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Treasury Chambers, Parliament Street, SW1P 3AG

P R C Gray Esq
10 Downing Street
LONDON SW1

27 October 1988

Note
~~Discussed~~
Pauld various comments to
Treasury, which were incorporated in
the subsequent draft.

Dear Paul

REC
28/10

CHIEF SECRETARY'S PAPER FOR PUBLIC EXPENDITURE CABINET

I attach a draft of the paper which the Chief Secretary would intend to put to Cabinet for their discussion of public expenditure on 1 November. Subject to any comments which the Prime Minister may have, the Chief Secretary would like to send the paper to the Cabinet Office tomorrow (Friday) for circulation on the first run on Monday morning.

Yours ever
Cairns

MISS C EVANS
Private Secretary

SECRET

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C(88)

28 October 1988

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CABINET

1988 PUBLIC EXPENDITURE SURVEY

Memorandum by the Chief Secretary, HM Treasury

At its meeting in July, Cabinet set the objectives of keeping as close as possible to the existing planning totals, and of ensuring that public spending as a proportion of national income continued to fall over the three Survey years from the level already reached.

Report on the Bilaterals

2. I have conducted bilateral discussions with colleagues against that background. The starting point was that Cabinet had agreed in July to add £1.7 billion to provision for local authority current expenditure in 1989-90. Subsequently, figures were agreed for the later two years, leading to additions of:

	(£ billion)		
	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	1.7	2.0	2.2

In addition, further expenditure in the Survey years was committed as a result of previous decisions on the 1988 health Review Body awards, and on changes to the new social security regime. There were also increases necessary to meet new forecasts of our net payments to the EC. These three items amounted in total to a further £1.4 billion, £1.6 billion, and £1.2 billion in the three Survey years. Apart from these items of agreed additional expenditure, I was also faced with substantial additional bids on a large number of programmes, so that the total additions sought amounted to:-

8.7	13.2	18.7
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adding CA work

In the course of bilateral discussions, additions to programmes have been agreed of about half these amounts:

3.5 6.8 11.3

I am grateful to colleagues for the reductions in their bids and the savings that they have agreed to provide.

3. Details of the settlements are at Annex A. These include large additions that were unavoidable (eg estimating changes on social security) as well as those increases that were already committed. But in addition to these, we have been able to agree substantial discretionary increases in priority services. These increases have been made possible by savings arising from the success of our policies in reducing unemployment, encouraging Right to Buy, restraining expenditure under the Common Agricultural Policy, and continuing to improve the performance of the nationalised industries. The Government's sound fiscal policy has also reduced the burden of debt interest.

4. At Cabinet the Chancellor will set out the level of Reserves which he believes will be required, and, in the light of this, he will then put proposals to colleagues on the planning totals to be adopted for the next three years.

Capital Spending

9.051

5. The new plans include extra provision for capital investment amounting to some £2½ billion in both 1989-90 and 1990-91. This includes increases for housing, hospitals, and prison and road building. It also includes additional investment by the water authorities on anti-pollution measures; by British Rail on service improvements; and by LRT and CAA on safety measures.

Science and Technology

6. The bilateral discussions on science and technology reflected the objectives agreed earlier by E(ST). I have agreed additions to DES spending on science and technology which amount to at least £120 million a year. This expenditure is partially offset by savings in areas of lesser priority within the Energy, Agriculture, and Trade and Industry programmes.

C

Running Costs and Manpower

7. The settlements are within the agreed objective of keeping the running costs share of the planning total roughly constant, though next January's White Paper will show a higher increase in 1989-90 than in previous years, and a manpower increase of 11,000 over present levels to a planned 591,000 in 1990-91.

8. We need to ensure that our record on Civil Service costs and size remains defensible over the Parliament. To this end it is helpful that most colleagues have now agreed three year cash settlements that are only to be reopened where significant and essential developments make adjustments necessary. I hope to reach similar agreements with all remaining departments during next year's Survey.

1988-89 outturn

9. The estimated outturn for the planning total in 1988-89 is £153.6 billion, £3.3 billion below the plans in the last Public Expenditure White Paper. A number of additions have already been made to programmes during the current year, including the increase of over £1 billion in health expenditure. These increases have been offset by higher privatisation proceeds, higher than expected local authorities and new towns receipts (exceeding the overspend on local authority capital expenditure), and lower social security expenditure resulting from the fall in unemployment.

Conclusions

10. I invite colleagues:

(a) to endorse the agreements I have reached on individual programmes;

(b) to endorse the conclusions on running costs in paragraphs 7-8 above;

(c) to note the estimated outturn for 1988-89.

