

Ref. A085/2846

PRIME MINISTER

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Public Expenditure Survey 1985

(C(85) 26)

BACKGROUND

Flag A At their meeting on 11 July the Cabinet decided that the public expenditure planning totals should be £139.1 billion for 1986-87, £143.9 billion for 1987-88 and £148.2 billion for 1988-89 (CC(85) 25th Conclusions, Minute 4). Since then there have been extensive bilateral discussions between the Chief Secretary, Treasury and spending Ministers and, more recently, in the Ministerial Group on Public Expenditure (MISC 120) under the chairmanship of the Lord President of the Council.

Flag B 2. The results are summarised in the memorandum by the Lord President (C(85) 26). As that paper shows, agreement has so far been reached with spending Ministers on all the programmes except housing. On this basis, the overall changes, compared with the Survey baseline and hence to the planning totals, are summarised in the following table. (All figures in this minute, unless otherwise indicated, are in £ million.)

## SECRET

	£ million		
	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
Agreed by Chief Secretary	+1,179	+1,608	+1,157
Local authority current expenditures (see paragraph 6h.)	+646	+359	-323
Changes in asset sales, the Reserve, and the 1988-89 planning total	-3,500	-2,500	-2,377
Agreed recommendations by MISC 120	+1,750	+664	+1,506
Net excess over planning totals	+51	+112	-51
Additional bids by the Secretary of State for the Environment, plus territorial consequentials	+819	+1,163	+1,072

It now seems likely that agreement may be reached in the course of today on housing, which would add £197 million to the baseline in the first year, £177 million in the second year, and £157 million in the last year. I will arrange to let you have separate briefing on the latest developments on this, and the Lord President will report orally at Cabinet tomorrow.

3. In broad terms, subject to the outcome on housing, there is a small gap to be bridged in each of 1986-87 and 1987-88. For 1988-89, the figures are slightly in credit, after taking credit for the addition of another £0.5 billion to the planning total proposed by the Chief Secretary at the beginning of the MISC 120

discussions. If the Secretary of State for the Environment's proposals for the housing programme were accepted, the excesses would be £0.8 billion, £1.3 billion and £1.0 billion for the three Survey years. These figures take no account of the further changes to be made to the social security figures resulting from the latest assessment of the takeup of benefits and from changes in the assumptions about the level of unemployment, which seem likely to add £0.3 billion, £0.5 billion and £0.5 billion respectively to the planning totals in the three Survey years.

#### MAIN ISSUES

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

a. Are the recommendations agreed between MISC 120 (or the Chief Secretary) and spending Ministers acceptable?

b. Subject to the Lord President's report, what changes should be made to existing provision for housing?

c. In the light of the conclusions on a. and b. above, is the outcome of the 1985 Public Expenditure Survey satisfactory? What is to be done to bridge any remaining gaps between the recommendations in C(85) 26 and the planning totals?

(d) Announcements.

#### Agreed programmes

5. The recommendations agreed between MISC 120 and the spending Ministers are set out in Annexes C to K of C(85) 26; in addition, Annex B gives brief details of changes agreed bilaterally between the Chief Secretary, Treasury and spending Ministers.

6. Items which seem most likely to attract comments and questions from members of the Cabinet are as follows:

a. Defence. The baseline is unchanged for the first two Survey years, so requiring the Secretary of State for Defence to absorb the costs of pay settlements and equipment cost increases higher than the provision for inflation. For the last year, the Secretary of State for Defence has agreed also to absorb £192 million for the costs of the Falklands operations within the previous Falklands-exclusive baseline figure. Given the projections for the GDP deflator, the figures imply real reductions in aggregate provision for defence of about 2 per cent in each year; part of this decline reflects the fact that the costs of the Falklands operations are themselves declining; excluding the Falklands, real defence provision is projected to decline by about 1 per cent of each of the first two Survey years, and 2 per cent in the third year. This position reflects MISC 120's judgment about the priorities to be attached to the different expenditure programmes, and also the increasing scope for efficiency savings on defence procurement.

