COVERING SECRET

TO ALL MEMBERS OF THE LEADER'S CONSULTATIVE COMMITTEE

I enclose a paper by the Department on the pay deal as a basis for discussion at the Shadow Cabinet meeting on Wednesday, 19th May 1976.

The paper is deliberately a little provocative since we thought it ought to raise the obvious political questions which are being asked.

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CFP/SMJ
18.5.76

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THE PAY DEAL

[Paper by the Research Department]

The newly unveiled agreement between the Government and the TUC about a second round of wage restraint raises many important questions for the Conservative Party:

1) What are the economic implications of the new rules for wages likely to be?

2) What attitudes should the Party adopt to the rules, both before they come into force and after?

3) What should be the Party's attitude to wages policy in general? Is it necessary to go much beyond the position agreed in the Shadow Cabinet in 1975, as extended by Sir Geoffrey Howe? Does it need to be restated?

4) How does the new agreement affect the relations between the Government and the TUC? What is the "price" exacted by the TUC in exchange for their acquiescence?

5) How, given answers to the previous questions, can the Party put them across publicly with the greatest effect?

This paper considers the issues raised by each question.

I THE IMPLICATIONS OF THE NEW AGREEMENT

Has wages policy affected the growth of costs

In the six months January-June 1975 wage settlements were running at 34% p.a. overall, with the private sector a little below that figure and the public sector well above at 39.7%.* This was about three times the year on year rate recorded in the first quarter of 1974. The £6 limit will, according to the Government be worth 13% p.a. Even if the outturn is somewhat higher at, say, 15% as might well be possible, the reduction from the 1975 levels will be of the order of two thirds or 20%. The new agreement is hoped to lead to increases of the order of 6% p.a., lower than the figure achieved in any year since the later 1960s.

The unemployment rate was 2.4% in the first quarter of 1974, 3.6% in the second quarter of 1975 and is now about 5½%. The increase since 1974 is substantial and has played an important part in holding back inflation. But there is no evidence to suggest that it could, of itself, bring about reductions in wage increases anything like as large as those achieved for a period by the £6 limit or sought under its successor. Past experience suggests that a 1% increase in unemployment reduces the rate of wage increase by about 2% in the following year. On that basis the 3% increase in unemployment should have reduced wage increases by about 6% p.a.

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* These figures refer to the annual rate of increase involved in individual settlements, as analysed in the reports of "Incomes Data Services", not the DE earnings index.

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LCC/76/110 The Pay Deal

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Problems deferred till the future

The typical manual worker's pay packet is built up from a variety of elements, of which his basic pay accounts for less than two-thirds. Both the £6 limit and increases under the new agreement are defined as supplements to his total earnings. But as soon as circumstances permit there will be strong pressures for them to be absorbed into the whole pay system. This in turn would lead to substantial increases not merely in basic pay but also in overtime rates, shift premia, etc. For an average male manual worker the effect of full consolidation after two rounds of restraint would work out at no less than 5½%. Thus the system of payment adopted by the Government has made probable in the future an unavoidable and substantial increase in wages. Since it will obviously have uneven effects when implemented, depending on the payment systems of different groups of employees, ultimate consolidation will also aggravate differential and comparability problems.

Attitudes to the new agreement

It is possible, though increasingly unlikely, that the TUC's special congress on June 16th will not endorse the agreement. If it does, pressures on the policy are likely to build up primarily at grass-roots level (Leyland) or in smaller white-collar organisations (Junior Doctors and Power Engineers) although action by larger groups (Civil Servants) is also possible. Whether such measures will totally destroy or merely erode the policy is impossible to predict. However, it is highly probable that Union leaders will be under the most intense pressure from their members at the very least to argue for a very flexible Stage III and, quite possibly, to abandon voluntary restraint completely. It is nearly certain that really fundamental problems both of differentials, relativities, special cases, implementing new pay structures and pro uctivity agreements will have arisen by mid 1977. This will face the Government with a familiar range of dilemmas. If any wages policy is to be pursued thereafter it must be flexible. If flexibility is not to mean wide-spread avoidance it will require complicated rules and institutions. These can only be achieved by a near-statutory policy with an elaborate system of monitoring, adjudication and so on. But the Unions will not accep a statutory policy . . .

How much will the new agreement achieve in rehabilitating the International Image of the British economy?

