A

CC SV

Prime Minister (1)

You asked for a few examples to be worked up.

I have discussed with Alan Walters. We share, reluctantly, the Chancellor's view that this idea would not work well in practice.

Agree to take it no further?

Yes

MCS 14/5

MS

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

PRIME MINISTER

PUBLIC SERVICE PAY AND CAPITAL INVESTMENT

At your meeting on 7 January I was asked to consider the practicability of earmarking part of the Contingency Reserve for capital spending late in the financial year, so as to allow the argument to be advanced in pay discussions that a moderate settlement would provide room in that financial year for additional capital expenditure. I was also asked to consider whether such an approach might also be extended to the local authority field.

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2. I sent you a preliminary report on 3 February; and you then asked me to draw up short-lists of areas where this approach might be relevant.

3. My officials have done this, in some cases in consultation with the other Departments concerned. They have identified five areas where the approach is, in principle, possible. They are central government; the National Health Service; universities; nationalised industries; and water authorities. On further consideration, local authorities were ruled out, since Government has no power to direct where local authorities should spend any additional funds made available, and we could not make such a scheme stick in these cases.

/4. Brief details

4. Brief details of the five cases examined are set out in the attached note. I am afraid the conclusion which I drew in each case - except conceivably some nationalised industries - is that the scheme would probably not be effective in practice. There are three main reasons:-

(a) The size of the "inducement" would be too small to be effective, or unattractive for other reasons;

(b) the linkage with the individual would be too indirect to affect his vote on a union ballot;

(c) the timing is all wrong. Pay settlements tend to be reached during a financial year. (The non-industrial civil service is an exception.) The scope for extra expenditure in the rest of the year is then rather limited, and the feasible items correspondingly less attractive to the unions. End-year pressure to spend money in a hurry also tends to be wasteful. Yet if new spending commitments are allowed to spread into future years, there can be no guarantee that they will be matched by continued pay restraint.

5. I am sending copies of this minute to the Ministers who attended your meeting on 7 January or who are directly involved in these proposals: the Secretaries of State for Education, Environment, Social Services, Industry, Energy, Transport, Employment, Agriculture, and the Chancellor of the Duchy. Copies also go to Sir Robert Armstrong and Mr Sparrow.

(G.H.)

10 May 1982

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PUBLIC SECTOR PAY AND CASH LIMITS

This note considers the scope for offering additional capital expenditure in exchange for pay restraint. It has been prepared by the Treasury after brief discussion with Departments. It concentrates on five areas where such deals seemed a priori feasible. It seeks to identify:

(a) The scale of the offer which might be made (in all cases, 1% of the relevant pay bill in 1982-83 has been taken, to illustrate the sort of deal; it is assumed that the whole of the amount saved on pay would be re-cycled into the programme).

(b) The additional capital expenditure which might be financed for that sum, and the effect on employment, morale, etc.

(c) the possible linkage with pay negotiations.

(d) Any other relevant special considerations.

1. Civil Service

A scheme would now apply to the 1983 (post-Megaw) pay round. The 1982 pay round is settled. From 1 April 1983 minor works will be for Departments to plan and provide, so any central initiative would require the agreement of Departmental Ministers to provide their share of the funds.

(a) Scale and nature of offer

1% of the pay bill in 1982-83 is approximately £42 million (for the non-industrial service). The money would be better linked with capital expenditure on accommodation than with additional jobs, which would conflict with the policy of contraction to 630,000 by April 1984.

(b) Capital Expenditure

PSA have just made an assessment (for other purposes: an exercise on civil service morale) of what could be done with £[illegible] million a year. A £42 million programme could (after a start-up lag) finance for example 32 new offices for 100 staff each to replace obsolescent black-spots plus minor works benefiting about 10,000 staff (repainting; carpets; new lighting; etc). Some of the expenditure would probably slip into the following year.

(c) Linkage

Such works would be locally-planned, and would reflect departmental priorities. Pay is centrally-bargained. The numbers of staff benefiting would be quite large, but in total only a small proportion of the civil service. The majority would not see any benefit. It is doubtful how much influence such an offer would have on central pay negotiations, or attitudes generally. Those concerned with these negotiations believe that the effect on unions would be negative or even counter-productive: the unions would argue that the employer should be prepared to pay for decent working conditions anyway.

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II. National Health Service

(a) Scale and nature of offer

The total NHS paybill is about £6 billion (75% of current expenditure,) so that 1% would yield £60 milion. For simplicity we have allocated the whole of this to the hospital service. In the NHS the most effective bargaining device would be to link capital expenditure to new jobs.

(b) Capital expenditure

The NHS capital budget (£650 million England) goes on building and equipping the hospitals. Most of the expenditures on replacing and upgrading the capital stocks: but about 30% is for equipment and vehicles. £60 million could be spent in 3 main ways:

(i) to bring forward the construction of major new hospital projects. A typical district general hospital costs some £20 million. The main problem with a proposal of this kind is the long lead time for planning capital projects of this size.

(ii) some of the money could be used to purchase medical equipment (eg kidney machines). It would not be easy to hypothecate capital resources in this way since the allocation of resources at the operational level is delegated to health authorities and operational units. Centrally-financed equipment tends to be that which has less obvious connection with jobs of services for the disabled such as wheelchairs and artificial limbs;

(iii) the resources could be devoted to minor works (eg to reduce the backlog of maintenance work). DHSS estimate that there is about £100 million worth of minor works of this kind which could be brought on stream at relatively short notice.

