

E(79) 4th Meeting

COPY NO

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
MONDAY 9 JULY 1979 at 4.45 pm

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department

The Rt Hon Lord Carrington
Secretary of State for Foreign
and Commonwealth Affairs and
Minister of Overseas Development

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Peter Walker MP
Minister of Agriculture,
Fisheries and Food

The Rt Hon Michael Heseltine MP
Secretary of State for the
Environment

The Rt Hon John Nott MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon John Biffen MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Francis Pym MP
Secretary of State for Defence

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Mark Carlisle QC MP
Secretary of State for Education
and Science

The Rt Hon Norman Fowler MP
Minister of Transport

The Rt Hon Reginald Prentice MP
Minister of State, Department of
Health and Social Security
(Minister for Social Security)

SECRETARIAT

Sir John Hunt
Mr P Le Cheminant
Mr P Mountfield

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1. GOVERNMENT EVIDENCE TO THE STANDING COMMISSION ON COMPARABILITY

The Committee had before them a letter dated 26 June from the Chancellor of the Exchequer to the Secretary of State for Employment, covering a draft of the Government's written general evidence to the Standing Commission on Comparability.

THE SECRETARY OF STATE FOR EMPLOYMENT said that the Standing Commission had almost completed work on its first batch of references. To submit Government evidence at this late stage would invite criticism from the trade unions that the Government was attempting to dictate the terms of Commission's reports without giving them a chance to comment.

THE PRIME MINISTER, summing up a brief discussion, said that the Committee agreed it was now too late to submit Government written evidence in the present round. The draft should however be agreed between the Ministers concerned, and submitted to the Standing Commission after the summer holiday, in good time to be taken into account in its consideration of the next group of references.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion and invited the Secretary of State for Employment to be guided accordingly.

2. PAY

The Committee had before them memoranda by the Chancellor of the Exchequer (E(79) 15) and by the Central Policy Review Staff (E(79) 17) about a number of general problems posed by the next Pay Round.

THE CHANCELLOR OF THE EXCHEQUER said that his paper, and that of the Central Policy Review Staff, were intended as general background to the Committee's specific decisions on subsequent items of the agenda. The points on which decisions were needed at this stage related to different ways of improving awareness of the negotiating climate in the next year. He would be circulating shortly a paper on the possibility of a National Forum for discussion of pay problems in the economic context. Work was already in hand on ways of strengthening competition policy and reforming industrial relations as means of restraining pay settlements and correcting the current imbalance in collective bargaining. Work was also in hand to review the Government's own contingency plans for possible pay disputes in essential services during the coming winter.

In discussion, there was general agreement that it was important to alter the climate of pay bargaining and to get away from the deeply-ingrained idea of a pay entitlement. The public must learn that higher pay, unrelated to higher output, led only to unemployment and price inflation. It would be desirable to concentrate pay negotiations into a shorter period each year, as the Confederation of British Industries (CBI) had recommended. But this was not something which the Government could enforce. The Government could however make a special effort to get its message across, both to a very large number of key employers in the private sector, and to leading union representatives. One possibility would be a series of simultaneous presentations by Cabinet Ministers, at various provincial centres, with an agreed text, to the chief executives of leading companies. Something of this kind had been done with great success to convey the previous Conservative Government's policies on exports in the early 1970s.

In further discussion, it was generally agreed that the Government should not set a 'Pay Norm' in the next round, nor should it allow a defacto 'norm' to emerge. It would not be easy to set cash limits in a way which would avoid this but the effort would have to be made. Mounting speculation about a possible freeze was a more difficult problem. The media had a vested interest in drama and conflict and tended to encourage such talk. Of course no Government could wholly rule out the possibility of a freeze though those in the past had been usually associated with acute difficulties for sterling. But speculation was damaging, and encouraged unions to bring forward early and excessive pay settlements in the hope of beating the gun. The Government should seek to create the impression that a freeze was a most remote possibility, not justified by present circumstances, and unlikely to succeed if implemented. It should nevertheless avoid absolute promises which were unnecessary vestiges to fortune.

In further discussion, it was suggested that the presentation of pay claims, particularly in the public sector, needed close attention so that public understanding of the facts could be increased. If possible information about each claim should be put on to a strictly comparable basis, whether in terms of take home pay, total earnings, or any other suitable method. In the private sector, the Government should wherever possible refrain from commenting on such settlements. In those areas, like Road Haulage, where a private sector strike would have damaging consequences for the economy, the Government should rely on contingency plans, rather than on seeking to influence employers' attitudes to pay negotiations. But it could not ignore the consequences for large publicly-owned companies like BL: these needed to be dealt with in the same way as loss-making nationalised industries and controlled through cash limits on their external finance.

