cc Civil Service (Manpower) Pt3

Ref: A01537

CONFIDENTIAL

PRIME MINISTER

Cash Limits and Civil Service Pay
(C(80) 14, 15 and 16)

BACKGROUND

Cabinet has already agreed on the level of Civil Service manpower and on the volume of public expenditure for 1980-81, and on the majority of cash limits to be applied to individual programmes. In particular, it has agreed the Rate Support Grant, with an implicit inflation assumption of 13 per cent, excluding the 'Clegg' carry over, and to cash limits for the National Health Service and for the non-pay items of all central Government votes including the Defence Budget, with a built-in inflation rate of 14 per cent. But Cabinet decided to leave the cash limit for the central Civil Service vote on one side, until now. They hoped that by end-February it would be possible to form a view, both on the likely rate of inflation next financial year, and on the likely outcome of Pay Research process.

2. There are thus two decisions for Cabinet to take: whether to reaffirm the cash limits already agreed, in the light of what we now know about inflation rates next year; and what cash limit to set for the Civil Service vote.

3. You set up a small group of Ministers, under the Chancellor's chairmanship, (MISC 38) to process these issues a little. The Chancellor has circulated a note (C(80) 16) reporting its views and bringing out the main issues.

Flag A

4. The timetable is tight, but not impossibly so. The Civil Service Department need to begin serious negotiations with the Staff Side no later than mid-March, in order to honour the present day agreement. The Treasury need decisions by about the same time, in order to publish the Estimates on Budget day as planned. This points to final Cabinet decisions either on 6th or 13th March, if you cannot reach agreement this week. But obviously, a clear decision this week would be preferable.

HANDLING

5. I suggest you take the discussion in two parts first, the generality of cash limits; and then Civil Service pay and numbers.

Flag B

A. General Cash Limits - C(80) 14 and C(80) 16 paragraphs 1 to 4

6. The Chancellor is sticking his neck out, in even asking his colleagues whether they reaffirm the existing cash limits. There is always a danger that someone will try to alter them. He now says that the 14 per cent inflation rate built into the cash limits (13 per cent in the case of the RSG) is likely to fall short by 3 - 3½ percentage points, on the assumption that indirect taxes will be indexed again this year (he says he will comment orally on this point: you will not want him to go into great detail at this stage because changes in indirect taxation are especially sensitive).

7. I think most colleagues will, reluctantly, agree to this. Pay settlements have been reached in parts of the public sector (Local Authority manuals, NHS ancilliaries) consistent with these cash limits. To re-open them now might risk re-opening the pay deals. The volume squeeze is uncomfortable, but with two exceptions it can be managed.

8. The two exceptions are the Defence Budget and the NHS. On the Defence Budget, you will remember the deal which was struck with Mr Pym in January. It is recorded in the Chancellor's paper C(80) 9, at the time, in these words: "The application to Defence of the same cash limits regime as for other programmes is likely to cause a further volume reduction in the Defence programme next year, but... we accept that the cash limits should be increased as necessary to accommodate any extra costs ... arising from the implementation of decisions on the forthcoming AFPRB report. They will also be subject to review during the year in the light of developments in the international situation and NATO's response to them." There has been some subsequent correspondence between the two Ministers concerned, but neither has any interest in re-opening the deal at this stage, and I understand that neither intends to do so.

(Flag C)

9. On the NHS side, the Government is committed by its Manifesto pledge ("it is not our intention to reduce spending on the Health Service"), which you reaffirmed as recently as 22nd January (Hansard Col. 195, when you said: 'The Rt. Hon Gentleman can be sure that our pledge, as we gave it in the Election, will be maintained.'). The Chancellor is discussing this bilaterally with Mr. Jenkin on Tuesday night. It is probable that, with a little manipulation of the figures, the Health Service programme can be maintained in real terms, and still keep within the cash limit already published. I shall if necessary let you have a supplementary brief on this point following Tuesday night's meeting. The point you need to watch is that any such deal does not tempt other Ministers to seek special treatment.

Record of meeting Flag J

10. The only other Ministers who may protest are the Secretary of State for Education and the Minister of Transport. The bulk of education expenditure is RSG - constrained, and no one is proposing that the RSG settlement should be re-opened. Mr. Carlisle may make a plea for special treatment for the universities, but I doubt if Ministers will wish to make any further exceptions. Mr. Fowler may similarly ask for special treatment for the road programme, but is unlikely to get much sympathy.

