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PRIME MINISTER

PUBLIC SERVICE PAY IN THE 1980-81 PAY ROUND

1. I attach a draft of a paper which I would propose to put to E Committee for discussion on 16th October about the announcement we must make about pay in the public services. I think you will want to see this as part of the background to our discussions on Monday about monetary matters.

2. I have considered whether there would be advantage in making an announcement of figures for pay assumptions relating to cash limits earlier than 19th November, which is the present plan, but I feel the balance of argument is against this. Accordingly I have omitted any concrete recommendation of figures in the paper for E; this will be for Cabinet. But we can and must make some progress meanwhile.

3. I should be glad to know if you have any comments before I circulate this paper.

(G. H.)

10 October 1980

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PUBLIC SERVICE PAY IN THE 1980-81 PAY ROUND

1. From two points of view we need to go for the lowest practicable level of pay increases in the public service in 1980-81:

(i) the need to hold back public spending - every 1% off public services pay would save nearly £300 million in FY 1981-82 (see Annex); and

(ii) the need to help the private sector arrive at settlements which will ease the financial pressure on companies and contribute to the restoration of balance in the economy.

2. When we settle the cash limits for public expenditure, we therefore need to do so on the lowest practicable assumptions about public service pay. The present plan is that cash limits (including the pay and inflation assumptions underlying them) should be announced on 19th November; the volume of spending plans and cash limits will be considered by Cabinet on 30th October. Meanwhile I shall be re-emphasizing in public our determination to hold increases in public service pay down.

3. It is not possible yet to decide on precise figures. But we can start to establish the framework for our decisions.

4. The prospect for earnings outside the public services during the current round is relevant. Of course there is much uncertainty about this; but there are signs that much of the manufacturing sector will be settling in single figures. On the other hand, one must expect that in the economy as a whole the average level of settlements will be higher because other areas are not under the same degree of pressure as manufacturing. But for the purpose of selecting a figure for the public services, it must be right to focus on the lower end of the range in the rest of the economy. And we have already indicated that we intend to go for something less than 10%.

5. The target for monetary growth (in spite of difficulties in achieving it) can also be taken as a rough guide: for the present financial year that points to a range of 7%-11% (centred on 9%); the medium-term financial strategy envisaged that for the financial year 1981-82 the range would be 6%-10% (centred on 8%). I would be guided by the bottom ends of these ranges.

6. There are two particular problems which need to be borne in mind:

(a) We have to remember there are certain groups for whom the cost of pay will be greater in the next pay round than in the current one, even without any new pay increases, because their last settlements were staged. Thus the non-industrial civil service will be up by 2% before we start, the teachers by 4% and the university teachers by 11%. In E(80)71 I argued that increases of this kind should come out of the allowance for new pay increases in the following year's cash limits. There would be criticism if we applied this approach to existing settlements. But I think we should follow this course since not to do so would mean that FY 1981-82 cash limits would once again finance increases in earnings higher than announced pay factors; we may have to soften the impact somewhat in the light of the figures we choose for pay assumptions generally.

(b) The amount of money available within cash limits for pay settlements in the new round but within this financial year is based on factors of 13%-14% - more than enough for increases of the kind we have in mind. The main announcement should make it clear that the cash limits for 1981-82 will correct for this so that all settlements in the new round are subject to the same degree of constraint. To prevent this problem recurring in future, we need to adopt provisional assumptions for pay in the 1981-82 pay round lower than those we are discussing for 1980-81.

7. The lower the actual level of pay settlements, the less we shall have to rely on reductions in the volume of public expenditure to achieve our aims. It is therefore important that the pay factors we adopt should actually be reflected in the average levels of settlements. Having set the limits, therefore, we must follow through and deal with all the difficulties of pay negotiation.

8. Beyond that, some particular aspects of negotiating machinery need to be changed if the ground is not to be cut from under our feet. Arbitration is the most important of these. The Secretary of State for Employment is putting a paper to E Committee on this. It is clear that where arbitration, on broad terms of reference, is automatically available to the demand of only one of the parties, any normal management responsibility for what can be afforded by way of pay is undermined. Legislation may be the only way of ensuring that such arrangements are changed.

9. We shall also have to be prepared if necessary to override other constraints such as the reports of the review bodies for the armed forces, doctors and dentists and top salaries.

10. I accept that there are limits to how far the approach I am suggesting can be pressed. In particular the lower the figure one goes for, the greater the risk of not achieving it, or doing so only at the cost of industrial action. Furthermore a very wide disparity in earnings between public services and the rest of the economy would create pressure for catching up. The third factor is how far we can go is what is happening to prices. Although the annual figure for the RPI is likely to have declined further by April 1981, when many public service settlements take place, it is still likely to be significantly above 10%: settlements, as I propose, well down into single figures will imply a significant cut in real incomes. If it were not for factors such as these I would be arguing for an even stronger approach.

Conclusions

11. (a) We should base cash limits on factors for pay increases in the public services well down into single figures.

(b) In future, staging should be dealt with as I proposed in E(80)71 and we should avoid staging from now on.

(c) We need to decide exactly how to deal with the overhang of staging from the 1979-80 pay round for the non-industrial civil service, teachers and university teachers; so far as possible I should prefer that it be included (without extra allowance) within whatever pay factors we think appropriate more generally.

(d) When setting cash limits for FY 1981-82 we will need to recognise that some cash limits in the current financial year are too generous in their provision for pay increases in the new pay round.

(e) To prevent the problem of over-provision recurring, we shall need to adopt at this stage provisional pay assumptions relating to the 1981-82 pay round, lower than what we decide for 1980-81.

(f) We should also decide on changes in arrangements for arbitration, possibly by legislation.

(g) We shall also have to consider whether, if necessary, we shall be prepared to override other constraints such as the recommendations of review bodies.

(h) I should make announcements relating to the above on 19th November.