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CABINETCASH LIMITSMemorandum by the Chief Secretary, Treasury

1. We have strongly supported the use of cash limits to control public expenditure. We will want to maintain and, where possible, reinforce them. I will be reviewing the range of services to which the previous Government applied cash limits and will bring forward in due course any proposals I have for extending it.

2. As the Cabinet are aware, the cash limits, once set, represent the maximum to be spent on the services covered, and Departments are expected to manage their programmes so as to keep within the limits. The majority of voted cash limits (including Rate Support Grants) are now co-terminous with the Parliamentary Votes, and Supplementary Estimates have to be presented and approved by Parliament to give effect to any increases. I ask my colleagues to ensure that the limits are rigorously observed by their Departments.

## THE 1979-80 CASH LIMITS

3. The previous Government published cash limits for 1979-80 before the Dissolution. But they left a number of loose ends on pay which we must now tie up. We will best support the cash limits system by announcing in the Budget the basis on which we have decided to operate the cash limits for the current year and then to hold to this basis.

4. For expenditure other than pay, the published cash limits provide for price increases based on the Industry Act forecast published last November. Price increases are likely to turn out higher than this. It should be possible to absorb a squeeze up to 4 - 5 per cent: provided that the post-Budget forecasts do not indicate a larger squeeze than this, I conclude that there is no need to review the published cash limits on this account. For each percentage point by which prices exceed the provision in the cash limits, the squeeze on central government, and local authority capital, expenditure amounts to £135 million at 1979 survey prices: there is also a squeeze on local authority current expenditure through the cash limits on the Rate Support Grants (RSG), but the effect of this is uncertain since local authorities appear to have rated on a scale sufficient to cover such price increases.

5. On pay, the previous Government set the cash limit on the basis of their 5 per cent policy which proved untenable. As a result they had to make a number of commitments to adjust the published cash limits and some settlements were reached on that understanding.

#### LOCAL AUTHORITIES

6. In the local authority field, the cash limit is on the RSG, which meets 61 per cent of local authority current expenditure in England and Wales (68½ per cent in Scotland). The previous Government agreed to raise the cash limits to cover the Government's share of the settlement with the manuals, including the cost of the outcome of the comparability study. They made a similar offer in respect of the teachers, but no settlement was reached in that case. The only major remaining negotiation in this round is for the white collar workers.

7. The local authorities appear to have set their rates on a scale which will not leave them short of funds, even if no further help is given through the RSG. But it would cause difficulty to go back on commitments already given, and we agreed last week that we should raise the RSG cash limits to the small extent necessary to cover our share of the cost of making the full increase in policy pay immediately: most of our share will be covered by the 50 per cent specific grant for the police, on which there is no cash limit.

8. The Chancellor and I recommend that, rather than discriminate between past and future settlements, we should be ready to increase the RSG so as to contribute our normal share of settlements. Depending on the outcome of comparability, this could add £300 million to the RSG cash limits. But this would not be incompatible with calling for volume reductions in local authorities' spending to provide offsetting economies towards the cost of pay settlements and towards meeting our budgetary problems. My paper on public expenditure reductions in the Budget contains a proposal to make such a call to local authorities and to reinforce it by cutting back the increases in the RSG proposed above.

#### CENTRAL GOVERNMENT

9. The main pay groups financed directly by Central Government are civil servants, the National Health Service, the armed forces and the universities. Here too the previous Government made some commitments.

10. The health authorities were told that, in addition to the volume squeeze resulting from higher prices, they would be expected to meet part of the cost of higher pay settlements by reducing the volume of their expenditure in 1979-80 by £24 million (at 1979 Survey prices). Subject to this, the cash limit would be increased to cover the cost of settlements, including any costs resulting from the decisions we have yet to take on the report of the Review Board on Doctors' and Dentists' remuneration. Depending on the outcome of comparability, this would involve raising the

present cash limit by £200 - £250 million. I propose that we should hold to this for this year unless the cost of the comparability awards is much higher than we expect, but in the medium term I hope we can press for larger administrative savings.

11. The universities were told that the cash limit on their recurrent grant would be raised to cover the extra cost of the 9 per cent settlement reached with their teaching staff and technicians. As the settlement was reached on that basis, it can hardly be re-opened. For the settlement with their manual workers however the corresponding increase in the recurrent grant was to be 2 percentage points less than the pay increase.

12. On the armed forces, we are committed to implementing in full the award recommended by the Armed Forces Pay Review Board. We agreed last week to raise the defence cash limit accordingly by some £270 million.

13. On the Civil Service, the difference between the pay award to the non-industrial Civil Service and the provision in the published cash limits is some 10 per cent, equivalent this year to £270 million or the full year cost of over 50,000 staff. The settlement for industrial staff, due from 1 July, is likely to add a further cost. This is too big a gap to be bridged by manpower economies in the current year.

14. The Lord President is bringing forward proposals for a temporary ban on recruitment and for a target for savings in staff costs in each Department in the current year; and on a procedure for setting cash limits in the light of the target. It is essential that these cash limits, like others, should represent an absolute upper limit on expenditure and be set at levels which can be firmly held. I propose that we should adopt the same approach as for the Civil Service in reviewing the cash limits on finance for fringe bodies.

#### NATIONALISED INDUSTRIES

15. Cash limits on the nationalised industries' requirements for external finance have also been published. It should be possible for the industries to observe these limits, provided that they are not prevented from doing so by the activities of the Price Commission. I propose that we should tell the industries that we expect them to observe the published limits, and will support them in doing so.

#### CONCLUSION

16. I invite my colleagues to agree that:-

- i. We should not adjust the published cash limits to cover higher price increases;

- ii. we should be prepared to adjust the cash limits on the RSG to cover the Government's share of local authority settlements, noting that I am bringing forward in the context of the Budget a proposal for economies in local authority current expenditure and for cutting back the proposed increase in the RSGs accordingly;
- iii. we should adjust the cash limit on universities and the National Health Service on the basis notified to them by the previous Government;
- iv. the cash limits on fringe bodies should be treated in the same way as those on Civil Service manpower, on which the Lord President is circulating proposals.
- v. we should tell the nationalised industries that we expect them to observe the published cash limits on their external financing requirements, and will support them in taking the necessary action including price increases.

If this is agreed, this policy would be incorporated in the Chancellor's Budget plans and announced in that context. This need not preclude earlier action in Departments or with local authorities when this is operationally necessary to achieve the required savings. It is likely that such action would have to be made public, but that is not in itself a serious objection.

W J B

Treasury Chambers

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