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rd 29.11.79

Mr Wolfson
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Prime Minister
These proposals will cause trouble in Cabinet because of the likely volume squeeze (see para 9). But higher figures would make the Chancellor's PSBR problems almost impossible. I think he should circulate his paper as proposed.

~~Agree~~? TL 29/11

PRIME MINISTER

PAY AND PRICE PROVISIONS FOR THE 1980-81 CASH LIMITS

The 1980-81 cash limits on the rate support grant (RSG) and on nationalised industries were announced on 16th November. We now need to take further decisions on the pay and price provisions for the remaining cash limits.

2. These are the limits on central government expenditure and on local authority capital expenditure. The provision should be approved by Cabinet and is on the agenda for 6th December. I shall be circulating a paper for that but I wished to inform you first what I have in mind to propose.

3. This is a major decision on public expenditure in 1980-81. The cash limits involved cover over £25 billion (at 1979 survey prices).

4. The main areas covered by central government expenditure are defence, health and universities, and the pay groups they cover, including the armed forces, doctors, dentists, nurses, and ancillaries, and university staff. We can leave civil service pay on one side for the time being since we have decided to make a global provision in a single vote which does not need to be decided until February.

/5. For the RSG

5. For the RSG we provided for a 13 per cent increase in costs (in this case all current, not capital) between 1979-80 and 1980-81 arising from new pay awards and from price increases. It would be desirable to follow the same approach here and use a single figure for cost increases on current expenditure.

6. This differs from past practice when a separate figure has been used for pay and two price factors used for the remainder of current expenditure. The advantage of the unified figure as for the RSG is that it avoids publishing an explicit figure for pay which could quickly become a starting point for negotiations. With prices expected to rise faster than pay, a single figure is likely to bear down more heavily in those areas with a relatively high proportion of current expenditure other than pay - notably defence. I think this has to be accepted in present circumstances.

7. I propose to continue past practice of using separate price factors for capital expenditure.

8. The provisions which I suggest are set out in the Annex. They are in line with the Industry Act forecast and the Government Actuary's Report, and should not cause surprise. The provision of 14 per cent for increases in current expenditure arising from prices and new pay awards is slightly higher than the 13 per cent used in RSG; but the 13 per cent for the RSG was part of a package in which we maintained the RSG grant percentage at 61 per cent; and unlike local authorities, the Central Government services generally have no other sources of finance to fall back on.

9. Even so, these provisions are almost certainly less than the increases in pay and prices which will actually occur. So they imply a squeeze of the volume programmes

/previously agreed.

previously agreed. On the basis of the Treasury's economic forecast, prepared two months ago now, the squeeze might be some £400-450 million (at 1979 survey prices), of which £140 million would fall on defence and £85 million on the NHS. On latest indications the actual squeeze will almost certainly be more.

10. Since our recently published plans for 1980-81 now look high in relation to our PSBR and tax objectives, some squeeze is welcome. But some of our colleagues will find difficulty with it, and I do not advocate attempting a larger squeeze by this route. If in the end widespread increases had to be made in cash limits in our first full year, it would seriously damage the cash limit system. I think that the figures I am suggesting strike the most appropriate balance.

11. If you agree, I will circulate a paper to Cabinet accordingly.

12. I am copying this to Sir Robert Armstrong.

(G.H.)
29 November, 1979

CONFIDENTIAL

ANNEX

A. Published figures

a. Government actuary

- Economy wide increase in earnings (including outstanding public sector comparability) of 14% between 1979-80 and 1980-81.

- RPI increase 14% 1979 (Q4) to 1980 (Q4).

b. Industry Act

- no earnings figure. Refers to "a progressive reduction in the rate of settlements over the coming year" by implications from the underlying increase of 15-16% mentioned for this year.

- RPI increase 14% 1979 (Q4) to 1980 (Q4).

c. RSG cash limit

- increase in costs of 13% between 1979-80 and 1980-81.

B. <u>Provisions proposed for 1980-81 cash limits</u> (consistent with Industry Act forecast)

	% increase 1980-81 on 1979-80
i) New pay awards and price increases on current expenditure	14.0
ii) Capital Expenditure:-	
Construction	
- Housing	15.8
- roads	16.4
- other	15.5
Land	15.0
Other capital expenditure	15.9

iii) Outstanding comparability awards

a) nurses in the range 20-25% annual increase in earnings. This assumption will be replaced by the actual figure if the Clegg Report is available in time.

b) university teachers in the range 15-20% annual increase in earnings.