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NBP? at this stage

CONFIDENTIAL

The Rt Hon John MacGregor OBE MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

23 October 1985

Dear John,

RUNNING COSTS CONTROL

will request if required.

Thank you for your letter of 14 October about the transition away from central pay assumptions and about provision for pay in departmental limits.

It is, I think, clear that the dropping of a central pay assumption will inevitably serve to focus the attention of Select Committees, the TUS and others, on the pay assumptions built into Departmental estimates of running costs. To reveal these assumptions before a Civil Service pay agreement had been reached would weaken the hand of the management side negotiators and might well serve to push up the level of the eventual settlement. Moreover to reveal, at any stage, the different pay assumptions made by Departments would lead Departmental Ministers into interminable wrangles with their Select Committees and their trade unions.

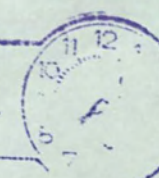
My conclusion is - and I do not think that this is in contradiction to anything which you say in your letter or in the notes attached thereto - that under your present proposals all Departmental Ministers will, in effect, be required to conceal their pay assumptions both before and after a pay settlement is reached. It seems to me that this is an important consequence of the new regime which you are proposing and I should be grateful if you would confirm that this coincides with your own assessment of the position.

Clearly it will be important for us all to adopt a common line in response to questions in Parliament or from our Select Committees. I note from your letter of 14 October to Geoffrey Howe that you would be surprised if another Select Committee took a different view about pressing Ministers or officials on this matter from the TCSC, supposing, of course, that it promulgates specific guidance. I would not share your surprise, and in any case the compliance of the TCSC would not provide us with an adequate response to similar questions from Opposition front bench spokesmen or backbenchers on either side.

I am sending copies of this letter to the Prime Minister, members of Cabinet, other colleagues in charge of Departments and Sir Robert Armstrong.

Yours wv,
George.

23. X.



Q To ask the Chancellor of the Exchequer if he has any further announcement to make about the control of expenditure on the running costs of Government Departments.

[CST to reply]

H 22/40

A My predecessor announced the Government's intention to set targets for the control of running costs in departments on 24 May 1985. The Government propose to set limits on running costs for each department, for the financial year 1986-87 and following years, to determine the cash available to finance departmental expenditure on administration.

These limits will be set at a level which continues to apply firm control on aggregate running costs, taking account of the factors expected to affect each department's paybill and other administrative costs. This will replace the single centrally imposed assumption about the pay increases for central government groups (the "pay assumption") which has been applied in previous years.

These limits on total running cost expenditure will be announced to Parliament, as will details of the Government's proposals on public expenditure, early next year. As with cash limits, departments will monitor and control their running costs against these agreed limits and if, exceptionally, a limit has to be changed during the year Parliament will be informed.

This change in the method of control of Civil Service costs will have consequences for the presentation of running costs in Estimates. The Government's proposals on this are being discussed with the Public Accounts Committee and the Treasury and Civil Service Select Committee.

RUNNING COSTS CONTROL

Background

1. Expenditure discussions this year have given particular attention to departmental running costs. The aim has been to agree limits for all expenditure on administration in 1986-87. This is the first year of a new system (announced 24 May).
2. Running costs do two things:
 - (a) they are better than a manpower control alone and get away from a central assumption on pay. With a leaner civil service, value for money and administrative efficiency are the proper criteria for decisions;
 - (b) they encourage good financial management. The FMI is all about delegated financial management. Running costs are an important step.
3. Running cost limits will make realistic but demanding provision for departmental expenditure based on department's own realistic estimates. These include estimates about pay. They will be tight estimates and tight controls. That is as it should be. Running costs totals will be budgetary limits so that programme expenditure is not available to finance overspends on running costs.
4. Running cost limits are still under discussion in the Survey and the agreed figures for departments will not be announced before publication of the Public Expenditure White Paper.

RUNNING COSTS: DETAILED POINTS TO MAKE

A Development of Civil Service Management

- (i) Ensures better planning, monitoring and control. Running costs above inflation for last few years, so control important.
- (ii) Running costs ensure planned efficiency. Old controls forced in-year changes of plan which were disruptive and inefficient.
- (iii) Consistent with developments in financial management in departments.
- (iv) Control limits will be for total administrative costs. Encourages departments to make appropriate choices in allocating resources (e.g. between staff and contracted out services).
- (v) Consistent with proposed way ahead on Civil Service pay.

B Effects on pay and Civil Service numbers

- (i) Running costs limits will govern amount department can spend on pay bill and other administrative expenses. No separate central pay assumption.
- (ii) Overall manpower controls will remain with published targets to 1.4.88. When running costs control working effectively, Government will review need for separate manpower control.
- (iii) No slackening of Government policies on pay. Continuing need for pay moderation in economy as whole. With inflation coming down, nominal settlements must come down faster. Where Government is direct employer it will look for reasonable and moderate settlements within

financial disciplines. Excessive settlements will still cost jobs. Additional points on wider implications attached.

C End of central pay assumption

- (i) Running costs limits, built up from departments' own estimates and negotiated with Treasury, will now determine cash available for wide range of administrative costs. New regime will be more effective than central pay assumptions which applied only to pay.

D Assumptions about future pay settlements in departmental running cost limits

- (i) Settlement with Treasury on limit concentrated on overall cash figure for running costs;
- (ii) department bid, on which settlement of limit based, a composite of a number of elements for pay, accommodation, external services and other administrative expenses;
- (iii) Necessary to make assumptions not only about increases in costs, of which pay rates one factor, but also about wide range of running cost elements - manpower numbers, grade mix, overtime, incremental drift etc.
- (iv) Important to stress that running costs limit is a single control total covering pay and other non-pay costs. Assumptions about pay rates only one factor in building up totals on which limits based.

DROPPING AN EXPLICIT PAY ASSUMPTION - KEY POINTS

Pay assumption never intended as a norm or entitlement, or to have wider meaning beyond being a necessary element of public expenditure planning. But came to be taken as signal of Government pay aims more widely.

In that respect has been useful. But usefulness running out; perceived differences between assumption and what people saw pay settlements to be actually damaging, as weakening force of the Government's message.

2. No change in Government's view on need for pay moderation in the economy as a whole. This is as strong as ever. Real earnings have been rising at 2 to 3 per cent per year, damaging employment. With inflation coming down nominal settlements must come down even faster.

3. So far as private sector goes, Government will maintain firm monetary and fiscal policies. No intention of bailing out companies who damage themselves and others through excessive settlements.

4. In the public services, where the Government is direct employer it will ensure moderate settlements; new running costs regime managerially more sensible and just as effective as pay assumption. For local authorities no intention of letting up on financial disciplines and penalties. Not a "victory" for public service unions who have campaigned for getting rid of the pay assumption; excessive settlements will still cost jobs.

5. Pay bargaining essentially a matter between employer and employee. But Government look to both sides to understand link between pay and jobs and act accordingly.