It was also suggested that the Government was making its own task more complicated by increasing interest rates. Against this it was argued that the Government was committed to a policy of strict monetary restraint, and that high interest rates were an inevitable part of this while inflation remained high. The real interest burden on borrowers was still low or negative. Direct controls on bank lending were not sufficient to restrict the growth of the money supply.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed on the need to improve public awareness of the Government's Pay Policy. The Secretary of State for Industry, in consultation with the Secretary of State for Trade, and the Secretary of State for Employment, should consider ways of mounting a major publicity campaign directed at the chief executives of large companies, and at union leaders. They should report their findings to her. The Committee agreed on the need to avoid any impression of a norm in the next pay round. They also agreed that, in public speeches, the Government should be seen to strain against any suggestion of a freeze, but it should not be ruled out absolutely. They noted that the Home Secretary was already considering contingency plans against major disruptions as a result of pay negotiations in the coming winter. The Committee would resume their discussion of public attitudes in the light of a paper from the Chancellor of the Exchequer on a possible National Forum, in due course.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion and invited the Ministers concerned to be guided accordingly.

3. CASH LIMITS FOR 1980-81 AND PUBLIC SECTOR PAY

The Committee considered a memorandum by the Chancellor of the Exchequer, (E(79) 15), about the establishment of cash limits for 1980-81.

THE CHANCELLOR OF THE EXCHEQUER said that his paper prescribed two options. Option A involved making an estimate of the growth in resources which could be devoted to public sector pay, and the establishment of cash limits in advance so that they could become a factor in pay negotiations. The difficulty of this course was that if cash limits thus established proved unrealistic, the whole cash limit system might lose credibility. Option B involved setting cash limits after the general pattern of pay bargaining had established a likely cost, while being prepared to adjust them to recover part or all of the cost of excessive pay settlements by a cut in the volume of expenditure. Of the two, he preferred Option A, interpreted in the most flexible possible way. Cash limits could, for example be more generous for some categories of expenditure, where Government policy required it, and tighter in other areas. If the Committee preferred Option B, it would need to be made fiercer.

In discussion, it was argued that Option A was rough, tough and crude in its application to different programmes, which would be effected in different ways. For example, in the Defence programme there was little flexibility over manpower, and there was no option of increasing prices; the strain of meeting cash limits thus fell entirely on hardware, and any major excess would break the cash limit completely. Option A presented a challenge to the militants in the Civil Service, who had wanted for some time to do away with pay research and engage in direct consultation with the Government on pay. Pay Research had served past Governments well, and was regarded by the moderates in the Civil Service unions as the touchstone of their employer's attitude. Cash limits implied some concept of a pay norm, and every settlement above that level would be hailed as a victory by the unions. They would be impossible to enforce in practice. It had been hard enough to secure the 3 per cent manpower cuts which Cabinet had agreed to impose this year to cover only part of the cost of excessive pay settlements. Although Option A might suit a perfect world, in practice it imposed a strait-jacket which prevented the

attainment of other desirable Government objectives and might even frustrate its own purposes - for example, by making it impossible to recruit supervisors and undertake more work in prison workshops, thus forfeiting additional revenue in later years. It also transferred responsibility for crucial decisions like hospital closures into the hands of non-elective health authorities. Ministers should be free to decide themselves on the offsetting measures needed to absorb increased staff costs.

Against this, it was argued that Option A was essential to the Budget strategy of strict monetary discipline and control of public expenditure. It would obviously need to be interpreted flexibly and sensibly, taking account of Government priorities, and supply and demand for particular categories of staff. It would not override Pay Research, which would remain an essential part of the system. No Government could follow something like course B while squeezing the private sector through strict monetary policy. To do so would be to continue the diversion of resources into the public sector from the wealth creating part of the economy. The Government's policy since taking office was equivalent to Option B, and had been very hard to apply, particularly with the teachers, because the Government could not tell the employers in advance how much it was prepared to pay. Cash limits as interpreted in 1979-80 under this policy were piling up large problems for later years. Three per-cent cuts in manpower were insufficient to pay for the huge comparability settlements in the present round. The present policy created insufficient defences for the Chancellor's strategy. A fixed sum set in advance would demonstrate to negotiators the inevitable consequences of pressing for excessive pay increases. However, cash limits would need to be applied sensibly, and need not necessarily produce the same result in every case, nor force reductions in services which the Government regarded as essential. It was however important to reach clear decisions, preferably well before the publication of the Public Expenditure White Paper at the turn of the year.

THE PRIME MINISTER, summing up the discussion, said that the Committee would need to return to the question of cash limits, and to the related problem of pay and efficiency in the nationalised industries. Before it did so, the

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Chancellor of the Exchequer should arrange for a paper to be prepared, demonstrating for some of the main programmes the way in which Option A might be applied in practice and with flexibility in 1980-81.

