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Prime Minister

To note

MS 27/11

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

PRIME MINISTER

## THE PAY SCENE

Now that we are a few months into the 1981/82 pay round it is timely to take stock. The outcome remains of cardinal importance to our economic strategy, since it will determine whether there is room for growth within the monetary framework.

Background

2. The underlying increase in earnings in 1980-81 was about 10½ per cent - some 11-12 per cent in the market sector (with little difference between public and private) and 8 per cent in the public services. Wage settlements averaged about 8½ per cent, with drift of about 2 per cent concentrated in the market sector. Individual settlements varied widely, but the overall picture was of settlements at around half the level of 1979-80. After a few high settlements, the big drop came fairly early in the round.

3. The present round is off to a slow start (like the last one). The police had 13.2 per cent in September, and 10 per cent has been agreed between the local authorities and the firemen. Both these settlements are indexed to past movements in earnings. The overall level in the private sector so far is just under 8½ per cent, including agricultural workers at about 10 per cent and BL at about 4½ per cent. Vauxhall are moving towards a 5 per cent settlement; at Fords a 4½ per cent offer has been rejected and is likely to be increased.

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4. Further developments in the public sector mostly await the coal industry outcome. The miners have rejected 7.3 per cent on earnings (presented as something like 9 per cent on rates). There is a further meeting today but no movement is likely before next week's NUM election. The water industry manuals have rejected 7.8 per cent on earnings, and will probably seek to match the miners' outcome. The other key early settlement in the public sector is the local authority manuals; but no offer is likely until the employers get some indication of the probable shape of the RSG settlement. The unions also are in no hurry, partly because they want to see how the round goes generally and partly because they still have in mind the possibility of co-ordinated action with other public service groups in the New Year.

5. In the private sector, the main engineering unions (1,750,000 workers) could well settle at 5.1 per cent on minimum basic rates, but we may not be sure for another fortnight. The BL episode has helped, both in the motor industry and more widely, to underscore the link between low pay settlements and job prospects, though the tanker drivers might still strike for 11 per cent.

6. Retail price increases seem steady around 11-12 per cent; last year they were falling, which helped.

7. Several issues in other contexts bear on pay:

(a) The Rate Support Grant settlement will both govern what local government employers can afford, and affect rates and thus the RPI.

(b) Public expenditure decisions, and especially:  
| (i) the question of extra provision for NHS pay; and  
| (ii) EFLs for nationalised industries.

(c) The Industry Act price forecast, due out in a week or so.





(d) Our decision on NIC, which must be announced by about the end of next week.

8. The Industry Act forecast and the NIC decisions both bear on expectations for real take-home pay, and presentation will be important. Telling nationalised industry boards their EFLs will provide another occasion for stressing our concern with the major public sector settlements; I hope sponsor Ministers will emphasise this strongly and watch developments very closely.

9. We must continue to seize every opportunity to put over the key message on the link between low pay settlements and job prospects, stressing also competitiveness and the need to leave room for investment. Generally, the CBI seek to put over the same general message as ourselves; we must encourage them to go on, and I shall do so when I see Sir Raymond Pennock later this week.

10. In sum BL was a good though in some respects atypical start; but the character of the round remains in the balance. We can as yet do little directly to influence settlements. There may be no major developments in the public sector until the miners have settled, and overt attempts at influence there would be counter-productive. But we can and must do three things:

(a) We must use all the influence we can in other public-sector cases.

(b) We must take careful account of pay-round implications in our own decisions, eg on expenditure.

(c) We must all stress publicly and repeatedly the direct and crucial link between pay and jobs.

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11. I am sending copies of the minute to our Cabinet colleagues,  
and to Sir Robert Armstrong.

(G.H.)

26 November 1981

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4. MR. VE. RSTLER

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10 DOWNING STREET

*From the Private Secretary*

30 November, 1981.

The Pay Scene

The Prime Minister was grateful for the Chancellor's minute of 26 November on the current position on the pay scene whose contents she has carefully noted.

I am sending copies of this letter to the Private Secretaries to the other members of the Cabinet, and to David Wright (Cabinet Office).

M. C. SCHOLAR

John Kerr, Esq.,  
HM Treasury.

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c. Mr. Hoskyns  
Mr. Ingham

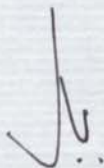
PRIME MINISTER

THE PAY SCENE

The Chancellor's minute of 26 November requires no more than a Private Secretary acknowledgment, since - as he points out - the time has not yet come when there is much the Government can do to influence individual settlements. I saw the minute at an earlier stage, when it was drafted as a paper for E, and suggested then that the current pay issues did not merit collective ministerial discussion.

