

Ref.A083/3185

PRIME MINISTER

Public Expenditure Survey 1983

(C(83) 34)

BACKGROUND

It has been the Cabinet's objective during the current Public Expenditure Survey to hold to the published planning totals for 1984-85 and 1985-86 and to hold total spending in 1986-87 at the same real level. The relevant figures are as follows.

	<u>£ billion</u>		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	126.3	132.1	137.2

The Cabinet have agreed that these figures should include adequate planning reserves.

2. In his minute of 18 October the Chief Secretary, Treasury reported good progress towards those objectives. But there were still gaps of £1.1 billion in 1984-85, £1.7 billion in 1985-86, and £2.5 billion in 1986-87. There were outstanding issues on defence, agriculture, foreign affairs, education, arts and libraries, and the nationalised energy industries; and agreement had not been reached on local authority current expenditure in 1985-86 and 1986-87.

3. You set up the Ministerial Group on Public Expenditure (MISC 99) under the chairmanship of the Lord President of the Council to try to resolve outstanding issues. The Lord President's Memorandum (C(83) 34) reports the results of the Group's work. Agreement has been reached on all the programmes except education and science, either within the Group or bilaterally between the spending Ministers concerned and the Chief Secretary. (The figures agreed for Arts and Libraries do not include anything in respect of the Priestley recommendations; but you have been discussing that separately with the Chancellor of the Exchequer

and Lord Gowrie, and I do not suppose that you will want to bring it up in Cabinet. The amount concerned - £5 million - is insignificant in the context of the totals, and should be capable of being accommodated without difficulty, if agreement is reached, and without prejudice to other programmes.)

4. There are still small excesses over the agreed planning totals (£129 million in 1984-85, £392 million in 1985-86, and £290 million in 1986-87). The figures include reserves of £3 billion in 1984-85, £3.5 billion in 1985-86, and £5 billion in 1986-87, as previously recommended by the Chief Secretary. C(83) 34 draws the Cabinet's attention to the outstanding issues on the education and science programme, and to the agreements that have been reached on the defence programme.

MAIN ISSUES

5. The main issues for the Cabinet are as follows:

(i) Do the Cabinet endorse the agreements reached on programmes other than defence and education and science?

(ii) Do they also endorse the agreements reached on the defence programme?

(iii) What view do they take of the issues raised on the education and science programme?

(iv) In the light of the answers to the questions at (i) to (iii) above, is the overall result satisfactory? In other words, can any over-shoot of the published planning totals be dealt with in a way which is realistic and will command public confidence?

(v) How should the Government's decisions be announced?

Electricity and Gas Prices

6. Of the agreed programmes the one most likely to provoke discussion is that for the nationalised energy industries, and in particular the savings assumed from price increases.

It has been assumed that domestic gas prices will increase by 5 per cent on 1 January 1984, instead of the 4 per cent preferred by the industry and the 6 per cent sought by the Treasury; and that electricity prices will increase by 3 per cent in both 1984-85 and 1985-86, although the industry is understood to be planning for a price freeze in 1984-85. The electricity price increase is particularly important since it produces savings of £210 million in 1984-85, £90 million in 1985-86, and £30 million in 1986-87.

7. Before he left for China the Secretary of State for Energy instructed his Minister of State, Mr Buchanan-Smith, to put these proposals confidentially to the industries. (The Lord President has written to say that this should not have been done in advance of the Cabinet discussion, but it is common ground that at some stage there would have to be an effort to talk the industries round to the Government's view.) Mr Buchanan-Smith will probably wish to report on the industries' reactions so far. We understand that on gas Sir Denis Rooke is reluctant to impose a domestic price increase higher than 4 per cent unless the industry is given a financial target (it does not at present have one). On electricity the industry is said to see great difficulty in justifying to their customers any price increase next year.

8. The Cabinet will wish to consider:

(i) whether the proposed price increases are reasonable;

(ii) what should be done if the industries are unwilling to go along with the Government's proposals.

9. There ought to be no dispute about the reasonableness of the proposed increases. On domestic gas the Treasury's original proposal was 6 per cent on the grounds that this was necessary to keep the price steady in real terms since the last increase 15 months previously. MISC 99 accepted the Secretary of State for Energy's proposal of 5 per cent purely on the grounds that this would give rise to less difficulty with the British Gas Corporation, and without prejudice to future gas pricing policy.