The Chancellor is reported to have said that, retail prices should rise by about 6% p.a. overall by the latter half of 1977 if the new agreement works according to plan. Of that total, wage increases would account for 2% while such factors as the fall of sterling and rising commodity prices would be responsible for the remaining 4%. He has also claimed that the new agreement will lead to lower wage increases than in any other country.

These claims are probably over-optimistic. With an 8% earnings increase as suggested earlier and the other factors just cited, price inflation could well run at 8% p.a., if not more even if the policy runs for another year without serious infractions. Meanwhile the OECD average could be as little as 6%, with some country's doing significantly better.

Will this small discrepancy matter? How far will those dealing in sterling on the exchanges be concerned? No clear answer is possible. But it should be noted that:

...../a) The

a) the Chancellor's suggestion that we must get our inflation rate down to the average for our competitors seems to ignore the freedom granted, at least in principle, by a floating exchange rate;

b) in all likelihood a small excess over average OECD inflation would therefore matter little if it were soon likely to disappear rather than increase and if the rest of the Government's policies were sensible;

c) but it would matter a great deal if these conditions were not met. Since the odds are on the latter, the international pressure to continue with an explicit counter-inflation policy as part of a broader programme of economic recovery is likely to be considerable. Apart from anything else we could be in desperate need of more foreign borrowing by that time, and of policies which reassure sterling holders and potential creditors such as the EEC or IMF. A further round of wage restraint might well be considered desirable, if not essential, as one of a package of such policies.

On this analysis the inadequacies of rounds one and two could leave any Government, whether Labour or Conservative with little choice but to go for a third round of restraint.

II WHAT ATTITUDE SHOULD THE PARTY ADOPT TO THE NEW AGREEMENT?

The first issue is how the Party should vote on the new agreement, it being probable that there will be a day's debate on it after a further major statement or White Paper. Some general considerations which must be relevant irrespective of the precise procedure adopted by the Government, are as follows.

Voting in favour

Among the problems of voting (in some sense) in favour are the following:

a) in so doing it is difficult to avoid the appearance of endorsing not merely a degree of pay restraint, but also the size of the conditional income tax cuts; the particular form of the wage rules and the rigid squeezing of differentials inherent in them; and the whole social contract relationship that lies behind it;

b) the Party might then be committed to some extent to be supporting the Government case by case as difficulties arise;

c) the Party might also be moving close to implicitly supporting a third round of restraint. For the second stage will almost certainly appear to need a successor of some kind to prevent rebound and consolidation problems from causing yet another wages explosion. Yet is is difficult to see how one can be successfully designed or implemented.

...../Voting against

Voting against

This would enable the Party to express its disapproval of the many bad features of the policy and its concomitants and some people argue that it would also allow us to escape form the political trap of having to attempt to out-bid the Labour Party for TUC support. However, it would involve not merely swimming against the tide of public opinion on what is rightly or wrongly considered to be a key issue of the day, but exposure to the criticisms that Conservatives now wanted to encourage inflation, that they cannot remain consistent to their 1975 position and that they are falling into the traditional opportunist anti-incomes policy posture of all opposition parties.

Abstenti n - reasoned criticism

This course of action, however reasonable in principle, is open to exploitation by the Government and those hostile to the Party, who will certainly construe it as covert opposition or sour grapes. It requires considerable skill and whole-hearted commitment to convey both that the Party approves in principle of the continuation for a further year of a degree of wages restraint, and that it disapproves of the form of the new agreement and much of what goes with it. Many people are not capable of appreciating such subtleties at all. Many others recoil from embracing complicated arguments such as these, even if they understand them because of the almost universal human tendency to seek very simple answers to very complex problems.

Whatever position the Party chooses to adopt, but particularly if it is decided to follow the line of reasoned criticism, it is for consideration whether we need to develop some idea of what we would advocate as an alternative to the Government's policy. This could help to buttress arguments for a reasoned amendment. It could also provide an intellectual position for "We told you so" criticism of the policy's failings once it comes into force.

After the new limit comes into force

When the second round of restraint begins it is probable that difficulties or possible infractions of the policy will become matters of great public interest. It is then likely that we will be forced to make our own position clear case by case. In particular, if we encourage the Government to create exceptions and special awards we may be criticised for undermining the policy.

III IS THERE A NEED FOR A RESTATEMENT OF THE PARTY'S GENERAL ATTITUDE TO INCOMES POLICIES?

The lively public discussion of the new wages agreement inevitably focusses attention not merely on the specific issue of whether round two of the Government's policy should be supported, but also on the broader question of Conservative attitudes to wages policies generally. It is therefore important to consider how far it may now be appropriate to set out what the Party's position is on the general issue and to reassert it clearly in public.

