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FROM: CHIEF SECRETARY
DATE: 30 October 1985

PRIME MINISTER

RUNNING COSTS: MINISTRY OF DEFENCE

Following Cabinet endorsement on 3 October of my proposals for handling running costs in the Survey, I am glad to say that I have reached agreement with nearly all colleagues on their running cost limits for next year.

2 My report to Cabinet indicated an overall increase at that time of 7 per cent. With the co-operation of colleagues that figure has been reduced. On the basis of agreements reached so far, the overall level of increase is currently 5.8 per cent. The published figures could show a slightly lower figure still, closer to 5 per cent, because the expected running costs outturn for this year, 1985-86, could be higher than the original estimate. But it is too early to be sure.

3 However, a major factor is the need to reach agreement on MOD's running costs. I have agreed with Michael Heseltine that it is sensible to exclude the bulk of the armed forces from the overall running cost aggregate. But the administrative costs of the Ministry of Defence are no different in principle from other departments. In discussions with colleagues, I urged restraint on the level of pay increases to be assumed within their running costs. In no case except MOD is an agreed limit based on a pay assumption of more than 5 per cent.

4 I have not, as yet, been able to agree the running cost limit for MOD with Michael Heseltine, not only because he is refusing to accept any limit upon his running costs, but also because he is pressing for a pay assumption of 7 per cent for his civilian staff. I cannot accept his special exemption from the regime endorsed by Cabinet,

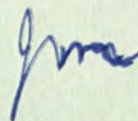
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and his civilian pay assumption would increase aggregate running costs by some £45 million (one-third of civil servants are in MOD). Apart from being unfair to other colleagues, and very hard to defend when the figures become public, it would push up the overall percentage increase (probably to more than 6 per cent) in Civil Service running costs in 1986-87.

5 There is also a pay policy point. MOD employs about one-fifth of civil service non-industrials and four-fifths of civil service industrials. We cannot be certain whether or when the MOD's pay assumption might have to be revealed to the House of Commons Select Committee on Defence or otherwise leak out. But it is going to be no help to what could be very tricky pay negotiations to have such a large department appearing to predict an earnings increase for the civil service 2 percentage points higher than any other department.

6 I am pressing Michael Heseltine hard to agree a running costs limit in line with those settled for other departments; but recognising, of course, that a somewhat higher pay assumption is needed for the Armed Forces. If I fail to reach agreement, you may need to hold a separate meeting to resolve this in view of the importance of MOD in our attempts to bring Civil Service running costs under greater control. I will report again if that proves to be necessary, but I wanted to warn you now of the problem.



JOHN MacGREGOR

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Civil Service - Long Term
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