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CABINET

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CM(92) 21st Conclusions, Minute 5

Thursday 9 July at 9.30 am

TSRB REPORT ON  
TOP SALARIES

The Cabinet considered a memorandum by the Chancellor of the Exchequer on the Government's response to the recommendations of the Top Salaries Review Body (TSRB) on top salaries - CP(92)8.

The Chancellor of the Exchequer said that the TSRB report was the first fundamental review since 1985. It proposed an overall increase in the pay bill of 19.7 per cent, at a cost of £27.6 million. This presented considerable difficulties at a time when unemployment was high and still rising, and business faced a difficult economic situation. Pay increases had now adjusted to the lowest level for twenty-five years, and were below 4 per cent in the private sector. Against this background it was necessary to take a strong line on public expenditure and pay in the public sector, and indeed a case could be made for no increase in top salaries. Since the last fundamental review in 1985, the TSRB groups as a whole had received an increase in excess of inflation, and had therefore shared in the general increase in prosperity. He was sceptical about arguments based on comparability, although the TSRB applied comparability only with a substantial discount from private sector pay levels. He therefore proposed a rigorous approach of both abating the recommendations and staging the increases. His proposal was that the recommendations should be halved to 9.8 per cent, to be paid in stages of 4 per cent in the current year, 3 per cent in 1993 and 2.8 per cent in 1994, in each case from 1 April. The view of the colleagues principally concerned with the TSRB remit groups was that it would be harder to secure early retirements if pensions were based on the staged payments. He therefore proposed that pensions should be calculated as if the full 9.8 per cent increase had been paid from 1 April 1992, although the policy since 1984 had been to base pensions on actual pay at the point of retirement. There were also arguments for establishing a stronger link between pay and performance, and for extending performance pay to the most senior grades. However, it

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would be wrong to give a public commitment to action before specific proposals had been developed, and the Government should take the line that it would examine the issue and give evidence to the TSRB in time for its review next year. The TSRB had also made a number of specific recommendations about the structure of the judiciary. The Lord Chancellor would have been prepared to accept all of these recommendations, but because this would mean larger increases for those concerned had accepted that this would not be possible. However the proposal for a new Group 5 could be presented as a change of grading, and was acceptable on that basis. Overall, the Chancellor of the Exchequer believed that the proposals struck the right balance in the present economic climate, and he commended them to the Cabinet.

In discussion, the following main points were made:

- a. The tendency to set excessive levels of pay had long been a fundamental problem for the British economy. It was therefore welcome that settlements generally had now declined to around 4 per cent. Against this background the Government should be very cautious about accepting large, or indeed any, increases based on comparability, an approach which had in the past led to an upward spiral in pay levels. It would be better to reject the report and make an increase in line with current pay settlements.
- b. The TSRB's proposals were not based on recruitment and retention considerations, and were not acceptable. Ministers had made many public statements in favour of lower pay settlements, and the Wages Councils which existed to protect the lower paid were being abolished. Figures to be published shortly would show a decline in the average household income of the lowest decile, and although these were open to question they would contrast with the proposed increase in top salaries. A total increase of 9.8 per cent would raise general pay expectations in the public sector. One way of moderating the proposals would be to omit the final 1994 stage, which would reduce the overall effect to 7 per cent. Alternatively the award might be staged over the whole period of five or six years up to the next fundamental review.
- c. There was a strong case for rejection of the report, both in terms of the state of the economy and the undesirability of across-the-board increases. There were good reasons for paying large increases to some of those concerned, but equally there were others who did not justify increases. The TSRB system should be abolished, and the underlying issues on remuneration at senior levels tackled directly. Decisions on pay should be delegated to Departments within strict cash limits; judgements could then be made about the appropriate rewards for individuals. Appointments should be made on the basis of limited-period contracts instead of lifelong tenure.
- d. The TSRB had looked back to their last fundamental review in 1985 and had identified a 3 per cent fall in real earnings for the most senior members of their remit groups and a 7 per cent real increase for the group as a whole. In the same period average earnings had increased by 22 per cent in real terms, and senior private sector earnings by 41 per cent, even after excluding excessive private sector increases from the comparison. Some of the jobs covered by the TSRB remit were among the most responsible in the country, and it was important to recruit people of the highest calibre, especially to the senior

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judiciary. The TSRB had made a strong case for their recommendations.

e. There would always be political pressures to restrict the salary increases for the TSRB groups, and if the Government did not face up to such increases early in a Parliament it would certainly not be able to do so later on. Appointments to non-departmental public bodies and executive agencies showed that public service salaries were not particularly competitive. The TSRB had been helpful in preventing erosion to unrealistic levels. They could well resign if their recommendations were simply rejected.

f. The TSRB had fulfilled the remit which they had been given, taking account of Government evidence. If the Government were dissatisfied with the results they should either abolish the TSRB or invite it to reconsider its recommendations on the basis of a new remit reflecting the Government's concerns, applying an interim increase in the meantime. The Government should be cautious about both abating and staging the recommendations which could have an adverse effect on morale.

