(1)

Prime Minister

This is a clear and uncontroversial draft paper. Agree that the Treasury submit it (John Vereker so recommends)?

MCS 20/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

19 January 1982

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

Yes MT

Dear Michael,

EVIDENCE TO MEGAW ON CASH LIMITS

The Megaw Inquiry have asked for a factual paper "describing the philosophy and mechanics of the cash limit system, and the current arrangements for reconciling it with pay negotiating systems".

.... The attached draft seeks to meet this remit. It is intended to be low-key and uncontroversial. It touches briefly on the 1982-83 settlement in the final paragraph because the Committee have explicitly asked about this.

Subject to any comments the Prime Minister or other colleagues may have, the Chancellor would like to send the paper to the Inquiry within the next few days.

.... I also attach for your personal information the Inquiry's own record of the Chancellor's oral evidence on 16 December. This will not be published.

I am copying this letter to Jim Buckley (Chancellor of the Duchy of Lancaster, David Omand (Defence), Don Brereton (Social Services), Richard Dykes (Employment), Jim Nursaw (Attorney General), Mrs Duncan (Lord Advocate) and David Wright (PS/Sir Robert Armstrong).

Yours ever

J. Walker

pp P.S. JENKINS
Private Secretary

CASH LIMITS, PAY AND THE PUBLIC EXPENDITURE PROCESS

NOTE BY HM TREASURY

This paper responds to the Committee's request for information about the cash limits system. It begins with a factual summary of the system and its history and then discusses its relationship with civil service pay negotiations.

Background

2. Cash limits were first introduced in 1974-75 and greatly extended in 1976-77. They are intended to provide greater control in the short term over the public sector's cash expenditure and an incentive to efficient management and cost control. They provide programme managers with a clear indication at the start of the year of the cash available to them so that they can plan accordingly. Each department knows that it will not be allowed additions to its limits in the normal course of events. The presumption is that cash limits, once set, will not be changed, even if there are unexpected fluctuations in costs or in other determinants of expenditure. Managers are normally expected to rearrange their activities so that the cash limit is observed.

3. Cash limits now cover virtually all central government services with the exception of those, such as the family practitioner service, which are largely demand-determined and cannot easily be controlled in this way. Originally they were operated as an administrative control. The majority have now been assimilated with the Supply Estimates voted by Parliament and are therefore subject to Parliament's approval. There are about 120 separate cash limits on Supply expenditure in 1981-82 and a further 13 covering non-voted central government expenditure, the external financing requirements of certain other bodies and the capital expenditure of local authorities and other bodies. A full list was given on pages 15-20 of the last public expenditure white paper (Cmnd 8175 of March 1981). The external financing limits of nationalised industries are also treated as a form of cash limit. The current expenditure of local authorities is not directly subject to a cash limit, but there is a limit on the rate support grant (RSG) paid to them by government.

4. Cash limits vary greatly in size, depending on the way in which the relevant programmes are administered and controlled. The largest is that covering defence

(£11½ billion, formally divided into four separate limits but by agreement with the Treasury managed as one). The smallest are of less than £1 million.

5. The cash limits are derived from the public expenditure plans in the public expenditure white paper published in recent years at the time of the Budget. A preliminary announcement about some of the plans for the forthcoming financial year is commonly made towards the end of the previous calendar year, as soon as they are decided by the Government.

The change to cash planning

6. In past years, ministerial decisions about public expenditure and the plans published in the white papers have been expressed in "constant" prices of a past period, and were then converted at a later stage into cash limits by a complex series of revaluations.

7. Following an announcement by the Chancellor of the Exchequer in his Budget statement on 10 March 1981, the 1981 public expenditure survey was, for the first time, conducted in terms of prospective cash expenditure, rather than in "constant" prices. The decisions announced on 2 December 1981 about programmes for 1982-83 were accordingly in terms of cash provision. The expenditure plans in the next white paper, to be published on Budget day 1982, will similarly be expressed in terms of cash. From 1982-83 onwards, cash limits and the white paper spending plans will be on the same price basis.

8. 1981 was a transitional year. At the beginning of the annual ministerial consideration of public expenditure it was necessary to convert the existing plans in the last public expenditure white paper from "constant" prices into cash. The conversion was initially performed in the spring on a provisional basis, which allowed for a general increase in costs of 7 per cent between 1981-82 and 1982-83, and increases of 6 per cent and 5 per cent respectively in the following two years. Subsequently, as announced on 15 September, the provisional factor for 1982-83 was reviewed and replaced by separate factors of 4 per cent for increases in earnings from due settlement dates and 9 per cent for increases in other costs compared with the 1981-82 average.

