

File

cc JD

18



FROM: CHIEF SECRETARY

DATE: 26 June 1984

ECON POL: Public Exp
: R27

PRIME MINISTER

1984 PUBLIC EXPENDITURE SURVEY

The first stage of the 1984 Survey has now been completed with the preparation of the Survey Report.

I am afraid that, once again, this is going to be a difficult operation. In a number of areas it will be impossible to resist additional provision; and if we are to stick to our established plans difficult decisions will be needed in reaching the required offsetting reductions.

Colleagues and I have already discussed at length the position on local authority current expenditure. We shall do all we can to hold the position, but I have to say that, in the prevailing Parliamentary climate, there is no avoiding a substantial increase here. If local authorities spend the same in real terms in 1985-86 as they plan to spend in 1984-85 they will exceed the White Paper provision by £1.5 billion (after taking account of reductions in real terms in rate-capped authorities of up to £200 million). Willie Whitelaw, Patrick Jenkin, Keith Joseph and I are to meet shortly to discuss what local authority settlement is best calculated to minimise this huge overspend. But I am sure it will require tougher targets and grant and holdback arrangements than

Patrick and my other colleagues on E(LA) have been prepared to contemplate hitherto.

There will be unavoidable increases, too, in central government expenditure. But whatever the pressures, I am clear that our objective must be to stick to our published plans, for 1985-86 and 1986-87. For the new final year of this Survey, 1987-88, we cannot prudently plan at this stage for aggregate growth of more than 3%, if we are to be sure of fixing plans we can afford and which will give some room for easing the tax burden. If we are to achieve these goals, it will be necessary during this Survey both to resist a large number of bids for extra provision and to identify new areas of saving.

We also have to consider the civil service manpower prospect. Cabinet agreed the plans announced last November on the understanding that every attempt should be made to improve on them. I believe that there is scope for significant reductions in present plans and I intend to pursue this vigorously with colleagues. I hope that we will be able to achieve a significant reduction below the 593,000 total for 1 April 1988.

We need, too, to look more rigorously at departments' running costs expenditure. Hitherto, the annual scrutiny of running costs has been essentially backward-looking; this year I am proposing that we should replace that with a forward look to 1985-86 within the overall Survey framework, so that we can take action to contain the growth of these costs.

A I attach to this minute a draft paper I would like to put to Cabinet - preferably for the 5 July meeting - setting out proposals on these issues. You will see that I have proposed, as in earlier years, that at this stage Cabinet should reach conclusions only on the overall approach and targets; and that I should then have detailed discussions bilaterally with colleagues and report back to Cabinet with my conclusions

in the autumn.

3 I am also attaching a separate draft paper about the finances of the nationalised industries. A meeting to discuss this in EA has been scheduled for 3 July. The pressures for additional provision in some areas combined with the difficulty of the Survey generally means that we will have to take a tough line with the industries this year. I am asking colleagues to agree savings below the baseline of £250m in 1985-86 of £500m in 1986-87 and of £1000m in 1987-88.

Tough as these targets are I do not think they are unrealistic. We can go a good way towards them by maintaining general pressures on the industries for greater efficiency for example by setting tough performance aims. But to meet the targets fully we shall also have to accept higher prices notably in the utilities (gas, electricity, and water). While these industries make profits, their rates of return are far below what the private sector is now earning. The current targets for electricity and water are for a return of just over 1 per cent and the target for gas of a 4 per cent return largely reflects the favourable PRT-exempt contracts in the Southern Basin.

I am not suggesting that we should return to anything like the large price increases imposed during the last Parliament. Each 1 per cent on nationalised industry prices is worth some £300m a year and the industries themselves are proposing increases below the projected level of inflation in each year of the Survey period. Quite small real increases therefore, would yield very substantial savings particularly in the later years. We cannot afford to reject this option.

10 Finally I attach a paper on contracting-out from the public sector, which I suggest should also be on the agenda for 5 July.

I would be grateful for your agreement that I should circulate these papers. The nationalised industries and contracting-out papers should I think, be circulated in the normal way.

SECRET AND PERSONAL

You may prefer, however, that the public expenditure paper be classified secret and held back until Monday 2 July, to minimise the risk of leaks over the weekend.

PR

PETER REES

SECRET AND PERSONAL

DRAFT PAPER FROM CHIEF SECRETARY TO CABINET

1984 PUBLIC EXPENDITURE SURVEY

The first stage of the 1984 Public Expenditure Survey has now been completed with the preparation of the detailed Survey Report.

2. This paper summarises the position and proposes public expenditure planning totals for the three years 1985-86 to 1987-88, together with revised manpower plans for the same period. It proposes, too, a new emphasis on the control of departments' running costs.

