



PRIME MINISTER

PAY INCREASES AND PUBLIC EXPENDITURE

I will ask John Kent for advice on this; you might glance through as further background to public expenditure Cabinet, though it does not bear directly on the decisions which

I am increasingly concerned about soaring public expenditure on the Treasury pay. The Chancellor of the Exchequer's paper on "Public Expenditure: the Economic Background" (C(79)27) has shown that earnings in the public sector in 1980/81 are likely to be as much as 18 1/2% higher than in 1979/80 - largely as a result of comparability awards - and that increases in pay are likely to add enormously to the projected total of public expenditure. This development leads me to think that we need to reconsider some of the decisions we have taken in our attempts to restrain the impact of pay increases on our public expenditure plans.

or asking for. 12 17

We have taken a series of decisions which we intended would impose some discipline on pay negotiations in the public sector and prevent the full cost of pay settlements feeding through into public expenditure. These decisions have been largely ineffectual:

- a) we decided to reduce manpower expenditure in the civil service by 3% in the current year but to allow cash limits to be increased by the full amount of any pay settlements that might be reached. The pay of non-industrial civil servants has increased by 25%, the pay of industrial civil servants seems set to increase by about the same percentage (not all in this financial year) and London Weighting may go up by between 18% and 48%, but compensating economies are limited to the 3% figure, which is out of all proportion to the expenditure involved;



- b we have reduced our expenditure on the Rate Support Grant by £300 million in England and Wales and by £35 million in Scotland but, although we have said the size of the cuts will be reviewed in the light of pay settlements, we are apparently committed to meeting a large percentage of the cost of any award which the Clegg Commission may give to the local authority manuals and the local authorities themselves are making a string of expensive settlements for which we are committed to pay the lion's share;
- c we have (quite rightly in my view) increased cash limits to meet the cost of the pay settlements for the armed forces and the police but we have not considered whether manpower is deployed to best effect in either area and our decisions are being prayed in aid as a justification for other groups loosely connected with law and order to receive increases unmatched by offsetting economies;
- d we decided to reduce Health Service cash limits by £24 million but, although we have said this figure will be reviewed in the light of pay settlements, our action seems to have done nothing to stop proposals for pay increases being put forward without consideration being given to offsetting economies; and
- e we have not considered the expenditure implications of pay settlements in those few areas which are not cash



limited and the idea seems to be abroad that, if an item of expenditure is not subject to a cash limit, there is no objection to it being increased to accommodate pay increases.

Part of the problem may have arisen because, of necessity, we took decisions in haste before the budget. Another part of the problem may stem from a belief that we are in a transitional period between the old and the new ways and that all will be well when we introduce our new disciplines in the next financial year. The fact of the matter is that public expenditure on pay is soaring without real restraint, while the decisions on phased pay increases which have been taken, and which we are shortly about to take, have expenditure implications for the 1980/81 financial year and beyond. Although few major settlements are due before the end of the calendar year, the new pay round starts in August and will affect public expenditure in 1980/81. In my view it is critically important to ensure that from this moment on, all concerned with public sector pay negotiations understand that:

- a pay increases involve increases in public expenditure;
- b increases in public expenditure limit our scope for reducing the PSBR and taxation; and
- c public expenditure should not <sup>be</sup> increased while there is realistic scope for offsetting the cost of pay settlements through manpower reductions or increased productivity.

I have attempted to deal with some of the symptoms of the problem by instructing the Secretaries to E(EA) that they should not

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circulate papers which do not identify the cost of proposed pay settlements, the effect on cash limits (if any), the scope for offsetting action to keep expenditure within cash limits (including price increases and reductions in manpower), and, where economies are not practicable, the cost of proposed pay increases in terms of tax or rate increases. The responses of my colleagues have varied but that is a matter I can pursue in E(EA) Committee. There are it seems more serious underlying problems which need discussion either in E Committee or Cabinet.

I suggest that we should consider the following points:

- a the desirability of reopening Cabinet's decision that this year's cash limits on Civil Service pay-related items should be reduced by only 3% before being increased to take account of pay increases to establish whether we can substitute a significantly larger percentage reduction in particular areas to offset the costs of particular settlements, for example the industrial civil service;
  
- b the need to review those few areas of public expenditure which involve pay costs but which are not cash limited to establish the scope for manpower economies to offset the cost of pay increases and to identify any changes which may be required in practices and procedures (or in legislation) to make it possible to achieve such economies;

/c ...



- c the need to review the decisions that the health authorities and the universities should bear only the first £24 million and 2% respectively of the cost of pay settlements over the provision in their respective cash limits to ascertain whether there is scope for further economies to offset the cost of pay settlements in the current financial year;
- d the need to bring home to the local authorities that any excessive settlements for their APTC grades and for other groups will be met by a further reduction in the Rate Support Grant over and above the £335 million we have cut so far;
- e the need to identify the extent to which decisions we have taken on Clegg awards etc. (and the decisions we are about to take on the industrial Civil Service) have committed us to extra expenditure next year and the nature of the economies needed next year to offset these costs;
- f the desirability of amending the Rate Support Grant arrangements for the next financial year so as to ensure that our contribution to local authority pay settlements is a fixed sum of money rather than a percentage of whatever extra expenditure the local authorities choose to commit themselves to;
- g the scope for dealing separately with local authority expenditures on pay and on bought in goods and services /and ...



and for fixing separate limits on our RSG contributions to each so as to force local authorities to consider offsetting pay increases by cuts in manpower rather than in services; and

- h the desirability of some reform in the Whitehall Committee machinery to ensure that those concerned with the administration of cash limits comment directly on proposals for pay increases and the scope for offsetting economies before papers are submitted to Departmental Ministers or to E(EA) Committee.

I realise that these proposals will not be popular with all our colleagues but something needs to be done if we are to achieve our overall objectives. Apart from point (h) which is a matter for you alone, I suggest that we need a discussion in E Committee which could recommend that Cabinet should reopen its decision on points (a) to (d) and that papers should be prepared on points (e) to (g) for discussion in E(EA) Committee.

I am copying this minute to members of E Committee and to Sir John Hunt.

KJ.

K J

11 July 1979