9. The figures so calculated provided the starting point for the ministerial decisions in the autumn about the final cash provisions for individual programmes. These decisions included, among other things, such allowances as ministers decided to make for movements in pay and prices affecting individual programmes expected to differ from the general factors.

10. It is not possible to be precise at this stage about the way in which the system will operate in future years. The starting point to the annual round of public expenditure

discussions - the white paper plans - will already be expressed in cash. Any additions or reductions to these plans when subsequent decisions are taken will also be in cash. The need to formulate revaluation factors (as this year) will not therefore arise. But some view about the trend of pay and other costs will be implicit within any decisions taken; and it will be open to ministers at any stage to review pay and price movements since previous plans were formulated and to make adjustments to programmes, upwards or downwards, should they so decide.

Changes in cash limits

11. Despite the presumption against them, changes to cash limits are sometimes made, both upwards and downwards, usually after policy decisions to change the level of expenditure on a particular service. Minor policy changes are generally accommodated within existing limits. Exceptionally, substantial changes in pay or other costs have also resulted in changes in cash limits; and adjustments may sometimes be necessary to reflect switches in expenditure from one cash limit to another. Changes involving increases in cash limits on voted expenditure require the approval of Parliament through the normal procedure for voting Supply.

12. All increases in cash limits in 1981-82, for whatever reason they arise, are being charged to the Contingency Reserve. The Reserve is an allowance within the public expenditure planning total which is not allocated to particular services at the beginning of the year. Provided that claims on it are kept within the total amount available - which is the Government's firm policy - they do not add to the total of planned expenditure. The Reserve has not been breached in any year since it was first established in 1976 as a control total on decisions.

Breaches in cash limits

13. Breaches in cash limits have been infrequent. Quarterly profiles of expenditure for each limit are established at the beginning of the year and expenditure monitored against them so that corrective action can be taken if necessary. There were two breaches of cash limits in 1976-77, two in 1977-78, four in 1978-79 and 13 in 1979-80. In 1980-81, six cash limits out of a total of 147 were exceeded. In absolute terms the amounts involved were marginal, save in the defence programme. In 1979-80, when the greatest number of breaches occurred, the total excess was one quarter of one per cent of the total expenditure subject to cash limits.

14. If a cash limit is overspent, an investigation is made which usually includes examination of the financial procedures of the department concerned. In addition to any corrective action resulting from this examination, policy is that any overspending will be

deducted from the cash limit for the following year. This ensures that expenditure on the service in question is in accord with ministers' decisions taken over the two years as a whole.

Timing of public expenditure decisions

15. In general, it is desirable that decisions about expenditure in the coming financial year should be settled by early December, for two main reasons.

16. First, decisions are needed by various spending authorities in order to frame their own budgets. This applies in particular to capital projects, which may have long lead-times, and to the rate support grant, which should be settled as early as possible if it is to have maximum influence on local authority budgeting.

17. Second, while much of the work of preparing the Supply Estimates in central government departments can be, and is, done in parallel with ministerial discussions, decisions on the main programmes are needed some three to four months before publication of the detailed Estimates at the time of the Budget. Once ministers collectively have determined programme totals, individual ministers and their departments have to decide on the distribution of their allocations between individual votes and between the different detailed subheads of each vote. The results have to be scrutinised and agreed by the Treasury. Finally, the Supply Estimates have to be printed. It is possible to leave a few areas of expenditure in doubt until later. But the scope for adjustment rapidly narrows as the Budget approaches.

18. The introduction of cash planning has eased the process of translating the programme decisions into figures for the Supply Estimates and cash limits. But it has not affected the time required very much.

Cash limits and pay

19. Cash limits do not in themselves constitute a public services pay policy. They are a mechanism of public expenditure control which can be used to give effect to whatever policy the Government of the day may decide is appropriate for the pay of each public service group.

20. Under the Labour Government, cash limits were used in a way which was consistent with the successive requirements of its incomes policy. Under the present Government the policy has been to set limits to reflect the scale of increases in public expenditure which it is judged the country can afford. That objective is related to the Government's objectives of controlling the public sector borrowing requirement and money supply, taking account of the burden on the private sector of taxes and interest rates.

