

Ref. A085/2516

PRIME MINISTER

Public Expenditure Survey 1985

(C(85) 23)

BACKGROUND

This year's White Paper on the Government's Expenditure Plans (Cmnd 9428) gave planning totals of £136.7 billion for 1986-87 and £141.5 billion for 1987-88; after the increases announced in the 1985 Budget in provision for employment and training schemes, and taking into account the £2 billion additions to the Reserve for these years announced at the same time, the baseline figures for the 1985 Public Expenditure Survey were £139 billion and £143.9 billion respectively. The baseline figure for 1988-89 was £147.1 billion; this was derived from the 1987-88 baseline by uplifting all programmes, with the exception of expenditure on the Falkland Islands, by 2½ per cent.

2. At the beginning of July the Chief Secretary, Treasury reported to the Cabinet, in his memorandum C(85) 18, that bids from Departments, net of reduced requirements, exceeded the baseline figures by £4.4 billion in 1986-87, £5.4 billion in 1987-88, and £6.6 billion in 1988-89. He proposed that the baseline figures for 1986-87 and 1987-88 should be maintained; and that the baseline for 1988-89 should be increased to £148.2 billion. This figure resulted from using an uplift factor of 3 per cent rather than 2½ per cent. The Chief Secretary also proposed that the Reserve should be £5 billion in 1986-87, £6 billion in 1987-88 and £7 billion in 1988-89.

3. The Cabinet approved these proposals; invited the Chief Secretary to pursue bilateral discussions of expenditure programmes with the Ministers responsible; and invited him to report again when he had completed those discussions (CC(85) 24th *Flag A* - Conclusions, Minute 4).

Flag B - 4. In his memorandum C(85) 23 the Chief Secretary reports on the current position. Although the detailed figures have not yet settled down, the general picture is clear enough. Even on the assumption that the objective agreed by E(A) on 17 July (E(A)(85) 14th Meeting) of keeping nationalised industry External Financing Limits at baseline for 1986-87, and reducing them below baseline by £250 million and £150 million in the two following years, is achieved - and the Chief Secretary says that he is still some way from this - agreed changes and outstanding bids from Departments amount to about £3 billion in 1986-87, £4.9 billion in 1987-88, and £5.3 billion in 1988-89. Although a number of substantial programmes have been agreed, there remain outstanding particularly large additional bids for defence, housing, health, and social security. In addition to these programmes where major policy issues are at stake, substantial increased bids have had to be accepted on a number of programmes where spending is determined by the prospect for inflation, interest rates and agricultural prices - the principal such programmes are social security, export credits and agricultural support.

5. The Chief Secretary proposes that a small Ministerial Group, on the lines of the Ministerial Group on Public Expenditure (MISC 106) last year, should be established with a remit to eliminate as much as possible of the excesses.

6. A particular question which arises on this year's Survey concerns the control of "running costs". Expenditure on the Civil Service has hitherto been controlled by means of manpower ceilings, and the provision in annual Estimates has been set by the application of a "pay factor" applied to agreed manpower

numbers. The resulting figures have not, however, constituted firm cash limits. Departments have been able in effect to transfer money from programme expenditure to meet the additional costs resulting from the fact that annual pay settlements have generally exceeded the pay factor by 1-2 per cent. It is now intended that in future - in accordance with the spirit of the FMI - Civil Service running costs should be controlled by means of overall cash limits, with Departments no longer held to specific manpower targets (although the existing targets up to 1988 would remain in force). There would no longer be any generally prescribed pay factor, and each Department's running costs total would operate as a separate limit. Departments would not normally be permitted to transfer money from their programmes to meet excess running costs.

7. Although this form of running costs control was generally agreed by Cabinet in July, some Ministers have subsequently expressed doubts about its operation (see for example the minute to you of 16 September from the Secretary of State for Scotland). Concern has been expressed that different Departments might make different assumptions about future pay increases for the Civil Service, which could prove embarrassing given the fact that pay is centrally negotiated by the Treasury. Treasury Ministers' line is that it is better to avoid specifying a single pay factor; sticking to last year's 3 per cent would hardly be consistent with a world in which the Government were seen to be promising the Civil Service a pay settlement not lower than the lower quartile of private sector settlements (as agreed by MISC 66 on 27 September) - but any higher figure would give quite the wrong signals about the Government's overall objectives for further reducing the rate of inflation, as well as serving as a target which union negotiators would seek to beat. The only alternative would be to go back to the present system, and reinstate both a low pay factor (ie 3 per cent) and rigid manpower controls; and spending Ministers would have at the same

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time to accept lower figures for running costs than they have agreed in their recent bilateral discussions with the Chief Secretary.

MAIN ISSUES

8. The issues requiring resolution at this stage are:

(i) the arrangements for securing decisions in this year's Public Expenditure Survey; and

(ii) the control of running costs.

