

CONFIDENTIAL

From: SIR PETER MIDDLETON  
Date: 5 October 1984

CHIEF SECRETARY

cc Chancellor  
Mr Bailey  
Mr A Wilson  
Mr Anson  
Mr Byatt  
Miss Brown  
Mr Spackman  
Mr Willis

VALUE FOR MONEY

"If you intend to have any limit put on expenditure, it is high time that you should be on your guard against efficiency ..... In the mouth of a Minister who wants to find excuses for a great increase in public burdens, it is a plea that ought not to be admitted without a great deal of carefulness".

W E Gladstone

I see that Robin Ibbs has written to you about taking forward his ideas on value for money on public expenditure. He and the Treasury ought in our view to be strong natural allies in keeping down expenditure and getting value for money. But as you know we are apprehensive about the effects of his activities. Perhaps I could explain why.

2. Robin Ibbs is planning to have a further round of talks with departmental Ministers later this year, both to review performance against the targets which he discussed with them for this year, and to ask what targets the Ministers propose



to set for next year. Such targets will also be on the agenda of the Prime Minister's seminars with individual Ministers; I gather that a further 4 - 6 seminars are planned for the coming year. It is good that he is offering to talk to you about the way in which he should set about this. But we need to make sure that there is a real meeting of minds before he begins.

3. As I understand Government policy, controlling public expenditure and rolling back the frontiers of the state are prime objects of policy. This means containing and indeed reversing the pressure to seek increased expenditure.

4. Value for money is also important. First the efficient use of expenditure is an element in the Government's attempt to improve the supply side of the economy. Second we need savings from increased efficiency in order to have any chance of meeting the Government's overall expenditure objectives.

5. If therefore we are talking about better value from a reduced amount of money, there would be no need for argument. The whole of the Government's central organisation would be devoted to searching for the savings necessary to reduce expenditure. It would be trying simultaneously to contain the growth of public sector output and providing this at minimum cost. Control of public expenditure and value for money are not separate subjects. They are aspects of the same thing. And they must be made to support each other.

6. It is here where Ibbs could be a danger to us. He sees that public expenditure control is unpopular. So he tries to divorce value for money from it. The Cabinet Office to which he is attached support him in this for reasons about which I am not clear. This is bound to produce a weakening in the forces of the centre because their energies are dissipated in treating two related things as though they are separate.

7. This situation is positively dangerous if the two forces pull in opposite directions. This happens very easily. Any spending department would prefer something called value for money to reducing expenditure if it thought there was a chance that



they could be regarded as alternatives. But Ibbs believes that only can only really provide incentives to managers to be efficient if those concerned can keep some of the efficiency gains to increase their particular bit of output. Whatever one thinks of this as a piece of psychology - and I come back to that in a minute - as a piece of arithmetic it is not likely to result in either much rolling back of the frontiers of the state or a more efficient allocation of resources within a fixed cash total.

8. The net result of this approach is to provide departments with an argument to use against the Treasury. Expenditure control can be made to look like an arbitrary process which cuts across another elaborately conceived set of targets. Public expenditure control is hard enough already without having to put up with this. It is for Ministers to judge their priorities as a collective matter. 'Incentives' cannot be adduced as a reason for not doing this. Whatever the result it is the job of management to achieve maximum value for money. They cannot be allowed to argue that they will not do this if they do not have the 'incentive' of increased output because Ministers have decided that some other programme should have priority.

9. Furthermore, Robin Ibbs is inclined to talk about changing the Civil Service culture in a general sort of way which seems superficially attractive. And this Government does, I have always believed, want to bring about a cultural change. But the Government is not like ICI, trying to increase its market share. It is trying to do exactly the reverse.

10. The cultural change which you want to effect is to encourage spending departments to believe that reducing expenditure is a great virtue, that their efforts should be bent in this direction and that contributing to such a reduction by efficient management would be a double virtue. I assume that this is still Treasury Ministers' objective. If so, it must be accepted that value for money targets are part of the expenditure control process - not something which the expenditure control process threatens and



which causes Ministers to withdraw co-operation (see the second paragraph of Ibbs' letter which shows that he has still not digested the message in the Chancellor's letter of 4 July following your dinner in June). Indeed it was this sort of thinking and advice which led to the Treasury being excluded from the Prime Minister's value for money seminars even though value for money is an integral Treasury responsibility. These seminars constitute a prime example of a lost opportunity.

11. This does not mean that there is no place for soundly conceived proposals to "spend to save", or, for example, to allow spending authorities to spend part or all of the receipts if they exceed their planned level of asset sales. This kind of incentive was not ruled out in the Chancellor's letter of 4 July, but the scope for it - as he pointed out - is limited by the overall public expenditure constraint.