Expenditure Baseline

3. The starting point is the Survey baseline. For 1985-86 and 1986-87 this represents the figures in the last White Paper (Cmnd 9143) less the savings resulting from abolition of the National Insurance Surcharge (NIS). For 1987-88 it was agreed to construct the baseline by adding 2½% to the 1986-87 provision (excluding the Falklands and local authority unallocated margin). The figures are:

		£ billion
1985-86	1986-87	1987-88
131.7	136.3	139.0

Departmental Expenditure Bids and Options

4. Colleagues have put forward substantial bids for additional provision in all three years. The details are in annex A. In total, net of reduced requirements and including local authorities and nationalised industries' External Financing Limits (EFLs), the bids rise from £4½ billion in 1985-86 to £8 billion in 1987-88. That is equivalent to 3½% of the baseline in 1985-86 rising to 6% in 1987-88. Acceptance of the bids would totally undermine our achievements of the last few years in reining back the growth of public spending.

5. Colleagues have also prepared material on options for reduction equivalent to 3% of programmes in each year (although the possibilities have not, regrettably, in all cases been properly displayed or ranked in order of acceptability).

Proposals for Expenditure Totals

6. We have laid great emphasis, in the Green Paper "The next ten years" and elsewhere, on the importance of firm control of public spending and of holding to our published plans. For 1985-86 and 1986-87 that means that we must stick to the baseline. Given the bids that colleagues have put forward this will be a formidable task. But we can do no less if we are to maintain the credibility of our economic strategy, and to give ourselves some room for easing the tax burden.

7. For 1987-88 we have now to establish a planning total figure for the first time. As indicated in the Chancellor's paper on the economic prospects, there are of course uncertainties in looking three years ahead. But the overriding requirement is to set a public expenditure total we are sure we can afford.

8. One option would be to uplift the 1986-87 total by $2\frac{1}{2}\%$, as agreed for programme baselines. But I recognise that these baseline figures were intended to establish a margin to allow the adjustment of priorities between programmes.

9. I therefore propose that we should allow the planning total to increase by 3% in 1987-88, giving a figure of £140.4 billion. We could not prudently adopt a higher figure.

10. I must warn colleagues now that we will face considerable difficulties in holding public expenditure to these totals. Some of the additional bids are virtually irresistible and the options available to make room for these are limited. There is therefore little or no prospect of accommodating any other additional bids. In addition to the bids by departments our published plans are under heavy pressure from local authority expenditure, the nationalised industries, the pay increases of the Review Body groups, and ~~{reference to the EC budget}~~, and EC Budget contributions which will be higher than the stylized assumptions in Cmnd 9143.
The Reserve

11. Cmnd 9143 provided Reserves of £2.75 billion, £3.75 billion and £4.75 billion respectively for the forward years. There are already very substantial pressures on the £2.75 billion Reserve in 1984-85; for example local authority current expenditure seems likely to take up £1.8 billion - two-thirds of the total - and we have just learned that in addition, local authority capital expenditure poses a new and substantial threat to the Reserve.

12. In the light of this year's experience there is a

SECRET

strong case for now providing substantially larger Reserves for the three forward years than in Cmnd 9143. It is essential for the credibility of our control over public expenditure to ensure spending is held within the planning total. The pressures for higher spending show no sign of abating. On the other hand, the required level of Reserves depends on how tightly the system is managed. If colleagues accept that the Reserve arrangements should be operated as stringently as possible, with every possible effort to offset unavoidable increases from within programmes, then I think we could risk setting the Reserve provisions at £3 billion, £4 billion and £5 billion respectively for the forward years.

Civil Service Manpower

13. Last autumn Cabinet agreed manpower plans for the years up to 1 April 1988 on the understanding that every attempt would be made to improve on them. Departments were therefore asked in this year's Public Expenditure Survey to aim for lower manpower figures than those published in Cmnd 9143.

14. The prospect in the Survey so far for total Civil Service numbers, allowing for departmental bids and reduced requirements, is:

	<u>1.4.85</u>	<u>1.4.86</u>	<u>1.4.87</u>	<u>1.4.88</u>
Cmnd 9143	608,208	605,255	600,554	592,723
1984 Survey	<u>608,243</u>	<u>605,442</u>	<u>600,614</u>	<u>592,610</u>
	<u>+35</u>	<u>+187</u>	<u>+60</u>	<u>-113</u>

15. These figures are net of reductions of 190, 2404, 2701 and 4068, which are more than off-set by bids for additional staff. Within the totals the figures for the

SECRET

Ministry of Defence and Property Services Agency (together one-third of the total) are the same as those in Cmnd 9143 because these two departments are still further reviewing their manpower requirements and have not yet felt able to submit fresh figures.

16. As they stand the figures do not show the improvements we had hoped for. Moreover, claims already made on the contingency margin of 7,500 which we agreed last year suggest that a bigger margin will be needed to see us through to 1988. I suggest a figure of 10,000.

17. I believe there is scope for significant reductions in the figures proposed by departments. During the rest of the Survey I intend to press departments for further manpower savings. I shall be aiming to find off-setting savings for an addition of 2,500 to the contingency margin to take it to 10,000. I hope also that the reviews by the Ministry of Defence and the Property Services Agency will lead to sizeable reductions in their present planned figures, thereby producing a significant reduction below 593,000 in the 1 April 1988 manpower total. My paper on contracting out (C(84)4) proposes a more vigorous approach to contracting work out from the public to the private sector. The consequent reductions in Civil Service manpower will enable us to reduce the total still further.

