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AW  
Prime Minister (2)  
You will wish to

Treasury Chambers, Parliament Street, SW1P 3AG  
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18 January 1982

be aware of  
his.

J Buckley Esq  
Private Secretary  
Chancellor of the Duchy of Lancaster  
Whitehall  
LONDON SW1A 2AZ

ms  
Ms 18/1

Dear John,

TSRB : ECONOMIC EVIDENCE

As you know it is normal practice for the Government to let the TSRB have a note on economic factors bearing on their work. The attached draft - which is very similar to the note already submitted to the DDR - has been approved by the Chancellor, who would be grateful to know whether Lady Young too would be content with it.

I am copying this letter to Michael Scholar at No.10 in case he wishes to show the draft to the Prime Minister.

Yours ever

*[Signature]*

PP P S JENKINS  
Private Secretary



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Chancellor of the Duchy of Lancaster

21 January 1982

From the Private Secretary

Peter Jenkins Esq  
Private Secretary to the Chancellor  
of the Exchequer  
HM Treasury  
Parliament Street  
LONDON SW1P 3AG

*Dear Peter,*

TSRB: ECONOMIC EVIDENCE

Thank you for your letter of 18 January. The Chancellor of the Duchy is content with the suggested evidence for the TSRB.

I am copying this to Michael Scholar at No.10.

*Yours sincerely,*  
*Jim Buckley.*

J BUCKLEY



22 JAN 1992





## 1. SALARIES REVIEW BODY

### GENERAL ECONOMIC BACKGROUND

General economic circumstances must play a major part in determining the level of pay settlements in the public sector. The Government is sure that the Review Body will wish to recognise this factor when framing its recommendations. In this section of the evidence the Government sets out its views on the nature and the importance of the economic considerations relevant to pay determination generally.

2. The financial instability caused by persistent and rapid inflation undermines the prospects for sustained economic growth. The Government's aim is to bring down the rate of inflation, and its monetary and fiscal policies have consistently been directed to this end. Considerable progress has already been achieved; and inflation is now around half the peak level of nearly 22 per cent reached in May 1980.

3. Monetary and fiscal policies create the overall context within which total income within the economy is determined. Excessive increases in pay reduce the scope for growth in output and employment. The international context is also important. The UK exports around 30 per cent of its total production against fierce overseas competition. And our home market is also vulnerable to imports. Our international competitiveness is therefore a key determinant of the level of employment and of the prospects for improved living standards.

4. Our past performance illustrates the damage which excessive pay settlements can cause. Over the 5 years to 1980 labour costs per unit of manufacturing output nearly doubled in the UK. In contrast, they rose by one-half in Canada, by one-third in the United States, by one-sixth in Germany and not at all in Japan. Almost all of the deterioration in UK competitiveness since the Government came to power can be put down to the higher rate of increase of UK labour costs compared to those of our competitors.

5. The Government has constantly emphasised the need for pay settlements to be kept as low as possible in order to improve the



prospects for employment: realistic pay awards are an essential pre-condition for any lasting reduction in unemployment. Some progress has already been made. Over the past year lower pay settlements, together with increased productivity, have meant that unit wage costs in manufacturing have shown little increase. But this is only a beginning. Pay settlements which bear a proper relationship to productivity need to become a feature of our economy, as they are in the strongest economies.

6. Some employees are not directly subject to the rigours of international competition. But no group can or should be immune from the need for realistic pay settlements compatible with what the country as a whole can afford and, in the case of public service employees, what the government and taxpayer can afford. Pay in the public services has a major influence on the health of the economy. It accounts for about 30 per cent of public expenditure. Excessive increases in this pay bill are bound to lead to increased taxation or borrowing (and, therefore, higher interest rates) with a damaging effect on private sector investment and costs, and on the prospects for economic recovery and employment. Excessive increases for particular groups of staff also have wider effects through repercussions on other groups and lead to self-defeating "leap-frogging".