21. In deciding what provision to make to meet increases in the public service pay bill, ministers have regard to a number of macroeconomic, financial and management considerations, including the prospects for inflation, the trend of pay movements within the economy as a whole and the general public expenditure outlook and competing claims within it.

Potential operational difficulties

22. As explained earlier it is a central principle of the system that, once cash limits are set, there should be a strong presumption against changing them. For the practical reasons described in paragraphs 15-18, the generality of voted cash limits, many of which include provision for civil service pay, have to be set by the December preceding the financial year to which they relate. This is some time before the outcome of civil service pay negotiations is customarily known. There is therefore a potential difficulty in reconciling the operational requirements of the cash limits and Parliamentary Estimates systems with the desire for meaningful pay negotiations.

23. In practice, what appears as an administrative problem is fundamentally a policy problem of the relationship between meaningful pay negotiations and judgement by the Government of what can be afforded. Once the policy issue is resolved, the residual administrative problem is a secondary one, which could be solved in various ways.

24. Now that public expenditure is planned in cash, it is essential that the material considered by Ministers in the course of the annual public expenditure survey, and the provision decided at the end of the survey for each programme, should incorporate some view about changes in pay bills for each of the years covered by the survey. For the year next ahead it may be desirable to use a specific assumption about pay increases. This planning assumption has to be published. It is not feasible to leave it implicit and unidentified in the totals.

25. The Estimates and hence the cash limits would normally make the same provision for pay as did the programme figures determined in the survey from which they are derived. Depending on other elements in programmes, this should usually present relatively little difficulty in cases where the pay settlements involve smaller increases than the allowance for pay increases in the planning figures. Again, if there are minor divergences in the other direction, with pay increases exceeding the assumption, it may in some cases be possible to accommodate them by adjusting other elements in the programme, such as staff numbers or non-pay costs.

26. There are two qualifications, however. First, some small blocks are almost exclusively devoted to staff costs. There, the scope for finding off-setting savings in non-

pay costs is small. Second, the smaller the provision for manpower in the original plans, and the larger the size of any planned reduction in the numbers already assumed in calculating the limits, the smaller the scope for making further cuts.

27. The planning total of public expenditure also includes the cash Contingency Reserve, not allocated to particular programmes at the beginning of the year. Provided that there is sufficient room within the Reserve, it is consistent with the system to charge to the Reserve any increases in pay which cannot be accommodated within the provision already determined for particular programmes. Parliamentary authority can be sought through Supplementary Estimates.

History of civil service pay settlements and cash limits

28. In each of the first three years of the cash limit system - 1976-77, 1977-78 and 1978-79 - it was assumed in calculating the cash limits that the policies set out in the relevant incomes policy white papers[1] would apply to public service groups, including the civil service. These policies involved increases of £6 a week for those earning less than £8,500 a year in 1976-77, a guide-line of 5 per cent with a minimum increase of £2.50 a week and a maximum of £4 a week in 1977-78 and a guide-line of 10 per cent with some flexibility within individual negotiating groups in 1978-79. In all three years the settlements in the civil service were within the policy and were accommodated within the cash limits without any difficulty.

29. The pay policy set out in the July 1978 white paper "Winning the Battle Against Inflation" (Cmnd 7923) was in operation in 1979-80. The suggested ceiling on settlements of 5 per cent, or £3.50 a week if this was greater, was the assumption used when the cash limits were first set. Following negotiations the Labour Government agreed a much higher settlement for the non-industrial civil service. Pay rates were increased on average by 25 per cent, but in three stages in order to limit the cost in the first year. The present Government honoured this settlement, but in issuing a revised set of cash limits decided on a 2½-3 per cent reduction in numbers to help further with meeting the cost.

30. In 1980-81, an increase for civil service pay of 14 per cent was assumed from due settlement dates. The whole of the increase was initially provided in a single central cash-limited vote, rather than in individual cash limits. This arrangement reflected the fact that the Government had specified the total increase in the pay bill which it was prepared to see in the year, while leaving the distribution open until the non-industrial negotiations had been completed. The provision in the central vote was allocated to individual votes by means of a Revised Estimate when the detailed settlement was known.

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[1] "The Attack on Inflation" (Cmnd 6151), "The Attack on Inflation: the Second Year" (Cmnd 6507) and "The Attack on Inflation after 31 July 1977" (Cmnd 6882).

