

cc Mr Walton  
Mr Byrnie

cc Mr Knight (cc)



Ann White 2  
This is the Treasury's  
next paper with plans  
for action more towards  
cash planning

Treasury Chambers, Parliament Street, SW1P 3AG cash planning  
01-233 3000 in PESC. 1

12 February 1981

Suggest you have  
a word with  
the Chambers about  
it on Tuesday.

T. Lankester, Esq.,  
No.10, Downing Street

Approved  
no

Dear Tim,

PRICE BASIS OF THE PUBLIC EXPENDITURE

As you know, we have thought long and hard since the spring of last year about the best way of moving from the present volume price basis of the survey to a system which brings home the importance of cash availability, particularly the movement of costs through the various stages of planning and execution of programmes. Following the discussion at the luncheon on 28 January, the Prime Minister made some very helpful comments on this subject in her minute of 30 January, in particular supporting the idea of a radical move to planning in cash.

At that stage we were still considering two possible approaches, but we now have a clear preference for a single scheme, described in the attached paper which the Chancellor has approved. He thinks, subject to the Prime Minister's agreement, it would be a useful focus for a discussion on this subject at Cabinet. We have yet to add a short passage on the Chief Secretary's proposal to go over to a cash-planned contingency reserve for 1981-82 (this minute of 11 February refers). This will be forwarded shortly. On timing, he thinks it essential for him to be in a position to announce changes in the Budget, this in turn means a discussion in Cabinet not later than 24 February. The meeting fixed between the Chancellor and the Prime Minister on Tuesday at 3.45 on the Budget would provide an opportunity for them to talk about the paper.

Flag A

Yours ever,  
Peter

P.S. JENKINS

B  
1372

## CABINET PAPER

1981 PUBLIC EXPENDITURE SURVEY

Note by the Chancellor of the Exchequer

I propose, and would like to announce in general terms in my Budget Speech, changes in the way in which we conduct the annual Public Expenditure Survey, beginning this year. They are designed in part directly to strengthen control and pressure for economy and efficiency, but mainly to enable all of us in Cabinet to see more clearly the prospective cash costs of expenditure as events develop and decisions are taken. I believe this will contribute to more effective overall management of public expenditure.

2. Our record so far on this is disappointing. Many of our supporters are highly critical. The effects on the outlook for even the most economically desirable tax cuts, for the Public Sector Borrowing Requirement and so for interest rates are widely resented.

3. When the full planned and forecast costs of expenditure for next year are published shortly, it will be seen that total cash expenditure is projected to have risen from £77 billion in 1979-80, to £94 billion in 1980-81 and £104 billion in 1981-82. Over the 2-year period the increase is 35 per cent. This is more than the rate of inflation over the same period. And there has been a sharp rise in the proportion of GDP we have taken for public expenditure.

4. This has happened in spite of considerable and repeated efforts to hold and reduce expenditures. Some of the explanation lies in commitments inherited from the previous Government, especially on public service pay. A major factor

has of course been the recession. It would be foolish to blame the system and to expect changes in the system to solve anything like all our problems or to make difficult decisions unnecessary. But I am convinced that the system under which we have planned expenditure has played an important and damaging role in preventing us all from being as fully and promptly aware of what was happening as we should be.

5. This weakness turns particularly on the traditional and out of date "constant prices" basis of the survey. This basis was part of the medium-term planning system which Plowden introduced some 20 years ago and which at the time had much to commend it. But inflation is very different now from what it was then. The much higher, and highly variable, rates of inflation of recent years have made the system more and more misleading - indeed I understand that Plowden himself now doubts whether his original system is workable. It prevents us from focusing on, or even knowing clearly, the cash implications of our decisions and the likely development of overall cash costs, as we go along. And these cash developments can falsify our intentions. A striking illustration is that, after the Cabinet decisions taken last November, it was still not possible for me to know their implications for actual cash expenditure in 1981-82 until a couple of weeks ago, and the eventual figures could - and did - contain some unwelcome surprises.

6. I attach a specification of the arrangements I propose for adoption for the 1981 survey, about to begin. It has been discussed inter-departmentally among officials. In essence, it provides for all plans and discussions, at least for the principal target year of 1982-83, to be conducted from the outset in terms of the kinds of cash values which will apply in that year. The focus throughout will be on ultimate cash cost. This is essentially the way in which any family (and almost every business) considers its budget for the year ahead.

7. The arrangements will give rise to some technical and management problems and no doubt some difficult (although possibly more helpful) discussions in Cabinet. It was considerations of this kind which led an inter-departmental group of officials to reject a number of similar proposals last year. The particular scheme I am proposing does not - no scheme can - overcome all the difficulties. Colleagues may find it helpful if I briefly highlight one or two of them.

8. First, it will be necessary for Cabinet to adopt for a period ahead - initially as long as 18 months or so - provisional figures for the likely course of inflation, and to decide whether to distinguish between the likely general rate of inflation and the increases the Government is prepared to see in its own costs, both for public service pay and for other prices. We cannot in a highly uncertain world hope for close accuracy of prediction. This is bound to mean an occasional need to review our assumptions, perhaps to make adjustments, but with the considerable advantage of doing so in terms which will show us at once the overall cash expenditure implications.

