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CABINET

1987 PUBLIC EXPENDITURE SURVEY

Memorandum by the Chief Secretary, Treasury

REPORT ON THE BILATERALS

At its meeting in July, Cabinet set itself the twin objectives of holding the level of public expenditure as close as possible to the existing planning totals and of ensuring that its share of national income, without allowing for privatisation proceeds, continued on a declining path, keeping within the percentages in last year's White Paper.

2. I have conducted bilateral discussions with colleagues against that background.

3. The starting point was that Cabinet had agreed in July to add £1 billion to provision for local authority current expenditure in 1988-89. Subsequently figures were agreed for the later two years, leading to additions of:

	£ billion		
	1988-89	1989-90	1990-91
	1.0	1.3	1.5

I was faced with further additional bids on the remaining programmes of:

	7.0	9.6	12.3
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In the course of bilateral discussions additions to programmes have been agreed of almost exactly half these amounts:

	3.6	4.8	6.2
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A large part of these increases were unavoidable; this was true, for example, of the very large estimating changes for expenditure on social security benefits, and also of EC contributions. Others were already committed, eg Launch Aid, the carry through of the Review Body pay awards in the National Health Service and the decision on compensation for income support claimants of cost of 20 per cent rates contribution. But the settlements also involved some difficult policy changes. Details are set out in Annex A.

4. Thus total additions to programmes, including local authority current expenditure, are:

	4.6	6.1	7.7
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compared with the Reserves which have been published for the first two years of:

	5.5	7.5	-
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leaving uncommitted only:

	0.9	1.4	-
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The sums which thus remain in the Reserves fall far short of those published in this year's White Paper and are manifestly inadequate.

5. 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 increased planning totals to be adopted for the next three years.

RUNNING COSTS AND MANPOWER

6. Running cost provision, though within the programme totals given in the Autumn Statement, is not separately identified until publication of the Public Expenditure White Paper.

7. Cabinet agreed in July that I should aim to keep roughly constant the share of running costs in total public expenditure, and seek to reduce by at least half the bids for 1988-89 (then £760 million, since increased to some £800 million by late bids). We also agreed that firm provision for the later years should depend on the preparation by all Departments of management plans committing them to annual and progressive efficiency gains equal at least to 1½ per cent of their running cost expenditure. Where these plans could not be prepared or agreed in time, settlement of the later years should be held over until the 1988 Survey.

8. For 1988-89, I have reached settlements involving additions to baseline of some £560 million. This is higher than the target which I proposed in July but close to the objective of constraining running costs to their present share of the planning total. For the later years, I have agreed firm provision for ten Departments on the basis of suitable management plans. Others are committed to developing plans which will provide a basis for similar agreements in next year's Survey.

9. Civil Service manpower for April 1988 will remain close to the last published figure of 594,000. Present indications are that numbers will fall to some 590,000 in 1988 and will remain roughly stable thereafter.

SCIENCE AND TECHNOLOGY

10. Following the Government's response to the House of Lords Committee in July which said that decisions on science and technology spending would be reported in the Public Expenditure White Paper, arrangements have been

made to monitor the position during the Survey. The net addition to provision for science and technology spending is currently of the order of £230/£270/£200 million in the three Survey years. This results in large part from the agreement to provide Launch Aid for Airbus and the additions for universities and the Research Councils within the education programme. The figures could change slightly as a result of the Department of Trade and Industry's review of innovation policy. Overall it is likely that spending on civil science and technology spending (including technology transfer) will grow by $7\frac{1}{2}/3\frac{1}{2}/\frac{1}{2}$ per cent in the three years.

THE OUTTURN FOR 1987-88

11. The current estimate for the outturn in 1987-88 is that the planning total will be undershot by £1 billion. This is entirely accounted for by higher proceeds from sales of housing, commercial property and land by local authorities and new towns. Other spending is in aggregate more or less in line with plans. I do not regard this undershoot as providing room to accommodate claims on the Reserve from other areas of expenditure, particularly given its nature.

CONCLUSIONS

12. I invite colleagues:

- a. to endorse the agreements I have reached on individual programmes;
- b. to note the aggregate position in relation to the starting Reserves;
- c. to note the outcome of the negotiations on running costs and on science and technology;
- d. to note the estimated outturn for 1987-88.