JOHN MAJOR

SECRET AND PERSONAL

ANNEX A
CMO UNTIL 31/12/1988SUMMARY OF AGREED PROGRAMMES

1988 SURVEY OUTCOME: ADDITIONS TO BASELINE

£million

	1989-90	1990-91	1991-92
Ministry of Defence	161	610	1,024
FCO - Diplomatic, Information, Culture	26	48	71
FCO - Overseas Development Administration	33	76	101
European Communities	500	630	230
Intervention Board for Agricultural Produce	-421	-396	-268
Ministry of Agriculture, Fisheries and Food	14	8	5
Forestry Commission	9	12	14
Department of Trade and Industry	72	79	-72
Export Credits Guarantee Department	56	27	-34
Department of Energy	34	-16	-93
Department of Employment	-205	-305	-405
Department of Transport	324	398	406
DOE - Housing	-1,284	-1,002	-734
DOE - Other Environmental Services	75	-71	-64
Home Office	246	354	324
Legal departments	34	61	106
Department of Education and Science	363	405	370
Office of Arts and Libraries	4	2	20
Department of Health	1,256	1,477	1,896
Department of Social Security	-157	1,626	3,685
Scotland	171	254	348
Wales	177	180	202
Northern Ireland	136	185	270
Chancellor's Departments	35	90	193
Other Departments	39	56	100
DOE - Property Services Agency	28	16	-29
Nationalised Industries	-171	-272	-440
Privatisation EFLS	167	259	1,814
Local Authority Relevant	1,715	1,968	2,196
TOTAL ADDITIONS TO PROGRAMMES	3,498	6,812	11,258

SUMMARY OF AGREED PROGRAMMES

CMO UNTIL 31/12/1988

£ million

	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
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<u>Defence</u>	+ 161	+ 610	+ 1024
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The additions recognise the pressure on the programme and, on the basis of current inflation forecasts, result in a real increase in expenditure over the period 1988-89 to 1991-92. The additions represent a firm three year agreement that will only be reopened in agreed exceptional circumstances.

<u>FCO (diplomatic wing)</u>	+ 26	+ 48	+ 71
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Increases for scholarships and exchanges, running costs, BBC External services grant, security measures and new technology are offset in part by favourable overseas price movements and savings on broadcast relay stations.

<u>ODA</u>	+ 33	+ 76	+ 101
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For the aid programme, the increases provide for the expected costs of the sub-Saharan debt initiative, and for the UK's contribution to the IMF ESAF; the settlement also provides additions to bilateral aid including ATP soft loans. On superannuation, provision is made for war service credit for former colonial servants.

<u>EC Contributions</u>	+ 500	+ 630	+ 230
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The White Paper figures were necessarily based on the artificial assumption that the EC 1.4% VAT contribution would be maintained. The new figures reflect the effect of the new arrangements for the financing of the Community, and other factors such as the increased import duties paid to the Community as a result of the buoyancy of UK exports.

IBAP - 421 - 396 - 268

The reductions are due to revised forecasts of the impact of CAP reform measures, of the size of UK harvests and (in 1989-90) of the effect of the American drought on world agricultural prices. The projections make allowance for future devaluation of the Green Pound.

Other agriculture + 14 + 8 + 5

Increases for running costs, flood prevention, and other programmes are offset in part by estimating and policy reductions in capital grants, and by savings from increased funding by industry of R and D and ADAS.

Forestry + 9 + 12 + 14

Increases mainly reflect higher planting grants following the removal of tax relief in the 1988 Budget. Forestry Commission disposals programme has been increased and will be subject to a policy review.

DTI + 72 + 79 - 72

There are increases in provision for Regional Development Grants as a result of a surge in applications before closure of the scheme; for Shipbuilding Intervention Fund Support; and for relocation plans. The reduced requirement in 1991-92 results from the run down of existing launch aid commitments.

ECCGD + 56 + 27 - 34

The changes reflect new economic assumptions.

Energy + 34 - 16 - 93

The changes result mainly from decisions on nuclear R&D programmes, notably to run down the fast reactor and fusion programmes, which generate redundancy and restructuring costs as well as savings. Further estimating savings arise on the Redundant Mineworkers Payments Scheme. In the two later years the reductions also reflect the transfer of nuclear safety research to HSC/HSE.

Employment - 205 - 305 - 405

Savings result from the rapid fall in unemployment and from the declining number of school leavers. This has enabled substantial savings to be made on the Youth Training Scheme, while still meeting the Government's guarantee. ~~A reduction has also been possible in adult training expenditure, though Employment Training remains a £1.4 billion programme.~~ There is increased provision for stricter benefit administration.

There is the addition - Reducing Fund, EAS, and other things together.

Transport + 324 + 398 + 406

The increases are primarily for construction and maintenance of national roads and bridges, reflecting increased construction prices, continuing traffic growth and the extension of VAT to new construction work. There are also smaller increases for local authority roads and airports.

Environment - 1208 - 1071 - 799

Increased projections of receipts from council house and other sales will yield some £4 billion over the three years. There are additions to gross capital spending on housing, of around £450 million a year. Plans include increased spending by the Housing Corporation on new homes for rent and by local authorities on renovation of their own stock through Estate Action. There are also additions for the Urban block and for the costs of preparation for the Community Charge.

PSA + 28 + 16 - 29

A combination of higher receipts from disposals and net rents and modest additions to the net baseline in 1989-90 and 1990-91 will enable the PSA to meet foreseeable requirements for major works, to continue to reduce the maintenance backlog and to invest in improved management structures, working towards full payment and untying in 1990 and Trading Fund status by 1993.

