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PRIME MINISTER

3 February 1986

HANDLING THE 1986 EXPENDITURE SURVEY

The Chief Secretary's proposals for changing the Survey are attractive and ingenious. The habits of putting in additional bids and taking every minor dispute to Star Chamber have become too deeply engrained. The Treasury are right to try to recover some ground. It is, anyway, worth changing the rules just to knock departments off balance.

But there is a risk that introducing a stronger presumption against every single additional bid may be so tough as to be unworkable. The Chief Secretary wants a system where a Minister only writes requesting an additional bid, copying the letter to you, in the most exceptional circumstances. But many spending Ministers will be able to point to estimating changes in their programmes arising from new inflation or interest rate forecasts. If 25 letters come through your office, each one beginning with a long account of how economic assumptions have changed, the exercise will be less effective. How about restricting the special letter to other bids?

The summer expenditure Cabinet will become more important. Hitherto, the judgment has been that Ministers are more likely to put their heads in the noose of sticking to the baseline if they are not confronted with the implications of that decision for individual programmes. A more open discussion of what that means increases the risk that the total will not be endorsed. I believe this risk is worth running, but you should be aware of it.

David Willetts

DAVID WILLETTS

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MR NORGROVE

From: J B UNWIN
3 February 1986

HANDLING OF THE 1986 PUBLIC EXPENDITURE SURVEY (CHIEF SECRETARY'S MINUTE OF 31 JANUARY)

You may like to have a few comments on the Chief Secretary's minute, the background to which I have discussed with Treasury officials in the light of last autumn's Star Chamber experience.

2. The Treasury have considered, and rejected, a number of more radical options for changing the annual public expenditure procedure. These range from a drastic curtailment of the Survey report itself (a massive exercise, of which only the tip of the iceberg eventually enters into the decisions that Ministers have to take) to a radical new treatment of local authority spending (eg scoring as public expenditure only that element financed from central government funds). Treasury Ministers have, however, rejected any such radical changes and the only new proposal in this note is the treatment of additional bids.

3. As you know, the PES report has tended to become a Christmas tree for adornment by Departments with long strings of additional bids. As the Chief Secretary comments, their purpose has become debased over time and in general they now serve primarily to stake out the negotiating position of the Minister concerned. This has in turn driven Treasury officials to write into the report offsetting savings options which both they and Departments know to be politically unrealistic, but whose inclusion has become a standard element in the ritual.

4. The Chief Secretary now proposes, therefore, that officials should not include additional bids in the PES report itself (presumably the Treasury would in return exercise a self-denying ordinance on proposals for offsetting savings); but that a Minister who feels he must table such bids, should do so personally in writing to the Chief Secretary by the end of May. This would then enable the Chief Secretary to discuss these before making his report to Cabinet in July.

5. I think that there are some risks in this for the the Treasury. I suspect that spending Ministers will respond to the Chief Secretary's invitation with not many fewer additional bids than would have been tabled by officials under the old rules

in the PES report. Such bids would also then imply a greater degree of personal commitment by the Minister concerned, making it more difficult for the Chief Secretary to discount them when preparing his July report to the Cabinet. The net effect, therefore, might be to make the subsequent bilaterals (and the fall out to the Star Chamber in the autumn) more rather than less difficult.

6. If the Prime Minister arranges a discussion, I think that it would be worth exploring this possibility further with the Chief Secretary. Is he really confident that it will make his task easier? Is there not a risk that he will find his hands more tied at the July Cabinet than they would have been under the old system, despite its defects? If, however, the Chief Secretary is convinced that this change is worth a try - reinforced by strong support from the Prime Minister on the lines that only absolutely unavoidable bids should be submitted by Ministers under the suggested new procedure - then the new idea had better be given a run.