Running Costs Targets

18. The annual scrutinies of departments' running costs have shown total costs increasing in each of the last five years faster than general inflation. We must ensure that the growth of these costs is contained.

SECRET

19. Departments were asked to indicate in the Survey the provision they seek for their running costs in 1985-86. There are some definitional difficulties, and the returns need careful scrutiny and checking. But these figures, which show an aggregate increase of about 3½% over the 1984-85 Estimates provision, are a welcome improvement from the larger increases of earlier years (although running costs in some departments still seem to be rising too quickly).

20. As a first step to improving our arrangements in this area, I invite colleagues to agree that the present backward-looking annual running costs scrutiny should be replaced by a forward-looking scrutiny during the Survey of the provision which Departments have now proposed for this category of expenditure in 1985-86. The agreed plans would then provide the basis for the detailed Estimates discussions during the winter.

Next Steps

21. Parallel discussions are already underway on expenditure provision for local authorities' relevant current expenditure and nationalised industries' external financing limits. We clearly need to conduct these discussions with the utmost stringency. Every addition conceded in these areas will mean increased pressures on central government programmes and will make our overall task correspondingly harder. I now propose that, as in earlier years, I should have a series of bilateral discussions with colleagues on their departmental expenditure and manpower programmes, and report back to Cabinet.

22. Against the background of this very difficult overall

SECRET

position colleagues will not be surprised if I ask them to examine very critically all the bids they have put forward. Additional spending must, wherever possible, be contained within existing programmes by re-ordering priorities. To cover those cases where additional provision for individual programmes proves inescapable, I have to emphasise that it will be essential for me to press for option reductions elsewhere.

Conclusion

23. The longer perspective of the Green Paper "The next ten years" shows how persistent and pervasive are the pressures for increased public expenditure and how difficult it will be to avoid successive upward revisions of public spending plans. Nonetheless, if we are to reap the benefits of our overall economic strategy, we must stick to our published plans.

24. I invite colleagues to agree

(i) public expenditure planning totals of £131.7 billion, £136.3 billion and £140.4 billion respectively for the three years 1985-86 to 1987-88;

(ii) the manpower contingency margin should be increased to 10,000; and, we should aim to reduce Civil Service numbers significantly below 593,000 as at 1 April 1988;

(iii) we should adopt the new approach towards controlling running costs set out in para 20 above;

(iv) I should report back to Cabinet when I have completed discussions with colleagues on individual programme and manpower allocations.

SUMMARY OF ADDITIONAL BIDS NET OF REDUCED REQUIREMENTS

	1985-86	1986-87	1987-88
1. Planning Total (cmd 9143)	132,080.0	136,680.0	
2. Baseline 1987-88 in PES Report			139,004.0
3. Agreed reductions (NIS etc (1))	-409.0	-386.0	
4. Adjustments to baseline (2)	48.3	-1.7	1.1
5. Baseline (after adjustments)	131,719.3	136,292.3	139,005.1
6. Additional bids net of reduced requirements			
Ministry of Defence	219.6	182.7	1,046.2
FCO - Overseas Development Administration	14.2	76.1	156.4
FCO - Other	36.3	55.0	60.3
<i>Net contributions to EC institutions</i>	300.0	125.0	185.0
Intervention Board for Agricultural Produce	7.6	-44.6	-69.5
Agriculture, fisheries and food	-47.5	-59.3	-63.8
Forestry Commission	-1.1	-1.7	-1.8
Department of Trade and Industry	205.3	291.0	210.3
ECGD	142.4	193.2	131.6
Department of Energy	7.6	-6.7	-5.4
Department of Employment	77.6	62.0	30.4
Department of Transport	41.0	35.0	62.0
DOE - Housing	250.0	350.0	400.0
DOE - PSA	55.3	11.9	0.8
DOE - OTHER	80.3	92.5	75.8
Home Office	43.8	44.4	67.4
Lord Chancellors Department			36.0
Department of Education and Science (3)	114.0	164.0	175.0
Office of Arts and Libraries	8.0	9.6	15.7
DHSS - Health and Personal Social Services (4)	476.0	625.3	1,078.9
DHSS - Social Security	319.4	387.7	1,515.5
Civil Superannuation	-58.5	-55.3	37.7
Scotland	4.3		
Wales	13.5	14.4	14.6
Northern Ireland			
Territorial departments: formula consequential	260.0	300.0	400.0
Chancellors' Departments	28.4	39.3	4.2
Other Departments	16.7	16.3	20.4
Local Authority current expenditure	1,500.0	1,500.0	1,500.0
Nationalised Industries external finance	892.0	1,330.0	1,315.0
7. TOTAL ADDITIONAL BIDS (NET OF REDUCED REQUIREMENTS)	4,706.2	5,626.2	8,213.7

Footnotes

1. Budget and other agreed changes.

2. Adjustments to baselines in AFF, DOE-Housing and territorials.

3. DES includes £16m, £42m, and £42m for the Switch-the Secretary of States' letter of 20 June refers.

4. DHSS Health includes bid of about £250m for 1984 NHS pay award not yet approved by the Secretary of State but expected next week.