7. While concepts such as productivity or output raise certain questions of definition in relation to the groups in the Review Body's remit, the considerations set out above provide a frame of reference against which all questions of the determination of remuneration must be considered. The application of these considerations to the question of pay in the public services is discussed more fully in the memorandum submitted to the Inquiry into non-industrial Civil Service pay under the Chairmanship of Sir John Megaw. (The memorandum is attached as Annex A). That Inquiry is directed to Civil Service pay; but the general arguments in the memorandum are relevant to the public services outside the Civil Service.

8. The Government attach special importance to the discussion in this memorandum of the necessity to give full weight in determining pay to market factors such as recruitment and retention. Rates of

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pay should not exceed what is necessary to recruit and retain staff of the right quality in the right numbers. A further important factor is job security which is significantly higher for the groups in the Review Body's remit than it is for most private sector groups. The Government consider that these considerations are of crucial importance at a time of high unemployment and widespread redundancies.

9. Finally, the Government wish to draw paragraph 4c of the memorandum at Annex A to the attention of the Review Body. This stresses that it is unrealistic to attempt to determine pay rates without regard to the resources available to finance them. What can be afforded is an essential consideration. In the public services, this fact has been expressed through the system of cash limits. The Government announced on 15 September the basis on which it had decided to provide for pay costs at the current stage of planning public expenditure. This allowed for an increase of 4% in earnings from due settlement dates in the coming year. (A copy of the relevant statement and supporting material is attached at Annex A2).

10. The small size of the particular groups within the TSRB's remit means that their pay does not have a large direct impact on total expenditure. This is not of course in itself a reason for generous treatment and the Government has to take account of the influence of changes in these salaries on expectations elsewhere in the economy, which may have an indirect effect on public spending. The Review Body's findings are of great importance to the Government in arriving at its decisions but, for the reasons set out here, the Government must, as in the past, reserve to itself the final decisions about the pay it is prepared to offer to these groups.



MEMORANDUM ON FUTURE PAY ARRANGEMENTS  
FOR THE NON-INDUSTRIAL HOME CIVIL SERVICE

Submitted to the  
Inquiry into non-industrial Civil Service Pay  
under the chairmanship of the  
Rt Hon Sir John Megaw

Civil Service Department  
Whitehall  
LONDON  
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OCTOBER 1981



## Introduction

1. The Committee of Inquiry into Civil Service pay has asked\* for "a memorandum setting out the main issues you believe the Committee should tackle and any views on them which you wish to place before the Committee". This memorandum is a first response to that request.

## Background

2. About 7½ million people are employed in the public sector of the United Kingdom economy (broadly the nationalised industries, local authorities, National Health Service, the Civil Service and the Armed Forces of the Crown). Within this total the Government is directly responsible for the pay and conditions of service of some 690,000 civil servants (of whom 150,000 are industrial civil servants), some 323,000 members of the Armed Forces, and some 1.2 million employees of the National Health Service. The methods used to settle pay throughout the public sector vary. They reflect both the history and the particular nature of the service or industry concerned.

3. The factual background memorandum already submitted to the Committee by the Civil Service Department (Chapters 5-7) describes the arrangements for pay determination in the non-industrial Home Civil Service (which is the subject of the present inquiry) and their historical development. The pay determination system for the bulk of this service was embodied in formal Pay Agreements, negotiated with the unions, from which the Government has now withdrawn. The system derived from the recommendations of the Royal Commission on the Civil Service ("Priestley") which reported in 1955. The Committee will no doubt wish to study that report in detail. Its main conclusion was that the primary principle governing Civil Service pay should be "fair comparison" with the current remuneration of outside staffs employed on broadly comparable work, taking account of differences in other conditions of service.

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\*In a letter from the Chairman of the Inquiry, Sir John Megaw, to the Lord President of the Council dated 6 August 1981.



Why a new system?