The October 1974 manifesto committed the Party to seek a voluntary policy for prices and incomes with the qualifications that:

- it might be necessary to "go statutory" if voluntary support could not be achieved;
- with no policy whatever the Government would have to take "harsher financial and economic measures than would otherwise be necessary" if inflation was to be mastered.

In the period immediately before and after the adoption of the £6 limit last July, the Shadow Cabinet agreed on the principles:

- the conquest of inflation required that all economic policies must be pulling in the same anti-inflationary direction, in particular public spending and monetary policy;
- an incomes policy could play a useful part as one of a comprehensive package of policies, but was not to be considered as an alternative to the others, and could not be expected to achieve much on its own.

Sir Geoffrey Howe's speech to the Bow Group on May 12th [copy to follow] developed the 1975 "Concordat" further. It modifies and enlarges the two propositions of July 1975 by arguin that:

- a permanent conventional incomes policy would be undesirable. What is needed is some kind of broadly based process like Germany's "concerted action" for ensuring that all groups in society understand and accept economic reality and the pursuit of anti-inflationary spending and monetary policies by the Government. Strict monetary policy is not enough on its own.
- there is a case to be made for short episodes of wage restraint such as the first and second round of the Government's present policy, provided they are not resorted to as an alternative to proper monetary or fiscal policies.

These principles offer the basis for an intellectually credible attitude towards the general issue. However restoratio of our political credibility requires more than a well-received speech. The case for reasserting the Party's general position and making it clear that there is unity on the issue therefore merits careful consideration.

Furthermore, without an united and clearly understood position the problem of responding coherently to the new wage limit is considerable. Above all, if a somewhat equivocal response should be deemed appropriate, there is the risk that the public at large will consider the Party to be still hopelessly divided and confused unless the opposite can be clearly demonstrated. This means that the response must be visibly related to a sensible and consistent approach to countering inflation and a realistic assessment of the current situation.

IV THE QUID PRO QUO FOR THE NEW WAGES AGREEMENT

There can be said to be three elements in the "quid pro quo":

1) Overt: The conditional tax increases and the £50 million increase in ublic spending recently announced by the Chancellor;

...../2) Covert:

2) Covert: the apparently separate demands for new policies put forward recently by the TUC in the Labour Party - TUC liaison committee:

3) Unperceived: the degree to which the general character and direction of Government policy has to be kept within narrow and undesirable limits in order to permit the Government-TUC relationship to survive.

Assessment of (3) and of (1) [which is one of its typical consequences], is fairly simple. The Government is clearly forced to sustain excessive levels of public spending, tax and borrowing by TUC pressure. Probably many of its own members would privately admit this. In that general context the over-generosity of the conditional tax cuts is only to be expected.

TUC suggestions for new policies (2) are another matter. The list of demands (see p.8 of annex 1) has many similarities with those put forward recently by the NEC and recently rejected by the Prime Minister in a carefully orchestrated display of public distaste. It includes, according to one press report, targets for redistribution of wealth and limitations on top salaries as well as the more conventional requests for import controls, nationalisation of financial institutions and so on.

It is difficult to know how seriously to take these demands.

On the one hand it could well be that, by a nod and a wink, Ministers have indicated that they now accept they must support and implement some of these policies in the fullness of time. That might well have been vital in ensuring the TUC's support for the "son of £6" in the intense negotiations which took place in recent weeks. The refusal to accept comparable demands emanating from the NEC could well be designed to ensure that when new commitments are made on the lines the TUC requested, they are clearly adopted in response to pressure from the unions rather than from Mr. Benn. Thus they would help Mr. Murray to prove to his members that the Social Contract still means something.

On the other hand it could be argued that the TUC's demands and the Government's response are just another part of the normal life of the Labour Party, in which the waves of wild Socialist ideas break (usually) fruitlessly and endlessly on the rocks of reality on which the Prime Minister and Chancellor at the moment stand.

In the former case, there must be a strong argument for a determined Conservative attempt to drive out into the open the realities of the covert deal, to make the maximum propaganda use of it and to do everything possible to ensure that it is not consummated. In the latter case it would probably be better to concentrate fire on the other elements in the Social Contract relationship which we find objectionable, and on the failings of the wage restraint provisions themselves.

(A more speculative note on the relationship between the Government and the TUC is attached at Annex 2).