The total full year increase in the non-industrial civil service pay bill as a result of the settlement would have been 18.75 per cent. But the settlement was contained within the existing totals by savings in manpower and other administrative costs of nearly 2½ per cent and by deferring implementation of the settlement from 1 April to 7 May. There was no increase in the total provision which the Government had made for civil service pay.

31. The use of a central vote was criticised by the Select Committee on the Treasury and Civil Service Department(2) on the grounds that it did not provide a sufficiently effective means of Parliamentary control and that the Government were left with too much scope for making adjustments in the cash limits between individual departments after the results of the central pay negotiations were known. In their reply to the first report,(3) the Treasury and Civil Service Department did not accept that the procedure weakened Parliamentary control, but indicated that they nevertheless shared the Committee's preference for making provision for the full expected cost of pay for each department, if this was practical, in the Main Estimates.

32. The Government have also accepted the view of the same Select Committee that it is desirable for the future to avoid the delay or staging of awards, which in their opinion erode the effectiveness of the cash limit system and confuse the comparison of the growth of earnings.

33. In 1981-82 a cash limit pay factor of 6 per cent was used for all votes. The pay settlement increased civil service pay rates by 7 per cent plus a flat rate payment of £30. It is being financed from within departments' cash limits by making offsetting savings in staff and administrative costs.

Pay and cash limits in 1982-83

34. The Government have given certain assurances to the civil service unions about next year's pay settlement and its relationship to cash limits. In particular:

(a) in a letter dated 6 May 1981 to the Secretary General of the Council of Civil Service Unions the then Lord President of the Council said "naturally the costs of the settlement will be a factor in next year's negotiations. But I repeat my assurance that the Government will be prepared to enter the negotiations without a pre-determined cash limit. There will be room for genuine negotiations".

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(2) First and fifth reports, Session 1979-80

(3) Cmnd 7883

(b) in a letter dated 17 July 1981 to the secretary general of the Council of Civil Service Unions it was stated, with the authority of ministers, that "in the event of disagreement the Government will accept recourse to the civil service arbitration tribunal but on the understanding that the Government reserves the right, if necessary, to ask the House of Commons to approve setting aside the tribunal's award on grounds of overriding national policy".

35. Confirmation was subsequently given that both these pledges are unaffected by the September announcement about the choice of a 4 per cent pay factor for 1982-83.

36. Final decisions on departmental budgets will not therefore be taken until the outcome of the civil service pay negotiations is known. There would be more than one way of dealing with the hypothetical situation of a settlement in excess of the existing provisions. As in the past, it may be possible to accomodate most, if not all, of any excess by making further savings in manpower and other costs. Insofar as it may prove to be impossible to accommodate the whole of an excess in this way, the relevant cash limits n be increased by Supplementary Estimates presented to Parliament after the beginning the financial year. The presumption would be that any such increases in cash limits would be charged to the Contingency Reserve, and would not therefore add to the planned total of public expenditure for the year.

HM Treasury
January 1982

Discussion with the Chancellor of the Exchequer

18 The Chairman welcomed the Chancellor of the Exchequer and his colleagues and thanked them for giving some of their time to meet the Committee. He invited the Chancellor to make some introductory remarks.

19 The Chancellor of the Exchequer said that he wanted to stress at the outset that contrary to some recent reports he had read, the Government had no doubt about the importance of an efficient, well paid, high morale Civil Service; it was not in the business of demolishing morale.. It therefore had a strong interest in a framework which would resolve the problem of Civil Service pay without industrial warfare and which would secure the recruitment, retention and motivation of the numbers and quality of civil servants it needed. It was looking for an ordered and agreed arrangement, but the system would have to be "affordable", and should be as smooth as possible, avoiding the violent fluctuations in Civil Service pay increases in the recent past.

20 There was, however, widespread concern at the manner in which current expenditure, particularly on pay, had for some time had priority over investment and capital expenditure despite best intentions. This had reduced profitability and investment in the private sector and had led to a marked decline in our international competitiveness. Since 1975 unit labour costs in the UK had doubled; the increase in competitor countries had been far less. In the US the increase had been $\frac{1}{3}$, in Germany $\frac{1}{6}$, and in Japan nil over the same period. In parallel there had been pressure for the public sector to grow. The public sector had formed 38% of GNP in 1970, 46% in 1976, 41% in 1978-9 and now 45%. This growth had been accompanied by a long and not always successful battle by successive Governments against inflation; a battle to which the present Government was firmly committed. No Government could win the battle by itself. But it had a key leadership role. It employed a fifth of the labour force; pay formed one-third of its total expenditure. Although the system of control of expenditure by cost rather than volume helped to curb spending, many items of current expenditure apart from pay, were indexed to inflation. Therefore the Government wanted to secure a pay system which would withstand the many factors leading to inflation, but which was based on agreement and acceptability.