The Committee -

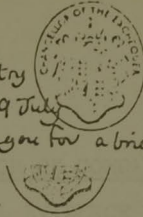
Took note, with approval, of the Prime Minister's summing up of their discussion, and invited the Chancellor of the Exchequer to be guided accordingly.

Cabinet Office

10 July 1979

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Mr Instone
We shall, after all, try
to take this at E on 9 July
& I have already asked you for a brief



Sir G. ...
Mr. le Chevalier (23M)
- M. Mountfield 1 end

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

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GOVERNMENT'S GENERAL EVIDENCE TO THE CLEGG COMMISSION

At Cabinet on 17th May I undertook to clear with Ministerial colleagues a revised version of our general evidence to the Clegg Commission.

I now enclose a draft text. It is clearly highly desirable to pass our evidence formally to the Commission as soon as possible. I should therefore be grateful for any comments you or any other recipients of this letter may have by close of play on Tuesday, 3rd July.

I am copying this letter and its enclosure to the Prime Minister, other members of E Committee, and Sir John Hunt.

M. H. Hill

(G.H.)

[Approved by the Chancellor
and signed in his absence]

The Rt. Hon. James Prior, MP

DRAFT

STANDING COMMISSION ON COMPARABILITY
GOVERNMENT GENERAL EVIDENCE

The Government offers this evidence to the Commission to draw attention to general issues raised by the Commission's work and its wider context. Evidence about particular cases may also be submitted from time to time.

Background

2. The Commission has been asked to do three things :
 - i. to see whether proper comparisons can be made;
 - ii. if they can, to collect evidence and make the comparisons; and
 - iii. in certain cases to recommend rates of pay based on its findings.

A case for using the comparability principle arises where an organisation provides goods or services which are not priced or sold in the market, or operates outside the

accounting rules of profit and loss. In such circumstances there is no framework in which market wages can be determined and, hence, a clear need to devise procedures which will act as an adequate substitute for it.

3. If comparability is to be done it must be done properly, which means "comparable pay for comparable work in comparable conditions". What this might mean in practice is outlined below.

Job for Job Comparisons

4. The starting point should be rigorous "job-for-job" comparisons :

- a. As far as possible each group or occupation distinguished by the Commission within the public sector should be homogeneous, as should the group outside with which it is compared.
- b. The widest possible range of comparisons should be sought : in particular, care should be taken to avoid any outside selection which may be inappropriately biassed by region, by size of company or other accidental factors, the object being to get the broadest possible view of the outside market.

c. Comparisons of the pay of a group with the general level of national earnings are not relevant. Such a linkage rules out the necessary shifts in relative earnings in response to changes in the pattern of supply and demand on which an efficient labour market depends.

d. Comparisons with outside groups which themselves make direct or indirect comparisons in the opposite direction will be misleading and should be avoided, particularly when the relativities each side seeks to establish are inconsistent.

e. It may not be possible to find a precise match in the private sector for public sector jobs. If this proves to be so the Commission should not feel inhibited from reporting accordingly. In some rare cases the Commission may feel able to suggest comparators on the basis of common factors, but these are not so reliable as proper job-for-job comparisons. They should therefore be regarded as giving no more than general indications, which must be heavily qualified in particular by consideration of labour supply and demand in relation to the job concerned.

The danger of historical comparisons

5. Comparisons should be based on current conditions. Past pay relationships, standards of performance and

market conditions cannot be taken as a proper guide to what is right in the present or future. Links fixed for extended periods, let alone for perpetuity, cannot reflect and must hinder the changes vital in a growing and evolving economy. Recent experience makes this an issue of particular importance. In the last decade there have been periods such as 1973-75 in which public sector pay as a whole grew more quickly than in the private sector, and periods such as 1976-9 when the trend was probably for the most part the other way. In both cases the desire to "catch up" was an important factor behind the claims advanced and the settlements concluded. But this process yielded no advantage to either side in the longer run, and harmed the economy. Such developments must be avoided in future.

Comparable Work and Conditions

6. In making proper comparisons, pay relationships are only one of many important elements to be examined. The other factors which should be taken into account will, of course, vary from case to case. Amongst the most important, and for the most part susceptible of quantification are: productivity, efficiency and manning levels; holidays, hours of work and leave; benefits in kind, subsidised loans, provision of special housing and pensions (including the way in which they are financed and the extent to which they are, by law or practice, protected against inflation). Others are less easily quantified. A cross-

bearing on job security may be obtained from an analysis of the unemployment statistics on the basis of "last job". Other factors include mobility; liability to accept change; inconvenience; flexibility of working practices; the status and esteem conferred by the job; its congeniality; and unsocial hours and physical conditions.

