



P 01839

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PRIME MINISTER

Fee Earning Businesses in Government
Flag B - E(A)(85)66, 68 and 70

BACKGROUND

1. The Secretary of State for Transport has questioned whether the present arrangements for controlling departmental running costs provide the right basis for managing those activities which can be regarded as businesses because they are financed from fees or charges. He argues that they should be able to adjust their resources up or down to match changes in demand. He has put forward three areas of his own Department which he suggests should be managed in this way. The Secretary of State for Trade and Industry in Flag C - E(A)(85)70 supports his argument, and suggests candidates of his own.

Flag D 2. The Chief Secretary, Treasury in E(A)(85)68 argues that control of gross running costs should continue, but that this need not be an impediment to the efficient operation of fee earning activities, on a case-by-case basis.

MAIN ISSUE

3. The main issues are:

(i) whether control of gross running costs should continue to apply for fee earning activities; and

(ii) if not, on what basis the resources used in such activities should be controlled.

Current Arrangements

4. Until recently the main emphasis in controlling the Civil Service has been placed on total manpower numbers. For the time being (until 1988) manpower limits remain in place along side the new running costs limits; in future the emphasis will move to running costs. Manpower accounts



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for about 70 per cent of running costs, but this move will give Departments a degree of flexibility in managing all the resources available to them, while still requiring tight budgeting and providing a spur to improved efficiency.

5. Running costs will be set on a gross basis, ie disregarding any income from fees and charges. This means that Ministers in charge of Departments start with a fixed amount of cash to meet the costs of all their activities, and - (rightly) - have to make decisions about priorities within that limit. It gives them no automatic room to respond to market pressures. For example, the Transport Secretary has to decide how much money and how many staff he should devote to driving tests in the light of competing demands from, eg the coastguard service, highway design, and the channel fixed link. If subsequently demand for driving tests increases, even though the costs of employing extra staff would be fully covered from fees, it would remain unmet unless the Transport Secretary could persuade the Chief Secretary that flexibility should be allowed (as the Chief Secretary now seems to be prepared to do in this particular case). The Transport Secretary argues that this is not the best way to organise this part of his Department's work, and also gives rise to presentational and political difficulties.

The Argument

6. The Government's important objective of reducing the size and cost of the public service may in some circumstances conflict with the economic efficiency argument that the resources devoted to particular activities should be determined by the market. The Cabinet in its July discussion of public expenditure accepted 'there was a case, within the Government's overall objectives for reducing the public sector, for some relaxation of policy on manpower where the benefits of additional employment could be shown to exceed the costs involved' (CC(85)24th, Minute 4). And E(A), in relation to the level of activity against social security and unemployment fraud, concluded that 'the main focus should now be on the net cost of Government activities'



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rather than exclusively on Civil Service manpower as such' (E(A)15th Meeting, Item 1).

7. There are in principle four types of Civil Service work where gross running cost controls may produce sub-optimal results, and where it might be argued that additional staff should be taken on as long as each additional employee achieves a net reduction in the PSBR:

(a) revenue collection, where the cost of extra staff is outweighed by extra yield;

(b) fraud prevention (eg Social Security) resulting in net savings of expenditure;

(c) licensing or test activities (eg Driving tests or the Patent Office); and

(d) trading activities not suitable for privatisation (eg Ordnance Survey, or the Tower of London).

8. To apply net costs control to all these categories could, if pressed to its logical limit, result in very large increases in tax, social security and other staff. There would be far-reaching political implications, and no means of ensuring efficient performance of their duties by all the staff concerned. However, the Transport Secretary is not in practice suggesting going as far as this, (although other Ministers would no doubt soon press to climb on the band-waggon), but instead a more limited liberalisation restricted to categories (c) and (d) above, where the civil servants concerned are wholly engaged in providing a service to the public whose costs are recovered through fees, charges or prices.

The Proposal

9. The Transport Secretary suggests that the main focus in these areas should be on unit costs rather than gross (or net) costs. This



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would enable fee earning activities to expand or contract as the market demanded. Pressure from improved efficiency would come from controls on unit costs; which would be designed to prevent monopoly or licensing activities from exploiting captive markets.

Why not RPI - X as for BT and BGC? Or something similar.

10. The Chief Secretary in effect argues:

(i) manpower controls should not be given up until running costs controls are seen to be working effectively;

(ii) manpower demands for fee-earning activities should be considered alongside demands for revenue collection, benefit fraud policing and prevention of drug trafficking;

(iii) many fee-earning activities are monopolies, and should not be controlled on a net cost basis; and

(iv) increases in running cost limits can be considered on a case-by-case basis on their merits where there is no net increase in public expenditure but with a presumption against increases in running cost limits.

He therefore offers to consider further cases like driving tests where unit rather than net cost controls can be devised on an individual basis, but is still concerned that the process could give rise to significant civil service manpower increases at a time when the new gross running costs control has still not been proven.

11. The main question is whether it would be reasonable to exempt fee-earning activities automatically from the normal manpower and running cost controls, where a satisfactory alternative unit cost control can be agreed and costs are covered by charges. The Transport Secretary in effect argues that it would be, while the Chief Secretary is not yet ready to take this step. In part the decision will no doubt turn on the extent of the potential threat in terms of higher civil service numbers: you will want to be satisfied that the Treasury are not overstating the scope of the exception which could be created.



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A decision in the Transport Secretary's favour would not strictly have any implications for the big battalions such as those engaged on tax collection or social security benefits, although they would no doubt be encouraged to press their claims harder. A possible compromise might be to maintain the present principle of control (at least until we have more experience of how effective the gross running costs control is) and to grant no automatic exemptions, but to record a conclusion in favour of more sympathetic "on merits" consideration by the Treasury of cases such as the Driving Test operation that Mr Ridley proposes.

HANDLING

12. You will wish to ask the Transport Secretary to introduce his paper, and the Trade and Industry Secretary to second it. The Chief Secretary, Treasury will wish to put the counter case.

CONCLUSIONS

13. You will wish to reach a decision on whether gross running costs should continue to be the means of controlling the whole of Departments' domestic expenditures, or whether Ministers should be ready to exempt fee-earning and commercial activities automatically from the application of running cost limits (and manpower ceilings) where effective means are available to ensure efficiency in the use of resources and to avoid the abuse of monopoly power and charges adequately cover costs.

J B UNWIN

Cabinet Office
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