4. The Committee will wish to know why the Government believes that the system derived from Priestley should now be brought into question. There are four main reasons -

a. Whatever its abstract merits, the Priestley system has not in practice worked well in recent years, and the resulting damage to its credibility has led to a loss of Civil Service and public confidence in it, as a means of settling Civil Service pay. In nine out of the last fifteen years the system has been over-ridden or implemented only after delay, often because its straightforward implementation would have conflicted with the formal incomes policies adopted by previous Governments. This in itself suggests that the system is no longer satisfactory: on more occasions than not it has not provided a means of solving the problem of pay for the Civil Service. This is partly because economic circumstances have changed since the mid-1950s, when there was near full employment, inflation was not a serious problem and pay increases indicated by the system were generally modest. It is also because of some characteristics of the system. There are two particular defects. First, a system based on comparability is almost bound to be "backward-looking" to some degree, and so is likely to generate increases which may be out of line with increases taking place elsewhere in the economy at the time. This poses particular problems at a time when the national interest requires a substantial reduction of inflation and inflationary expectations. And second, because any such system tends to establish expectations of entitlement to an increase in pay - but does nothing to take account of the fact that the cash allocations to meet these expectations cannot necessarily be made available.

b. An essential element in any pay system must be an attempt to assess the market and to consider whether pay rates are at the level required to recruit, retain and motivate the appropriate number of staff of the right quality. In the Priestley system it has been assumed, in effect, that the pay rates indicated by "fair comparisons" are a reasonable proxy for the market. But it is increasingly questioned whether the system provides an



adequate reflection of the market rates of pay. It has tended to insulate Government employees from the realities of life as they exist in the private sector, partly because intangibles such as job security, which cannot be easily reduced to a cash value, are under-rated. The Government believes that the information available in the pay determination process should include a systematic analysis of recruitment and wastage. Such statistics need to be interpreted with care in relation to a service which is traditionally regarded as a lifetime career, because the results of failure to recruit and retain staff of sufficient quality may not be fully reflected in the performance of the service except over many years; but the ability to recruit and retain staff, as demonstrated in statistics, can help to show whether pay rates are in line with the market for each particular type of labour and thus "fair" both to employees and to the taxpayer.

c. We live in a world in which rapid economic changes - for example drastic changes in the price of oil - may require equally rapid and often harsh reaction. In such a setting "fairness" - certainly desirable - may not always be sustainable. Trading concerns have to react to such circumstances by laying off employees, or by acknowledging that no pay increase at all is possible. The public service cannot expect to be insulated from the impact of adverse economic developments simply because the money to meet the wage bill comes from the taxpayer. The questions of availability of finance and what can be afforded were treated as secondary in the old system and introduced, if at all, only as reasons for overriding the system and not as part of it. Outside Government, the ability of the employer to pay is inevitably a crucial part of the process of determining pay. It is true that the question of the Government's ability to pay involves judgements which are different from those which have to be made by private sector employers and often more complex. But the question is no less important for the Government for that reason. It involves the interests of every taxpayer and the economic health of the country. A system which ignored this and appeared to generate pay rates which were in some abstract sense, and without relation to availability of finance, "correct" was artificial and unreal. The Government's judgement of what it is justified in paying, taking account of financial and macroeconomic considerations and the competing claims of other elements in public expenditure, as well as of managerial considerations, must necessarily play an essential part in the process of determining what pay should be.



d. Even on its own terms, the old comparability system no longer commands confidence that it gives truly "fair" results. In the Government's view it is questionable whether comparisons were made with the right outside analogues; whether the wider problem of "circularity" - which has to be faced in any case if there is any tendency among private sector firms whose employees are taken as analogues automatically to reflect Civil Service pay increases - was not compounded by the use of public sector analogues; whether, given the growth of fringe benefits in the private sector, the valuation placed on them had not become too detailed and mechanistic; whether adequate allowance was made for the benefit to civil servants of index-linked pensions; and whether the methods used to evaluate pay research evidence, and to bring it up-to-date as a basis for negotiation, were justifiable.