7. The Chief Secretary has no new suggestions of substance on the Star Chamber. He merely suggests that the Prime Minister should warn the Cabinet in July that the Star Chamber would be working rigidly within whatever margin was left within the plans after his bilaterals with spending Ministers. This is in fact the basis on which the Star Chamber has already operated. The catch is that Departments do not, and will not, trust the Treasury. Just as they try on additional bids themselves purely for negotiating purposes, they know that the Chancellor and Chief Secretary will always have some magic device up their sleeve to help square the numbers when the crunch comes. As the Chief Secretary says, the asset sales card has probably now been played to its maximum; but colleagues will not be convinced that, at the end of the day, there is not some other legitimate scope for "massaging" the figures (eg through the Reserve assumptions or the economic assumptions and derived revenue projections).

8. I suspect, therefore, that it is wishful thinking to suppose that any exhortations in July about the role of the "Star Chamber" will have any significant deterrent effect. That said, however, it will clearly be important to keep to a minimum the issues going to the Star Chamber. Last autumn's Star Chamber agenda was the biggest so far, and I think it was clear to all involved that it would be extremely difficult to cope successfully with any more. However, the alternative - taking more issues at Cabinet itself - would for a number of obvious reasons create even greater problems; so that there is no feasible alternative to the Star Chamber or something like it.

9. The Chief Secretary's minute does not mention the possibility of another priorities discussion by the Cabinet like the one at Chequers last July. This is because Treasury Ministers do not want one. They regard it as an unnecessary interference in the Survey process, which is likely from their point of view to do more harm than good. If, however, a meeting is held, the Prime Minister may wish to raise this. My own view last year was that on balance it did serve a useful purpose. On the negative side, it at least prevented members of the Cabinet from being able to argue that they had had no opportunity to discuss expenditure priorities. More positively, some themes emerged that were carried through and influenced the subsequent discussions. Most notable was the general feeling that the time had come to start reining back on defence expenditure. I felt that this did play a part in the Star Chamber's deal with the then Defence Secretary which, though short of the Treasury's aspirations, nevertheless marked a significant change in the pattern of defence budget expenditure.

J B UNWIN

03. 11. 1986

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FROM: CHIEF SECRETARY
DATE: 31 January 1986

PRIME MINISTER

HANDLING OF THE 1986 PUBLIC EXPENDITURE SURVEY

I have been considering what lessons we should draw from the 1985 Public Expenditure Survey for the handling of this year's exercise. This minute sets out my conclusions. I also attach a draft of a minute that, if you are content, I propose to send to Cabinet colleagues.

Outcome of the 1985 Survey

2 In all the circumstances I think the outcome of last year's Survey was reasonable. For 1986-87 and 1987-88 it was possible to hold to the planning totals set at the time of the 1986 Budget. The revised plans, detailed in the latest public expenditure White Paper, show that there is now the opportunity to turn the corner and break the upward trend of spending. The plans have been reasonably well received by commentators and the markets. And we are beginning to get across the message about value for money.

3 But we need to recognise how we were able to hold to the planning totals. Provision for total departmental expenditure in 1986-87 was increased by £4 billion, in large part as a result of demand led increases (particularly in social security following the inflation 'blip' in 1985); and to provide for local authority spending. £1½ billion of this was accommodated by the normal process of allocating money from the Reserve as plans for the forward years are firmed up. The other £2½ billion came from extra privatisation proceeds, without which it would not have been possible to balance the books. As in 1984, only a few departments found savings from changes in policy.

Prospects for the 1986 Survey

4 If we are to hold to our strategy, we need to stick to the published plans and achieve our objective of holding expenditure level in real terms.

5 This will be extremely difficult:

(i) our present provision for local authority spending is unrealistically low. In the last Survey we did not decide on local authority current spending for 1987-88 and 1988-89 although we provided some extra money in the Reserves for those years. Realistically, local authority spending is likely to absorb all the extra money we will have available in the Reserves to allocate to programmes;

And public sector pay is becoming ever more difficult

(ii) extra privatisation receipts will not be available. The programme is now in top gear.

6 In the next Survey, therefore, all additions to programmes will have to be matched by savings.

7 I have been thinking about how best to tackle the next Survey given this prospect. The suggestions below are intended to do two things: to minimise the number of bids; and to maximise the incentive for departmental Ministers to reach agreement with me on where savings should be found to match any unavoidable bids. Progress in these two areas will increase the chances of a successful outcome to the next Survey.

