



Ref. A084/451

PRIME MINISTER

Capital and Current Expenditure

C(84) 7

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BACKGROUND

On several previous occasions members of the Cabinet have expressed disquiet at a decline in the proportion of public expenditure going to capital investment. This disquiet was reflected in the discussion on the 1983 Public Expenditure Survey on 10 November 1983, when the Chief Secretary, Treasury was invited to give thought to how more satisfactory information on the split between capital and current expenditure could be made available, and to circulate proposals (CC(83) 33rd Conclusions, Minute 4). There was a further exchange in the Cabinet on 12 January (CC(84) 1st Conclusions, Minute 5).

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2. In his memorandum C(84) 7 the Chief Secretary, Treasury provides a new presentation of the figures for capital spending. These include a number of adjustments, of which the most important appear to be as follows:

(a) Sales of assets are excluded because they have no bearing on the volume of new work.

(b) Expenditure on defence equipment and construction is counted as capital expenditure (the international statistical conventions on the preparation of national accounts count all defence spending as current).

(c) The capital expenditure of the nationalised industries is scored, rather than their external financing limits.

3. The adjusted figures, which will appear in the Public Expenditure White Paper published on 16 February, show that in cost terms public capital spending on goods and services has stayed broadly constant over the period 1978-79 to 1983-84, and should continue to do so in 1984-85. Comparisons with plans



for later years are more difficult because of the expected transfer to the private sector of major nationalised industries; but the Chief Secretary suggests that if adjustments are made for this there should be little change in 1985-86, and a small fall in 1986-87.

4. The Chief Secretary recognises that the new figures will not satisfy the Government's critics. However, he points out a number of further points that can be made in reply.

(a) Much current expenditure is as valuable economically as capital expenditure; and current expenditure may be as good as or better than capital expenditure in securing particular objectives.

(b) Some public investment, for example in housing, should be carried out by the private sector.

(c) Demographic and other factors may mean that less capital expenditure is needed.

(d) Investment in industrial and commercial activities is of little value if it fails to earn a proper return, as much investment by the nationalised industries and other public sector bodies has failed.

5. Finally, the Chief Secretary points out that the balance between capital and current expenditure is the result of decisions by spending Ministers on their programmes: it is not a matter that can be determined centrally by the Treasury. The case for capital expenditure will have to be considered project by project.

6. In his letter of 3 February to the Chancellor of the Exchequer, the Secretary of State for the Environment proposes the establishment of an interdepartmental group with terms of reference requiring it:

"to examine the state of the publicly owned civil capital stock of housing and roads, water and sewerage, hospitals and education buildings, the Government civil estate and the capital stock of universities; to evaluate such evidence as is readily available of its present and likely future condition and fitness for its purposes and its needs



for maintenance, repair and replacement; to consider means of assessing the position and keeping it under review as a basis for cost-effective decisions on public expenditure and investment; and to make recommendations".

The defence estate and the nationalised industries would be excluded. The group would have a Treasury chairman and would be asked for an initial report by May or June in time for it to be taken into account in the 1984 Public Expenditure Survey.

MAIN ISSUES

7. The main issues before the Cabinet are as follows:

- (i) Do the figures as now presented allay the disquiet which has been expressed by some Ministers in the past?
- (ii) If not, what should be done about it?
- (iii) In particular, do Ministers wish to establish special machinery, such as that proposed by the Secretary of State for the Environment?

The figures

8. The Cabinet may well feel that although the unadjusted figures which have previously been used exaggerate the problem, the new figures circulated with C(84) 7 still leave grounds for disquiet.

(a) Defence expenditure gives employment to the construction and equipment industries, and may help strengthen our industrial base. But it makes no direct contribution to the country's productive capacity. If the defence figures are excluded from the calculations, the figures in Annex B to C(84) 7 appear to imply a decline of about 1/7th, in cost terms, in capital spending on goods and services between 1978-79 and 1984-85.

(b) Ministers have been concerned not only at the absolute decline in capital spending but also in its decline

What contribution to productive capacity did investment in steel and power stations make?



as a proportion of public expenditure. Public expenditure has increased substantially both in real terms and as a percentage of GDP since 1978-79. Moreover, if the capital spending figures are increased by adjustments such as the exclusion of asset sales, the same adjustments must be made to public expenditure, and the totals will be correspondingly higher.