......./V PUTTING

V PUTTING ACROSS THE PARTY'S POSITION EFFECTIVELY

It is regrettably the case that the public does not hold a high opinion of the Conservative Party's general position on fighting inflation or its response to the Government's wages policies. There is nothing to be gained from pretending otherwise. The Party is believe to be in a profound state of disagreement on the issues and to be making occasional somewhat half-hearted equivocal noises in order to conceal that situation. Therefore whatever particular decisions are made about counter-inflationary policy, whether in general or in particular, much needs to be done.

a) The Party's view about incomes policies in general must be asserted clearly and consistently; and

b) developed in a way which provides full justification for our appraisal of "son of £6", our Parliamentary tactics and our attitude to the "quid pro quo" for the wage agreement;

c) if the Party's position remains, as it currently is, somewhat complex and equivocal, then that apparent equivocation must be defended. It is legitimate to refuse to answer simple-minded questions about complex issues of the kind the Government, the media and the public would like us to answer. But it is foolish to do so without demonstrating that one has good reasons for one's attitudes. If that cannot be done, then outsiders cannot be blamed for forming the worst conclusions about us.

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18.5.76

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ANNEX 1

THE NEW PAY LIMIT

The new pay limit is planned to run for a year from 1st August 1976. The details are contained in the statement made by the Chancellor on 5th May and in the guidance put out by the TUC on the same date.

It means that in any given week, a supplement to pay may be given of £2.50 or 5% per week, whichever is the larger, with a ceiling of £4. Although this is considerably higher than the 3% figure which the Chancellor mentioned in his budget as being the sort of increase on which tax concessions would be conditional, he has justified giving the concessions on two grounds

- it is very much tighter even than the £6 limit: there will be no transitional problems, no increase for equal pay, no consolidation, no exceptions for productivity bargaining or anomalies,

- its impact on average on wages and salaries will be 4½%: this figure has been so presented as to suggest that the national pay bill will grow by only 4½% between August 1976 and August 1977.

This note argues:

(i) that the operation of the new limit is more complex than is generally supposed,

(ii) that it may be difficult to encourage overtime under it: this may slow down the recovery,

(iii) that it will further narrow differentials,

(iv) that it may run into problems in certain major negotiations,

(v) that the possibility of special cases may not have been ruled out,

(vi) that the impact on the national pay bill will be considerably more than 4½%,

(vii) that the policy may yet prove to be still born,

(viii) that even if the policy survives till next year, inherent pressures for a wage explosion then are being built up,

(ix) that the full price of agreement has not been disclosed.

(1) How will the new limit operate?

It is not yet appreciated that the new limit means that pay will be calculated from week to week for wage earners and from month to month for salaried staff. The increase will be paid as a further supplement to earnings. As what people earn may vary from week to week or month to month due to changes in overtime, shiftwork and payment by results, so the amount of the supplement may vary.

...../The operation

The operation of the new limit is illustrated in the table below.

Table 1

Car workers' pay: the operation of the new limit

		Current weekly earnings	Earnings in 1976/77	
			Week 1	Week 2
		£	£	£
A	Basic rate	47.00	47.00	47.00
B	Overtime	4.00 (3 hrs)	4.00 (3 hrs)	8.00 (5 hrs)
C	Payment by results	4.50	4.50	4.50
D	Shift Premium	3.00	3.00	3.00
E	£6 supplement	6.00	6.00	6.00
	New 5% limit (5% of A+B+C+D+E)	-	3.27	3.43
	Increase on current earnings	-	3.27	6.63

Note: These figures are based on the New Earnings Survey statistics for average pay for male annual workers in motor vehicle manufacturing in April 1975.

It was possible to increase earnings under the £6 limit by more than £6 for example by working more overtime. The table shows that this remains true under the new limit. Providing the overtime worked results in a genuine increase in production it need not be inflationary.

The Chancellor has stated that:

"Apart from its change in form the new limit will be subject to the same rules as the £6 limit and the same enforcement procedures will apply". This means that once again the limit relies largely on the goodwill of bargainers. The only means of ensuring that settlements stay within the limit is via indirect monitoring through the price code in the case of the private sector and cash limits for the public sector. Those who think that they can meet the costs of higher pay settlements without having to base an application for a price increase upon labour cost changes can pay beyond the limit.

