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From the Private Secretary

on the books

John Wiggins Esq
Private Secretary to the Chancellor of the
Exchequer
HM Treasury
Parliament Street
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27 January 1981

Dear John,

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ECONOMIC EVIDENCE TO THE TOP SALARIES REVIEW BODY

The Top Salaries Review Body have asked for any further Government evidence to be submitted to them by Thursday, 29 January. I ... therefore attach a draft of the economic evidence we propose to submit, in accordance with the conclusions of E Committee. This closely follows the evidence which has been submitted to the Doctors' and Dentists' Review Body, with minimum changes reflecting the different circumstances of the TSRB groups.

I am afraid time is very short: I would be grateful to know by tomorrow whether the Chancellor is content with this evidence.

I am copying this letter to the Private Secretaries to the Prime Minister, the Lord Chancellor, the Secretary of State for Defence, the Secretary of State for Social Services and Sir Robert Armstrong.

Yours sincerely,

J. Buckley

J BUCKLEY

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THE ECONOMIC FACTORS

The Government invites the Review Body, in framing its recommendations, to take account of current economic circumstances. Partly because of world recession, but also because of very high public sector pay increases in the last two years (exceeding those in the private sector), financial pressures on employers in both the public and private sectors are severe. Profit margins have been particularly affected in sectors that export or compete against imports, where the strong exchange rate has added to the problems of poor competitiveness caused by excessive unit labour costs, but other sectors are also experiencing a tight squeeze. Moreover at the same time real incomes and living standards have risen very substantially (largely because of the effect of North Sea oil on the exchange rate) without a matching increase in output or productivity. Given the further need for continuing firm monetary and fiscal restraint to combat inflation, unrealistic pay increases anywhere in the economy will reduce competitiveness and lead to losses of jobs. So it is crucially important that public services pay settlements should be reached at levels taxpayers and the economy can afford, because of their direct impact on public expenditure, and because of their effect on expectations from others. The change in settlement levels since the summer of 1980 is already clear: these, rather than historical data, are what is important. *

*The year on year increase in the published Index of Average Earnings provides no guide to current settlement levels as it is so heavily influenced by events in the last "pay round". The changes in earnings reported in the New Earnings

Survey (NES), while indicative of the general historical trend, also need very careful interpretation. In particular, the populations represented in the various centiles may vary considerably from year to year, and increasing unemployment, if unduly concentrated at the lower end of the earnings distribution, may also lead to an exaggeration of year on year increases at particular centile points. The changes in earnings of particular NES centiles do not, therefore, measure directly the changes in earnings of particular groups in employment from year to year.

2. In order to ensure that the burden of economic adjustment does not continue to fall almost exclusively on the private sector, public borrowing and expenditure must be held back. A key part of the mechanism for controlling spending in the public services is cash limits. In setting cash limits for the public services, the Government has to decide how much can be afforded, given the severe problems of many sectors of industry, the commitment to monetary control and falling inflation, and the need for a sustained reduction in the Public Sector Borrowing Requirement. There are strict limits on what can be provided for increases in public services pay in 1981-82. Considerations such as comparability have to take second place. No groups, whether in the public or the private sector, can be insulated from the current difficulties which limit the ability of employers to finance increases. The decision to suspend pay research for the non-industrial Civil Service is one reflection of these changed circumstances.

3. The Government has announced that the RSG cash limit for 1981-82 will provide for increases in earnings of 6

per cent from due settlement dates, and that other cash limits will be set within broadly the same financial disciplines.

4. The Chancellor of the Exchequer made clear on 24 November 1980 that the Government thinks it desirable for the future to avoid the delay or staging of pay awards and will avoid it where it is itself the employer. The Treasury and Civil Service Committee have taken the same view in their Fifth Report (Session 1979-80). Staging in some cases in the past has resulted in a higher rate of pay being carried forward into subsequent years than would otherwise have been consistent with the cash limit, so eroding the effectiveness of the cash limit system.

5. As far as the particular groups within the TSRB's remit are concerned, their pay does not have a major direct impact on expenditure. Increases for these groups do however influence expectations elsewhere in the public sector and can therefore have a substantial indirect effect on public spending. The Government therefore believe it is right to ask these people in positions of high responsibility to continue to set an example of pay restraint. The Government thus hopes that the Review Body will take full account of the level of cash limits being set for the public services.

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J. Buckley, Esq.,
Private Secretary to the Lord President
of the Council,
Civil Service Department
Whitehall
LONDON SW1A 2AZ

Dear Jim,

ECONOMIC EVIDENCE TO THE TOP SALARIES REVIEW BODY

You wrote to me on 27 January attaching draft evidence to the Top Salaries Review Body. The Chancellor has considered this draft, and feels that a rather sharper presentation of the economic situation is desirable, making more, in particular, of the declining levels of recent settlements in the private sector. I attach a draft which he has approved.