21 A fair system was desirable, but fairness applied also to those who paid the bill, who might be in unfavourable circumstances. "Comparability" should embrace not just pay levels but the state of the trading sector, where the labour force had been reduced by 15% compared with a reduction of 7% in the Civil Service. This was what the Government had had in mind when it had said in its Memorandum to the Inquiry, that fairness was not always attainable in the short run. A fair system would be based on a framework of agreement which would be sustainable in the system's operation (Priestley's "capable of operation in practice"). The Government did not like the term "override", but could not agree to operate a system which yielded unaffordable results. Therefore "affordability" must be inherent in the system. Its absence had been a drawback in the Priestley system and the main cause of the frequency with which settlements based on pay research had been set aside. Relevant factors which ought to be considered within the system might include rises in oil prices, a long period of no growth, the fight against inflation, and shifts in the relative labour market positions of groups of employees.

22 As a result of the 1979 and 1980 settlements, non-industrial Civil Service pay rates had risen by 48% while national average earnings had risen by only 38%. Equally significantly since 1979 the public ~~service~~ service pay bill had increased by 45%; while that in the private sector had risen by 23%. This did not necessarily mean that civil servants were overpaid, since it reflected past imbalances; but an important point was that public service numbers had not fallen as they had done in the private sector with a consequent effect on the relative pay bill.

The power of the parties in Civil Service pay bargaining was not equal. Bargainers for and members of Civil Service unions were relatively immune to personal hardship over a period of selective but damaging industrial action. Management was, however, exposed to severe political and public opinion pressures as such action took effect. In the trading sector industrial action might jeopardise an organisation's existence, and this would be realised by sensible bargainers. The functions of Government departments could not simply be terminated; it was the public which suffered from Civil Service strikes. So a process had to be designed which would avoid warfare and recognise the imbalance in bargaining power, or encourage the bargainer to use restraint.

24 A system with a high degree of automaticity might look tempting but its results might frequently prove unacceptable. The TUC had rightly stressed that a system for determining pay should not usurp the role of negotiation.

25 In discussion the Chancellor of the Exchequer made the following points in reply to the Committee's questions:-

(a) the role of comparisons

Any pay system had to have room for manoeuvre, since automaticity would raise expectations which would often not be realisable. However, the alternative was not the liberated recklessness of "free" collective bargaining. As ACAS had suggested, comparisons had an important role, as they did for all responsible employers, but much of the evidence submitted to the Inquiry had helpfully described comparability in terms like "a useful tool". The system should provide bricks for responsible bargaining. The Committee would wish to consider whether there should be a single independent fact-finding agency or, as the CBI rather interestingly proposed, separate arrangements for each party. An independent body should confine itself to fact-finding and should not stray into an adjudicating role. The pay research system, with its search for medians and so forth, had become too prescriptive. The concept of affordability and matters connected with cash limits and economic policy were matters of judgement and did not fall within the scope of fact-finding. Under the Priestley system, conceived in different times, factors such as job security and differential unemployment risks had received less than their due attention.

(b) avoidance of industrial action and no strike agreements

A system which compensated civil servants for not taking industrial action would in most years go beyond what the country could afford. The Government hoped, however, that the Committee would consider ways of diminishing the risk of industrial action. It was difficult to produce a watertight list of "sensitive areas" where no strike agreements could be considered; for example, the degree of sensitiveness of sectors varied over time. If legal restrictions or curbs on rights were to be accepted they would have to be accompanied by a demonstrably fair and automatic system. That designed for police pay had worked well so far, but it was "affordable" for only a small group. It would be helpful if the Committee could investigate the "no strike agreement" area, because it had attractions to the public, but he himself saw serious disadvantages in attempting to secure extentions of no strike agreements, because of the price that would inevitably have to be paid for them.