It would have been technically possible to have the 5% supplement apply to some elements of pay, rather than all. Practically, however, it would have been difficult to apply the limit only to basic rates (A), since interpretations of these vary, or to exclude overtime, payment by results and shift premia (B, C, and D). In an essentially voluntary policy it is simplest to relate increases to the more easily defined earnings levels. Nevertheless, the supplement need not have applied to the £6 supplement already paid (E). If the £6 supplement had been

...../excluded

excluded, this could have saved £156 million on the national pay bill in a full year.*

(2) <u>What incentive will there be to work overtime or shifts?</u>

It has been noted in the preceding section that working more overtime will allow employees to obtain increases in pay in excess of £4 per week, and the likely picking up in the economy will create more overtime opportunities next year. Paradoxically, however, the effect of the £6 supplement and taxation may be such that working overtime or shifts will not be sufficiently attractive to encourage employees to do so, and this may slow up our recovery. The table below shows the position on overtime for the national average manual male worker.

Table 1

Average male manual worker: the new limit and overtime

		Current weekly earnings	Earnings in 1976/77	
			No increase in overtime	4½% more hours worked
		£	£	£
A	Basic rate	41.40	41.40	41.40
B	Overtime	7.90	7.90	10.79
C	Payment by results	4.70	4.70	4.70
D	Shift Premium	1.70	1.70	1.70
E	£6 supplement	6.00	6.00	6.00
	New 5% limit (5% of A+B+C+D+E)	-	3.09	3.23
	Total before deductions	61.70	64.29	67.82
	Total take-home pay	45.80	48.50	50.30
	Increase before deductions	-	3.09	6.12
	Increase in take-home pay	-	2.62	4.50
	Increase in take-home pay in 1976/77 produced by working 4½% more hours			1.80 (3.9%)

Notes: 1 These figures are based on the New Earnings Survey statistics for average pay for male manual workers in all industries and services in April 1975.

* The Chancellor estimated that 40% of wage earners would obtain the full 5%. 5% of the £6 supplement is 30p. 30p per week for 10,000,000 people is £156 million per annum.

...../2 Take home

2 Take-home pay is calculated on the basis of tax for a married man with two children under 11 and national insurance contributions.

The CBI anticipates growth in production from the last quarter of this year to the last quarter 1977 at a rate of 4½%. The above table assumes that this would be reflected in a similar growth of overtime from August this year. Overtime for the average male manual worker is paid at about 1.4 times the basic rate. Taxation, increased national insurance contributions and 2 years of unconsolidated supplements to earnings, however, mean that for working 4½% more hours, he would only increase his take home pay by £1.80, or 3.9%. An analysis on a similar basis of figures for underground workers in coal mines and car workers indicates that working 4½% longer would increase their take home pay by only 5.1% and 3.5% respectively.

It must be doubted whether these will prove adequate incentives.

(If the incentives did prove adequate, and 4½% growth led to a similar increase in hours worked, it should be noted that earnings for the average male manual worker would increase by more than £4 per week, whilst a miner's would increase by £8.50 and a car workers by £6.50).

(3) <u>What effect will there be on differentials?</u>

The policy is so formulated that it will further narrow differentials. Obviously, employers of large numbers of people on lower than average earnings will be glad that there is not a further year of £6 flat-rate limit. But the £2.50 minimum alternative to the 5% limit will mean that those on less than £50 per week (36.2% of men and 85.3% of women in April 1975) will be permitted larger percentage increases than the general 5% whilst those on more than £80 per week (14.9% of men and 1.9% of women in April 1975) will be limited to a £4 maximum (less than 5%).

Further, most of those on £80 and more will be salaried staff with much less chance of overtime and shift work. The result of the policy will be to disturb differentials more. This will wreak havoc with wage and salary structures. At the higher levels, and amongst those who are potential top managers, there will be a stifling of initiative and encouragement to emigrate.

(4) <u>In which major negotiations will the strains show?</u>

The £4 a week limit bites at £80 per week. Underground workers in coal mining were earning on average £75.80 per week in April 1975 and can now be assumed to be earning £81.80 per week. Others similarly caught will be chemical workers, engineers, teachers in further education and secondary schools, firemen and many civil servants. It should, however, be noted that some of these groups receive considerable salary supplements through the operation of incremental scales which will lessen the impact of the £4 ceiling.

Some workers in motor vehicle manufacture will also be caught, though probably not more than 15%, but greater problems will be caused in that sector by the rigidity of the policy. More precisely, it would appear that British Leyland will not be able to rationalise their pay structures so that the disputes which have bedevilled their operations lately can be expected to arise again next year - probably with greater vehemence.

