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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

1980-81 CASH LIMITS AND PAY

Memorandum by the Chancellor of the Exchequer

When in July we had a first discussion about how to handle cash limits for 1980-81, we favoured Option A, which would fix cash limits, including provision for changes in pay and prices, in advance of pay negotiations so that known limits on availability of cash could influence wage negotiations. This contrasted with Option B, under which provision for pay increases would be decided after the relevant settlements had been made.

2. But we saw a need for more flexibility than in the original version of Option A, which would have required us to fix this autumn general assumptions about pay and prices which would then be maintained in all the cash limits, whatever happened subsequently. This we thought too rigid. It would set up, in the general assumptions, a target for militant unions to exceed. And, partly for that reason, it would risk putting too great a strain on cash limits: if in the event pay settlements were to exceed the provision by a wide margin, we might find that holding the cash limits would then require a reduction in numbers or in services greater than we could accept. If the policy were to lead to a large number of breaches, or forced increases, in cash limits, the whole cash limit system would be undermined

3. So we asked for a note to illustrate how in practice cash limits would be set in certain illustrative cases under a more flexible version of Option A; and to examine how far the assumptions underlying the cash limits could be kept private.

4. The attached note by officials covers this ground.

5. On the second question this note concludes that we could not expect to keep the assumptions private. Parliament and spending authorities will want to know the basis of the provision; and negotiators need to know it if it is to influence pay negotiations. In any event comparison with the previous year's figures would allow it to be calculated within a narrow margin of error.

6. I agree with this conclusion.

7. As for the way in which cash limits might be fixed, the scheme described in the paper would maintain (with one possible exception) the essential feature of Option A, that each cash limit should be fixed in advance of the relevant pay negotiations, so that negotiations take place within that framework. But it would introduce more flexibility, by fixing the cash limits in batches and as late as is consistent with setting the Parliamentary Estimates in time to publish them before the financial year begins. Thus a separate decision can be taken for different groups of public service employees as to the provision for forthcoming pay settlements. This would keep open the option of making different provision in different cases, to take account of their particular and possibly changing circumstances, including, if we so wish, the emerging pattern of pay settlements. We could apply through cash limits such financial pressure on the negotiations as we think right at the time, with less risk of getting committed in advance to respond to an excessive settlement by cuts in numbers and services going beyond what we could accept.

8. The paper also suggests some further devices for additional flexibility:

(i) a sliding scale for Rate Support Grant Increase Orders, so that local authorities get a reduced percentage of support in proportion to increases which they make in their rates, or possibly in proportion to pay increases conceded early in the pay round (paragraphs 13-14 and Appendix B);

(ii) a new kind of cash limit, in effect a global provision, for civil service pay increases, so that this provision can be settled as late as possible before the pay negotiations, and with greater flexibility in distributing the available cash among Departments (paragraphs 21-23). This suggestion will need to be put to the Public Accounts Committee, and also to the new Select Committee on the Treasury/CSD if it has been set up and is ready to deal with the point.

9. My view is that the paper offers a sensible modification of the original Option A in the direction we wanted, and that the arrangements should in general be workable. The suggestions about a sliding scale for local authorities and global provision for the civil service need to be studied further.

10. But I draw attention to two points:

(i) While this scheme would keep open the option of differential provision for different groups, we must recognise that, as the paper points out, there will be difficulties in discriminating overtly in advance of negotiations. This makes especially important our first decision concerning cash limits for next year, the Rate Support Grant (which covers the pay of teachers, local authority manuals and white-collar staff). It will go some way to set the pattern for the rest.

(ii) In each case a Ministerial decision will be needed as to

the provision to be included for the forthcoming pay settlements, and this will become known. The problem of target setting is diffused but not removed.

11. If we adopt the approach described in the note, I will bring forward in October proposals for the provision for cash limits on the nationalised industries (discussed in my separate paper) and the Rate Support Grant cash limit due to be published in November. Our decisions on the other cash limits need not be settled until later; that for civil service pay could be left until February.

12. My proposals for the Rate Support Grant will take account of the new short-term economic forecast for 1980-81 which will become available next month. I shall then be able to make a fresh assessment of the fiscal and monetary prospects, taking account of recent developments including implications of Clegg. If the prospects for 1980-81 look unsatisfactory, we may also have to reconsider, either next month or in the period leading up to the Budget, other elements of our policies, including the volume of expenditure which we are planning.