(c) problems of time-lag

Problems with timing of Civil Service pay settlements had been caused mainly by incomes policies and the consequent tensions. Within any one year it should not be impossible to arrive at a settlement which was not out of line with settlements outside. This happened in some foreign countries, where admittedly the annual pay round was a tidier process than in the UK. The planning factor for annual pay increases was announced in the autumn for pay settlements next April; this timetable permitted the input of appropriate information to produce a suitable settlement at the right time. The time-lag problem in 1981 had not been typical following a large comparability-based settlement in 1980, and the over-riding need to reduce the level of inflation. The level of pay increases had halved within a short period, and the Government had been bound to take account of this in its offer to civil servants.

(d) arbitration and mediation

In pay bargaining the monopoly power of the Civil Service unions and the impossibility of the Government's going bankrupt was balanced by the Government's inescapable duty to control expenditure in the national interest. Thus in the event of disagreement in negotiations an irresistible battering-ram encountered an immovable wall. In such circumstances compulsory arbitration as the only means of reaching a settlement would not help; it constrained full bargaining and might produce results unsustainable by the public purse. Arbitration should not be entirely excluded; it had traditionally been available with the agreement of both sides, and frequently been useful particularly for relatively peripheral matters and matters of rights, but unilateral arbitration of major questions of interest would land the Government in difficulty. As for the possibility of a role for Parliament in arbitration, if arbitration were to be unilateral and binding the Government would have to reserve its constitutional right to ask Parliament to override an arbitration ruling. It would however be inappropriate for anyone to seek to put forward the idea of an appeal to Parliament on a free vote as a way out of an impasse. The Government could not abdicate its responsibility in this way, nor could Parliament easily behave like a "Quaker meeting" in such circumstances. Mediation, or conciliation as suggested by ACAS, might not be sensibly built into the structure of the pay system, since it would then be difficult to rule out in inappropriate cases. It might be useful to consider such possibilities on occasions. ACAS would not necessarily be the right agency since it was a "creature of Government".

(e) following pay trends and setting examples

The Civil Service could not be asked to accept lower-than-average pay increases over a number of years. This would build up an inverse pay differential which might 'explode' and might reduce the Service's capacity to recruit and retain adequate staff. Civil servants' pay settlements should therefore be broadly consistent with what was happening outside, and the Government did not want to impose exemplary settlements year after year. If the Government were to insist on Civil Service pay settlements year after year which were lower than outside market rates this would build up immense difficulties and make recruitment and retention impossible. He was not arguing that Civil Service pay should be used to give a lead as such; and it was desirable to avoid accumulating lags and sudden leaps caused by catching up. It was more a question of the Civil Service moving with the rest of the covoy rather than giving the wrong signals; and an out of phase or retrospective settlement could affect the expections of everyone else in the next round. When expections were moving downwards, as they had been last autumn, a Civil Service settlement reflecting the settlement levels some months previously could have a disastrous effect.

The Government had to announce its intentions on pay in announcing cash limits for the coming year; this had to be based on its best forecast for the year, which in turn was based on a judgement of what could and should be afforded in the public sector. In this context, it might be helpful if there was some national view agreed in an economic forum about the amount in terms of overall pay increases the country could afford, but this kind of development seemed at present very unlikely to take place. It would be an insecure basis for Committee recommendations.

(f) cash limits and affordability

Cash limits and their relationship with Civil Service pay were a key factor for the Committee to consider, and the Government wanted to find a way of fulfilling its manifesto commitment to find a way of reconciling cash limits with public service pay arrangements. A paper on cash limits as requested by the Committee, would be provided shortly. It was by no means unusual for pay negotiations in the private sector to be conducted within the framework of a given budget. But the Government as employer was currently in the somewhat strange position that cash limits had to be publicly announced before negotiations. It was an interesting question whether this should be so. In this way, however, cash limits brought in the key concept of 'affordability': they could not themselves be negotiable. Their use in practice could be illustrated by the provisions made for the current year. The 4% planning factor for public sector pay announced for the coming year referred to the total average cash bill, leaving room for negotiation on numbers, spread of settlements, and variation between groups. 4% was not the last word for every group covered by the aggregate figure. This arrangement lay behind the assurance which had been given to the unions that there would be genuine negotiations with no pre-determined cash limit in 1982. It reflected the Government's perception that it was difficult to bargain on totally fixed cash limits. So there was some room for manoeuvre, though the announced figure was intended to be a real constraint. It was the Government's best judgement of the affordable outturn. Excessive settlements would have to be funded by manpower reductions. To the extent that this was impossible resources would have to be found in the contingency reserve for employees for whom the Government are the sole paymasters. (Local Government increases would have to be met from increases in rates.)

