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From pd  
NBPM  
12/16/2  
✓  
cc. J.V.

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16th February 1982

Dear John,

Michael Scholar wrote to the Treasury on 21st January to say that the Prime Minister had suggested that letters be sent to Pay Review Bodies stressing that powerful economic evidence was being put to them.

I attach a copy of the evidence which it is proposed should be put to the Armed Forces Pay Review Body by the Ministry of Defence. This has been drafted in consultation with Treasury officials but the Chancellor may wish to see it before it goes. Subject to his views we would propose to put it to the AFPRB as quickly as possible. Mr Nott's preference would be for the evidence to be forwarded under cover of a suitably robust official letter, which would refer to Ministerial endorsement of the line taken. A separate letter to the Chairman to warn of its arrival will not therefore be necessary.

I am copying this letter and the attachments to Michael Scholar and to the recipients of his letter.

Yours sincerely  
Nick Evans

(N H R EVANS)

## 1982 PAY REVIEW : GENERAL BACKGROUND

In its tenth report, the Armed Forces Pay Review Body acknowledged that in framing its recommendations for 1981/82 it had taken into account the recession in the economy which had affected both earnings and security of employment in many areas. The Government welcomes this approach and, in this part of the evidence for the 1982 review, wishes to stress the continuing importance of achieving realistic pay settlements in the public sector. It particularly asks the Armed Forces Review Body to give full weight to the level of economic activity; to the present satisfactory state of recruitment and retention; and to the relatively good job security which members of the Armed Forces continue to enjoy.

2. The financial instability caused by persistent and rapid inflation undermines the prospects for sustained economic growth. The Government's aim is to bring down the rate of inflation, and its monetary and fiscal policies have consistently been directed to this end. Considerable progress has already been achieved; and inflation is now around half the peak level of nearly 22 per cent reached in May 1980.

3. Monetary and fiscal policies create the overall context within which total income within the economy is determined. Excessive increases in pay reduce the scope for growth in output and employment. The international context is also important. The UK exports around 30 per cent of its total production against fierce overseas competition. And our home market is also vulnerable to imports. Our international competitiveness is therefore a key determinant of the level of employment and of the prospects for improved living standards.

4. Our past performance illustrates the damage which excessive pay settlements can cause. Over the five years to 1980 labour costs per unit of manufacturing output nearly doubled in the UK. In contrast, they rose by one-half in Canada, by one-third in the United States, by

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sixth in Germany and not at all in Japan. Almost all of the deterioration in UK competitiveness since the Government came to power can be put down to the higher rate of increase of UK labour costs compared to those of our competitors.

The Government has constantly emphasised the need for pay settlements to be kept as low as possible in order to improve the prospects for employment: realistic pay awards are an essential pre-condition for any lasting reduction in unemployment. Some progress has already been made. Since the beginning of this year lower pay settlements, together with increased productivity, have meant that unit wage costs in manufacturing have shown little increase. But this is only a beginning. Pay settlements which bear a proper relationship to productivity need to become a feature of our economy, as they are in the strongest economies.

6. Some employees are not directly subject to the rigours of international competition. But no group can or should be immune from the need for realistic pay settlements compatible with what the country as a whole can afford and, in the case of public service employees, what the government and taxpayer can afford. Pay in the public services has a major influence on the health of the economy. It accounts for about 30 per cent of public expenditure. Excessive increases in this pay bill are bound to lead to increased taxation or borrowing (and, therefore, higher interest rates) with a damaging effect on private sector investment and costs, and on the prospects for economic recovery and employment. Excessive increases for particular groups of staff also have wider effects through repercussions on other groups and lead to self-defeating 'leap-frogging'.

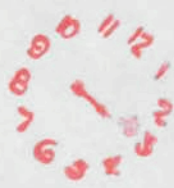
7. Evidence on the manning position in the Armed Forces is being provided separately. The Review Body will note from this the improvement in recruitment and retention since last year. There are now few areas

in which manpower difficulties are being experienced. The Government believes that this should be an important factor in influencing levels of pay, particularly for those ranks to which recruiting takes place. Another important point is that the degree of security of employment in the Armed Forces is significantly higher than for most private sector groups. There will in due course be some redundancy in the Armed Forces as manpower levels are adjusted to meet the plans outlined in the Defence White Paper of June 1981 (Cmd 8288) but it is likely that most of this will be on a voluntary basis and no one will be obliged to leave before April 1983. The Government considers that relative job security is of crucial importance at a time of high unemployment.

8. The Government hopes that where there is room for judgement in the process of arriving at a proper level of pay for the Armed Forces, taking account of their special position, the Review Body will have full regard for the economic and other factors mentioned above.



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CT Treasury agree MOD evidence)  
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MR. SCHOLAR

cc: Mr. Hoskyns

EVIDENCE FOR THE ARMED FORCES PAY REVIEW BODY

I think the draft economic evidence proposed by MOD for the AFPRB contains most of the points we would want to have made. In particular, it is important that, as we move towards a redefinition of the AFPRB's working practices, the maximum weight be given not just to macro-economic considerations, but to recruitment, retention and job security. These points are now covered in paragraph 7, although I would prefer to see them expanded and supported with the detailed evidence which I know from our other work is available within MOD.

You may feel the best way forward would be to wait for the Treasury to respond and then to suggest to the Prime Minister that we make this point.

17 February 1982

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