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Econ Pol: May 79 1:

Prime Minister Public Exp.
Are you content with
the attached draft to
be circulated to
Cabinet under your
name? No not
R 11/15

Ref. A09536

PRIME MINISTER

Pay and Cash Limits

In my introductory brief on this subject, I suggested that you might want to have a general discussion in Cabinet, for which purpose we could produce an "annotated agenda" for you to circulate to your colleagues. You agreed to this suggestion. We have therefore prepared the attached draft, which you may care to consider. If you approve this, or any amended version you prefer, it might then serve as the basis for a general discussion in Cabinet next week to precede discussion on related subjects (e.g. cash limits in 1979-80, the Standing Commission) which your colleagues will be bringing forward for decision. It may also be a useful background to subsequent discussion in the relevant Committees on particular cases.

X The Chancellor will be putting in a paper on cash limits. He and Mr Prior have already circulated a paper on the

John Hunt
JOHN HUNT

11th May, 1979

Standing Commission (included in your folder on Teachers Pay for E Committee).

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Discussion on this paper would be fruitful - and on any other paper which raises such enormous questions & requires so few answers! It would need our best - not strengthen it. John Hunt
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PAY AND CASH LIMITS

Memorandum by the Prime Minister

We face a series of decisions over the coming months on pay and related cash limit problems. It may help if we first have a more general discussion. This note is intended to focus such a discussion, not as a vehicle for decisions about individual cases.

The Private Sector

2. We aim to leave this to the companies and workers concerned. As the Manifesto put it, 'no one should or can protect them from the results of the agreements they make'. But:

a. the attitude of both sides and particularly of management, will be influenced by our monetary policy and in the short term by the state of company liquidity (which is not particularly tight at present). We cannot yet forecast how companies will act in the next wage round. It will depend on the general situation at the time as well as on the circumstances of individual employers. But we can generate a climate through our policies and actions and through informed public debate. The case for enlightened self-interest in pay matters should not go by default. In this connection we will need to carry forward our Manifesto proposal for "more open and informed discussion of the Government's economic objectives". I return to this below.

b. Our policy depends on 'striking a fair balance between the rights and duties of the trade union movement'. We are committed to three immediate changes in trade union law, after discussions with the unions. If this is to affect the 1979-80 pay round, the legislation must be introduced this summer. Can this be done? Are there other aspects of trade union reform which we should be considering on a contingent basis?

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c. We must withstand demands for Government funding from companies which run into difficulty by granting excessive pay increases. How best can we make this clear in advance - if possible before the first case hits us? And do we need a working definition of 'excessive'?

The Public Sector

3. Our policy is for pay bargaining in the public corporations to "be governed by what each can afford" and in central and local government to "take place within the limits of what the tax payer and rate payer can afford". However in our first year of office:-

a. We have inherited cash limits (set out in Cmnd 7515) which make insufficient allowance for the promises our predecessors made but which we have to honour. Frequently these promises relate to the 'catching-up' of pay in the public sector which follows inevitably from three years of rigid pay restraint. To this extent they represent a temporary rather than a permanent problem. Do we accept that we must act within the limits of the possible this year and consider each case on its merits and subject to our prior commitments?

b. The most important of these commitments relate to the armed forces and police where we have already taken our decisions which require expenditure going beyond the provision made by our predecessors.

c. During the election campaign we deliberately exempted certain parts of the public sector (eg the National Health Service) from major cuts. We must nevertheless seek vigorously for sensible economies.

4. Within this general framework we will need to consider several different categories of public sector cases:-

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a. Nationalised industries: The circumstances of individual public corporations vary widely and different considerations and issues arise on each. Thus the "public utility" corporations (electricity, water, gas and the Post Office) are able, within limits, to set their prices at whatever level is necessary to achieve profitability. Are we prepared to leave them this freedom? If so, what steps are open to us to impose other disciplines which will provide the necessary incentives for efficient operation? Then there are industries such as British Rail where it is unrealistic to expect their charges ever to cover their costs. Obviously cash limits impose a useful discipline but our decisions on BR financing will effectively set the limit of pay increases they can grant or the volume of services they can provide. The problem of unprofitable railways which nevertheless provide an essential service (eg for the London commuters) is common throughout the world. How far are we prepared to leave decisions of this kind to the Railway Board alone? The heavy basic industries, such as steel and shipbuilding, form yet another group. They face, in common with their overseas competitors, very depressed markets and are inevitably passing through an expensive phase of contraction. Here, too, we will need to strike the right balance between the long term and the short. Next, in a category of its own, comes the National Coal Board, which ought to be profitable - the rising price of oil benefits it as much as OPEC - and whose product is of considerable long-term importance to our energy supplies and the balance of payments, but which appears to be heading for serious deficits. Do we ask them to take the whole strain on prices, investment and pit closures? Or do we seek some intermediate position knowing that this will inevitably draw us into the industries' management decisions? Finally there are the mainly manufacturing public industries ranging from British Aerospace to British Leyland where our basic cash limits doctrine can probably be applied without very great difficulty. Ministers concerned must investigate the situation in the industries and corporations for which they are responsible. Our basic aim should be to minimise the outflow of central Government funds to the nationalised industries and, where appropriate, to maximise the inflow.

