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THE CPRS STUDY ON PAY

ECONOMIC

POLICY

JUNE 1981

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Top papers with the
Prime Minister

Date 23.12.81

Chancellor to Pm 23.12.81.

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10 DOWNING STREET

From the Private Secretary

22 September 1981

cc Master
SUBJECT
cc J. Horgan
cc J. Horgan
J. Horgan
ds
Econ Pol
cc 23/4/81

As you know, the Prime Minister held a meeting yesterday afternoon to discuss the CPRS report on pay, which had been circulated under cover of a letter from Robin Ibbs dated 14 September. The following were present: Chief Secretary, Chancellor of the Duchy, Secretaries of State for Industry, Social Services, Environment, Employment and Energy, Sir Robert Armstrong and Robin Ibbs.

Introducing the CPRS report, Mr. Ibbs said that the issues raised in it were very difficult. The CPRS had tried to take a detached look at the present framework of policies which were aimed at bringing about a fall in real wages, and it indicated various ways in which the CPRS believed they could be made to work better. The CPRS, however, took the view that present policies, even if they were working better, might not be sufficient. They had therefore examined various alternative policies. They concluded that three of the alternatives examined were not worth pursuing further, but that the fourth - the idea of a wage-inflation tax (WIT) - might be worth exploring in greater detail. The *raison d'être* for the WIT proposal was that, even with improved existing policies, market forces might well fail to produce a satisfactory result on the pay front: the purpose of the WIT was to make market forces operate better. His personal view was that the WIT was open to a number of serious objections; nonetheless, he thought that Ministers might still want further work done on it.

The ensuing discussion proceeded under the following headings:

Wage-Inflation Tax Proposal

It was generally felt that the arguments against the WIT proposal were overwhelming. Accordingly, the Prime Minister said it was agreed that no further work should be done on it.

Public Understanding

There was general agreement with the CPRS view that a crucial task, if there was to be room for expansion, was to change present deep-seated attitudes towards pay. There had to be a better understanding of the link between pay, profits and productivity; and people had to be made to recognise that they had no automatic entitlement to annual pay rises. Furthermore, youngsters leaving school had to understand better that the state did not owe them a living.

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It was suggested that the Government might mount a new campaign, aimed at putting over the message of greater economic realism. Against this, it was argued that general campaigns of this kind were of little value. Attempts by Ministers to preach the virtues of economic realism to private industry were likely to fall on deaf ears. It would be better to leave it to the CBI to make the running with their members. Furthermore, there was a limit to what could be achieved by any general message from the centre. People were much more likely to understand the link between pay, profits and productivity if the point was made at company level. Unfortunately, far too many firms were still failing to communicate properly with their employees, despite the efforts by the CBI in this direction a year or two ago. There was much evidence to show that, if employees at the shop floor level were made properly aware of their companies' performance and problems, they would take account of it in their attitudes to pay bargaining. The fact that so little progress had been made in this regard was reflected at the recent TUC Conference, where not one speaker had mentioned the importance of profits and profitability as a means to better living standards. It would be better if the Government and the CBI could persuade employers to improve communication with their employees voluntarily; the Government might issue an appropriate code of practice. But it might be necessary to consider introducing legislation on this subject to make improved communication mandatory. Such legislation might even go beyond communication to ensuring a greater measure of employee involvement in management decisions. If the Government did nothing in this area, it would be leaving the field to the Labour Party, which wanted to resurrect Planning Agreements, and to the SDP/Liberal alliance. On the other hand, there would still be a continuing role for Ministerial speeches; and while a general Government campaign would be unwise, it would be worth exploring the possibility of less conventional ways of putting over the economic realism message. For example, Mr. John Cleese had done some very effective work for individual private sector companies; and it might be worth considering asking him to put together something which could be used on television in free non-Party time.

In further discussion, it was suggested that the first priority for Government was to communicate better with its own employees. In some ways, the task of communication was more difficult in the public sector than in the private sector because objectives were less well defined. In the public services, more had to be done to get people to understand the importance of value for money. Only in this way would they accept the need for staff economies. The Department of the Environment had made special efforts with this approach, and it had paid off in terms of improved efficiency and acceptance of manpower cuts. Other Departments could well emulate DOE's methods, though their differing circumstances meant that improved communication was not necessarily a sufficient means of achieving better efficiency. Nor was the system of cash limits in itself sufficient to bring about a change in attitudes. In the nationalised industries, there was room for improved attitudes amongst both management and employees: in some industries, for example the National Bus Company and the National Transport Docks Board, there had been a noticeable stiffening of management resistance to unrealistic pay claims, but Ministers needed to keep up the pressure on managements generally.

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Summing up this part of the discussion, the Prime Minister said they were agreed that there should be no general campaign. But Ministers should continue to make speeches on the general theme of the need for greater realism, and the possibility of using less conventional methods to get over the message should be explored further on the lines discussed. (The Prime Minister would like a report on the latter within the next three weeks: I suggest that the Treasury should consult the No.10 Press Secretary and the Lord President's Office and report back accordingly.) In their contacts with the CBI, Ministers should indicate that it was for the CBI to remain in the lead in getting over the message with their members. The CBI should also be encouraged to continue their activities aimed at improving employer/employee communication at company level. In the meantime, the Secretary of State for Industry should consider the possibility of issuing a code of conduct covering communication and possibly greater employee involvement generally with or without legislation. The Secretary of State for Education should also consider how schools might be encouraged to educate young people better in the economic facts of life.

Arbitration

Mr. Ibbs said that, at present, most arbitration references resulted in settlements that the arbitrators regarded as fair rather than what could be afforded. The CPRS suggested that further work should be done on how arbitration arrangements could be improved so as to ensure that proper attention was paid to arguments based on ability to pay.

In discussion, it was suggested that it was important to distinguish between public and private sectors. In the private sector, few employees had unilateral access to arbitration; there was therefore little for the Government to do except to advise companies not to get drawn into arbitration except on terms that were demonstrably satisfactory. The situation was different in the public sector, where many employees had unilateral right of access to arbitration. One task for the Government would be to try to find ways of eliminating the latter. At the same time, further work should be done to try to improve the specific procedures of arbitration arrangements so that the "affordability" criterion could be properly taken into account. Although arbitration tribunals were often supposed to take into account the public interest, in practice they failed to translate this into "affordability".

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Summing up this part of the discussion, the Prime Minister asked the Secretary of State for Employment to co-ordinate further work on arbitration with a view, in particular, to giving more weight to "affordability", and to report back.

Industrial Relations Legislation

The meeting took note that changes in the law covering trade union immunities, secret ballots, etc., could have an important part to play in improving the pay bargaining framework, and that the Secretary of State for Employment would be bringing forward his proposals shortly. The Prime Minister asked the Secretary of State to give special attention to the possibility of including a provision which would allow the laying off of white collar workers, as proposed by the Engineering Employers Federation.

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Water Workers

There was brief discussion of the possible risks of a national water strike. In this context, it was suggested that it might be worth looking again at the possibility of extending the concept of no-strike agreements, although it was recognised that such agreements were likely to be negotiable only at substantial cost. There was also the question of enforceability, although the Prime Minister pointed out that this would be much less of a problem if employers could take action against trade union funds.

The Prime Minister asked the Secretary of State for Employment to consider further the possibility of negotiating no-strike agreements in the context of his proposals for trade union legislation generally. The Prime Minister also invited the Civil Contingencies Unit, or if appropriate a smaller group within the CCU, to look again at the likely effects of industrial action in the water industry, and at the options for dealing with them; and to report back accordingly.

Unemployment Benefit

It was noted that the CPRS report indicated that a cut in unemployment benefit would have a beneficial effect on pay bargaining and on employment. Estimates of how much employment would increase if the benefit level was reduced varied greatly; if some of the higher estimates, such as those made by Professor Minford, were correct, there would be a strong argument for imposing a cut. This was quite apart from the public expenditure argument. On the other hand, it was argued that a cut in unemployment benefit would only be tolerable if, over a period, pay was seen to be rising less than the cost of living. In fact, this had only begun to happen since early 1981. Furthermore, the problem of the overlap between the living standards of those who were in and those who were out of work had been greatly exaggerated: it was only serious in the case of people who worked part of the year and then drew unemployment benefit, and this latter problem was being tackled through the taxation of unemployment benefit, which should come into effect in July 1982.

The Prime Minister said that the Secretary of State for Social Services was no doubt considering the question of unemployment benefit uprating in the context of the decisions on public expenditure; she invited him to take into account the link between the unemployment benefit level and pay and employment, and to look in particular at Professor Minford's work on this subject.

Wages Councils

The Secretary of State for Employment said that E Committee had already decided against legislation to abolish the Wages Councils. He was attracted by the general proposition that the Wages Councils should give more emphasis to economic criteria; but he did not think the CPRS proposal that their arbitral powers should be removed was a runner. The Government should effect modest improvements in the operation of the Wages Councils as and when the opportunity arose.

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The Prime Minister said that the case against the Wages Councils was now stronger, given the higher level of unemployment, particularly among young people. Accordingly, the Secretary of State for Employment should reconsider the options for abolishing or curtailing them and report back to E Committee.

In the general context of improving the prospects for youth employment, the Prime Minister also asked the Chief Secretary to ensure that publicity was given to the Young Workers Scheme as part of the Business Opportunities Programme. The Central Office of Information might also be asked to put out something on it if it had not done so already.

I am sending copies of this letter to the Private Secretaries to the Chancellor of the Duchy of Lancaster, the Secretaries of State for Industry, Social Services, Environment, Employment, Energy, Education and Defence, the Home Secretary, the Lord President, Sir Robert Armstrong and Robin Ibbs.

Handwritten initials

Tim Latham

Terry Mathews, Esq.,
Chief Secretary's Office,
HM Treasury.

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To: PRIME MINISTER
From: J R IBBS

18 September 1981

CPRS Pay Report

1. At Monday's meeting Ministers are to consider the CPRS pay report (my minute of 11 September). The recommendations in it fall into several groups, and might be discussed in the following order:

(a) Strategic. The present system, even with the improvements we discuss, cannot be relied on to keep pay increases on a satisfactory downward path. Therefore the trend needs to be closely watched (and preparatory work done - see below) to enable Ministers to react quickly if necessary (recommendation (i)). Merely to assume that a freeze could be introduced is not enough (recommendation (xi)).

(b) Public Understanding. This is the most important part of Section 2, not covered elsewhere. Ministers need to consider whether the message is articulated as clearly as it can be (see our Section 1.1), and what more can be done to put it across - we have made some suggestions in our recommendations (ii) to (iv) (private meetings with employers, a code for management, employee communication, a push for current cost accounting).

(c) Further Work. We would like Ministers to commission further work on two main topics:

- arbitration (recommendation (v) - the arguments are in Section 2.3 of our report);
- contingency planning for a wage-inflation tax (recommendation (xii) - there may be a risk of leaks, but if Ministers agree that this option is worth pursuing, more work needs to be done).

2. This leaves over the bulk of Section 2, which is being considered elsewhere, so that Ministers need do no more than take note:

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(a) Industrial Relations Legislation (recommendation (vi)). Will be considered by E Committee shortly, on the basis of proposals from the new Secretary of State for Employment.

(b) Public Services (recommendation (vii)). Cabinet has set the provisional pay factor and will consider adjustments, e.g. for the NHS, in the public expenditure discussions. The PSP(0) Committee is preparing a separate paper for Ministers in E(PSP) on Review Bodies (and we have made proposals for further work on arbitration - above). The evidence to the Megaw enquiry will also be coming before Ministers shortly.

(c) Public Trading Section (recommendation (viii)). Ministers discussed the approach to the next pay round and reached conclusions in line with our views - though obviously this is a continuing battle which will need co-ordination and strategic thinking.

(d) Low Pay (recommendations (ix) and (x)). Covered in the Treasury labour market package, which we and they are to develop for consideration by Ministers.

3. There is just one point in Section 2.6 which may not be fully considered elsewhere. This is the argument on 'no-strike agreements', in paragraphs 70-73. Our conclusion is negative, but Ministers may wish to consider whether they agree with this, because it is relevant to the fire service (and other uniformed services) as well as the public utilities.

4. If the discussion has ranged widely, it would be helpful to conclude *Flag A* - by going through the recommendations (listed at the front of the Report) to make sure they are decided or will be considered elsewhere.

5. Sir Robert Armstrong has seen and is in agreement with this brief. 11

SRJ

PRIME MINISTER

cc. Mr. Hoskyns
Mr. Walters
Mr. Duguid

CPRS REPORT ON PAY

The CPRS were asked to report on the pay bargaining framework generally, and on pay determination machinery in the public services. These both remain central to the success or failure of the economic strategy, and therefore to the success or failure of the Government.

The main decisions required at your meeting on Monday concern the further work that should be done. We think the most fruitful areas for exploration are those listed below. They are not entirely drawn from the CPRS' recommendations: a note on each of those is attached at Flag A; and a separate note on why they should not pursue their principal suggestion, a "wage-inflation tax", is at Flag B. Until Megaw has reported, and we can start to set up market-based systems in the public sector, we are not attracted to radical alternatives to the present way in which pay is settled in the economy generally, and least of all to any of the various forms of incomes policies outlined in Section III of the Report. We think they are likely to be even more unsatisfactory than present arrangements, even if the coming pay round proves unexpectedly difficult.

A. THE GENERAL PAY BARGAINING FRAMEWORK

1. Getting a better result from arbitration

We agree that the Department of Employment should be asked to examine the prospects for getting affordability more clearly reflected in arbitration awards. It might be difficult to secure that, and it would certainly be difficult to ensure that the arbitrator did what he was supposed to do, but it may be possible at least to increase the weight which arbitrators attach to it.

/2. No strike agreements

2. No strike agreements in the context of new pay determination systems

A return to the pre-1971 no strike laws for public utilities would require effective sanctions. We think the exposure of trade union funds is an essential first step. No strike agreements might be an ingredient in public service agreements after the Megaw Report, especially if we move towards a more general framework of enforceable contracts.

3. Enabling employers to get labour cheaper

Enabling extra staff to be taken on at the lower end of the labour market means more jobs and helps to exert downward pressure on wages generally. If the abolition of Wages Councils is politically too hard to sell, then the CPRS proposal for removing their arbitral power to fix minimum pay would be the next best thing.

4. Cutting benefits to the unemployed

There are major political difficulties about lowering the real level of unemployment benefit or supplementary benefits. But their indexation against a background of falling levels of real pay reduces the incentive to work and inhibits the fall in wages. Professor Minford argues that a 10% cut in real benefits would reduce unemployment by half a million in two years. The Chancellor has raised this issue in the context of Merseyside. The political difficulties may increase as an election draws nearer.

5. Industrial relations legislation

We agree with CPRS that the benefits from changes in industrial relations law, important as they are, will emerge only slowly as the bargaining balance is affected.

/Mr. Tebbit

Mr. Tebbit will be making proposals separately, but it is useful that the CPRS now recognise:

- the importance of exposing union funds to produce an effective sanction against unlawful action, while reducing the risk of individual martyrdom;

- the importance of secret ballots.

The Policy Unit's paper on this also identifies these properties. But we think that it would be best to establish the new position for trade union funds before giving the Government a more direct role in disputes by taking power to order cooling-off periods.

On the right to lay off, CPRS do not distinguish two different EEF proposals: one is for a broad power to lay off anyone as a result of a strike in an essential service. This is too ambitious. But their more modest proposal is that a company or organisation should be able to lay off those white collar workers for whom there is no work as a result of strike action by fellow employees. This is a long overdue reform, necessary to head off the growing threat of selective strike action. The recent Civil Service strike provides a good example of the abuse of the present system.

B. IN THE PUBLIC SERVICES

6. What would be required if we wind up the Review Bodies?

The Review Bodies, generating comparability-based and often excessively high recommendations, cannot co-exist in their present form with cash limits. We think they

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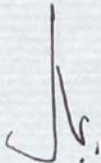
should all be wound up, or at the very least put on ice, unless they are prepared to accept a purely mechanical role. We ought to look at what the consequences would be, i.e. the subsidiary but quite difficult problems of dealing with the judiciary, doctors' expenses, armed forces relativities and so on.

7. The 1982/83 Pay Round

Ministers will naturally want to concentrate on improving the prospects for the pay round now starting. But we think it would be wrong to assume, as the CPRS does (Report, Paras 53 and 54) that by the time the 1982/83 round begins we shall have a market-based, post-Megaw system for the Civil Service - or that such a system may be applicable to other public services. It may well take a year to negotiate a post-Megaw agreement, and work ought to start soon on the role of cash limits in the next pay round, even though decisions will not be required until next summer.

Work on industrial relations legislation is, of course, proceeding separately; and social security benefits are primarily a public expenditure issue.

In our view, the other five issues should constitute the agenda for officials, and E(PSP), to work on with a view to reporting to Cabinet before Christmas.



