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1989 PUBLIC EXPENDITURE SURVEY: NORTHERN IRELAND

Purpose

1. The purpose of this letter is to set out my proposals, covering both PES and DRC, for the 1989 Public Expenditure Survey. The letter covers five main areas:
 - (a) my review of PES priorities in the Northern Ireland Block;
 - (b) details of a bid for electricity generation which you agreed to consider sympathetically in your letter of 16 September 1988;
 - (c) other PES issues which we may need to consider in the Survey;

- (d) some observations on the operation of Comparability in the 1989 Survey; and
 - (e) DRC requirements within the NI Block.
2. Consistent with agreed practice, this letter does not detail proposed PES reallocations within the Block since I cannot sensibly consider them until the picture on resource availability, largely determined by Comparability clarifies in September/October.

Review of Priorities

3. The procedures for handling the Survey in Northern Ireland are familiar to you from previous correspondence. Thus what follows reflects my consideration of public expenditure strategy and priorities at the outset of the NI Survey. The determination of this strategic approach creates the framework for continuing scrutiny of NI programmes by DFP, and for the decisions on specific allocations which I will be making at the conclusion of the Survey.

Law and Order

4. I have, as you would expect, retained law and order as the highest public expenditure priority within the Block. The continuance of terrorist violence means that the police need substantial resources and there seems little prospect of radically reducing activity levels during the Survey period. However law and order expenditure has taken up an increasing proportion of the NI Block excluding Social Security Benefits (rising from under 14% in 1984/85 to over 16% in 1989/90), and the squeeze which this has put on other Northern Ireland programmes remains a concern to me and a focus of criticism within the Province. Recently the Northern Ireland Economic

Council commented adversely on this trend, and I will have to maintain a difficult balance between the pressures from the law and order sector and the very real needs of other programmes.

Strengthening the Economy

5. Since 1987 the objective of strengthening the economy (ie giving priority to programmes which contribute to economic growth) has been my second strategic target. This objective remains critical since per capita GDP in Northern Ireland is only 77% of the national average and unemployment remains substantially higher, at over 15%, than even the worst affected region of Great Britain (North of England, 11%). Given the comparative weakness of the region's economy, and the relatively low level of private sector employment, the need for expenditure to promote self-sustaining economic growth continues to be of great importance in Northern Ireland. In this context both the IDB and LEDU have recently scored significant successes, but even with nearly 11,000 job promotions in 1988/89, the combination of economic and demographic factors mean that major programmes to strengthen the economy must be maintained and developed if we are to stimulate productive employment and hold NI unemployment even to current levels, which are so far above the UK average.

6. The return of Harland and Wolff and Shorts to private sector ownership is consistent with this strategic priority and should reduce the dependence of the industrial sector in Northern Ireland on public funds, although in the short term the employment implications may well be adverse. I am most grateful for the help and co-operation you have given on these difficult issues over recent months.

Other Considerations

7. Aside from these two main priorities, there remain disproportionately high levels of unmet need in other sectors in Northern Ireland, and I have to consider how to address these problems within the resources available. As well as high unemployment, Northern Ireland still has substantially poorer housing conditions (8.4% unfitness in 1987) than elsewhere (though both public and private sector efforts have made a considerable impact on this in recent years).

8. Nor has the upturn in the Northern Ireland economy been as strong as in the other parts of the UK. I may, therefore, need to continue to fund for example the Action for Community Employment and Job Training Programme measures at or above current levels, whereas the declining requirements in some other regions will produce savings. YTP requirements are affected by the difference in demographic trends in Northern Ireland as distinct from Great Britain. The overall pattern is that, whereas there are now shortages of young people entering employment in Great Britain (and a number of measures have been already introduced to begin to counteract this), the relevant age groups in Northern Ireland are not contracting to the same degree as in Great Britain and this has major implications for my labour market programmes in particular.

9. Another important factor which impacts on NI priorities, and certainly on PE requirements within the Block, is policy development at the national level. Major new policies, such as Education and NHS Reforms, require a response here if Government's approach to these sectors is to be consistent. While clearly there is some scope for local variation of detail and of timetables, such initiatives do create significant and largely inescapable claims on Block resources. I have to finance these developments against a

position where there is a relatively larger school population in Northern Ireland and higher levels of morbidity.

10. On a smaller scale I will be seeking to build on the measures I initiated last year to reduce community division. The intention will be to shape policies and public expenditure allocations in ways which improve community relations and thus contribute to tackling one of the fundamental problems facing the Province.

11. Overall I hope to accommodate the various needs and pressures within the resources made available through the Comparability system, subject to its operation not being affected by distortions such as that which necessitated the special supplement in the 1988 Survey. However the various requirements outlined above do create substantial pressures and necessitate difficult decisions. Constraints on the health and housing programmes in the last two Surveys, and the relative under-provision in labour market services, provide clear recent examples of this. In the current Survey, the present indications are that bids from Departments (excluding Kilroot II and Shorts) exceed likely available resources by some £145m rising to £215m over the Survey period. Consequently it is not possible for the Block to finance certain major structural problems in whole or in part without quite unacceptable consequences for mainstream public services. It is for this reason that I am compelled to raise certain issues which I am confident you will agree should be outside the scope of the Comparability system. These are described below.