7. The Commission will wish to reflect carefully on how differences in manning levels and productivity are to be taken into account. They cannot be ignored, and the Commission will wish to spell out in its report the differences it finds. If there are significant differences, then equal rates of pay cannot be justified. To give the opportunity for the negotiation of reduced manning levels and improved productivity, the Commission might find it convenient to suggest a range of rates of pay linked to changes in these areas.

Supply and Demand

8. The considerations outlined above will, in a properly functioning market, be reflected in people's readiness to enter jobs in the public and private sector, and in the desire of employers to recruit them. The balance of supply and demand thus established is the essential background against which the Commission has to carry out its work. When the Commission makes its own recommendations,

or when others are negotiating on the basis of information it has provided, the objective must be to establish pay levels which even out imbalances between public and private sectors in the demand for and supply of recruits of adequate quality. Temporary or strictly localised fluctuations which are likely to work themselves out fairly quickly are obviously to be disregarded. But where the balance remains out of line for any length of time, the presumption must be that pay conditions or some other factor needs to be altered to restore a proper balance. Achieving a similar balance between supply and demand in both private and public service jobs is usually a decisive practical test of whether genuine comparability has been achieved, and particularly of whether proper weight has been given to factors which it may be difficult to quantify.

Further Pitfalls

9. The Government must also draw attention to three issues which often play an important part in pay negotiations, but which should have no place in comparability studies or recommendations based on them :
 - a. the past or future rate of inflation;
 - b. views about the "going rate" for pay settlements;
 - c. low pay.

All three are incompatible with the central principle of comparability, which focuses strictly on relative levels of pay and conditions. The particular problem of low pay raises basic questions of productivity, tax and social policy, which are for the most part best dealt with in national policies which affect the whole economy.

The Wider Context

10. The Commission has undertaken to make binding recommendations about pay levels and their implementation in the cases of a number of major groups. In accepting this responsibility, the Commission is, in an important sense, acting as proxy for the negotiating process in Central and Local Government. In discharging that task it is reasonable to expect that it will have some regard to the constraints on employers as well as to the claims of employees, and to the wider impact of their recommendations.

11. As regards constraints, the Commission will already be aware of the Government's commitment to reduce the levels of taxes, public spending and public borrowing. This is essential; both in order to master inflation, and to lighten the burden of financing the public sector which is holding back the performance of the rest of the economy.

12. This commitment becomes of central importance when viewed alongside the scale and costs of the groups of public sector employees whose cases the Commission is investigating. The reference on teachers covers 630,000 employees with a pay bill of £3,700 million a year; that on local authority manual workers about 620,000 and £1,900 million a year; that on nurses 410,000 and £1,500 million a year (all employment figures on a "full time equivalent" basis). These three groups alone constitute over 1½ million people, about a third of central and local Government employees, and their pay constitutes over £7 bn, a fifth of all current expenditure on goods and services. An additional 5 per cent on their pay would cost about £350 million. To finance that increase from taxation one might have to:

add 1p to the basic rate of income tax; increase the standard rate of VAT by 1 per cent; add 4p to the duty on a pint of beer, 9p to a packet of cigarettes or nearly 10p to a gallon of petrol; or increase local rates by nearly 10 per cent - over £12 per year on average for every ratepayer.

13. However, given that the levels of public expenditure originally planned this year were excessive and that stringent economies are being sought, the realistic question is not how such additional pay increases might be financed by extra taxation, but rather how they could be accommodated within an unchanged spending total. As

successive Governments have made clear, additional wage costs above those budgeted for will as far as possible have to be offset by economies elsewhere, or reductions in numbers employed. To offset the £400m mentioned above would involve lowering the standards of service to the public by reducing the rest of current expenditure in Local Authorities by (20%), or cutting back numbers employed by about 100,000, or by a combination of both.

14. The numbers and money amounts involved in important public service settlements are such as to affect the balance of the economy as a whole. The level at which public service groups' pay is set therefore may well cause changes in the very conditions on which the judgment of the appropriate increase was made. For example the Commission's work could have a direct impact on inflationary pressure in the rest of the economy if it recommends large settlements and these in turn influence claims and negotiations elsewhere. Here, too, sheer size is a major consideration, coupled with the very wide distribution of public service employees throughout the country and the inevitable publicity surrounding their pay settlements.

15. To take these considerations into account is not to discriminate against the public services. It is to strike a proper balance between their needs and those of other workers and members of the public. It implies

rates of pay and conditions of service for public service employees no more attractive than is needed to recruit and retain such employees in adequate numbers, and thus no more attractive than are enjoyed by employees doing comparable work with comparable effort outside the public services.

16. The Government, and where appropriate local authorities, must reserve the general right to decide how any recommendations made by the Commission should be financed and implemented, including whether or not increases should be staged, and what provisions should be made for financing or offsetting any extra costs.