J. M. VEREKER

18 September, 1981

A

POLICY UNIT VIEWS ON THE RECOMMENDATIONS

The CPRS list 12 recommendations:

(i) Watch the trend of settlements closely, so as to react if objectives are not being achieved.

We - through the Department of Employment - do this already. But we do not share the CPRS' pessimism about the likelihood of this pay round going seriously wrong.

(ii) More should be done to promote public understanding.

We believe that public understanding results from events and Government decisions, much more than from Ministerial speeches; but Ministers already make a major effort. Mr. Pym has already circulated a speaking note on the 4% pay factor, and has suggested it be used as a basis for discussions with employers - but most private sector employers don't need us to tell them of the virtues of pay restraint.

(iii) Management-employee communication should be encouraged.

MISC 14 has worked on this; Mr. Prior ran something of a campaign on it, with CBI and NEDC support. You gave it a boost with your speech at Bulmer's in Hereford. Of course this effort should continue.

(iv) Greater prominence for current cost accounting.

We agree: this might avoid employees getting a false impression of company profitability.

(v) Arbitration should be more responsive to affordability, unemployment and the national interest.

We agree, but there are real difficulties.

(vi) A step-by-step approach to industrial relations legislation.

Mr. Tebbit will make proposals. CPRS ideas reflect some of the right priorities: trade union funds and secret ballots. The ability

to lay-off white collar workers unable to work because of a strike by fellow employees is a priority. Cooling-off periods should only come later.

(vii) In the public services:

- (a) Pay factor not unrealistically low - already decided.
- (b) NHS pay factor should be 1% higher - to be considered in the public expenditure discussions; the decision should depend on the supply of and demand for NHS staff.
- (c) Arbitration and Review Bodies should be lectured on the consequences of excessive awards - they are already; and we think Review Bodies should be wound up.
- (d) Comparability for uniformed services should be ended - we agree.

(viii) In the public trading sector:

- (a) Present coal as a special case - we agree.
- (b) Face up to a strike on carefully chosen ground - we agree.
- (c) Emphasise the pay/productivity/performance/investment links - we agree.

(ix) Employment Subsidies

In general we do not favour employment subsidies: the present scheme, for young workers, was introduced as a "crisis measure" and we see no case for extending it.

(x) Cut in unemployment benefit

We agree that this would have a helpful effect on pay.

(xi) A statutory pay limit cannot be relied upon if drastic measures are required.

We agree; but we don't foresee a need for measures as drastic as that if the cash limit discipline is maintained. We would not rule out a freeze at the beginning of the round.

(xii) Further consideration of a Wage-Inflation Tax.

See Annex B.

THE PROPOSED "WAGE INFLATION TAX" (WIT)

The WIT is the report's main new recommendation for further work. It is described in detail on pages 42-44 of the report; its essence is that the Government would set a norm for pay increases, and impose a special tax on employers who paid more. We expect the CPRS to press strongly the case for further work to be done on such a scheme, as contingency planning against the day that a fundamental change in pay policy is needed to protect the economic strategy. We think the scheme has far too many inherent drawbacks to make it worthwhile looking at the details; and if it became known - which it would be - that we were considering such a scheme - there could be a rush for high settlements before it was introduced, thus making it inevitable.

The inherent weaknesses of the WIT are these:

1. It would have a perverse effect on incentives. Successful and profitable firms, who could pay their employees well, would be penalised. Market forces could no longer play a proper part in determining pay, which would to a large extent be established across the board by the Government.
2. It would operate more on the private sector than on the public. The concept of a norm for the private sector, which could not apply to the public services (Report, para. 118) and probably not to the nationalised industries, is the exact opposite of the Government's approach to pay. It would deny the logic that the Government's responsibility is for the pay of those it employs, and that pay elsewhere is largely determined by what other employers can afford.
3. It's not designed as an emergency measure, but as a permanent feature of pay bargaining arrangements. Layard, whose idea this is, conceived of it as an entirely new pay bargaining framework. In a crisis such as the CPRS postulate, the massive changes to our tax system could not be put in place quickly.

4. It wouldn't work.

It wouldn't work for two reasons. First, it would operate on the employer, not the employee, which is no good if the employees' bargaining power is strong (eventually the tax burden would simply bankrupt the employer). Second, there are too many ways round it: wage negotiations would keep the increase per hour within the norm, but overtime and fringe benefits would rocket.

5. It would be bureaucratic.

Not just new staff, but a whole new organisation, would be required to police the scheme, as well as the extra staff needed in related departments.

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cc Mr. Lankester
Mr. Duguid

MR. VEREKER

CPRS STUDY

I too find the CPRS Report rather disappointing. I agree with all the strictures which you raise in your memorandum. And I would add one or two more for good measure. I think it would be most unwise to allow CPRS to do further work on the WIT.

In my view the interpretation of the terms of reference is quite stultifying. (At least I think it is a problem of interpreting terms of reference, rather than just omissions.) A number of points along these lines.

1. One of the main objectives of getting real wages down is to increase the profitability of employing people. Yet there is no outline calculation of the effects of various real wage regimes, inflation rates, output per head and employment on the change in real profits. On my back-of-the-envelope calculations the profits of the consolidated manufacturing sector should, if all goes well, increase by about 75%. This is, of course, gross and does not take account of the tax bite. (Incidentally, one way of increasing the profitability of employing people is to reduce the taxes on profits - and in particular the unearned income surcharge. This would expand employment for a given real wage.)
2. They say that supply side measures are beyond the scope of this paper, but then they do discuss social security benefits in para 92 saying they will have no large effects on pay, a point which is nowhere argued in the report. But surely, cuts in benefits would have a large effect on unemployment. (Incidentally, I believe that much of the econometric evidence is wrong and in any case irrelevant.) The point that they miss is that benefits are indexed, thus if real wages are to fall of the order of 5% during the next year and real benefits remain the same, this will create a much greater incentive to stay on the dole. This increased disincentive will be on top of

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that which has been experienced this last year as a consequence of a cut in real wages of the order of 3-5% in the private sector. Supposing we bring real wages down 10% over these two years, then the effect on disincentives must be very considerable indeed. The CPRS report does not even mention this, but in para 83 they say that if the low paid wages are held down, then there will be difficulties in recruitment. But why? Only because the attractiveness of the dole is greater than that of working. But again they do not mention this.

3. I should have thought there is a fairly good case now for instituting no strike rules in the public service. I think we underestimate the break-through that Reagan achieved when he fired the Air Traffic Controllers. He had wide public support. I suspect that the climate of opinion has changed quite a bit.
4. I find much of the discussion about norms and related matters very difficult to understand. For example, para 104 iii. suggests that Government should operate an exchange rate target and fiscal and monetary policies in order to maintain real wages. I do not know whether the authors have read about the disasters of 1972/75 when there was widespread indexation of real wages and other income on the consumer price index, and over that period the terms of trade changed dramatically against Britain so that her real income went down like a stone. But of course such a drastic fall was not reflected in the retail price index so the levels of real wages were maintained while real income fell. Of course profits took the brunt and there was a great cuffuffle in 1974.
5. I would like to see our fiscal and monetary policies encouraging the non-unionised sector. At the moment virtually all our hand-outs are to the heavily unionised, and usually publicly-owned, sectors. Even our private sector aid for industry goes primarily to finance exports by GEC, etc. The State largely subsidises the unions.

6. I must say

CONFIDENTIAL

- 3 -

6. I must say I think the WIT scheme is quite dreadful. Of course the main argument against it is the one which you have made, the effect on incentives. But I don't think anyone has yet calculated the order of magnitude of these effects. Suppose the WIT is 50%, then if we add that 50% to the normal marginal tax rate, 30% standard plus the insurance contribution etc, the marginal rate must be near or over 90%. We know from experience in this country and also from the sad history of Sweden in recent years, that such rates are both evil and self-defeating. (Incidentally, the fact that the employer pays the tax rather than the employee is irrelevant under competitive conditions.) I should have thought that since one of the planks in the Party programme is to increase incentive, such taxes are just simply not on.

7. The second point which the CPRS does not even mention, is concerned with the period for the WIT to be in operation. The thrust of the CPRS report is concerned with wages taking off as the employment situation does not get worse or perhaps even improves. It is, as it were, a reaction to something of an emergency. But, as Layard explained, the WIT scheme only makes analytical and policy sense if it is construed as a permanent feature of our bargaining arrangements. (I don't think it makes sense then, but never mind.) It is a long haul from a measure designed for emergencies to a massive permanent change in our tax and incentive system.

8. The third argument against it is concerned with the enormous opportunity for switching numbers of hours and fringe benefits, etc. I cannot understand the CPRS argument that a WIT system would reduce overtime. I would predict that, on the contrary, it would encourage increasing overtime as the scheme wore on. I am sure that the nominal hours of work would expand considerably. All wage negotiations would ensure that in order to make the wage per hour increase suitably low. If I ran a

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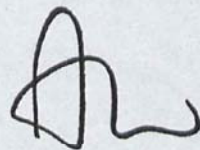
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- 4 -

factory I would have an additional social hour at the end of the day, and it would pay me as the employer to supply the beer. In other words, the WIT would have a great effect on the nature of pay deals. The objective would be simply to cash in by getting an increase below the norm.

9. Finally, I cannot understand why the CPRS is so loathe to eliminate Wages Councils. Now we have a new Secretary of State for Employment I should have thought the time is now ripe. But we have been through all these arguments before.

16 September 1981



ALAN WALTERS

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PAY

Report by the Central Policy Review Staff

Table of Contents

| | Page |
|---|------|
| SUMMARY AND CONCLUSIONS | |
| LIST OF RECOMMENDATIONS | |
| SECTION I: OBJECTIVES AND PROSPECTS | |
| 1.1 Objectives | 1 |
| 1.2 Prospects | 3 |
| 1.3 Courses Open | 5 |
| SECTION II: MAKING THE PRESENT SYSTEM WORK BETTER | |
| 2.1 The Framework of Pay Bargaining | 6 |
| 2.2 Public Understanding | 7 |
| 2.3 Arbitration | 9 |
| 2.4 Industrial Relations Legislation | 10 |
| 2.5 Public Services Pay | 15 |
| 2.6 The Public Trading Sector | 22 |
| 2.7 Other Issues | 31 |
| SECTION III: ALTERNATIVES TO THE PRESENT SYSTEM | |
| 3.1 The Consensus Approach | 34 |
| 3.2 Formal Pay Policies | 36 |
| 3.2A A Statutory Pay Limit | 38 |
| 3.2B A Relativities Board | 40 |
| 3.2C Compulsory Arbitration | 41 |
| 3.2D The Wage-Inflation Tax | 42 |
| ANNEX A: THE PRIVATE SECTOR BARGAINING FRAMEWORK | 46 |
| ANNEX B: WAGES COUNCILS | 51 |
| ANNEX C: WAGE-INFLATION TAX - ADMINISTRATIVE QUESTIONS | 55 |

CONFIDENTIAL

PAY

Report by the Central Policy Review Staff

SUMMARY AND CONCLUSIONS

Section I: Objectives and Prospects

S1. The success of the Government's economic policies turns on getting lower pay settlements in the next two pay rounds. This is necessary if competitiveness is to be improved, though longer-term supply-side factors are relevant as well. With a "national cash limit" on total money demand, there will only be room for a recovery in output if it is not pre-empted by higher pay.

S2. The 1980-81 pay round went better than expected. Settlements were driven down to single figures, well below the rate of increase in prices. But this was achieved in a year of falling output, and high and rising unemployment. The crucial test will be to keep the average level of pay settlements falling as output begins to pick up.

S3. If nothing more is done, prospects for the current round are not good. RPI increases are likely to continue above 10%, and wage negotiators may be unwilling to accept a further cut in real pay. There are risks at various points in the public sector. And in the private sector, even though some companies are in severe difficulties, imperfect understanding, particularly among unions, of economic realities reduces the chance of achieving moderate and "responsible" settlements: each group of employees sees itself losing if it accepts a low settlement and other groups then force pay rates higher. Therefore the CPRS has examined policy options under two main headings.

Section II: Making the present system work better

2.2 Improving Public Understanding

S4. The Government is faced with the task of changing deep-seated attitudes to make employers and employees recognise that there is no automatic entitlement to annual pay rises high enough to maintain and improve living standards. The CBI is encouraging employers to put more emphasis on ability to pay, and the Government could do more to reinforce this. Employers should provide their employees with more and better information about their company's financial state; the Government might encourage this by issuing an appropriate code of practice, and by advocating wider use of current cost accounting.

CONFIDENTIAL

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2.3 Arbitration

S5. The expectation that pay increases will be determined by "comparability" has been reinforced by current arbitration arrangements, particularly in the public sector. Officials should examine in detail how arbitration arrangements can ensure that proper attention is paid to arguments based on ability to pay, the impact on employment and on other settlements. The Government will need to back its views on acceptable limits by being ready to cut back numbers and services if an award goes beyond those limits.

2.4 Industrial Relations Legislation

S6. This section of the report reviews the options, and concludes that enforceable changes in legislation are unlikely to make any dramatic change in the pay bargaining balance. It recommends a step-by-step approach, with the timing related to the impact of industrial relations experience on public opinion. The first step, if and when it were judged to be enforceable and politically acceptable, would be to bring trade union immunities into line with those of individuals, notably on secondary action. Further steps might be to re-introduce a power to order cooling-off periods and secret ballots in national strikes; and, if experience confirmed its usefulness, a general requirement for secret ballots before industrial action. The sanction in each case would be a withdrawal of union and individual immunities.

2.5 Public Services

S7. This section suggests that the system of "modified cash limits" which is to operate for the 1981-82 round is an unstable compromise, which will need to be replaced for the following round by arrangements which take account of recruitment/retention needs and national interest considerations; the Government's evidence to the Megaw enquiry should pave the way for this.

2.6 Public Trading Corporations

S8. This section reviews options for tackling this difficult area ("ring fence", no-strike agreements). It concludes that Ministers will need to establish closer relations with Boards, along lines proposed in our nationalised industry report, and play a more positive role to co-ordinate the industries' negotiations in the coming pay rounds, while leaving the negotiations with them.

2.7 Other issues

S9. Various pressures could help to keep down pay at the bottom of the wages pyramid - curtailment of Wages Councils, the Walters scheme for young workers, and perhaps restraint on short-term social security benefits which set the floor.

CONFIDENTIAL

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Section III: Alternative Approaches

S10. The results of present policies, backed up by any improvements that can be made in the light of the above review, will need to be monitored closely. If the trend of settlements fails to meet current pay objectives, or if wage inflation starts to re-accelerate, more fundamental changes will need to be considered.

S11. Before embarking on a fundamental change, Ministers will want to be reasonably satisfied that it will be effective, will not be overturned by union resistance and will last long enough to have a worth-while impact.

3.1 Consensus

S11. A forum might be established using either NEDC or a more public version of it, aimed at demonstrating the importance of pay restraint. If successful it could publish reports on the consequences of specified levels of average pay increases for prices and output, with the aim of influencing expectations and negotiating positions in the pay round. However, recent experience with NEDC suggests that a forum would fail to reach a consensus, and would be seen by the TUC merely as an opportunity for putting pressure on the Government to change its macro-economic stance. Even if a consensus could be reached, its effectiveness would be limited to some influence on attitudes unless it led on to one of the longer-term policies discussed at 3.2B-3.2D below. We do not believe that an effective consensus is likely to be achieved through offering a public expenditure package in exchange for undertakings on pay restraint.

3.2A Statutory Pay Limit

S12. If pay accelerated, the standard response would be to limit all pay settlements either to zero (a freeze) or to a low "norm" of, say, 5%. But, if pay settlements had been rising through double figures, it cannot be taken for granted that employees and unions next in line would accept this sudden stop - particularly if imposed during a pay round. Prices would continue to rise for a time and real wages would fall excessively (unless room could be found for tax cuts). To gain tacit acceptance, it would be essential to say at the outset how long the limit would last, and what successor policy would be introduced to prevent a pay explosion when it was lifted. Except as an emergency measure before introducing some more satisfactory long-term alternative, we see no benefit in a freeze or a norm.

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3.2B Pay Board

S13. The most obvious longer-term possibility would be to re-establish a pay board to determine relativities, so that pressures did not build up to the point where they could wreck a statutory pay limit. However, a pay board with statutory powers cannot hope to reflect market conditions adequately, and remains vulnerable to a determined union with monopoly power.

3.2C Compulsory Arbitration

S14. A system of compulsory arbitration, requiring employers and unions to take a dispute to an arbitration court before there is industrial action, would not require a "norm" and would thus be less rigid. It could follow naturally from a developing consensus on the need for lower pay increases to promote employment (the Meade approach). To avoid reinforcing "comparability", clear arbitration criteria would have to be established giving most weight to market forces in the sector or trade concerned. To enforce arbitration awards it would be necessary to provide for strong legal sanctions (eg withdrawal of union immunities). But to gain acceptance of these sanctions a measure of consensus would be needed which is not likely to be secured in present circumstances.