9. Secondly, my proposals will give greater weight to the constraints on cash costs compared with the traditional sense of "entitlement" to some particular volume or level of service. But there will be scope for review of both general and particular movement of costs, and adjustments of cash provision to meet them. The presumption will be, as I believe it should be, that increased provision will be made only if thoroughly justified, and not as at present largely automatically. In some areas of expenditure, particularly those which we have not found it possible to subject to cash limits, the main problem will be that of prediction, rather than direct control. Even so, we shall arm ourselves better to consider these areas of expenditure, as well as their impact on the total, if we are constantly aware of their prospective development in actual cash cost.

10. Thirdly, colleagues concerned with cash-limited expenditures will note that the form of revaluation proposed at the outset of the survey builds from year to year, including the effect of cash limits set previously. The practical result is that any squeeze or slack which may have emerged for spending managers in handling expenditure within cash limits in one year would normally be carried forward into the next year. This contrasts with the curious feature of the present system (reflecting the traditional commitment to a particular volume of expenditure irrespective of cost) that a part of the revaluation process each year has been to restore cash provision to accommodate price changes in the previous year, whatever effect the cash limits for that previous year may have had.

11. It must be right to carry forward effects of economy and efficiency in this way. I recognise, however, that there must be limits, and that a cumulative series of squeezes year after year could rapidly reach unrealistic levels. My proposals allow colleagues responsible for cash-limited programmes to seek special adjustments where they believe their actual experience of price movements in those programmes, and inability to absorb them without intolerable reductions in levels of service, justify increased cash provision. Again, it is right that the presumption should be that continuing efforts are made to operate within cash constraints, and without special adjustments, but this can be no more than a presumption.

12. Finally, the specifications of the scheme leave open the question how far we should attempt to carry detailed planning beyond the focal year of each survey and how far, if at all, we should deal with later years on the basis of cash valuation. This question could be considered further on the occasion when, shortly after my forthcoming Budget, I present colleagues with actual proposed figures, the detailed ground rules for launching the 1981 survey on which I shall need their agreement.

CONFIDENTIAL

Conclusion

13. I invite colleagues:-

- (a) To agree broadly on changes in the 1981 survey, on the lines of the attached specifications.
- (b) To agree that I should give some general indication of intentions in my Budget speech which might be on the lines of the very provisional draft also attached.
- (c) To note that, immediately following the Budget, I shall be bringing to Cabinet proposals for the provisional inflation assumptions to be built into the construction of 1982-83 prices for the survey and indicating further assumptions which would, if desired, make possible the presentation of 1983-84 figures in terms provisionally appropriate for that year.

H.M. TREASURY  
12 February 1981

PROPOSED CHANGES IN PUBLIC EXPENDITURE SURVEY

The following is a specification of the proposed changes, with some comment on their immediate implications.

1981 Survey: The Target Year 1982-83

2. The starting-point will be the provisional planning figures agreed for 1982-83 as a result of the 1980 survey. These will be published in the Public Expenditure White Paper next month in "1980 survey prices" (broadly the prices of 1979-80 or around autumn 1979).
3. The first objective will be to lay the basis for discussion of 1982-83 plans in the course of the 1981 survey in terms of the cash or approximate prices of 1982-83 in which money in that year will actually be spent. This requires a form of revaluation covering a span of three years. It is intended to carry through the whole revaluation at the outset, but there will be two stages in the process, and each needs to be specified:-

(a) Departments will be invited to revalue their 1981-82 and 1982-83 plans, first by the normal "survey to survey" revaluation from autumn 1979 to autumn 1980 (or from average 1979-80 prices to estimated average 1980-81 prices), and then by the cash limits factors agreed for 1981-82. This work has already been done for cash limits for 1981-82, but should be extended to non-cash-limited expenditure in that year and to all expenditure in 1982-83. The figures for 1981-82 should accord closely with the cash figures being included in the Public Expenditure White Paper this year for the first time.

(b) A further adjustment to the 1982-83 figures will then be made by the Treasury to reflect provisional assumptions about inflation between 1981-82 and 1982-83. These assumptions (covering public service pay and prices) will be considered by Cabinet on the basis of proposals by the Chancellor.

4. From this process, there will emerge base-line figures for 1982-83 which will provisionally be the cash forecasts and cash limit figures for the various programmes, in terms of the actual cash expenditure planned for 1982-83.

Normal Adjustments, Bids and Options

5. Starting from the base-line just described, survey discussion about 1982-83 will be conducted on traditional lines in respect of adjustments to reflect current decisions, bids for new or amended expenditures, and any options for reducing expenditures. Throughout, however, the discussion will be in terms of cash.

6. Where a decision is taken to adjust a cash limit for the current year (1981-82), this will normally be carried into the figures for 1981-82. A simultaneous decision will be taken whether to carry a corresponding or some other adjustment into the figures for 1982-83. Similarly, where estimating changes are made (for example in demographic or economic assumptions), their cash implications will be presented for consideration, as a basis for deciding whether to make provision for them or seek some fresh decision.