Conclusions.

13. I propose the following conclusions:

(i) We should adopt the general approach suggested in the attached note, taking note that the basis of provisions made for pay settlements cannot be kept private.

(ii) The idea that the Rate Support Grant cash limit should be linked inversely to increases in rates and/or pay settlements (paragraphs 13-14 of the note) should be further pursued by the Department of the Environment in consultation with the Treasury and other departments concerned, so that this can be considered further when we take decisions on the Rate Support Grant in October.

(iii) The Treasury and the Civil Service Department should develop the proposal for a global cash limit covering civil service pay increases (paragraphs 21-23 of the note), including the necessary consultation with the Parliamentary Committees.

H.M. Treasury (G.H.)
14 September 1979

1980/81 CASH LIMITS AND PAY

Note by Officials

1. This paper describes the general stages which will be involved in setting the 1980-81 cash limits and illustrates their application to the three specific areas. It goes on to examine the possibility of keeping the assumptions private. A separate paper is being circulated containing illustrative cash limits for certain nationalised industries.

A. Setting 1980-81 cash limits

2. The proposals that follow start from the previous discussion of E Committee and Ministers decision (E(79)5th) to adopt an approach as close as possible to Option A but with a measure of flexibility introduced according to the circumstances of each cash block. The objective is to ensure that the cost of settlements is contained within the cash available. This cannot be done by the cash limits alone; they will have to be supported by firm negotiation by the public service employers, including the Government where they are the direct employers. The cash limits will need to be set as realistically as possible in relation to the likely settlements and this aim can be assisted by delaying some of the key decisions a little, so that the Government has the maximum possible information on which to base a judgement both of what the Government can afford and of the likely order of the settlements which can be reached.

3. The following proposals introduce flexibility by providing for the various categories of cash limits to be finalised at different times but, subject to the possible exception in paragraph 16, retain the essential character of Option A that cash limits should in each case be fixed before, and not after, relevant pay negotiations. By contrast Option B would involve setting cash limits after pay settlements had been reached and the presumption would be that they would largely accommodate the results of pay negotiations.

4. The starting point for cash limits is the decisions taken by Ministers on the volume of public expenditure in 1980-81. This will include the effect on 1980-81 of decisions yet to be taken on reducing

Civil Service manpower by 1982-83. These decisions on public expenditure are expressed on the basis of the main public expenditure programmes and in "1979 survey prices". The basic steps which will be involved this autumn in calculating the corresponding cash limits are as follows:

(a) identifying the expenditure within the main programmes concerned which is cash-limited and that which is not;

(b) taking account of pay and price increases which have already occurred ie since 1979 survey prices were settled, generally in the autumn of 1978;

(c) making such provision as may be decided on by Ministers for future pay and prices.

5. The first step will be based on Cabinet's decisions on volume. Further work is required to translate the decisions into cash limits. Not all expenditure is covered by cash limits. Expenditure in one main programme may fall into several cash limits.

6. The second step is to re-express the volume of expenditure decided upon by Ministers at more up-to-date pay and price levels. It will involve taking account of price increases and pay settlements which have taken place between the date on which 1979 survey prices are based - for most programmes the autumn of 1978 - and the autumn of 1979 when departments are making the allocation to cash limits in step one above. The calculation which is undertaken by departments will be based on their knowledge of pay and price movement in the areas involved.

7. The third step will be to add such amounts as Ministers decide on for future pay and price increases. The amounts of the allowances for future pay increases will be determined by Ministers collectively. This is a crucial decision. A similar decision will also be required for price increases. Within this provision spending authorities will have to meet both new pay awards and any outstanding staging in the implementation of past settlements, for example the Clegg awards. In previous years incomes policies have been operating and it has been assumed that all public service employees receive the same pay award.

It will be possible, if Ministers so wish to make different provision for new pay awards for different groups of employees. In practice there are obvious difficulties in this. On prices a limited range of price factors are applied to the different types of expenditure. The list of factors used in 1979-80 is shown at Annex A.