12. Moreover, in a more general way, we often say that a department wishing to increase expenditure in-year on one particular service must find off-setting reductions within its programme. In this way a department can often divert extra efficiency savings to some purpose of its own choosing. But its ability to do this cannot be absolute - and certainly not if the Reserve already looks likely to be exceeded.

13. I cannot believe that Ibbs, as a businessman, does not share the Treasury's desire to reduce the tax burden on industry and the citizen. Greater efficiency is one way of facilitating this. So the Treasury and the Efficiency Unit are basically on the same side. I hope that a real effort can be made to persuade Ibbs to see this, and that we shall both be less effective if either sees the other as a threat. The Chancellor's letter of 4 July offered a basis for this co-operation which I hope he could fully accept. In practice this means:

- (a) The Survey must continue to set public expenditure totals and allocations which the country can afford and which are consistent with the Government's objective of reducing the tax burden. Performance targets must not be framed in such a way as to hinder this process.



- (b) Once such departmental allocations have been made, they should be allocated to line managers in such a way that the department's total expenditure does not exceed its allocation. This means having an adequate departmental reserve and/or flexibility to deal with contingencies.
- (c) Performance targets should be expressed in terms of better ratios of output to input, rather than in terms of absolute levels of output, which would risk putting upward pressure on cash allocations.
- (d) Where a department succeeds in getting more than expected in a year from a given amount of cash, it may well in practice (short of some July crisis) be able to improve some other departmental service.
- (e) But it cannot then expect to have a prescriptive right to that benefit in perpetuity. The whole purpose of an annual survey is to enable Ministers to decide their priority between that department, or some other department, or reducing taxation. One cannot allow incentives to create a permanent distortion in such priorities. And in present circumstances, the Treasury is bound to press the case for lower taxation, and hence lower overall spending. If others were equally seized of the need for this, without needing incentives to seek efficiency, we could have a more rational debate of this whole subject.

14. Sorry about a rather long minute, but I want to get this right. The organisation of the centre to deal with efficiency matters and the indeterminate role of the MPO is a matter to which I will return after a little further consultation.



P E MIDDLETON



*Personal*



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Sir Peter Middleton KCB  
Permanent Secretary

18/10.

Dear Robin,

If you would like a little background to the arguments which led to the PM's meeting yesterday - and which were largely resolved out of court - you might like to glance at the attached minute.

Yours ever,  
Peter





*C. S. P. Henderson*  
*M. Bailey*  
*M. Ridley*

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4 July 1984

Sir Robin Ibbs  
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 LONDON  
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*J. H.* *R. B.*

Many thanks for organising a delicious and very useful dinner last Monday. I know that Peter Rees and Barney Hayhoe were as pleased as I was to have the opportunity to discuss so many important issues. There were three topics in particular where I think we established a clear line ahead.

First, it is clear that all our efforts to improve value for money must take place in the context of Government policy. The Government has a clear policy to reduce the burden of public expenditure and get taxation down to reasonable levels. Until we have achieved that, we need to do all we can to ensure that increased efficiency shows up in lower expenditure. We cannot afford changes in financial management which become a means of institutionlising present levels of expenditure, and then try to console ourselves that public sector output has risen.

This does not of course mean that we should let up in any way in our efforts to improve the measurement of output, which I strongly support. Nor does it mean that there will not be instances where some of the efficiency gains can be retained by the department making them. Indeed, this probably already happens quite extensively. But in present circumstances I am sure that all our efforts must be devoted to securing the maximum possible efficiency savings as one of the key means of reducing public expenditure.

Second, we went over the implications of moving progressively to a target for running costs. I think we were all agreed that to do so would be desirable. Manpower targets are a less rational (and more emotive) overriding goal, running costs fit well with new initiatives to encourage contracting out, and this shift would permit us to phase out the pay factor. But we agreed equally that this change would require a gradual shift of emphasis, much better data, and that it would be right to continue to monitor staff numbers even if they were to lose their target status.

Third, we discussed the Prime Minister's seminars. We confirmed that the Efficiency Unit would consult Treasury officials in advance of each to take account of ideas we might have about fruitful avenues to pursue, and that the Unit would de-brief the Treasury afterwards.





As Peter and I mentioned, we shall be preparing in earnest in August for Peter's September bilaterals with the spending Ministers. Any further ideas you may have about issues we could raise then will be most welcome.

*Yours  
Nigel*

NIGEL LAWSON