It ought to be difficult for Sir Denis Rooke to reject this proposal since his own estimate of inflation since the last price increase is 5.1 per cent. On electricity it seems very likely that a price freeze in 1984-85 would have to be followed by a price increase of around 6 per cent in 1985-86. MISC 99 considered that, quite apart from the public expenditure savings, it would be much more acceptable to have a price increase of 3 per cent, well below the inflation rate, in each of the two years 1984-85 and 1985-86.

10. The first step must obviously be to persuade the industries to fall in with the Government's views. Even if the initial reaction reported by Mr Buchanan-Smith is adverse, the Cabinet may feel that it is too soon to give up the effort. Should the effort eventually fail the options would be to impose the increases (which would probably require legislation and would raise obvious political difficulties) or insist that the industries find equivalent offsetting savings.

Wales

11. The letter of 8 November from the Secretary of State for Wales to the Chief Secretary raises a number of points on his programme. He asks the Chief Secretary to accept that the Cabinet's decisions will not be taken to rule out separate agreement on a solution. Presumably this means that an increase in the Welsh programme would not be precluded. Clearly the Cabinet cannot go into details. If the Secretary of State for Wales raises the matter, it should suffice to agree that the Cabinet's decisions are without prejudice either to the Secretary of State's right to claim on the contingency reserve or the Chief Secretary's right to resist.

Defence

12. You will wish to treat defence as an agreed programme for endorsement by the Cabinet and to avoid encouraging more discussion than is necessary. We understand that exchanges are still going on between the Secretary of State for Defence and the Chief Secretary, Treasury about the interpretation of the form of words relating to the two earlier years but the Cabinet should not become involved in that. In relation to the third year, 1986-87,

the important point is that the figure of £18,650 million is a straightforward cash provision, unqualified by any words about commitments to real growth. It is true, as a matter of arithmetic, that the figure was arrived at by adding 1 per cent on top of the 3 per cent cash factor for 1986-87, but there is no implied commitment to 1 per cent real growth in 1986-87.

Education and Science

13. There are two issues, discussed in detail in Annex C of C(83) 34:

(i) Do the Cabinet endorse the recommendations of MISC 99 on student grants and university current expenditure?

(ii) If not, how should any resulting changes in the figures be dealt with?

In addition the Secretary of State for Education and Science may be tempted to re-open some of his rejected bids for additional expenditure, notably that for science. Since the education and science programme, unlike all the others, has not been agreed, he is entitled to do so, but you will not wish to encourage him to widen the area of debate beyond the two issues which have been identified.

14. On student grants, as you know, the Cabinet will wish to weigh the need for savings of £25 million, £45 million and £50 million over the three years, against the political difficulty of further reducing the value of grants; and also, if savings are to be made in this area, to consider whether the balance of the proposed package is acceptable in its impact at various income levels.

15. On university current expenditure the main issue is whether an efficiency saving of £50 million in 1986-87 would be inconsistent with your assurance of 7 June about holding higher education expenditure steady in real terms after 1984-85.

16. If the Cabinet should reject all or part of the MISC 99 recommendations, the excess over the planning totals will be increased. There would be three possible ways of dealing with the situation:

(i) The Secretary of State for Education and Science could be asked to find alternative savings. But he and MISC 99 are agreed that the recommended savings are the most that could be found within his programme. And it could be regarded as unfair for the Cabinet to insist that the Secretary of State should find savings in a form which he regards as undesirable, having rejected his own proposals for savings.

(ii) Other Ministers could be asked to find savings. That would mean re-opening all other programmes. It hardly seems practicable.

(iii) Treasury Ministers will have to deal with the addition to the excess in some way or another.

Overall Situation

17. The net result of the changes made before the Survey, bilateral agreements between the Chief Secretary and spending Ministers, and the recommendations of MISC 99 is an excess of £129 million in 1984-85, £392 million in 1985-86, and £290 million in 1986-87, compared with the objectives agreed in July. These figures might, of course, be marginally changed as a result of any discussion of individual programmes on 10 November.

18. The gaps could be bridged in one or more of the following ways:

(i) Proceeds from the disposal of Enterprise Oil will not be available until 1984-85, instead of 1983-84 as previously assumed. This will increase resources in 1984-85 by £400 to £500 million. About £300 million of this will be needed to cover prospective overruns on social security expenditure; but we understand that unless the agreements on individual programmes come seriously unstuck on 10 November, there will still be enough to cover the gap without touching the reserve of £3 billion for 1984-85.



(ii) It would be possible to show higher, but still credible, figures for asset sales in 1985-86 and 1986-87.

