



Re

DG

10 DOWNING STREET

16 September 1985

From the Private Secretary

Dear Richard,

CONTROL OF CIVIL SERVICE RUNNING COSTS

The Prime Minister has seen the Chief Secretary's minute of 10 September. She has noted that the Chief Secretary will discuss progress in implementing running cost controls when he reports to Cabinet on the results of his bilateral discussions. The Prime Minister hopes that all Departmental Ministers will make every effort to find the economies necessary to make the new system a success.

I am copying this letter to the Private Secretaries to members of Cabinet, to Sir Robert Armstrong and to Sir Robin Ibbs.

Yours sincerely,

David

David Norgrove

Richard Broadbent, Esq.,
Chief Secretary's Office,
H.M. Treasury.

6

CONFIDENTIAL

CONFIDENTIAL

PRIME MINISTER

CONTROL OF CIVIL SERVICE RUNNING COSTS

1. John MacGregor sent me a copy of his minute to you of 10 September.

2. I fully recognise the need to control running costs in the Civil Service and the level of pay settlements generally. I was puzzled, however, by what he said in paragraph 5 of his minute about the public presentation of such pay assumptions. We are apparently to say that there is no central guidance to Departments and that each Department has made its own assumption in determining its running cost limit. If we are then pressed e.g. by our Select Committees, to say what the assumption is, I do not believe we can refuse to tell them. If we do reveal the assumptions, and thereby their implications for actual staffing levels, and if one Department is found out to have made a lower assumption than others, the TUS reaction in that case is likely to be particularly intense. More important, however, is the difficulty of a general argument which says that the Treasury will continue to negotiate pay for the Civil Service as a whole but that each Department makes its own advance guess about the level of settlement. This will strain credibility to breaking point.

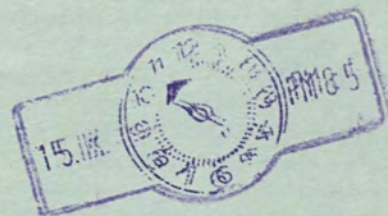
3. I think we need to be a good deal clearer about what our posture should be in response to these sorts of questions before we adopt the approach which John MacGregor is

suggesting, and I would therefore welcome collective discussion of the matter.

4. I am copying this minute to other members of the Cabinet, Sir Robert Armstrong and Sir Robin Ibbs.

G.Y.

16 September 1985



CONFIDENTIAL

PRIME MINISTER

13 September 1985

CONTROL OF CIVIL SERVICE RUNNING COSTS

The Chancellor will raise this subject in his bilateral on Monday.

The Treasury are right to propose that we discard the pay factor and manpower targets. Another pay factor of 3% would be unrealistic and provocative. A higher factor would signal that we were relaxing on pay. Manpower targets are increasingly unattractive, too. They suggest that reductions in Civil Service jobs are an end in themselves for this Government.

The running costs cash limit concept is an astute replacement of these two management devices. These limits would put pressure on Departments to save manpower. The (leaked) knowledge that such limits exist will put some restraint on Civil Service Unions' pay demands. It might also encourage the unions to trade off over-generous allowances (1st class travel, accommodation, entitlements, subsistence allowances) in return for higher pay.

Effectiveness

You want to stress to Nigel that the limit needs to be challenging and take account of known inefficiencies, such as

CONFIDENTIAL

CONFIDENTIAL

- 2 -

those revealed by efficiency scrutinies. Extra-departmental scrutinies will be needed in the event of any over-runs.

Presentation

You ought to discuss the presentation of this shift of policy with Nigel. The high-paying CBI members and some backbenchers will argue that by dropping the pay factor, the public sector will no longer "set a good example". The limits will be seen to be tough on Departments, and on pay, too, because pay accounts for 70% of running costs. There are also political advantages in the new approach. You will want to approach an Election with the Civil Service of a size appropriate to its tasks and not still in the process of being pruned back. You will want by then to have an efficient, motivated Civil Service which can share in the improved prosperity which your policies have generated. Running costs' limits can allow scope for this. They can be presented in the language of efficiency and value for money, which sound considerably warmer than manpower cuts and pay factors.

Judith Rud

R NICHOLAS OWEN

CONFIDENTIAL

CC 210
B. T. 13?

FROM: CHIEF SECRETARY

DATE: 10 September 1985

PRIME MINISTER

CONTROL OF CIVIL SERVICE RUNNING COSTS

1. When you gave your agreement in April to my predecessor's proposals for extending the running costs targets we first introduced last year you asked the Treasury and Efficiency Unit to consider what needed to be done to ensure the success of the new system. In response to this Peter Rees' minute of 26 July described a number of measures, including the arrangements Treasury Ministers were envisaging for the monitoring and in-year control of departments' running costs limits. As foreshadowed in that minute, I now attach a note setting out our proposals on monitoring and control in detail.