b. Aid. Although the Cabinet paper does not say so in so many words, the agreement with the Foreign and Commonwealth Secretary provides for a flat total aid programme in real terms throughout the period. Within this total there will be rising provision for multilateral aid and ATP, which means that there will be some continuing real reduction in United Kingdom bilateral aid programmes. In presenting the figures the Ministers concerned will no doubt wish to concentrate on the aggregate for the programme as a whole.

c. Education and Science. The Secretary of State for Education and Science has agreed a settlement which falls well short of his bids on the universities, science and

school building. It is possible that the Lord President's Ministerial Group on R & D priorities (MISC 119) may recommend some changes at the margin which might further help the Secretary of State for Education and Science, but the position on this is not yet clear. There also remains a problem of financing the "switch" in higher education towards science and technology in the third year. The transfers from other programmes to finance it in 1986-87 and 1987-88 were not carried forward into the third Survey year, since the assistance was intended to be transitional; but the Secretary of State for Education and Science does not consider that higher education institutions will be able to carry the burden within existing provision from 1988-89 because of the continuing high costs of necessary redundancies/early retirements among arts and social science staff. If the switch cannot be financed in any other way, the money will have to come from local authority capital.

d. Arts and Libraries. This small programme has attracted a disproportionate amount of attention, not least because of the effect of the abolition of the GLC and the Metropolitan Counties. The settlement agreed with the Minister for the Arts gives for 1986-87 a total Grant to the Arts Council only a few million pounds short of the figures for which Sir William Rees-Mogg has been pressing in discussion with Ministers. For the later years, the settlement assumes that efforts by the Arts Council and the performing companies to secure replacement funding from the successor authorities will be more successful.

e. Health Service. MISC 120 has been relatively generous to the health service but, without a greater effort, it is doubtful whether the NHS hospitals will be able to deliver sufficient efficiency savings to absorb both the impact of this year's pay increases for nurses and the continuing demographic increase in the burdens on the service. For

1988-89, the settlement presupposes some restriction of the coverage of the present exemptions from prescription charges.

f. Social Security. Given that MISC 111 has not yet completed its work, it should be possible to avoid any detailed discussion of social security. But Ministers will need to be aware of the further postponement of the promised abolition of the retirement pensioners' earnings rule, and of the proposed further restrictions on single payments which may well prove highly controversial. The savings arising from requiring employers to take over payment of maternity allowance on the same basis as Statutory Sick Pay will be offset in PSBR terms by a reduction in employers' National Insurance contributions. The provisional figure to be shown in the Autumn Statement for 1988-89 represents some rounding down of the total projected by the Secretary of State for Social Services after allowing for the agreed savings.

g. Water. The MISC 120 recommendations, which involve no change to baseline, take into account the fact that the water industry should be able to finance in 1986-87 the increase in investment previously planned, on the basis of an increase in domestic water charges of about 8 per cent or slightly less (1 per cent less for other consumers). This represents some relaxation of the demanding programme agreed last year by E(NI) for improvements in the industry's return on assets; but there may still be resistance to the required increase in charges by some water authorities. The prospect of early privatisation may, however, make it possible for Ministers to defuse much of this opposition.

h. Local Authority Current Expenditure. The Rate Support Grant figures for 1986-87 have been agreed in E(LA), but some overspend in relation to the agreed figures is

inevitable. Thereafter it has not proved possible to set any "realistic figures". Showing rising expenditure in cash terms would on the one hand be taken as a challenge to local authorities to increase their overspend, while at the same time it would risk appearing not to give enough to meet the requirements of Government policy, eg on the police or the restructuring of teachers' pay. The solution adopted is to put in constant figures in cash terms, and increase the size of the Reserve. The fact that the figures for 1987-88 and 1988-89 are purely conventional, and that further (unspecified) provision will in due course be found from the Reserve, will be made clear in the Autumn Statement.

#### Housing

7. The arguments on the disagreement between MISC 120 and the Secretary of State for the Environment were covered in the separate brief submitted on 5 November by Mr Unwin. As noted above, discussion is still in train in an attempt to reach an agreement, and separate briefing will be provided.