J M

Treasury

27 October 1987

RESULT OF THE SURVEY

	Changes from baselines £million		
	1988-89	1989-90	1990-91
Ministry of Defence	228.8	493.3	671.1
FCO - Diplomatic wing	-7.9	-5.3	-4.1
FCO - Overseas Development Administration	32.6	62.7	72.9
European Communities	346.2	396.0	219.3
IBAP	-223.4	-207.9	-101.0
Domestic Agriculture	24.6	23.7	25.8
Forestry Commission	6.0	9.0	9.0
Department of Trade and Industry	286.0	291.8	196.7
Export Credits Guarantee Department	22.8	92.5	73.0
Department of Energy	26.2	27.0	-10.8
Department of Employment	41.5	-3.5	-58.7
Department of Transport	31.9	27.6	33.4
DOE - Housing	-31.0	-127.0	-169.0
DOE - other environmental services	-130.1	-3.2	1.7
DOE - Property Services Agency	-22.1	-58.7	-56.1
Home Office	82.6	115.0	105.1
Lord Chancellor's Department	19.4	26.4	60.5
Department of Education and Science	259.7	328.0	327.2
Office of Arts and Libraries	35.6	46.5	52.9
DHSS - health and personal social services	710.0	790.0	1,230.0
DHSS - social security	984.0	1,846.0	3,090.0
Scotland	78.2	159.8	209.7
Wales	114.5	103.5	118.5
Northern Ireland	94.0	113.3	146.0
Chancellor's departments	155.9	183.5	217.0
Other departments	42.3	24.8	47.3
Local authority relevant expenditure	1,038.1	1,275.6	1,477.1
Nationalised industries	344.7	23.9	-330.1
TOTAL CHANGES TO PROGRAMMES	4,591.1	6,054.3	7,654.4

Note: these figures differ from those negotiated in the Survey as they are consistent with the position which will be published in the Autumn Statement ie after implementing agreed interdepartmental transfers.

SUMMARY OF AGREED PROGRAMMES

	<u>£ million</u>		
	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>
<u>Defence</u>	+228	+493	+671

The additions recognise the pressures on the programme following the end of a period of substantial real growth. The figures also incorporate the additions agreed earlier this year for Lynx helicopter orders for Westland.

2. <u>FCO (Diplomatic Wing)</u>	-8	-5	-4
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Increased provision for the BBC External Services (current), the refurbishment of the Old Public Offices and some other minor items are more than offset by reductions in the capital provision for the BBC External Services and the estimated cost of the FCO's overseas operations.

3. <u>ODA</u>	+33	+63	+73
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The revised plans provide for the programme to rise slightly in real terms from its present level. Within the totals the Foreign Secretary will accommodate the cost of a number of international initiatives including the interest relief costs of the IMF's Structural Adjustment Facility. If the Chancellor's debt initiative for Sub-Saharan African gains international acceptance the consequent costs will be met from the Reserve or be accepted as agreed bids in subsequent Surveys.

4. <u>EC Contributions</u>	+346	+396	+219
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In order not to prejudice our position in the negotiations on future Community financing, the projection assumes the continuation of the 1.4 per cent VAT ceiling. The sharp increase in the net contribution in all years is a result of an increase in our share of gross contributions, reflecting higher customs duties and levies and a revised forecast of our VAT base, and of a sharp fall in our forecast share of agricultural receipts.

<u>IBAP</u> (excluding territories)	-223	-208	-101
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The main change here is to the estimated cost of CAP support in the UK including savings on account of CAP reform already agreed and still subject to negotiation. The projections make some allowance for future devaluations of the Green Pound but assume that EC support prices in ecus remain constant on average in the next three years.

6. <u>Other Agriculture</u> (excluding territories)	+25	+24	+26
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Increases for ALURE, the EC extensification scheme, a variety of minor programmes and increased estimates for demand-led schemes are offset in part by savings on capital grants and from increased industry funding for R&D and ADAS.

7. <u>Forestry</u>	+6	+9	+9
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Increases in forestry grants under the ALURE measures.

8. <u>DTI</u>	+286	+292	+197
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The greater part of the overall increase in the programme is accounted for by launch aid for Airbus, the transfer of functions from Department of Employment, and revised costing of demand-led schemes. The Secretary of State is proposing a restructuring of regional assistance. This will have an initial cost but will produce increasing savings by the end of the Survey period. The allocation between programme and running costs remains to be decided.

9. <u>ECGD</u>	+23	+93	+73
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These changes mainly result from changed assumptions about interest rates in the UK and abroad.

10. <u>Energy</u>	+26	+27	-11
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There are increases for increased estimates of the cost of redundancy payments to miners in the first two years, with

reductions in the third year for the cost of new accommodation and for increased payments to the Atomic Energy Authority for work on decommissioning and nuclear waste management.

11. Employment +42 -4 -59

In the light of the improved unemployment prospect, the Secretary of State is restructuring his programme to absorb the extra costs for his department and the MSC of the January employment package and the withdrawal of income support for school leavers. Measures will include the closure of the Job Release Scheme and the New Workers Scheme and savings on the Youth Training Scheme, the Community Programme and adult training. He is planning also to privatise Professional and Executive Recruitment and restructure the Skills Training Agency.