2. Our proposals are designed to be as simple as possible, and to rest heavily on the cash limits system, which has proved its worth as an instrument of control. As such, I hope they will commend themselves to you and to colleagues. But there is one fundamental point on which I hope we are all clear: however effective the systems which are put in place in departments to deliver these new targets, running costs limits can only be a success if we are all determined that they should be delivered.

3. As agreed at the 11 July Cabinet, I shall be aiming in the bilaterals to reach agreement on tough but realistic limits for each department. Discussions between officials are making useful progress, but it seems likely that there will be a number of issues which I will need to resolve with colleagues. Our agreed procedure for negotiating these limits, basing the discussion on each department's own proposal for a target for itself, usefully allows us to take proper account of relevant particular circumstances for individual

CONFIDENTIAL

departments. In this way, and especially by identifying offsetting savings and economies wherever possible, we will be seeking to take account of particular factors to which colleagues have drawn attention in earlier correspondence; and those to which we agreed in July to give special attention (running costs bids relating specifically to the control of fraud and the staffing of services whose costs are wholly recovered by fees).

4. Colleagues agreed in July to return in September to the question whether we should adopt a pay assumption for 1986-87. The Chancellor and I are firmly of the view that to announce a pay assumption as we have in recent years would be less appropriate in this year's circumstances. Until recently the pay assumption has been valuable in reducing expectations about pay increases both in the public services and more widely. But this year a pay assumption could, again, clearly not be more than 3%. The usefulness of a pay assumption at this level would be highly questionable. It would also put an impossible strain on the new running costs limits if they are, as they must be, tightly set and rigorously operated; and if delegated budgets within departments are to be taken seriously and developed, as we all wish them to be, they cannot indefinitely be based on artificially low pay assumptions.

5. Great care would, of course, be needed if we decide, on the basis of such considerations as these, to move towards a system in which there is explicitly more realistic provision for pay: we must at all costs avoid the - erroneous - impression that the government's commitment to public expenditure control has in any way weakened. To this end we might aim to argue in public that there was henceforward to be no pay assumption in the old sense, since that had been made redundant by running costs limits, which

CONFIDENTIAL

CONFIDENTIAL

had been set at tight but realistic levels. If we were pressed to say more we could acknowledge that a range of different assumptions underlay departments' running costs limits, and that no central guidance to departments had been offered by the Treasury because we have no crystal ball for predicting the outcome of the pay negotiations; and that pay is, anyway, only one element in overall running costs, so that if departments' pay assumptions proved wrong, the intention would be, as in the past, that they should find economies in order to live within their agreed provision.

6. This line would help to underpin our argument that running costs limits were a principal determinant of what can be afforded for pay, and not vice-versa. But the treatment of these matters in Supply Estimates raises further problems. When the Chancellor and I have made a further assessment of the practicalities here we will put proposals to the Cabinet. Meanwhile, my intention is to conduct the bilaterals, as agreed at Cabinet on 11 July, with a view to reaching agreement on tough but realistic running costs targets for each department. My report to the Cabinet on the results of these discussions will, of course, cover any areas in which I have been unable to reach agreement with colleagues, as well as the implications of what I have agreed for total running costs and the overall targets we have set ourselves.

7. I am sending copies of this minute and the enclosed paper to the other members of the Cabinet, Sir Robert Armstrong and Sir Robin Ibbs.



JOHN MacGREGOR

CONFIDENTIAL

MONITORING AND CONTROL OF RUNNING COSTSNote by the Treasury

This paper gives guidance to departments on new arrangements which are proposed for monitoring and control of departmental running costs. The arrangements build on departmental systems for monitoring and control already in operation. From 1986-87 running costs would be subject to in-year control as limits (like cash limits) rather than as targets. Where the new system has been proved to be effective, there should be no need for separate control of manpower targets after 1987-88.

*P17.
Need
to
pause
over this and have strong evidence of effective controls.*

Limits for 1986-87 onwards: PES provision

2. Running cost limits will be agreed for each department during the 1985 Survey. The intention is to publish the aggregate limit in the Autumn Statement and departmental limits in the 1986 PEWP for one year ahead. Running costs cover the civil service (excluding trading funds) and the armed forces, and include pay, accommodation, personnel overheads, office services and other services such as charges for contracted out work. The limits for each department will be based on gross costs excluding receipts. Manpower targets will be published in the 1986 PEWP up to April 1988, but it is intended that any totals published for later years should only be indicative.