8. The first occasion for which provision to be made for future pay and price increases will have to be decided is in October for the settlement of the Rate Support Grant (RSG) in November. This will have a powerful influence upon the decision about other cash blocks. It will be hard in practice to justify provision for these out of line with that used in the RSG. It will be most important for this provision to be seen to be consistent with the government's monetary objectives in the light of the autumn economic forecast. For cash limits other than the RSG, the deadline for decision depends on the time at which the Estimates need to be settled and sent for printing so that they can be published by the end of the financial year. For most of these Estimates a final decision on the provision can be left until mid-January and the provision for Civil Service pay, if the approach outlined later in the paper is adopted, could be left open until March if Ministers wished.

9. The cash limits calculated for the illustrative purposes of this paper include provision for future pay and price increases in line with the projections in the Chancellor's paper C(79)27. These assumed an overall increase in public service pay of 18½% between 1979-80 and 1980-81 (including a judgement on the likely outcome of the Clegg reviews), and an average increase in prices of around 15%. More specifically, it has been assumed in this paper that in a full year the cost of those comparability awards which have not yet been determined will average 10% and that new awards in the public services in 1980-81 will average about 10%. <u>These assumptions are used for illustration only</u>.

B. <u>The procedure in particular areas</u>

(i) <u>Rate Support Grant</u>

10. The starting point for the Rate Support Grant (RSG) is the total of local authority "relevant expenditure". This is based on Cabinet's

July decisions on public expenditure. It contains elements from a number of programmes, such as education, roads, housing, law and order and other environmental services. The process follows three basic stages:-

(a) total of relevant expenditure as already decided by Ministers at 1979 survey prices - about £13½ billion;

(b) taking account of pay and price increases to autumn 1979. Price increases between survey prices and autumn 1979 are estimated at around 15% and pay increases 12-13%. This brings the figure to over £15 billion;

(c) making such provision for future pay and price increases as may be decided on by Ministers, including the outstanding staging of comparability awards. On the assumptions described in paragraph 9 above this produces a total of some £17½ billion.

11. The RSG is an agreed percentage of relevant expenditure which has been varied from time to time. The figure in the Main Order for 1979/80 for England and Wales was 61% and Cabinet will be considering in the autumn for the figure for 1980-81. In addition to the grant percentage (based on expenditure in November pay and price levels) a cash limit is set on increases in grant arising from changes to pay and prices after November. The RSG settlement is announced in November for the coming financial year.

12. 61% of an expenditure total of £17½ billion would produce a cash limit of £10.7 billion which would normally be set in November. But this would not itself impose a ceiling on local authority current expenditure since local authorities can finance their expenditure through their rate calls which they determine early in the new year, and by drawing down their balances. One problem in this area is to reduce their scope for circumventing the discipline of the RSG cash limit by raising rates.

13. One suggestion for dealing with this problem, which would be a new initiative, would be to make the RSG Increase Order percentage dependent on the level of rate increases. For example, authorities might be told that RSG would be 60% if rate increases were 10% but only 58% if rates increased 15%. A sliding scale would be made known at the time of the settlement in November. The cash limit would not be finalised until late March in the light of rate increases. To make this device usable it might be necessary to take statutory power to enable the government to discriminate between authorities on the basis of their rate increases. This would enable local authorities to take rating decisions without fear that they might lose grant because of the decisions of others.

14. Another approach would be to make RSG payments inversely related in this way to the level of pay increases agreed by local authorities between November and March as well as to the level of rate increases. A disadvantage of this approach is that it would be directed at only one major pay settlement, the local authority manuals, and could lead to charges of discrimination against this one group of employees.

15. A numerical example is attached at Annex B. The degree of penalty for high rates would depend on the schedule set down. In the example, total authority income falls as rates increase because the loss of RSG receipts more than offset the extra rate income.

(ii) National Health Service

16. Cabinet's July decision was that programme 11 (health) expenditure in England for 1980-81 should be about £6½ billion at 1979 survey prices. The steps involved in setting the cash limit are:-

(a) separating out the expenditure in the programme which is not cash limited (the family practitioner service): this leaves the provision for the hospital and community health services and the other centrally financed services which are cash limited - some £4½ billion at 1979 survey prices (after taking account of certain receipts from national insurance contributions);

(b) taking account of pay and price increases to the autumn of 1979. Price increases are presently put at around 17% and pay increases around 16%. This brings the overall figure to just over £5¼ billion;

(c) making such provision for future pay and price increases as may be decided by Ministers, including outstanding staging of comparability awards. On the assumptions described in paragraph 9 above this produces a figure for the cash limit of £6¼ billion.