(c) The combined effect of the points at (a) and (b) above is that more than all of the published increase in public spending in real terms since 1978-79 has gone to current expenditure, defence capital expenditure, and transfer payments.

What should be done?

9. Even if the Cabinet should feel that the figures in C(84) 7 give too reassuring an impression, it is hard to quarrel with the ✓ Chief Secretary's assertion that the remedy, if one is needed, is mainly in the hands of spending Ministers. Given the overriding need to hold to the published planning totals, it is hardly reasonable to expect the Chief Secretary to reject savings offered by spending Ministers on the grounds that he thinks, in contradiction to the judgment of the Minister with operational responsibility, that to do so would produce the wrong balance between capital and current expenditure in a particular programme. If the Secretary of State for the Environment and other spending Ministers responsible for the capital stock and the public services consider that the policies which are being pursued in their areas on repair maintenance and replacement are economically unsound, they should demonstrate the case for changing those policies with specific evidence that more expenditure now will avoid the need for much greater expenditure later. Any bid for additional expenditure would have to be considered alongside other bids.

10. Spending Ministers will no doubt argue in reply that the practice of dealing with expenditure programme by programme, primarily by bilateral discussion, makes it difficult for the Cabinet collectively to ensure that deserving bids for additional expenditure are given adequate priority. If a particular



spending Minister is unable to find an offsetting saving himself, he is likely to feel constrained to abandon his bid. In an ideal world it may have been more desirable in terms of the national economy that an offsetting saving should have been made in some other programme to accommodate his bid.

11. The only way of getting round this difficulty is for the relevant spending Ministers to convince not just Treasury Ministers but their colleagues collectively that some additional expenditure is desirable. If Ministers are so persuaded collectively, and if they nevertheless wish to avoid an increase in public expenditure as a whole, they each have to be prepared to make their own contributions to the savings required to offset the additional bid. The fundamental requirement remains that evidence has to be produced which would convince Ministers collectively of the need for this adjustment in expenditure priorities.

Machinery

12. If it is agreed that this is what needs to be done, the question then arises of what new machinery, if any, is required to assist the process.

13. The Secretary of State for the Environment's proposal seems to have some considerable disadvantages:

(1) The terms of reference of the proposed committee are loaded with questions to which the answer could not fail to be "more money".

(2) If the existence of the committee became known, it could become the object of a whole variety of pressures for more expenditure.

(3) The committee could itself all too easily become a lobby for higher expenditure all round, indeed an anti-Treasury lobby, arguing the case on generalities and deflecting attention away from the need for hard evidence on specific cases.

In general I doubt the value of a general review of the adequacy of the stock of infrastructure assets; each area - roads, hospitals or whatever - needs to be looked at specifically, and decisions on priorities for expenditure brought to Ministers in the context of the regular discussions on public expenditure.

14. A possible way forward would be to invite the Chief Secretary to consider how, in the context of the next Public Expenditure Survey, special examination should be made of any proposals from Departments



for cost-effective expenditure on the repair, maintenance and replacement of the public sector capital stock: and how the results of this examination might be assembled and presented to Ministers collectively within the framework of the existing Public Expenditure Survey Committee system and the PESC report. This would avoid the creation of elaborate new machinery and ensure that new work was properly integrated into existing control systems.

HANDLING

15. You will wish to ask the Chief Secretary, Treasury to introduce his memorandum. All Ministers in charge of spending Departments are likely to wish to comment: the Secretary of State for the Environment will no doubt want to develop the suggestions in his letter of 3 February; and I understand that the Secretary of State for Education and Science is likely to support them.

CONCLUSIONS

16. You will wish the Cabinet to reach conclusions on the following:

- (i) Any points arising from the new presentation of the figures for public capital spending.
- (ii) Whether it is accepted that the case for capital expenditure must be considered project by project on the basis of specific evidence put forward by individual spending Ministers.
- (iii) Whether any new machinery is required for enabling Ministers collectively better to assess specific bids for additional capital expenditure against other expenditure priorities.

approved by ROBERT ARMSTRONG
and signed in his absence.

Lindsay Wickham.

8 February 1984