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1987 PUBLIC EXPENDITURE SURVEY

Memorandum by the Chief Secretary, Treasury

INTRODUCTION

Our policy is to bring public spending down progressively as a proportion of national income. Over the past four years we have succeeded in achieving this. Even excluding privatisation proceeds, general government expenditure (the combined spending of central and local Government) has fallen from 47 per cent of Gross Domestic Product (GDP) in 1982-83 to 44 per cent in 1986-87, and there will be a further fall in this share in 1987-88 - though it will still be higher than it was in 1978-79. Our progress over the last few years has enabled us to combine a steady but controlled growth of public expenditure in real terms with a reduction in borrowing and, in each of the last five Budgets, a reduction in taxes. This restraint in public spending has made possible the strong performance of the economy which the Chancellor has described in his memorandum (C(87) 13).

2. In our Election Manifesto we pledged ourselves to continue the policy of ensuring that public spending takes a steadily smaller share of our national income. This is essential if we are both to maintain the momentum of our economic performance and to deliver our Manifesto pledge to reduce the burden of taxation.

3. For this year's Survey we have set baseline totals for spending of £154.2 billion in 1988-89, £161.5 billion in 1989-90 and £165.5 billion in 1990-91. For the first two years this was done by retaining the planning totals set out in last year's Public Expenditure White Paper and for the third year we have used an uplift factor of 2½ per cent.

4. Departments were then asked to review their programmes within their baseline figures and to put proposals to me where they felt, after a review of priorities, that additional resources were required. In my minute of 17 July to the Prime Minister, I summarised the bids received from Departments.

OBJECTIVES FOR THE SURVEY

5. I have to make it clear to colleagues that bids on this scale are far beyond what can be afforded. If anything like this were accepted we could

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not make the further progress in reducing public spending a a proportion of GDP we have set ourselves. This would not only may our objectives for taxation unattainable, it would also trigger a complete reappraisal of the Government's financial standing in the markets, and provide a severe setback to the economic progress we have made. We must keep as close as possible to the existing planning totals and must not in any circumstances exceed the share of GDP in the White Paper.

6. With the time lost as a result of the Election, it has not been possible to analyse the bids as thoroughly as normal. There are major uncertainties in a number of areas which I will want to probe further, eg the large estimating changes for social security and the projections of our contributions to the European Community. But it is clear that to hold to our policy on public spending we will have to face up to difficult decisions in a number of areas. Bids will have to be significantly scaled back and, to the greatest extent possible, policy savings found to offset.

DEPARTMENTAL RUNNING COSTS

7. Colleagues have sought increases in their Departments' running costs implying overall cash increases of 8 per cent for 1988-89 over 1987-88 with further increases in later years. The associated manpower projections reverse the downward trend we have achieved, implying a 15,000 increase over published plans for 1988-89. Increases on this scale are clearly unacceptable.

8. In the last few years, the increases in spending on departmental costs agreed for each first Survey year have exceeded our aims. In many cases the figures for the later years have not been set at realistic levels and as a result have had to be increased further in later Surveys. We need to agree a realistic method for planning provisions over the Survey period so that Departments have a reasonably reliable basis for making medium-term plans to improve efficiency.

9. My proposals, set out more fully in the annex, are that:

i. The running costs share of total public spending should not rise over the Survey period. This implies that running costs would grow on average in line with our plans for public expenditure generally, ie by about 1 per cent a year in real terms, though individual Departments would, of course, have no entitlement to such an increase.

ii. Cost and other pressures will need to be met to a large extent by efficiency gains of at least 1½ per cent a year in the use of all resources including manpower. These will need to be planned well in advance and Departments should have contingency plans for larger improvements in case they are necessary.

iii. Departments should prepare management plans to deliver these gains over the full Survey period. In any case where the plans are not suitably ambitious, or are unrealistic, I would hold over agreement on the later Survey years until the next Survey.

iv. For 1988-89, the aim should be to reduce the overall increase in provision sought by at least half.

NATIONALISED INDUSTRIES

10. In the 1987 Investment and Financing Review, the nationalised industries' own initial and unamended bids, made in May, exceed the baseline by £0.9 billion in the first year and £1.2 billion in the two subsequent years. These bids are clearly unrealistic and cannot be afforded. They now need to be scrutinised rigorously, and a number of industries are revising their proposals so that we will have a sounder basis for judging them. Apart from the electricity industries in England and Wales and in Scotland, I propose that our aim should be to reduce the provision at least to baseline and, where we can in the case of individual industries below it. Failure to achieve this would mean greater pressure on departmental programmes. There are particular problems relating to the electricity industry this year, notably the need to set new financial targets, the implications of privatisation and assessment of a new power station programme. Notwithstanding these uncertainties, the pressure on public expenditure means that it is essential to appraise the industries' bids critically and to set challenging financial targets.

LOCAL AUTHORITY RELEVANT PUBLIC EXPENDITURE

11. It has been agreed in the Ministerial Steering Committee on Economic Strategy, Sub-Committee on Local Authority Expenditure that provision for relevant public expenditure in England should be set at £27,969 million (£27,538 million for relevant current expenditure and £431 million for Rate Fund Contributions to Housing Revenue Accounts). This is an increase of £819 million above the White Paper baseline. Aggregate Exchequer Grant in England is to be set at £13,775 million, an increase of £750 million ($5\frac{3}{4}$ per cent) on the 1987-88 settlement figure including teachers' pay. I have reached agreement on the settlement for Wales and discussions on Scotland are continuing. But it is likely that, for Great Britain as a whole, the increase in provision for local authority relevant public expenditure will be around £1 billion over the previous plans. This is a substantial addition and we must recognise that it will severely limit what can be made available for other programmes.