Home Office + 246 + 354 + 324

There are increases for prison building and prison manpower, and smaller increases for a range of non-prisons spending, partly offset by higher local authority capital receipts and a number of other savings measures.

Lord Chancellor's Department
and other legal + 34 + 61 + 106

There are increases for legal aid, running costs, and court building; for the Serious Fraud Office; and for the Crown Prosecution Service, particularly in 1991-92.

Education + 363 + 405 + 370

The agreed additions provide for an increase of some 16 per cent in the Science budget between 1988-89 and 1989-90; put the polytechnics and colleges on a sound footing for their new, independent status; allow the value of student awards to be maintained; and provide for sufficient capital allocations to allow local education authorities in England to continue a programme of school improvements.

Arts and Libraries + 4 + 2 + 20

The settlement rolls forward the three-year programme agreed in the 1987 survey (with increases in the new third year, for example for incentive funding); and provides for the construction programme for the British Library, St Pancras project.

Health and Personal Social Services + 1256 + 1477 + 1896

The settlement represents the largest increase ever made available for the NHS. It provides for the increased salary costs resulting from the nurses' grading review and the 1988 Review Body pay awards. It also provides resources for service growth and to correct health authorities' accumulated revenue deficits. Provision has also been made to meet forthcoming Whitley pay settlements, the growing cost of AIDS treatment, and increased capital spending. Health authorities will also benefit from new cost improvement programmes and a reduction (of £277 million) in employers' superannuation contributions, bringing the total extra resources for the NHS in England alone to £1³/₄ billion in 1989-90 and over £2 billion in 1990-91.

<u>Social Security</u>	- 158	+ 1626	+ 3685
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Lower unemployment has led to considerable savings on this programme, amounting to over £1½ billion in 1989-90. This saving has been offset in 1989-90 by increases elsewhere, notably a large rise in the estimated cost of disability benefits. In the later years these increases greatly exceed the savings from lower unemployment. Child benefit has been frozen as last year, and more help has been provided for poorer families.

Territorial Departments

Scotland	+168	+254	+348
Wales	+177	+180	+202
Northern Ireland	+136	+185	+269

The settlements for Scotland, Wales and Northern Ireland reflect broadly the normal working of the territorial block formula. They also include sums for regional development outside the blocks and special additions made in respect of the recent ECJ ruling on VAT.

<u>Customs and Excise</u>	+ 16	+ 29	+ 59
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The additions provide for the costs of increasing workloads, net of cumulative efficiency savings of about 2½ per cent a year, and for the funding of an approved major computer project for the handling of import and export freight.

<u>Inland Revenue</u>	+ 48	+ 61	+ 66
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Increases provide for the introduction of Independent Taxation. There are partial offsets from reductions in forecast costs of life assurance premium relief and mortgage interest rate relief to non-taxpayers.

<u>Nationalised industries</u>	-	4	-	13	+ 1373
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Cabinet's remit to keep total nationalised industry provision to baseline or less is fulfilled in years 1 and 2. The whole of the additional provision in year 3 is accounted for by the loss of electricity industry's substantial negative EFLs after privatisation. Settlement provides for increased capital investment in water industry to meet EC and domestic requirements, partially offset by price increases of 9.8 per cent. Large increases in London Regional Transport (LRT) to finance investment are more than offset by reductions from baseline in other transport industries. LRT fares will rise by about 12 per cent and British Rail fares by 9.4 per cent. Electricity prices will rise around 6 per cent in 1989-90.

<u>Local authority relevant</u>	+1,715	+1,968	+2,196
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Ministers agreed in July to make provision for relevant public expenditure in 1989-90 by local authorities in Great Britain which implies substantial increases over baseline. Figures for later years are broadly the same in real terms as the provision agreed for 1989-90.

PUBLIC EXPENDITURE

Negotiations are now virtually complete. Aiming for announcement next Tuesday. Key elements of the outcome are:

- Planning total in current year, 1988/89, likely to be significantly under-spent. As a result, public expenditure/GDP ratio will fall to 40 per cent or slightly less - lowest figure for 20 years.
- Revised plans for 1989/90 will be held within existing planning total of £167 billion. Some £3¹/₄ billion will be added to the existing plans for 1990/91, with a revised total of £179¹/₂ billion for that year.
- New plans imply a further modest fall in public expenditure/GDP ratio, to around 39 per cent by 1991/92. Annual real growth in public spending over this period, will average 1¹/₄ per cent.
- Unchanged planning total for 1989/90 a highly satisfactory outcome. Have found extra resources for priority programmes partly by normal process of allocating money from the Reserve as plans are rolled forward. But also from stimulating extra local authority housing receipts (£1¹/₄ billion net), achieving savings in agricultural support (£400 million), and reduced spending on employment measures (£200 million).
- Major increases agreed for 1989/90 include health (£1¹/₄ billion), local authority current spending (£1³/₄ billion), estimated EC contributions (£500 million), education and science (£360 million), transport (£320 million), law and order (£280 million) and defence (£100 million).
- Most controversial decision likely to be freeze on child benefit. But nearly £¹/₂ billion savings will go on extra help for low income families.