Changes in Approach

8 It is striking that, only a few months after we reach difficult decisions on cash programmes in one Survey, the next annual cycle regularly starts with enormous further bids coming in from spending Ministers. For the first

year of the Survey the additional bids have repeatedly been of the order of £6 billion, with even higher figures in the later years. Some part of the bids may, I recognise, be unavoidable, for example in the big demand-led programmes. But the greater part is avoidable, and all too often involves re-presenting bids rejected by earlier Surveys. We then face an uphill task in getting back to the baseline, with exaggerated press reports of Cabinet arguments and the label of "cuts" being misleadingly, and often damagingly, attached to the process of rejecting bids for more. The need to balance all bids with savings in the next Survey will make this problem acute.

9 So I have been considering how we can avoid starting the Survey with a mountain of additional bids. If there was a complete procedural answer to the problem it would have been found before now. But I think that we must take steps to disturb departments' habits of using each new Survey as the opportunity to put forward a shopping-list of additional bids. The process of departmental officials regularly assembling additional bids from April to June, before we have considered the prospects collectively at Ministerial level, has become institutionalised. There is every incentive to departments to build up the highest opening negotiating position they can.

10 This year I propose that we should get it across to our colleagues at the outset how wasteful this process has been, and urge them to give their personal attention to avoiding additional bids. One way is by greater effort to find efficiency savings or by re-ordering priorities within their programmes. With this in mind, I propose that the Survey report prepared by officials as a basis for our discussions should not include additional bids. If, despite these efforts, a Minister cannot avoid requesting more money, he should write to me about it, with a copy to you, and other colleagues who would be directly affected, by the end of May.

11 As well as setting out why he believed the bid was unavoidable, he should say what offsetting savings he will achieve; I could then discuss the position with him before putting proposals to Cabinet in July. If you will add your authority to my request to Ministers to restrict their additional bids, that will be enormously helpful.

12 But there will still be bids, some of them unavoidable. I am conscious of the heavy burden that the resolution of these bids can ultimately place on the Star Chamber under the Lord President's leadership. Moreover, the Star Chamber's existence encourages some Ministers to prolong their discussions with me without seriously seeking agreement. I have considered whether it would be possible to ease this load on colleagues by radical changes in this part of the procedure, but reluctantly I have come to the conclusion that it is not (yet) possible to do without the Star Chamber. I have therefore looked for ways to ensure that its work is kept to the essential minimum and that there is the maximum incentive for individual Ministers to settle with me bilaterally.

13 An important element in this is for spending Ministers to feel that, if they take their programme to the Star Chamber, they stand to lose as well as gain. This might be achieved if you were to warn the Cabinet in July that the Star Chamber would be working rigidly within whatever margin was left within the plans after my bilaterals with spending Ministers. If that message carried conviction - and, as I have said, it is certainly the case that asset sales will not come to the rescue this year - spending Ministers might well feel that it was in their interests to settle with me rather than wait for a share of whatever was left at the stage of the Star Chamber.

14 The precise handling in July will need to be considered in the light of developments in the opening phase of the Survey. For this reason the attached draft minute to colleagues does not touch on it, and focuses on the handling up to the end of May. It will in due course need to be supplemented by a formal Survey guidelines document, which I propose to circulate as soon as possible after the Budget. Apart from procedural aspects this will cover the question of the uplift factor for 1989-90. It will also cover the handling of running costs and manpower in the new Survey, where we need to build on the procedures established last year in creating the running costs target for 1986-87.

15 Meantime, over the coming weeks, I shall be giving thought to the key priority areas on which we shall need to focus in this year's Survey. Some important reviews, such as R and D and legal aid, have been completed or are under way. You are shortly to take a meeting about territorial provision. We will need all the savings we can get from reviews of this sort to offset the inevitable upward pressures.

16 Before I circulate the attached minute, I should like to know that you are content that I should do so. I am sending copies of this minute and the attachment to the Lord President and the Chancellor of the Exchequer. You may think that it would be useful if the four of us were to have a word about it.

