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Ref. A083/2589

PRIME MINISTER

Public Service Pay and Public Expenditure in 1984-85  
(C(83) 31)

## BACKGROUND

For several years the Government has distinguished in its public expenditure planning between increases in pay and increases in the prices of other inputs, and has set an explicit separate "pay assumption" or "pay factor". It is necessary, whatever the system of public expenditure planning, to promulgate to Departments by about December pay assumptions for the preparation of the subsequent year's Supply Estimates. Under cash planning it has been the practice to decide and announce the assumption in about September.

2. The pay assumptions in recent years have been as follows:

1981-82: 6 per cent  
1982-83: 4 per cent  
1983-84: 3½ per cent

In each year public service pay settlements have typically been about 1-2 per cent higher than these figures. The extra cost has been found by such measures as administrative economies and staff reductions greater than previously planned.

3. The pay assumption normally applies to all central government pay, including the Civil Service, Armed Forces, and the National Health Service (it has been the practice in recent years later to adjust the Defence cash limit to accommodate the recommendations of the Armed Forces Pay Review Body).

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4. In his memorandum C(83) 31, the Chief Secretary, Treasury proposes to follow this broad pattern. Specifically, he proposes that there should be a separate pay assumption for 1984-85; that it should be set at 3 per cent; and that it should be announced forthwith.

5. Existing public expenditure provision for 1984-85 is implicitly based on provision for inflation of 5 per cent, not differentiated between pay and prices. The Chief Secretary proposes that if a pay assumption of 3 per cent is adopted, the planning baseline should be reduced accordingly. This would produce a saving, compared with published plans, of about £400 million.

6. The Official Committee on Public Sector Pay (PSP(0)) has prepared a note on aspects of the current pay round. This has been circulated to Ministers as E(PSP)(83) 15. It points out, among other things, that each year since 1979-80 both settlements and increases in earnings have been lower on average in the public services than in either the public trading sector or the economy as a whole. It suggests that the cumulative effect of this will have increased the pressure on the public service unions not to accept settlements below the average in the coming pay round. It is, however, too soon to assess how the current pay round will turn out in either the public or private sector.

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#### MAIN ISSUES

7. The main issues before the Cabinet are as follows:

- i. Should there be a separate pay assumption?
- ii. What should it be?
- iii. Should it be announced?

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#### A Separate Pay Assumption

8. Although they are logically separable, in practice questions i. and ii. are likely to be discussed together. If it is accepted that there should be a separate pay assumption, it is not easy to see an alternative to the proposed 3 per cent. A lower figure, as the Chief Secretary says, would risk being neither credible nor sustainable: the slightly easier economic climate may induce some private sector employers to concede larger pay increases than in the recent past; and there is a limit to the extent to which the public services can be expected to continue to conclude pay settlements below the private sector average. It might be possible to use 3½ per cent again, stressing that the Government expected settlements to be

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 closer to that figure than they were last year. But when a similar approach was suggested last year it attracted little support from the Cabinet (CC(82) 42nd Conclusions, Minute 6).

9. Conversely, any Ministers who may consider 3 per cent unrealistic are likely to argue that this points against setting a separate pay assumption, at least at this early stage of the pay round, rather than to argue for a different figure.

#### The Case Against a Separate Assumption

10. The following main points may be made against a separate pay assumption:

a. The logic of cash planning is that managers are given a budget which they are free to spend to the best advantage, in the light, among other things, of movements in relative prices. There is no more reason to distinguish between the prices of labour and of other inputs than to distinguish between any other categories of goods and services.

b. A separate pay assumption shows the employers' negotiating hand and may "paint the Government into a corner" because the pressure in successive years is always to reduce it. The aim should be to dispense with it.

c. The proposals on public sector pensions in C(83) 30 may create a particular difficulty. The Government may seem to be offering a pay increase of 3 per cent with one hand and to be taking most of it away with the other.

d. It may be necessary eventually to have a separate pay assumption for the purpose of the 1984-85 Estimates (paragraph 1 above). But that will not be for a few months. It will be possible then to reach a more informed judgment in the light of settlements in the early months of the current pay round than it is now.

### The Case For a Separate Assumption

11. The following points may be made in favour of a separate pay assumption:

- a. There is a difference between labour and other inputs. For example, in practice it is usually more difficult to vary staff numbers than the use of other factors of production.
- b. The existing expenditure plans in effect provide for pay increases of 5 per cent in 1984-85. This generates excess provision in comparison with the level of pay settlements which seems reasonable and attainable. Especially given the likely difficulties of the current public expenditure survey it would be wrong to forgo the savings that would result from a lower pay assumption.
- c. It would also be assumed that the Government expected pay increases to run at about 5 per cent in the current pay round. This would give the wrong signals.
- d. An explicit assumption will have to be set for the Estimates. It is unlikely that the figure chosen in December would differ from the figure chosen now, and the opportunity would be lost to exert some influence on the formative stages of the pay round.

### Announcements

12. If it is decided to set a separate pay assumption now, the Cabinet is likely readily to agree that it should be announced as soon as possible. The decision would have to be made known widely in Departments because of its importance for the public expenditure survey; it would therefore be certain to leak. The Government should take the initiative and get its own presentation into the media.

### Public Expenditure Consequentials

13. If a separate pay assumption is set, it is logical to reflect it in the public expenditure planning totals as the Chief Secretary proposes. So far as we know, no Department is likely to question this.



## HANDLING

14. You will wish to ask the Chief Secretary, Treasury to introduce his memorandum. The Chancellor of the Exchequer may wish to amplify it by outlining the economic background and prospects for the current pay round. The Home Secretary and the Secretaries of State for Education and Science, Defence, Scotland, Environment and Social Services will have views on the implications for pay negotiations in the services for which they are responsible. The Secretary of State for Employment will wish to comment more generally. Any of your colleagues may wish to speak, either from the standpoint of their departmental programme or more generally.

## CONCLUSIONS

15. You will wish the Cabinet to reach conclusions on the proposals in paragraph 11 of C(83) 31, ie:

- i. The assumption for increases in pay rates affecting 1984-85 for all public services apart from the local authorities should be 3 per cent.
- ii. This should be announced immediately.
- iii. The public expenditure baseline for all affected programmes should be reduced accordingly.

ROBERT ARMSTRONG

13 September 1983