(c) Linkage

The problem is that NHS pay is centrally-bargained, while capital improvements are planned locally. In the present climate of pay bargaining the Health Service unions seem more concerned to maintain and improve pay levels than to protect jobs. Attempts to reduce pay in order to help finance facilities for patients would be condemned as moral blackmail.

(d) Special factors

Fresh capital expenditure would cause problems. Nearly 1000 beds in new hospitals in England are unopened for lack of revenue funds; this is likely to increase. Several authorities are revising their capital programmes. It would be odd to save on the paybill in order to build yet more capital facilities. (It might be possible to re-cycle the savings, instead, into opening up existing capital facilities: this would at least create new jobs, while leaving the revenue account unchanged overall.) Alternatively, new capital funds could be allocated to minor works to clear up black-spots. But this would benefit the patients rather than the staff.

III. Universities

(a) Scale and nature of offer

The paybill is about £1200 million (70% of gross expenditure). The capital programme is only £150 million. So 1% off pay would finance about an 80% increase in capital. But at a time of rundown in the university programme this seems irrelevant. There might be more chance of success with a scheme which used savings on pay to finance eg slower rundown or better redundancy terms.

(b) Capital expenditure

This could finance a very sizeable capital programme. But this does not seem appropriate at a time of contraction.

(c) Linkage

Capital expenditure is planned locally, and pay negotiated centrally. A different scheme (eg, as above, better redundancy terms) could be negotiated centrally.

(d) Special factors.

As above.

IV. Nationalised Industries

The negotiating circumstances vary widely between industries, reflecting bargaining power, manpower intensity, etc. This note therefore deals with four examples, illustrating different problems.

(1) The National Coal Board.

A 1% saving on pay would provide the NCB with an extra £25 million, equivalent to about 3% of the industry's capital programme. The industry has a large programme of projects for improving and extending old mines, and an extra £25 million could be of some significance here. For example, it would buy twelve new sets of winding gear, three new coal handling and preparation plants, two sets of self-advancing "chocks" and would be equivalent to half the cost of opening a new face. In certain circumstances, this sort of expenditure could make the difference between closure of a pit and continued working. The NCB are already involved in trade-offs between closure and investment and working practices etc. with their unions.

(2) Electricity Supply Industry.

A 1% pay saving here would be worth about £13 million - or around 1% of the industry's capital programme. This is certainly not significant, even less so in view of the long-term nature of much of the industry's investment programme (Heysham II nuclear power station will cost over £1.5 billion at present prices). Phasing of investment expenditure from year to year is not easily or sensibly related to short-term developments. Even so, two-thirds of all employees work for Area Boards, and their capital programmes are typically of the order of £30 million - only 20% of which is discretionary. In that context an extra £1 million of finance for investment could be significant provided suitable projects could be found (which is open to doubt). But a "windfall" of this kind would be of more interest to management than to union negotiators.

(3) Post Office

The Post Office is highly labour-intensive, and ought in theory to be one of the most promising candidates for a special incentive of this kind. 1% of the industry's paybill is worth £16 million, which is equivalent to almost 14% of the industry's planned fixed asset spending in 1982-83. The industry's existing capital expenditure is made up of roughly one-third construction, one-third plant and machinery and one-third vehicles (including leasing of vehicles). Additional funds might be spent on roughly that pattern. There might also be some scope for expenditure on counter mechanisation - on which the industry have not yet put forward any proposals. But:

(i) it would probably take the Post Office some time to raise its level of asset acquisition, and extra funds made available in 1982-83 could well lead to demands for extra funds in later years eg to complete the construction of projects;

(ii) the Post Office's record of investment is unimpressive at least in the area of plant and machinery. Their one major spending programme in this area - letter mechanisation - has been disastrous, and one of the questions we shall want to ask in the forthcoming discussions on the industry's medium-term plans is whether it should be continued and

(iii) we should want to take a very close look at any new investment projects.

A simple mechanistic link between moderate pay settlements and extra investment funds would thus be most inappropriate in the case of the Post Office.

(4) **British Rail**

1% of British Rail's paybill would be equivalent to £15 million, 5% of the industry's expenditure on fixed assets, and 8% of the industry's fixed asset spend financed by capital (ie excluding that part financed by revenue). This could buy 92 miles oftrack renewal, a modest signalling scheme, a small "infill" electrification scheme (eg Preston-Blackpool, Liverpool Edge Hill-Earlsdown) 750 freight wagons or 60 mark III passenger coaches. But neither the NUR or ASLEF, whose principal concerns are preservation of jobs and increased pay are likely to perceive schemes of this sort as worth paying for in terms of their members' earnings. Even the much larger and thus more generalised carrot of electrification has had little impact in either the pay of productivity context. It was not used in the 1982 pay round (which in any case broke down over the ASLEF resistance to flexible rostering).

More generally, there is the problem that any such scheme would tend to involve central government much more in individual pay negotiations. So far it has deliberately tried to avoid being drawn in.

V. Water Authorities

(a) **Scale and nature of offer**

The industry's paybill is about £0.5 billion, so 1% would yield £5 million. Capital investment related to job-creation seems the most attractive offer.

(b) **Capital expenditure**

This would buy only one sewage treatment plant, or five water treatment plants for towns of 100,000 people. Such plants are very capital-intensive and would create few new jobs.

(c) **Linkage**

For this reason the linkage is exceptionally indirect. Pay is centrally-negotiated and the 'savings' would have to be allocated arbitrarily to one or more authorities.

(d) **Special factors**

This industry is believed to be seriously overmanned. It is in a monopoly position and cannot price its workers out of a job. Because the service is essential the unions are in an exceptionally strong bargaining position.