Electricity Generation

12. In your letter of 16 September 1988, following E(A) consideration of future electricity generation in NI, you agreed to consider sympathetically a bid for the construction

of Kilroot II as a dual capacity oil/coal fuelled plant. I now wish to lodge that bid. It is not necessary to restate here the full case for this proposal, since it was fully explored last year. There has been, however, one important development in this context. When we corresponded on electricity generation last year, I referred to the possible need for a Flue Gas Desulphurisation facility to be incorporated in the Kilroot II project. We have examined this in some considerable depth, not least because of the substantial PE implications. You will readily appreciate that, although FGD at Kilroot II is a Northern Ireland expenditure proposal, the need for it arises from broader consideration of UK environmental policy rather than a particular NI requirement. At the end of the day, therefore, the decisive factor in our consideration was Government's increasingly clear and public commitment to environmental protection, and the difficulty of reconciling that commitment with proceeding with what will in effect be a major new power station not incorporating this technology. I have, therefore, concluded that I must add FGD to my bid for Kilroot II.

13. Some other complex and important decisions in the electricity sector will need to be made, for instance on future tariff policy, and on the timetable and arrangements for electricity privatisation. Notwithstanding this, I believe that it is essential to settle the PE aspects of Kilroot II in the current Survey because, to achieve the commissioning of Kilroot II by October 1996 (as envisaged last year), we need to start work in 1990/91. Any implications for PE provision of these matters can be taken into account as appropriate when the relevant policy and other considerations become clearer, hopefully during this Survey.

14. The amount of my 1989 Survey bid for Kilroot II itself is:

1990/91	1991/92	1992/93
£7.3m	£13.2m	£57.2m

These figures reflect the repricing of the profile of expenditure discussed last year, consistent with commissioning in October 1996, and some other changes which are explained in detail in my officials' letter. The profile of expenditure beyond the 1989 Survey period is currently estimated at:

1993/94	1994/95	1995/96
£75.1m	£65.3m	£27.2m

15. The addition of FGD increases costs as indicated below:

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	£m
KII	7.3	13.2	57.2	75.1	65.3	27.2	
FGD	2.0	23.0	31.0	26.0	10.0	-	
Total	9.3	36.2	88.2	101.1	75.3	27.2	

I should emphasise that because of the complexity of integrating the Kilroot II and FGD projects, the above phasing may be subject to considerable change, and indeed the total PE requirement might need to be revised somewhat. My officials will keep in touch with yours as the costings firm up.

Shorts

16. As you know from the progress of negotiations on the disposal of Shorts (and in particular my letter of 22 May), it is now to be expected that some of the cost to Government will fall in 1990/91 and later. The quantum and phasing remain uncertain, but the costs during the Survey period are likely to be significant. I will, as you requested in your 23 May letter, quantify these as soon as possible. I would hope that, as in 1988/89 and 1989/90, you will be able to agree that this pressure is exceptional and unmanageable and should not be a call on NI Block resources. I wish, therefore, to lodge a bid, over Comparability, for the full costs of the Shorts disposal in the Survey, including the sales financing arrangements. It has always been our first preference to seek to achieve a clean break by a satisfactory disposal of the sales financing subsidiaries, and the costs of such a disposal would clearly be an unmanageable pressure on the Block. If disposal does not prove possible, I would find it difficult to accept that the related contingent liabilities should be a call on the Block in the first instance. But we can look at this in more detail, as you suggest, when the available options have been identified and the financial implications assessed.

Harland and Wolff

17. When we considered the resource implications of the Harland and Wolff disposal in March, I drew attention to a likely pressure of some £11m on my Block in 1990/91, but undertook to use my best endeavours to cover it. This, of course, remains my intention but I will wish to assess, once the resource position is clearer, probably in September, whether I can in fact do so. Should the pressures seem unmanageable at that point I may have to come to you before the Survey ends to discuss a possible Block increase, over

Comparability, to cover this pressure. I shall avoid doing so if at all possible. In March you also indicated that you would consider sympathetically any Survey bid necessitated by an overrun on the BP SWOPS contract. I will only need to bid in respect of overrun costs arising after the point of sales and in accordance with the formula set out in the sale agreement.

Local Authority Expenditure and Comparability

18. Consequent on the introduction of the New Planning Total, this Survey will be the first in which the new arrangements in respect of Comparability on the local authority sector will apply. While I am satisfied in principle with the GRE-based Comparability system which has been agreed for the 1989 Survey, I must reiterate that we are expecting that it will provide a more realistic and fairer basis for LA-related Comparability than has been the case in the past. I am reassured that your officials have indicated to mine that much greater realism will be evident in the construction of LA figures in this Survey. I have asked my officials to keep this very closely under review, since it could have a critical impact on the yield from Comparability and on my ability to resource the pressures which I face.