All of these should be regarded as examples: they are not exhaustive.

...../(5)

(5) Will there be special cases?

It will be recalled that in all previous policies, subsequent stages have been characterised by greater flexibility and generosity. The current policy will also have its strains, and they are likely to be exaggerated by the fact that the next stage will be less generous than the last in a period when unemployment will have stopped rising and the economy will be visibly picking up.

The Chancellor has said: "No special exceptions are proposed for productivity bargains. There is no loophole for rectifying what many people may see as anomalies". This appears on the face of it to rule out any possibility of special treatment for particular groups. But the choice of wording may have been very careful. Anomalies were very closely defined by the Pay Board as cases where an established link between the pay of two groups was broken by the timing of the launch of the new policy. They were differentiated for example from relativities (relationships between large groups of workers of importance to the community as a whole). If the Chancellor was using 'anomalies' in this strict sense, his wording might allow through special exceptions which were not productivity bargaining exceptions (e.g. British Leyland to allow them to rationalise their pay structures). In this context it should be remembered that Labour originally intended the Royal Commission on Distribution on Incomes and Welath to act as a kind of Relativities Board. (source: Labour's Programme 1973).

Mr. Len Murray, however, seems to accept that the wording has a wider meaning. He is reported as saying that the miners' had once been a "unique, special case" but that could not happen again. "There are no special cases". (The Times, 6th May 1976).

(6) What will the impact be on the national pay bill?

The Chancellor has achieved a fine glissando in dealing with this. From saying that he concentrated in discussions with the TUC about the new limit on "its impact on the nation's pay bill" he moved on to state that "The result was a pay limit which ... can be expected to add, on average, about 4½% to wages". The truth is that he has set a 5% limit as a supplement to earnings and that the impact on the national wages and salaries bill is likely to be much higher than 4½%.

Admitting that there had been slippage under the £6 policy (usually reckoned to be 2 or 3% although it may well prove to be higher), the Chancellor maintained that there would be less this year because there would be no transitional problems and no further equal pay increases. In fact, slippage last year was probably more attributable to the permission of further increases beyond the limit where clearly defined incremental scales operated than to the causes suggested by the Chancellor, and these payments will continue under the new limit.

It can also be argued that the widespread settling within the policy was based upon the employees' negotiators' fear of galloping unemployment and the managements' inability to pay. The increase in unemployment is clearly tailing off now and probably will not be growing during the next 12 months. Fear of redundancy can be expected to decline accordingly. It must also be recognised that those who obey the limit will often see the real value of their take home pay decline due to continuing inflation. Until last year, this was unprecedented in post war Britain. Union Bargainers will have greater difficulty in understanding that this must continue when our economic position is improving as it will be over the next 12 months. Further, as the economic recovery begins, employers will find themselves freer to pay higher wages without having to apply for price increases. This may be reflected in pay rises above the new limit which will be hidden because the Price Commission will receive no notification of them.

...../ Any permitted

Any permitted special cases will also produce slippage.

It should be noted that Stage 2 of the Conservative Counter Inflation policy - widely regarded as a success - set a carefully defined limit of 4% + £1 on earnings which was legally enforceable, and which allowed special treatment of only 2 cases - the Civil Service and heating and ventilating engineers. This 4% + £1 represented 6.8% on average earnings for full time manual men as they stood in November 1972 before the Stage 1 freeze. In fact average earnings for full time manual men increased in the 12 months from October 1972 by 14.2% and the wages and salaries bill rose by 13.4% between 1972 IV and 1973 IV.

All these points suggest that if the current proposals are carried out:

i) both average earnings and the wages and salaries bill will rise 1977 III on 1976 III by more than 4½%,

ii) the lowest rise would be more likely to be around 6%,

iii) a higher figure of 8% or even more would seem most probable.

(7) Will the policy get off the ground?

Despite the early agreement between the TUC General Council (by a large majority of 25-5) and the Government to the new limit, it is possible that it may never actually come into force for one of two reasons.

1. It is conceivable, though very unlikely, that the TUC might reject it at their Special Congress on 16th June.

2. More likely, though still not probable, events before 16th June might so weaken confidence that the limit would have to be enforced at a less generous level.