The cash limit need not be finalised until January when the Estimates must be settled and sent for printing. If Ministers wished to fix the cash limit earlier so as to limit the cash available for the ancillaries' settlement in December, it would however be open to them to do so.

17. Within this cash limit over 65% of the expenditure relates to pay. This means that for every 1% the average level of pay settlements in the NHS exceeds the assumed level, the volume of HCHS and OHS expenditure would be squeezed by £38 million, or 0.7%, if the cash limit were unchanged. Similarly for every 1% prices exceed provision the squeeze on volume would be £18 million or 0.3%.

(iii) Civil Service

18. Civil Service pay is spread over some 40 cash limits, many of which contain little else but pay. There are two main pay settlements: for the non-industrial Civil Service in April, and the industrials in July.

19. The way in which the cash limits would be calculated if the procedure for other cash limits were followed as in previous years is:

(a) the provision for Civil Service staff in each department's programme as approved by Ministers in the public expenditure survey;

(b) allowance for pay and price increases to autumn of 1979 (about 15% and 16% respectively, this year);

(c) making such provision for future pay and price increases as may be decided on by Ministers including outstanding staging.

20. In the past the decision on c) has been simplified by the existence of a precise pay policy limit on pay increases. One factor in 1980-81 will be Ministers' decision that pay research should be the means of determining the pay of the non-industrial Civil Service. It is necessary to reconcile this decision with the system of cash limits. Pay research information for the non-industrial Civil Service becomes available between October and February. No decision has been taken on the means of determining pay of the industrial Civil Service.

21. If the settlement exceeds the provision in the cash limits, the cost can only be kept within the cash limits by reductions in staff numbers. As this year's experience has shown, the gap which can be closed in this way is quite small. A change which would help would be to introduce a new type of cash limit, in the form of a global cash-limited provision for pay increases. This would not make it any easier to accommodate pay settlements in excess of the provision, but it would have three main advantages. First, settling the central provision could, if Ministers wished, be delayed longer than separate provisions for individual departments' Votes, which have to be settled and sent to press in January, and so could incorporate a later view (based on pay research findings in the case of the non-industrial Civil Service) on the appropriate pay provision. Second, it could even out the distributional variations in the cost of the settlement between departments. A pay research settlement gives different increases to different grades and so affects individual departments differently according to the composition of their staff. Third, the central pay provision would not be widely known before publication, which need not be until March, and would remain confidential longer.

22. Under an arrangement of this sort the Votes for individual departments would be published without any provision for future Civil Service pay increases, but would include the (known) outstanding staging from the 1979 settlements. The central cash limited provision would be for the new awards and be calculated by applying the future pay increases decided on by Ministers in the light of the pay research evidence for the non-industrial Civil Service, and by an appropriate assumption for the industrial Civil Service / to the total estimated Civil Service manpower included in individual departments' Votes at 1979 pay settlement levels. On the assumptions used in this paper the central cash limited provision would be some £450 million.

23. When the new pay research settlements had been reached, this central provision would be allocated as appropriate to departmental Votes. The mechanics would need to be developed by Treasury and CSD and be discussed with the Public Accounts Committee and possibly the Treasury Committee. A single composite Supplementary Estimate may be the most appropriate method of distributing the central provision to departments. (The PAC may have views on this). Similar arrangements would be needed for Northern Ireland Votes.

C. Revealing the assumptions

24. E(79)23 pointed to the dilemma. Revealing the pay assumptions risks creating a starting point for negotiations and in this way could go a long way to falsifying the initial provision and so result in volume adjustments. On the other hand, if the provision in cash limits is to exert financial pressure on the negotiations, negotiators need to know what it is.

25. In practice the assumptions cannot be kept confidential. Parliament has in the past been informed of the pay and price assumptions used in setting cash limits and would no doubt expect this procedure to be continued. Members could argue that, without this information, the House cannot properly judge the Estimates it is asked to Vote.

26. Many Vote subheads relate exclusively to the pay of identifiable groups of employees and it is a simple matter to calculate the pay assumptions within a narrow margin of accuracy. Bodies like local authorities and health authorities would also expect to be told broadly what provision has been made in their cash limits, and any such information would be likely to become public knowledge and indeed they could work it out.

