PA

MR MOUNT

cc Mr Walters
Mr Scholar
Mr Ingham

PAY

You asked me for some parting thoughts about pay.

This Government differs from its predecessors in the way it defines what people should be paid. We do not try to equate pay with what is necessary to achieve a particular standard of living, or with what others in comparable occupations are getting. We believe that the price of labour, like theprice of anything else, should be left to find its own level in a free market. So, where others have constructed incomes policies, we have been concentrating on the operation of the labour market. This little preliminary explanation is vital because all else follows from it, including the immediate outlook.

This policy has worked reasonably well for three years, at least by comparison with the policies that have been tried during any three year period over the last twenty years or so. In aggregate, pay rises have fallen sharply, as has inflation:

| | PAY ROUND (August-August) | | | |
|---|---|---|---|---|
| | 1979-80 | 1980-81 | 1981-82 | 1982-83 (Forecast) |
| Overall average settlements | 17% | 8.5% | 7% | 6% |
| of which: | | | | |
| Private Sector, Manufacturing | 17% | 9% | 6% | 5.5% |
| Private Sector, Non-Manufacturing | 19.5% | 9% | 7.5% | 6% |
| Public Trading Sector | 18% | 9.5% | 7.5% | 6.5% |
| Public Services | 15% | 8% | 6.5% | 5% |
| Mid point (April) RPI | 18.2% | 13.9% | 10.2% | 4.0%* |

[Source: Monthly Pay Briefs]

(* but likely to come back to around 6% in July)

The onus is on those who argue for a different policy to show what is wrong with the present approach before launching an incomes policy that effectively inhibits the operation of the labour market. The most commonly heard criticisms are these:

(1) Inadequacy. It can certainly be argued that the fall in pay rises has not been sharp enough, especially in the current pay round when pay is for the first time in this Parliament likely to exceed the mid-year RPI (just). With a controlled money supply (which is achieving its targets) there is no longer a relationship between pay and inflation - but there certainly is one between pay and unemployment. Ceteris paribus fewer and fewer people will be employed at higher and higher real wages. Since unemployment is so high, real wages must be too high, although at the lower end of the labour market, lower real wages need to be matched by lower rewards for not working. It can therefore be argued that the labour market is not working well enough for this approach to work without very high unemployment.

That is true. Union monopoly, symbolised by the closed shop, still dominates the supply of labour in many industries. And the demand for labour is artifically restricted, especially in the small business and informal sectors, by the hidden costs of employing people. But the remedy lies in tackling these problems, not in throwing out the whole policy. And in tackling them we should not be overly influenced by the views of existing employers, who may well have an interest in the continuation of the present system.

A prior condition for more radical reform of the labour market is widespread understanding that labour mobility, closed shop reform, lay off and dismissal powers, lower real social security benefits, and fewer health/safety/redundancy obligations for small employers are all part of tackling unemployment. We have spent most of this Parliament persuading people that high pay settlements mean high unemployment, and to some extent we have succeeded; now we need to devote the next to persuading people that labour monopolies mean the same thing.

(2) Bias. The present policy generates two kinds of bias. One matters and the other doesn't.

It matters that the most heavily unionised sectors are winning the biggest pay rises - not everywhere, viz steel, but generally.

This effect, when compounded with the way regional policy has directed resources to the declining industries, produces large disparities of unemployment across the country, of which Northern Ireland, with the highest level of real wages and the highest unemployment , is the most glaring example. Nobody can alter the fact that our domestic car market is not large enough to support three volume car manufacturers; but the ones who survive will be the ones who make most progress against the union monopoly.

It doesn't matter that the most profitable industries are awarding exceptionally high pay rises (although Ministers find it hard to swallow). Banks and insurance companies ran away with it in 1980/81 and 1981/82, but will find it harder to do so now; at present 25% of private sector pay settlements (by number of employees) are running at over 7%, but if anything we should be delighted. We want employment to be attracted to profitable sectors, not the struggling. The table below shows the distribution of private sector settlements so far this round:

| | Under 3% | 3%-4.9% | 5%-6.9% | 7%-8.9% | Over 9% |
|---|---|---|---|---|---|
| Manufacturing | 4% | 9% | 63% | 20% | 4% |
| Non-manufacturing | 0% | 0% | 85% | 11% | 4% |

[Source: D/Employment; Sample: 25%]

The only bias apparent is towards a "going rate" of 5-7%, which is also the likely range of the RPI throughout the period.

(3) Brevity. It won't last: that is a common criticism, particularly in the written media. The argument goes that pay rises have fallen only because inflation has fallen and unemployment is high, and that when the upturn comes pay will break loose again. A variant on this argument is that the policy is so biassed towards labour monopoly in the public utilities that a better way must be found. Even sympathetic commentators, such as Walter Eltis, have asserted this (usually after a public sector strike, or before a threatened one).

