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SECRETARY OF STATE
FOR
NORTHERN IRELAND

Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

24 May 1990

Dear Norman,

1990 PUBLIC EXPENDITURE SURVEY: NORTHERN IRELAND

1. I am writing, in accordance with the Survey guidelines, to set out my PE and DRC proposals for the 1990 Survey. I will cover eight main areas:

- (a) NI Block priorities
- (b) NI Survey prospects, including Comparability
- (c) Costs of complying with EC Drinking Water and Bathing Waters Directives
- (d) Law and Order
- (e) Electricity
- (f) Social Security Benefits (including the impact of the new Community Care policy) and Housing Loan Charges
- (g) Departmental Running Costs
- (h) Contingent Liabilities

I cannot of course at this stage give details of proposed reallocations within my programme, as that cannot be addressed sensibly until the autumn when I know the likely total of resources available.

2. I enclose:

- (a) a table, in the prescribed format, summarising my bids;
- (b) the Executive Summary of the Management Efficiency Plans prepared by NI Departments and NIO;
- (c) the Management Efficiency Plan for the NIO.

REVIEW OF PRIORITIES

3. As is customary, I reviewed Block public expenditure priorities during March, to establish a strategic framework for the conduct of the Survey within Northern Ireland.

4. The key considerations remain largely as in recent years:

- (a) There is not the slightest doubt that the PIRA have the resources to continue, and indeed intensify, their terrorist campaign. Only high intensity policing over the past year has succeeded in preventing a serious worsening in the security situation - a success reflected in the key indicators. However, the latest security assessments suggest that the threat remains at a dangerous pitch and it is essential to maintain RUC activity at a high level if we are to keep up the pressure on the terrorists.
- (b) Unemployment in the Province stood at 14.1% in March, compared to 5.4% for Great Britain and 8.6% for the North of England, the next worst-affected UK region. It is also a source of concern that these unemployment rates mask the fact that, due to a complex combination of factors, the unemployment rate among Roman Catholics is more than twice as high as among Protestants.
- (c) On housing conditions, the most recent comprehensive data relates to 1987, when NI's unfitness level was measured at 8.4%, compared to 4.8% in England and Wales in 1986. Thus much more needs to be done, particularly in rural areas where unfitness problems tend to be more intractable and expensive to deal with.
- (d) In the education sector, we are implementing the national reform package, suitably modified to take account of local conditions. Our experience has been that, as at national level, substantial resources are required in order to plan and initiate these radical

and wide-ranging measures. Allied to the proportionately large size of the Province's school age population (19.6% of the total compared to 14.6% in England), these reforms constitute a real challenge and one which I feel compelled to address vigorously within available resources.

- (e) Health Service reforms are also under way and are being applied to a NI structure which links health and the personal social services under unified management. Again the resource requirements are proving to be very substantial. These have to be accommodated within a programme whose growth has, essentially for reasons of affordability, been pitched at levels lower than in GB in recent years, though morbidity continues to be higher and waiting lists proportionately larger than in GB.

5. Having considered these factors I have concluded that dealing with the terrorist threat and with weaknesses in the NI economy should continue to be my first and second public expenditure priorities.

6. On Law and Order, this means that the programme will probably continue to consume an increasing proportion of Block resources, particularly since police pay and pay related costs can be expected to increase at a relatively fast rate. I will refer to the broader implications of this later.

7. The priority attached to Strengthening the Economy will continue to be focused on PE measures which will contribute to the cost-effective creation of viable, self-sustaining economic growth and private sector employment. It will increasingly, in line with my new economic strategy, concentrate on improvements in the competitiveness of NI industry and commerce, as we believe that to be the key to future economic growth.

8. There are, of course, important linkages between the political and security problems which the Province faces and the social and economic problems which result from low incomes and unemployment. While social and economic disadvantage is by no means the sole cause of political division and paramilitary activity, the security situation and communal conflict are undoubtedly exacerbated by these economic and social problems. I have been giving considerable thought to how we might use our social and economic expenditure more effectively in order to reinforce our efforts in countering terrorism and in promoting political development.