EC Water and Sewerage Directives

19. Finally on the PES front, I would draw your attention to an issue with some unusual features. A major pressure for me in the 1989 Survey is the need to bring standards of water supply and sewerage services into line with the EC directives. I have received bids for some £33m and £34m in 1991/92 and 1992/93 respectively and I understand that similar annual investment will be required for a number of years beyond the Survey period. Additional revenue would be raised in NI on account of this, through the regional rate,

but under the normal rules that cannot be used to offset the additional public expenditure. In England and Wales the cost of complying with the EC directives will be reflected in the privatised water authorities' charges to the consumer but, by contrast, will not impact on PE plans. With the very different structure of Government in NI, the Water Service is embedded in the Department of the Environment for NI, and with our best endeavours, it will inevitably take some considerable time to bring it to a state where privatisation could take place. I suggest that our officials should consider the most equitable way forward on this, in light of developing circumstances.

Departmental Running Costs

20. Turning to running costs, I attach an Executive Summary of the Management Efficiency Plans prepared by departments within the NI Block. I am seeking DRC provision of:

	1990/91	1991/92	1992/93	£m
Provision sought	584.2	612.8	634.9	
Block Baseline	577.6	605.5	620.6	
Bids over baseline	6.6	7.3	14.3	

21. These bids reflect my review of the plans underlying the 1988 Block MEP in the light of:

- (a) major new, mainly parity, additions to workload, including the NHS White Paper, the 1991 Census, General Revaluation and Salmonella Monitoring; and
- (b) forecast inflation which has been revised upwards (the implications for my requirements to be reviewed in the light of emerging information);

(c) a limited number of new NI initiatives, including increased staffing for the ARU and additional staff to detect Social Security fraud as recommended in a recent Efficiency Unit Scrutiny Report.

22. I have been able to find efficiency savings, in excess of the required minimum 1.5% per annum, which in total now represent some 2.2%, 1.7% and 1.3% of the provision sought. I am, however, unable to contain all of the new pressures within the baselines agreed last year. This partly reflects the fact that some of the new requirements simply could not have been foreseen or quantified in 1988, since the policy decisions which give rise to the requirements had not been made. Despite the newly emerging requirements, my DRC Block bid is pitched at just above forecast inflation (as it affects DRC) in 1990/91 and below forecast inflation in the later years (reflecting, for instance, anticipated savings from Opstrat).
23. The NI Block figures above do not take account of proposed DRC transfers from DSS of £6.1m, £8.8m and £8.8m (subject to confirmation), to cover the costs of certain Social Security work which DHSS(NI) is to undertake as agent of DSS. This is, of course, merely a transfer and should result in a net saving insofar as NI has been chosen because of costs, recruitment and retention factors.
24. The DRC provision I am seeking represents a taut assessment of my requirements. My NIO Ministerial colleagues were asked to scrutinise carefully the bids made by their Departments to ensure that they were tightly drawn. Following scrutiny of bids by DFP I have made further reductions of £1.5m, £1.6m and £1.7m. I have done this despite the implications for service delivery, in order to constrain DRC growth and its claim on Block PES resources. The submitted bids take account of a framework of priorities described in the Block Executive Summary. They have been framed against the

background of a slightly slower rate of DRC growth in NI compared to GB Departments (excluding MOD) and significantly lower unit costs in NI. Taken together these broad indicators confirm that relatively strong downward pressure has been exercised on administrative costs over recent years. My DRC bids are, therefore, the minimum which I realistically require and will entail difficult choices and decisions if I am to manage the various services for which I am responsible within the proposed baselines.

25. The Block Executive Summary gives details of how these bids have been derived. Also attached is the Management Efficiency Plan specific to the Northern Ireland Office. Your officials are aware that the requirements for the NI Prison Service, the provision for which was ring-fenced in the 1988 Survey settlement, pending further consideration, take no account of the "Way Forward" proposals (to replace "Fresh Start"), as these have yet to be agreed with the POA(NI). I have some grounds for optimism that "The Way Forward", if accepted, will result in additional savings which would have the effect of further reducing my DRC bids in the survey period. It may, therefore, be necessary to revise the Prison figurework and my officials will keep in touch with yours on this. For the time being, therefore, the Block Summary continues to show Prisons as a separate component of the Block figures.

Conclusion

26. I hope you will recognise that I am continuing to make the best use of the PES resources available in the NI Block in the face of very real and substantial pressures, and am constraining DRC increases where this is consistent with workload pressures. I am determined to keep up the pressure to achieve value for money in all NI programmes. I have referred above, by way of illustration, to significant

constraints on housing, health and labour market provision and to the requirements of law and order, the economy, health and education. Against that background I will only be able to contend with these pressures if the costs of electricity generation and Shorts are covered in full by way of additional resources over and above whatever Comparability makes available for other purposes. I am confident that, following your officials' comprehensive and in-depth scrutiny of my Block in the 1988 Survey, you will be reassured that I cannot absorb such substantial pressures. I look forward to a constructive dialogue on the various issues set out above.

27. I am copying this to the Prime Minister and Sir Robin Butler.

TK