

Ref. A084/2622

PRIME MINISTER

Public Service Pay and Expenditure in 1985-86

C(84) 26

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BACKGROUND

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 become the practice to decide and announce the assumption in September or October.

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

1982-83	4 per cent
1983-84	3½ per cent
1984-85	3 per cent

In all years, these 'pay factors' have been lower than the assumed increase in the price of other inputs and thus, on the face of things, have implied a reduction in the average real value of public service pay. In practice, public service pay settlements have typically been about one or two percentage points higher than the pay assumption. The extra cost has been found by such measures as administrative economies and staff reductions greater than previously planned.

3. The pay assumption usually applies to all central Government pay, including the Civil Service, the armed forces, and the National Health Service (though in some recent years the Defence cash limit has subsequently been adjusted to accommodate the recommendations of the Armed Forces Pay Review Body). It also applies to the universities, but not to local government or the nationalised industries. It is applied to planned manpower levels, so that savings from planned reductions in staff numbers are not available to finance higher pay settlements.

4. In his memorandum C(84) 26, the Chief Secretary, Treasury proposes to follow this broad pattern, apart from one significant departure. He proposes that there should be a separate pay assumption for 1985-86; that it should be set at 3 per cent; and that it should cover the public services other than local government. Since the published cash plans for 1985-86 were based on a general uplift factor, applying to pay and prices alike, of 4 per cent, a pay factor of 3 per cent will reduce the public expenditure baseline by some £200 million a year. The Chief Secretary in effect proposes to claw this back from departmental programmes and so ease the problem of containing the total of programmes within the published figures.

5. The departure from previous years is that the Chief Secretary proposes that there should be no formal announcement of the pay factor in advance of the Autumn Statement. He suggests that the pay factor should be regarded as a routine part of the public expenditure planning machinery, and no more deserving of a special announcement than any other part of the machinery.

MAIN ISSUES

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

- (i) Should there be a separate pay assumption?
- (ii) What should it be?
- (iii) If it is less than 4 per cent, should the resulting reduction in the public expenditure baseline be treated as the Chief Secretary proposes?
- (iv) Should there be a special announcement regarding the pay factor?

A Separate Pay Assumption

7. In practice, questions (i) and (ii) seem likely to be discussed together. If there is to be a separate pay assumption, it is not easy to see an alternative to the proposed 3 per cent. Since 1979-80 most public service groups have received lower settlements and increases in earnings than the averages in both the public trading sector and the private sector. Although the

1984-85 pay round is at an early stage, there is little sign that settlements will be lower than the 5 $\frac{1}{4}$ to 5 $\frac{1}{2}$ per cent which is the likely outcome of the 1983-84 round. To set a lower pay assumption than last year's 3 per cent would be regarded as unrealistic (and perhaps provocative). It might well therefore be ineffective; if so, it would probably increase the threat to the public expenditure planning totals from excessive pay increases.

8. On the other hand, there is no doubt that a reduction in the level of pay settlements in the economy remains highly desirable. To set a higher pay factor than last year would give very much the wrong signal. It therefore seems likely that any Ministers who may consider 3 per cent unrealistic will argue against setting a separate pay assumption, at least at this stage, rather than argue for a different figure.

The Case Against a Separate Pay Assumption

9. 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. The Chief Secretary himself appears to accept this to some extent, since paragraph 6 of C(84) 26 implies that his aim will be to ensure that departmental running costs do not rise by more than the general uplift factor of 4 per cent, and that he will not be seeking to distinguish between labour and other inputs.

(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.

The Case For a Separate Pay Assumption

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

(a) There is a difference between labour and other inputs. For example, 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 4 per cent in 1985-86. This generates excess provision by comparison with the level of pay settlements which the Government would like to see.

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.

Public Expenditure Treatment

11. I understand that some Ministers may be briefed to object to the Chief Secretary's proposal to reduce the baseline of those programmes which are affected by the choice of pay assumption. It must be conceded that the pay out-turn in the public services next year is likely to be greater than 3 per cent. This will mean a further squeeze on departmental programmes. If (as in the case of the NHS Review Body Groups this year) the excess is too large to be offset by efficiency savings, there is likely to be a call on the Contingency Reserve. The public expenditure saving of £200 million arising from the choice of a 3 per cent pay assumption is therefore arguably bogus. Even so, however, it is probably right to accept the Chief Secretary's proposal. The extra pressure to squeeze more efficiency from departmental programmes does no harm; and, although the Chief Secretary would not wish to concede at this stage that pay awards well in excess of the pay assumption may have to be financed in part from the Reserve, he will no doubt have the possibility in mind in determining the appropriate level for next year's Reserve.

Announcements

12. The arguments against making a separate announcement of the pay assumption are set out in paragraph 7 of C(84) 26. But there are two points that the Cabinet will wish to probe:

(a) It has been assumed in discussions in previous years that the Cabinet's decision on the pay assumption will leak, because so many people in Departments have to know about it for their work on the Public Expenditure Survey. Is there not a risk that, if there is a leak, the Government will still get the 'unhelpful headlines' which the Chief Secretary mentions, and even more misunderstanding and misrepresentation than in previous years?

(b) It is not clear that it will be possible - or even wise - to refuse to comment before the Autumn Statement, as the Chief Secretary appears to envisage. Apart from the likelihood of a leak, there is a meeting between senior Ministers and representatives of the local authority employers on 22 October to discuss the prospects for the current pay round. There is likely to be some discussion of the pay factor: indeed, the meeting would probably be less helpful to the Government than it could be if Ministers were unable to say that the public expenditure plans for 1985-86 will be based on a pay assumption of 3 per cent. It is one thing to refuse to single out the pay assumption for special mention; another to refuse even to discuss it publicly before the Autumn Statement.

HANDLING

13. 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. Others of your colleagues may also wish to speak, either from the stand-point of their departmental programme or more generally.

CONCLUSIONS

14. You will wish the Cabinet to reach conclusions on the following:

(i) Should there be a separate pay assumption of 3 per cent for 1985-86, applying to all public services other than the local authorities?

(ii) Should the public expenditure baseline for programmes affected by the decision be reduced accordingly?

(iii) Should the Government's decision, unlike previous years, not be the subject of a special announcement? And if there is to be no special announcement, should the Government positively refuse to make its intentions known before the Autumn Statement?

If there is to be an announcement, should it be made formally by the Treasury or informally by No. 10?

RTA

ROBERT ARMSTRONG

3 October 1984