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b. Local Government: The last Government made various promises about pay and Rate Support Grant which will take expenditure this year beyond the published levels. We cannot go back on these and we have added our own promises on police pay. But many local authorities seem to have budgeted for quite large cash balances, and we should not accept that any further pay settlements should automatically attract RSG support. If necessary they can draw their balances down, or trim their services: and they must be made to take responsibility for the consequences of their decisions. Looking ahead, we may well want to trim the level of RSG support we offer for next and subsequent years in order to encourage the authorities to exercise restraint in their expenditure. We will also need to consider what other means are available to us to promote economy and efficiency in local government services, some of which are extravagant and wasteful.

c. The National Health Service: The Government finances virtually the whole cost of the NHS. The Health Authorities were told by the last Government that their cash limit would be increased to finance this year's pay settlements for nurses, NHS ancillaries and ambulancemen (and some other related groups): and we confirmed in the election campaign that it was not our intention to look for major cuts in NHS services. We need nevertheless to find ways of improving the cost-effectiveness of the NHS where we are likely shortly to face even bigger wage bills following the Report of the Doctors and Dentists Review Body.

d. Central Government: The main settlement for the non-industrial Civil Service, based on pay research, was reached just before the election. The existing cash limit covers only about one-third of the cost. A research-based settlement for the industrial Civil Service is due in July; it is likely to put further pressure on cash limits. Other settlements to come - for the Prison Officers and the TSRB grades - are likely to be of less significance in cash terms. None of us is fully satisfied with the operation of pay research, and we will need

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to look at it again. But detailed improvements in the pay determination mechanism are not enough. We will need substantial savings to offset at least part of the cost. Of course the 'catching-up' element in present pay settlements poses a once for all problem this year of exceptional magnitude. Once we are back to a cycle of annual settlements the scale of our task will be reduced. Nevertheless, it is clear that we need a sustained and continuing effort to cut out waste, find more cost-effective means of carrying out our policies and a strong operation of priorities in Government expenditure. Departmental Ministers must give this effort the impetus it needs.

5. Comparability: We inherited a growing system for determining pay in the public services on the basis of comparability. For the non-industrial Civil Service the system has its origins in the Priestley Royal Commission of 1953-1955 and has evolved into a structured arrangement with the Pay Research Unit (PRU) to provide data; a Pay Research Unit Board (of which Sir Derek Rayner is Deputy Chairman) to provide independent supervision of the PRU's activities; and complex pay agreements between the Civil Service unions and management governing the pay negotiations which are based on the PRU evidence. Do colleagues agree that, whatever view we take on the subsequent spread of comparability beyond the non-industrial Civil Service, we should not overturn this structure: and that our efforts must be concentrated on improving it on the lines set out in our Manifesto?

6. Similarly would it be counter-productive to seek to change the three Review Bodies (Armed Forces, Doctors and Dentists and Top Salaries) which have existed for some time and which have gained a wide measure of acceptance? In the longer term we may need to consider some rationalisation but it is of great value to have authoritative and independent means for determining salaries in these areas - including of course the salaries of MPs and Ministers.

The first part of the report deals with the general situation of the country and the progress of the work done during the year. It is followed by a detailed account of the various projects and the results achieved. The report concludes with a summary of the work done and a list of the names of the staff members who have been engaged in the work.

The second part of the report deals with the financial statement of the organization for the year. It shows the income and expenditure for the year and the balance sheet at the end of the year. It also shows the details of the various items of income and expenditure and the names of the persons who have been engaged in the work.

The third part of the report deals with the general remarks and conclusions of the organization for the year. It shows the progress of the work done during the year and the results achieved. It also shows the names of the staff members who have been engaged in the work.

7. Extending the comparability system through the Standing Commission on Pay Comparability is however a different matter. It can of course be argued that comparability provides a useful tool for determining the proper 'rate for the job' in the public services (not the trading corporations) and applying it by a means which minimises the possibility of industrial disputes. And clearly there are a number of groups - nurses for example - where independent assessment of pay is necessary and an experienced Standing Commission may have advantages for this purpose over ad hoc inquiries. The danger however is that like will not be compared with like and that a system, apparently fair, will in fact become an engine for inflation. We will need to consider our attitude to the Standing Commission separately on the basis of a paper which the Chancellor of the Exchequer is circulating.

8. The Bargaining Climate: Our counter-inflation policy rests heavily on the restoration of firm monetary policies, including cash limits, and on a new approach to trade union power. But we want to encourage responsible collective bargaining, and our Manifesto therefore provides for 'open and informed discussion of the Government's economic objectives ... so that there is wider understanding of the consequences of unrealistic bargaining and industrial action'. This will require a resumed dialogue with both sides of industry as well as in Parliament and more widely. In the case of the unions should we seek to hold them to the target they accepted jointly with the last Government of reducing inflation below 5 per cent by 1982? Or do we have a different approach?

Conclusion

9. We do not want to run an interventionist pay policy but we have general responsibilities for the health of the economy and specific responsibilities in the public sector. The main lines of our policies are already clear. We must now work to apply them in detail so as to achieve our common objective. I hope that the general discussion we are to have in Cabinet will help us all in this task.

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10 DOWNING STREET

From the Private Secretary

MR. VILE
CABINET OFFICE

PAY AND CASH LIMITS

Sir John Hunt sent the Prime Minister with his minute of 11 May a draft "annotated agenda" for her to circulate to Cabinet.

The Prime Minister has considered the draft, and has now decided that she does not want an "annotated agenda" of the kind which Sir John had in mind, discussed in Cabinet.

Her comment on the draft is as follows:

"Discussion on this paper in Cabinet would be futile - and on any other paper which raises such enormous questions and supplies so few answers. It would weaken our hand - not strengthen it."

T. P. LANKESTER

14 May 1979

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