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CABINET

1986 PUBLIC EXPENDITURE SURVEY

Memorandum by the Chief Secretary, Treasury

The report on the baseline for the 1986 Survey, covering both expenditure to be incurred and the outputs and performance to be achieved, was circulated on 30 May. Colleagues have also completed an examination of their programmes and where they are seeking additional provision, have put their proposals to me. I have circulated a summary of departmental bids - my minute to the Prime Minister of 10 July. This paper examines the prospects for public expenditure and makes proposals for the next stage of the Survey.

2. In recent years it has been the practice to consider the prospects for local authority current expenditure separately in the Sub-Committee on Local Authority Expenditure of the Ministerial Steering Committee on Economic Strategy (E(LA)) and for the aggregate objectives for nationalised industry external financing limits to be considered at a separate meeting of the Sub-Committee on Economic Affairs of the Ministerial Steering Committee on Economic Strategy (E(A)). This year I believe it would be helpful, in considering the overall objective for public spending, to take into account the position reached on local authority expenditure; and to set the objectives for the nationalised industries as part of the wider picture. The Lord President of the Council will be circulating separately a progress report on the discussions in E(LA). On nationalised industries, Departments have already received copies of the Investment and Financing Review (IFR). The position is further discussed in paragraph 12 below.

EXPENDITURE BASELINE

3. For 1987-88 and 1988-89 the baselines for individual programmes have been the figures in the 1986 public expenditure White Paper (Cmnd 9702) plus the changes announced in the Budget for employment measures, together with a few minor technical adjustments. For 1989-90 we agreed to construct the baseline for individual programmes by adding $2\frac{1}{2}$ per cent to the provision for 1988-89, but consideration of the aggregate planning total figure for that year was left until now.

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PROPOSALS FOR EXPENDITURE

4. In my minute to the Prime Minister of 6 February I urged Departments to "live within their existing baselines with pressures for extra resources met by cutbacks elsewhere and - of particular importance - improvements in efficiency and effectiveness". Although colleagues were asked to scrutinise personally priorities within their programmes, I regret to say that substantial additional bids have been put forward, full details of which were set out in my minute of 10 July. It is very disappointing that so few offsetting savings were identified and that bids were not in general supported by statements of objectives. In my bilaterals I shall be pressing colleagues further on the setting of targets and the measures on which subsequent evaluation would be based. It is clear that the bids made are far in excess of what can be accommodated and that the problem of establishing priorities in the Survey will therefore be severe.

5. Firm control of public spending is central to our economic policy. It is an essential part of our efforts to improve the performance of the economy, and the prospects for both output and jobs, by limiting the role of the state and enabling us to reduce the burden of public borrowing and taxation. It has played an indispensable part in bringing inflation to the lowest level for 19 years. Moreover it is largely because of these achievements, coupled with the reputation we have established for prudent financial management, that we succeeded in weathering both the miners' strike and the collapse in oil prices without any financial crisis. Over the past year both long and short-term interest rates have fallen by $2\frac{1}{2}$ per cent. but further progress is critically dependent on our retaining the confidence of financial markets.

6. If we are not to put all this at risk, it is essential that in the Survey we once again work within the existing and published planning totals for 1987-88 and 1988-89. For 1989-90 we agreed to set the uplift for individual programmes a little below the rate of inflation of 3 per cent assumed for that year in the Medium Term Financial Strategy. I propose that we now confirm that the planning total should rise by 3 per cent. This will allow a margin for the adjustment of priorities between programmes. This gives broad planning totals for the three years of £144 billion, £149 billion and £153 billion.

RESERVES

7. In the White Paper, Reserves of £4½ billion, £6¼ billion and £8 billion were set for the three years of the plans, figures which were large compared with those set in previous White Papers. In the current year it is already clear that the Reserve of £4½ billion will be under extreme pressure. I must, therefore, treat all applications for access to the Reserve in the current year most strictly and seek colleagues' co-operation in ensuring that cost increases are absorbed and underspendings surrendered.

8. The precise level of the Reserves required for future years depends in part on the decisions taken on programmes during the course of the Survey. If, for example, provision made in programmes is as realistic as possible, lower Reserves can be set than if, as was the case with local authorities in the last Survey, provision is made on a notional basis. I propose, therefore, to consider the precise level of the Reserves later in the Survey, but we must leave, within the public expenditure totals, scope for Reserves which are fully adequate, rising through the period and credible to the financial markets.

PRIVATISATION PROCEEDS

9. During the course of the last Survey the projections for privatisation proceeds were raised from £2¹/₄ billion to £4³/₄ billion. I indicated in my minute of 6 February that the privatisation programme was now in top gear and that additions to the level of proceeds could not be expected. Although preparations for the British Gas Corporation sale are proceeding well, and other issues are being worked upon, there is no scope for receipts to be significantly further increased. Moreover, the sums raised by these issues will depend very much on market conditions, which in turn will be strongly influenced by the outcome of the Survey.

NATIONALISED INDUSTRIES

10. I have circulated separately the officials' report on the 1986 IFR of the nationalised industries. This shows that the industries' own initial and unamended bids, made in April, are over the baseline by approximately £850 million, £750 million and £575 million in each of the three years respectively. These bids are clearly unrealistic and cannot be accommodated. They now need to be scrutinised rigorously and a number of industries are revising their proposals so that we will have a sounder basis for judging them. In the meantime we cannot take a firm view on the likely overall outcome, but our aim must be to reduce the provision at least to baseline and, where we can, below it. Failure to achieve this would mean greater pressure on departmental programmes.

RUNNING COSTS AND MANPOWER

11. Additional bids for increases in provision for running costs amount to over £550 million in 1987-88 and higher sums for later years. If they were conceded the increase in total running costs expenditure would be more than 6½ per cent on a year earlier, very substantially in excess of the present and expected rate of inflation. Increases of this order would scarcely demonstrate our intention to control expenditure on departmental administration.

12. A significant part of this increase is accounted for by additional bids for pay. But any real increases in pay must be matched by growing productivity if the overall rise in departmental costs is to be kept close to the rise in prices in the economy generally. Departments should be planning the measures necessary to achieve this.

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13. Another large part of the increase claimed for running costs is accounted for by bids for additional manpower. Colleagues will know from the minute I sent to the Prime Minister of 17 February that we must keep a very tight rein on manpower numbers if we are to hold to our published manpower targets. The position now is that if the additional numbers sought by Departments were agreed, the target of 590,400 staff at 1 April 1988 would be exceeded by 14,000, reversing the downward trend achieved since we took office.

14. I must therefore ask colleagues to re-examine their departmental programmes with a view to reducing the increase in running costs to much more modest levels and to keeping at or below their manpower targets.

CONCLUSION

15. I invite colleagues to agree:

- a. that I should now conduct bilateral discussions with colleagues on their individual public expenditure programmes; and on their targets for running costs and manpower;
- b. that once again we work within the existing and published public expenditure planning totals of £144 billion and £149 billion for 1987-88 and 1988-89 respectively, and £153 billion for 1989-90;
- c. that we should aim to hold the provision for nationalised industries at least to baseline and where possible below that;
- d. that we should seek to restrain the growth of running costs and that existing manpower targets should be held.

J M

Treasury Chambers

15 July 1986

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