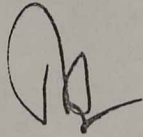


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PRIME MINISTER

PUBLIC SECTOR PAY

1. E Committee will be discussing public sector pay Wednesday, 23 July. I attach a paper suggesting the work that we believe has to be done if these problems are to be solved.
  
2. I am copying this minute, and the paper, to members of E Committee, other Ministers attending the meeting, Sir Robert Armstrong and Robin Ibbs.



JOHN HOSKYNS

PRIME MINISTER

PUBLIC SECTOR PAY

1. WE HAVE A VAGUE OBJECTIVE AND NO STRATEGY

1.1 Although we have reached some decisions in principle, our cash limit and pay outturn objectives have still not been specified. If we exhort the private sector to settle for increases within the target range of monetary growth, should the public sector pay objective - where there is less risk of redundancy - be at the lower end of the 7-11% range?

1.2 The Chancellor's paper at the outset of the last round provides a sobering reminder of how much easier it is to express determination than to achieve results:

"Our main and most immediate contribution will be a vigorous and sustained and publicly-understood toughness on the part of the public service employers in all pay bargaining. . . . From the outset, we must take every opportunity of ramming home our intentions clearly and forcefully; to those on both sides of the negotiating tables, and to the public at large. But it will be at least equally important that we are seen to act in accordance with those intentions, particularly and promptly if in the early stages any potential difficulties arise."

1.3 The paper (E(79)39) went on to propose that all public sector employers should notify Ministers in good time of the developing pay situation in their field and of the pay offers they were likely to make. In the event, these procedures were not rigorously adhered to. Nor did we have a plan, or even a mechanism, for handling each case - still less anticipating it.

1.4 Our fear is that if the Government approaches the next round armed only with a determination to "do the best we can", the result will be the same. We need a clearly thought out strategy, against which performance can be constantly checked.

2. DO WE REALLY KNOW WHAT IS INVOLVED?

2.1 If public expenditure is to adapt to the MTFS, do we know what is the maximum by which we can allow public services pay in aggregate to increase? Remember that large chunks of public expenditure are effectively indexed either by policy or commitment. This includes Defence spending, most transfer payments, etc. And some EFL breaches seem inevitable.

2.2 Once we have some idea of the objective, we can look at the alternative approaches for public service pay and judge whether they have the remotest chance of success. It makes no sense to decide the policies before the objectives.

3. ALTERNATIVE STRATEGIES

3.1 We have to try the different approaches for size first before deciding which one is worth serious effort.

3.2 The choice, roughly speaking, is between case-by-case persuasion and negotiation on the one hand, and the imposition of a more or less uniform formula on the other. We also need to decide how widely the approach is to be applied (see 3.4.2 below).

3.3 The case-by-case approach

3.3.1 To assess this approach on its merits requires careful analysis (as set out in Section 4.4.1 below). We only have to look at Annex A to see what we're up against; the great variety of different bargaining groups, with their negotiations spread right out through the year giving maximum opportunity for each group to search for "upward comparators"; improve its own negotiating technique; make the best use of its disruptive powers. In each case we have to decide whether the employers can really help us much: What's in it for them? Why should they put up a fight? Can we make them any more effective in doing so?

3.4 Alternative formulae

3.4.1 All formula approaches would mean abandoning - to one degree or another - our "fear of norms". Remember that our real objection



is to a private sector norm - where, in reality, circumstances differ and norms really can paralyse the market function. In the public sector - or at least in the public services - circumstances do not differ so much. No-one can go bust; widespread redundancies are unlikely. The approach could take one of several forms:

- (1) A flat rate, eg 8%, with variations strictly to reflect supply and demand - and perhaps productivity.
- (2) A formula along the lines of "comparability minus 5%" - which is one way of presenting the MPs' decision.
- (3) A de-indexing formula based on "inflation minus X%" - providing an upper limit to the size of the real cut in living standards. This could be combined with some variations to reflect supply and demand - by varying X.

3.4.2 It would obviously be unrealistic to attempt to apply indiscriminately a formula which meant large cuts in real living standards to the monopoly nationalised industries and the lame ducks. This could only be contemplated through an across-the-board incomes policy or freeze, whose damaging side effects the Government is determined to avoid. As the PO Telecoms case shows, the power of the unions in the monopolies is a problem which is so far insoluble - except where the monopoly "box" can be dismantled.

### 3.5 Timing

3.5.1 If we adopt a formula, there is a strong case for doing it early in order to allow maximum "protest time" so that the ensuing debate can expose the moral and intellectual bankruptcy of the union position, the very real conflict of interest between public sector and private sector union members, the absurdity of self-fulfilling inflationary wage claims when inflation is beginning to fall. As before, you won't get new behaviour unless you have new attitudes. And you won't get new attitudes without new information and enough elapsed time for it to be put across, explained by the media and understood by the public.

3.5.2 An early announcement of the approach to public services pay would have much more impact on private sector behaviour than exhortation.

Colleagues recognised this when they decided to cut the two TSBB recommendations. But this needs to be followed through with a clear statement about the policy to much larger groups - which are more closely comparable to private sector union members.

4. WHO IS GOING TO MAKE IT HAPPEN?

4.1 Initial tasks

4.1.1 We need a systematic look at Annex A, categorising the different groups by their degree of Government control, their militancy, their disruptive power, numbers, effect as comparators for other groups, etc.

