

MR SCHOLAR

13 June 1983

For your next

cc Mr Mount
 Sir Alan Walters
 Mr Ingham

Yes - it had better be a long meeting regular meeting with the Chancellor?
 mb
 Mrs 24/6

THE NEXT PAY ROUND

The Prime Minister will wish to establish with the Chancellor the line which the Government should pursue in the next pay round. Agreement is needed at the earliest opportunity, certainly before therecess, in time to influence expectations in the run-up to the negotiating season. Pay expectations are already drifting upwards, threatening the Government's considerable achievements on the pay front: my note of 13 May sets out the background. If settlements increase in the first round after an election, who knows where they would end up by 1988?

Three aspects should be discussed with the Chancellor: tactics; pay targets; and presentation. As regards tactics, the Chancellor is due to present a paper to E Committee on 29 June. His officials may dissuade him (for fear it may provoke a premature, general discussion on economic policy) but we feel that he should present the paper, and that it should be a tough one, to marshal colleagues' efforts in support for the policy. There has been too much backsliding in the past: and there will be an understandable instinct to relax now.

A target figure will be needed. In order to secure public sector settlements of below 4% in the next round - a minimum achievement? - the Government should aim for settlements of 2 - 2½%. This is a realistic objective and the circumstances are favourable. Inflation is expected to continue to fall; the Government's policy has been resoundingly endorsed by an increased majority; and the Government's negotiators will not be encumbered yet awhile with Megaw-type arrangements.

Presentation requires an early reference in a key note speech (possibly by the Chancellor, in July) in order to condition negotiators'

thinking. The line to take is clear:

- large settlements are a matter of history;
- those in work have done well: falling inflation has allowed real increases in earnings, even with declining settlements;
- those in work have an obligation to the unemployed:
low settlements create the means - a recovery in profitability and in competitiveness - to create new jobs.


NICHOLAS OWEN

MR OWEN

cc Mr Scholar ✓

THE NEXT PAY ROUND

Thank you for a sight of the draft paper on the above and your comments.

As the paper is largely concerned with presentation, it may be helpful if I make some comments which I hope you will feed in.

My first point is that, for me, the draft paper lacks cutting edge, and strength of purpose.

The Government's objective is to get pay settlements down still further - and productivity simultaneously up to improve competitiveness, produce more profit and create more jobs. In these circumstances the paper should address itself in a more vigorous way to the achievement of this rather than to the problems involved.

To examine the issue logically:

The Government has made remarkable progress in reducing the level of pay settlements and improving competitiveness without, however, lowering living standards. The truth is that those in work have done well out of this Government. Thus the Government has nothing to apologise for to them. Indeed, it has demonstrated that living standards can rise even with what until recently would have been described as derisory pay settlements when, partly as a result of falling settlements, inflation is brought down dramatically, too.

So the platform on which the Government can legitimately build is:

- those in work have done very nicely because the country has taken the sting out of inflation;
- it is in their continuing interests to achieve low pay settlements;
- but it is also their obligation to the unemployed to continue to reach low pay settlements and to raise productivity in order to create the means, and competitiveness, to create new jobs;

- there can be no letting up on wage settlements if the drive to hold down inflation and create new jobs is to be maintained.

But we have to do one more thing: specifically to destroy hopes, or expectations, of a return to big pay settlements.

The Government has got to state at the earliest possible opportunity that there can never be a return to big wage settlements regardless of the consequences; moderation in pay is in everyone's interest, and not the least that of the unemployed whose plight featured so strongly in the election.

This is the necessary - and the urgent - task of any incoming Government because of the inflationary tendencies in our society viz:

- the national tendency to revert to former less exacting habits;
- the national desire for people to claim a higher reward when things seem to be easing a bit;
- the institutional factors of a helpless (and hopeless) trade union movement; and the generality of companies who are largely incompetent in negotiation in protecting their trading interest; and
- the worrying tendency in the Civil Service, for example, to produce new and possibly flabby comparability formulae, regardless of the market.

It would be unrealistic to expect a Labour Government to grasp the nettle. It would be swamped by trade unions claiming reward. Nor could an Alliance Government, or coalition, expect to cope. The trade unions would simply put it to the sword test.

