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CABINET

CASH LIMITS AND CIVIL SERVICE PAY

Memorandum by the Chancellor of the Exchequer

1. Cabinet has before it two separate memoranda, by myself and the Minister of State, Civil Service Department, about cash limits (C(80) 14 and 15 respectively). He and I discussed these in draft last week in a Ministerial Group under my chairmanship (MISC 38) with the Secretaries of State for Defence, the Environment and Social Services, all large employers. We all thought it would be helpful for Cabinet if I set out our provisional conclusions, and the options from which Cabinet must now choose.

2. We agreed that it is essential to maintain the generality of cash limits on the basis already decided, as set out in my paper C(80) 14. Apart from the Rate Support Grant these assume a 14 per cent average increase in new pay awards and prices of current expenditure between 1979-80 and 1980-81.

3. The cash limit for the Civil Service remains to be determined. The Minister of State's paper C(80) 15 shows that the likely increase in Civil Service pay settlements in a full year allowing for the pensions deduction - and this is no true deduction, since it should be happening anyway - is likely to be about $18\frac{1}{4}$ per cent. We consider it important to seek to negotiate a lower figure than this. (Quite apart from the substance, the presentational consequences of failure to do this would be damaging.) But if this is carried too far, we risk being defeated at arbitration or having to denounce the existing pay agreement unilaterally at short notice, both of which we want to avoid.

4. At the same time, we were in no doubt that it was impossible to set a cash limit for the Civil Service Vote which implied a higher rate of inflation from that built into the other limits. We therefore agreed that the 14 per cent figure must be applied to the Civil Service Vote.

5. This leaves a gap of around $4\frac{3}{4}$ percentage points. As a percentage of the baseline this is just over 4 per cent. We saw two main ways of doing this:

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- a. By a volume squeeze on Departments.
- b. By staging the implementation of the pay settlement.

We cannot afford to leave the choice between a volume squeeze and pay to the staff. They would demand their full pay, and leave it to us to live with the consequences for volume. We must therefore decide upon the size of the volume squeeze that we need to secure.

6. On the volume squeeze we recognise that this will create real difficulties for several Departments, on top of the cuts which have already been agreed. But we need a contribution from further economy to bridge the gap, and public opinion will expect it. We do not believe that it can be convincingly argued that there is no scope for making reductions by a volume squeeze, particularly if complemented by the types of study which Sir Derek Rayner has in hand.

7. On staging, we considered that, although the unions and the staff would protest vigorously at this breach of the agreement which would have to be backed by denial of the right to arbitration, they were more likely to acquiesce in a staged settlement than one which clearly departed from the Pay Research Unit evidence. For example 2 per cent could be saved by paying 10 per cent immediately and the remainder three to four months later.

8. Various permutations of these two devices are possible: for example, 1 per cent by squeeze and 3 per cent by staging, 2 per cent and 2 per cent, or 3 per cent and 1 per cent. Because Civil Service pay is negotiated centrally, we must have a single figure for staging. There are three ways of applying a volume squeeze: the whole Civil Service could be required either to apply a uniform squeeze across the board, or to repeat the pattern of cuts adopted for 1979-80, or to decide on a new pattern. We need this settled before the negotiations, which leaves little time for the third.

9. MISC 38 made two further recommendations:

- i. That, whatever the outcome of this year's negotiations, the whole system of pay research and its alternatives must be reviewed again as well as the future of the Clegg Commission.
- ii. That the Civil Service Department and Departments must together vigorously develop management systems to control Civil Service numbers and costs, department by department.

10. I invite the Cabinet:

- i. To agree that the decisions on cash limits already agreed should stand.

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- ii. To agree that the cash limit for the Civil Service Vote should similarly be set at a level which implies an average 14 per cent increase in earnings from new settlements.
- iii. To agree that the Civil Service Department should now open negotiations with the Staff Side with the objective of reducing the overall increase in the pay bill as far below 18 per cent as possible, while recognising that there is only limited scope for this within the present pay agreement.
- iv. To agree that the gap of just over 4 per cent between the likely earnings increase and the cash limits provision should be bridged by a combination of staging and of manpower squeeze, and to determine the proportion of this to be contributed by manpower, and on what basis.
- v. To agree that there should be an early further review of the pay research system and its alternatives, and of the Clegg Commission.
- vi. To agree that the Civil Service Department and employing Departments be invited jointly to develop management systems to control Civil Service numbers and costs; and that Sir Derek Rayner should be invited, as a matter of urgency, to advise on how his analysis could be exploited, both in the short and in the long run, to this end.

G H

Treasury Chambers

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