

Ref.A09924

PRIME MINISTER

Cash Limits for 1980-81 and Public Sector Pay
(E(79) 15)

BACKGROUND

1. I have set out the main issues in my brief on the first item.
2. There is however one specific problem. It concerns the interpretation of decisions already taken about pay and cash limits during the current financial year and the present wage round. There has been confusion about this in successive discussions in E(EA). The Secretary of State for Industry, as Chairman, has commissioned a paper on the background, which I hope will circulate to E(EA) before this meeting. His underlying worry seems to be that the present system puts no discipline on negotiators to seek offsetting savings for 'excessive' pay settlements (ie those higher than the rate allowed for in the previous Government's cash limits). He is particularly concerned about the way in which staged settlements are piling up large commitments for 1980-81, for which cash limits have not yet been set, so that it is not possible to use cash limits to enforce offsetting savings at the time the settlements are made. The Treasury/CSD line has been that these are matters best - and indeed can only be - considered when Cabinet has taken its decision on the volume of public expenditure in 1980-81 (which it is due to start on 12 July) and when this Committee has considered the right approach to cash limits in that year. He is likely to mention this problem. If he does, the right response, I suggest, is to invite him to reconsider the matter in E(EA) once he has a clear lead from this Committee about 1980-81.
3. For 1980-81, the choice posed in this paper is a clear one:

Option A: to fix cash limits in advance, to reflect an a priori view of 'what the Government can afford' in money as well as volume terms, implying some view about the appropriate level of wage settlements. This means using cash limits to enforce discipline in pay negotiations and being willing to accept in advance that if actual pay settlements go above the assumed levels, offsetting cuts in services will be found by one means or another.

Option B: to set cash limits to reflect decisions on volume and on price changes only; leaving them to be adjusted for pay in the light of the outcome of wage settlements, but with the option of imposing a further volume squeeze if the pay settlements prove excessive.

HANDLING

4. You might call the Chancellor of the Exchequer (or, if he prefers, the Chief Secretary) to introduce the paper, and then seek comments from the Lord President, the Secretary of State for Industry (both as Chairman of the E(EA), and as a large 'nationalised industry' Minister); the Social Services Secretary; the Environment Secretary; and any others who wish to comment. You might leave the Secretary of State for Employment to the end.

5. There is a clear choice for the Committee between Course A and Course B, and not much room for blurring at the edges.

6. Course A comes closer to the sense of the Party Manifesto and the line you and the Chancellor have taken in public statements so far. It means that cash limits would be used to buttress restraint on pay settlements in the public sector. But it risks the breakdown of the cash limits system if pay settlements run very far ahead of expectations. This could mean throwing the baby out with the bath water by risking discrediting the whole cash limit system if the 'volume' savings required to balance the books proved politically unacceptable. Individual sponsoring and employing Ministers will also see difficulties in Course A, because of the threat of automatic volume squeezes which it implies. They can be expected to shy away from the uncertainties for their policies which Course A implies. If Course A is followed cash limits will need to be realistic.


7. Course B means relying on the private sector (within the constraints of fiscal and monetary policy) to discipline itself and establish a going rate. The public sector would then follow suit. However it leaves open the possibility of a volume squeeze if things get out of hand. In this it is very close to the line taken so far in this round by both Governments. This gets the Government out of the firing line for a bit, but the open-ended threat of volume cuts 'in due course' may sound like bluff and be ignored by the unions. The discipline is less automatic although the Government's response is more flexible.

8. It is difficult to argue the choice between these courses in abstract. If the Committee is to have a further discussion on pay (and the limited time available makes this almost inevitable) it might be worth calling for some costed examples of how Option A would work out in practice for a couple of central Government Departments; for the Rate Support Grant; for the key nationalised industries - as suggested in my brief on the next item; and for the NHS. This would illustrate the difficulties of applying this policy to concrete situations - eg the next Local Authority manual workers settlement, the Clegg Commission report on nurses, or the findings of next year's PRU. If Cabinet reaches firm decisions on the level of public expenditure 1980-81 on Thursday, those figures could be used as a basic example. If not, then illustrative figures could be used.

CONCLUSIONS

9. If you accept this suggestion, then the conclusion might simply be a remit to the Chancellor of the Exchequer, in consultation with the Lord President, the Secretary of State for the Environment, the Secretary of State for Industry and the Secretary of State for Social Services, to produce a paper about how Option A might work on varying assumptions about the gap between the level of pay incorporated in cash limits and actual pay outturns taking into account the decisions on the volume of public expenditure which the Cabinet will be taking later this month.

10. If however the Committee rules out Option A, then all that is needed is a decision in principle in favour of Option B, together with a request to the Chancellor to circulate at the appropriate time the form of words with which he would accompany the announcement of Cash Limits for 1980-81, so that other Ministers can see the terms of the implied threat.


JOHN HUNT

6 July 1979