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PRIME MINISTER

1980-81 Cash Limits and Pay

(E(79) 23)

BACKGROUND

This is the paper which you commissioned at the last E Committee discussion on pay - E(79) 4th Meeting on 9th July. You will remember that the discussion at the previous meeting concentrated on the difference between "Option A" and "Option B". The first involved, crudely, setting cash limits in advance and using them to influence pay negotiations. The second involved blurring cash limits, or adjusting them after the event, so that they followed rather than preceded pay negotiations. The second course did not exclude a search for offsetting savings, but meant that it could not be deployed in advance.

2. The paper is unsatisfactory in two respects. It does not provide the detailed examples for which the Committee asked, and it does not deal with the parallel and important question of nationalised industries (despite, if I may say so, a clear indication from the Cabinet Office that this was what Ministers would need). However, the whole operation has been very rushed, and internal differences within the Treasury, and between Treasury and other Ministers, has contributed to the delay. It is now very important that Ministers should give reasonably clear instructions, so that work can proceed during the summer on preparation of cash limits, notably because the RSG negotiations will be under way early in September. You will not, on present plans, have time for another discussion on pay in this Committee or in Cabinet before the Recess.

HANDLING

3. You will want to call on the Chancellor to introduce his paper, and then seek comments briefly from the Lord President, the Secretary of State for Industry (whose minute to you of 11th July is highly relevant), the Secretary of State for Education and Science, the Secretary of State for Social Services, the Secretary of State for the Environment and any other Ministers, including the Secretary of State for Employment, who may want to join in a general

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discussion. But the Committee has already had its "Second Reading" debate of this problem, and you may want to keep such comments brief and return to these specific issues quickly. The paper is a difficult one to discuss, because it is divided both horizontally - between the different problems involved - and vertically - between the different services. I think the horizontal classification is the easier one on which to structure discussion. In that case, it falls into four parts:

A. Pay and Price Assumptions (paragraphs 4-10)

As the Committee recognised before, the main problem is how to avoid establishing an informal "norm", whose existence will rapidly become known to the unions. The problem is even more acute in the public services, which are all broadly similar, than in the nationalised industries, where there are differences in market conditions. The paper tries to deal with the argument that cash limits will derive from the Government's monetary objectives: but the argument is circular, as those objectives themselves are derived from a view of the future rate of inflation in the public sector next year, as the paper shows. Most of that is already predetermined, by existing commitments to bring in "comparability" awards by staging. The rest is an attempt to forecast the likely updating necessary - for example, in the Civil Service Pay Research settlement next April. And the choice for Ministers, crudely, is whether to accept the best forecast that can be made now of that update, or whether to seek to influence it. (This ties up with the separate paper on pay research.) I do not think that Ministers can take a final view on this until they see some costed examples, with the elements for existing commitments and for estimated "update" shown separately, which is why this paper is so unsatisfactory. It will therefore be important to ensure that the further paper which the Chancellor promises to bring forward in the autumn should deal with this in detail. At that stage, the choice will be between setting cash limits which overshoot the expected outturn, so as to avoid putting too much strain on the cash limits system, or cash limits which fall a little short of the expected outturn, so as to put pressure on the negotiators. It will be possible to blur the issues in other ways too - discussed below - but this will be the most difficult single decision.

B. Timing (paragraphs 11-15)

Another way of blurring the decision - i.e. operating cash limits flexibly - is to defer the setting of cash limits until a point one or two months into the pay round. The paper suggests leaving it till the New Year. (Past practice has involved leaving cash limits until February or March.) Once again, the problem is that this course puts insufficient pressure on negotiators. For this purpose, the key negotiations are probably those for the local authority manuals and the NHS ancillaries and ambulancemen, both of which have a settlement date of November or December. In practice, negotiations often drag on a bit beyond this, but the negotiators need a clear lead from an earlier stage. Paragraphs 24-27 suggest that the cash limits for the Civil Service could be left even later, until preliminary results on pay research for the very large group of non-industrials who settle in April were available. But this too puts very little pressure on union negotiators. The RSG cannot be deferred in this way unless a different formula, like the proposed taper referred to under D below, is introduced.

