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E(82) 17th Meeting

COPY NO 66

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held
at 10 Downing Street on
THURSDAY 1 JULY 1982 at 11.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for
the Home Department

The Rt Hon Sir Keith Joseph MP
Secretary of State for
Education and Science

The Rt Hon Peter Walker MP
Minister of Agriculture,
Fisheries and Food

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

The Rt Hon Nigel Lawson MP
Secretary of State for Energy

The Rt Hon Cecil Parkinson MP
Chancellor of the Duchy of
Lancaster and Paymaster General

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon James Prior MP
Secretary of State for
Northern Ireland

The Rt Hon Michael Heseltine MP
Secretary of State for
the Environment

The Rt Hon David Howell MP
Secretary of State for Transport

The Rt Hon Baroness Young
Lord Privy Seal

The Rt Hon Norman Tebbit MP
Secretary of State for Employment

The Rt Hon Lord Cockfield
Secretary of State for Trade

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon John Biffen MP
Lord President of the Council

Mr Allan Stewart MP
Parliamentary Under-Secretary of State
Scottish Office

The Rt Hon Norman Fowler MP
Secretary of State for Social Services

Mr J Sparrow
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P L Gregson
Mr M S Buckley

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1. PAY IN THE COMING YEAR

The Committee considered a Note by the Chancellor of the Exchequer (E(82) 53) about the Government's approach to pay from the autumn of 1982 to the summer of 1983.

THE CHANCELLOR OF THE EXCHEQUER said that the Government had achieved good progress in reducing the rate of inflation and of increases in earnings. Prospects for inflation were now rather better than they had seemed at the time of the Budget. Pay settlements, averaged over the whole economy, were now running at a level of about 7 per cent, with 'drift' bringing the increase in earnings up to about 9 per cent. Nevertheless, this was not a good enough performance by the standards of our main overseas competitors. The increase in earnings in this country had been two or three times as great as in the United States, West Germany and Japan; this had been offset only by exceptionally rapid growth in productivity (and a decline in the exchange rate), which was unlikely to be repeated. Compared with 1979, unit labour costs in the United Kingdom were probably still over 30 per cent higher than elsewhere. It was essential to continue to reduce the rate of growth of earnings in the interests both of increasing our international competitiveness and of containing public expenditure. This would require a vigorous campaign by all members of the Government to influence public opinion: officials should be asked to draw up a programme to enable the Government's message to be adequately put across. In his view, it would be unwise for the campaign to include mention of numerical targets; but privately the Government should have in mind an aim of increases in earnings no higher than 6 per cent, which would entail settlements no higher, on average, than 4 per cent. He had not yet reached a final view on whether it would be desirable to have a separate factor for pay in planning public expenditure. The separate pay factors which had been published in the two previous years had helped to reduce the rate of increase in earnings in the economy generally, as well as in the public services. On the other hand, there was less difference between the rates of increase in pay and in prices than in the recent past, so that there was less operational need for separate factors. The recommendations of the Megaw Committee on the pay of Civil Service would also be relevant.

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THE SECRETARY OF STATE FOR THE ENVIRONMENT said that he endorsed the objective of working towards lower pay settlements. This would require people to accept a reduction in their living standards, but they would not do so unless they could see tangible results. He believed that these should take the form of an offer by Government to increase capital expenditure in the public sector in return for pay restraint. The figures at issue were large: a reduction of 1 per cent in pay increases throughout the economy would reduce labour costs by £1.3 billion. He accepted that there was a risk that an increase in capital expenditure might not in practice secure pay restraint on this scale. But the risk was worth running: even if it failed altogether, the net cost would be far less than the gross cost because of savings in unemployment benefit and increases in revenue to the Exchequer.

In discussion, the following main points were made -

a. Real gross earnings had not fallen severely during the current pay round, but real take-home pay, because of the tax increases which it had been necessary to impose, had fallen significantly. This would increase the difficulties of securing a further reduction in the rate of increase of pay.

b. There were disturbing signs that the Confederation of British Industry and many individual employers in the private sector were likely to take an insufficiently robust attitude to pay increases in the coming months. The improvement in the economy and the financial position of companies was influencing them towards restoring at least part of what was widely regarded as the sacrifice by workers during the current and previous pay rounds. They should instead be guided by market considerations and the need to restore competitiveness. Their attitude stemmed partly from the misguided beliefs that an annual increase in pay was natural and inevitable, and that their workforces, having accepted considerable constraint for two years in succession, could not be expected to accept a third year of severe restraint. Government spokesmen should point out that, particularly as inflation declined, it should no longer be assumed

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that there must be automatic annual pay increases. They should also point out that it was necessary to look at pay and competitiveness as long-term matters: the need to be competitive on world markets was permanent. We were moving towards a world in which there would be no pay increases except those justified by higher output.