g. The Government should be cautious about dispensing with the TSRB system unless it could identify a replacement. It would certainly be difficult for the Government to determine judicial pay without the benefit of independent advice.

h. It was difficult for members of Cabinet who had not seen the TSRB report to form a view on its recommendations. It might be helpful if in future the report could be circulated to the Cabinet in advance of the discussion. On the other hand the report had been seen by the Ministers who were most directly concerned, and it was the normal practice for Cabinet to take decisions on the basis of recommendations from a smaller group of Ministers who had looked closely at the issue in question. It was reasonable to assume that the TSRB had carried out their remit faithfully in putting forward their recommendations. The Cabinet's task was to make a political judgement on the acceptability of the recommendations.

i. The Government's response to the present report would inevitably have to be a compromise between rewarding those who worked on the Government's behalf, and giving the right signals on pay in the current economic situation. For the future there was a need for a more radical examination of the way in which senior public servants were paid, leading to greater emphasis on performance and job weight, as was already happening in executive agencies. Undifferentiated pay increases should be avoided. The case for maintaining the links between the judiciary and other public servants should also be re-examined.

j. Some of the TSRB's recommendations were for specific adjustments for the judiciary in addition to the annual increase, and it would be helpful if these could be followed through in Scotland. On the other hand the Lord Chancellor had accepted that such adjustments should not be made on this occasion, and it would be wrong to create exceptions.

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k. The proposal to allow pensions to be based on notional salaries would be controversial and would create a precedent which other groups would seize on. It would be a mistake to revert to an approach which the Government had successfully abandoned. The arrangement would also give prominence to the 9.8 per cent total increase in salaries, when it was important to focus on the 4 per cent first stage. There was a case for facilitating retirement for some senior civil servants, for senior military officers who were affected by Options for Change and for senior judges, and it was important that their pensions should not be prejudiced by staging. But any necessary action should be targeted specifically on those concerned, without a general change in the pension arrangements.

THE PRIME MINISTER, summing up the discussion, said that Cabinet agreed with the Chancellor of the Exchequer's proposals on the pay of the TSRB remit groups. The Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster would be considering how the scope of performance pay might be extended, and a stronger reference to performance pay would be included in the Written Answer which he would give that afternoon. The aim would be to give the top of the Civil Service and senior military officers a much larger performance-related element in their pay, but the Government would not be in a position to announce specific changes until it had an alternative to propose. Cabinet did not feel able to endorse the proposal that pensions should be calculated as if a 9.8 per cent increase had been paid in full from 1 April 1992. They were conscious however that this would cause operational problems, most obviously for the Secretary of State for Defence since larger than usual numbers of senior military officers were being retired early under Options for Change. There should be mechanisms to enable those who retired early in the public interest to avoid being disadvantaged. There was a risk that the proposed regrouping for senior circuit judges might be seen as an additional pay increase on top of the 9.8 per cent, and the announcement of this regrouping should therefore be delayed until after the announcement of the salary increases. The Prime Minister would in future arrange for Pay Review Body reports to be circulated to all members of Cabinet shortly before they were to be discussed, although it could not be expected that all background papers considered in prior Ministerial discussions could be seen by all members of the Cabinet before decisions were taken. He would ensure that members of the Cabinet had the TSRB report before the announcement of the Government's decision was made that afternoon.

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The Cabinet -

Took note, with approval, of the Prime Minister's summing up of their discussion, and:

- (i) agreed that the Government's decisions on the recommendations of the Top Salaries Review Body on top salaries should be announced by written answer that afternoon;
- (ii) invited the Chancellor of the Exchequer in consultation with the Lord Chancellor, the Secretary of State for Defence and the Chancellor of the Duchy of Lancaster to consider how the performance pay system could be extended among the TSRB remit groups;
- (iii) invited the Chancellor of the Exchequer, in consultation with the Lord Chancellor, the Secretary of State for Defence and the Chancellor of the Duchy of Lancaster to make arrangements so that those who retire early in the public interest should not be disadvantaged by the staging of the top salary awards.

Cabinet Office

10 July 1992

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MOST CONFIDENTIAL RECORD  
TO  
CM(92) 6th Conclusions

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The Cabinet considered a memorandum by the Chancellor of the Exchequer on Economic Strategy (CP(92)1).

THE CHANCELLOR OF THE EXCHEQUER said that economic recovery had been longer delayed than had previously been hoped. The rise in consumers' incomes had so far been used to repay debt. Nevertheless the point would come at which this would cease, and consumers would begin to spend more. The full effect of interest rate reductions also had yet to feed through into consumption. He now expected 1 per cent growth in gross domestic product for 1992 as a whole. This reflected a delay in the onset of the recovery rather than a change in the rate at which growth was likely to take place. There had been a sharp deterioration in the public finances, which was attributable not to extravagance but to the effects of the recession in both reducing tax revenue and pushing up expenditure. He was conscious that considerable political expectations were now centred on the Budget, but the room for manoeuvre would be very limited. It would be important for the Government to maintain its reputation for financial prudence, and the Government's monetary and fiscal policy would need to be seen to be consistent with its medium-term strategy. It was therefore necessary to be realistic about the scope for action in the Budget. He would be grateful for the views of the Cabinet, particularly on priorities as between the personal and corporate sectors.

