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PRIME MINISTER

Pay: Some Current Questions
(E(79) 13 and 17)

BACKGROUND

You agreed on Thursday that Sir Kenneth Berrill's general paper on pay dated 4th July should be circulated to the Committee (E(79) 17); at the same time, the Chancellor decided to circulate one by Treasury officials (E(79) 13). The two cover much the same ground and can be taken together. The CPRS paper is however the shorter one, and might provide the more convenient framework for the discussion.

2. It might be worth reminding the Committee that they took some preliminary decisions at their meeting on 1st June (E(79) 2nd Meeting, Item 1). But a lot of flesh needs to be put on the bones. Some very big issues, particularly over the settlement of next year's cash limits, have to be taken quite soon. Public sector employers, and to a lesser extent those in the private sector, are looking to the Government for a lead. There will not be sufficient time at this meeting to take all the necessary decisions, and you will probably need a further round before the Recess. By that time, too, the paper which you commissioned from the Home Secretary at the first 'Hoskyns Group' meeting, will be ready, and this will give the Committee some feel for the individual problems to be expected in the next round. Given that the time available at this meeting has, necessarily, had to be curtailed, it would also be possible to defer lesser specific issues like Civil Service Pay Research and the Government evidence to the Standing Commission on Comparability to a later meeting.

HANDLING

3. I suggest you might begin yourself, by making the points in paragraph 2 above. You might then ask the Chancellor to introduce his paper, and (if you think this appropriate) invite Sir Kenneth Berrill to add anything else about his. Then, taking the CPRS paper as a framework, you might get through the main headings as follows:

(a) Climate. (paragraphs 2 to 4; also paragraphs 26-32 of the Chancellor's paper). The main issues here are: what can be done in the present round to improve the climate and the general awareness of the problem? And what can be done to redress the balance of power? You have postponed the discussion of specific papers on the Forum and the Council of Economic Advisers to a later meeting, pending a talk with the Chancellor. But both these ideas are floated in the Chancellor's paper. The Committee will probably feel that, while these are useful, they will not significantly affect the position next winter. They may also feel that the various changes in industrial relations law planned by the Secretary of State for Employment, while also useful, will not make a big shift in the power balance this year though they could have important psychological effects. Nevertheless, there are important questions of presentation: does the Committee feel that the Government should mount a major educational effort, and if so how and when? What more should be done to influence employers - for example, to take full advantage of their existing and future legal rights vis-a-vis the employees?

(1)

(b) The next pay round (paragraphs 5 to 7; no corresponding section of the Chancellor's paper). There seem to be three issues here:

(i) Is it agreed that the Government must avoid anything which can be interpreted as a norm (which then inevitably becomes a floor)? - presumably so.

(ii) Should the possibility of a freeze be allowed to lurk in the background, particularly as a means of encouraging early settlements? Or should it be killed to avoid pressure to get through the gate before it closes? And would a denial be believed?

(iii) Does the Committee agree with the CPRS that, in the end, a cut in real earnings will be necessary before inflation can be halted? If so, how does the Government get the message across?

(c) Private sector (paragraphs 8 to 9; also paragraphs 5 to 8 of the Chancellor's paper). The issues which arise here are these:

(i) How tight will the squeeze really be next winter? (Your discussions about mortgages will have given you an idea of the likely monetary climate, although you will not yet have had your planned talk with the Governor about interest rates, etc.).

(ii) Which will hurt companies more - a squeeze on their liquidity, or a squeeze on their profitability? (The former may actually tempt them to dash for a quick settlement, at a price, rather than stand a strike: the CBI is thinking in terms of financial assistance for firms which decide to sit out a strike. Should the Government help?)

(iii) Is the Government prepared to stand aside from key negotiations like Ford - despite their knock-on effects - and to refuse to bail out companies who get into difficulties?

(iv) Conversely, what does the Government do about a really crippling strike in the private sector (BOC or Road Haulage)? Stand back or lean on the companies to settle quickly? (This question may not be capable of answer in advance of an actual situation arising on the ground but the tone of Government thinking will be important).

(d) Public services (paragraphs 10 and 11; also paragraphs 16-25 of the Chancellor's paper). I assume that the Committee will earlier have ruled out any possibility of establishing a 'norm'. In that case, decisions revolve around 'fair comparisons' and 'cash limits'. There are separate papers on each of these; and there are ways of reconciling them:

(i) If it is agreed that 'fair comparisons' is bound to survive in some form in the public services then the problem becomes one of imposing discipline on the system and ensuring that it works in ways fair to both sides. The papers on pay research (Item 4) and the evidence to Clegg (Item 5) both deal with this. Comparability, sloppily applied, can of course be highly inflationary: but Governments, like other employers, have, in the end, to pay the market rate to obtain the labour force they need.

