSC hearings.

4. I attach a copy of your letter to Mr Fowler on "earnings versus settlements", in case you want to draw on that.

*Mpw.*

MOIRA WALLACE

(To choose an example at London!)

CONFIDENTIAL



*Mark  
prep*

SECRETARY OF STATE FOR ENERGY

THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QU

01 211 6402

CH/EXCHEQUER	
REC.	25 MAR 1988 ✓ 25/3
ACTION	CST
COPIES TO	

Jonathan Taylor Esq  
Private Secretary to  
The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

24 March 1988

*Dear Jonathan,*

ESI MANUALS' PAY

Following the discussions between the Secretary of State and the Chancellor last week, I am writing to let you know that at the NJIC on Friday the unions representing the ESI Manuals accepted, without a ballot, an offer of a 7% increase on salaries. The unions agreed not to publicise the offer but the Manuals received a letter explaining the increase yesterday.

*Yours sincerely,  
Stuart Brand.*

STUART BRAND  
Private Secretary

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BF 29/3

*papers etc*

QUEEN ANNE'S GATE LONDON SW1H 9AT

30/3

25 March 1988

Dear Chief Secretary,

CH/EXCHEQUER	
REC.	28 MAR 1988 ✓ 28/3
ACTION	CST
COPIES TO	

POLICE PAY REVIEW

Thank you for your letter of 18 March.

As I explained in my letter of 8 March, my officials had considerable difficulty even in keeping the door open for the outcome of the survey of pay settlements to influence the Official Side's approach to this year's pay settlement. There is nothing to be gained and much to be lost by seeking to press the Official Side any further at this stage. In my judgment, we have taken this as far as we can and we must now await the results of the survey.

The financial implications of the proposed change in the pay settlement date from 1 September to 1 April were considered by George Monger's PSP(O) group on police pay on 23 March. In the light of that discussion, my officials have undertaken to prepare a paper on this, with the assistance of the Department of Employment, for further consideration by the group.

On rent allowance, I accept that ideally automatic updating of whatever replaces rent allowance should be avoided. But the Official Side concluded that there was no prospect of negotiating their package of proposals unless some form of automatic updating was offered. We did better than expected in persuading them to offer a link with the RPI and I fear that we could not now reopen this issue.

Copies of this letter go to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, Sir Robin Butler and George Monger.

*Yours truly  
N. Swanson*

*(approved by the  
Home Secretary and  
signed in his absence)*

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~~BF 3/13?~~ pmt  
 FROM: JILL RUTTER  
 DATE: 29 March 1988

MR C W KELLY

cc:  
 PS/Chancellor  
 PS/Paymaster General  
 Sir Peter Middleton  
 Dame Anne Mueller  
 Mr Anson  
 Mr H Phillips  
 Mr Turnbull  
 Mrs Case  
 Mr Hawtin  
 Mr Gilhooly  
 Mr Potter  
 Mr Revolta  
 Mr A M White  
 Mr de Berker  
 Mr Brook  
 Mr Cropper

**POLICE PAY REVIEW**

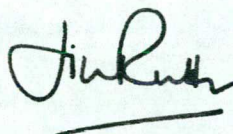
The Chief Secretary discussed with you, Mr Gilhooly, Mr de Berker and Mr Brook the current state of play on the Police Pay Review. Mr de Berker outlined the present position. There remained a possibility of feeding the results of the Survey of settlements into the police pay negotiations once those results were known.

2 The Chief Secretary said he did not think this was good enough. We needed to work on the basis of the results we knew the Survey would produce. It was vital to persuade the official side to push hard for changing the basis of the Edmund Davies formula. There was a considerable risk that the Home Secretary's remarks to the Police Conference (which Mr de Berker subsequently told me takes place in the week beginning the 16 May) would simply knock the prospect of any reform of Edmund Davies off the agenda. Action on allowances was very much second best. It was therefore important to keep the pressure up on Mr Hurd. The Chief Secretary asked about progress on the PSP(0) paper. Mr de Berker said that Department of Employment officials intended to clear this with Mr Fowler after Easter.