(g) productivity bargaining

It was difficult to introduce any substantial element of productivity bargaining in the Civil Service. Measurement of output was very difficult, and although no doubt more could be done in some areas, a central measure would be meangingless. The monolithic structure of pay bargaining was another obstacle; as was the fear that local bargains would simply increase costs. Reductions in numbers of staff were sometimes due to reductions in functions rather than to increased productivity. Improvements in efficiency in the Civil Service had always been regarded as being outside the realm of pay bargaining, given its basis of "fair comparison", so separate productivity bargains had not been sought. Failure to achieve greater efficiency and reduction in numbers was usually attributable to both management and staff. It was not possible to finance productivity increases from total reductions in manpower, even if this could be justified, because the cash limit applied to Civil Service pay took account of the Government's target for reductions. But there had been some marginal room for manoeuvre in the past two years because the target reductions had been achieved slightly faster than expected.

(h) decentralisation of pay bargaining

The Government by no means ruled out some move towards decentralisation of pay bargaining but did not expect the Inquiry to look in great detail at the scope for this. Probably civil service management should have done more thinking on this in the past. Ministers were conscious that they did not have the same relationship with their employees as managers in industry. There might be areas where differences in productivity could be measured and reflected in local pay arrangements, as could regional differences in the market for labour. This need not lead to a rise in costs if there was a good system of cash control. While he did not expect this aspect to be central to the Committee's report, therefore, its reflections on possible further work to be done in the longer term could be helpful.

(i) pensions and the Scott Report

The Government was not yet in a position to comment on the Scott Report, but would be in touch with the Committee about possible developments when this was appropriate. Changes in index-linked pension arrangements would need legislation and would take time. A very wide range of organisations outside the Civil Service was affected, not all susceptible to direct Government influence. The Committee should not feel impelled to go over the ground already covered by Scott, and if it wished to look at this area at all, he would not be surprised or disappointed if it chose to confine its comments to ways in which Civil Service pay might reflect the Scott Report recommendations and Government decisions on it.

(j) the Government's commitment to the Inquiry

There was no question of the Government ignoring the Inquiry's report when it appeared. The Inquiry had been set up because the Government was anxious to have its advice.

26 The Chairman referred to the main evidence of the Council of Civil Service Unions, which the Committee would be discussing internally in January and thereafter with the unions. If the Government wished to put forward any comments, particularly on facts, it would be helpful for the Committee to have them as soon as possible so that the areas of factual agreement and disagreement were established. The Chancellor of the Exchequer apologised that the flow of further evidence to the Committee had been interrupted by changes in the machinery of Government. Every effort would be made to provide the Committee speedily with the information requested. The Government might also submit further general observations when it had appraised the main evidence which the Committee had received from other witnesses.

27 The Chairman thanked the Chancellor for his helpful and patient responses to the Committee's questions, and said that the Committee might suggest another meeting at a later stage with either Ministers or officials.

Inquiry into Civil Service Pay
22 Kingsway
LONDON WC2B 6JY

22 December 1981

Cab. Sec.

pa.

MR SCHOLAR

EVIDENCE TO MEGAW ON CASH LIMITS

The Treasury paper on the operation of the cash limits system is clear and uncontroversial. In particular, paragraph 23 - which explains that the setting of cash limits in advance creates administrative difficulties rather than policy problems - is helpful.

But the Inquiry's own record of their discussion with the Chancellor shows (paragraph 25(f)) that the Chancellor told them that the pre-determined cash limit "was intended to be a real constraint". So the Inquiry may not be totally convinced by the written evidence.

I do not normally suggest that the Prime Minister troubles herself with the Megaw evidence. But these papers are of more interest than most, and she may wish to glance at them.

J. VEREKER
20 January 1982

BK

file

10 DOWNING STREET

From the Private Secretary

22 January 1982

Evidence to Megaw on Cash Limits

Thank you for your letter of 19 January with which you enclosed a draft paper for Megaw on the cash limit system.

The Prime Minister is content for you to submit this to the Inquiry.

I am copying this letter to Jim Buckley (Chancellor of the Duchy of Lancaster's Office), David Omand (Ministry of Defence), David Clark (Department of Health and Social Security), Barnaby Shaw (Department of Employment), Jim Nursaw (Attorney General's Office), Christine Duncan (Lord Advocate's Department) and David Wright (Cabinet Office).

C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury

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