12. Transport +32 +28 +33

The main increase is for the national roads programme, mainly for a programme of bridge renovation. There is higher gross capital expenditure by local authorities, offset by higher receipts.

13. Housing -31 -127 -169

Increased projections of receipts will yield some £1 billion over the three years. This will allow substantial additions to gross capital spending in each year, including the setting up of Housing Action Trusts. The figures shown are after transferring to DHSS the Housing Benefit costs of projected increases in rents.

14. Other Environmental Services -130 -3 +2

A higher level of receipts from New Towns and Local Environmental Services will provide for increased spending on Urban Development Corporations, the Development Commission, the Countryside Commission, the Nature Conservancy Council and the Sports Council.

15. PSA -22 -59 -56

A combination of higher receipts from disposals and rents and a small addition to provision in 1988-89 should enable the PSA to reduce the present backlog of maintenance over the next three years.

16. Home Office +83 +115 +105

Over 80 per cent of the net addition is accounted for by the prison building programme following H Committee's decision in July that there should be a substantial expansion and acceleration of the programme.

17. Lord Chancellor's Department +19 +26 +61

There are increases for court building, running the courts, and for the phasing in of the permanent scheme of payments on account for lawyers to which the Government is committed.

18. Education +260 +328 +327

Additions have been made to establish a fund to assist university restructuring and for the consequences of the academic pay award following last year's Survey. There are also increases for capital work to schools, for science and for the cost to central government of implementing the national curriculum.

19. Arts and Libraries +36 +47 +53

A significant part of the increase is for new estimates of the costs of the British Library. For the main programme, a three-year rolling settlement has been agreed under which the figures will not be reopened in future Surveys except in specified circumstances.

20. Health and Personal Social Services +710 +790 +1230

The increases reflect principally increased demand on the Family Practitioner Services, the growing cost of AIDS, and the

knock-on costs of this year's Review Body awards. In addition the health service will benefit from service improvements financed by the higher dental and sight test charges agreed in September and by a new programme for generating income from non-NHS use of hospital goods and services, including franchising. Part of the overall increase is reserved for the financing of future Review Body and negotiated pay awards.

21. Social Security +984 +1846 +3090

In spite of the improvement in the unemployment prospect, there are very large estimating additions to this programme. The main reasons for these increases include larger numbers of Income Support claimants; the reduction in unemployment being disproportionately among those with lower entitlement to benefit; and an increase in projected expenditure on sickness and invalidity benefits. The figures also reflect the agreement to raise benefits to protect income support claimants against the cost of the 20 per cent rates contribution. To offset part of these increases, the Secretary of State has announced the introduction of the new income-related benefits in April 1988 at levels slightly below the illustrative rates given in the 1985 Reform White Paper updated in line with price movements. He has also announced that child benefit will not be updated in April 1988 and that the housing benefit taper is to be increased to 65 per cent in 1988-89; the taper will be further increased in 1989-90.

22. Scotland +78 +159 +210

The settlement provides for an increase to Scottish programmes of industrial assistance so as to allow for a shift in regional policy in line with the changes proposed for England. On the Block, the Secretary of State has agreed to offset against his formula consequential on other programmes the £71 million by which the increase agreed in July for his local authority relevant provision exceeded the formula consequential of the increase for England.

3. Wales +115 +104 +119

The settlement on the Block reflects the formula consequentials of the agreements on English programmes. There is increased provision for industrial assistance both to meet estimating increases in demand-led programmes and to permit a restructuring of regional policy in line with changes proposed for England.

24. Northern Ireland +94 +113 +146

Apart from the normal operations of the formula, the main increase is required to meet revised estimates of social security costs in the province.

25. Chancellor's Departments +156 +184 +217

Additional resources have been provided for the Revenue Departments to deal with increases in workload and to strengthen controls against drug smugglers. Nearly one-third of the overall increase reflects changes in the estimates of the cost to public expenditure of providing relief on life assurance premiums and mortgage interest to non-taxpayers.

25. Nationalised Industries +345 +24 -330

The settlements provide for increases in capital investment programmes particularly in the Electricity and Water industries. To help finance these it has been agreed that the profitability of the electricity industries in England and Wales and in Scotland should be increased from its present low level. This will involve an average electricity price increase of about 8½ per cent next April. There are substantial savings from a number of other nationalised industries particularly British Coal and British Steel.

26. Capital expenditure

Taking all the programmes together, the additions to planned capital expenditure are likely to be around £1 billion in each of the next two years, mostly for local authorities and nationalised industries.