4.1.2 Throughout the pay round, there will be several factors influencing behaviour: low settlements in the parts of the private sector exposed to overseas competition; higher settlements in profitable companies and the service sector; high and increasing unemployment; falling inflation; opposition by militants to Government's policies in general; the outcome of previous strikes.

4.1.3 The opening phase. Inevitably, the course of the first few settlements in the public sector will influence those that follow. They are thus particularly important:

- (1) The police, where there is a commitment to index in September - ie around 18%.
- (2) University teachers, with absolute security of tenure and an excess of supply over demand. A strong case for a very low settlement.
- (3) Nationalised industries facing tough trading conditions and contraction - BL and BSC.
- (4) Nationalised industries with strong monopoly unions (miners and water manuals). Unions will be aiming for settlements at or above the rate of inflation.
- (5) Local authority manuals and firemen.



(6) NHS ancillaries, craftsmen and ambulancemen.

4.1.4 Expectations in the last two groups are bound to be well above what we can afford. The sooner they know this, the better - so that they also know that groups which come later will be getting the same treatment.

4.2 Decide the approach

4.2.1 Do the employers at present have any idea what is at stake, any understanding of the aggregate objective to which their efforts must contribute? Presumably not, because we don't yet have a clear view of the necessary outturn for public services pay, once all the indexing in public expenditure is allowed for. The Chancellor plans to see the nationalised industry chairmen shortly, but what sanctions does he have? And how do we influence the negotiators - on both sides - in the public services? Even if we go for a case-by-case approach, we need to introduce maximum consistency (not the same as uniformity) and this will take careful preparation. Without it, last year's experience will be repeated.

4.2.2 Alternatively, we might decide that "case-by-case" is most unlikely to produce anything like the right results. This would mean one of the formulae discussed at 3.4.1 above.

4.3 Preparatory moves

4.3.1 Whichever route we take, there are several preparatory moves to be considered quickly:

- (1) The Employment Act 1980 and the decision on SB for strikers may be put to the test. We may need to go further if the remedies against secondary blacking - eg NUR refusing to move imported coal - prove ineffective. We think that legislation to allow management to lay off white collar workers during a dispute is a necessary precaution to head off selective action. How quickly could this be done?
- (2) What rehearsals or training should we undertake ourselves - or encourage the nationalised industries to undertake?
- (3) What further action do we need to take to ensure that the costs of strikes are high, and seen to be high?

- (4) What are we prepared to say about future pay rounds - and the principle of comparability? Do we believe it could be made to work once inflation is beaten?
- (5) Should we be moving some of the settlement dates so as to concentrate them at one point in the year? Eventually the public sector dates could be aligned with the fiscal year in order to make the connection between pay, cash limits and EFLs.

4.4 Team approach

- 4.4.1 Public services pay, together with proper control of monopoly nationalised industries and a coherent approach to the lame ducks, is the key to getting a grip on public expenditure. Failure here means that the whole battle against inflation will have been fought simply to build a Britain safe for the public sector to live in.
- 4.4.2 In our view, nothing will happen, no thinking will be done, no proper preparation will be made unless a (small) team is assembled, probably under a Minister, whose job it is to succeed in achieving a clearly-specified result. It won't even be possible to say what a realistically achievable result is, until that team has done the sort of thinking suggested in this paper. This team could report to E, but E itself is not a problem-solving team in this sense.

5. CONCLUSION

- 5.1 It is virtually impossible to overstate the public expenditure problem; all too easy to underrate it. This is particularly true at the moment, when there are the first signs that the Government's economic strategy is working. But we should see these chinks of light in perspective. We have had booms and recessions in the past, but they have all been part of the same downhill switchback. Each rosy dawn has been no more than a temporary remission in a steady decline. The last Government brought a higher inflation down, faster, than our plans promise to do - and yet the whole

economy was back in serious trouble within months of that success. We're now doing the same process, from a far weaker base. We are not yet cutting public expenditure fast enough for the monetary deceleration to work properly (ie without doing unnecessary damage to the private sector). Public expenditure has grown relentlessly for 30 years. It won't change course unless policies change. A handful of people around the Cabinet table resolving to try harder is not enough.



NATIONALISED INDUSTRIES (inc. BL) ANNEX A

LOCAL PUBLIC SERVICES

CENTRAL GOVERNMENT

1/4	C.S. non-Industrial trials	1/9	Police	1/11	Firemen	1/11	BL
1/4	Armed Forces	1/10	University Teachers	4/11	L.A. Manuals	7/12	Water Manuals
1/4	TSRB	13/12	NHS Ancillaryaries	1/7	L.A. Non-Manuals	1/1	British Airways
June	MPs	1/1	NHS Craftsmen	1/4	Teachers	1/1	Miners
1/7	C.S. Industrial trials	1/1	NHS Ambulancemen	1/4		1/1	BSC
		1/4	NHS Admin Admin & Clerical	1/7		1/1	Gas Manuals
		1/4	NHS Nurses & Midwives			1/2	Elect. Engineers
		1/4	Drs. & Dentists			17/3	Elect. Manuals
		1/4	BBC			1/4	P.O. UPW
						1/4	British Rail
						1/4	BS
						1/5	Elect. Clericals
						1/7	P.O. Engineers
						1/7	Gas Staff
						1/7	Water Non-Manuals