9. At the root of this are the persistent differentials in the economic and social status of Roman Catholics and Protestants in NI. As I have said, unemployment rates among Roman Catholics are more than twice as high as those for Protestants; Catholic

households have a lower average income; a higher percentage of Catholics leave school with no formal educational qualifications of any kind; levels of household overcrowding are greater in the Catholic community; and areas defined as suffering from multiple disadvantage (eg parts of Belfast and the least favoured rural areas) have Catholic majorities. These differentials are linked to perceptions of disadvantage which feed alienation and fuel violence. The fair and just society in NI towards which we are working demands a reduction in these differentials.

10. The causes of these differentials are deep rooted and public expenditure allocations cannot provide a complete solution to them. I am satisfied nevertheless that one aim of our PE allocations should be to reduce these differentials by seeking to target allocations more effectively on the people and areas in greatest need, with a view to reducing the differentials that exist. Hence I have adopted Targeting Social Need as a third ranked priority.

11. The presentation of this decision within Northern Ireland will require extremely careful handling, partly because unrealistic expectations could easily be created in the Catholic community, and partly because of the fears and concerns that could arise among Protestants. It may take time to work up the new priority fully, but I will be seeking to begin to shift allocations to reflect the change in this Survey, to build on action already started through the Making Belfast Work and Londonderry initiatives and other measures.

12. Whilst I have placed my three public expenditure priorities in rank order, the complexity and inter-relationship of Northern Ireland's political, security, economic, social and community relations problems require me to follow a carefully balanced approach. I must not, for example, allow the demands of the law and order priority to restrict drastically action on the priorities for strengthening the economy or targeting social need.

SURVEY PROSPECTS

13. I have, naturally, noted carefully the signals which you have been sending about prospects for the national Survey, and I recognise the significant difficulties which we face.

14. Within my Block, I face bids from NI Departments and NIO of some £440m rising to £720m over the Survey period, excluding Social Security Benefits, Housing Loan Charges and the technical adjustment in respect of NIE privatisation (see below) set against internal room to manoeuvre of only £90m rising to £175m (including assumed Social Security transfers for Community Care, see para 31 below).

15. I recognise, of course, that accommodating bids on this scale will simply not be possible and I will be reducing those totals radically for the purposes of the Survey within NI. Similarly I will be seeking to increase room to manoeuvre within the Block by identifying scope for reductions in lower priority areas. Nonetheless rising inflation, particularly on pay, the essential requirements of the Law and Order and Economic Strengthening programmes, the requirement to make a greater impact on community differentials, and national policy initiatives on Community Care as well as education and health reforms, all mean that my programmes will need substantial additional provision.

COMPARABILITY

16. Needless to say, the outcome on Comparability will be of paramount interest to me, especially insofar as the Local Authority component is concerned.

17. In 1988 a formula was agreed, during the tenure of our predecessors, providing for Northern Ireland to receive Comparability based on the Total Standard Spending aggregate for England. When writing to John Major at this time last year, Tom King referred to assurances from Treasury officials that much greater realism would be evident in the construction of Local Authority figures in the 1989 Survey than previously.

18. The Total Standard Spending figures for 1990/91, from which NI's Comparability in the 1989 Survey was derived, was £32.8 billion. This provided an increase of less than 5% between 1989/90 and 1990/91, compared to the 6.5% inflation figure acknowledged at Budget time. Some pay bills have risen or are forecast to rise at substantially higher rates. Such factors must go some way towards explaining why Local Authority budgets are now £3 billion above the TSS figure, although obviously over-spending also contributes significantly to this increase.

19. With the benefit of hindsight, adjustments on this scale do call into question the realism of the 1989 Survey figures, and thus the appropriateness of the Comparability settlement based upon them. This is most regrettable in the first year of the new agreed system's operation. While I appreciate the extent of the difficulty associated with local authority finance at national level, I would ask you to recognise the major significance for NI of this part of the Survey settlement.

20. I have not, as you know, sought to query the 1990/91 position, because local easements gave me a manageable Survey outcome although the Block is looking very tight indeed in the current year. I am, however, obliged by this experience to seek your agreement that, in this new Survey, NI's Comparability in the Local Authority sector will be determined by the agreed mechanism, reflecting figures consistent with realistic and appropriate allowance for Local Authority finance.

21. As my officials interpret the position, a substantial NI Comparability yield can reasonably be inferred from the increase in Local Authority expenditure which has already been acknowledged in the 1990 Financial Statement and Budget Report. I expect that I will need the full effect of this, and/or whatever further adjustments to Total Standard Spending are agreed in this Survey, to provide a fair settlement for services in NI in this Survey.