3.2D Wage-inflation Tax

S15. A more promising approach, in present circumstances, would be to reinforce market incentives by imposing a special tax on employers' payroll if their annual pay bill (in terms of earnings per hour) rises by more than a set average percentage - and paying a rebate to those whose pay bill rises by less than this standard. This allows some flexibility, for those employers who can afford to pay, but should strengthen the resistance of those who cannot. It would be a cumbersome new tax, with unpredictable effects, and would tend to penalise expanding firms and those paying extra for productivity gains. But it would strengthen the impact of the Government's policies on pay inflation, without imposing a rigid central view. It would need to be complemented by a tough Government policy in the public sector, including a link in the nationalised industries between excessive pay settlements and reduced investment.

S16. Accordingly, if Ministers decide, now or later, that pay prospects are bad enough to require drastic action, the CFRS recommends this approach as the most promising candidate. We recommend that administrative implications and alternative versions should now be explored by officials on a contingency basis.

CONFIDENTIAL

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Report by the Central Policy Review Staff

LIST OF RECOMMENDATIONS

- (i) The trend of settlements needs to be closely watched, and alternative approaches examined, to enable Ministers to react quickly, and decide on the need for further action, if their objectives are not being achieved (paragraph 13).
- (ii) Because public attitudes to pay continue to be quite unrealistic and many workers still think that there is no relation between pay, inflation and unemployment, there is an enormous need to promote public understanding of the importance of moderate pay settlements to reflect economic realities. Ministers and Government information services should do more, in co-operation with the CBI. In particular we recommend that senior Ministers should hold a series of private meetings with employers to emphasise the need to put the message across (paragraph 21).
- (iii) Ministers should take steps to encourage improvements in management-employee communication on the business; perhaps by publishing a voluntary code of conduct (paragraph 22).
- (iv) The Government should look for ways of encouraging greater prominence for current cost accounting, because its more realistic presentation is useful in the pay context (paragraph 23).
- (v) Officials should be asked to examine in detail how arbitration by independent bodies (including ACAS) can be made more responsive to arguments based on the employer's ability to pay and on broader considerations of employment and the national interest (paragraph 26); and whether the arbitration powers of Wages Councils should be removed (paragraph 90).

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- (vi) On industrial relations legislation the CPRS recommends a step-by-step approach with each move being considered in the light of developing industrial relations experience (paragraph 28):
- the first move, preparing the way for using removal of immunities as a sanction, should be to bring trade union immunities into line with those of individuals in respect of secondary picketing, secondary action and closed shops (paragraph 29);
 - a second move would be to re-introduce a power to order cooling-off periods and secret ballots in national strikes (paragraph 31);
 - more effort should be made to encourage secret balloting (paragraph 34);
 - a further step, to be considered in the light of experience of secret ballots in national strikes, might be to require secret ballots before any major industrial action (paragraph 35);
 - another move worth considering would be the EEF proposals to relieve employers of statutory obligations to their workforce when affected by a strike (paragraph 36).
- (vii) For the public services in 1981/82, the pay factor (including that for RSG) should not be set unrealistically low, and should be presented as an average, requiring some settlements to be lower. The NHS pay provision should be, say, 1 per cent higher, and should be allocated by DHSS to management sides as firm pre-determined cash limits (paragraph 48). Arbitration and review bodies cannot be required to make an award within a cash limit, but should be told firmly the consequences of an excessive award (in terms of reduced numbers and cuts in services) and the broader arguments for restraint ((v) above) (paragraph 50). For the longer term it may be possible to move to a more "market-based" system (e.g. for the Civil Service following Megaw), but this should not be an excuse for reinstating "comparability", and the

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opportunity should be taken to re-examine index-linking for the uniformed services (paragraphs 53 and 54).

- (viii) For the public trading sector, a high coal settlement, if it occurs, must be presented as a special case (paragraph 61) and the damage limited by tough bargaining, e.g. in the non-utility industries, reinforced by willingness to face up to a strike on carefully chosen ground where management can win (paragraph 67). If a settlement contains an additional element for productivity, this should be explained in the public presentation of the settlement (paragraph 87). Ministers need to concert a strategy for pay negotiations for each industry, emphasising the link between performance (including pay) and investment (paragraphs 88 and 89).
- (ix) The principle of setting a pay ceiling for employment subsidies, as in the new scheme for young workers, should be applied where possible if any further subsidies are introduced (paragraph 91).
- (x) If Ministers are considering a cut in unemployment benefit as a candidate for public expenditure saving, they will wish to bear in mind that it would also have some helpful longer-term effect on pay (paragraph 92).
- (xi) If pay develops in such a way that Ministers decide more drastic action is needed, a statutory pay limit (freeze or norm) could not be relied on to hold, particularly in the middle of a round, unless backed by macro-economic policies to avoid excessive cuts in real income, and by Government readiness from the outset to discuss a successor policy to prevent "bounce-back" (paragraph 106).
- (xii) In case a fundamental change in pay policy is unavoidable in order to protect the economic strategy, the CPRS favours further consideration of a wage-inflation tax system: employers whose annual pay bill (in terms of earnings per hour) rose by more than a standard percentage would be liable to pay a proportionate sum, and correspondingly those whose pay bill rose by less would receive

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a rebate. An equivalent link between pay bill and investment should be made in the public trading sector. We recommend that officials should examine the administrative implications and work out a detailed scheme on a contingency basis (paragraphs 112 to 122).

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Report by the Central Policy Review Staff

SECTION I: OBJECTIVES AND PROSPECTS

1. The CPRS was invited to examine what action should be taken to improve the framework within which pay bargaining takes place in the United Kingdom, including the machinery for determining pay in the public services.

1.1. OBJECTIVES

Real Wages and Competitiveness

2. The Government's overall objective is to secure a healthy economy with at least enough growth to bring down unemployment progressively to an acceptable level. To achieve this objective the economy must be internationally competitive. At present wages are too high in relation to productivity, which damages competitiveness in two ways:-

i. unit costs, including wage costs, are higher than those of overseas competitors;

ii. profits are too low, and, partly in consequence, there is not enough investment in new products, processes and services.

Nominal Wages, Inflation and Employment

3. One of the Government's main aims, in restoring a healthy economy, is to bring down the rate of inflation. For this purpose it is necessary to keep a firm check on total money demand (the "national cash limit"). Then, if there is to be room for real growth in output and employment, wages need to increase on average by less than the rate of growth in the national cash limit.

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Objectives

4. The Government's objective must be to hold the rise in nominal earnings below the rate of growth of the national cash limit. Whether competitiveness actually improves depends also on a number of other factors, not under the Government's direct control - the behaviour of other costs, the exchange rate and productivity. But if the rate of increase in nominal wages falls faster than that of prices, so that there is a cut in real wages, this will improve unit wage costs (and profits) and hence competitiveness. Hence the Government's objective should be not merely to hold down nominal wages but also to make some reduction in real wages if this is feasible.

5. In more detail, the objectives depend on the time-scale. Immediately the aim must be to keep the rate of increase in pay settlements in the 1981-82 round low enough to ensure that price inflation continues to fall; this implies increases in average settlements of not more than 5 per cent (earnings of 6-7 per cent). Thereafter, the medium-term objective will be to prevent an up-turn in output setting off the inflationary spiral again, and to contain real wages so that higher profitability can create greater investment and output growth.

6. There is a longer-term objective of improving the health of the economy by making the labour market more flexible, so that changing needs can be met without renewing inflationary pressures, and productivity gains can be secured at reasonable cost. But this merges into wider supply-side problems such as restrictive labour practices, inadequate and inflexible training, ineffective management, slowness to develop new products, processes and services, low start-up rate of small firms, and the other familiar problems of United Kingdom industrial performance. The economy will only be transformed from the high-inflation to the low-inflation category if progress is made on all these fronts. The problem of achieving such progress by a range of supply-side measures is beyond the scope of this paper.

7. But one major longer-term theme needs stating at the outset. The unresponsiveness of the labour market reflects deep-seated attitudes. Expectations have been allowed to build up, through the post-war period, which take for granted a "round" of annual pay increases in a narrow range related to a "going rate"; in normal times this "going rate" is set rather above the expected rate of increase in the RPI, to match a notion of "entitlement" to some share in economic growth which is again taken for granted. These attitudes are difficult to change, because each individual bargaining group cannot risk being left behind, with a lower standard of living, by accepting a "responsible" settlement. The Government is now struggling to reverse these attitudes, which have been institutionalised not least in the public sector. Private sector employers are finding that the cost of automatic pay awards cannot be passed on in higher prices, so that they are compelled to negotiate for differential pay settlements in terms of their ability to pay. In the public sector, backed by the Government's power to tax and borrow, this is less convincing, and a few sharp lessons may be needed to establish that the Government means what it says and will not find extra money to finance excessive settlements.

1.2. PROSPECTS

8. In 1980-1, with unemployment high and rising, inflationary pressures were damped down, and the rate of wage increases was roughly halved. The average rise of earnings in 1979-80 had been 22 per cent; for 1980-81 it was cut back to around 12 per cent. This relative success was achieved by a combination of world economic conditions, macro-economic tightness and strict policies in parts of the public services. Specifically:-

- recession, severe financial constraints and the resulting squeeze on profit margins hit the private sector;
- unemployment rose by over 1 million between August 1980 and April 1981;
- price inflation fell (in part because of sterling's appreciation), with the result that average real take-home pay did not begin to fall until early 1981;

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- firm government action through cash limits brought down a number of settlements in the public services (mainly local authority employees, NHS ancillaries, nurses and civil servants).

9. Conditions in 1981-2 are unlikely to be as favourable:-

a. outside forecasts suggest an end to price deceleration, with a rate of RPI increase stuck in the 9-12 per cent band; and continuing weakness of the exchange rate could make the prospect worse;

b. real take-home pay has fallen, partly because of the April 1981 Budget, and employees may, wherever they can, resist further cuts in their living standards;

c. unemployment, though high, will not be increasing as rapidly as before, and those in work may feel less threatened by redundancy;

d. as the economy levels off, there may be scope for some profit re-building, making it more difficult for management to ask for sacrifices from their work-force;

e. trade union leaders appear to be even less willing to co-operate in efforts to restrain pay.

10. There are increasing pressures on pay in the public services and public trading sector, discussed further in sections 2.5 and 2.6 below. In particular, recourse to arbitration and review bodies risks the kind of inflationary award, based on a generous view of "comparability", which has occurred in the past. Public sector settlements are likely to have a powerful effect on settlements generally, despite continuing difficult trading conditions in the private sector.

11. Forecasting pay and price increases in advance is a very inexact science (for example, over the 1970s, the average error on the RPI forecast by the Treasury model was over 3 per cent). The 1980-81 pay round went rather better than expected. Nevertheless, the pressures described in the last two paragraphs suggest that current policies alone may not be

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sufficient to ensure that the short-term targets set out in paragraph 5 will be achieved if current policies continue; and there is some risk that the pay round could go seriously wrong.

1.3. COURSES OPEN

12. We have considered a number of options for improving on this outcome. We have looked at the experience of other countries, but have found no blueprints for major improvements which could usefully be adopted here. The options can be divided between action to make the present system work better (Section II below), and broader alternative approaches (Section III). Whether the latter are necessary depends on one's view about what the present system can be made to deliver, as compared with the objectives above. These objectives may be obtainable if the present framework can be made to work better. But in our view the improvements discussed in Section II would have only a small effect, and some of them only in the longer term.

13. The risks of the objectives not being achieved are therefore high. The consequences of failure would be very serious. And even if the short-term objective can be achieved, this would mean no more than maintaining the present rate of progress on inflation, with little helpful effect on output and employment. Hence the CPRS believes there is a strong case for examining different approaches, either as ways of securing a sharper and more lasting decline in inflation, or as a fall-back for use (perhaps at short notice) if it becomes clear that the objectives are not being achieved within present policies. Ministers will then be in a position to react quickly to any unfavourable change in the trends of pay and prices as they emerge from the monthly statistics. It is most important that the trend of settlements be watched closely.

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SECTION II: MAKING THE PRESENT SYSTEM WORK BETTER

14. The CPRS has examined a number of measures which could be taken within the framework of the present pay bargaining system. This section considers first how the system can become more responsive to market forces, and what can be done to change the attitudes of those operating it. It then examines some practical issues likely to come before Ministers shortly (industrial relations legislation, policy for the public services and public trading sector etc) from the standpoint of the overall pay objective.

2.1. THE FRAMEWORK OF PAY BARGAINING

15. Since the war, one trend in private sector employment has been for pay bargaining to move away from the national level towards plant and company negotiation. Recent studies (of which a more detailed analysis is given in Annex A) have shown that this process of decentralisation of bargaining is far advanced. In manufacturing industry in 1978, for two-thirds of manual workers and three-quarters of non-manual workers, the principal form of bargaining on pay questions was one of single-employer agreements covering one or more plants in a company. In the services sector, outside Wages Council industries, decentralisation is even more pronounced: in 1980, multi-employer bargaining occurred in only 10 per cent of establishments.

16. There is little hard evidence to show that moving the negotiation near to the shop-floor has led to moderation in the level of settlements, except in the present recession. But plant or company level bargaining does give local management the facility of better control over pay and employment conditions, and it is leading in many firms to better personnel-management practice, and so, it may be hoped, in the longer term to more informed bargaining in a better industrial relations climate. The Government should encourage the trend where possible in the private sector, though the scope for action is limited; in the public services and public trading sector there are different considerations, discussed in sections 2.5 and 2.6 below.

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17. There have also been changes in recent years in the timing of pay settlements, but less of a consistent trend emerges, and arrangements are still dominated by the annual pay round. There are sound theoretical arguments for trying to weaken the hold which the annual pay round has on negotiators' attitudes, in order to diminish pressures to catch up and leap-frog, and to strengthen the link with the economic reality of the firm's financial position. The American economy has benefitted from the prevalence of fixed three-year contracts which have held down real wages in times of rising inflation. On the other hand, such changes could not be imposed here by legislation without encountering serious resistance; and changes which have to be negotiated have to be paid for. At a time when future inflation rates are widely believed to be uncertain, the unions would demand either very big pay increases, or pay indexation in the second and subsequent years of wage agreements to guard against the risk of big rises in inflation. The effect on settlement rates would be unhelpful as new agreements were negotiated, and might continue to be bad if pay indexation became more prevalent.

18. In favour of synchronised bargaining for most or all pay groups, it is argued that this would help to avoid leap-frogging by establishing a single settlement rate. However, particularly in the public sector, synchronised pay bargaining carries the risk that unions will use it to increase their bargaining strength (cf. the Triple Alliance). It is likely to be costly, and the CPRS does not recommend that it should be pursued.

2.2. PUBLIC UNDERSTANDING

19. The aim of promoting public understanding is two-fold:- to persuade employers that to concede excessive pay settlements, for the sake of industrial peace, is not in their best longer-term interests; and to convince employees that they have an interest in the survival and expansion of the concern employing them, which should weigh against their short-term self-interest in seeking the highest possible settlement.

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20. On the employers' side, the CBI have already started a campaign urging lower settlements in the 1981-82 pay round. They should be fully encouraged and supported in this activity. Ministers should lose no opportunity to encourage both public and industry to seek lower settlements, and Government information sources should be mobilised more fully than at present to explain the economic reasoning for lower settlements.

21. To reinforce this, the CPRS suggests that a specific attempt be made to influence the thinking of the private sector's leading employers by direct Ministerial contact, even more systematically than at present, through private meetings held by senior Ministers with the heads of employer organisations and with large and medium-sized employers. Such meetings would no doubt give rise to wide-ranging discussions on the economy, but Ministers would aim to put across the pay restraint message set out at the beginning of this report (paragraphs 2 and 3).

22. One reason why settlements fail to reflect the economic circumstances of the bargaining unit is that the employees are either given no financial information about the company, or the information they get is unintelligible and useless. In some instances it is provided only on rare occasions to support the management's case, and tends therefore to be disregarded as special pleading. The CPRS suggests that, in parallel with the public relations programme, and in co-operation with the CBI and NEDO, Ministers should take steps to encourage improvements in management-employee communication, perhaps through the publication of a voluntary code of conduct on communicating business information to employees.

23. A weakness of the financial information conveyed to employees, and indeed considered by employers themselves, is that it is mainly expressed in terms of historic costs. It is well established that, in times of high inflation, historic cost accounting gives a misleading picture of a concern's real profitability and the extent to which it is maintaining the real value of its productive assets. The accounting profession has now promulgated a standard (SSAP 16), which requires larger companies to produce current cost accounts, but only as a supplement to their main accounts. It

is doubtful whether this more realistic presentation has yet had much effect on the thinking of employers or the financial information presented to their employees. The CPRS does not wish to press for early legislation that would require companies to treat current cost accounts as their main accounts; but we recommend that the Government should look for ways of encouraging greater prominence for current cost accounting, because of its value in the pay context.