In two respects the Chancellor's minute is already overtaken by events: Ford have now increased their offer to 7.4%, which has also been rejected; and of course the meeting between the NCB and the NUM on 25 November made no progress, save for an agreement to meet again on 8 December, after the presidential ballot.

The Chancellor's main recommendation is to make sure the case for pay moderation is put across, particularly in the context of next week's announcements on public expenditure and related matters. Unfortunately, although the Chancellor has also suggested that we take careful account of the pay round implications in those decisions, the announcements will be almost entirely unhelpful. I believe Bernard Ingham has already mentioned to you that the Lord President has agreed to circulate guidance for ministerial colleagues on the day the announcement is made; and Bernard has asked me to let you see the present draft of this, which I attach.



27 November 1981

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GUIDANCE FOR MINISTERS

The Effect of the /2 December/ Announcements on Pay Bargaining

Background

The Chancellor's statement on public expenditure and the associated announcements of the Industry Act Forecast, the Government Actuary's Report, and the Government's decisions on the RSG make it even more apparent than it has been hitherto that if those in work settle for pay increases in low single figures they will suffer a significant fall in living standards. It is possible that the announcements may lead to a rise in the temperature of the pay bargaining climate; and it is therefore particularly important that colleagues take every opportunity to explain why the measures the Government is now taking are right; and why continued pay restraint is necessary, even if it means falling living standards in the short term.

The Announcements

The bad news for pay bargainers is:

- (i) Take home pay will be lower because of the rise in National Insurance Contributions. And the Chancellor has made it clear that the level of public spending he has announced may mean higher taxes in the Budget if interest rates are not to rise further.
- (ii) The cost of living (November 81 - November 82 RPI) is now officially forecast to rise by 10 per cent this pay round. This covers the cost increases implied by other announcements (such as higher rents and rates) but of course the sudden rise in those items will have a greater effect on pay expectations than the steady rise in prices throughout the year.

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- (iii) Average Earnings are now officially forecast to rise by 7½ per cent in the course of the pay round. Employees in the public services will regard the difference between that and their 4 per cent cash limit as an indication of the extent to which they are being asked to settle for less than the going rate because of their greater job security.

The good news for pay bargainers is:

- (i) The worst off are protected from the sharpest rises in costs - many of those paying rents, rates and health service charges receive special assistance in the form of rebates or exemptions.
- (ii) Tight control of public spending means that taxes and/or interest rates are lower than they otherwise would be.

## Points to make

1. The long term nature of any successful effort to get the economy competitive again. The Government has always said it would take years, not months. That is why it published a medium term strategy, covering the life time of this Parliament. We mustn't give up now just because things are looking difficult. The difficulties reflect the extent to which we allowed ourselves to fall behind our competitors in the 1960s and 1970s.
2. The Titanic struggle that any administration faces to keep public spending under control. All recent British Governments have faced regular public expenditure "crises". The fact is that public spending rises of its own accord unless it is strictly controlled. Controlling it in a recession is particularly difficult and some rise is inevitable. The Government has done well to keep it to a level which is consistent with the continuing fall in public borrowing set out in its medium term strategy.

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3. We always said those in work would have to have a cut in their living standards. That is a necessary condition of becoming competitive again. It is widely recognised that there was a substantial moderation in pay settlements in the last pay round: but the rise in average earnings still almost kept pace with the rise in the cost of living. Getting competitive again does mean that sooner or later real pay has to be cut: the time for that is now.

4. So the 23 million who are employed will have to make some sacrifice to help the 3 million who are not. The unemployed have to be supported; and they also have to be given the hope of new jobs, which can only come if the employed help create a thriving economy. If wage earners won't accept the sacrifice in their pay packets, sooner or later the sacrifice will be made for them - in more job losses, or in higher taxation, or in higher interest rates.

5. It's working: don't let's throw it all away now. Over the five years to 1980, our labour costs (per unit of manufacturing output) nearly doubled. They rose by only one half in Canada, one third in the US, one sixth in Germany and not at all in Japan. But now for the first time for many years our unit labour costs are rising more slowly than those of our competitors. There's a long way still to go, but we're going to get there.

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c. Mr. Scholar ✓  
Mr. Hoskyns  
Mrs. Gilmore ) HMT  
Mr. Dixon )

MR. INGHAM

EFFECT OF THE FORTHCOMING ANNOUNCEMENTS ON  
PAY BARGAINING

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You asked me after your meeting yesterday to have a look at the likely effect of next week's announcements on the behaviour of typical pay bargainers, on various assumptions about the decisions Ministers have to take over the next few days. And I undertook to think how best to present the whole package from the point of view of minimising the adverse effect on pay determination.

