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Prime Minister (4) cc JV B

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Prime Minister

27 May 1982

I have considered Geoffrey Howe's letter of 10 May about the scheme I originally proposed to link restraint in pay for additional capital investment.

I agree his conclusions in the context of the scheme he examined of trying to trade a specific additional investment in a given industry in return for restraint by workers in that industry. I do not believe that such a scheme is a starter because it is based on the inherently unsustainable concept that you can ask workers in an industry to forgo pay increases to enhance investment from which they may not benefit (with enhanced efficiency might actually lose jobs) but which benefit the community at large, many members of which were showing no equivalent restraint. My proposals would have no prospect of success on such a basis.

I wish to return however to my original concept which seems to me urgent and particularly against an electoral timetable attractive.

We are achieving - so far- most helpful pay settlements in this round. As we have pointed out they represent a real reduction in living standards. That has to be if we are to force inflation down. Within only a few months we have to start again. The next pay round also will be aimed at below inflation levels and must be if it is to continue our progress.

I want to show tangibly and visibly by government decision that there is a prize. I want to put very obvious arguments before our supporters that are more than just an act of faith in long term economic improvements. It seems to me that an offer to increase investment in the nation's roads, schools, hospitals, houses and other economic and social infrastructure in return for continuing pay restraint has everything to commend it.

You will remember that the equation rests on a specific capital boost for broad acceptance of pay restraint within the Chancellor's assumed pay factor. The sums of cash must be significant - at least £1bn - to have the necessary impact but the off-sets are equally dramatic. Today, a 1% pay increase is worth £400m in the public sector alone and because our offer would largely affect private sector demand I believe it would spill over and moderate pay settlements there as well. 1% on private sector settlements adds £900m to industrial and commercial costs.

Of course it is impossible to guarantee a perfect trade off between the stimulus and the lower pay claim. But it would be possible to phase the actual release of the actual cash throughout the year making it generally dependent on the progress of the pay round. And the more careful we are with the actual projects we select the more we can direct them to high unemployment areas particularly through the construction industry where a fair proportion of the extra cost could actually be financed by lower levels of unemployment pay.

I am copying this to all members of E Committee and to Sir Robert Armstrong.

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