2.3. ARBITRATION

24. However well articulated, exhortation by the Government can have only a limited effect in influencing the negotiating positions of private sector employers, let alone employees. A parallel problem is to influence the criteria used by arbitrators in pay disputes, particularly in the public sector.

25. All too often in the past, arbitration and review bodies have concentrated on achieving "fairness" for employees, by comparison with pay levels or increases elsewhere, without giving weight to an employer's ability to pay (in the private and public trading sector) or the harmful repercussive effect on other negotiations (especially in public sector arbitration where the Government is seen as effectively the employer). This has encouraged employers and unions generally to think in terms of a standard "going rate", and therefore makes the Government's task of changing attitudes more difficult.

26. This is an intractable problem, which particularly affects the public services and the public trading sector. Even within these sectors there is a very wide variety of arbitration procedure. The CPRS recommends that Ministers should ask the Department of Employment, in consultation with other Departments, to examine in detail what can be done, along the following lines:-

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i. Employers should avoid being taken to arbitration wherever possible (as the private sector now generally does avoid this). This means seeking to end a union right to unilateral access (eg British Rail), and avoiding assurances such as that given to the Civil Service this year. If a right to unilateral access cannot be renegotiated, the employer should make clear that he does not regard such arbitration as binding.

ii. where arbitration is inevitable, the terms of reference should be such as to ensure that employers have a proper opportunity to present arguments based on their ability to pay; and in the public sector the Government should ensure that proper attention is paid to the impact on other settlements and on employment. The terms of reference of ACAS and other existing bodies should be examined from this point of view.

iii. such arguments from the employers' side will need to be better articulated and presented. In particular the Government will have to be prepared to give firm quantified views, based so far as possible on macro-economic arguments, and to back these by its determination not to provide more money, and if necessary to cut back services, if the award goes beyond what it has said.

2.4. INDUSTRIAL RELATIONS LEGISLATION

27. Ministers will shortly be considering the responses to their Green Paper on Trade Union Immunities, and deciding what changes (if any) to propose in present legislation. They will have a number of objectives - safeguarding of personal liberty, promotion of harmonious industrial relations, and so on. But this report is concerned only with the objective of securing lower pay settlements, and therefore does not consider measures, such as legislation on closed shops, which in our judgment would not in practice significantly affect the bargaining strength of unions in relation to pay, even if desirable in other ways.

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28. It can be argued that existing legislation in this country, which gives trade unions virtually complete legal immunity for action in furtherance of a trade dispute, has helped shift the balance of power too far towards the unions. This has made pay less responsive to market forces than elsewhere, and has hindered productivity improvements. But there is a difficult political judgment about the speed with which it is possible to change the balance of power and the role that legislation should play in the change. Trade unions are extremely sensitive about any changes in their immunities, and their reaction to the introduction of sanctions directly against them might make legislative changes counter-productive to efforts to limit pay. Before the Government makes any move it will need to consider the likely trade union reaction, and be confident either that they will accept the change, or that the support of public opinion will enable the law to be put into effect against union resistance. The CPRS favours a step-by-step approach. The timing of each move will need to be carefully considered, and presented as a way of correcting defects in the law demonstrated by recent events. Because a step-by-step approach seems to be the only one that will succeed, and because of the time required for legislation, it is doubtful whether many of the measures considered below under this heading could have much effect on achieving the immediate objectives on pay.

Sanctions

29. In the United Kingdom it is the civil law which provides sanctions in industrial relations matters. Unless the truly radical step of bringing industrial relations legislation within the scope of the criminal law is contemplated, then enforcement of legislation will have to continue to rely on the removal of civil law immunities for non-observance. The 1980 Employment Act removed immunities for individuals for acts of secondary picketing and most other secondary action. However, the CPRS see problems in acting only against individuals because of the danger of personalising issues, particularly in a national strike context. We recommend that, while continuing to provide for sanctions against individuals (to allow for unofficial action), the law should be changed to permit sanctions directly against trade unions in some instances. As a first step, trade union

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immunities should be brought into line with those of individuals in respect of secondary picketing, secondary action and closed shops (ie bring S14 of the 1974-76 Act into line with S13). Thereafter individual and trade union immunities should be moved in parallel. This initial move should also help the bargaining balance by further reducing the incidence of secondary picketing and other secondary action. We realise that even this modest proposal is highly contentious, and that its introduction would be a matter of delicate political judgement.

Cooling-Off Period

30. Statutory cooling-off periods are used in several countries, and were incorporated in the 1971 Industrial Relations Act. Under this Act, the Secretary of State could order a statutory cooling-off period for a period of up to sixty days whilst a secret ballot was held. The provision was only used once, in the 1972 rail dispute. In this case, the order was observed and the industrial action was suspended whilst the ballot took place. However, the result of the ballot was endorsement of strike action, and the strike was resumed. In the recent Green Paper, evidence and responses on the effectiveness of cooling-off periods are mixed. It would seem quite possible that, in a national strike context where the grievance of the strikers is not too great, the cooling-off periods would be observed and would provide the extra time in which settlement could be reached.

31. The CPRS suggests that an approach to national strikes would be to provide powers for the Government to order a sixty day cooling-off period and secret ballot - perhaps funded by Government in the second thirty days of the period - in circumstances where a strike has been called or has started without a prior secret ballot. The sanction for not complying with the order would be removal of immunities.

32. A disadvantage of statutory cooling-off periods is that the action is initiated by Government, so that the Government starts to become involved in an employer-union dispute. The legislation would also be seen by the unions as a threat to their immunities, risking a general confrontation at the time when the legislation is introduced, or when the first order is

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made. Therefore the CPRS recommends that this change should be made only when events have demonstrated that the present legal position is unsatisfactory, and preferably after a damaging strike which there is fairly obvious reason to believe could have been avoided by ordering a cooling-off period and secret ballot.

Secret Ballots

33. A further step would be to promote increased use of secret ballots more generally than in the limited case of a national strike. The procedures in many unions are far from democratic, giving great power to small groups of militants, and in many cases allowing decisions on strikes or other industrial action to be taken without full consultation with the membership.

34. The 1980 Employment Act included measures to encourage secret balloting. This approach could be extended, and more effort made to encourage proper ballots, eg by widening access to funds for secret ballots and by ensuring that employers provide adequate facilities.

35. A more radical approach would be to legislate that secret ballots must be held before strikes or other major industrial action. Again the sanction for non-observance would have to be the withdrawal of trade unions and individual immunities. Either the requirement could be mandatory, or provision could be made for the right of a group of workers in the same company or economic unit affected by a strike to petition for a ballot. It is a difficult matter of judgment, without much reliable evidence, whether on balance this would help, by avoiding strikes, more than it hindered, by hardening attitudes in favour of strikes and making them more difficult to call off. Experience with the proposed provision for secret ballots in national strikes would give a better basis for a decision on this further step.

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Right to Lay Off (the EEF Approach)

36. The Engineering Employers' Federation (EEF) have put forward a totally different approach. In their response to the Green Paper, they propose legislation that would relieve employers of their statutory or contractual obligations, eg guaranteed pay, redundancy payments etc, either when part of their workforce is on strike or when their business is affected by a strike. The reasoning is that by laying off other employees without pay pressure will be brought to bear on the strikers to return to work, and at the same time the financial burden on employers will be reduced. The major drawback is that it gives the employer sweeping powers to abrogate his employees' contracts of employment unilaterally. Since this will affect white more than blue collar employees, it will probably accelerate the spread of white collar unionism. If the powers were ever used by an employer, he might sour his employee relations for a long period. Once again, the time for considering such legislation, and assessing the prospects of implementing it successfully, would be immediately after widespread and unjustified hardship had been brought about by unions and caused the public to lose sympathy with them.

Conclusion

37. In the present climate of public opinion, those changes in legislation likely to be enforceable are unlikely to make any dramatic change in the pay bargaining balance between employers and unions. At best, the balance of industrial power can be tilted only gradually and to a limited extent. As a sanction, action to remove trade union immunities will almost certainly lead to conflict between the unions and Government, and a heightening of the industrial relations temperature. This could be counter-productive in pay terms, and the potential danger should be recognised. The outcome would depend on public opinion and the trade unions' reaction to it. A step-by-step approach to changes in legislation is therefore recommended, with, at each stage, the Government taking stock of the impact of existing measures. As a first step, if and when it is judged to be enforceable and politically acceptable, the CPRS recommends action to bring the immunities of trade unions into line with those of individuals in respect of Section 14 of the 1974 Act.

38. In the case of national strikes, the re-introduction of cooling-off periods with secret ballots required before strike action is worth considering. Such a cooling-off period and ballot would be ordered by the Secretary of State for Employment, who would judge whether it was enforceable and likely to be effective before making the order. A further step, the merit of which requires further examination, would be a general requirement for secret ballots before major industrial action.

2.5. PUBLIC SERVICES PAY

39. The outcome of pay negotiations for the public services has considerable influence on the private sector. In 1980 the public services comprised nearly 4.4 million employees (around 18 per cent of the employed labour force) in a very wide variety of jobs. The pay bill is forecast to be some £25 bn (1980 survey prices) in 1981-82, probably around a fifth of total wages and salaries in the economy. The effect on public expenditure, of which wages make up about a quarter, is also of the first importance. In 1980-81, public service pay settlements averaged 8 per cent (as against 9 per cent in the rest of the economy), but this followed a number of high "catching up" settlements in 1979-80.

Present System

40. The Government's broad policy for the public services has so far been that their pay should be determined by cash limits. This means that the key decision for Ministers has been the pay factor or factors to be used in determining cash limits for the coming year.

41. Once the provision for pay is fixed and announced, the system means that pay settlements can exceed it only in one of three ways -

- a. if pay settlements for other groups within the same cash limit are kept below the limit;

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b. if the cash limit cover other, non-pay items, which can be kept below the amount provided for them;

c. if there is scope to cut numbers, below what is already allowed for within the cash limit, so that the increase in the wage bill does not exceed the pay factor.

42. An important exception to this general pattern has been made for some uniformed services (armed forces, police), who have been allowed to continue the existing pay arrangements linking them with overall pay movements; these settlements have then been financed by adjusting the cash provided. With pay increases generally declining, and restrained in other public services, these special cases have therefore done relatively well - in 1980-81 the increases averaged 10 per cent for the armed forces and 21 per cent for police against 8 per cent for public services generally.

43. The Government's influence over local authority pay is much less direct. The RSG is calculated to provide for a stated percentage increase in pay rates, but like other aspects of local authority expenditure this does not determine the outcome- RSG provides only part of local government spending, and the authorities can decide to finance higher settlements from other sources, eg rates.

Pressures for Change

44. The system of determining public services pay by pre-set cash limits is now under threat, from several directions:-

a. Those public service groups which settled in the 6-7½ per cent range in 1980-81 have fallen behind not only the RPI which has risen by around 11 per cent in the past year, but also the average settlement for the private sector and nationalised industries (both 9 per cent), as well as the uniformed services.

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b. Among the services subject to cash limits there has in practice been varying flexibility (paragraph 46 above); for example in the NHS management argues that there is no scope for cutting numbers, in most groups, without unacceptable damage to levels of service, and given the complex negotiating structure it has been necessary to impose a rigid 6 per cent limit regardless of recruitment needs or other factors.

c. If cash limits are over-riding there is not real scope for arbitration or independent Review Bodies. Thus the Doctors and Dentists Review Body (DDRB) has to be told this autumn whether there is a role for it in the coming round.

d. In the 1981 settlement for the Civil Service, assurances were given that for the coming year there would be genuine negotiations without a pre-determined cash limit, and that there would be access to arbitration (subject to over-ride by House of Commons resolution). The Treasury has prepared a paper about the reconciliation of these assurances with the setting of cash limits. The Government can still argue, in negotiation and at arbitration, for a given level of pay increase on broader grounds of national interest and "national cash limit" policy, but not on the basis of a fixed cash limit determining "what can be afforded".

e. The local authorities, whose relations with the Government are under increasing strain for political and financial reasons, are not prepared to break index-linking for firemen (following police), and are less likely take a tough line with low-paid manuals. They cannot easily deny teachers and white-collar workers access to arbitration, in view of the Government's assurance to the Civil Service.

Negotiation

45. Ministers will wish to maintain the cash limit system as firmly as possible, while not going back on the assurance given to the Civil Service and providing enough flexibility in the system to allow for this and other factors. This is broadly the line proposed by the Treasury:-

a. A provisional pay factor would be set and announced soon, as a basis for cash planning and to influence expectations.

b. The local authorities would be given a firm provision for pay as part of the RSG settlement.

c. Central Government cash limits would be set as late as possible, and might be varied from the provisional factor to allow for the Government's view of pay prospects at the time.

d. If the non-industrial Civil Service had not settled by then, the Government would have to decide in the light of the eventual settlement whether and how far to adjust the cash limit by supplementary Estimate to meet any excess (as for armed forces now); the extra cash might be found from the Contingency Reserve.

46. The main weakness in this modified system, in the CPRS's view, is that it removes the cash limit discipline as the over-riding factor in Civil Service pay negotiations. Without this, there is no firm basis for arguing in terms of 'what can be afforded'. It is still open to Ministers to argue that a given cash provision is the maximum they are prepared to find, and that, if the cost of a settlement is pushed beyond it in negotiation or at arbitration, the extra will have to be found by additional staff economies. But the important point, for other public services, is that the Government is no longer committed in advance to taking this line, and has discretion at each stage whether or not to do so. The other groups are likely to perceive this change as a weakening in the Government's attitude.

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47. This is a radical change from the 'pure' cash limits system. In the CPRS view, the consequences have not been thought through, and will appear in the course of this year's pay negotiations. We regard it as an unstable compromise, which even if it survives for the year is likely to need replacing for the 1982-83 pay round. It is particularly awkward for the NHS, where a broad assurance was given to nurses about the Government's willingness to consider "comparability" arrangements, and where there has to be a firm limit for management side negotiators dealing separately with a wide range of NHS staff groups.

48. For 1981-82, we see no alternative to an approach on the lines envisaged by the Treasury, and make the following supplementary recommendations:-

i. The recent changes mean that the system is not so robust that it can be relied on to deliver a very low pay increase for the public services on average. Hence the provisional pay factor should not be set unrealistically low (so as to avoid a subsequent revision upwards which would be seen as a defeat for the Government and encourage other groups to become more aggressive); the same applies to the provision for local authority pay in the RSG. It should be presented as an average, requiring some settlements to be lower. This is an extremely difficult point to get home; it must not be seen as a starting point, for negotiating upwards from opening offers. The risk is that, if cash limits are no longer "pre-determined" any announced figure will be treated as a norm which unions will then try to exceed.

ii. For the Civil Service, the balance of advantage is likely to be against rushing through an early settlement before cash limits are fixed. But Ministers will need to consider negotiating limits and tactics at an early stage, to stand the best chance of reaching a reasonably low settlement without either an embarrassing climb-down on the one hand, or another lengthy conflict on the other.

iii. The NHS pay provision should be planned from the outset to be, say, 1 per cent higher than the pay factor in other cash limits, despite the awkwardness in relation to other public services. It need not be announced until later when cash limits are fixed. This extra sum should be allocated by DHSS to those groups (eg nurses) where the pressures and arguments on merits are strongest - but should then be presented to management sides as firm pre-determined cash limits, so that the decentralised Whitley Council system for pay negotiation can continue. The DHSS believe that this would be workable.

Arbitration and Review Bodies

49. The provision for recourse to independent bodies - notably, for civil servants to arbitration, and for doctors and dentists to the DDRB - means that cash limits cannot be relied on to hold in those cases (any more than for the armed forces). In each case it is open to the Government to reject the award (subject, for the civil service, to House of Commons resolution). But in practice it is very awkward for the Government to reject the award of an independent body after that body has considered the Government's own evidence. It is bound to exacerbate relations with the group concerned, perhaps to the point of industrial action, particularly if the group see themselves as being singled out arbitrarily for specially harsh treatment.

50. Therefore the CPRS attaches importance to the recommendation in Section 2.3. that independent bodies generally should be encouraged to give full weight to broader economic considerations. Such a change would enable the Government to put all the considerations before such bodies with more effect; in particular they should emphasise the likelihood that, if the award goes beyond what the Government is prepared to pay, there will have to be cuts in employment to keep within the cash limit, even at the cost of some loss of efficiency and diminution of service.

51. If the Government's evidence can be marshalled effectively, this should have a considerable impact. But such bodies are set up to form their own independent judgement, so that there can still be no guarantee that their awards will always be acceptable. Therefore the Government will still wish to retain a long-stop power to over-ride awards, though this power could and should only be used very rarely.

