

## CONFIDENTIAL

PRIME MINISTERPAY  
E(79)5 and C(79)6

## BACKGROUND

Mr Prior's Paper on pay - C(79)6 - was originally intended for Cabinet but you diverted it to E and asked for a parallel paper by the Chancellor. This is now available to the Committee as E(79)5.

2. I do not think either paper sufficiently comes to grips with some difficult problems so this brief is inevitably rather longer than usual. I realise however that you may want to confine tomorrow to a "second reading" discussion.

3. This discussion will set the framework for the Government's approach to pay especially in the next pay round which begins in August. The broad lines of your strategy are established and your administration is likely to be far less involved in the detail of individual pay negotiations than were your predecessors. In particular you will be relieved of involvement in private sector pay settlements other than through maintaining the proper level of external financial discipline. But you will need to monitor carefully what is going on - if only because private sector settlements set the pace for public sector ambitions. And you will also find that some private sector settlements - like Fords next year - have a substantial influence on union negotiators in other private sector cases, especially where the mass unions run across firms and industries and where matching the "going rate" becomes a virility symbol for the negotiators concerned. This does not mean that the Government need interfere in detail. It does, however, place a good deal of importance both on maintaining the necessary financial discipline and on efforts to create the right climate of expectations in which bargaining takes place.

4. The real problems for Government arise in the public sector. The Government needs to set cash limits for next year in advance of knowing the outcome of pay negotiations and, in some of the nationalised industries, faces the additional problem that, because of their monopoly or quasi-monopoly position, management and men can jointly bleed the consumer. In addition the same problem

arises in the public sector as in the private where large unions bargain with a number of public sector employers in circumstances where the results of one negotiation read across to the others (the classic chain being gas, electricity, water but there are a number of others). And this year the unions co-ordinated their approach over the whole NHS/ Local Authority field.

5. The hardest problems are likely to revolve around cash limits. In the short run it is perfectly possible to set the limits on the basis of an expected outturn and to correct for any under-estimation by reducing staff numbers and services. But in the longer run this process, especially when accompanied, as it will be, by a separate and specific drive for economies, risks facing the Government with the choice of breaking its cash limits or accepting reductions in services below the levels which it wants to provide. This is an area where a good deal more thought is required, I suggest, before a fully workable and acceptable system can be devised. Clearly little can be done for next year. Cash limits will have to be set in the normal way and at whatever figure the Government feels to be justified, and the consequences accepted. But we really ought soon to begin to examine whether there are ways, eg by a better co-ordination of the timing of public service pay negotiations with the processes of setting cash limits, the Rate Support Grant and so on, which would enable a better fit to be made between forecast and achievement. It may also be that the uncertainties are such that we should be thinking of budgeting for a larger Contingency Reserve, especially to cover pay based on comparability, in order more readily to accommodate financial control with the bargains actually struck in the market place. (This would mean, on a technicality, putting the Contingency Reserve on a cash as opposed to a resource basis.) And in all this you will find your problems reduced as the size of the public sector shrinks and as the identification of options for cuts in functions creates a hidden "Contingency Reserve".

6. But for this year - the year of transition - I suspect you will have to improvise.

#### HANDLING

7. I have bracketed these two papers together on the Agenda, and I think the discussion will best be handled as a single item. You might start by asking the Chancellor to introduce his paper, which I suggest is a better framework for discussion, and then ask the Secretary of State for Employment to supplement it. The other main speakers at this stage will probably be

Secretaries of State for Industry and the Environment. Then I think you might take the Committee through the main headings of the Chancellor's paper (which incidentally covers most of the same ground as Mr Prior's) and pick up the remaining points from Mr Prior's paper at the end. In that case, the main topics are these:

