

S E C R E T

FROM: CHIEF SECRETARY

DATE: 7 SEPTEMBER 1983



*Mes notes
about this
subject*

PRIME MINISTER

*Agree circulate
not*

PAY AND PUBLIC EXPENDITURE IN 1984-85

... I attach a draft of the paper I propose to table for Cabinet on 15 September on the treatment of pay in the public expenditure plans for 1984-85. If you agree, I would like to circulate this on 8 September. You will see that I propose to follow much the same course as last year, but with a pay assumption of 3 per cent.

2. Last year, Cabinet decided to make the announcement the day after the decision had been taken. This did not work very well. I propose this year that the announcement should be made immediately the decision has been taken, which implies agreeing a draft press notice and line to take as far as possible beforehand.

... I attach a draft of what I have in mind, which I suggest my officials should discuss further with Bernard Ingham.

3. I am sending a copy of this to Sir Robert Armstrong.

PETER REES
7 SEPTEMBER 1983

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PUBLIC SERVICE PAY AND PUBLIC EXPENDITURE IN 1984-85

Note by the Chief Secretary to the Treasury

We need to decide how to deal with public service pay before finalising the public expenditure plans for 1984-85. I promised to come forward with further proposals in my July paper C(83)23.

2. As last year, we have to make an explicit assumption about increases in pay rates to provide a firm basis for our public expenditure discussions, and subsequently for the preparation of Estimates. Whether we wish it or not, our decision will be treated as a signal of our intentions for the next pay round in the public sector and of our hopes for pay increases more generally.

The number

3. For 1983-84 we used a figure of 3½ per cent. For 1982-83 it was 4 per cent and for 1981-82 6 per cent. I propose that for 1984-85 we use a figure of 3 per cent.

4. A lower figure would point more strongly to a reduction in the level of settlements. But with inflation running at 4.2 per cent and generally expected to rise modestly over the next few months, it would risk being neither credible nor sustainable. If not tenable, its value as a constraining influence on the expenditure plans would be much weakened.

5. Anything more than 3 per cent, on the other hand, would be taken as implying that we were expecting a level of settlements much the same as this year, which is not the message we want to get across. The unions are bound to treat whatever figure we choose as a floor. They and others will be well aware that in each of the last three years public service settlements have been between 1½ and 2 per cent higher than the pay assumption used.

6. The choice of a pay assumption for 1984-85 is not directly affected by the proposals on public service pensions in C(83)? which we are also discussing on 15 September (though quick progress on those proposals could affect the climate for pay bargaining next year).

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Application

7. The assumption determines the provision made in the aggregate pay bill for 1984-85 and later years for increases in pay rates and allowances deriving from settlements between now and 31 March 1985. This is not, of course, the same as the increase in the pay bill in 1984-85 compared with this year, which will also be affected by changes in numbers, grade structure and other similar factors. The assumption will be applied to the provision for pay in our expenditure plans, and in the Estimates, for all public service groups including the armed forces and the health service, and to the universities and other expenditure treated in this way last year, but not to the local authorities. There is no operational need to make any assumption for the local authorities, since decisions have already been announced about the provision for their current expenditure in 1984-85. We can say if necessary that our assumption is consistent with this. Nor, as last year, does the assumption apply to the nationalised industries (though we will need to stress here also the need for settlements lower than in the current year and set EFLs accordingly).

Effect on public expenditure

8. I shall take account of the effects of this new assumption about pay in the proposals about public expenditure which I shall be putting to Cabinet shortly. Our published plans implicitly contain provision for inflation, both pay and prices, of 5 per cent made during the move to cash in the 1981 survey. We will therefore immediately reduce the PES baseline for programmes containing public service pay (other than local authorities) by the difference between 5 per cent and 3 per cent for all forward years. The figures for local authority current expenditure will not be affected. The reduction in the baseline will produce savings of about £400 million a year.

Announcement

9. Our decision will need to be widely disseminated for operational reasons, and we will have to accept that it will become public knowledge. I propose therefore that we should announce it immediately.

