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FROM: CHIEF SECRETARY
DATE: 22 April 1985

PRIME MINISTER

**PUBLIC EXPENDITURE SURVEY AND
RUNNING COSTS TARGETS**

A number of colleagues have offered comments on my proposals for the guidelines for the 1985 Public Expenditure Survey and for the control of running costs. There is, I think, general agreement that we should now proceed on the lines proposed, but it may be helpful if I respond to the points that have been raised. with
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2 Your private secretary's separate letters of 12 April indicated that you were content with the proposals. I am grateful for your specific endorsement of my proposals for the costing of options for reductions, an issue raised by Michael Heseltine.

3 Most of the detailed points raised by colleagues relate to the running costs arrangements. As my earlier paper made clear, the initiative for proposing individual Departmental targets will rest with Departments themselves, and it will obviously be necessary in the subsequent discussions in each case to take into account a range of particular factors and concerns. The points raised by, for example, Geoffrey Howe, Peter Walker and Lynda Chalker fall into this category, and can best be pursued bilaterally as the Survey proceeds.

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4 Norman Fowler raised a number of points on running costs. Some of these will also be better pursued bilaterally, for example his concern about central controls which is already under discussion between officials. On his point about parallel running of manpower controls and running cost targets up to 1988, I consider it essential that the new system must first be properly run in and shown to be effective; for that reason I think some period of parallel running is inevitable. The arrangements for publication of the running costs targets, and the way they are presented, will clearly need to be considered carefully in the light of the Survey discussions. As with other aspects of the Survey machinery it will of course be necessary annually to review the position for the later years of the Survey period, and to take account of new or unexpected developments.

5 I recognise Michael Heseltine's concern about Service pay and, although I do not think it would be right to make any separate and specific adjustment to targets on that account, this is certainly one of the range of factors to be taken into account in reaching agreement on defence running costs targets. Michael's concerns on this front highlight the more general conclusion - which I strongly endorse - that high pay awards will put strain on our running costs controls.

6 Michael Jopling expressed concern about classification changes. The intention of course in setting these targets is to compare like with like in each relevant area: so, where classification changes lead to significant changes in measured running costs these will be reflected in setting subsequent targets.

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Attached 7 Turning to the Survey guidelines, Michael Heseltine and Norman Fowler questioned the proposed 2½ per cent uplift factor for 1988-89. This factor is purely a mechanism to provide the initial baseline and starting point for subsequent Survey discussions. It does not prejudge either the size of the aggregate increase in public expenditure in 1988-89 - which will need to be decided by Cabinet later in the Survey; or the size of individual programmes in 1988-89. If, as projected in the FSBR, inflation in 1988-89 is around 3 per cent, a decision by Cabinet later in the Survey to increase aggregate public expenditure in that year by, say, 3 per cent, would leave on my proposal a margin for manoeuvre of ½ per cent to distribute between different programmes and the Reserve. I am sure that to enable realistic discussion of priorities we should retain this flexibility and stick with the 2½ per cent uplift.

8 Finally, Michael Heseltine and Grey Gowrie raised points on the new arrangements for sales of surplus land and empty housing. I can assure Michael that the only departure intended from past practice in his case is that expected receipts will need to be separately identified in the Survey. I recognise Grey Gowrie's concern about the tightness of the timetable, particularly in relation to Non-Departmental Public Bodies. I would hope it would be possible to assemble the basic background information quite quickly, but obviously common sense must prevail; if there are one or two points which are not to hand at the same time as the rest of the Survey report material, the main discussions can still proceed while these are sorted out.

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9 I think the way is now clear for the Survey guidelines to be formally promulgated, and with your agreement I will make the necessary arrangements.

10 I am sending copies of this minute to Cabinet colleagues, Sir Robin Ibbs and Sir Robert Armstrong.

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PETER REES

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