#### Approach to a new system

5. As the Committee's terms of reference make clear, the Government starts from the proposition that there is a substantial public interest in the recruitment and maintenance of an efficient and fairly remunerated Civil Service; in the orderly conduct of the business of Government and its services to the public; and in the maintenance of good industrial relations in the Civil Service. On the other hand there is an equally clear public interest in the provision of essential public services at maximum efficiency and minimum cost. The Government recognises that in a free society it is not possible in the long term to impose pay and conditions of service by fiat; and that there is an inevitable cost to the Exchequer and to society if pay in sensitive areas is settled by the process of industrial confrontation. It is therefore the Government's intention when the Committee's report is available to seek to negotiate a new Pay Agreement with the Civil Service unions which will be informed by the Committee's findings. In these negotiations the Government will aim to arrive at an ordered and agreed arrangement for determining Civil Service pay which, so far as possible: can endure; provides a sound basis for good industrial relations; is acceptable to the staff concerned; commands the confidence of both Parliament and the public; and takes proper account of broader economic considerations. The Government is under no illusions that it will be easy to reconcile these objectives but it looks to the Committee to help it to do so.



6. In negotiating any new agreement the Government will be seeking a means of arriving at rates of pay which are adequate but not excessive, to recruit, retain and motivate sufficient numbers of staff of satisfactory quality. The Government recognises that, in the longer term, Civil Service pay rates must bear a reasonable relationship to those of outside employers if serious management problems, including industrial relations difficulties, are to be avoided. The Government also recognises that comparisons with outside rates of pay and conditions of service in comparable employment provides a useful broad indication of what is required for these purposes. Comparability in some form plays a part in pay negotiations in the public and private sector alike. Accurate information about the labour market is a valuable management tool particularly for an employer like the Civil Service which has to recruit and retain a very wide range of employees in a wide variety of locations with different skills, aptitudes and qualifications.

7. At the same time, the Government strongly believes that it would be undesirable for any new arrangements to give rise to a presumption of an automatic entitlement to rates of pay based on pay comparisons without adequate regard being paid to other relevant considerations, including the Government's duty to control public expenditure and to manage the economy in the interests of the population as a whole.

8. This means that the process for determining civil service pay must take proper account of financial and macroeconomic considerations. The Government must in any event retain the right, in the last resort, to decide whether on any particular occasion the wider national interest should take precedence over the operation of any system, however well constructed. But the Government would prefer to have procedures which should make it possible for agreed settlements to be the general rule and for resort to "override" to be necessary only in exceptional circumstances. The Government would be grateful for the Committee's advice on how and at what stage financial and macroeconomic considerations can best be taken into account in the process of pay determination.



The basic issues

9. In carrying out its remit to make recommendations on the process by which the remuneration of the non-industrial Civil Service should be determined there are a number of important general issues which the Committee will want to examine and on which the Government would welcome the Committee's views -

a. The form of a new pay system.

It is obviously desirable that a new pay system should be agreed by the Government with the unions and it has already been made clear that it is the Government's intention to seek to achieve this. But how far should the new pay system be a highly structured one? How far should prior agreement on the use to be made of agreed factual analysis determine the outcome and how much should be left for negotiation?

b. The relative weight which should be attached in any new system to comparisons of pay and other conditions of service and to other factors such as the position on recruitment and retention, relative efficiency and relative job security.

Under the old system other factors besides those based on direct comparisons could be, and were, introduced into the negotiations which followed pay research but this was not done on a quantified or structured basis and the influence of such factors on the final outcome was relatively modest. The Government would particularly welcome an assessment of the practicability of evaluating such factors and recommendations on methods for doing this.

c. The scope under a new process of pay determination for keeping pay increases for the Civil Service more in phase with those in the community generally.

As explained in paragraph 4a. this problem has caused considerable difficulty in the past.

d. The reconciliation of any arrangements for pay determination in the Civil Service with the Government's general economic responsibilities for controlling public expenditure and maintaining the value of money.