Structured and disciplined comparability is an attempt to measure the market price in an acceptable way and as an alternative to confrontational negotiations.

(ii) But acceptance of 'fair comparisons' as a long-run system raises acute questions for the operation of cash limits, particularly in the short run. The Chancellor's separate paper (Item 2) deals with this point. It poses a stark choice between using cash limits to set, in effect, a public sector pay norm (with the employees faced with choosing between higher pay and lower numbers) or of using them as a monetary expression of the Government's need for staff, combined with a realistic assessment of the outcome of pay negotiations, and with a relatively small negative margin to exert pressure for economy and efficiency. (In this latter formulation there is an analogy with the old farm price review system where farmers were reimbursed their extra costs less a margin for assumed higher productivity). There is a good deal of disagreement within the Treasury on these matters and you may well find the same disagreement surfacing among your colleagues. But there is a sense in which the argument is one of degree, not substance. Whatever assumptions about pay the Government builds in to its cash limits, the pay of individual employees is bound to be settled in negotiation. The question is not therefore whether the Government reserves the right to cut functions as well as improve efficiency - it has that freedom anyway - but whether it is prepared to say in advance that it will regard its budgeted total wage bill as determining the functions it will carry out. Seen in this light the argument about cash limits and their relationship with pay is really one about the degree of freedom the Government is prepared to permit itself in deciding the functions it will perform.

You might defer detailed discussion of both sets of problems till we reach the respective papers.

(e) Local government (paragraphs 12-13; and paragraphs 16-25 of the Chancellor's paper again). Much the same problems arise. The particular problem is how to put pressure on the local authority employers. The CPRS paper implies that, once decisions have been taken on next year's public expenditure levels in volume terms, these could be translated into Cash Limits and Rate Support Grant quite quickly. But the CPRS formula (paragraph 13) involves making a forward estimate of the rate of inflation, and setting cash limits which allow for it in full. This puts no further squeeze on local authority employment on the grounds that the appropriate cuts have already been imposed through the public expenditure decisions. Is this what Ministers want? If so, should the Secretary of State for the Environment bring forward detailed proposals for this year's Rate Support Grant negotiations before the Recess? Without a clear lead from Ministers, there is a danger that the Government will become committed in informal negotiations with the local authorities, and its room for manoeuvre in the autumn limited. In any case, final decisions have to be taken well before the 'statutory meeting' in November. You might also in this context raise a more general issue of timing. Whatever approach Ministers adopt they will need to take a view on the pay assumptions to be built into the RSG negotiations. But forecasting is an inexact science. What margin of error or uncertainty attaches to forecasts made this year about the pay, or inflation, outturn in 1980-81? Does this in itself pose problems and are there means available to narrow the gap?

(f) Clegg. Is he to continue? The Cabinet has reserved its position so far. But E(EA) has now decided that the local authority APTC Groups can be referred to Clegg if both sides agree (as being preferable to an 'in house' local government comparability review and less expensive than an immediate full scale settlement). While this will give Clegg a very full programme for the next year it also brings to an end the list of potential major clients for this year, and thus gives the Government time to determine its longer term attitude to Clegg in the light of his performance - which will begin to become apparent very soon as his first reports reach Government.

(g) Nationalised industries (paragraphs 16-19; also paragraphs 9-15 of the Chancellor's paper). There is a separate paper (Item 3) on the nationalised industries. But the Chancellor's paper raises a number of important points not fully treated there: on timing, on cash limits, on efficiency targets, on limits on the Wage Bill, and on limits on prices. You might say that these points must be considered under Item 3. But at the end of the day, hard decisions have got to be taken industry by industry. One possibility would be to commission a paper for the Committee, either before or immediately after the Recess, setting out a game plan for each industry, showing what would be involved in terms of wages, levels of employment, levels of service, prices, and borrowing, from the kind of policy outlined in the CPRS paper. This could serve as very useful background to the operational decisions as they arise.

CONCLUSIONS

4. You may prefer to leave summing up until the end of the meeting. The main conclusions to emerge at this stage will, I think, be:

(i) To agree that the Government's general policy remains the control of inflation through its general monetary and fiscal policies, without the establishment of a separate pay norm.

(ii) That in the private sector, the Government's intervention should be confined to the creation of the right climate of opinion, and the provision of information. (Noting that you will arrange a further discussion of ways of doing this, including the proposed Council of Economic Advisers and Forum).

The remaining conclusions can be picked up under the later items on the agenda.

John

(John Hunt)

6th July, 1979