PRIME MINISTER 21 February 1985

PUBLIC EXPENDITURE

It is said that all the easy cuts have been made. Yet all about us we see examples of waste and mismanagement.

Take the Export Credits Guarantee Department. They have at risk £32 billion. In recent years, the quality of their lending and their guarantees has deteriorated sharply, with over half now in the higher risk categories C and D. The current year deficit has risen to around £400 million, and we can only look forward to a further rise unless a tighter management grip is exerted rapidly. The deterioration in the level of provisions is set out clearly in the report and accounts, qualified by the auditors, which makes grizzly reading.

Look as well at the Nimrod programme (BBC's Panorama, 18 February 1985). A massive cost overrun has coincided with considerable difficulty in making the aircraft perform the function for which it is designed. Several hundred million pounds have already disappeared through bad management, and more may follow.

Or visit the PSA. Even under Gordon Manzie there is a lack of urgency in disposing of old property and in tightening up the management of the estate. Throughout Government, within and beyond the PSA, there may be £1 billion worth of empty or under-used property awaiting disposal, without any great urgency to do so.

Or take the nationalised industries. Yes, we have achieved some improvement in their financial performance. But this has mainly come about through allowing them large price rises, incurring the criticism that they are surrogate tax collectors. The rate of progress in improving their productivity has been disappointing. The table below examines the period 1981-84 (fiscal years).

Industry	Employment Cost Increase (Base Rates)	Price Increase
English & Welsh Water Authorities	+23.0	+38.0%
National Bus Company	+22.5%	+34.5%
British Railways Board	+25.5%	+34.5%
British Airways	+22.0%	+49.1% (rev. per passenger kilometre)
Electricity Supply Industry	+35.9% (wages & salaries cost per employee	+25.0%
National Coal Board	Not agreed	+25.0%
Retail Price Index		+21.5%

Source: HM Treasury

The real prices for rail, air and bus travellers, and water consumers, have shot up, with modest real increases for energy users. Yet, thanks partly to the coal strike and partly to managerial difficulties of British rail, we are still failing to deliver the EFLs set, and it is going to remain a struggle to get the nationalised industries into a cash-neutral position. Even BL is trying to get a Government guarantee for another £500 million. The only thing that seems to work is splitting off parts of their business and returning those to the private sector - as we have seen with Jaguar, ship-repairing, National Freight and Scott Lithgow.

Conclusion

There are things that can be done without getting us involved in highly sensitive arguments with strong interest groups. **Tighter management of the items above could save £1 billion next year.** Much of it entails stepping up the tempo of the privatisation programme to reduce Government's risks and costs. For the rest, the Treasury needs support to deliver.

Why not publish a list of properties and commercial assets where we would be open to bids or suggestions for management participation and new private capital? Why not ask for a progress report to E(A) soon?

John Redwood

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ANNEX

The problem of public expenditure and monetary growth has been building up for some time.

<u>7 November</u>: Public Expenditure Cabinet - too much laxity;

<u>20 November</u>: Policy Unit special paper on Public Expenditure - decision to set up a meeting to review 1985-86 and 1986-87 expenditure;

<u>2 January</u>: Policy Unit note on Funding position. Both Public Expenditure and Money Supply overshooting;

<u>11-24 January</u>: Michael Scholar and Policy Unit briefs on Public Expenditure and Funding, stressing need for further control;

<u>28 January</u>: Policy Unit note on the dangers of high interest rate effects on public sector finances.

<u>Controlling public expenditure rests on three things</u>:

1. **Turning down suggestions for new spending approval, which come through with too much rapidity.** To give you some idea of the orders of magnitude, the select list below illustrates the problem:

(All figures approx)

	Departmental Bid	No.10 Advice	Result
Training for jobs	£65m	£30m	£30m
New structure for teachers	c£300m	NIL	NIL
Abolition of GLC Arts budget	£50m	£35m	£50m
Children in care	NIL	-£100m	NIL
GLC and MCC savings	-£100m	-£150m	NIL
Switch to engineering and technology in HE	£55m	NIL	NIL
Local authority capital spending	£1,100m	£250m	£250m
BNOC	c£70m	£30m	c£70m
Sleipner	£2,000m pa on balance of payments	NIL	NIL
Ninth round auction bidding	NIL	-£120m	-£120m
Airbus	c£500m	0	c£250m
ECGD Frigates, Tornados, Guandong	£980m	£73m+	£560m

2. The second method is to have policy reviews. For example:

<u>Review of domestic support for agriculture</u>

Analysed options for savings of up to £290m.

No.10 view that £200m was possible.

Outturn reduction of £63m.

<u>Regional Aid</u>

Looked at options of around £300m of savings.

No.10 advice for savings of that order.

Phased savings reaching £180m.

<u>Review of territorial programmes</u>

Looked at options for around £500m of savings from Scotland.

Result: tiny savings.

	Departmental Bids	No.10 Advice	Result
GRAND TOTALS	+£3,020m	-£952m	+£840m

3. The third method is through the sale of public sector assets; reducing the amount of expenditure on servicing those assets; pocketing a receipt and reducing the risk of losses and things going wrong.

For example:

More rapid progress with energy privatisation could raise over £2bn from the gas industry; and structural change in the coal industry could cut the bill for coal industry support by many hundreds of millions of pounds next year.

Land and buildings in Local Authorities, Health Authorities, PSA and government departments. Total of £1bn+.
Slow progress.

Sell or give away component businesses of BL, BSC (outside the 3 big complexes), British Shipbuilders, to cut Government risks and give them a better chance.