This is an area of particular difficulty not only in deciding how financial and macroeconomic considerations can best be taken into account



in the process of pay determination but also at a more technical level in reconciling procedures and timetables for fixing cash limits and for negotiating Civil Service pay. The Treasury is ready to provide more detailed evidence on the public expenditure procedures involved, including the fixing of cash limits.

e. The reconciliation of the Government's ultimate accountability to Parliament for expenditure on Civil Service pay with an ordered pay system agreed with the unions.

Clearly if a new pay process is to be negotiated with the Civil Service unions and to have a reasonable prospect of long term acceptability it would need to pass two tests. First, it must be capable, in normal circumstances, of serving as the basis for pay settlements which are justified on management grounds and acceptable not only to the negotiating parties, but also to Parliament and the public. Second, it would need to contain as clear an indication as possible of the circumstances in which, and the manner by which, it could exceptionally be overridden by Government on wider policy grounds of the national interest. In considering these matters the Committee will wish to consider, for example, the role which Parliament might be invited to play.

f. The role of arbitration.

The Government accepts that arbitration will have a role to play in any new system for settling Civil Service pay as it has done since the Arbitration Agreement of 1925. The present Arbitration Agreement provides for unilateral access to arbitration, although successive Governments have consistently and publicly reserved the right to refuse access to arbitration on grounds of policy. It has also been accepted over the years that, while preserving the constitutional position that Governments cannot commit Parliament to expenditure without its approval, Governments would not invite Parliament to approve the setting aside of an arbitration award.\* The Government has not withdrawn from the Arbitration Agreement

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\*The special arrangements to which the Government is committed for next year's pay settlement differ from this. The Government has accepted in advance of these negotiations that there should be access to arbitration should negotiations fail. It has however also expressly reserved the right to ask the House of Commons to approve the setting aside of any resulting arbitration award should the Government judge this to be necessary in the national interest. The arrangements derive from the particular circumstances of 1981 and should not necessarily be regarded as a precedent for the future.



with the Civil Service unions as it has from the Pay Agreements with them. But clearly the role of arbitration under any new system will need to be considered in the negotiation for any new Pay Agreement following the Committee's report. For the avoidance of misunderstanding, however, it should be made clear now that the Government attaches the greatest importance to ensuring that, whatever the future arrangements may be, it cannot be forced into an arbitration process with an award which it is required to implement regardless of circumstances. This could be achieved either by the Government reserving the right to withhold agreement to go to arbitration (making resort to arbitration subject to the consent of both sides) or by the Government reserving the right - perhaps subject to the agreement of the House of Commons - to override an arbitration award; or indeed by a combination of the two. There are arguments for and against each course, and the Government would be grateful for the Committee's views on the options. But it is in the Government's view essential to retain in the process of pay determination some safeguard preserving its right of ultimate decision in exceptional circumstances.

Technical issues arising in the process of comparison

10. If the Committee considers that a new system should provide for structured pay comparisons a number of technical questions would arise about how this should be done. The Committee's views would be particularly welcome on the following points -

a. Should comparisons be made with actual outside pay rates or with percentage movements in pay?

Comparison with percentage movements in pay could ease the problem of mis-match between the movement of Civil Service and outside pay referred to in paragraph 9c. But it is outside rates of pay for comparable work which reflect the real position in the labour market and hence affect the employer's ability to recruit and retain employees. Moreover, information on rates can be collected in much more detail so as to establish separate and more valid comparisons for different groups of staff.

b. What outside analogues should be used and how should they be selected?  
Comparisons need to be as representative as possible. But any process of comparison runs the risk of circularity, with all major employers being influenced by the rates which others set. It has been suggested that this risk may be acute where comparisons are made with other public



sector analogues. The Scott Committee on the Value of Index Linked Pensions recommended the exclusion of public sector analogues from the field of comparison for both pay and pensions purposes. It has also been argued that the fields of comparison used by the PRU were biased in favour of large and "good" employers and took insufficient account of the realities of the wider labour market. There are also particular problems in using pay comparison where the Civil Service is itself the main employer of a particular type of staff; and, as with some professional staff, where significant numbers of the profession as a whole are self-employed.

c. Is "whole job" comparison the best approach?