See Mr Fowler's minute of 27.2.80 Flag I

11. You should therefore invite the Chancellor to introduce this part of the discussion, and try to get it accepted 'on the nod' that the first four categories of cash limited expenditure (paragraph 2 of C(80) 14) should be reaffirmed. The particular problems of the nationalised industries will have to be set on one side, pending discussion in E next week.

Flag D

B. Civil Service Pay and Cash Limit - C(80) 15 and C(80) 16 paragraphs 5 onwards

18¾%

14%

12. If Cabinet reaffirms the 14 per cent inflation assumption in the other cash limits, it then has to decide whether to treat the Civil Service vote in the same way. MISC 38 agreed unanimously that the Government could not afford differential treatment. 14 per cent thus sets the lower limit. PRU sets the upper limit. So the problem is how to bridge the gap.

13. The arithmetic of the gap is complicated, but paragraph 8 of Mr. Channon's paper C(80) 16 explains that it comes down to just over 4 percentage points (actually 4.2). How can this be bridged? There are three variables:

(a) The pay increase itself

(b) Some staging of the increase, to reduce its average cost over the year

(c) A squeeze on numbers

14. As the MISC 38 paper shows, various permutations of these are possible. MISC 38 did not think that the pay element could be negotiated further downwards; CSD now think that it might be easier to do this than to introduce staging. Some of the big employer Departments think that staging is in fact less offensive to Staff Side than abatement of the eventual increase. The objections to further manpower cuts come not so much from the Staff Side as from employer Ministers.

15. The Pay problem concerns mainly the non-industrial Civil Service (there is a separate settlement for the industrials in July; CSD expect it to follow roughly the same pattern). Some Ministers may be disposed to argue that the PRU evidence does not establish an absolute limit. This is true, but the evidence can be interpreted very differently. The unions will be able to make a plausible claim of over 25 per cent (more for senior grades). The CSD thinks that the lowest point to which they can negotiate downwards on the basis of the evidence is between 18.75 per cent and 18 per cent. Any lower than this, and they fear that they can be taken to arbitration and would lose. Ministers who press for a tougher deal have to remember that pay research is a basis for negotiation. Unless Ministers are prepared to break the pay agreement, and risk the industrial action which might follow, there is a limit, somewhere, on how far they can press downwards.

16. Staging is another matter. There was much Staff Side opposition to staging last year, but this was aimed as much at the timing of the staging proposal as to its substance. Some of the big employer Departments think, based on informal contacts with the Staff Side, that they can get away with

staging. CSD itself thinks that staging is likely to provoke trouble. It is not particularly logical, and has not been applied (in this Round) to any other public sector group. But it will help to get the overall pay bill for the year down. Two purely illustrative examples demonstrate this. If 3 per cent were saved on manpower, the balance could be found either by deferring the settlement date by about 1 month from 1st April; or by paying 10 per cent from 1st April and the rest about 7 weeks later. But any staging, like the eventual rate of pay, has to be negotiated: and CSD should not be tied down to any precise formula, provided they can deliver the overall reduction.

17. The real fight in Cabinet will come over manpower, and will be a re-run of the two previous rounds. Mr. Channon proposes a further squeeze of 3 per cent across the board. We suspect that, as a realist, he would accept 2 per cent; but anything less runs the risk, of which he is well aware, of making the Government seem half-hearted in its search for economies. He is likely in any case to argue very strongly for 3 per cent. On the other hand resistance from employing Ministers to cuts as large as 3 per cent will be very fierce, especially from the big battalions. I doubt whether DHSS can do much more than 1 per cent - perhaps $1\frac{1}{2}$ per cent at maximum. The two Revenue Departments have told the Chancellor that they could cut between 1 and 2 per cent. He will probably stick at $1\frac{1}{2}$ per cent. The Ministry of Defence might in due course be able to offer more, from the various in-house studies already in train, but Mr. Pym will be very reluctant to promise now to deliver his cuts later in the year, though he may be prepared to agree to 1 to $1\frac{1}{2}$ per cent. The Home Secretary will say that he could not make a 3 per cent cut in the Prison Service; but that is presumably included in the "limited exemptions" referred to in paragraph 17 of Mr. Channon's paper.