52. In practice this means that neither the DDRB nor the Civil Service Arbitration Tribunal can be formally required to make an award within a pre-set cash limit. But the Government should still firmly state its view of what it is prepared to pay, and the implications of exceeding that limit for other pay negotiations, for numbers employed and for the standard of service. If the award exceeds the limit, and is not overturned, the Government should be ready to announce a cut-back immediately to demonstrate the firmness of its position. Local authority employers should be encouraged to take a similar line if they are taken to arbitration by teachers or white-collar staff.

Longer Term

53. For the 1982-83 pay round, the system for determining civil service pay is under consideration by the Megaw enquiry. The Government is preparing evidence to the enquiry, and this is likely to invite consideration of a system which takes more account of the recruitment and retention needs of particular groups of staff. Such a system has been examined in some detail by officials. In the CPRS view there is a strong case in principle for taking recruitment/retention explicitly into account, and avoiding a formalised system which makes this more difficult. In practice there are no doubt limits to the applicability of this test in a large diverse service, where the "marketability" of particular skills varies widely and where internal relativities can have their own organisational importance.

CONFIDENTIAL

54. It is even more difficult to find data to establish what rates of pay are needed to recruit and retain in other public services where large groups (eg nurses, teachers) have no analogues on a comparable scale in the private sector. Such groups will not indefinitely accept pay increases determined by cash limits which have been set in advance at an arbitrary across-the-board percentage, when other groups can argue for higher increases on "market" tests and can take their claims to arbitration. When the inquiry has reported next summer, officials will need to examine the recommendations (if they are broadly accepted for the Civil Service) and consider how they can be adapted to apply to other public service groups. But in the CPRS view this should not be allowed to lead back to a vague form of broad "comparability". There is probably no alternative to a careful assessment of the position for each major group, in which Ministers will have to form a judgement based on recruitment/retention needs and trends, pre-set pay factors and other industrial relations aspects. At the same time the automatic "comparability" arrangements for the uniformed services should be ended, to allow more account to be taken of these other factors.

2.6 THE PUBLIC TRADING SECTOR

55. The public trading sector employs $1\frac{1}{2}$ million workers, and their pay amounts to 10 per cent of the national wage bill. While less under Government control than public services, it is nevertheless seen as a Government responsibility, and high settlements influence the private sector.

56. But pressures for high settlements in some industries are strong. The most acute problem is posed by the utilities (and coal as an indirect utility - through its contribution to electricity) because:-

CONFIDENTIAL

- industrial action can lead to serious damage to domestic life and to industry, in some cases very quickly;
- the coal (1 November) and water (1 December) settlements come early in the pay round, and influence other bargainers;
- the NUM has the solid support of the miners and a history of success.

In some of the other industries, such as BR, Posts, BT, industrial action (eg against the London commuter service) can also have serious effects, and indirectly hit utilities (eg movement of coal for power stations, telecommunications control of oil and gas pressure).

External Financing Limits

57. The front line of defence against excessive pay increases in the public trading sector is the External Financing Limit (EFL). EFLs are designed to act as a restraint on the total financial demands of each industry in the public trading sector. They should therefore take the place in pay bargaining of the threat of bankruptcy or closure for private sector bargainers. But in many cases the effect of EFLs has been limited, and a number of settlements have been reached much higher than those assumed by the industry and Government in the EFL.

58. The weakness of EFLs as a constraint on pay bargaining has been due to:-

- their small scale and unpredictability as the residual between much larger totals of revenue and expenditure; labour costs are a small element in the finances of capital-intensive industries, notably gas and electricity;

CONFIDENTIAL

- the arbitrariness of EFLs compared with the realities of the industry and of union power within it, as seen by bargainers in utilities or other de facto monopoly industries such as coal;

- their vulnerability to changed external circumstances: the rail pay negotiations were complicated by the public knowledge that BR is already in breach of its 1981/82 EFL.

59. EFLs have an essential role in the financial control of industries. They are one method by which Government can exert tighter pressure for change, for productivity improvement or for low pay settlements. They can be used to strengthen management's resolve in bargaining. But they are only one element in the bargaining framework, and they cannot be relied on to counteract strong unfavourable pressures. For other counter-pressures, it is necessary to look at individual industries.

Coal

60. The most important settlement in the public trading sector is that in coal. Following successful industrial action in the early 1970s miners have substantially improved their relative pay position. On the other hand, in the last three pay rounds miners have accepted settlements which were not aimed at further improving their relative position.

61. The CPRS considers that the NUM's bargaining position is a strong one, and that the balance of bargaining power will only be changed by a coherent longer-term strategy. In the short run the Government should avoid exacerbating the miners' grievances. If as seems likely the settlement is higher than the Government would wish, it should be presented as a special case, in order to limit the damage as far as possible.

CONFIDENTIAL

Gas, Electricity, Water

(1) The background

62. The bargaining framework in these utilities is dominated by the potentially serious effects of industrial action on domestic life and industry. Action by supervisors and senior engineers can have an immediate impact; action by manuals takes longer to take effect but soon poses serious problems for health and safety.

63. This creates problems not only for the employers and Government, but also for the trade unions. They need to find some form of selective action in order to avoid appearing to attack society and thus losing public sympathy. They have traditionally been responsible, but there are growing signs of militancy, eg a narrower definition of safety cover in the recent one-day strike in gas, and similar NUPE attitudes in water.

64. Trade union bargainers in these utilities have, where possible, pressed for comparability with the miners, in order to benefit from their solidarity, proven record of success and hold on public sympathy. Partly as a result, earnings in the 1970s increased in gas, electricity and water relative to average earnings -

| % of average earnings: | <u>1972</u> | <u>1980</u> |
|------------------------|-------------|-------------|
| Gas | 109 | 117 |
| Electricity | 106 | 118 |
| Water | 96 | 103 |

Earnings in water nevertheless remain relatively low, reflecting earlier history and the relatively unskilled nature of much of the work.

(2) Solutions

a. A ring-fence

65. The first objective should be to achieve lower settlements for these utilities than is likely for coal. This will need careful handling, to emphasise the special features of a coal settlement and the particular circumstances of each industry.

66. An alternative is to operate a 'ring fence' round these industries. This would involve treating them as a special case even without formal 'no-strike' provisions, and would mean drawing a clear distinction between them and other groups, eg BR, Posts, local authorities, NHS. (In fact the historical link between local authorities and water has been much weakened since the reorganisation of the water industry in 1974.)

67. To achieve this will mean a tough policy elsewhere, and is likely to involve confrontation in difficult (if less essential) areas. The more publicity such confrontations are given (and the less the utility settlements get) the greater the likelihood of lower figures being established in the public mind. The more pain Government is prepared to accept in the public sector, the more impressed will be employers in the private sector.

b. Public Opinion

68. The destructive effect of industrial action forces both sides to mount a campaign to retain public sympathy. Unlike miners, most utility workers live among other workers who, with their families, will immediately be affected by a strike. This tends to constrain disruptive actions by these unions, and provides a background for compromise before or in a dispute.

69. Public resentment at tariff increases could be mobilised at an earlier stage in order to restrain pay demands. But the scope for this is reduced because:-

- direct pay represents a relatively small proportion of costs;
- the bulk of recent tariff increases in gas and electricity have been the result of the Government's policy to raise energy prices to more economic levels, making it more difficult to blame further increases on union action.

c. No-strike provisions

70. Given that the services provided by the utilities are essential, is collective bargaining appropriate? Is not the threat to withdraw labour as ill-placed as in the police and armed services? Would not the overall climate of pay bargaining be less influenced by utility settlements if they were seen clearly as a special case?

71. Legislation to make strikes unlawful must in our judgement be ruled out as unenforceable unless the climate of public opinion were drastically changed by an unpopular strike. 'No strike' agreements offer an alternative approach. The minimum conditions on pay would probably include a one-off increase to buy such an agreement for (say) three years, plus provisions for arbitration based on stated criteria. A commitment to index-linking might also be required as part of the price. Arrangements to settle non-pay disputes, eg by arbitration, would also be needed.

72. The major advantage for overall pay bargaining would be if the utilities could be removed from the pay round, and hence from the frame of reference of other bargainers. The more automatic the increases the less risk of argument: from this point of view index-linking might be preferable, with increases perhaps quarterly or six-monthly.

73. The disadvantages are obvious:-

- it would be expensive both in a once-off payment, and in settlements at the RPI level when the Government may be aiming for a reduction in real wages;

- it extends the principle of index-linking more widely;

- it might not be honoured. Grass roots feeling, especially in the relatively low-paid water industry, might regard a 'no-strike' agreement, on whatever terms, as a sell-out by its union leadership.

74. In present circumstances these disadvantages appear too great to risk seeking to negotiate formal 'no-strike' agreements.

d. Decentralisation of bargaining

75. Bargaining in the utilities has been centralised by the statutory framework. The issue of decentralisation arises most sharply in the water industry because of the proposed abolition of the National Water Council. When this is discussed with water authorities, the Government will have to consult about future bargaining arrangements. Decentralisation of bargaining in water, if achieved, will have unpredictable effects on the pay framework. Of the principal water unions, GMWU and NUPE, the latter is more militant and is also more heavily represented in some of the more vulnerable metropolitan areas. Decentralisation would dilute the moderating effect of the GMWU: this might lead to a wider spread of settlements, or it might cause both unions to compete to show greater militancy and to achieve higher overall settlements as authorities were picked off one by one.

76. Decentralisation might weaken political pressure on government to bring about settlements at excessive cost, and it would remove the demonstration effect of a national water settlement. But it would not in itself weaken the trade union position vis-a-vis any particular authority, and could well strengthen it by allowing the trade unions a bargaining strategy based on achieving particular high settlements and then going for parity. For this reason the CPRS considers that a move to decentralisation would be unhelpful.

77. Decentralisation of bargaining in gas and electricity is not immediately practicable: the distribution systems of both industries now give them a natural unity, and one which the trade unions concerned would not easily give up.

The non-utility, service industries

78. The adverse bargaining framework in the utilities makes it even more important for low settlements to be achieved in 'less essential' publicly owned industries, such as BR, Posts, BT, which are not subject to the pressures of international competition. Yet the ethos of these industries has historically been that of a utility. Indeed, as their respective management and unions well know, major parts of BT are essential to business (including oil and gas supply), and the role of BR's London commuter services is like that of a utility.

79. The Government must have a strategy for each of these industries which allows it to demonstrate both to management and unions that higher wages will, through higher tariffs, mean less business. This requires a convincing background of competitive pressure sustained over time. Thus -

- BR must see its market share threatened by car and deregulated bus services, and its electrification plans stalled if its costs are too high; the threat to close parts of the business (including lines) must be a reality;
- Posts and BT must see the licensing of competitive services as a reality.

80. But these pressures may take time to be perceived as real. A national strike may at some point be necessary, as in Posts in 1971 (and Steel in 1980). In each of these industries it is therefore essential that the Government takes full account of the risks of industrial action; it should choose its ground carefully and make preparations accordingly.

The Trading Corporations

81. Trading corporations (ie those such as BA, BSC and BS which have to compete internationally) should pose less of a problem, at least in the short-term when they face severe financial difficulties. The key is the belief among bargainers that Government will allow the closure of unviable parts of the business, or even the business as a whole. The Government achieved this eventually in the 1980 steel strike.

82. Nonetheless, the financial position of the business is only one of the factors which bargainers take into account. The labour market is also a relevant factor, which may require managements to pay money wage increases even when a business is wholly supported by public subventions.

The Labour Market, Comparability and Productivity Bargaining

83. A move towards tougher pay bargaining in the public trading sector must therefore not lose sight of the labour market. Many jobs in nationalised industries are not well paid and involve unsocial hours. If the remuneration of these jobs is held down, there may be difficulties in recruitment. Therefore an arbitration award will not necessarily yield a low figure, even when due weight is given to market and other factors (section 2.3 above); in such cases it is important to emphasise special factors in order to minimise repercussions.

84. One way to reconcile these pressures is through more effective productivity bargaining. This has a particular role in nationalised industries because of the scope for reducing the restrictive practices which have built up due to the lack of competitive pressure. Effective productivity bargaining can increase real wages whilst lowering unit costs.

85. The argument for attaching productivity bargaining to the annual pay round is that it forces the issue: it brings out the trade-off between jobs and pay, and may reduce the endless prevarication which trades unions unwilling to lose members can introduce to productivity bargaining on its own. It encourages employers to attempt to make a wage settlement self-financing.

86. Dangers to be guarded against when combining pay and productivity bargaining are that -

- a. it is more likely to lead to dispute (steel, rail);
- b. it may lead to high settlements which, although justifiable in the industry context, may be quoted out of context by other bargainers.

87. It is clearly right to avoid any link between pay and productivity in cases where the productivity gains can be made without cost. But if the only way of getting the productivity is to concede part of the saving in increased pay, the Government should encourage the link, taking care that the reasons for an apparently high settlement are then explained in its public presentation.

Investment

88. The climate for pay bargaining in some industries (eg BR, and BT) may be improved if management and unions believe that future investment depends on the performance of the industry. Investment approval is sometimes too blunt an instrument to be used directly to influence any particular pay settlement. But a consistent policy of relating the speed of investment approval to overall performance - if IFR pressures allow this - may help to reinforce an improved framework for bargaining in the industry. (This argument does not apply to Posts, where unions resist investment since it principally replaces jobs.)

Conclusion

89. The implication of this analysis is that the Government needs to play a more positive role in pay bargaining in the public sector. This role can only partially be played through the mechanism of EFLs. It is a role not of bargaining itself, which is management's job, but of setting a framework in which management is most likely to achieve the best results. This requires discrimination between industries (especially between utilities, with coal, and the rest), and a strategy for each industry. For Ministers to play this role effectively will require an improved framework in their overall dealings with nationalised industries, a subject on which the CPRS has already reported.

2.7 Other Issues

a. Wages Councils

90. The CPRS believes that there is not sufficient evidence to justify seeking to abolish the Wages Councils, in the face of strong political resistance. They should however be influenced by the proposed greater

emphasis on economic criteria (section 2.3 above). We also see advantage in further study of removing the Councils' powers of arbitration, so that they would function solely as a forum for negotiations and a protection against exploitation; details in Annex B.

b. Low pay

91. The scheme for subsidising jobs for young people at rates of pay up to a threshold should help to restrain the pay of juveniles. In any new employment measures (eg subsidy for new jobs on Layard lines), it would be worth seeking to extend this principle.

c. Cuts in benefits to the unemployed

92. A cut in the value of benefits available to the unemployed should encourage some unemployed to accept jobs at lower rates of pay. The full effect would take time, perhaps a long time, to come through because:-

- institutional barriers to entry limit the extent to which the unemployed can price themselves into a job;
- the contingent cost of being made redundant may be only weakly perceived by those in jobs.

93. There would be obvious political problems in adopting such measures. In the CPRS view, their effect on pay is not likely to be large enough, or immediate enough, to provide a justification on its own. But if Ministers see this area as a promising candidate for a further public expenditure saving they will wish to note that the longer-term effect on pay should also be helpful.

d. Improved Working of the Labour Market

94. One strand that runs throughout present problems on pay is the unresponsiveness of the labour market in the United Kingdom to demand changes. An obvious example of this is the very muted effect which substantial unemployment has on rates of pay - at best a lowering of wage increases rather than an absolute downward effect on wages. The CPRS

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attaches great importance to action on any other "supply side" moves that could improve the working of the labour market. This wide range of subjects is not examined further in this report, but the CPRS is committed to considering this further in collaboration with the Treasury.

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SECTION III

ALTERNATIVES TO THE PRESENT SYSTEM

95. As explained in paragraph 12, it can be argued that fundamental changes in approach may not be needed if an optimistic view is taken of the chance of success which is likely to be achieved through present policies, aided by changes of the kind set out in Section II. But it is not too early to look at possible measures for use, perhaps at short notice, if it becomes clear that the objectives are not being achieved. This could happen if the rate of pay increases did not come down as fast as hoped or, worse, if it began to re-accelerate. This relates to our recommendation that Ministers should be in a position to react quickly if necessary (paragraph 13).

96. A further consideration is that, even on the optimistic view, we do not believe that current policies will lead to a step change for the United Kingdom from being a high-inflation country to becoming a low-inflation one. We therefore see advantage in examining alternative approaches which could make a bigger contribution towards bringing about such a change. Is any likely in fact to be successful in the longer term? If so, are the expected economic benefits likely to counter-balance the political costs?

97. We consider alternative approaches under two headings - the consensus approach, and formal pay policies of various kinds.

