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My ref:

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30 SEP 1985

In Wharfe

CONTROL OF CIVIL SERVICE RUNNING COSTS

Thank you for sending me a copy of your minute of 10 September.

As Rodney Elton said in his letter of 22 August to Peter Rees, we fully support the drive to make running cost targets effective. I am content with the monitoring arrangements which you propose, but there are one or two more general points I should like to make.

First, as you will know from my letter of 16 September, there remain some problems about the appropriate definition of PSA's running costs for target setting purposes; I hope these can be resolved in further discussions between officials.

Secondly, I welcome the assurances in your minute that you will be giving special attention to bids relating to the staffing of services whose costs are wholly recovered. I agree with Norman Tebbit that we should consider the interaction between running costs and public expenditure as a whole, in order to ensure that the controls are genuinely effective.

Finally, I appreciate the force of the arguments against an explicit pay assumption. But it is essential that running costs limits are set at realistic levels, bearing in mind that the centre and not the Department makes pay settlements; and that all Departments are treated on the basis of a set of consistent principles in the bilaterals which take place on running costs.

I am sending copies of this letter to the Prime Minister, other Cabinet colleagues, Sir Robert Armstrong and Sir Robin Ibbs.

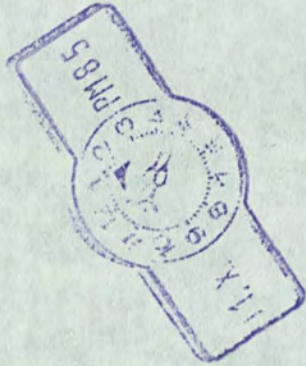
John MacGregor
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KENNETH BAKER

CIVIL SERVICE

LONG TERM MANAGEMENT

PT 18.



RUNNING COSTS CONTROL

Background

1 In line with the Chief Secretary's announcement in Parliament on 24 May, PES discussions have given particular attention to departmental running costs with a view to agreeing limits for 1986-87.

2 Running costs cover most of the administrative costs of departments - pay (70%), accommodation (11%), personnel overheads such as travel and subsistence (6%), and services like postage, telecoms and charges for contracted out work (13%).

3 Aim is to provide departments with a framework within which to manage their administrative services to continue the drive to efficiency and economy. In-year, these running cost totals will be treated as budgetary limits, so that programme expenditure is not available to finance overspends on running costs but any underspend may be used in programme expenditure, subject to the normal virement rules, and value-for-money considerations.

I RUNNING COSTS

Positive

- 1 Natural stage in evolving Government's policies for Civil Service management. Ensures better departmental accountability for administrative costs.
- 2 Consistent with devolved budgeting developments in departments.
- 3 Sensible to control through total envelope of administrative costs. Assists resource allocation by allowing departments to make appropriate choices between inputs (e.g. between staff and contracted out services).
- 4 Ensures better planning, monitoring and control. Running costs above inflation for last few years, so control important.
- 5 Manpower controls and (low) central pay assumptions on their own do not provide incentives for planned efficiency. They force in-year adjustments (when pay settlements higher than assumption) which are disruptive and inefficient and allow departments to use programme expenditure to finance administrative cost increase.
- 6 More appropriate to likely long-term arrangements on Civil Service pay, because running costs will depend on more realistic assessment by departments of pay increases and provide an envelope within which extra pay costs absorbed.

Defensive

A Transition from old system presents handling problem. Possible attack that government softening on pay or Civil Service numbers.

Points to make

- (i) Running costs will be tighter control because departments not allowed to make transfers from programme expenditure

- (ii) Intention still to get running costs limits near to expected rate of inflation. Depends on further Survey discussions
- (iii) Final figure will be higher than 4 per cent (half a per cent below expected rate of inflation). But this defensible. Comparison will be with this year's outturn which we do not yet know but will be higher than provision. There will be additional manpower for fraud and fees etc. Need to provide for Civil Service pay settlement higher than 3 per cent
- (iv) Manpower controls remain
- (v) No softening on pay

B End of central pay assumption difficult to present

Points to Make

- (i) Central pay assumption incompatible with running costs set on realistic basis. Also incompatible with possible long term arrangements for Civil Service pay
- (ii) Central pay assumption determined cash available for pay. That role now fulfilled by running costs for wider range of administrative costs
- (iii) Central pay assumption never intended as signal for Government pay policy widely. That policy remains as a need for pay moderation. With inflation coming down, nominal settlements must come down faster.
- (iv) Mistake to compare central pay assumption with estimates used by departments in building up running cost totals. The latter is simply an arithmetic estimate, like other costs. What matters is total pay bill and total running costs limit.