In discussion the following main points were made.

- a. The Chancellor of the Exchequer's assessment of prospects in the year ahead arguably erred on the side of caution. There were signs of optimism among businessmen, and there had been considerable growth in personal disposable incomes. A main source of uncertainty was the impending General Election, but if the Government was re-elected a revival of confidence and activity might be expected. The labour market was now more flexible than in the past, and while firms could shed labour rapidly, they would also need to take staff on quickly as demand increased, particularly in the service sector. There might therefore be rather more room for manoeuvre than the Chancellor had suggested.
- b. On the other hand it would be wrong to overlook the severity of the recession, or to base the Budget on a more optimistic view than the Chancellor had put forward. It was important to maintain the confidence of the markets,





and the Government's reputation for prudence. Where politically advantageous measures were taken, they would need to be shown to make sense in economic terms. The Budget would need to be constructed on a basis which would have been just as appropriate after as before the Election.

c. There was a very strong expectation of a 1p reduction in the basic rate of income tax. Such a reduction would increase business as well as consumer confidence, because it would stimulate demand. It would also clearly differentiate the Government's approach from that of the Opposition, who were already committed to reversing any reduction.

d. On the other hand the Opposition could claim that a basic rate reduction demonstrated that money was available for the increases in expenditure which they proposed, including their proposed pensions increase which would have a similar cost. An increase in income tax allowances would be of proportionately greater benefit to the less well off, and the Opposition could not undertake to reverse it, though equally it would not serve to differentiate the Government's approach from that of the Opposition. Another approach would be to make a larger reduction in the basic rate at the lower end of the scale, as a first instalment towards a general reduction in the basic rate at a later stage.

e. Scope could be created for cuts in direct taxation by increasing excise duties in excess of inflation. This was also desirable for health and environmental reasons. But caution was needed since the impact of excise duty increases was immediate, whereas direct tax reductions would take time to come into effect. If there were real increases in excise duties, tobacco would probably be the least unpopular area in which to make them.

f. There was a case for increasing capital allowances to bring them more closely into line with the rate of depreciation which a modern business would be likely to use, though it was right to go on resisting pressure for 100 per cent allowances. On the other hand increased investment depended on a revival of demand, and would not be stimulated by changes in capital allowances.

g. To tax capital gains at the same rate as income was illogical, and would also encourage the Opposition to increase the rate of capital gains tax to match their new higher rate of income tax if they came to power. On the other hand a reduction in capital gains tax would only benefit a relatively small number of people. Some easement of inheritance tax for modest properties might be worth





considering, and further encouragement to small savers would be helpful.

h. There was a good case for moderating the large increases in the unified business rate (UBR) which some businesses faced. The financial benefit would not be large, but it would show that the Government had the interests particularly of small businesses at heart. On the other hand such action would be of limited political value, since even the present UBR arrangements posed much less of a threat to business than the Opposition's proposal to allow local authorities to set their own business rates.

i. It would be important to refer again in the Budget to the increases in health, education, and social security expenditure which had been announced in the Autumn Statement, so that the Government gained fresh credit from the action which was already being taken. It would also be helpful to include in the budget social security measures targeted at those in need, such as the less well off pensioners, which would contrast with the Opposition's unselective approach.

j. There was a good case for a reduction in interest rates to stimulate the economy. This would help both business and consumers, where it could have a bigger impact on disposable spending than tax reductions.

k. The Government would not want to increase taxes later, so tax reductions had to be seen as a long-term measure. It was therefore important to be sure that tax cuts were consistent with sustained control of the public sector borrowing requirement, which would be essential if the United Kingdom was to be a candidate for joining a single European currency. While it was quite reasonable for there to be a borrowing requirement at the appropriate stage of the economic cycle, it would be important to be able to show that the level of borrowing was justified by cyclical effects, and was consistent with getting back to balance as the economy revived. The public expenditure round next autumn was likely to be very tight if tax concessions were made in the Budget.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had noted the economic background to the budget set out by the Chancellor of the Exchequer in CP(92)1. A number of suggestions had been made in the course of the discussion which the Chancellor of the Exchequer would take into account in framing his budget. The Cabinet had reaffirmed their commitment to prudent management of the public finances, in order to maintain public and market confidence and promote the conditions for sustained recovery in the economy.





The Cabinet -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.
2. Invited the Chancellor of the Exchequer to take account of the discussion in preparing his Budget.

Cabinet Office

25 February 1992