The policy has already been rejected by the Civil and Public Servants Association (the largest Civil Service union), by ASTMS and by the agricultural workers union. Between now and 16th June, it may also be rejected by the Society of Civil Servants, the Trades Council Conference, the Boilermakers, the miners' executive, the Engineers and Local Government employees. Whilst this woul[illegible] not be sufficient to bring about rejection at the special Congress, [illegible] would raise doubts about the potential effectiveness of a policy so greatly dependent on bargainers' goodwill for success. In view of the current high press interest in union proceedings, the decisions of these gatherings are likely to obtain an exceptional degree of coverage. The experience following the Welsh and Scottish TUC's suggests that this could be reflected in the value of the pound. A point may be reached where only a commitment to a statutory wage freeze will restore confidence.

Against this must be set the widely held view that the pound is already undervalued.

(8) What pressures will be built up if the policy survives till Summer 1977?

It must be recalled that the essence of this policy is that the pay limit should decline from year to year, until Britain has a rate of inflation similar to its competitors abroad.

Whether the Government's counter inflation strategy will demand a further year of pay restraint and what limit would be implied, will depend upon the relative rate of inflation in the UK in Summer 1977. It is difficult to offer any authoritative

...../ predictions

predictions on this, not least because none have been made since the recent decline of sterling. The National Institute forecast implies that prices in the 24 member countries of the OECD will rise by around 6% in 1977. (Source: NIESRI 1976, page 51 paragraph 2). Their forecast at that time of price movement in the UK 1977 III on 1976 III was 5.6. This was based on the assumption of wage growth of 6%. It has already been noted that 6% lies at the optimistic end of the probable income growth under the new pay limit.

This suggests that our inflation rate in August 1977 will still be above that of our competitors, and that further reduction by means of the present counter inflation policy will imply an incomes increase limit of less than the new 5% in 1977-78.

But strains in incomes policy always become greater in successive stages.

In addition to the greater temptation to break the limit, 'special case' demands, reactions to depressed differentials, and the calls for more flexibility to allow companies to rationalise pay structures, which it has already been noted will jeopardise the current limit, there will be the particular probelm of consolidating the pay supplements. Eventually the money that is now paid as a supplement to earnings is likely to be moved to basic rates, and other payments dependent upon the movement of basic rates will increase accordingly. By next Summer, the average male manual worker will probably be getting more than £9 per week in the form of earnings supplements (possibly more where the Stage 3 index linked payments have not been fully consolidated). The table below indicates the full effect of consolidating all of this at that time.

Table 3

Average male manual worker: estimated effects of consolidation

		Estimated earnings unconsolidated	Estimated earnings Summer 1977 consolidated
		£	£
A	Basic rate	41.40	50.63
B	Overtime	10.79	13.19
C	Payments by results	4.70	5.75
D	Shift premium	1.70	2.07
E	£6 supplement	6.00	
	New 5% limit	3.23	
	TOTAL	67.82	71.64
	Increase		3.82 (5.6%)

Note 1. These figures are based on the New Earnings Survey statistics for average pay for male manual workers in all industries and services in April 1975. A growth in hours worked during 1976/77 of 4½% is included.

This shows that on the assumption that overtime, payments by results and shift premium were increased pro rata, full consolidation would lead to an increase of at least 5.6% in pre-tax pay. The final cost could be even larger since there will probably be a growth of overtime during 1977/78, and as other payments (e.g. private occupational pension schemes) are likely to move with the change in basic rates.

...../ All these

All these considerations suggest,

(i) a further year of restraint is implied at a lower rate than 5%,

(ii) pressure for a wages explosion will be extremely high, particularly in light of the consolidation problem.

(9) What is the price for the agreement?

The agreement marks the outcome of negotiations between the Government and TUC teams on the new pay limit. The Chancellor has indicated that "The recent discussions have not been confined to pay alone". He maintained that the price for TUC support was,

a) the continuation of price and profit control - modified to encourage investment and jobs,

b) the abandonment of the proposed 5p increase in school meal charges (cost: £35 million per annum),

c) more money to the Manpower Services Commission for training and job creation (cost: £15 million per annum)

The total additional expenditure involved was £50 million which would be charged to the contingency reserves and not added to already announced public expenditure totals.

It should be recalled, however, that the TUC/Labour Party Liaison Committee has been reported to be working on a new version of the Social Contract entitled "The next 3 years and the Problem of Priorities". This is reported as including:

(i) extension of public ownership into financial instituions, including both banking and insurance,

(ii) at least £1,000 million more funds for the National Enterprise Board,

(iii) 'progress towards' a pensions target of half of average earnings for a married couple, and one third for a single person,

(iv) new investment reserve fund consisting of 'blocked balances' from profits of large companies: firms with investment plans agreed with the unions and Government would get priority in withdrawals from the fund,

(v) planning agreements between the Government and the top 100 firms to be concluded by end 1977,

(vi) commitment to early legislation to introduce a Welath Tax during 1976/77 Parliamentary session,

(vii) programme to meet targets for redistributing wealth,

(viii) top salaries to be determined as a generally agreed ratio of the median wage,

(ix) changes in the banking system including the Bank of England,

(x) import penetration ceilings to be set for all major sectors.