Estimates provision

3. It is proposed that the running costs limit agreed in the Survey for each department (including those departments whose expenditure is not classified as public expenditure) will form the control total for determining Estimates provision. When preparing Estimates departments would not be free to switch provision into running costs beyond the limit (unless a transfer between departments has been agreed within the aggregate running costs total, eg associated with a transfer of staff between departments not anticipated in the Survey). It may be possible in some other cases to agree running cost limits in Estimates below the figures agreed in the Survey, eg following a dropping of functions by the department. In all cases departments and Treasury expenditure divisions will need to be able to demonstrate a reconciliation between PES and Estimates figures.

In-year monitoring

4. The Treasury will continue to develop the monitoring system initiated for 1985-86. For all substantial blocks of running cost expenditure, departments are producing profiles of forecast and expected outturn supply expenditure through the APEX system, updating the figures monthly. In order to develop the system, a collective effort will continue to be needed from departments and the Treasury, to provide timely and good quality outturn information and updated forecasts as a basis for in-year control. The data supplied by departments will also be used regularly within the Treasury to brief Treasury Ministers. It will, however, remain the responsibility of departments to alert their Treasury expenditure divisions to any possible breach of their running cost limit.

In-year control

5. If running cost limits are to be delivered, control mechanisms must be adequate. Within departments these may include budgetary controls, targets for improving productivity or reducing costs, and economies on particular items such as accommodation. The Treasury, however, proposes to use control mechanisms that are already in place as described below:

- (1) Virement: In future, the Treasury will normally only agree to virement into a subhead which contains running costs where the department can demonstrate that this involves a switch within its running cost provision, with a corresponding decrease on another running cost subhead on the Vote. This virement control cannot, of course, be applied to switching within a mixed running cost/non-running cost subhead, although departments are asked to follow the same principle. On the other hand, where running costs are divided into two or more subheads, eg for different budget centres, the presumption will be that the Treasury will be prepared in normal circumstances to approve virement between the subheads, provided no increase in running cost provision is implied; a token supplementary would only be considered necessary for large or unusual cases.
- (2) Cash limit increases: As now, cash limit increases because of higher running costs will not normally be granted unless offset by cash limit decreases also for running cost provision. The presumption against in-year changes in cash limits will remain.
- (3) Claims on the Reserve: As now, in normal circumstances claims on the Reserve will not be conceded for increased running costs. In recent years no claims on the Reserve have been attributed to civil service pay increases.

6. These controls will not, however, provide a sufficiently sharp focus for running costs control. It is proposed therefore that the necessary control will be achieved by applying to running costs certain elements of the cash limits regime:

- (1) Any change in the running costs limits would need the Chief Secretary's approval, with the revised limits being published in an arranged PQ.
- (2) The presumption would be against in-year increases. Where an increase is agreed, this would normally be financed by offsetting savings within the cash limit or exceptionally from another cash limit in the department's programme. If an in-year decrease in the limit were agreed, the first call on such savings would be to offset unavoidable overspends within the department's programme which might otherwise lead to a claim on the Reserve.
- (3) The Treasury would require a departmental investigation into any breaches at the end of the year.
- (4) Estimated outturn figures would also be published, together with the final provision for each running costs limit, in the Cash Limits Outturn White Paper in July.
- (5) Where the running costs limits agreed in the Survey involve interdepartmental transfers, the policy responsibility for delivering the limits (which will be set gross) should be clearly understood between the departments concerned. The normal presumption will be that it is the department receiving the transfer or providing the service who will have responsibility to find any necessary in-year savings, except where in-year variations in the total cost of the services involved are agreed to be within the responsibility of the department purchasing them.

7. These control arrangements are somewhat similar to those for cash limits, and, as with that system, rely on collective commitment. In this context, the improvements which departments are making in their internal budgeting arrangements are a crucial ingredient to the success of the new control system. In turn, the limits agreed in the Survey should offer a realistic and timely basis for departmental planning.

Conclusion

8. This paper proposes the following arrangements for the monitoring and control of running costs.

- (1) For 1986-87 Estimates, departments' running costs provision will be confined within the total agreed in the Survey;

- (2) in-year monitoring for 1986-87 will continue as this year, with increasing emphasis on high quality and timely data. Departments have the responsibility for informing Treasury expenditure divisions of any prospective breach;
- (3) in-year control will be introduced for 1986-87. Virement and cash limit proposals which increase running costs in aggregate will not normally be accepted, and for any increase there should be offsetting savings within overall PES provision to avoid a claim on the Reserve. These arrangements will be developed by analogy with the cash limits control regime. In-year changes will be announced and published in similar form to cash limits. These should be financed in the cash limits Outturn White Paper and will be investigated by the department and the Treasury.

Long Term: Civil
Service

PE 18