.....

I am copying this letter to the recipients of yours.

Yours ever

John Wiggins

A.J. WIGGINS

THE ECONOMIC FACTORS

1. There is no disguising that the current economic climate is severe. Its impact on the level of pay settlements is already clear. The Government is confident that the Review Body, in framing its recommendations, will wish to recognise these factors.
2. Severe financial pressures have been placed on employers by a combination of the world recession and by pay increases over the past few years higher than could be afforded. Because these pay increases have been nowhere near matched by productivity increases, they have sharply reduced our international competitiveness. In the private sector, the result has been both to squeeze profit margins severely, and to force redundancies and short-time working. The unemployment figures show this only too clearly. Unrealistic pay increases anywhere in the economy will further reduce our competitiveness, and lead to further - and unnecessary - job losses.
3. This situation is recognised in many recent private sector pay settlements. In road haulage, settlements so far have ranged from 3.0 per cent to 6.8 per cent; BL have settled at 6.8 per cent; Rolls-Royce range between 5½ per cent and 8 per cent; the National Engineering Agreement is for 8.2 per cent; and some settlements, for example in the textile industry have provided for no increase at all. The latest figures for the CBI Databank show that the average for settlements in manufacturing industry is now into single figures, and the level is still declining.
4. Equally important is the evidence about unemployment, resulting from widespread plant closures and redundancies in the private sector. This highlights the importance in current circumstances of job security in the public sector. For example, of 1.4 million redundancy payments between 1975 and 1979, only 7,800 went to Government employees (including the NHS), and 11,600 to others in public administration. These two together account for less than 1.5 per cent of the

redundancy payments but well over 10 per cent of total employment. Recent unemployment figures show a similar picture. The August 1980 figures, classified by last recorded job, show an unemployment rate of 3.0 per cent for central and local government, compared with 6.7 per cent for the private sector. Finally, redundancies in the private sector are not confined to manual grades or non-manual grades up to lower managerial level. They have affected the equivalents of the top salaries group as well. Where major workforce slimming has taken place management has not been exempt.

5. The financial pressures on the public sector are also important. The PSBR must be reduced if the Government's monetary aims are to be achieved without placing an intolerable burden on industry through high interest rates. The task of reducing the PSBR is made more difficult by the fact that the recession has inevitably pushed up borrowing requirements. The Government has announced cuts in the volume of spending and increases in revenue, but these by themselves are not enough. Over half of central government cash limited expenditure and 70 per cent of local authority current expenditure, goes on wages and salaries: and between last financial year and this, the public sector's wage and salary bill will have risen twice as fast as the private sector's. This rapidly rising public sector pay bill inevitably put an increasing burden on the rates and taxes paid by the private sector.

6. A key part of the mechanism for controlling spending in the public services is cash limits. In setting cash limits for the public services, the Government has to decide how much can be afforded in the light of the facts set out above. The inevitable conclusion is that there are very strict limits on what can be provided for increases in public service pay in 1981-82. Considerations such as comparability have to take second place. No group, whether in the public or the private sector, can be insulated from the current difficulties which limit the ability of employers to finance increases. Probably

the most important comparison to make is with the steadily declining level of pay settlements. The suspension of pay research for the non-industrial Civil Service is one reflection of these changed circumstances.

7. The Government has announced that the RSG cash limit for 1981-82 will provide for increases in earnings of 6 per cent from due settlement dates, and that other cash limits will be set within broadly the same financial disciplines.

8. The Chancellor of the Exchequer made clear on 24 November 1980 that the Government thinks it desirable for the future to avoid the delay or staging of pay awards and will avoid it where it is itself the employer. The Treasury and Civil Service Committee have taken the same view in their Fifth Report (Session 1979-80). In the past, staging has sometimes resulted in a higher rate of pay being carried forward into subsequent years than would otherwise have been consistent with the cash limit, so eroding the effectiveness of the cash limit system.

9. As far as the particular group within the TSRB's remit are concerned, their small size means that their pay does not have a large direct impact on expenditure. But this cannot itself justify more generous treatment. Increases for these groups influence expectations elsewhere in the public sector and can therefore have a substantial indirect effect on public spending. The Government hopes therefore to be able to look to these people in positions of high responsibility to continue to recognize the need for very real moderation, and believes it is right to do so.

10. The Government therefore asks the Review Body, in reaching their recommendations, to take full account of the level of cash limits being set for the public services; of current settlements levels in the private sector; of the favourable position of the public sector on job security; and of the impact of any excessive settlement on expectations and employment throughout the economy.