22. I realise from your signals on the national PE position, and on the economic context, that there will be strong reasons for downward pressure on PE plans in the Survey. Thus I will be taking further steps to restrict as far as possible the pressures which I face. If, aside from the LA sector, where the agreed system seems likely to generate a substantial entitlement, Comparability is small, I will apply, as far as practicable, the sort of restrictions which colleagues will have to introduce in GB. If, on the other hand, it does in the end prove possible for there to be some enhancement of GB comparable programmes, I will clearly need to make broadly similar provision to most of those services in the Block. But there are two areas where the circumstances are so exceptional that I must seek additional provision over Comparability.

WATER AND SEWERAGE: COMPLIANCE WITH EC DIRECTIVES

23. The first of these special pressures is in relation to the major expenditure required to comply in the agreed timescale with the EC Drinking Water and Bathing Waters Directives, on which Tom King wrote to John Major last year. To rehearse the key points briefly:-

- (a) expenditure on compliance, over and above what can be covered from the routine NI Water Service budget, during the Survey period is estimated at £12m, £33m and £71m. As indicated in my letter of today to Chris Patten, I hope that ways can be found to reduce the expenditure required. For the present, however I must plan on the basis of the current definition of the requirements. Naturally I will also be reviewing those figures critically to ensure that they represent the minimum consistent with our commitments to the Community;
- (b) the privatisation of the English and Welsh Water Authorities means that Northern Ireland receives nothing via the Comparability formula in respect of Water and Sewerage services;

- (c) clearly these requirements are not catered for by the Comparability mechanism (the Green Dowry arrangements were operated outside Comparability) so, there is no realistic prospect, given other pressures, of my accommodating all or even part of them within whatever Comparability yields;
- (d) because of privatisation, the costs of compliance in England and Wales can be met without detriment to other services;
- (e) I need to make provision for this programme for all three Survey years now because of the long lead time of the capital programme.

24. Consequently I am seeking your agreement that the costs of compliance be met by an addition to the Block, over and above the full Comparability entitlement under the agreed system. I will also wish to ensure that, as in England and Wales, where Water Authority charges will be kept in check following the major cash injections and the write off of NLF loans, the major additional expenditure does not impact unfairly on the consumer through unacceptably high increases in revenue raised through Water Charges and the Regional Rate. Some special arrangement on that aspect may be required alongside my PE bid, and my officials will follow this up as necessary with yours.

LAW AND ORDER

25. I also need to seek additional provision, over and above Comparability, for Law and Order. As Tom King mentioned last year, our efforts on the security front have obliged us to devote an ever-increasing proportion of the Block excluding Social Security Benefits to the Law and Order programme (from under 14% in 1984/85 to nearly 17% in 1990/91). The effect which this has on other programmes is a matter of continuing concern to me, and criticism arising from it recurs regularly. Earlier this year the Northern Ireland Economic Council drew this trend to my attention, as it has done with my predecessors, and criticised the restrictive effect which growth in the Law and Order sector is having on expenditure programmes which would improve employment and housing conditions in NI. Their call was that Law and Order should be removed from the Block. I am not asking for that but I do require some relief from the implications of its retention within the Block.

26. The fundamental problem is that, on the Law and Order front, Northern Ireland is not comparable to other parts of the UK, and the Comparability formula does not produce the funds that I need. In the last three PE Surveys, for every £3 that had to be allocated to Law and Order within the Block, only £1 was received from Comparability on GB Law and Order provision. The "loss"

which this and similar in year reallocations represents to other Block programmes was about £200m over the period 1988/89-1990/91 - though this was partially offset by the helpful 1988 Survey settlement. However the "loss" is so substantial and continuous that I find I need further relief for the period of this Survey. The figures to which I refer, of course, reflect only the more recent effects of the needs of this programme and of the priority which I and my predecessors have quite rightly attributed to it.