3.1 The Consensus Approach

98. On this approach, the Government would establish a forum to consider pay questions with at least the CBI and TUC and perhaps others (eg representatives of financial institutions). This could be achieved either by using NEDC to discuss and report on general pay issues, or by setting up a new body, with meetings, say, twice a year at times relevant to pay bargaining. The main aim of the forum would be to provide information about feasible and desirable average pay increases in the economy as a whole, given the Government's counter-inflation objectives and determination to

CONFIDENTIAL

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stick to a planned deceleration of monetary growth. In practice, the message from the national level can hardly be conveyed in a form with a practical bearing on wage bargains unless it is expressed as some kind of norm. We do not think it realistic to leave pay bargainers to infer the feasible path for pay from the growth for £M3 set out in the MTFS. And as the Conservative Central Office document "The Right Approach to the Economy" noted in 1977: "The Government must come to some conclusions about the likely scope for pay increases if excess public expenditure or large-scale unemployment is to be avoided; and this estimate cannot be concealed from the representatives of the employers and unions whom it is consulting".

99. The disadvantages of a norm in the context of a formal incomes policy are well known - a norm is too rigid, and tends to be treated as a minimum. But in the context of a system of pay determination largely based on free collective bargaining, there is no question of rigid enforcement of a norm. If it is the outcome of tripartite discussions there might also be less inclination to regard it as something to beat in order to prove the virility of union representatives on the shop floor.

100. The forum approach should spell out the price consequences of aggregate bargaining behaviour - consequences which may well not be perceived by individual bargaining groups who feel, and rightly, that their particular pay settlement would itself have very little effect on the RPI, and who understandably ignore the cumulative repercussive effect of settlements. These price consequences, set against the national cash limit, would then bring out the implications for employment. By this means, the Government might hope to influence expectations favourably, and thus limit the rises in unemployment which otherwise result from ignorance of the scope for overall pay increases in the economy.

101. But we do not think it would be worth while for the Government to seek any formalised agreement by treating the forum as a basis for bargaining. It should resist any attempts from the CBI or TUC to trade price or pay moderation for changes in monetary, fiscal or other policies. With the shift towards decentralised pay bargaining (paragraphs 15 and 16 above),

neither the CBI nor, in particular, the TUC is able to deliver any commitment on pay (or therefore prices) over a sustained period. For these reasons we do not think there is scope for achieving effective consensus by offering a public expenditure package in exchange for undertakings on pay restraint.

102. We consider that the consensus approach could at best be expected to have only a broad influence on attitudes in pay bargaining. It might pave the way for a more formal pay policy of the kind discussed later, such as a system of compulsory arbitration (Section 3.2C below). However, in the light of recent experience of the TUC's attitude in NEDC, Ministers may well take the view that such an initiative on this consensus approach would at present be fruitless.

3.2 Formal Pay Policies

103. Experience so far is that pay freezes, norms etc. have only worked temporarily: inflation may fall in the early "freeze" phase of the policy but bounces back in the subsequent "thaw" phase. Thus pay policies have affected the path but not the underlying level of inflation over time. The benefits have been slight, and outweighed by the costs in terms of distorted labour markets and other distortions (eg dividend restraint, price controls) introduced in order to gain union acceptance.

104. The lessons of past failures suggest certain minimum criteria to be observed if formal pay policies are to have any chance of securing a lasting effect:-

i. Acceptance

Above all, there is a need for widespread public acceptance of the policy, including at least tacit acceptance by trade union leaders. If the trade unions and employees generally decide to challenge the Government head on, no policy, however tough and whether or not

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statutory, can succeed. If the policy is presented as "temporary austerity to meet a crisis" there will be less willingness to accept longer-term institutional arrangements to prevent a "bounce-back".

ii. Preserving Living Standards

This need for acceptance is a limit on the extent to which pay policy can seek to reduce real living standards. The basic presentation should be modest, simple and appeal to commonsense: since high nominal earnings increases lead to higher prices and higher unemployment, it would be more sensible to have lower money awards all round with smaller price rises and healthier economic prospects.

iii Complementary Fiscal and Monetary Policies

Domestic fiscal and monetary policies need to:

- avoid the development of excess demand in the economy
- ensure as far as possible that pay moderation does not lead inadvertently to excessive reduction in real wages. In particular, macro-policies should aim to secure an exchange rate sufficiently buoyant to bring about some deceleration of import prices. Fiscal changes - for example, cuts in indirect taxes - should aim to compensate if an excessive squeeze on real living standards appears likely to result from the lags before lower costs feed through into lower prices.

iv. Fairness

To maintain acceptance of the policy, it must be seen to be reasonably fair. The policy should be kept as simple as possible. In particular, help for the low paid should not form part of pay policy but of fiscal and welfare policy.

v. Preserving Labour-Market Flexibility

Policies need also to accommodate the shifts in relativities which are necessary to meet the changing requirements of the labour market.

105. In the light of these criteria, we now examine four main types of formal pay policy: - a statutory pay limit, a relativities board, compulsory arbitration, and a wage-inflation tax.

3.2A A Statutory Pay Limit

106. A freeze or formal pay norm would be acceptable only as a temporary measure to cope with a crisis - for example, if pay rates were clearly beginning to re-accelerate in the 1981-82 wage round. The choice between a freeze or norm also depends on conditions at the time. If average settlements were in double figures, a freeze would be a major shift and might well be thought unlikely to hold because the reduction in real wages would be too drastic; the problems of managing macro-economic policies to prevent this would be extremely difficult. A low norm would be more realistic in such circumstances. To have the best chance of gaining acceptance, consideration would have to be given to the following aspects:

i. Enforcement

A statutory pay limit raises the question of sanctions and enforcement. It is axiomatic in this area that a penalty will serve as a deterrent in the occasional case only if the policy is generally accepted. It will be overturned if a large body of employees, with or without the support of their unions, is determined to resist the policy. Given this major proviso, a practicable sanction would comprise substantial fines on employers who accede to, or on unions who go on strike to press for, a rise in pay beyond the norm.

ii. Timing and Duration

Although by the spring of 1982 it may be possible to foresee a pay crisis, it would be better if possible to delay a decision to introduce a statutory limit until the summer months, in order to avoid arbitrary restrictions on outstanding settlements, and to enact the necessary legislation for a statutory freeze or norm from the beginning of August 1982 - just prior to the next wage round. Should a crisis develop earlier or later than this, the legislation would need to provide for commitments entered into but not implemented before the commencement of

the policy (ie whether these should be honoured). The measures would have to be put into force as soon as they were announced to avoid a rush of wage increases before introduction. As for duration, experience suggests that a freeze would not last longer than 6 months. Again, feasibility depends on the climate of opinion at the time; as a general rule, it would probably be easier to sell a low norm for a year, rather than a freeze. A mixture of both - a 6-month freeze followed by a 6-month norm to ease re-entry - is a further possibility.

iii. Coverage

There would be questions whether to apply a freeze or norm to basic pay alone or also to rates of pay for overtime, piece rates and the like; whether productivity-related increases should be allowed; and whether there should be exceptional cases (eg manpower needs). As a general rule, a freeze or norm in the circumstances we envisage can take advantage of a sense of national crisis by being pretty crude and uncomplicated, allowing no exceptional cases and applied to all pay increases. To add a small degree of flexibility, the norm could be expressed in terms of the pay of a bargaining group (ie pay bill per head) rather than for individual pay rates; once the total group sum has been established, it could be distributed - favouring one set of workers to another - as the negotiators wished. Previous short but crude pay policies have generally succeeded with very little leakage while in force.

iv. Complementary Policies

Typically a pay freeze has been accompanied by freezes on other incomes (rents, dividends) and prices, partly as a means to sell it as a package on grounds of equal misery. Price control, however, has proved less than effective even over short periods, and control of other incomes, while perhaps equitable, is likely to be distortionary. Circumstances permitting, we would prefer to see the policy accompanied by tax reductions to avoid an excessive effect on wage earners' real incomes - and indirect taxes have of course the most direct effect on the RPI.

v. Follow-up

The policy will be severely criticised if it offers no more than a sharp reduction in pay increases for, say, 12 months, with no longer-term measures to prevent a "bounce-back" thereafter. To gain the necessary degree of acceptance, the Government would have to be prepared to say something at the outset about its intentions for a successor policy, and probably to discuss this with both sides of industry.

107. The CPRS accordingly does not believe that the possibility of introducing a statutory pay limit (freeze or norm) is by itself a sufficient insurance against a crisis centred on a renewed pay explosion. The rest of this report examines longer-term measures which might be used either as successor policy after a short-term pay limit, or from the outset to improve prospects for pay restraint.

3.2B A Relativities Board

108. A statutory limit on pay increases could be made more flexible by setting up an independent board which could permit higher increases in cases where it judged that certain broad criteria laid down by the Government were satisfied. But the difficulties of attempting to prolong a statutory limit by this means are well known. As case law builds up, the list of exceptions allowed by the board grows, whether on grounds of recruiting and retention needs, past relativities or (however disguised) the industrial power of unions in monopoly industries. Other unions focus on these cases and the pressures for "comparable" increases are stepped up. In the absence of any real market test to cope with these pressures, the board is likely to be swamped with more and more detailed casework, while the essential belief in the system's "fairness" is lost. We do not believe that to re-establish a board on these lines is likely to provide a satisfactory way of prolonging the life of a statutory policy.

3.2C Compulsory Arbitration

109. Under the simplest version of this system there would be no limit on pay increases freely negotiated between employers and unions, but if no agreement could be reached the parties would be required to refer the case to independent arbitration before they took industrial action. The effectiveness of this would depend on the extent to which the arbitrators took account of broader guidelines of the kind suggested in section 2.3 above.

110. If the unions had not been consulted on these guidelines, they might refuse co-operation and ignore the awards. The next step, to tighten up the system, would need to be sanctions, perhaps through fines, against unions (or employers) who rejected an award. But the problem of making sanctions effective against large bodies of employees has already been discussed. A further possible step, to avoid the inequity of agreed but inflationary settlements, would be for the Government to be able to call in selected settlements for compulsory arbitration.

111. To avoid putting too great a strain on sanctions, advocates of variants of this system - notably Professor Meade - assume that it could be introduced only as a result of broad public support, embodied in a consensus reached between the Government and both sides of industry aimed at co-operation to improve the inflation and unemployment trade-off. The criteria applied by the arbitration body would have been agreed by employers and unions collectively (Meade suggests a simple test: award in favour of whichever negotiating position is more likely to promote employment in the industry). It might then be possible to apply sanctions (eg penalties on strikers, removal of immunities) to deter the parties from rejecting an award. But all this turns on achieving a firm consensus between the Government, CBI and TUC, involving a strong statutory restraint on industrial action, which the TUC almost certainly could not be persuaded to endorse in present circumstances. Consequently we do not recommend this approach as an immediate option.

3.2D Wage-inflation tax

112. A wage-inflation tax (WIT) scheme requires the Government to set a target or standard for the average level of pay increases across the economy; this could be related to the national cash limit, at a rate which would allow some reduction in unemployment. Then pay increases above that level are subject to a special tax, and/or increases below it qualify for a rebate.

113. In principle there would be attraction in taxing employees direct, to remove all or part of any pay increase above the standard. But administrative complications probably rule this out. And even in principle, if the intention were to tax away all of the excess, this would remove all flexibility and approximate to a cumbersome version of a pay freeze. On the other hand, a tax removing only part of the excess might perversely encourage powerful groups of employees to demand higher pay increases to achieve a given net target.

114. Thus we regard a tax on employers as preferable. This could have any number of variants. The CPRS considers that a version worth examination would be as follows. The Government would set a standard rate of pay increase - say 5 per cent. Then, if the earnings per hour paid by an employer to his workforce over a "pay year" exceeded the earnings per hour in the previous year by more than 5 per cent, he would be required to pay in tax an amount equivalent to a substantial percentage (say 30 per cent) of the excess; and if earnings per hour had risen by less than 5 per cent, he would similarly receive a rebate equal to 30 per cent of the shortfall.

115. As with any new tax, there would be administrative complications and problems. These are discussed further in Annex C. So far as we can see at present, none of these difficulties is over-riding, though it must be admitted that no other country has yet introduced a WIT scheme on these lines.

116. The main advantage of the scheme is that it strengthens the existing market incentive on employers to hold pay increases down, without imposing a rigid framework or preventing them from offering higher pay where they consider it in their interest to do so. Hence it could be presented as permanent scheme, with a new standard pay increase to be set by the Government each year in line with its macro-economic policies and expectations.

117. The most difficult question is whether the scheme would be effective. Unions who have the power to extract excessive pay increases from their employers now would still be able to do so, and, particularly in monopoly conditions, the employers could pass on the extra cost in price increases. But this is true under any alternative policy except a rigid statutory "norm", with all its disadvantages and limitations. In pay negotiations, employers could show that their ability to pay more than the standard rate of increase was substantially curtailed by the tax - the deceleration of private sector pay increases in the last round suggests that this general argument from "ability to pay" can have some effect. Large employers in conditions of oligopoly (eg banks) who are not now required to account for large pay increases would have to explain in their annual reports, to shareholders etc, why they had found it necessary to pay more than the standard rate and incur a heavy tax bill. In the last resort, to the extent that pay increases exceeded the Government's target there would be additional revenue to help the PSBR or reduce other forms of taxation.

118. A WIT scheme could not be effective in the public services. In the public trading sector, one possibility would be to establish a clear relationship between excessive pay settlements (including the consequent tax liability) and the level of permitted investment. A firm Government stand on public sector pay would be strengthened, given that the Government was putting analogous pressure on private sector employers to concede no more than a standard rate of increase on average.

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119. One serious criticism of the scheme is likely to be that it taxes expanding firms and those wishing to pay extra in return for productivity gains. A firm which pays more overtime, or which needs to raise its pay rates to attract more workers, will face a tax penalty. But arguably a penalty on increased overtime is no bad thing in conditions of high unemployment, and an expanding firm should find it easier to recruit, with only a small differential beyond the standard increase, when other employers are forced to think twice about following it and setting a new "going rate" beyond the standard percentage. One way of meeting the point about productivity might be to set up tribunals to exempt genuine productivity deals.

120. Finally there is the question of acceptability. The tax would certainly be unpopular with employers, and the exemption of small firms is discussed in Annex C. But it might be difficult for employers' organisations such as the CBI to argue convincingly against the scheme in a situation where their pleas for continuing "voluntary" de-escalation of pay had clearly proved ineffective. The unions, particularly in the public sector, might be inclined to treat it as a Government-imposed norm which they would seek to overturn. But in the private sector (and competitive areas like BL) this could be shown to be against the interests of the employees themselves. In the public sector, as a minimum, the Government might argue that a few high settlements in monopoly situations (eg coal) did not conflict with the scheme, provided that they imposed an appropriate penalty analogous to the tax, eg through investment, if pay settlements were too high.

121. This scheme would be a large-scale addition to the industrial scene, complicating the negotiating tactics of all large employers and unions. It would have budgetary implications. It might be introduced either as a response to a crisis (whether or not following an initial statutory limit) or as a long-term Government initiative to improve pay and employment prospects. More work needs to be done on the administrative details, and on alternative versions, and we recommend that officials should now undertake this work on a contingency basis.

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122. None of the fundamental changes in approach that have been examined appears very satisfactory or attractive. The wage-inflation tax scheme is in our view worth exploring further. Before dismissing it, there is a need to view its possible use against the background of the serious situation that would exist if wages cannot be brought down sufficiently by present policies, so that the alternative is failure of the basic economic strategy.

CONFIDENTIAL

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ANNEX A

THE PRIVATE SECTOR BARGAINING FRAMEWORK

1. The framework of pay bargaining in the private sector has changed rapidly over the last decade. Ever since the war, the trend in private sector employment has been for pay bargaining to move away from the national level towards plant and company negotiation. The pre-war system of multi-employer national agreements has tended to break down and devolve into single employer bargaining, with national industry bargaining moving from settlement of rates or earnings' levels and conditions to minimum rates and perhaps conditions only. This prperhaps conditions only. This process continues, and one can envisage the weakening of most of the remaining national agreements as time goes by.

Manufacturing Industry

2. Surveys have shown that the point has been reached where a considerable majority of employees in the private sector now have their pay settled locally with a single employer on a plant or company basis. In manufacturing industry in 1978, on pay questions, for two thirds of manual and three quarters of non-manual employees the principal form of bargaining was one of single employer agreements covering one or more plants within a company. However, it has also been noted that there is a counter move in the large companies where responsibility for pay bargaining is being moved up the hierarchy, presumably to permit greater senior management control of the outcome. This seems particularly true in foreign-owned companies, which often make better use of their personnel management, but also in some of the major companies with integrated businesses such as the motor manufacturers. The surveys also showed that 15 per cent of non-manual and only 4 per cent of manual employees had their pay settled with no bargaining.

3. Multi-employer agreements are still of importance in some manufacturing industries, including printing and clothing, which are generally characterised by low industrial concentration and ease of entry. However, these cover only about a quarter of the manual and a tenth of the non-manual workforces. United States experience in similar low capital usage industries confirms a view that multi-employer bargaining will continue for the foreseeable future, albeit on a reduced scale.