C. Adapting the Coverage of Cash Limits (paragraphs 16-18)

The overriding principle has been, so far as possible, that cash limits should coincide with blocks of managerial or Ministerial responsibility. In this way the "programme manager" can shift resources around within his empire. But for most services, there are separate cash limits for pay: this partly reflects traditional Parliamentary requirements (now that cash limits are aligned with Parliamentary votes) and partly the separate controls exercised by the Treasury and the CSD. There is a lot to be said for amalgamating these: the Secretary of State for Defence, for example, already has in practice power to "vire" between one heading and another so that the defence budget is for practical purposes as a single cash limit. (Even then, he complains that the squeeze on his budget, and the relative flexibility of his manpower, is such that the whole strain falls on hardware: but he probably exaggerates this.) The alternative (canvassed in paragraph 27) is to create a single horizontal cash limit for all Civil Service manpower: this reflects the realities of the negotiating system, whereby CSD negotiate on behalf of all Departments, but it separates cash limits from Ministerial responsibility for individual programmes. If the CSD were responsible for administering a single cash limit block, and then squeezed it to make room for "excessive" central pay settlements, there would be endless rows with individual spending Ministers about the way in which their individual bits of the central cash block should be trimmed to fit the new total. On balance, the present system seems best.

D. Offsets

This is the most important and the weakest part of the paper. The whole point of the "Option A" approach is to set cash limits in advance, and then to seek offsets for any pay settlement which exceeds the provision made. Only in this way can pressure be applied in the course of negotiations: vague and unspecified threats, such as Ministers have had to use this year, are much less satisfactory. But to be credible, these offsets have got to be worked out in advance and deployed during the negotiations. That in turn means that they probably have to be agreed by Ministers in advance: it is no use coming back to the Cabinet and complaining, after the event, that there is no prospect of squeezing (say) the social security cash block to accommodate the extra cost of the settlement for Civil Service clerical staff, a very high proportion of whom work in social security offices. Thus, the "manpower contingency plans" referred to in paragraph 28 would need to be worked out and approved beforehand. The alternatives, of recourse to a very small contingency reserve already under strain, or of cuts in other non-pay bits of public expenditure, are equally implausible unless worked out in advance and deployed in negotiations. (This is the line which the Secretary of State for Industry has consistently been taking, and has a lot of force.) If that fails, and if the Government is determined not to increase net borrowing, then the only alternative is further taxation. If this indeed were the solution, there would be a lot to be said for tying specific tax increases to specific pay settlements: for example, the National Health element of the insurance stamp could be increased to cover the cost of NHS pay settlement. Or an increase in indirect taxes or even in VAT could be quite specifically related to the next Civil Service pay settlement. This would serve to demonstrate the last Government's maxim that "one man's pay rise is another man's price rise". Another device, suggested in paragraphs 33 and 34, could be to introduce a "tapering" RSG formula. This proposal, new in its present form, has a lot of appeal, and comes close to your own view that it may be necessary to take powers directly to control rates. It thus has applications in other areas in the immediate problem of pay. It would therefore be useful for the Committee to have a detailed scheme worked out when it returns to this question: the scheme could also be brought into play when Cabinet returns to the public expenditure discussions in the autumn.

4. The paper says nothing about nationalised industries, and I think you will need to take that as a separate item of the agenda. I am submitting a separate brief accordingly.

5. Whatever the decision, you will want to recall the Manifesto commitment "in consultation with the unions, we will reconcile these /i.e. pay research etc./ with the cash limits used to control public expenditure" (page 12). In context, this went much wider than central government, and included local government, health and education. You will want to return to this question, and decide how to handle this commitment, at the next discussion of pay. If there is to be time for consultation, this will have to be fairly soon after the summer holidays.

CONCLUSIONS

6. I think you might aim to record three conclusions from this discussion, which will be sufficient to hold the position during the summer months:

(i) To endorse Option A of the Chancellor's earlier paper E(79) 15, with some of the modifications described in the present paper E(79) 23.

(ii) To invite the Chancellor to produce proposals for cash limits for central government, NHS, and, in consultation with the Secretary of State for the Environment, local authority RSG, for the Committee's consideration in September.

(iii) To invite the Sub-Committee on Economic Affairs (E(EA)), in considering pay settlements in the remainder of the 1978-79 pay round, to seek off-setting savings wherever this is necessary to avoid exceeding the present cash limits, but to apply this policy flexibly and not specifically to seek offsetting savings in 1980-81 until the Committee has resumed its discussion in September.

JOHN HUNT

16th July, 1979