This approach, used by the PRU, involved the identification of jobs in external organisations whose functions and responsibilities taken in the round were closely similar to Civil Service jobs. The Committee may wish to consider how far "whole job" comparisons are appropriate for all types of Civil Service work particularly at the higher levels where difficulties were experienced under the pay research system in making reliable comparisons. The Pay Research Unit Board for example suggested that the cut-off point for pay research should have been lower under the old system.

d. How should "fringe benefits", including index-linked pensions, be taken into account in the comparison process?

Outside pay rates need to be adjusted for differences in other benefits and conditions of service. The Committee will wish to satisfy itself that any new arrangements provide for these elements to be properly and stringently valued. The Scott Committee made recommendations on the evaluation of index-linked pensions. These are at present being considered by the Government.

e. What, if any, arrangements should there be to ensure that any data collected are "up to date"?

The techniques of adjustment to current rates used in the latter stages of operating in the old pay agreement were the subject of much criticism and especially the "uprating" of the outside rates collected by the PRU by reference to price movements. There are questions here of both principle and practice.



f. What organisational arrangements would be best suited to the collection of data under any new system and what role should any data collection agency play?

In examining this question the Committee will wish to consider the nature and status of any new data collection organisation. Should it be free-standing and visibly independent of management and unions? Could it be grafted on to an existing organisation like the Office of Manpower Economics? The Committee will also wish to consider the role of any new agency. Should the role be confined to the collection of data or extended into processing and analysing?

g. To what degree should the data collected for purposes of pay comparisons be made publicly available?

Much of the data collected by the Pay Research Unit was provided on a confidential basis by individual employers. But public confidence depends on public information. This problem links in with the role to be assigned to any new organisation charged with data collection.



Other issues

11. In addition to those described above there are other issues about the future pattern of Civil Service pay arrangements on which the Government would welcome the Committee's views -

a. What role should internal relativities play in settling pay rates?

Internal relativities are an important secondary factor in the determination of Civil Service pay rates. It is inevitable that in a structure as complex as that of the non-industrial Home Civil Service the pay of some groups of staff will need to be settled on the basis of an agreed internal pay relativity with that of another. In some areas there are also questions of vertical relativities with the industrial Civil Service. The arrangements which are made must enable pressing management problems to be dealt with by pay adjustments where these become necessary. There are also wider questions about the relationship between pay and grading structure. The problem is to achieve the best balance between considerations of internal management structure and the matching of pay rates for different groups to the outside market.

b. Is there a place for using merit pay in the Civil Service, and if so how should it be applied?

Outside the Civil Service, particularly in the private sector, extensive use is made of merit pay arrangements. But there are special management difficulties about the application of merit pay systems in the public service.

c. Is the use made of incremental scales in the Civil Service justified and are modifications desirable?

Apart from their possible use as an instrument for rewarding merit, questions arise here on the use of incremental scales as such.

d. Is there a case for introducing productivity bargaining into the pay system for the Civil Service?

Successive Governments have taken the view that the pursuit of improvements in productivity and efficiency of Civil Service operations is a management function with which staff are expected



to co-operate without special payment on the basis that such co-operation should be given in return for a fair rate of pay. This links with the problem of assessing comparative efficiency inside and outside the Service in making pay comparisons.

e. Is there a case for wider geographical variation in rates of pay for civil servants?