27. Given that there can be no question of any slackening in the efforts of the RUC to combat and defeat terrorism, I see it as necessary that the social and economic programmes should again be given some relief from the past and continuing demands of the Law and Order programme. This needs to be approached from two angles. First, I will keep the bids for Law and Order to the minimum consistent with the essential requirements of the programme, and work on this is continuing. Secondly, I would look to you to cover the residual which will remain after this scrutiny by an addition over Comparability, the figures likely to be in the region of £26m, £34m, and £60m. The main objectives would be to provide for Police pay and allowances at levels consistent with operational requirements; and to meet forecast entitlements for criminal damage and criminal injuries compensation. Further details of the components of this expenditure and the related objectives will be provided by my officials.

28. I should emphasise that these figures do not include any provision for a possible requirement for additional RUC manpower and/or overtime. Your officials are aware of how this issue is developing. The Chief Constable faces a steadily increasing drain on his resources through the growth in static protection work that the RUC is obliged to do. I share his concern that the RUC's operational efforts should not suffer as a result. The case for more manpower or overtime, or a combination of both, is currently being considered with great care, but that scrutiny is not yet complete and I cannot therefore be definitive about the quantum of resources that might be required (the amounts may be of the order of £6m, £14m and £20m in the three Survey years). I would be obliged, therefore, if you would note this marker that the Law and Order bid may be increased later in the Survey to take account of this additional dimension.

ELECTRICITY

29. As you know, work on the privatisation of Northern Ireland Electricity is progressing, with the objective of a sale in early 1992. It would be appropriate in this Survey for NIE public expenditure provision for 1992/93 and 1993/94 to be eliminated. As the figures are negative (-£119m and -£122m) this will entail technical increases in my Block and I have therefore included this in my list of bids. As you know the current figure makes no allowance for expenditure on new generation capacity.

30. Should there be unavoidable delay on privatisation (and I see no reason to expect this) I think the best way to reflect our previous understanding on the costs of new generation capacity would be to readjust my Block by the amount of a new EFL for NIE for 1992/93. This would take account of NIE's forecast debt repayments for that year and the capital expenditure which would be required for new generation capacity - as you know there are several options for the latter still under consideration.

SOCIAL SECURITY AND COMMUNITY CARE

31. My officials will, as usual, provide further details of my routine bid for Social Security Benefit expenditure. The main special feature which affects Benefit expenditure this year is the new policy on Community Care. I propose to retain the savings on Benefits which will result from the new policy, as a main source of funding for the new expenditure by Health and Social Services Boards. I would then not be entitled to Comparability on the amount transferred from Social Security to Personal Social Services in GB though Comparability would be relevant to any new resources allocated to DoH (or Local Authorities via TSS). If you agree this approach, our officials can sort out the details.

HOUSING LOAN CHARGES

32. Annex 1 also includes my routine bid arising from the effect of interest rate movements on the subsidy to NI Housing Executive.

DEPARTMENTAL RUNNING COSTS

33. Turning to running costs, I have reviewed the plans underlying the 1989 Block MEP and taken account of a range of developments in drawing up my 1990 Block MEP, including:

- (a) additions to workload, reflecting the continued implementation of parity-based policies such as Education and Health Service reforms; the 1991 Census; the Employment Initiative in Social Security offices, and compliance with EC Directives on Water and Sewerage;
- (b) forecast inflation, which has been revised upwards but is subject to review later in the year to take account of emerging information;
- (c) a limited number of new NI initiatives, including the setting up of a new Government Purchasing Service, and additional staff for Social Security Offices to meet a projected increase in unemployment, partly offsetting reductions being achieved elsewhere in Social Security administration.

34. I have also revised and updated efficiency savings, which are front loaded and now amount to 2.4%, 1.4% and 1.1% across the Survey period - thus cumulatively exceeding the 1.5% per annum minimum target. Despite the most careful scrutiny I am, however, unable to contain the emerging pressures within the baselines agreed last year. In my 21 September 1989 letter to John Major, on the outcome of the 1989 Survey, I referred to the modest increases which had been agreed for 1991/92 and 1992/93. I said that I saw a risk that I might have to re-open the settlement this year to take account of unforeseen changes in policy, workload and other costs. This has proved to be the case. The breadth of the coverage of the Block means that inevitably some new requirements arise from policy decisions which could not have been foreseen or quantified in the previous year. In addition the 1989 settlement has been seriously eroded by changed expectations on inflation.