But it is hard to see why this should be so. Inflation may move up and down but under a successful monetary regime it is not going to go back into double figures. If falling inflation has been an influence on falling pay rises, roughly stable inflation might have a roughly stabilising effect on pay rises. Increased economic activity may well generate shortages of labour in some areas, but unemployment is so high in virtually all skill sectors that the effect on wages must be small. And on any reasonable projection unemployment is going to remain high.

As for the monopoly industries, the first point to make is that there are now very few of them, and within them, rather few sectors which matter and where alternative supply or labour cannot be found. They are indeed an awkward embarrassment, but they certainly do not constitute a reason for returning to comparability, norms and all the rest of it. The end of the water strike has even showed, as well as a number of useful lessons about our lack of dependence on water workers, that exceptional settlements in the public monopolies are not necessarily infectious - electricity workers subsequently settled for less, and local authority workers for much less. But it remains true that some monopoly industries are in a very strong position indeed and need to be discouraged from striking (I have suggested ways of doing that in a separate note).

<u>The Enemies of Promise</u>

The real threats to our approach to pay come not from overt criticism, but from subversion from within and from the insidious arguments of those who actually have to manage a pay negotiation. The one dominant impression left after three years of public sector pay is the extent to which public service employers will go to avoid actual pay bargaining. So in a Government committed to the free play of market forces we have seen Review Bodies vigorously defended and even new ones proposed; the crudest and most inflationary indexation arrangements set in concrete; uniformed services taken right out of bargaining; a new comparability based system offered to the Civil Service and proposed for the health service; and binding arbitration arrangements retained, with the honourable exception of that for the teachers. Such arrangements are the true enemies of promise, for they come between the Government's policy and its execution.

In the next Parliament bringing down unemployment will be a high priority. That can only be done if real wages fall. Within continued monetary restraints, inflation will be in low single figures. Nominal pay rises will have to be very low indeed. They will be, if the labour market is allowed to operate more freely. The Government will have to operate vigorously on two fronts - first, a more radical attack on union monopoly power; and second, a stauncher resistance to formalised pay arrangements designed to remove the scope for pay bargaining, and thus the scope for setting pay at market levels.

JOHN VEREKER

8 March 1983

MR VEREKER

Econ Pol

cc Mr Mount
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PAY

Your parting thoughts about pay are very interesting and have sparked me to make the following contribution.

Your initial point about the relative success of this Government's market approach should not blind us to reality. This Government has been remarkably - some would say astonishingly - successful in moderating pay settlements even though market forces have been very weak in a number of areas. That success does not stem solely from its approach and supporting policies. It arises, too, from the high international level of unemployment; from moderating inflation (for other than domestic reasons); and from the demoralisation of the trade union movement.

Moreover, that demoralisation - and the bankruptcy of the trade union movement's leadership - is complemented by the divisions within and bankruptcy of its political wing, the Labour Party. The trade unions have not recovered from the realisation that their excesses put their Government out of office.

In other words the whole atmosphere and environment is against the application of trade union power. Thus I do not believe we can look at the current pay scene merely in economic terms. The situation is much more complex than that.

It follows that keeping the lid on pay bargaining is not simply a question of continuing to allow market forces to operate within a supportive framework of monetary, fiscal and social policies.

And I think we shall fail to keep the lid on when the economy starts to take off unless:

- we recognise that the labour market is going to be defective for a long time to come; we are, for example, unlikely to get rid of the closed-shop in the foreseeable future though we must do everything we can to free up the market;

- we stop kidding ourselves that this Government's peculiar form of incomes policy has left no pent up demand;

- we accept that the trade union movement's objectives are more political than institutional - more associated with the advancement of their power than with the advancement of their members' condition; in other words, that they can be relied upon to act irrationally in terms of their members' interests;

- we determine to press ahead rapidly with the democratisation of the unions and to require procedures, ballots, etc (which were the subject of a separate minute); and, last but not least,

- we pay a considerable amount of attention to supporting strong, fair and inventive management and to the economic education of individual workers; in other words by-passing unions and addressing their members over their heads.

I would add one other thing: having had the guts to stand out for greater reason during distressingly high levels of unemployment, we must resist the temptation to go soft when we feel we can afford a bit more elbow room.

Forgive me if I see the pay situation much more strongly a political than what might be described as classically economic terms. But the Government's resolute determination to maintain its policies and distance from the trade union movement and to act on labour monopoly in the early months of a new Parliament is crucial, otherwise, possibly all the gain of the last few years will be lost.

B. INGHAM

16 March 1983