(iii) The proposed reserve of £5 billion for 1986-87 is high; it might be possible to reduce it by, say, £½ billion without undue risk, but Treasury Ministers will probably be reluctant to do so at this stage.

19. Treasury Ministers will not wish to show their hands too clearly; and you will probably not wish to press them to go into detail. Even so, there will be great advantage in being able to say - and say in public - on 10 November that the 1983 Survey is now concluded, within the previously agreed totals; and Treasury Ministers will need to provide sufficient information for that to be said with reasonable conviction.

Announcements

20. It is usual to announce the figures for individual programmes for 1984-85 in the Autumn Statement which is due to be made on 17 November. (Details for later years eventually appear in the Public Expenditure White Paper.) But you will probably wish the Cabinet to approve a form of words for immediate use, to the effect that the Survey has been "satisfactorily concluded and totals held". I understand that the Chancellor of the Exchequer intends to discuss a draft with you before the Cabinet meeting.

Manpower

21. At the Cabinet meeting on 20 October it was reported that there was an outstanding disagreement about the manpower target for the Ministry of Defence. The Secretary of State for Defence had withheld his agreement on the grounds that the targets generally were not sufficiently demanding. He has however now accepted the Chief Secretary's proposed target on the understanding, approved by the Cabinet on 20 October, that every attempt would be made to improve on the targets set for Departments.

Capital/Current Expenditure

22. The Cabinet asked on 20 October for information about the breakdown between capital and current expenditure. A note by Treasury officials has therefore been attached to C(83) 34 at Annex E. Some Ministers may express disappointment that the note is not more informative. The Treasury has however had genuine difficulty since some Departments have not yet decided their own capital/current split. There are also problems about how the two categories should be defined. You will wish to discourage further discussion at this stage. If need be, the Chief Secretary might be asked to circulate a fuller paper in good time before the next Public Expenditure Survey round.

HANDLING

23. The Chancellor of the Exchequer is most anxious that individual programmes should be settled before he describes how any remaining gap can be bridged: he fears that if he shows his hand too soon, any outstanding issues will be settled over-generously; and it is even possible that agreed programmes may be re-opened. You may therefore wish to divide the discussion into three parts:

- (i) individual programmes, especially defence and education and science;
- (ii) the overall situation;
- (iii) announcements.

Individual Programmes

24. You might introduce this part of the discussion by inviting the Lord President of the Council to introduce his memorandum. The Chief Secretary, Treasury could then be invited to make any general points. The Secretary of State for Defence and the Secretary of State for Education and Science will wish to discuss the points arising on their programmes. Mr Buchanan-Smith (in the absence of the Secretary of State for Energy) may wish to speak about the savings to be found from the gas and electricity supply industries. Any of your other colleagues may wish to contribute. But you will naturally wish to discourage any attempt

to re-open agreements; if there are points of detail still to be settled, they should be discussed between the spending Minister and the Chief Secretary.

Overall Situation

25. In the light of the first part of the discussion you might invite the Chancellor of the Exchequer to speak, in particular on how any remaining gap between agreed expenditure programmes and the planning totals is to be covered. The Chancellor might also give such indication as he considers right regarding revenue prospects and other matters to be covered in the Autumn Statement on 17 November. (This would do something to meet the wish expressed by some members of the Cabinet on 20 October to have information about the likely revenue outturn when reports are made on prospects for expenditure.)

Announcements

26. Again, you might invite the Chancellor of the Exchequer to propose a form of words for use in response to enquiries about the progress of public expenditure discussions.

CONCLUSIONS

27. You will wish the Cabinet:

(i) to agree the figures for individual expenditure programmes in 1984-85, 1985-86 and 1986-87;

(ii) in particular to decide such matters as arise on

- defence
- education and science;

(iii) to note the Chancellor of the Exchequer's account of the general situation and how he proposes to bridge any remaining gap between the agreed expenditure programmes (plus reserves) and previously agreed planning totals;

(iv) to agree on the terms of an announcement.

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CONFIDENTIAL

SECRET



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10 DOWNING STREET

From the Private Secretary

MR. GREGSON

CABINET OFFICE

I would like to ensure that my record and the MISC 99 report are consistent. Any comments?

The Treasury are still disputing whether the wording on the inflation compensation will be published. They say this was not discussed at MISC 99, and have asked for the sentence in the second paragraph on page 2 to be included. Any views?

Andrew Turnbull

6 November 1983

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