The system of "provincial differentiation" was abandoned in 1958, and Civil Service pay rates now apply nationally, with extra payments ("London weighting") to staff employed in Inner and Outer London. National rates are logical and convenient where there is an obligation or widespread practice of mobility; but for types of employment where there is considerable regional variation in pay levels (eg clerical and typing staff) it can lead to anomalies and distortions: over-payment in some areas and inability to recruit and retain staff in others. It is for consideration whether Civil Service rates for at least some (eg the non-mobile) grades, if not for all grades, should attempt to match local pay conditions more closely.

f. Is there scope for the introduction of "no industrial action" agreements into the Civil Service?

It is sometimes suggested that long term agreements on mechanisms for settling pay in the public services should be associated with some form of agreement restricting the right of staff to take industrial action. The Committee may wish to consider this possibility either in relation to the Service as a whole or for limited groups of staff engaged on particularly sensitive work.

#### Higher Civil Service Pay

12. The terms of reference of the Committee cover the non-industrial Civil Service as a whole. The Higher Civil Service have not been covered by the process of pay determination and negotiation which applies to the rest of the non-industrial Civil Service; recommendations on pay rates



for the Higher Civil Service are made by the Top Salaries Review Body (TSRB). This difference of treatment reflects both the difficulty of settling the pay of these senior management grades by any process of negotiation and the fact that rather different considerations apply in the settling of their pay, including not only relativities with senior levels in other public services but also relativities with Ministers. Nonetheless, problems have arisen from the co-existence of two separate processes of pay determination covering different parts of a unified career structure, and particularly at the "interface": the grades of Assistant Secretary (covered by the general system) and of Under-Secretary (covered by the TSRB) and their equivalents. The Committee will no doubt wish to have discussions about the position and the problems with the Review Body.

#### Conclusions

13. The Committee has been asked to advise both on the principles which should form the basis of a new pay arrangement for the Civil Service and on practical arrangements for applying it. Naturally both the principles and the practical arrangements will need to take account of other conditions of service and of other aspects of Civil Service management which bear on the question of appropriate remuneration. Accordingly the Committee has been given terms of reference which leave it free to examine any aspect of Civil Service management and practice which it regards as relevant to its task.

14. It will be apparent to the Committee that this first paper on issues is in part simply an annotated agenda. The Government is ready to provide fuller evidence on any of the points covered by it and indeed on any other matters where the Committee would find further information helpful to its work.





# H. M. TREASURY

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.15.9.81

## PUBLIC EXPENDITURE PLANNING: CASH FACTORS

The Chancellor of the Exchequer announced in his Budget statement on 10 March, 1981 that the Public Expenditure Survey this year would, for the first time, be conducted in terms of prospective cash expenditure, rather than in terms of "constant prices". For this reason, the plans in the last Public Expenditure White Paper (Cmnd 8175) were, at the outset of the Survey, put onto a prospective cash basis, which included an allowance for cost increases between now and future years.

In the spring a provisional allowance was made for general increases in costs of 7 per cent between 1981-82 and 1982-83 and of 6 per cent and 5 per cent respectively for the following two years.

In now preparing for the main decisions on the cash totals for each programme, the Government has reviewed the provisional allowance for 1982-83 and has decided to use separate factors for pay and for other cost increases. These factors will be, for earnings, an increase of 4 per cent from due settlement dates in the coming year, and for other costs an increase of 9 per cent between this financial year (1981-82) and next (1982-83). This change has little net effect on the overall cash total of public expenditure, but it does affect the distribution between programmes.



The pay factor does not imply that all public service pay increases will or should be 4 per cent. Some may be less, and some may be more. There is no automatic entitlement to any particular pay increase: each must be justified on its merits. The pay factor is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

All public service wages are paid for from rates, taxes or borrowing. Excessive wage increases can only mean higher rates or taxes or further cut-backs, for example in public sector capital investment, which will cost jobs in both public and private sectors. The lower the level of pay settlements, the more there could be available for job creating investment throughout the economy.

The cash expenditure figures arrived at by applying these pay and price factors provide a framework for the further Ministerial decisions to be taken later. The final cash provisions for individual programmes, and where appropriate cash limits for next year, will follow from those further Ministerial decisions to be taken subsequently.

