



PRIME MINISTER

PUBLIC EXPENDITURE: END-YEAR FLEXIBILITY

In my Cabinet paper on Public Expenditure (C(80)40), I refer in paragraph 10 to the need for a large contingency reserve to provide, among other things, for some flexibility in end-year expenditure. This minute and the attached note explain what is envisaged. It is for information at this stage: I am not asking for an immediate decision.

... The Treasury have been preparing a scheme, described in the attached note, to provide within limits for unspent allocations at the end of each year of certain types of expenditure - mainly capital and procurement programmes - to be carried forward and added to programmes in the following year. This would reduce the incentive, about which Sir Derek Rayner has been concerned, to wasteful end-year spending when unspent funds are "lost" to Departments at the end of each year.

The scheme in the attached note has been discussed with Sir Derek Rayner. He has said that it meets his concerns about "annuality" and has his strong support.

The scheme applies to underspending, not overspending. I am sure, and again Sir Derek Rayner agrees, that we must continue to treat cash limits as firm limits. However the scheme does help Departments which have to aim below the limits in order to avoid the risk of overspending, since underspent amounts can be carried forward.

A scheme which allows quite large sums of money to be added at the end of one year to the programme in the following year raises problems for control of public expenditure and the PSBR. To ensure that such additions are provided for in the plans, a larger contingency reserve becomes necessary, from which the sums would be provided.

You ought to know that we have also been discussing with the nationalised industries chairmen a scheme of a rather different kind for end-year flexibility for them in managing their external financing limits. This is part of work not yet completed but it will also impose a requirement on the contingency reserve. Together the two schemes involve earmarking about £600 million in the 1981-82 contingency reserve (at 1980 Survey prices).

This is a large sum. It is to be expected that the scheme in the attached note would cause Departments to underspend slightly more, because they would not be so anxious to spend their full allocations before the year-end. This might justify our adding another £100 million or so to the contingency reserve without actual expenditure turning out any higher. Even so, £600 million is a large sum to earmark in a reserve now standing at £1250 million for 1981-82, especially when the economic and industrial situation may throw up other contingencies.

I do not therefore propose an immediate decision to introduce the scheme described in the attached note. It will not be too late to introduce it this year if we decide in a few months time, when we can see whether a contingency reserve of the necessary size is available and when we may be clearer about possible threats to our expenditure plans for 1981-82. The delay will also allow us to take account of a report which the PAC are preparing on end-year flexibility.

I favour the scheme, and hope that we will be able to decide in due course to introduce it this year. To this end, I hope the

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Cabinet will agree with the recommendation in my paper on Public Expenditure not to reduce the contingency reserve now provided in the plans for next year.

I am copying this minute to other members of the Cabinet, the Minister of Transport, Sir Robert Armstrong and Sir Derek Rayner.

W. J. B.

JOHN BIFFEN

8 July 1980

## PUBLIC EXPENDITURE: FLEXIBILITY BETWEEN FINANCIAL YEARS

The purpose of this paper is to set out the general arguments for and against a scheme of carry-over between financial years of unspent funds in cash limits. It also described the scheme currently under consideration.

2. General arguments. There has for some time been interest in arrangements for flexibility between financial years, and there has been discussion from time to time of schemes of various types. The Public Accounts Committee have been interested in it, and have recently held hearings on the subject: their report is awaited. The White Paper on the introduction of cash limits in 1976 (Cmd. 6440) envisaged that cash limits would point up the case for some arrangements for flexibility. It said:-

"For certain services, such as the roads and hospital building programmes, where the timing of expenditure on existing projects cannot be precisely controlled, some arrangements are needed to allow a limited amount of flexibility between successive financial years and between current and capital expenditure. The extent to which such arrangements are required will be decided in the light of experience".

3. Ministers considered in 1979 the possibility of introducing a scheme for end-year flexibility but the scheme then envisaged was not at that time supported by Departments. The Chief Secretary proposed that consideration should be deferred. He did not rule out introducing a scheme for carry-over into 1981-82 and said that this was a decision for this summer.

4. There are two main arguments in favour of carry-over:-

(i) Some expenditure, particularly on capital programmes, cannot be regulated within narrow limits at short notice. To ensure that uncontrollable factors do not carry spending over the limits, it is necessary to aim below the limits and this causes allocations to be significantly underspent in most years.