CONCLUSIONS

12. I ask Cabinet -

1. To reaffirm the Manifesto policy of ensuring that public spending takes a steadily smaller share of our national income; and to agree that the level of public expenditure is held as close as possible to the existing planning totals and that its share of national income does not exceed the path in last year's White Paper.
2. To note that to secure the policy objective at i. bids will have to be substantially cut back and difficult decisions will have to be faced in a number of policy areas.

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3. To agree that we should aim to hold the external financing limits of the nationalised industries other than electricity at least to baseline and possibly below; and that we should seek to keep the electricity industries' external finance as low as possible.
 4. For running costs, to agree the proposals set out in paragraph 9 and in the Annex.
 5. To agree that I should now conduct bilaterals with colleagues on their spending programmes.

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Treasury Chambers

21 July 1987

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1987 PUBLIC EXPENDITURE SURVEY: DEPARTMENTAL RUNNING COSTS

Departmental Ministers have sought increased provision for running costs totalling £761 million for 1988-89, £956 million for 1989-90 and £1,203 million for 1990-91.

2. We cannot accept increases of this size. They would mean that overall expenditure on running costs would rise by 8 per cent in cash and 4 per cent in real terms between 1987-88 and 1988-89, with further real increases in the later years. They would also imply an increase in Civil Service manpower of nearly 15,000 over the manpower plan of 583,000 for 1 April 1989 published in this year's public expenditure White Paper and further increases in later years, though some 5,000 of this rise stems from increases agreed after the last Survey.

3. There are undoubted pressures on running costs. In spite of large manpower reductions (135,000 since 1979 and 50,000 since 1983) and, in most years, Civil Service pay settlements at or below general inflation, running costs have continued to rise in real terms as a result of increases in non-manpower costs (eg more buying-in of services rather than providing them internally) and changes in grading mix. Tight pay settlements will continue to be the aim. But if departments are to recruit and retain the staff they need and the Government's objective of making the Civil Service pay structure more conducive to an efficient service and more responsive to labour market conditions is to be met, future pay offers cannot be expected to be immune from pay movements in the economy generally.

4. It is thus realistic to provide for some rise in overall spending on running costs; but the Manifesto pledge to press ahead with management reforms to improve public services and reduce their cost, as well as the aim of ensuring that public expenditure takes a steadily smaller share of national income, mean that the rise must be contained to well below the levels sought.

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5. I propose we that we should base our plans on the firm constraint that the share of running costs in total public spending should not rise over the Survey period. This implies that overall running costs must grow no faster than our plans for public expenditure generally, ie by about 1 per cent a year in real terms. If increases in the volume of activity are to be met in some parts of the Civil Service, there must be reductions or lower rates of growth in others where demand is less or of lower priority.

6. To achieve this overall objective, colleagues' running costs bids will need to be substantially scaled down, to less than half the additions to baseline that have been sought for 1988-89; and all departments will need firm plans to offset pay bill and other cost pressures through sustained and incremental efficiency gains. The improved budgetary and management systems stemming from the financial management drive of recent years, the Government's large and continuing investment in new technology, and further improvements in purchasing as well as the continuing processes of scrutiny and inspection must be used to deliver further improvement in performance, benefiting both input costs and outputs. On the input side, further improvements in the use of manpower and better control of non-manpower costs will be essential.

7. These efficiency gains will be easier to make on the necessary scale if they are planned well in advance; and if the plans are ambitious there will be greater scope for flexibility in future years. I propose that all departments should now prepare or revise management plans committing them, over the Survey period, to the delivery of defined and wherever possible measured improvements in outputs, and progressive overall efficiency gains of at least 1½ per cent a year, with contingency plans for larger improvements in case they are necessary. This is a reasonable minimum target for well managed service organisations. These plans will be especially important for departments with large executive operations.

8. Departments' plans, and their implications for restraining growth in running costs would be discussed in the bilaterals.

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Agreement to increases over baseline, particularly for the later years, would be withheld until plans for efficiency gains of at least 1½ per cent a year were demonstrated in a departmental management plan. Departments would be expected to deliver these plans.

Civil Service manpower

9. Earlier this year it was announced that manpower targets would not be set after 1 April 1988, and pressure on Civil Service numbers would be maintained through running costs. The proposed approach to running costs will mean large reductions in the manpower projections of some departments. It is important to show that the running costs regime is an effective control on all Civil Service resources, including manpower. There will otherwise be pressure to reintroduce manpower targets.

Conclusions

10. I invite Cabinet to agree that:

i. the objective should be to restrain running costs over the Survey period to their present share in total public spending by offsetting so far as possible any real rises in pay and other costs through efficiency gains;

ii. departments should prepare or revise three-year management plans for sustained output and cost improvement, for discussion in the bilaterals;

iii. for 1988-89 the aim should be a reduction by at least half of the £761 million additional provision sought in order to keep the overall increase in running costs in line with the medium-term objective in (i) above.