10. When we do, we should present it as before not as a decision determining any individual settlement, but as the provision we are making in our cash plans. It will not rule out settlements higher, or lower, than 3 per cent. But, as in previous years, it does imply a presumption that the additional costs of any higher settlement will be found from within existing provisions. We cannot at this stage say that recourse to the Contingency Reserve is excluded. But certainly there is no presumption that it will be allowed.

Conclusion

11. I propose that:

- (i) For the cash plans and Supply Estimates we should use a single general assumption for increases in pay rates affecting 1984-85 of 3 per cent for all public service and other affected groups apart from the local authorities.
- (ii) This decision should be announced immediately.
- (iii) I shall take account of the assumption by reducing the public expenditure baseline for all affected programmes to reflect the difference between 3 per cent and 5 per cent.



PUBLIC EXPENDITURE PLANNING AND PAY
DRAFT PRESS NOTICE

Public Expenditure plans for 1984-85 will include an aggregate provision of 3 per cent for the effect of increases in rates and allowances resulting from future settlements affecting central government pay.

2. It is usual at this time of year for the Government to review its cash plans for public expenditure. As part of the process of reaching final decisions about 1984-85, it is necessary to decide the provision to be made for wages and salaries. This provision is determined principally by numbers employed and the rates at which they are paid.
3. A decision has now been taken to budget for sufficient additional cash in 1984-85 to provide for average increases in wage rates and allowances of 3 per cent, from due settlement dates.
4. This decision concerns the cash provision made in the public expenditure plans. Similar assumptions have been made in previous years. It is not a pay norm. Nor is it intended to determine individual settlements, which will be approached on their merits.
5. The assumption applies to the provision made for all central government pay, including the civil service, the armed forces and the health service, and to certain other groups expenditure habitually treated in the same way. As in previous years, it does not directly cover the local authorities nor the nationalised industries, which are not within the Government's direct control. But they will be constrained by the rate support grant proposals and by External Financing Limits respectively.

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Notes for Editors

6. A similar announcement about the provision for pay in 1983-84 was made on 1 October last year, when the corresponding figure was $3\frac{1}{2}$ per cent.

The Government's plans for total public expenditure for 1984-85 and later years are still being considered. An announcement will be made later in the year. Today's announcement is part of the preparation of those plans.

Line to take

1. The decision affects the provision to be made for pay and public expenditure plans for 1984-85 for those groups for which the Government is directly responsible.
2. The need for such an assumption arises with cash planning because for operational reasons the cash plans for the year ahead have to be determined well before negotiations start on any of the major settlements. The corresponding figure last year, which affected 1983-84, was $3\frac{1}{2}$ per cent (announced on 1 October). The year before it was 4 per cent and the year before that 6 per cent.
3. The decision is about public expenditure provision. It is not a norm. It does not pre-determine any individual settlement. Settlements higher, or lower, than 3 per cent are not ruled out. Each will be dealt with individually.
4. Of course, as in previous years, the decision does imply a presumption that the additional cost of any settlement above 3 per cent will be found from within the existing provision. Recourse to the Contingency Reserve in such circumstances is not ruled out. That will be for decision, if necessary, at the time. But there is no presumption that it will be allowed.
5. The decision does not apply to local authorities and nationalised industries because they are not directly controlled by central government and because for them the comparable need for a planning assumption does not arise at this stage in the same way. The Government has already announced the provision it is making for local authority current expenditure in 1984-85. This is consistent with a range of pay outcomes, but, of course, the lower settlements are the is more available for services. Similarly, in setting EFLs for nationalised industries Ministers will be looking carefully at the assumptions made, including pay assumptions. But once EFLs have been fixed it will be for the management of each industry to choose between expenditure on pay and expenditure on other things, including investment.

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DRAFT BIDDING LETTER FOR SECRETARY OF STATE FOR DEFENCE

PUBLIC EXPENDITURE SURVEY 1983

At its meeting on 21 July, Cabinet agreed that our objective for this year's Public Expenditure Survey should be to keep to the planning totals for 1984-85 and 1985-86 published in the last White Paper, and to maintain expenditure at about the same level as this in cost terms for 1986-87. We are to meet at 4.30 pm on 20 September to discuss how your expenditure programme might be adjusted to help in meeting this overall objective in each of the Survey years.