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Private Non-Manufacturing Industry

4. A recent survey has shown that pay bargaining in the services sector, excluding wages council industries, follows a rather different pattern from that reported in the manufacturing sector. Firstly, unilateral decision-making by management on pay is far more common than in manufacturing; in 1980 nearly one third of establishments in the services sector reported no pay bargaining for their non-manual workers and one fourth for their manuals. Secondly, company or divisional bargaining as opposed to plant level bargaining is much more common; about 30 per cent of establishments reported bargaining at company level for non-manual workers and about a quarter for their manuals. However, industry-wide, multi-employer bargaining occurred in only 10 per cent of establishments, and for these the national agreement represented only a minimum or fall back for a majority of employees. Thus, the picture in private sector non-manufacturing industry, excluding wages council industries, is one of decentralised bargaining at company and plant level, with a surprisingly high proportion of employees whose earnings are fixed unilaterally by management.

Institutional Changes

5. The move from multi-employer centralised bargaining to decentralised bargaining has been marked by two institutional factors. First, employer organisations have not lost members in great numbers. They have changed to a more representational role, particularly with government, and employers retain membership for this and for access to advice, particularly on industrial relations as the disputes procedure in many national agreements has been retained. Second, there has been a rapid increase in the number of lay union officials at plant level; many of them full-time shop stewards paid by employers. This change has been accompanied by the spread of the closed shop to cover about 30 per cent of the manufacturing workforce, with a majority openly supported by management, and widespread acceptance of collection of union dues by management.

6. These changes mean that the traditional employers' associations are unlikely to have an effective role in the establishment of incomes policies beyond that of acting as a channel of communication.

7. The studies attributed the change from centralised to single employer-level bargaining to the desire of employers to regain full control of their pay, and hence cost structure, and to government intervention. The introduction of comprehensive employment legislation during the 1970s has forced employers substantially to improve the quantity and quality of personnel management at plant level, and this has led to pressure from managers for autonomy in pay bargaining as well as the other aspects of personnel management. These changes have been coupled with a spread in job evaluation, and other payment grading schemes and work study, but the use of an incentive element in employee earnings has remained fairly static except for a modest increase in its use in smaller companies. It is also noted that the move to single employer bargaining has coincided with a greater incidence of strikes and other industrial action. No particular reason can be given for this, but the reduced influence of full-time union officials may be a factor.

Link with Bargaining Unit Performance

8. The move to decentralised bargaining fits with the theories about moving the pay negotiation nearer to the point where it should be influenced by the economic performance of the bargaining unit. However, recent surveys indicate that, certainly in the mid-1970s, settlements were little influenced by the economic state of the company or bargaining unit. The rapidly rising unemployment level may have changed this in the last couple of years, but no evidence is available. Equally, there must be a suspicion that, even for the relatively high proportion of non-manual employees whose pay is settled unilaterally by management, the level of settlement is more influenced by the settlements of bargaining groups than by the economic circumstances of the plant or company.

9. Past failure to link settlements to company or bargaining unit financial performance can be ascribed to a number of reasons. It may be due to poor communications by the management. The amount and quality of financial information provided to employees by company managements remains consistently poor, and is probably debased if used only in the context of

pay bargaining. Alternatively, the growth of the large company with subsidiary plants may have hindered the process. Until recently, many subsidiary company employees simply did not believe that the parent company would let a subsidiary company close or go to the wall. This perception has probably changed in the last twelve months as major companies have been forced to rationalise. But how long will the memory last when the upturn comes?

10. More likely, both management and employee perceptions have been the overriding influence on pay settlements at plant level. The perception of RPI movements, comparability and equity all play a large part in establishing the final settlement, particularly when the enterprise is unprofitable, and even though managements regularly present the poor financial results of the company as part of their defence against a claim.

11. The major drawback to decentralised, plant or company level bargaining is for small companies operating in a heavily unionised environment. A powerful union can often pick off such companies one by one in a leap-frogging process, relying on weak management resolve when faced with the threat of strike or other industrial action. This problem was epitomised in the road transport industry, which is probably the archetypal free market, where the TGWU picked off small transport firms one by one, forcing up rates on the threat of putting the companies out of business. There has been a temporary lull in this activity during the recession. It will be interesting to see if it re-emerges.

Summary

12. The process of decentralisation of bargaining in the private sector is well on its way to completion. Events show that the process is continuing. Multi-employer bargaining is thought likely to remain in the long term only in the industries with low capital requirements and high ease of entry, eg clothing. There is a counter trend of centralisation of bargaining within companies, particularly in foreign owned and integrated businesses and in the services sector. However, following the trend of decentralisation, there is little hard evidence to show that moving the negotiation nearer to the plant has led to moderation in the level of settlements, and it may even lead to higher settlements in an upturn.

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13. Despite the doubts about whether taking bargaining to plant level in the private sector really does produce moderate settlements, at least when the economy is relatively buoyant, there seems little point in seeking to reverse the trend. Other advantages outweigh the disadvantages. Plant or company level bargaining does give management the facility to exercise better control over pay and employment conditions. It is leading to better personnel management practice, and so we hope in the longer term to more informed bargaining in a better industrial relations climate. The disadvantage is that control over the bargaining process is even more widely dispersed.

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ANNEX B

WAGES COUNCILS

1. Wages councils, by a process of consultation between employers, employees and independent council members (who can exercise a casting vote), establish statutory minimum rates of pay for youths and adults in certain industries where collective bargaining is thought to be inadequate. 34 councils cover around 2½ million workers, the majority (2 million) in the retail, hotel and catering trades.

2. In principle, there would be a case for councils if employers, either by colluding or by exercise of monopsonistic strength, paid exploitative low pay and possibly limited employment opportunities in order to earn excessive profits. But the number of Gradgrind unscrupulous employers is probably now few, and certainly far less than in the early years of this century which saw the beginning of the present wage council system.

3. In today's conditions, councils tend to underwrite higher rates of pay than would occur if competition was unfettered. They thereby reduce employment opportunities - perhaps particularly for the young, whose minimum pay is probably fixed too high in relation to that of adults. Quantification of the economic effects is extremely difficult: if large, the councils' actions could be deemed prejudicial (though, of course, low-paid workers covered by the councils are better off than otherwise); if on the other hand the effects were small, the councils would simply be an unnecessary administrative burden.

4. When Ministers last reviewed the future of wages councils they concluded against early legislation providing for abolition of the system or for exclusions from its scope of the young or part-timers, but favoured some modest improvements, including rationalisation of numbers.

5. The radical solution would be to abolish all wages councils. We believe that there is insufficient evidence to justify the trouble that this would cause. Short of abolition we suggest that any change should meet two conditions:-

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- it must be publicly defensible in the sense of providing insurance against the (limited) risk of genuinely exploitative low pay;
- it should encourage employment by allowing a greater role for competition in wage fixing.

6. Three intermediate options are:-

- i. to give the councils an overriding statutory duty to ensure that wages are set to maximise employment;
- ii. to fix a statutory upper limit to the minimum relative pay of youths;
- iii. to remove the arbitral powers of the councils.

All three options would require legislation.

Option 1: Promoting Employment

7. Taken to its limit, this option would lead in principle to a pattern of pay little different to what would have emerged as a result of abolition, though without the administrative savings. In practice, the option may not prove particularly effective, not only because of the considerable problems of judgement involved. In many cases, councils establish minima which follow increases which have already occurred in the general level of earnings in the trade concerned. Thus, on employment promotion grounds, a rise in minimum pay may often be deemed necessary in those firms represented on the council lest workers be lost to competing firms who have agreed more favourable collective bargains.

8. This procedure tends to underwrite the collective bargain and prevents the council firms under-cutting rivals and unions and thereby expanding the industry and employment as a whole. But in practice deeply-ingrained considerations of comparability and fairness would, we believe, push the system towards the more limited interpretation of 'employment promotion'. The final outcome could be little different from the present system.

Option 2: A Limit to Youth Minimum Pay

9. The question of determining the appropriate limit poses the main difficulty with this option: too low a limit on relative youth pay may discourage effort and new entrants, especially if unemployment-related benefits proved attractive in comparison. The appropriate differential would also vary from trade to trade depending, inter alia, on skill requirements and thus training needs of young entrants. Any centrally-determined limit, universally applied in wage council industries, is therefore likely to be distortionary in some cases. A better way forward on youth pay is provided by the Young Workers' Scheme - devised by Professor Walters - which should have some effect in widening youth - adult pay relativities, including those set by wage councils.

Option 3: Removing the Councils' Arbitral Powers

10. Under this option, the statutory powers to fix minimum pay would be removed. The role of councils would therefore become largely one of providing a suitable forum for employers and employees to negotiate freely pay and conditions. This should ensure automatically an appropriate and greater role for competition in wage fixing. The independent members would be there to conciliate and mediate: clarifying areas of agreement and disagreement, providing on request impartial information about labour market developments and suggesting approaches to a settlement.

11. In addition, they would have the important role of monitoring the behaviour of employers in the new environment to guard against exploitation of employees. As mentioned previously, genuinely exploitative rates of pay or conditions may result if:

- a. the employer has a monopoly of the local employment market;
- b. employers collude to force down pay.

CONFIDENTIAL

Independent members would need to draw to the attention of the Secretary of State for Employment any evidence of either form of behaviour; and following a formal hearing of the evidence from all sides, employers found culpable would be subject to fines. Other reasons for low pay - poor market conditions, lack of educational attainment etc - would not however be available to the plaintiff as submissible evidence; insuring against pure exploitation would be the only role of the council.

12. The CPRS recommends further study by officials of this option as one which is both publicly defensible and a spur to greater competition.

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ANNEX C

WAGE-INFLATION TAX -

ADMINISTRATIVE QUESTIONS

- i. Earnings per hour. This measure is chosen to make some allowance for variation in overtime worked, numbers of part-timers, etc. The annual pay bill should be readily available, but the total number of hours worked in a year may be less easy to calculate and check. If these problems cannot be resolved, a less satisfactory measure would be earnings per head (where man-years worked should be easier to determine); this would still be better than total pay bill, in that it allows for changes in numbers of employees.

- ii. Productivity. In principle the penalty on firms which find it necessary to pay more in order to secure productivity gains (paragraph 121) could be avoided by relating growth in earnings per hour to growth in output per hour. But for this purpose some measure would be needed of real output, independent of price charges - otherwise firms with monopoly power could pay higher wages, and offset this by higher prices, without penalty. It seems doubtful whether an independent measure of real output could be made objectively precise enough to serve as a basis for tax assessment. If not, the only possibility if this is thought a serious objection would be to allow firms facing a tax penalty on account of productivity payment to appeal to a tribunal which could judge the genuineness of their case, and rule on exemptions accordingly.

- iii. Fringe benefits. Some way would have to be found to prevent firms giving benefits in kind and not counting these as part of their annual pay bill.

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- iv. Pay year. Ideally this should run from the operative date of the annual increase for the largest group of employees concerned. But some employers will have numbers of different groups (see "tax unit" below). Companies might find it easier to make their pay year coincide with their accounting year, and this would probably be acceptable, with the annual standard rates of pay increase (which would presumably run through each pay round, from August to August) apportioned accordingly.
- v. Tax unit. There is a question whether the tax should be assessed on each company as the employer (which would probably be simplest) or on some smaller unit such as the establishment or bargaining unit (which might have a more immediate impact on employees' attitudes).
- vi. Small firms. In principle, and in practice, there is a strong case for exempting employers with less than a rather large minimum number of employees, on the grounds that the smaller employers operate in a more competitive labour market and do not influence pay rates more generally. But to avoid depriving small firms of rebates, and to deal with other boundary problems, it might be necessary to allow firms below the threshold to opt to join the scheme, in which they would then have to remain from year to year (cf VAT).
- vii. Avoidance. Some firms facing large tax bills will no doubt find ways of avoiding or minimising these - for example by ceasing to employ their highest-paid staff (thus cutting back their average pay bill) and then paying for their services as self-employed "consultants". But concentration on larger firms should reduce opportunities for this kind of thing - though no doubt there would be a series of awkward cases and administrative problems.
- viii. Staff. As a new tax, the scheme would need additional staff to run it, and the CPRS does not believe that it could be grafted on to an existing tax (eg NIS or corporation tax) to lessen this demand for staff.

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MR WALTERS

cc ~~Mr Lankester~~
Mr Duguid

R.

The CPRS Pay Study

I should be grateful if you could let me know what you think about the proposal in the CPRS pay study (sent to the Prime Minister last weekend: I believe Andrew Duguid has a copy) for a wage inflation tax (WIT).

The Prime Minister has agreed to hold a meeting next Wednesday to discuss the report, and I shall provide a brief on a number of points. In general, I think Ministers will be a little disappointed at the report, since it tends to come down against most of the easily grasped propositions (such as abolition of the wages councils, or synchro-pay) as ineffective, to say that there is no likely effective radical new approach, and yet to concede that the chances of pay objectives not being achieved are high. But of course we ought not to expect straightforward or short-term solutions to a problem as endemic to the British economy as high wage expectations.

The report falls into two halves: ways of making the present system work better, and alternatives to the present system. The first half is not helped by the fact that the summary and recommendations are not accurate reflections of the main body of the report. I know Andrew Duguid will be looking at Section 2.4 on industrial relations legislation, and I have already drawn the Prime Minister's attention to the recommendations in Section 2.5 on review bodies, in the context of today's Cabinet meeting. Much of the rest of the first part of the report covers issues with which Ministers are already grappling. When it comes to proposals for alternatives to the present system, the CPRS devote rather considerable space to various forms of incomes policy, but the summary at least rules them out ("except as an emergency measure we see no benefit in a freeze or a norm"). On the basis of the logic of paragraph 13 of the report, which says that since the present approach may fail, other approaches must be considered - logic which seems to

CONFIDENTIAL

/me

CONFIDENTIAL

me to be faulty in itself, since the issue is surely whether other approaches are likely to be less unsuccessful than the present approach - the CPRS then looks at two further possible approaches: compulsory arbitration and WIT. I certainly think that arbitration arrangements merit further examination, although curiously the actual recommendation in the report is only in the context of improving the responsiveness of present arbitrators to employers ability to pay, not in terms of an examination of the prospects for making arbitration compulsory. But I must say that the WIT approach seems to me about as unattractive to this administration as any form of pay policy could possibly be.

As explained in the report, it ^{appears} ~~says~~ that the WIT is essentially the same as the Layard scheme set out in the paper dated 3 September which you were sent by LSE. The disadvantages seem to me to include:-

- a) The setting of an across-the-board norm implies a massive distortion of market forces.
- b) The proposed tax would penalise successful profitable firms whom one would expect to be able to pay their employees well, with the converse effect on unsuccessful firms. It would provide a disincentive to success.
- c) It fails to operate on the front line of the pay bargaining process: that is, the penalty ^{ap}plies to the employer not to the employee.
- d) The scheme would tend to provide a disincentive to increase the skill level of an employer's workforce.
- e) It would require a substantial bureaucracy to operate, and a substantial degree of intervention.

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(f)

CONFIDENTIAL

-3-

- f) It appears to be totally ineffective in the public services, and almost entirely ineffective in the nationalised industries.
- g) It would require controversial legislation.

Subject to your views, I think that even to allow the CPRS to do further work on such a scheme, the knowledge of which would certainly become public, would be wrong. I should also be glad to have any other comments you may have on other aspects of the report. I myself will be looking at the prospects for no-strike provisions in essential services, which seem to me at first sight to be worth pursuing.

J. M. M. VEREKEN

15 September 1981

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10 DOWNING STREET

Caroline

Please file

C. 1519

Meeting 23/9 at 1700

CSE Pay

Mr. Blake will represent

Mr. Vott

Alan

15/9

B/F 22/9

MISS STEPHENS

Please arrange a meeting - 1½ hours - to discuss the CPRS Report on Pay. The following to be invited:

- Home Secretary
- S/S Defence, -
- Chancellor of the Exchequer - *Chay See*
- S/S Employment - *Tedd*
- S/S Industry - *Teller*
- S/S Energy - *Laura*
- S/S Environment -
- S/S Social Services - *Fowler*
- C.S.D. - *body bag*
- Robert Armstrong
- Robin Ibbs
- ✓ Alan Walters
- ✓ John Hoskyns
- ✓ John Vereker

Can we discuss when this meeting can be?

R
..

14 September 1981

Arranged for wed 23rd sept.
at 1700. Defence will
ring to say and Minister
will be coming. *ed. 15/9*

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

MR. IBBS

Pay

The Prime Minister was glad to receive the copy of the CPRS Report on Pay, which you enclosed with your minute of 11 September.

The Prime Minister would be grateful if you would now send copies of the report to those Ministers who received copies of Clive Whitmore's minute of 26 June, and also to the Home Secretary and the Secretary of State for Defence. She has asked us to arrange a meeting with all these Ministers, and we will be in touch with you to arrange a time and date.