18. Your best tactics are therefore, probably, to get Cabinet agreement on the size of the manpower cut (the only thing on which individual Ministers have to deliver) and leave Mr. Channon free to negotiate on the other two variables (pay and staging) so as to get down to 14 per cent.

19. You should start this part of the meeting by calling Mr. Channon, followed by the Chancellor. But it may not be possible to reach agreement in one meeting on the incidence of cuts. If Cabinet can establish a broad target (and I doubt if this can be more than 1½ per cent) then you might ask Mr. Channon to mount the usual series of bilateral talks, and report back in two weeks time. But it is only worth doing this if the four big employers (Defence, Social Services, the Revenue Departments and DOE/PSA) are prepared to offer reductions on this scale (they represent more than ¾ of the staff concerned). They will point out that these cuts come on top of the cuts Cabinet has already agreed; that this decision comes very close to the beginning of the financial year, and it takes time to secure the economies. The actual manpower cuts needed would be more than 1½ per cent to deliver an average 1½ per cent reduction over the year.

20. That leaves two more loose ends: the review of comparability, and the involvement of Sir Derek Rayner.

C. Comparability

21. E Committee has trodden this ground twice already, and it agreed to have another go in the summer in the light of the remaining Clegg reports (teachers). Nobody loves comparability: the problem is to decide what to put in its place, and how to agree this with the unions without provoking a total breakdown. However, it is clear that the subject will have to be re-examined. You should therefore invite the Chancellor to set this exercise in hand, consulting the Secretary of State for Employment and the Minister of State, Civil Service Department. The Treasury will then establish an official group bringing in all the other employer and sponsor Departments. You might ask for a report back at the end of June.

D. Information Systems and Rayner

22. You will remember that on two previous occasions in Cabinet, Mr. Heseltine has raised the question whether Ministers have enough information available to control their Departments properly. He did so again at MISC 38. The Chancellor suggests that, in addition to the work the CSD are already doing with Departments in this area, Sir Derek Rayner could help.

(FLAG E) In particular, the proposals which Sir Derek has just circulated for departmental scrutiny of running costs (his letter of 22nd February to the Home Secretary) might be sufficient to do the trick. We know that Mr. Heseltine does not regard the Rayner proposals as going into enough detail for his purposes. But Rayner argues that most Ministers do not have the time available, or the interest, to do the very detailed examination which Mr. Heseltine insists on for DOE. It should however be possible to compromise on the formula proposed in the Chancellor's paper, which I understand Sir Derek Rayner is happy to accept. I understand he is sending you a minute about this. His point is that manpower policies and decisions come first, and that systems are secondary.

CONCLUSIONS

23. Subject to the course of discussion, I think the conclusions may come out something like this:-

(i) To reaffirm the cash limits already agreed for the Rate Support Grant, Nationalised Industries External Finance Limits, Current Expenditure of central Government other than Pay, and Capital Expenditure of central Government and Local Authorities, and non-Civil Service central Government Pay. (Paragraph 2 of C(80) 14).

(ii) To agree that the cash limit for the Civil Service Central Pay vote should likewise build in an increase of 14 per cent, while noting that the PRU evidence points to an increase in the pay bill of approximately 18.75 per cent.

(iii) To agree that part of this gap should be bridged by a further cut of /$1\frac{1}{2}$ per cent/ in the pay bill by means of a reduction in Civil Service numbers (not a cut of $1\frac{1}{2}$ per cent in Civil Service numbers by the end of the year, which produces a different - and lesser - result).

(iv) To invite the Minister of State, CSD, to consult all the employer Ministers bilaterally, and to bring forward in two weeks' time firm proposals for achieving reductions on this scale.

(v) To invite the Minister of State, CSD, to begin negotiations with the Staff Side over the Central Pay Settlement for the non-industrial Civil Service, which will, taken together with the manpower cuts, be consistent with the cash limit, through a combination of tough negotiating on the pay settlement itself, and possibly an element of staging.

(vi) To invite the Chancellor of the Exchequer, in consultation with the Secretary of State for Employment and the Minister of State, Civil Service Department, to set in hand a review of pay comparability as it applies to the Civil Service and to report on it, and the alternatives, by the end of June.

(vii) To invite the Civil Service Department in consultation with Sir Derek Rayner and the employing Departments to develop management systems to help Ministers control Civil Service numbers and costs.

D J Wright

(Robert Armstrong)

approved by Sir R. Armstrong and signed in his absence

26th February 1980