Keeping Inflation Prospects Under Review

7. As part of the arrangements, it will be particularly important for Departments to keep under review the current and prospective evolution of pay and prices affecting individual programmes. Where these diverge from the average, Departments may propose some compensating adjustment to the cash provision. More generally, it may be necessary in the light of developments to make at some point a general adjustment to the 1982-83 prospective cash figures, to reflect a more optimistic or pessimistic outlook for pay and prices. The presumption, however, should be against changes unless they are significant and likely to be matched by corresponding trends in revenue.

8. It will be desirable to come close to final agreement around November 1981. Some later adjustments may be possible, until January, although those responsible for managing Estimates and other plans within Departments, and particularly those concerned with instructing outside agencies (local authorities, health authorities, etc.) will be very conscious of the need to reach finality in order to give timely instructions to managers and print Estimates for Parliament.

9. Although there will have been a process early in 1981 analogous to that by which cash limits pay and price factors have been set in the past, and that process may remain identifiable, particularly if adjustments are made late in the survey cycle, the basic discussions



in Cabinet about expenditure plans, being conducted in cash, will not make the same distinction between volume changes and price adjustments as has been made in the past. Much of the discussion will of course be concerned with levels of service and their prospective cost, but the arithmetic will be geared to the final cash numbers, rather than to their precise composition. The initial arithmetic of pay increases may well have become overlaid by a variety of adjustments to cash totals which in some areas may effectively mask it, and this could be helpful. Of course individual managers and negotiators will need to make their own calculations of the amount of money available to finance pay increases, but they may in some areas be able to achieve a degree of freedom of negotiation within their own cash target figure, without the inhibition that the basis of their calculations is officially and publicly announced.

#### 1983-84

10. It is for consideration whether the principle of cash planning should be carried further forward, at the outset of the 1981 survey, by adding provisional inflation assumptions for the year 1983-84. The process would be similar to that already described for 1982-83. The uncertainty one year further into the future would of course be greater, and the figures might well have to be reviewed later at the opening of the 1982 survey. But if provisional assumptions can be agreed there would be some advantage in making this complete move to cash planning for the future. The alternative would be to handle the plans for 1983-84 at this stage in the same sort of prices as 1982-83.

#### Longer-term comparisons

11. There would be a continuing demand for analysis of the traditional kind on a "constant price basis" extending into both past and future. Probably the simplest and most convenient response for the time being will be to retain 1979-80 (1980 survey prices) as the base year and express other years in 1979-80 prices, with relative price effects (i.e. in "cost terms"). Departments would be able to comment, in the relevant chapters in Part 2 of the White Paper, on the evolution of levels of service within individual programmes, by reference to this series or any other usefully illustrative measurement they may develop.

Public Presentation

1a. The annual Public Expenditure White Paper, beginning in 1982, would reflect the new basis of the survey system. 1982-83 figures would automatically be expressed in terms of the cash numbers which had been agreed by Cabinet. The treatment of subsequent years would depend on the decision taken for handling 1983-84: there would be either a "constant price series" showing the provisionally planned volume changes from 1982-83 onwards, or a provisional view of prospective cash expenditures for each subsequent year.

13 FEB 1981





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

7.  
13/2

13 February 1981

T. Lankester, Esq.,  
No.10, Downing Street

*Dear Tim,*

PRICE BASIS OF THE PUBLIC EXPENDITURE SURVEY

I mentioned in my letter of 12 February that we would be forwarding a short passage on the proposal contained in the Chief Secretary's minute of 11 February to go over to a cash-planned contingency reserve for 1981-82. .... I attach this draft; the most appropriate place to insert it in the Cabinet Paper would be after paragraph 12 (i.e. just before the Conclusion) with a separate heading "Contingency Reserve". This will require an extra conclusion, (b), which would read: "To endorse the proposal in paragraphs 13 - 15 on the Contingency Reserve".

*Yours ever,*

*P.S.*

P.S. JENKINS

DRAFT PASSAGE FOR CABINET PAPER

CONTINGENCY RESERVE

- 13 There is a related change which I propose we should make now, affecting expenditure in 1981-82.
  
- 14 The contingency reserve has operated in the past as a control on decisions to add to the volume of expenditure. As part of the move towards a greater emphasis on cash spend, I propose that any decision we take to increase a cash limit should be a charge on the reserve, regardless of whether the change is technically classified as volume or pay or price.
  
- 15 For expenditure not subject to cash limits, the reserve in 1981-82 would continue to be confined to decisions we take to add to volume. For 1982-83 we will need to look again at this area in the light of our decisions on the cash basis of the survey.

16 February 1981

Price Basis of 1981 Public Expenditure Survey

Thank you for your letter of 12 February which I have shown the Prime Minister. She has read the draft paper which you enclosed with it, and would like to discuss it with the Chancellor when they meet tomorrow afternoon.

T P LANKESTER

P. S. Jenkins, Esq.,  
H.M. Treasury.

27