

CONFIDENTIAL

Prime Minister ①

PRIME MINISTER

Do you wish to discuss these
two points at dinner ^{on} Tuesday?

Agree we send a copy of this
note to the Chancellor?

Prospects for the Next Pay Round

MCS 29/7

You are dining with the Chancellor next Tuesday evening, and I understand from Michael Scholar that you have no other meeting with him planned before the summer holidays. I would like to suggest that you and he take this opportunity for a word about two particular aspects of our preparation for the next pay round.

We have been successful so far in setting the right background. The Chancellor's 6 July speech - "substantially lower pay rises than last year ... very low pay rises indeed" - opened the debate; and it has since been followed up usefully in Mr. Heseltine's statement on the RSG - the reference to "low single figures if rates are not to increase disproportionately" was inserted at our request, and attracted a lot of attention, particularly on TV - and in the CBI's booklet, "Pay 1982-83", published today.

But one important ingredient has not yet been added to this recipe for lowering expectations. That is the announcement, normally made in September, of a pay factor for public service pay. In the past that was required for cash limit planning purposes, to move from one year's prices to the next; and a pay factor for the Rate Support Grant, in particular, had to be made known early in the autumn. There is no doubt at all that the announcements of the 6% pay factor in 1980, and 4% last year, had an important effect on the expectations of both employers and employees. However, the move to cash planning means that separate pay and price factors are no longer strictly necessary - 6% is already built into the cash figures - and the Treasury are at present undecided whether to announce a pay factor for the public services at all. The Chancellor has said he will bring this to Cabinet on 30 September.

We think we should announce a pay factor, and a low one. If we do not, local authority employers will have only Mr. Heseltine's announcement to go on, and most of them will I believe read it as

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/broadly

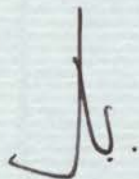
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broadly endorsing a 5% pay assumption. 5% is therefore likely to become the floor for the public service pay round. As you know from my note briefing for the recent E discussion, we do not believe that even 4% settlements - implying an overall earnings growth of about 6% - would be consistent with the Government's objective of a pay round low enough to make a significant contribution to employment. Ideally a pay factor should be announced before Mr. Heseltine sees LACSAB (the local authority employers) in mid-September, to get them to lower their sights; but the actual negotiations with the manual workers will not begin until early October, so a decision on 30 September would just about do.

The other key aspect of the next pay round in the public services will be our handling of the Megaw report. You already know of our doubts about the proposed Megaw system, from our note of 9 July, which the Chancellor has also seen. Briefly, it seems to us likely to offer scope for a new pay agreement only at the price of continued comparability, and therefore of higher pay increases than would be produced by a system genuinely rooted in market factors, job security and affordability. The Chancellor's group (MISC 83) has broadly endorsed the Megaw recommendations, as he will be reporting to you separately.

Much rests on these two decisions - whether to announce a low pay factor, and whether to offer the unions a Megaw-type system. You and the Chancellor may not want to make them now. But I am sure you would find it helpful to agree how hard you are prepared to push for the Government's declared objectives for the next pay round, and at what cost in terms of difficulty with the public service unions, to avert what I fear may otherwise become a pay round no lower - and possibly higher - than the one now finishing.

If you do agree to discuss this with the Chancellor, I think it would be helpful for him to have a copy of this note.



29 July 1982

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