Yours ever

JM

JOHN MacGREGOR

SECRET

DRAFT MINUTE

PRIME MINISTER

HANDLING OF THE 1986 PUBLIC EXPENDITURE SURVEY

With the 1986 Public Expenditure White Paper now published, we need to decide on the arrangements for the early part of this year's Public Expenditure Survey.

2 In the new Survey we will need to hold to the plans we have set if, as we have claimed, expenditure is to remain broadly stable in real terms and decline as a proportion of national income. It is too soon to make any firm assessment of the difficulties we shall face in achieving that objective. But it is clear that it will not be easy.

3 In the 1986 Survey there will not be room for additions to programmes which it proved possible to make within the overall totals in the last Survey. The privatisation programme is in top gear and additions to the planned level of proceeds cannot be expected. The scope for financing net additions to departmental provision within the established planning totals will therefore be extremely limited. With decisions yet to be taken on local authority current spending, the Reserves are very tightly set, so there will have to be a clear presumption that all departments must seek to live within their existing baselines, with pressures for extra resources met by cutbacks elsewhere and - of particular importance - improvements in efficiency and effectiveness.

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4 Against that background I think we must consider carefully whether the established Survey procedures, particularly in the early stage of the process, are best adapted to the situation we will face. My conclusion is that, in one major respect, there is room for improvement.

5 As I look back over the last Survey and its predecessors, I am struck by the fact that, despite our agreeing programmes in cash - often with great difficulty - at the end of each Survey, by the beginning of the next Survey only a few months later there are bids for further additions regularly amounting to £6 billion or more. Sometimes -if, for example, there has been a marked deterioration in the prospects for inflation - some of these bids are understandable. But all too often they involve re-presenting bids rejected in earlier Surveys. We then face an uphill task in getting back to the baseline, with exaggerated press reports of Cabinet arguments and the label of "cuts" being attached to the process of rejecting bids for more. In practice, the great majority of bids for net additions to cover new policies have had to be rejected; but the process is wearisome and damaging.

6 I think that the way in which the Survey is conducted in its early stages at official level provides a large part of the reason for this situation. The Survey Report, which performs the essential role of providing an agreed statement of the existing level and objectives of programmes, also provides an occasion for the aggregation of a large number of additional bids.

7 It is in all our interests to keep to a minimum the demands which the public expenditure process imposes on us and the controversy which it stimulates. Given the very narrow margins in the plans, I therefore ask that colleagues should this year give their personal attention to avoiding requests for additions to their programmes, particularly in 1987-88 and 1988-89 for which figures have already been set. With this in mind I suggest that officials should be asked not to include additional bids (or options for reductions) in the Survey Report.

8 Instead I ask Ministers personally to scrutinise priorities within their programmes, and make every effort to accommodate upward pressures through offsets and improved efficiency. If, having done so, they nevertheless conclude it is essential to put forward proposals for net additional resources, they should write to me by the end of May, with copies to yourself, the Lord President and other Cabinet colleagues directly affected, setting out their proposals. These letters should give detailed support to any outstanding bids, explaining why they are unavoidable and what savings they would make if absolutely necessary.

9 This material could then be put together by the Treasury, along with information on any possible options for reduction I might ask colleagues to prepare, and form the basis of my paper to the Public Expenditure Cabinet in July. Before putting that paper to Cabinet I would have the opportunity for a discussion with any colleagues who feel that they have to put forward proposals for additions and see if there is any alternative before bringing them to Cabinet.

10 I envisage that, as soon as possible after the Budget, I shall be making detailed proposals for this year's Survey guidelines, including the question of establishing the baseline for 1989-90, the new third year of the Survey. But I am minuting now on this general procedural change, so that it can be taken into account in the way Departments approach the Survey over the coming months. I do not propose any change in the timetable for the Survey report which would set out the basic facts and figures of Departments' existing plans. We would aim for the final formal document to be circulated before the end of May, the time by which I suggest colleagues should write to me if there are any additional bids that they wish to press.

11 I am sending copies of this minute to Cabinet colleagues, the Minister of State (Privy Council Office) and Sir Robert Armstrong.

JM