2. Cabinet will not have the opportunity to discuss the provision to be made for pay in 1984-85 until mid-September. In the meantime, I suggest we should prepare for our bilateral discussion on the basis that there will be a single standard assumption about pay increases for the Civil Service and related groups, the Armed Forces and the NHS, that it will be rather lower than the 5 per cent and the agreed assumption will, like last year, be removed from all programmes before final decisions are taken.

3. Our current commitment is to increase defence expenditure by 3% per annum in real terms up to 1985-86. For our discussion I am prepared to take this commitment as our starting point. Defence budget provision in 1983-84 is £15,719.6m. On the basis of the cash factors and an assumption that a 3 per cent pay factor is adopted for 1984-85, 3 per cent growth up to 1985-86 (Falklands exclusive) would

be met by the following provision:

	<u>1984-85</u>	<u>1985-86</u>
£m	16,910.4	17,933.7

I could not agree to any growth in excess of the NATO aim.

4. The provision above will necessitate reductions in the current cash baseline for defence. This means, of course, that I cannot accept your bids for the first two years. I must also mention that the objectives set by Cabinet for the Survey are very stiff ones. If I am unable to make sufficient progress towards these objectives in my round of discussions with colleagues it may be necessary to look again at all programmes, which would mean that for defence I might have to seek a contribution which would lead to provision lower than in paragraph 3 above. But the overall position is unlikely to be clear by the time we meet on 20 September.

5. You are seeking two further additions for 1986-87 - another year of 3 per cent real growth and provision for extra Falklands costs. For the non-Falklands budget my view is that we should plan on the basis of the Cabinet's objective for public expenditure as a whole, ie to maintain defence expenditure at about the same level as is established for 1985-86. Although I naturally realise that provision must be made for extra Falklands expenditure in 1986-87, my hope is that we can agree a figure substantially below your present bid of £623 million and in line with Parliamentary and public expectations that the burden of extra Falklands expenditure will reduce, not increase.

Manpower

6. Our discussion should also cover the civilian manpower aspects of your programme up to 1 April 1988. You have proposed for civilian manpower:

	1/4/84	1/4/85	1/4/86	1/4/87	1/4/87
baseline	200,000	198,000	197,000	197,000	197,000
net change		<u>-13,966</u>	<u>-13,926</u>	<u>-14,972</u>	<u>-15,142</u>
proposed requirement		184,034	183,074	182,028	181,858

As you know, Cabinet agreed on 21 July that we should secure rather larger reductions to the present total than those so far identified by departments. The 1982 PES exercise showed a run down to 197,000. The Government cannot claim the planned change in status of the Royal Ordnance Factories as a new saving. Without the ROFs the baseline is 178,500 so the present bid adds 3,358. I hope that the development of MINIS and a continued search for savings can produce substantial reductions. You will have your own views on what can be achieved and how but I would regard a reduction to 170,000 at 1.4.88 as a reasonable initial target at this stage with an expectation that greater savings will be identified when MINIS becomes fully operational.

[PETER REES]

Revised by London.
8/9 1030

Letter to John Gieve, Chief Secretary's
Office, HM Treasury from Robin Butler

Pay and Public Expenditure in 1984/85

The Prime Minister has seen the Chief Secretary's minute of 7 September and agreed to circulation of the paper attached to it. In the interest of maintaining security until next Thursday, Sir Robert Armstrong will no doubt consider whether the paper should be circulated in the CMO series.

The Prime Minister has noted that Treasury officials will discuss the draft Press Notice with Mr. Ingham.

I am copying this letter to Robert Armstrong.

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From the Principal Private Secretary

7 September, 1983

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I am copying this letter to Robert Armstrong.

M. C. SCHOLAR

pp F. E. R. Butler

John Gieve, Esq.,
Chief Secretary's Office

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