



Prime Minister (1)

Agree? (John Vercher

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

so recommends)

3 December 1982

MCS 8/12

Ms Mary Brown
Private Secretary to the
Lord Privy Seal

Yes mt

Dear Mary,

ECONOMIC EVIDENCE TO THE TSRB

We will shortly need to submit evidence to the Top Salaries Review Body for their 1983 review of salaries. We know that on this occasion they will be concentrating on salaries of MPs and Ministers, and do not envisage more than updating recommendations for other TSRB Groups. Accordingly, the Chancellor envisages that the main evidence submitted should be the usual economic material.

I now enclose a draft of this evidence, and should be grateful if you, and those to whom I am copying this letter, would let me know whether your Ministers are content with it by Friday 10 December.

I am sending copies to Michael Scholar (No.10), David Staff (Lord Chancellor's Department), Richard Mottram (Ministry of Defence), Felicity Everiss (Department of Employment) and to Richard Hatfield.

Yours Sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

DRAFT

TOP SALARIES REVIEW BODY: ECONOMIC EVIDENCE

In this evidence the Government sets down economic factors which, in its view, need to be taken into account in considering the level of salaries.

2. In the Government's economic strategy bringing down the rate of inflation is a central objective. A very large reduction has been achieved from a peak of 21.9 per cent in May 1980, and progress continues. The year-on-year increase in the retail prices index was down to 6.8 per cent in October and is expected to be down to 5 per cent early next year. These are the lowest levels for a decade.

3. In these circumstances the assumption of automatic annual increases in pay needs to be increasingly questioned. There can of course never be any general entitlement to pay increases based on price movements, because living standards depend on economic performance; but in practice when inflation was high pay bargainers took it as a major influence on pay levels. Greater stability in prices should now enable negotiators to get away from this and concentrate on what is needed in market terms and on what can be afforded.

4. The national need for low settlements remains compelling. Pay is one of the main factors in costs, and therefore in competitiveness; and better competitiveness is the key to higher output and lower unemployment. With unemployment very high and still rising, pay settlements must be kept to very low levels. Moreover, the existence of so much slack in the labour market generally means that there can rarely be a market case for substantial increases in pay.

5. Company profitability is now improving a little, but it is still much too low for industrial health. The net real rate of return in manufacturing has fallen to about 2 per cent, compared with an average of over 10 per cent in the 1960s. There

are several reasons for this, but the pressure of high wages ranks high among them.

6. Since the beginning of 1981 there has been some recovery - around 15 percentage points - in our manufacturers' international cost competitiveness. But this followed a loss of about 40 per cent over the previous two years. And because other countries have continued to make their own advances our competitiveness has shown little or no further recovery in 1982. Imports (excluding oil) are up by some 10 per cent since the first half of 1981 and, though exports have held up quite well, our share of world markets has not increased. We must reckon also with the effects of continued wage moderation in competitor countries. Public service pay increases of only 2 per cent, for example, are planned in both the Federal Republic of Germany and in Japan.

7. There is therefore no scope for letting up on pay. The slowing down of earnings growth over the past two years needs to be maintained and indeed sharpened. Higher pay may offer higher living standards for some in the very short run; but only at the eventual expense of lower profits, more inflation, lower output, and fewer jobs. Our living standards as a nation would then continue to fall further and further behind those of other countries.

8. These economic factors bear directly on the trading sector of the economy. But they are crucially relevant also to the public services. High public service settlements inevitably influence expectations and tend to increase the settlement levels which can be achieved in the trading sector. And public service pay increases cost money which has to be found by taxation, or by more borrowing which pushes interest rates up. Higher taxation weakens incentives and aggravates the difficulties of holding down wage increases elsewhere. And higher interest rates worsen companies' financial cash position, making them less inclined towards investment and enterprise. All these repercussions must bear heavily on judgements about pay in the public services.

9. The Government has to make a judgement on what the country can afford. It has decided on an assumption of $3\frac{1}{2}$ per cent to calculate the cash provision for the pay of the armed forces, the civil service, and certain other groups in 1983-84. This does not mean that all public service settlements will be as much as or no more than $3\frac{1}{2}$ per cent. But it does indicate the sort of level which negotiators generally need to have in mind. However, there is no minimum: the lower the level of pay increases, the better for output and employment.

10. The small size of groups within the TSRB's remit means that their pay does not have a large direct effect on total expenditure. But the same rigorous criteria need to be applied to all public service pay costs, whether large or small; and increases in top salaries, inevitably conspicuous, can have a substantial impact on expectations elsewhere.

11. Finally, full weight needs to be given to job security in the public services. This remains a substantial if unquantifiable benefit, relevant to judgements on financial remuneration.

Econ Pol

NBPM

MUS 14/12



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01-218 9000 (Switchboard)

MO 4/6/2

13th December 1982

Dear Margaret,

ECONOMIC EVIDENCE TO THE TSRB

will request if required

Thank you for sending Richard Mottram a copy of your letter of 3rd December to Mary Brown, and of the draft economic evidence to the TSRB which it covered.

I have shown the draft evidence to my Secretary of State. He has no comments to offer on it.

I am copying this letter to the recipients of yours.

Yours sincerely
Nick Evans

(N H R EVANS)

Miss M O'Mara

14 DEC 1982



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ECON POLICY
(W)

B/C J Verokov

10 DOWNING STREET

From the Private Secretary

9 December, 1982

ECONOMIC EVIDENCE TO THE TSRB

Thank you for sending me a copy of your letter to Mary Brown.

I showed the Prime Minister the attached draft evidence of the Top Salaries Review Body. She is content that it be submitted to the Review Body.

I am sending copies of this letter to David Staff (Lord Chancellor's Office), Richard Mottram (Ministry of Defence), Felicity Everiss (Department of Employment) and Richard Hatfield (Cabinet Office).

M. C. SCHOLAR

Miss M. O'Mara,
HM Treasury

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SP



Portionant
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Miss Margaret O'Mara
Private Secretary to the
Chancellor
Treasury
Great George Street
LONDON SW1

9 December 1982

Dear Margaret

ECONOMIC EVIDENCE TO THE TSRB

with mcs?
Thank you for sending me a copy of your letter
of 3 December to Mary Brown.

My Secretary of State has seen the draft of
the evidence and is content with it.

I am sending copies of this to the recipients
of your letter.

Yours Sincerely,
Kathy Weniss

MS F M EVERISS
Private Secretary

Econ Pol, TO RB, P44



- 8 DEC 1982

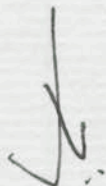
cc Mr. Mount
Mr. Walters

MR. SCHOLAR

ECONOMIC EVIDENCE TO THE TSRB

You asked for my comments on the draft submitted under cover of the letter of 3 December from the Chancellor's office to Lady Young's office.

We saw the evidence in draft, and we are content with it. The Prime Minister may want to note particularly the first sentence of paragraph 3, a further indication of the Government's wish to get away from the assumption of automatic annual increases. The only paragraph that could cause difficulty is paragraph 10 which attempts to argue that even where larger pay rises can be afforded, there is a case for holding them back - unfortunately, we have been unable to apply that principle to nationalised industries board pay.



JOHN VEREKER

8 December 1982