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11/2/81

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PRIME MINISTER

PAY AND CASH LIMITS

You will have seen the letters to me from the Secretary of State for Social Services and the Lord President of 10 and 11 February 1981. I agree that, if the timetable of the negotiations requires this, we should discuss this at E Committee tomorrow. It might help the discussion if I set out my views for you and our colleagues before then.

2. It is essential that we should draw a clear distinction between the discussion of the pay settlement and the discussion of the cash limits factor. We did not intend the 6 per cent factor to be a pay norm. It is the basis for calculating the cash limits, which determine the finance available for each service. We have made it clear throughout publicly that particular settlements will diverge from that factor.

The pay negotiations

(a) National Health Service

3. I accept that it may well be necessary to settle at over 6 per cent for the NHS ancillary staff. I think that the negotiators should be instructed to do everything possible to secure 7 per cent rather than 7½ per cent.

4. I would see no difficulty with the move of the settlement date, subject to the conditions which Patrick Jenkin proposes. The first is that the lump sum should be subject to the limit he suggests. The second is that the base level for 1982-83 cash limit should not be increased by more than the pay factor for 1981-82. Payments during the current year would of course have to be contained within the existing cash limit.



5. But I am not convinced by the arguments that there has to be the same level of settlements throughout the NHS. The ancillaries had a smaller increase in the last round than other groups, so it would not be inconsistent for them to be paid more in this one. Moreover, most of the arguments in the letter seem to be based on comparability in this round. They ignore both the extent to which public sector groups have done relatively better in recent years, and the need to limit settlements to what we can finance.

(b) Civil Service

6. I think we must take a robust line on civil service pay. It would do great damage both economically and politically if we were seen to retreat in this area. The civil service has enjoyed increases in pay rates over the last two years of nearly 50 per cent and, despite our reduction in manpower, is enjoying job security at a time when unemployment is rising sharply in the private sector. There is little public sympathy for civil servants and I believe the unions and their members realise this and are influenced by it.

7. I see no reason why a settlement higher than 6 per cent for the NHS ancillaries requires an increase higher than 6 per cent for the Civil Service.

Cash limits

8. Even if the pay settlements have to be higher than 6 per cent, that does not in itself require a higher factor for pay in setting cash limits. There are powerful reasons to sustain our previous decision of 6 per cent.

9. A change of 1 per cent in the pay factor would cost £120 million for the NHS and Civil Service. We cannot afford additional expenditure next year on that scale, especially after what has happened since November to increase the intended volume for next year.



10. To announce an increase in the pay factor alone would be seen as a major climb-down by the Government. It would rightly draw considerable criticism from our supporters and from private sector employers. It is widely assumed that "broadly the same financial discipline" means 6 per cent. Nothing has happened since we fixed that factor for the RSG which should lead us to a change of view. It will be clear that we have ourselves based the Estimates on that assumption. If the pay factor alone were changed we would either have to delay publication of the Estimates, explaining why, or publish them as they stand and take a whole series of Supplementaries.

11. An announcement now would undermine the position which the Secretary of State for Education has taken in the negotiations on university teachers' pay. We should not prejudice achieving that settlement. The change would lead to pressures to re-open cash limits already announced, for the Universities and for the RSG: we cannot contemplate that.

12. Nor should sticking to the 6 per cent factor lead to an unacceptable squeeze on programmes. The prospect for inflation in the coming year is now somewhat better than I expected when I proposed, and Cabinet agreed, the price factors of 11 per cent. This may give some room for manoeuvre in those cases where the cash limits include both pay and price elements, since the cash limit will overprovide for the latter. In the case of the NHS, improvement by, say, 1 per cent in actual prices is worth £30 million, compared with the cost of an additional 1 per cent on pay of £70 million (for the United Kingdom as a whole). The net effect is that the volume is likely to be 1/3 per cent lower than we had in mind in November when the factors were first discussed. If inflation were somewhat less than 10 per cent - which is quite possible - there would be no squeeze at all. I recognise the Secretary of State's concern to maintain the volume of health spending, but in present circumstances running the risk of a marginal reduction would seem justifiable.



13. Even that risk only arises on the assumption that all NHS staff would receive the higher pay settlements. I have argued above that it would be defensible to give the ancillaries more than others. Since an additional 1 per cent of the ancillaries' pay bill would cost about £12 million, it is clear that it could be afforded within the margin created by the improvement in the prospect for prices.

14. There is less room for manoeuvre between the pay element and the price element on the majority of Votes and cash limits which include Civil Service pay. In those cases holding to the present 6 per cent factor while agreeing a higher settlement would involve a greater reduction in numbers than already planned. But it would be difficult, surely, to defend an increase in the pay factor of 7 per cent on the grounds that 6 per cent would involve an intolerable extra reduction in Civil Service manpower. If colleagues consider that such a reduction is intolerable, then we must go for a lower settlement.

Conclusion

15. I therefore feel very strongly that the right course now is to retain the 6 per cent factor and to accept that any settlements of a higher percentage rate should be financed by the advantage to be gained from retaining the 11 per cent price factor, and from economies within the cash limits concerned. If despite the arguments I have set out colleagues were to consider that we had to increase the pay factors, I would have to propose the reduction of the price factor to 10 per cent for the reasons which we discussed earlier, not least the need to offset the increased cost of £120 million. The effect of the two changes would mainly be a switch between different cash limits with a slight net increase in public expenditure (some £15 million). The effect on the NHS cash limits would be to increase gross expenditure by just over



$\frac{1}{3}$ per cent. It hardly seems worth the opprobrium and other disadvantages in changing the factors to achieve such a marginal effect.

16. I am copying this minute to members of E Committee and Sir Robert Armstrong.

GH

(G.H.)

11 February 1981

APPROVED BY THE CHANCELLOR OF THE EXCHEQUER
AND SIGNED IN HIS ABSENCE