(ii) In the absence of provision for carrying forward underspending, the annual limits encourage Departments to spend in March on items of low priority because unspent allocations are 'lost'.

5. Two important considerations are:-

(i) For purposes of managing the PSBR, safeguards are required against annual public expenditure totals being exceeded.

(ii) So far as possible the incentive should be retained for Departments to refine and sharpen the systems for monitoring and managing expenditure. Such incentive is now provided by the prohibition against exceeding cash limits coupled with Departments' own desire to make the maximum use of the money allocated to them. But the nature of certain programmes is that no amount of incentive can produce precisely accurate management.

6. A scheme of end-year flexibility could take the form of both allowing underspent amounts to be carried forward to the following year and of allowing cash limits to be overspent with a corresponding deduction from the following year, or of allowing only one of these two.

7. The scheme recommended is one which would allow, within defined limits, underspent amounts to be carried forward and added to the same cash limit in the following year, but which would not allow cash limits to be overspent. A scheme which condoned the overspending of cash limits would be contrary to the Government's policy that cash limits are strict limits, not targets.

8. Many of the arguments in favour of flexibility would be met by a scheme which allowed underspent amounts to be carried forward. The amounts carried forward would be known early enough in the following year for firm limits to be set for that year. Such a scheme would reduce the incentive to spend money wastefully to prevent its being lost. It would also make more tolerable aiming off in order to keep within the cash limit, because a consequent underspending is not lost.

9. Coverage. The scheme is intended to provide flexibility in those programmes where progress and cash flow cannot be managed with precision. In the main this means capital expenditure and certain procurement programmes. Departments have provided details of the expenditure they wish to see treated as eligible.

10. Limits. To contain the potential additions to subsequent years' expenditure, there should be an upper limit to the amount of carry-over. It is proposed that this should be 5% of the eligible expenditure in each cash limit. It should also be an object of policy to avoid large numbers of Supplementary Estimates for relatively trifling amounts. It is therefore proposed that there should be a lower limit of 1% of the eligible expenditure in each cash limit.

11. Contingency reserve. Funds carried over into a year would be charged against the contingency reserve for that year. In this way the scheme does not add to the planned public expenditure totals and to the planned PSBR.

12. It would be necessary to provide a reserve large enough to carry this cost. The amount of expenditure Departments wish to be covered by the scheme amounts to £8000-10,000 million, of which 5% is £400-500 million. It is unlikely that the full amount would be carried forward in any one year. This suggests that, to accommodate the scheme, the contingency reserve would need to be some £300 million at 1980 Survey prices higher than it otherwise would be. Ministers would need to decide in the context of the public expenditure Survey discussions whether this can be accommodated within acceptable public expenditure totals.

13. One consideration is that the scheme could be expected to result in somewhat higher shortfall than would otherwise have occurred, because Departments would be under less pressure to use up available funds at the end of the year. But some of this shortfall would have happened anyway, and it would be unwise to assume that the whole of the amount carried forward into the year will be matched by extra underspending. If it is assumed that the amount carried forward into 1981-82 is £300 million and that underspending is £100-150 million higher as a result of the scheme than it would otherwise have been, it follows that the scheme would increase

expenditure in 1981-82 by £150-200 million net (all figures at 1980 Survey prices). This should be allowed for in making the plans for 1981-82 and subsequent years.

14. Mechanics. The sums carried over would be calculated from provisional statements of outturn in time to take provision in Summer Supplementary Estimates. Further adjustments would not subsequently be made if outturn turned out to be slightly different from what had been expected. The amounts eligible for carry-over to the following year would be calculated as a percentage of the totals for the current year thus produced.

15. The scheme contains a presumption that Parliamentary authority would be given to a Supplementary Estimate. This aspect has been brought to the attention of the PAC.

16. Overspending. Overspending would continue to be regarded as a serious matter for detailed investigation and the control total for the following year reduced on that account.

17. Recommendation. It is recommended that Ministers consider in this year's Survey the proposition that the scheme be introduced in the current year. This would mean that the amounts underspent this year within the eligible categories would be added to the corresponding cash limits in 1981-82 and debited to the contingency reserve for that year. If it was decided that a contingency reserve of adequate size to cover this extra requirement could not be provided in 1981-82, the possibility could be retained of looking at this again next year, in the hope that the contingency reserve for 1982-83 might be less tight.



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