#### Scotland

8. A different sort of difficulty arises in the case of Scotland, as is explained in C(85) 26. MISC 120 do not recommend that further savings should be sought in this public expenditure round from the Secretary of State for Scotland. They believe, nonetheless, that an equitable evaluation of priorities would result in substantial reduction in the Scottish block - the evidence is clear that Scotland is over-provided relative to the rest of the United Kingdom. Making changes would, however, be politically a very difficult issue; and unless the Government are willing to confront it Ministers cannot overtly acknowledge the present Scottish over-provision. If such acknowledgment were ever to be made it would clearly be essential for this to be based on indisputable up-to-date evidence, and for that reason

MISC 120 recommend that a fresh needs assessment should be made covering the whole United Kingdom, whose results could be taken into account in future public expenditure rounds. This assessment would be made on a confidential basis within the Government, but Ministers would have available to them, in the event of its becoming public knowledge, the defence that it was not looking specifically at any one part of the United Kingdom, but was intended to reassess the position of every part of the country in the light of the major structural economic changes of the last decade.

#### Outcome of the 1985 Survey

9. Even if the recommendations of MISC 120 are accepted as they stand, there will remain excesses over the agreed planning totals. To these excesses will need to be added, before the Chancellor of the Exchequer's Autumn Statement, the impact of changes to the social security figures, which as explained above will substantially increase the problem of bridging the gap. I understand that the Chancellor of the Exchequer has indicated in discussion with you that he is looking to bridge the gap through further changes in receipts from asset sales and in the Reserve; he will no doubt wish to make this clear to the Cabinet.

#### Announcements

10. Unless the Cabinet judge that the outcome of the 1985 Survey is unsatisfactory, the results will be reflected in the Autumn Statement which the Chancellor of the Exchequer intends to publish on Tuesday 12 November; further details will appear in due course in the mid-1986 Public Expenditure White Paper. As is noted in C(85) 26, the Chancellor intends publishing summary figures for each programme for all three Survey years in next week's Autumn Statement; in the past only the first year's figures have been given. This fuller publication responds to substantial Parliamentary pressure, and should make it possible



for the Government's decisions about each programme to be presented in a more effective and coherent way. In previous years details about the second and third years have tended to leak out piecemeal, making the task of overall presentation much more difficult. The fuller publication may also have the incidental effect of partially compensating the Treasury Committee for the loss of information about projected revenue in the year immediately ahead and the scope for a fiscal adjustment in the next Spring Budget, which the Chancellor had decided to exclude from this year's Autumn Statement. We know of no particular difficulties created for individual Ministers by the publication of three years' figures rather than only one as hitherto; any problems presented by the figures would, of course, have to be coped with in any event before long, when the full White Paper is published early next year.

11. You will also wish to settle a form of words to be used in reply to questions from the media that are bound to follow immediately on tomorrow's Cabinet. Any mention of housing will require particular care.

#### HANDLING

12. You may find it convenient to divide the discussion into the following parts:

- a. general situation and agreed programmes, including Scotland;
- b. housing;
- c. outcome of the Survey and announcements.

13. The discussion of the general situation could be opened by the Lord President of the Council introducing his memorandum and reporting the position on housing. You could then ask the Chief

Secretary, Treasury whether he wishes to add any comments. This part of the discussion will then offer an opportunity to members of the Cabinet to question any of the agreed recommendations from MISC 120, or features of the bilateral agreements between the Chief Secretary, Treasury and spending Ministers, though you will not wish to encourage the reopening of agreements.

14. The final part of the discussion could be introduced by the Chancellor of the Exchequer who could give an outline of the general economic situation and the main likely features of the Autumn Statement. He would also be able to explain how the conclusions of the Cabinet on the 1985 Survey fitted into the Statement.

#### CONCLUSIONS

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

- a. Are the recommendations agreed between MISC 120 and the spending Ministers concerned, and summarised in paragraphs 7-21 of C(85) 26, together with the Lord President's recommendations on housing, endorsed?
- b. Should a fresh needs assessment be undertaken on a confidential basis within the Government, to serve as a basis for the allocation of future public provision to the different parts of the United Kingdom?
- c. In the light of the conclusion of a., is the outcome of the 1985 Public Expenditure Survey satisfactory?

d. If so, the main features of the Survey will be reflected in the Autumn Statement, with further details given in the 1986 Public Expenditure White Paper. What guidance should be given in reply to immediate inquiries from the media?

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ROBERT ARMSTRONG

6 November 1985