c. In addition to these points, it would be important to bring out in public discussion that excessive pay increases would increase unemployment (and pay restraint would improve job opportunities); that profitability was vital for investment and hence for long-term job prospects; that it was unit labour costs, rather than absolute pay levels, that counted; and that it was accordingly essential to relate pay to output. On the other hand, it was suggested that the Government's message must be simple to be effective. It should therefore concentrate on the link between pay and unemployment. This should, however, be put in a positive way: that pay restraint would allow people to price themselves into jobs; and that it alone, especially by increasing our international competitiveness, offered a prospect of sustainable economic growth.

d. There would be much resentment in the private sector if the Government appeared to be preaching pay restraint to others while allowing excessive pay increases in the public sector. It would be desirable to have a separate pay factor for planning public expenditure, both in order to give a lead to the rest of the economy and to avoid the impression that the general inflation factor was an appropriate figure for pay increases. This would be particularly important in the context of the Rate Support Grant settlement. On the other hand, it was suggested that it would be difficult to justify appearing to single out the public services in order to set an example to others; and that the Government would be unwise to run unnecessary risks of confrontation with the public service trade unions in what was likely to be a difficult pay round.

e. There was considerable sympathy for the aims of the schemes advocated by the Secretary of State for the Environment. The general view, however, was that it was unlikely that this would work in practice. The link between increased investment and pay restraint was, for most

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areas of the economy, too remote and uncertain. The trade unions would argue that they were being asked to forgo justified pay increases in order to finance investment which the Government recognised to be necessary. It could also be argued that there were objections of principle: it was essential that pay bargainers should be guided by the circumstances of their own service or industry, not by unrelated events in the economy at large.

THE PRIME MINISTER, summing up the discussion, said that the Committee endorsed the approach set out in E(82) 53, and particularly the emphasis on a positive link between low pay increases and the creation of more jobs. All members of the Government should emphasise the need for pay restraint and for greater competitiveness. In doing so, they should point out that pay must be considered in relation to output; that there was no automatic entitlement to regular pay increases, but that pay increases must depend on performance; that profitability was vital for investment and therefore for jobs; and that only if these facts were recognised and acted on could this country expand production and exports, reduce the volume of imports, and so generate greater job opportunities. It was also essential to match the product to the market: pay restraint and greater efficiency would not be sufficient if the product was wrong. These were permanent facts of life, not things to be accepted for one or two years and then ignored. While sympathising with the aims of the scheme advocated by the Secretary of State for the Environment, the Committee regarded the practical and other objections to it as decisive.

The Committee -

1. Approved the proposals in E(82) 53.
2. Invited Ministers to use all appropriate opportunities to argue the case for lower pay settlements in the next round on the lines indicated in the Prime Minister's summing up.

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2. PAY IN THE PUBLIC TRADING SECTOR

The Committee considered a Note by the Chancellor of the Exchequer (E(82) 54) on pay in the public trading sector.

THE CHANCELLOR OF THE EXCHEQUER said, that the average effect on earnings of settlements in the public trading sector during the 1981-82 pay round was estimated at about $7\frac{1}{2}$ per cent; but when allowance was made for 'drift', the total increase could be as large as 10 per cent. This was rather higher than in the private sector or the public services. The range of settlements was narrow: about half were between 7 and 8 per cent. In some respects, this was not an unsatisfactory outcome. But there were worrying signs for the future. Many of the industries were too ready to accept that the level of settlements which appeared to be established early in the pay round should apply to them irrespective of their own circumstances, and to take too little account of market factors. It was essential to be more explicit with the boards of nationalised industries about the Government's objectives for pay and to impress on them the importance of pay restraint for employment and competitiveness. The external financing limits of the nationalised industries should be set at a level which required them to strive for moderate pay settlements. Although it was right to continue to remain at arms length from individual negotiations and settlements, it was important to ensure that the Government received adequate notice from the nationalised industries of their intentions and of potential difficulties. Industries should be reminded of the need to give at least seven days notice of offers, especially initial offers. Finally, it would be useful to have an indication of the main sources of potential difficulty on pay in the public trading sector in the year ahead. Officials should conduct an early review on the position and provide a brief assessment before the summer recess.

THE PRIME MINISTER, summing up the discussion, said that experience in the 1981-82 pay round had shown that the external financing limits of some nationalised industries had been set at a level which allowed room for excessive pay increases. It was important to avoid any appearance of

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of dictating pay or inflation assumptions to the industries; but their own assumptions, and their financial forecasts in general, should be examined closely and any apparent over-provision eliminated. There should be no question of subsequently increasing the external financing limit in order to accommodate a larger pay settlement than had been assumed. The Committee recognised that in certain industries the unions had considerable economic power which they could use to gain large pay increases: the only way of dealing with this problem in the short-run was to ensure that pay expectations in the economy generally were moderate. The Chancellor of the Exchequer should discuss these matters with the Nationalised Industries' Chairmen's Group; Ministers with sponsoring responsibilities for the nationalised industries should follow this up in separate discussions with individual Chairmen.

The Committee -

1. Approved the proposals in E(82) 54.
2. Invited the Chancellor of the Exchequer and Ministers with sponsoring responsibilities for the nationalised industries to proceed as indicated in the Prime Minister's summing up.

Cabinet Office

2 July 1982