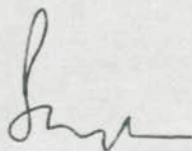
Only if this Government is re-elected will we have a Government which can be expected to do what is required - which is what I have outlined above - because only such a Government would have the required authority. This political analysis has got nothing to do with my personal views; it is harsh reality.

Thus contingency papers on the next pay round need to cater for different electoral outcomes.

However, on the assumption that the present Government is re-elected, the paper needs to:

- be sharp, tough and clear on what is required - and much less discursive and hand-wringing;
- emphasise, particularly, the need for swift Government action on pay [I shall be doing a separate paper for the Prime Minister on information/PR action required on her return and this will cover pay policy];
- offer no excuse for limpness or a tendency to relaxation; (don't overlook the tendency for returning Governments to try to have it easier or, when re-elected in June, to rush off on holiday without doing all that is required of them).

I hope this is helpful. You may care to discuss.



B. INGHAM

23 May 1983

Prime Minister

PRIME MINISTER

13 May 1983

Thoughtful

cc Mr Mount
Mr Walters
Mr Ingham

ms

piece - worth
getting out again
after June 9th.THIS PAY ROUND, AND THE NEXT

MUS 1375

Now that this pay round is virtually concluded it is a good time to take stock and prepare for the next.

The table below shows that the progress towards lower settlements has been steady, and general. The expected average for 1982/83 is 5½%: the public services sector settlements will average ½% below this, the public trading sector settlements ½% above. The water industry's settlement of 7.8% on an annual basis did not upset the trend; electricity and gas manuals subsequently settled at 5.7% and 5.2% respectively; other public services (teachers, non-industrial civil servants) at less than 5%.

AVERAGE SETTLEMENTS

	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>	percent <u>1982-83</u> (Expected outcome)
Whole economy average settlements	17	8½	7	5½
Public sector	15½	8½	6½	5½
- public trading sector	18½	9½	7	6
- public services sector	14½	8	6½	5
Private sector	18	9	7	5½
- manufacturing	16½	8½	6½	5½
- non-manufacturing	19	9	7½	6

Source: Department of Employment

I detect signs within Whitehall and outside that the drive to sustain this progress might now relax. It would be a natural response but must be avoided, otherwise the benefits of the recovery will be pre-empted by those in work, and denied to those who are not. Public sector expenditure will be even more difficult to reign back as a percentage of GDP. More specifically, I sense that:

(i) Forecasters may repeat the mistake of previous rounds of over-estimating inflation. The expected blip to 6% later this year may influence settlements even though there must be reasonable grounds for predicting that inflation could fall and remain at traditional German levels (4% or less). As inflation reaches the lowest level for decades there is, understandably, disbelief that it can go even lower;

(ii) As unemployment flattens out, and profitability improves, union negotiators may seek to make good the "sacrifices" which they think they have made in previous rounds;

(iii) "Creeping comparability" could hook up public sector pay to these higher private sector settlements.

In handling the next pay round I think that the Government needs to concentrate on four points:

(i) Those in work have not, on average, made "sacrifices". In reality, their pre-tax real earnings grew in the three previous rounds by 5½%, 0% and 1%. In the current round they are expected to rise by 2%. No signs of sacrifices there;

(ii) Take a firm line with employers and the CBI. Private sector employers were the Foolish Virgins in 1979/80. They offered 19% increases in the expectation that inflation and a depreciating pound would cover them. They are paying real increases of 2% this year - a year when the budget has provided their employees with benefits equivalent to an increase of another 1½%. Recruitment is no problem for

most types of labour. Industry still needs to double its real rate of return to achieve the 1960s average level consistent with sustainable growth. Why, then were employers so generous? They should not ask for Government help to reduce their costs and simply pass the benefits straight through when there is no economic need to do so. Indeed, their priority must be to recover competitiveness and real profitability;

(iii) Squeeze the public sector industries' EFLs on the assumption of low pay factors;

(iv) Be in no hurry to accept the creeping comparability in the public sector, institutionalised by Megaw-type arrangements. The more the Government accepts "comparability" the more it weakens its strongest argument, namely, that so long as it is reducing Civil Service numbers it will not need to match outside settlements. This point will become more important when the private sector begins to recruit additional staff.

NICHOLAS OWEN