35. Following DFP scrutiny of bids I have made reductions of £5.3m, £6m and £7m on the amounts sought by departments. These are significant sums and will have implications for service delivery, but I believe that it is right to make these reductions in order to constrain DRC growth and its claim on Block PE resources.

36. I am therefore seeking DRC provision of:

| | 1991/92 | 1992/93 | 1993/94 |
|--------------------|---------|---------|---------|
| Block Baseline | 625.7 | 646.5 | 662.7 |
| Proposed Additions | 19.9 | 26.7 | 39.1 |
| Provision Sought | 645.6 | 673.2 | 701.8 |

37. The Block figures do not take account of proposed additions of £0.5m, £0.6m and £0.9m (subject to revision) for agency services undertaken on behalf of DSS.

38. The DRC provision I am seeking, reflecting an 8.9% increase for 1991/92 over 1990/91, represents a taut assessment of my requirements. It takes account of Block priorities as set out in the Executive Summary, and will entail difficult choices if I am to manage the various services for which I am responsible within the proposed baselines. The fact that DRC growth has been slower in NI than in broadly analogous GB Departments, and that DRC unit costs are significantly lower in NI, is clear evidence of the economy which has been applied to administrative costs within the NI Block over recent years.

ANNEX "A"

| | £million | | |
|---|----------|---------|---------|
| | 1991-92 | 1992-93 | 1993-94 |
| BASELINE (NI BLOCK) | 6,170.8 | 6,395.0 | 6,554.9 |
| Proposed additions: | | | |
| Central government | | | |
| 1. Social Security Benefits | 41.2 | 64.1 | 144.0 |
| 2. Housing Loan Charges | 4.2 | 5.7 | - |
| 3. NIE | - | 118.8 | 121.8 |
| 4. Water and Sewerage | 12.3 | 32.6 | 71.2 |
| 5. Law and Order | 26.4 | 33.6 | 60.0 |
| TOTAL (Baseline and Bids excl Comparability) | 6,254.9 | 6,649.8 | 6,951.9 |
| TOTAL NET CHANGE PROPOSED OVER AND ABOVE COMPARABILITY | +84.1 | +254.8 | +397.0 |

Notes:

- Bids 1 and 2 are primarily for routine adjustments on foot of revised economic assumptions etc.
- Bid 1 also reflects the proposed transfer of:

| | 1991/92 | 1992/93 | 1993/94 |
|--|---------|---------|---------|
| | 14.5 | 38.0 | 54.5 |

from Benefits to HPSS to fund the proposed new Community Care policy.

- Bid 3 is a technical adjustment on foot of the proposed privatisation of NIE.

CONTINGENT LIABILITIES

39. My report on Contingent Liabilities at 31 March 1990 is being forwarded to your officials. The only new liability expected in the Survey period is in respect of various exhibitions at the Ulster Folk and Transport Museum which are estimated at £1.75m in each of the Survey years.

SUMMARY

40. It is clear that we face substantial difficulties in the 1990 Survey if we are to achieve a satisfactory balance between the objectives of our broad economic policy and the needs which public expenditure programmes address. In view of this, I am naturally reluctant to present bids since the Comparability system should, if properly implemented, normally meet Northern Ireland's needs in broad terms. However the situation with which I am faced contains a number of special features which Comparability either has not or does not adequately address. First it is apparent with hindsight that the Comparability settlement in the 1989 Survey did not reflect full realism in relation to Local Authority expenditure and I would welcome your assurance that the agreed system will be applied in this Survey. Secondly, the substantial costs of complying with EC Directives on Water and Sewerage are demonstrably outside the scope of the Comparability arrangements; and, thirdly, NI's top priority programme, Law and Order, consumes about three times as much resources within the Block as Comparability provides from the corresponding GB programme. Thus, while I fully appreciate the difficulties which you face in the Survey, the case for Northern Ireland being given relief on these issues is so compelling that I feel obliged to make it. I will, of course, continue to pursue value for money within the Block, for example through the purchasing and market testing initiatives on which Northern Ireland's performance has, as you know, been encouraging.

41. I hope that you will recognise the force of the arguments, which I and my officials will be happy to deploy in greater detail, and that we can reach a reasonable and equitable agreement.

42. I am copying this letter (excluding the two Management Efficiency Plan papers) to the Prime Minister, Chris Patten, Malcolm Rifkind and David Hunt.

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