- (a) the remainder of this round. The real risk is of 're-opening' past settlements. Now that you have decided to maintain the Clegg Commission, at least for the existing reference, the danger is reduced. Most probably the remaining public sector claims can be fitted into the pattern already established. There are a few difficult ones. Much the worst is the local authority APTC grades (covered by NALGO). The issue will be whether to refer them to Clegg. You will not want a snap decision at this meeting. You might therefore ask Mr Heseltine to put a paper to E(EA). The same procedure should apply to any other difficult cases - for example probation officers whose pay problems are already the subject of Ministerial correspondence.
- (b) Rate Support Grant - 1980-81. The Chancellor suggests that the autumn negotiations should take their tone from the Clegg findings. It will not be quite so simple as this (Clegg will not tell us what next year's pay outcome will be) and the RSG will have to include an estimate which will also in part determine the pattern of next year's wage round. Ministers cannot therefore wholly avoid taking a view about a desirable rate for settlements in the following pay round and they may want to take a preliminary look at this problem before the summer recess (there will be a relatively little time at the end of September to do so before the negotiations begin in earnest).
- (c) Public Services. You will also need to take a preliminary view on the desirable level of settlements, eg in the NHS, as well as the Civil Service, well before setting cash limits for next financial year - and this means taking a view not much later than Christmas. If the Chancellor agrees to this timetable, you might ask him to bring forward proposals towards the end of the year.
- (d) Nationalised Industries. The Chancellor proposes a general review of pay, prices, financial targets and efficiency. I note from Mr Lankester's letter of 29 May that you want to reserve judgement on how to organise the review which the Chancellor proposes. This needs to be related in some way to the general review of nationalised industry policy which Sir Keith Joseph has set in hand, and on which you have promised to arrange a general discussion in E when he has produced a revised paper. At this

stage - with no major industry pay settlements outstanding in the present round - you might simply note the problem, and say that you will write to the Ministers concerned when you have decided how this is to be resolved. I can then let you have <sup>some</sup> suggestions.

- (e) The Longer Term and the 'Forum'. The Chancellor floats a number of suggestions here, which are also touched on in Mr Prior's paper. You yourself have floated the idea of a 'Council of Economic Advisers', but I understand that by this you only mean some relatively informal and infrequent gathering. You may have a clearer idea, from your talks with Mr Murray, of the sort of reception you might expect from the TUC to such proposals.
- (f) Comparability. You asked the Chancellor to include more specific conclusions on this point (para 13 (iv) and (v) do this). May I suggest that any review of comparability should cover not only PRU and the review bodies, but also the future of schedule 11 of the Employment Protection Act and of the Central Arbitration Committee? These last can have quite an important effect on the public sector where there are direct analogies with the private sector (Road Haulages a good example) and make it very difficult to avoid extending 'the going rate' into parts of the nationalised industries.

8. Turning now to the remaining points in Mr Prior's paper which have not been covered above:-

- (g) Procedural changes. Mr Prior plans to bring forward his proposals on industrial relations reform to E in about three weeks. It will be important not to rely too much on these changes to influence the next pay round in the private sector. Even if legislation could be introduced and acted in time, the changes proposed are relatively modest, and will not of themselves greatly influence unions' attitudes. They may have some part to play in weakening the strike weapon, but the more they are seen to be designed for this purpose, the more bitterly they will be resisted by the unions.
- (h) Monitoring and information. Mr Prior suggests that sponsoring Ministers should keep in fairly close touch with the course of public sector negotiations, and that his own Department should continue to monitor pay movements in the private sector. While you will want to avoid any impression of intervention or structured pay policies, I'm sure that both of these proposals are sensible.

CONCLUSIONS

9. Subject to the course of the discussion, I think you may be able to guide the Committee to agree to the five conclusions set out at the end of the Chancellor's paper, and in addition -

- (vi) to invite the Secretary of State for Employment to come forward with his proposals for industrial relations reform as soon as possible;
- (vii) to agree that sponsored departments should maintain close liaison with public corporations on pay negotiations;
- (viii) to agree that the Department of Employment should continue informal monitoring of private sectors. You may also care to suggest that thought be given to the technical problem of improving the pay forecasts on which cash limits have to be set; and of any changes, eg in the timing of negotiations which would enable greater realism to be achieved.

*[Handwritten signature]*

*for* JOHN HUNT

31 May 1979