The Rate Support Grant paid to the local authorities for 1982-83 will be determined by Ministers' decisions on the cash provision for local authority services which may themselves be affected by overspending in the current year. But the



framework will be the plans revalued using these factors of 4 per cent for pay increases and 9 per cent for increases in other costs.

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136/81

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Notes for Editors

Public expenditure surveys, Ministerial decisions on them, and public expenditure White Papers have hitherto been expressed throughout/prices ruling at an earlier time, known as "constant prices" or "survey prices", rather than the prices which might be expected to rule at the time the money is actually spent. For example the March 1981 White Paper set out the plans for 1981-82 and later years in terms of "1980 survey prices": these were broadly the prices ruling in autumn 1979. The Chancellor announced in his Budget/<sup>speech</sup> the decision to express plans in future in terms of the prospective cash spend. He explained the objectives of the move to be to get away from the presumption inherent in the old volume system that what was once planned could always be afforded, however much its costs might have risen, to focus much more closely on the money actually spent, and to relate decisions to the cash that would be available. (Hansard, 10 March 1981, Col 768-9)

2. This year, as part of the change to cash planning, it is necessary to convert the existing plans in constant prices - 1980 survey prices - in the last public expenditure White Paper (Cmnd 8175) to the new prospective cash basis, to act as a starting point for this year's survey.

3. This conversion was done on a provisional basis in the Spring so that work on the survey could be in cash from the outset. It allowed for a general increase in all costs of 7% between 1981-82 and 1982-83, and increases of 6% and 5% respectively for the following 2 years.



It was envisaged from the outset that this provisional basis of revaluation would be reviewed at this point before the final stages of the survey, in which Ministers take their decisions. This review has now been made.

4. The 7% general factor provisionally applied for increases in all elements of cost between 1981-82 and 1982-83 is, as the notice says, to be replaced by separate factors of 4% for pay and 9% for other costs. The weighted average of these two factors is close to the provisional 7%. The change therefore will have very little net effect on the total for expenditure plans in 1982-83 in the last White Paper revalued to cash. But it does affect the split of totals by programmes.

5. The single factors for general increases in the subsequent 2 years, 6% and 5% respectively, are not changed.

6. The switch to cash planning has changed the sequence of decisions.

Decisions are no longer taken first on the plans in terms of "survey prices" and then on the cash limit factors to be used as part of the conversion of those decisions to cash limits/ <sup>and Estimates.</sup> Discussions and decisions on the survey are taken in cash throughout. This requires, at least for this year of the change, the general cash factors used in revaluing the existing plans from the old price basis to be confirmed - or to be revised - before the main decisions are taken. (This is some weeks earlier than the first cash limits factors would have been settled under the old system.)

7. Decisions on programmes may lead to reductions in some, increases in others compared with the last White Paper converted to cash. Such



decisions may include among other things, an adjustment upward or downward to the cash provision for a particular programme to allow, in whole or in part for movements in pay and prices which are especially affecting that programme and which are expected to differ significantly from these general factors.

8. As the decisions will be in cash, it will be possible to derive the cash limits from them without any further change in price basis. The presumption will be that cash limits will be set to correspond exactly to the decisions on programmes. Also, as now, the presumption will then be that cash limits, once set, will not be changed. If in an exceptional case, Ministers decide later to provide more cash than allowed in their original decisions on the programmes, that increase will have to be met from within the Contingency Reserve.

9. The 9% price factor represents what is considered realistic provision, on the basis of the information at present available, for the prices to be paid by departments. It is not a precise forecast.

10. The pay factor applies to the increase in earnings (basic pay plus overtime etc), not basic rates, and applies from settlement dates.

11. If a reduction in <sup>manpower</sup> numbers is planned (as in the Civil Service) that will be taken into account in the calculation of the provision for the relevant programmes.