I am sending a copy of this minute to Sir Robert Armstrong.

T. P. LANKESTER

14 September 1981

CONFIDENTIAL

889

file vs.

bc Caroline
John Vereker

*Mr. Lankster:
for info.*



CABINET OFFICE
Central Policy Review Staff

R

With the compliments of
From: J. R. Ibbs
Sir Kenneth Berrill KC

70 Whitehall, London SW1A 2AS

Telephone 01-233 7765



*David
Vercher*

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

R
175

From: J. R. Ibbs

Qa 05672
CONFIDENTIAL

14 September 1981

Dear Chancellor

Pay

Mr Whitmore's minute of 26 June conveyed the Prime Minister's request that the CPRS should examine what action should be taken to improve the framework in which pay bargaining takes place, and should report after the Summer Recess. E Committee on 2 July asked us to pay special attention to the machinery for determining pay in the public service.

We have consulted other Departments, and the No 10 Policy Unit, and have now produced the enclosed report. It offers a fairly wide review of the ways in which changes might be made in the framework within which pay settlements are arrived at. In the time available it has not been possible to explore all the issues in full detail, and the report recommends further work in two key areas (arbitration, and the mechanism of a possible wage-inflation tax).

Parts of the report, particularly Section 2.5, are relevant to the Cabinet discussion about pay factors on 15 September. At the Prime Minister's request I am therefore sending copies immediately to those Ministers who received a copy of Mr Whitmore's minute, and also to the Home Secretary, the Secretary of State for Defence and Sir Robert Armstrong. I imagine that the Prime Minister may wish later to call a meeting at which the report can be discussed.

Some of the discussion, particularly in Section III on alternative approaches, is sensitive. No doubt Ministers receiving copies will ensure that the report is handled with appropriate care to guarantee confidentiality.

yours sincerely,
J. R. Ibbs

J R Ibbs

CONFIDENTIAL

Qa 05670

To: MR WHITMORE

From: J R IBBS

Pay

1. Your minute of 26 June conveyed the Prime Minister's request that the CPRS should examine what action should be taken to improve the framework in which pay bargaining takes place, and should report after the Summer Recess. E Committee on 2 July asked us to pay special attention to the machinery for determining pay in the public service.

2. We have consulted other Departments, and the No 10 Policy Unit, and have now produced the attached report. It offers a fairly wide review of the ways in which changes might be made in the framework within which pay settlements are arrived at. In the time available it has not been possible to explore all the issues in full detail, and the report recommends further work in two key areas (arbitration, and the mechanism of a possible wage-inflation tax.)

3. Some of the discussion, particularly in Section III on alternative approaches, is sensitive. If the Prime Minister is content, I suggest that copies of the report might be sent to those Ministers who had copies of your minute dated 26 June. A meeting might then be arranged at which it could be discussed.

4. Parts of the report, particularly Section 2.5, are relevant to the Cabinet discussion about pay factors on 15 September, and it is for this reason that I am sending you an immediate copy.

5. I am sending a copy of this minute and the report to Sir Robert Armstrong.

11 September 1981

Att

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Prime Minister

22

he will need a meeting to discuss this, probably after you get back from Melbourne.

Shall I fix up with those Ministers* whose ~~minutes~~ departments have been consulted in the preparation of the report?

Yes not

If you agree, I will send copies of the report to them.

Yes not

11/9

Plus 8
→

VRJ

not available.

12

- Home Office ✓
- Defence ✓
- * Chancery ✓
- Employment ✓
- Industry ✓
- Energy ✓
- Environment ✓
- Social Services ✓
- CSD ✓

to Mr Dupont
Mr Verbeke

CONFIDENTIAL

Econ P.D.
CF: back-up
from for E.
for

Qa 05507

30 June 1981

To: MR WHITMORE

From: J R IBBS

Pay - CPRS Remit

1. Thank you for your minute of 26 June conveying the Cabinet remit to examine what action should be taken to improve the framework within which pay bargaining takes place.

2. The Chancellor's paper (E(81)66) on pay in the coming year, which E Committee is to consider on 2 July, proposes further work on three closely related topics. It may be useful if I set out, before that discussion, how I see these pieces of work relating to each other, and what ground the CPRS study might cover.

A. Short Term

(i) To prepare for the year ahead, the Chancellor's paper makes three proposals:-

- (a) Public services. It is essential to start now to plan the handling of public service pay negotiations in the next round. The Official Committee which reports to the Ministerial Committee on Public Service Pay should be asked to make initial proposals before the Recess.
- (b) Nationalised industries. Officials in the Departments concerned (Treasury in the lead) should be asked similarly to consider how to influence the next round in the nationalised industries. One opportunity will be the meeting between Ministers and the NI Chairmen's Group on 9 July.
- (c) Private sector. The Chancellor's paper proposes publicity, and liaison with the CBI; Ministers will want to consider how this is to be organised, and in particular how to follow up the CBI's proposed initiative.

B. Longer Term

(ii) All these pieces of work are needed in the next few weeks. But there is also the broader question of moves to influence the outcome of pay settlements by changing the balance of industrial power and altering the incentives and penalties which face wage bargainers. The CPRS proposes to tackle this by addressing the following questions:-

- (a) Can the Government's objectives for improving the framework of pay bargaining and achieving a better relationship between pay and productivity, in both public and private sectors, be more closely defined?
- (b) What are the obstacles to achieving those objectives?
- (c) Are there any further moves, within the framework of present policy, beyond the short-term options reviewed in A above, which Ministers should consider?
- how to bring more pressure or persuasion to bear on employers (eg in co-operation with the CBI);
 - how to affect the attitudes of employees (eg by reducing real wages at the lower end, by such measures as abolishing Wages Councils; reducing wage/benefit overlap by holding down real levels of benefits; ceasing encouragement of short-term working as an alternative to redundancy).
- (d) For the longer term, can the balance of industrial power be affected by further measures of industrial relations legislation? - the Secretary of State for Employment will be making proposals following the Green Paper consultations.
- (e) Can the framework on pay bargaining be changed in ways which would help with the Government's overall objectives? - eg moves to settle pay at plant or regional level, rather than nationally (cf the proposals for the water industry); pay synchronisation etc.
- (f) If pay increases outside the Government's direct control were not sufficiently restrained by these indirect means, are there options worth considering for altering incentives via the tax system?

CONFIDENTIAL

274



10 DOWNING STREET

From the Principal Private Secretary

MR IBBS

Pay

The Prime Minister has asked me to write to convey to you formally the remit to the CPRS agreed in Cabinet on 17 June and to outline the scope of the remit for the benefit of other Departments concerned as well as the CPRS itself.

The CPRS is invited to examine, in consultation with the No. 10 Policy Unit and with Departments as necessary, what action should be taken to improve the framework within which pay bargaining takes place.

This will be part of the background to Ministers' discussions of pay problems in the coming months, and the Prime Minister therefore hopes that the CPRS will tackle it urgently, with a report for Ministers to consider at latest when they return from the Summer Recess.

B/K
1-9-81

I am sending copies of this minute to the Private Secretaries to the Chancellor of the Exchequer, the Secretaries of State for Industry, Employment, Environment, Social Services, Energy, the Lord President and to Sir Robert Armstrong.

G. A. WHITMORE

26 June 1981

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JWP

SECRET

PRIME MINISTER

PAY: THE CPRS STUDY

When I submitted to you last weekend the letter which it was proposed to send to the CPRS and the Departments concerned outlining the Cabinet's remit to the CPRS on pay and setting the timetable for the study (Flag A), you said that you did not think the CPRS needed any further guidance.

Because you were concentrating in the early part of the week on yesterday's debate, I have not troubled you with this matter again. But I have in the meantime had a word with Sir Robert Armstrong about your reaction to the proposed letter. He feels - and so does Mr. Ibbs - that it would be helpful to the CPRS, in their dealings with the Departments which they will have to consult in the course of the study, to have a piece of paper from No. 10 formally setting down the purpose of the remit and, in particular, its timetable. But, in an effort to meet your concern, Sir Robert Armstrong has suggested the shortened version of the draft letter to Mr. Ibbs at Flag B.

At the same time Mr. Ibbs has produced the draft paper at Flag C. The purpose of this is to try and avoid the risk of a muddle arising between the follow-up work which E is likely to require when next Thursday it discusses the Chancellor of the Exchequer's paper about the next pay round, and the CPRS's pay study, which is aimed more at the longer term. If something like Mr. Ibbs's paper goes to E, then there is no need for a letter from No. 10 to him, whether in the original form or in the shortened version. On the other hand, Mr. Ibbs's paper will have a wider circulation than the proposed letter; and parts of it, especially paragraphs 6 and 7, are very sensitive. I suggest that the best way of proceeding would be to send out the shortened version of the letter at Flag B. This describes, without going into any detail, the objective of the study and will help the CPRS by setting a timetable which will require Departments to respond quickly to the requests for assistance which the CPRS will inevitably have to put to them.

Flag 'B' looks to be uninitiated as if we are
open for a fully fledged pay policy in the private
sector or well. We are not
SECRET

SECRET

- 2 -

If you are still reluctant to agree that a letter should go out, may I suggest that you discuss the matter with Sir Robert Armstrong when he sees you at 0915 tomorrow to discuss forthcoming business.

TWW -

Note

The Prime Minister discussed this with Sir R. Armstrong this morning - agreed that the letter should go out as amended.

25 June 1981

TWW
26/6

SECRET

e.c. 2 Venku

SECRET

Qa 05501

25 June 1981

To: MR LANKESTER ✓

From: J R IBBS

Pay - Further Work

1. I understand that you are seeking clarification of the remit to the CPRS to examine ways in which achievement of the Government's pay objectives might be assisted. It may be helpful for you to see the attached draft paper which aims to draw a distinction between what the Chancellor is proposing in his paper (E(81)66) which is due to be discussed at E Committee next week and the somewhat longer term considerations which the CPRS is tackling.
2. It is obviously desirable to avoid duplication and achieve a general understanding of who is doing what. I thought it might be helpful to circulate this paper, subject to any necessary modifications, before the meeting of E Committee if the Prime Minister is content. Obviously the need for security will need to be weighed.
3. I am sending a copy of this Minute and the draft paper to Sir Robert Armstrong.

JR
J -

SECRET

SECRET

Draft Paper for E Committee: 1 July

Pay - Further Work

Note by the Central Policy Review Staff

The Committee is to consider the Chancellor's paper (E(81)66) on pay in the coming year. This proposes further work on three aspects. At the same time Cabinet has asked the CPRS to examine more broadly what can be done to achieve the Government's pay objectives. This note suggests how the work might be shared out.

A. Short Term

2. To prepare for the next pay round, the Chancellor's paper has three proposals:-

- (a) Public services. It is essential to start now to plan the handling of public service pay negotiations in the next round. The 'Official Committee which reports to the Ministerial Committee on Public Service Pay should be asked to make proposals before the Recess.
- (b) Nationalised industries. Officials in the Departments concerned (Treasury in the lead) should be asked similarly to consider how to influence the next round in the nationalised industries.
- (c) Private sector. The Chancellor's paper proposes publicity, and liaison with the CBI; Ministers will want to consider how this is to be organised, and in particular how to follow up the CBI's proposed initiative.

B. Longer Term

3. All these pieces of work are needed in the next few weeks. But there is also the broader question of moves to influence the outcome of pay settlements by changing the balance of industrial power and altering the incentives and penalties which face wage bargainers. The CPRS proposes to tackle this by addressing the following questions:-

- (1) Can the Government's objectives for pay settlements in the public and private sectors be more closely defined?
- (2) What are the obstacles to achieving those objectives?
- (3) Are there any further moves, within the framework of present policy,

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SECRET

beyond the short-term options reviewed in A above, which Ministers should consider?

- how to bring more pressure or persuasion to bear on employers (eg in co-operation with the CBI);
- how to affect the attitudes of employees (eg by reducing real wages at the lower end, by such measures as abolishing Wages Councils; reducing wage/benefit overlap by holding down real levels of benefits; ceasing encouragement of short-time working as an alternative to redundancy).

4. For the longer term, can the balance of industrial power be affected by further measures of industrial relations legislation? - the Secretary of State for Employment will be making proposals to E Committee following the Green Paper consultations.

5. Can the framework of pay bargaining be changed in ways which would help with the Government's overall objectives? - eg moves to settle pay at plant or regional level, rather than nationally (of the proposals for the water industry); pay synchronisation etc.

6. If macro-economic policy, plus these expedients, does not succeed in limiting pay increases outside the Government's direct control, are there options worth considering for altering incentives via the tax system?

- penalties on employees to remove or reduce benefits of excessive wage-bill increases;
- penalties on employers to discourage excessive settlements.

7. Are there other options for changing the statutory framework (if this proves necessary) which have not already been tried without success and which are therefore worth considering? - eg the Layard scheme for a degree of "market" flexibility.

8. Is there experience from other countries suggesting ways of restraining pay which might be effective in the UK?

Conclusion

9. These **are exceedingly** difficult questions, and the CPRS may well not be able to put forward firm answers - but this risk is not, of course, a conclusive argument against tackling the questions if they are important enough to justify further work. Ministers will wish to consider whether they agree with this plan of work, whether they wish to rule out any lines of enquiry in advance, and whether on the other hand they wish the CPRS to concentrate on any specific proposals.

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cc Mr. Duguid

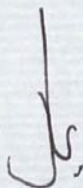
MR. LANKESTER

KML
25~

Pay: The CPRS Study

I am not sure how you propose to deal with David Wright's minute to you of 19 June, which you and I saw yesterday, by which time the Prime Minister had already commented on it; but I think the question of how the terms of reference will be set still has to be answered. The Prime Minister suggests that the CPRS need no further guidance; Robert Armstrong's Office think that the CPRS could be guided by the discussion at E next Wednesday; and I was told today that the CPRS themselves are proposing to send to the Prime Minister a draft of their paper for E, as a means by which she could indicate her views on the terms of reference. It does seem to me, particularly in view of the fact that the Prime Minister's own ideas concentrate sharply on trade union reform, that it would be best to set the terms of reference outside the context of the E discussion, lest the substance of the terms of reference become watered down. If we give the CPRS no further guidance now, there is bound to be a discussion of the remit in E.

So should we not look at the CPRS's draft paper for E, decide on the basis of that what the terms of reference should be, persuade the Prime Minister to pronounce accordingly before the E discussion, and let the E discussion focus on the substance of the problem rather than how to limit further studies?



24 June 1981

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Ref: A05124

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Prime Minister. A
Concur with 3 more with
as in the attached copy?
Agree x/1 then?

MR. LANKESTER

Pay: The CPRS Study

KKH
19th

It is necessary to follow up Cabinet's decision on Wednesday (CC(81) 23rd Conclusions, Minute 2(ii)) with a more formal remit to the CPRS. The attached draft seeks to do this.

2. It would also be helpful to the CPRS to have an indication of the Prime Minister's approach to the Chancellor of the Exchequer's paper on pay (E(81) 66) which is due to be discussed at E on 1st July. The choice is between using that meeting as an occasion for a broad discussion which could inform the CPRS's work, or as an occasion for taking decisions with the subsequent CPRS study being confined within the framework of the decisions taken. We think the former approach is to be preferred. If the Prime Minister agrees she will no doubt guide the meeting on 1st July accordingly.

X |

(D. J. Wright)

I don't think CPRS
need any further guidance

The remit will include

balance of T.M. power,
unenforceability of collective contracts
national bargaining.
monopoly power of unions
bargaining in nat'l. utilities
etc water,

19th June, 1981

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etc.
ref.


CONFIDENTIAL

DRAFT MINUTE FROM THE PRIVATE SECRETARY (No. 10)
TO MR. IBBS.

Copies to the Private Secretaries to:

Chancellor of the Exchequer
Secretary of State for Employment
Secretary of State for Industry
Secretary of State for Energy
Secretary of State for the Environment
Secretary of State for Social Services
Lord President

Pay

The Prime Minister has asked me to write to convey to you formally the remit to the CPRS agreed in Cabinet on 17th June and to outline the scope of the remit for the benefit of other Departments concerned as well as the CPRS itself.

2. The CPRS is invited to examine, in consultation with the No. 10 Policy Unit and with Departments as necessary, what action should be taken to achieve the Government's objectives for pay settlements in the public and private sectors. [This study will need to consider the obstacles in the way of achieving those objectives, and policy options aimed at removing or diminishing the obstacles in the private sector as well as in the public sector.]

3. ~~This is a wide-ranging remit, and it may not be possible to fix a firm deadline at the outset. But the Prime Minister sees~~ ^{This will be part of the background} ~~this as contributing to Ministers' discussions of pay problems in the coming months, and therefore~~ ^{the P.M.} hopes that the CPRS will tackle it urgently, with a report for Ministers to consider at latest when they return from the Summer Recess.

4. I am sending copies of this minute to the Private Secretaries to

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