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3 The Chief Secretary said it was imperative for the Chancellor to talk to the Prime Minister as soon as possible. A pre-emptive strike was critical. He therefore asked you to finalise a minute he could send to the Chancellor setting out his present concerns and attaching the Treasury ammunition paper which he could then discuss with the Chancellor at his first bilateral after Easter.

4 The note to the Chancellor should say that he was becoming increasingly worried on the prospect of changing Edmund-Davies as agreed in E(PSP). He was not convinced at all that Mr Hurd was going in the right direction. It was very likely he would have to take a public position in May and it would be desirable to clear lines with the Prime Minister soon against the propositions Mr Hurd was likely to put to her. The minute should flag the possible need for another meeting of E(PSP). It should mention the point you raised, that as a possible fallback the Treasury should consider a commitment in principle to change Edmund Davies next year.



JILL RUTTER

Private Secretary





5/4

EXCHEQUER	
05 APR 1988	
CST.	
COPIES TO	

QUEEN ANNE'S GATE LONDON SW1H 9AT

31 March 1988

Dear Tommy,

POLICE PAY REVIEW

At the meeting on 16 March of the Police Negotiating Board committee which deals with rent allowance, the Official Side outlined their proposals for changes in the recent allowance arrangements and the abolition of certain other allowances and invited the Staff Side to join in more detailed discussion in joint working parties.

In the preliminary meeting of the Official Side, my officials continued to reserve the position of the three Secretaries of State for the Home Departments over the timing of the implementation of any new arrangements for rent allowance. Later developments in the joint meeting made this somewhat academic.

The Staff Side accepted that certain changes would have to be made to the existing rent allowance arrangements in the light of the introduction of the community charge. They were themselves formulating proposals and would be submitting them for consideration after they had been finalised at a Staff Side meeting on 14 April. But some of the Official Side's proposals (in particular, the proposed abolition of compensatory grant) had nothing to do with the community charge and the Staff Side found them totally unacceptable. Nor could they accept the proposal that whatever replaced rent allowance should be updated by reference to the RPI, instead of reflecting increases in housing costs.

The Staff Side considered this issue too important to be left to a joint working party and said that they would only be prepared to discuss it in the full committee (of which no meeting is scheduled until October). This would clearly take time and in the Staff Side's view it was very doubtful whether an agreement could be negotiated, or an arbitration award obtained, before 1 April 1989, when the community charge was to be introduced in Scotland. They proposed, therefore, that rent allowances should be frozen at their present levels until the issue had been resolved.

London allowance is dealt with by the committees responsible for the pay of the various ranks and the first opportunity for the Official Side to explain their proposals on this will come on 15 April. On the other allowances, they decided for tactical reasons not to spell out their proposals. They said only that they felt these items to be in need of discussion and would be bringing forward proposals in due course. The Staff Side's response was that some of these items were a matter for negotiation in other committees but, in any case, they would want to be provided with a separate paper on each item before considering the Official Side's proposals.

It is clear that the Staff Side's tactics are to split the Official Side's package of proposed reforms into its individual components and then to use delaying tactics in the different PNB committees to their maximum effect over each individual item. The Official Side would have to decide in each case whether the issue should be taken to arbitration, instead of considering the whole range of pay and allowances issues as a package, as had originally been envisaged.

All this will take time and it now seems unlikely that any changes in rent allowance or other police allowances will be agreed before this year's pay settlement date of 1 September. There is, moreover, a risk that changes in the rent allowance arrangements will be neither agreed nor arbitrated upon in time for them to come into effect on 1 April 1989, when a new system for Scotland will be essential.

The Home Departments' representatives will obviously do what they can to expedite matters but in my view we need to have a solution to fall back on if the PNB machinery looks like failing to deliver in time. This would mean Malcolm Rifkind, Tom King and I putting our own proposals to the PNB and then, in the light of their comments, making amending regulations to impose our solution in time. We should only embark on this course if there is no other alternative, and we shall probably not be able to reach a final view on this until the autumn. Nevertheless it would be wise to begin preparatory work now and I am instructing my officials accordingly.

Copies of this letter go to the Prime Minister, other members of E(PSP), Malcolm Rifkind, Tom King, Sir Robin Butler and George Monger.

Yours,

Doggin.