The document is quoted as admitting that "Many of the goals which the Labour movement seeks are costly in terms of national economic resources". (Source: Daily Mail, 26th April, 1976).

...../ Certainly

Certainly, the first three imply directly increasing public expenditure, whilst (iv) to (ix) will do nothing for the investment confidence and the management initiative so essential to our recovery, and (x) invites costly reprisals just when we need to increase our exports.

It is unknown how far the TUC/Labour Party Liaison Committee agreed to this programme 9 days before the new pay deal was announced, but the Government must not be permitted to separate consideration of these points from the debate on the 5% policy and the budget. The document itself is reported as saying that these priorities 'provide an essential context in which an agreed policy on inflation can succeed'.

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ANNEX 2

HOW DOES THE NEW AGREEMENT AFFECT THE RELATIONS BETWEEN THE GOVERNMENT AND THE TUC?

In the £6 limit pay round, the Government accepted the TUC's suggestions for the figure and form of the limit. While threats were made about reserve powers and a restricted form of legal enforcement through the Price Code was adopted, in the end obedience to the pay limit was achieved through the TUC and the main union leaders who form its General Council. The same formula of the TUC deciding the limit which they think their members can accept and of using them as the enforcement agency has been adopted again.

Dependence on the unions to state the amount of the pay limit obviously runs the risk - whatever advice the Treasury may give - that a higher figure than can be afforded will be set. Further, the use of union negotiators to police the policy (backed up by the moral authority of their leaders) rather than a stricter Pay Code interpreted by an external semi-Governmental body means that the limit must be simple. This more than any other consideration explains why the limit is a straight percentage or lump sum rather than a percentage plus a lump sum, why it is paid as a supplement to earnings rather than as an addition to basic rates, and why it is assessed individually rather than pooled.

Union negotiators, their leadership and the TUC are clearly being made responsible for the success or failure of the policy. The threat in the event of their failure is less vague and indefinable this time than the mythical dragon of legal powers which would not impose penalties on work people that was trotted out last time. It is that the Chancellor will readjust income tax rates in his next budget (or sooner, presumably, if necessary). Yet, as has already been noted, the format made necessary by using union negotiators in this way is likely to lead at least to higher wage growth than 4½% within the policy and quite possibly to breaches. It may also be that even strict obedience would not be enough to counteract other economic forces which may be at play during the 12 months from August.

It is unknown how much union observance of the £6 limit was based upon the actions taken by the Labour Government in pursuit of the agreed Labour Party/TUC programme (Trade Union and Labour Relations Acts, Employment Protection Act, food subsidies, price control, pensions increases, expansion of training, repeal of the Housing Finance Act etc.) It is known, however, that the Government will be greatly constrained by economic circumstances from offering similar commitments over the next 12 months, although there may of course be tacit understandings about future programmes.

What is clear is that the TUC and responsible union leaders have placed themselves in a very exposed position where they stand liable to carry the blame for both the failures of their own negotiators and those of the Government. If the Government is forced to change tax rates or take other draconian measures in the coming year, the public may well blame the TUC. Nor will its problems cease at that point. A body comprised of organisations in which hard bargaining for the highest settlements is the real test of success is likely to find many

...../ amongst

amongst its ranks who will blame the leadership which abandoned that principle: the pro-incomes policy lobby may be in a clear majority now, but past experience has shown how rapidly that can change. Internal upheaval is a likely further consequence of failure. Finally, it must be likely that the outcome of this will be that the close ties at policy-making level so painstakingly reconstructed between the Labour Party and the TUC after the 1968-70 collapse will once again break.

The conclusion here is that the Social Contract of co-operation between Labour and the unions which has been their electoral trump card since February 1974 may be under great strain in the coming 12 months, despite the proximity of a General Election. The very closeness of the relationship which has been its main selling point may prove intolerable to union negotiators and the TUC. The likely outcome, it is suggested, could be a revulsion by the TUC, and possibly the public, against such an incestuous relationship being formed again.