Decisions on programmes

9. It will be at least as difficult as in previous years to secure decisions on the individual programmes consistent with the previously announced totals. The task of Lord Whitelaw's Group (which you discussed with him and Treasury Ministers on 30 September) will therefore once more be very difficult. But the excesses are comparable with those with which the Government has had to deal in previous years, and once the scope for reductions has been exhausted, there presumably remains the possibility of securing some additional receipts from the sale of public sector assets, as well as some scope for further allocation to programmes of funds from the Reserve. Treasury Ministers will not, however, wish to give any hint of such possibilities at this stage, especially since the figures for sales of assets are already at the top end of the range and the Reserve was increased by £2 billion in each year in the 1985 Budget.

10. On this occasion, therefore, any extended discussion of the totals or of the figures for the individual programmes would not be helpful. You have already agreed the establishment of Lord Whitelaw's Group (Mr Norgrove's minute of 1 October recording its

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composition is attached for ease of reference), and those involved have already been approached informally. It would also be preferable (and consistent with past practice) to avoid telling the Cabinet who are to be the members, as this is your decision and not theirs.

Running costs

11. The background to the decision has been summarised above. The Chief Secretary will not seek any extended discussion of this subject, although he will be ready to respond if arguments are made in favour of a common pay factor, or for the maintenance of the current position. The Chief Secretary appears to have accepted that it will not be possible to avoid some overall increase in Civil Service running costs, as compared with the 1985-86 Estimates provision, of 6½-7 per cent. This seems a disappointingly high figure. But some ½ per cent is due to increases in staff numbers in areas where extra revenue secured or public expenditure saved can be expected to outweigh the costs of the additional staff employed (an example is firmer control of claims for unemployment benefit); and a further 1 per cent of the increase is accounted for by the fact that the 1985 pay settlement at 4.9 per cent could only be financed by the transfer of funds from programme expenditures. Thus the overall running costs increase allows on average for a pay settlement next year of the order of 4½-5 per cent, the minimum realistic allowance within a binding total for a pay settlement not below the lower quartile of private sector settlements. The new form of the controls will mean that somewhat less detail is given to Parliament in the Estimates, in that sub-heads confined to pay expenditures will no longer be given; Treasury Ministers are sounding out the Chairman of the Treasury Select Committee on these new arrangements. Despite the fears of the Secretary of State for Scotland, it should in practice be possible for spending Ministers to refuse to answer questions about pay assumptions, on the basis that there are a number of variables

also to be considered - including staff numbers, grading, and a whole range of other housekeeping expenditures, each of which could be varied to some degree even in the short run depending on the outcome of next year's pay negotiations.

HANDLING

12. You will wish to make clear at the start that this is not the occasion for any extended discussion of the overall public expenditure totals, or of the figures for individual programmes. You might then invite the Chief Secretary, Treasury briefly to report whether there are any last-minute developments since his memorandum, and its attached table, was prepared. He could at the same time refer briefly to the question of running costs, although without specifically inviting substantive discussion. Once the position on running costs has been clarified, you might announce your decision to set up a Ministerial Group under the chairmanship of the Lord President of the Council. You will wish to emphasise to your colleagues the importance of sticking to the public expenditure totals agreed in July, and of doing their utmost to assist the work of the Lord President's Group, which will necessarily take a very tough line on the unresolved issues referred to it. A speaking note on these lines is attached to this brief.

CONCLUSIONS

13. You will wish the Cabinet to record conclusions:

- (i) reaffirming their July decision to move to a system of running costs control of expenditure on the Civil Service, and

(ii) endorsing the establishment of Lord Whitelaw's Group to review outstanding differences between the Treasury and spending Departments and to make recommendations on how they should be resolved.

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ROBERT ARMSTRONG

2 October 1985

To close the
discussion

SECRET

SPEAKING NOTE ON SETTING UP THE "STAR CHAMBER"

In the light of the Chief Secretary's Report, and of our discussion, I have again decided to invite the Lord President to be the Chairman of a small Group of Ministers to consider and report to the Cabinet on the outstanding expenditure issues arising from the Survey.

2. This follows the practice of last year and previous years. But I am sure that colleagues will appreciate that, given the size of the outstanding problems, the Group will this year need to consider individual programmes with the utmost rigour and severity to ensure that they are brought into line with the overall expenditure totals which we have collectively agreed and to which we are publicly committed. It is vitally important to the Government to show that we are keeping public expenditure under firm control. So we must be prepared to take the decisions needed to stick to our cash plans.

3. I earnestly hope, therefore, that colleagues whose programmes have not yet been agreed will rigorously reappraise their bids so that they are settled in the Group in a manner consistent with the overall public expenditure decisions we have already taken.

4. There has, of course, already been extensive speculation in the press about the establishment of a "Star Chamber". I see no objection to confirming, in response to any enquiries, that, as in the course of previous public expenditure surveys, a small group of Ministers has been set up to consider and report to the Cabinet on issues arising from this year's Survey. But it is most important that no further information on our discussions to date, or on the subsequent discussions in the Ministerial Group, should be given to the media. Previous experience shows how damaging and divisive such leaks can be. It is also particularly important that no details should be disclosed at next week's Party Conference and no commitments entered into that would in any way prejudice our public expenditure discussions.

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