I did attempt some quantification, but rapidly concluded that I had neither the information nor the resources to do it properly. It is, however, clear what the main effects will be, and that they will be unhelpful. I am not sure that we gain anything very much by going further than breaking the effects down as between reductions in take-home pay and increases in the cost of living.

So I have attempted in the attached draft some guidance for Ministers indicating where the dangers lie, and suggesting how the announcements might be put across in a way which may lead pay bargainers to believe that what is proposed is reasonable, and necessary for longer term recovery. If you think it worthwhile, we could take the opportunity of our meeting with the Lord President at midday today to ask him whether he would consider circulating something along these lines to his colleagues on the day of the announcement (assuming always that they all come out at once). Against that possibility, therefore, I am sending a copy of this note and enclosure to Rosalind Gilmore and Peter Dixon in the Treasury for their comments. Ideally, this guidance ought

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also to contain a paragraph about the relationship between the Government's monetary targets and the recovery, the issue extensively exposed in the various exchanges of minutes between me and Alan Walters. But it is only fair to await Alan Walters' own recovery before going firm on that.

J. M. M. VEREKER

25 November 1981

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GUIDANCE FOR MINISTERS

The Effect of the /2 December / Announcements on Pay Bargaining

Background

The Chancellor's statement on public expenditure and the associated announcements of the Industry Act Forecast, the Government Actuary's Report, /RSG decisions and Nationalised Industry EFLs / make it even more apparent than it has been hitherto that if those in work settle for pay increases in low single figures they will suffer a significant fall in living standards. It is possible that the announcements may lead to a significant rise in the temperature of the pay bargaining climate; and it is therefore particularly important that colleagues take every opportunity to explain why the measures the Government is now taking are right; and why continued pay restraint is necessary, even if it means falling living standards.

The Announcements

The bad news for pay bargainers is:

- (i) Take home pay will be lower because of the rise in National Insurance Contributions - £ a week for the average wage earner. Family income will be reduced where a member is unemployed, because of the cut in unemployment benefit - £ a week below the level implied by full linking to the rate of inflation. And the Chancellor has made it clear that the level of public spending he has announced /may/will/ mean higher taxes in the Budget if interest rates are not to rise further.
- (ii) The cost of living (November 81-November 82 RPI) is now officially forecast to rise by 10 per cent this pay round. This covers the cost increases implied by other announcements, i.e. higher rents and rates, prescription and dental charges, and students fees, but of course the sudden rise in those items will have a greater effect on pay expectations than the steady rise in other items throughout the year.

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- (iii) Average Earnings are now officially forecast to rise by 7½ per cent in the course of the pay round. Employees in the public services will regard the difference between that and their 4 per cent cash limit as an indication of the extent to which they are being asked to settle for less than the going rate because of their greater job security.

The good news for pay bargainers is:

- (i) The worst off are protected from the sharpest rises in costs - [40 per cent] of those paying rents, rates and health service charges receive special assistance in the form of rebates or exemptions.
- (ii) Tight control of public spending means that taxes and/or interest rates are lower than they otherwise would be.

Points to make

1. The long term nature of any successful effort to get the economy competitive again. The Government has always said it would take years, not months. That is why it published a medium term strategy, covering the life time of this Parliament. We mustn't give up now just because things are looking difficult. The difficulties reflect the extent to which we allowed ourselves to fall behind our competitors in the 1960s and 1970s.
2. The Titanic struggle that any administration faces to keep public spending under control. All recent British Governments have faced regular public expenditure "crises". The fact is that public spending rises of its own accord unless it is strictly controlled. Controlling it in a recession is particularly difficult and some rise is inevitable. The Government has done well to keep it to a level which is consistent with the continuing fall in public borrowing set out in its medium term strategy. NO

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3. We always said those in work would have to have a cut in their living standards. It is widely recognised that there was a substantial moderation in pay settlements in the last pay round: but the rise in average earnings still almost kept pace with the rise in the cost of living. Getting competitive again means a temporary set-back in living standards: the time for that is now.

4. So the 23 million who are employed will have to make some sacrifice to help the 3 million who are not. The unemployed have to be supported; and they also have to be given the hope of new jobs, which can only come if the employed help create a thriving economy. If wage earners won't accept the sacrifice in their pay packets, sooner or later the sacrifice will be made for them - in more job losses, or in higher taxation, or in higher interest rates.

5. It's working: don't let's throw it all away now.

Over the five years to 1980, our labour costs (per unit of manufacturing output) nearly doubled. They rose by only one half in Canada, one third in the US, one sixth in Germany and not at all in Japan. But now for the first time for many years our unit labour costs are rising more slowly than those of our competitors. There's a long way still to go, but we're going to get there.

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