27. In the case of the Civil Service even with a global provision for pay increases a calculation could easily be made by comparing the provision for pay increases with the existing cost of the Civil Service, and a result produced which would be accurate within a reasonably narrow margin.

ANNEX A

The pay and price assumption used in setting the 1979-80 cash limits were described in detail in the Main Estimates. The relevant Section is:

THE PRICE BASIS OF THE 1979–80 VOTES

As announced on 1 August 1978 (House of Commons Official Report, Column WA 245) Votes are being presented for 1979–80 on a new basis. In the past, Votes were generally presented in terms of the pay and price levels ruling at the time they were drawn up, usually some months before the start of the financial year. Supplementary provision was then sought during the year to cover subsequent pay and price increases. Under the new arrangements, the Votes also include provision for pay and price changes during the year ahead. This note explains the general principles upon which this has been done in these Votes.

The starting point for the provision in Votes is the planned volume figures for 1979–80 in the White Paper "The Government's Expenditure Plans 1979–80 to 1982–83", adjusted to reflect any changes since that White Paper. The provision has been converted to pay and price levels for 1979–80 by first allowing for pay and price increases known to have occurred up to the time when the Votes were prepared, and then by applying to the main economic categories within the Votes a set of general factors to provide for future increases. As in the cash limits for previous years, a small number of further adjustments have been made in cases where this appeared to be necessary. The categories of expenditure are set out below together with the general price factors applied to provide for future increases. The values shown in brackets represent the assumed increase between the average price levels of 1978–79 and 1979–80 on the basis of 1978–79 = 100:

1. Pay—allowance is made for settlements in 1979–80 adding up to 5 per cent (or £3·50 a week, which ever is the greater) to annual earnings from due settlement dates. Provision is included for the cost of the staged increases agreed last year for firemen, police, the armed forces, others covered by the Review Bodies and university teachers under the arrangements outlined in paragraph 15 of 'Winning the Battle against Inflation' (Cmnd. 7293).

   For pensions payable under public service pension schemes, provision is made for uprating in November 1979 by 8½ per cent, in line with the Industry Act forecast of the movement in the retail price index between the fourth quarters of 1978 and 1979.

   The provision for employers' national insurance contributions reflects the above assumptions on earnings and the revised contribution scale effective from April 1979.
2. Other current expenditure on goods and services (108.2);
3. Purchase of land and existing buildings (110.7);
4. Public sector building and works:
   (a) Public sector housing (112.6);
   (b) Roads (115.3);
   (c) Other (113.1);
5. All other current and capital expenditure (109.0);

The figures for items 2 and 3 are derived from indices prepared for this purpose. Those for item 4 are derived from outturn price indices prepared using the methodology described in an article in Economic Trends, July 1978. The index used for item 5 is that for the gross domestic product deflator at market prices.

A statement was made by the Chief Secretary to the Treasury on 23 February 1979 (House of Commons Official Report WA (Cols 334/335)) that cash limits would not be increased if prices rose faster than provided for but that in certain circumstances, the cash limits might need to be adjusted if pay settlements exceeded the relevant provision. Supplementary Estimates will be presented if any such adjustments are proposed.

ANNEX B

A Possible RSG Scheme

Assume that

(i) total of relevant expenditure in Main Order at November 1979 prices is £87

(ii) total of relevant expenditure in cash is £100; this means the limit on Increase Orders is £13

(iii) rate income in previous year £36.

In November the local authorities would be told

a) the RSG percentage on the Main Order - say 61% giving a Main Order payment of £53 (61% of £87)

b) the sliding scale of RSG percentage applicable in the Increase Order. This might be as follows:

Rates increase	5%	RSG on	Increase	Order	62%
"	"	10%	"	"	"	"	60%
"	"	15%	"	"	"	"	58%
"	"	20%	"	"	"	"	55%

Local authority revenue would then be (£):

	Rates Increase			
	5%	10%	15%	20%
Rates	38	40	41	43
RSG Main Order	53	53	53	53
RSG Increase Order	9	7	5	2
Total revenue	100	100	99	98

In this example authorities gain no more revenue in total through rate increases and, beyond a certain level, the additional rate increase is more than offset by reductions in the RSG Increase Order.