Pt. B

PO CH/GH/0158

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PUBLIC EXPENDITURE IN THE LONGER TERM 1982

30-11-82

DD's 25yB NA3/4
13-3-97

CABINET OFFICE PAPER

The following Cabinet Office papers have been taken off the file. If you require access to these papers please contact the Cabinet Office.

Reference	Date Of Paper
C (82)	SEPTEMBER 1982

[redacted]

CHANCELLOR
31 AUG 1982
Mr Hall
CST, FST, EST, MST(C),
MST(R), Sir D Wass,
Sir A Rawlinson,
Sir K Couzens
Mr Burns,
Mr Barratt,
Mr Bryant,
Mr Middleton,
Mr Wilding,
Mr Kemp,
Mr Monck Field,
Mr Bottrill,
Mr G P Smith,
Mr Rayner,
Mr Ridley

CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

Qa 06045

Covering CONFIDENTIAL

31 August 1982

The Rt Hon Sir Geoffrey Howe QC MP
HM TREASURY
S W 1

Dear Geoffrey,

Longer Term Options

In the light of your comments at the meeting last Friday, we have re-cast our draft paper for 9 September, to make it more of a fundamental review of options for the main programmes, and less a list of possible cuts.

I enclose the revised draft. If you are content with it as a basis for collective discussion, I will arrange for it to be circulated. Otherwise I would of course be very glad to have another word with you about it.

You told me that you would be discussing the handling of the meeting with the Prime Minister, and I am accordingly sending a copy of this draft to her. I am also sending a copy to Sir Robert Armstrong.

Yours sincerely,

John

John Sparrow

Enc

30/180

7

FROM: T A A HART
DATE: 1 September 1982

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr Burns
Mr Barratt
Mr Wilding
Mr Kemp
Mr Mountfield o/r
Mr Bottrill
Mr Culpin
Mr Faulkner
Mr Goldman
Mr Hall
Mr N King
Mr O Donnell
Ms Seammen
Mr G P Smith
Mr I Wilson
Mr Rayner
Mr Ridley

THE LONGER TERM - BRIEFING FOR CABINET ON 9 SEPTEMBER

The Cabinet will be taking this subject at an extended meeting on 9 September. There will be three papers in all - your own paper (including the fiscal annex); the final report of the official group on public expenditure in the longer term (LTPE); and a paper by the CPRS, commissioned by the Prime Minister, on options for reductions in public expenditure in the longer term. The papers have not yet been circulated by the Cabinet Office, but you have seen a draft of the CPRS paper. I understand that you would find it helpful to have the main body of the briefing before you leave tomorrow for Canada: we may, of course, need to supplement it with further notes to await your return on 8 September.

The aim

2. Your main aim will be to obtain your colleagues' agreement that the long-term prospects suggested by the officials' reports are unacceptable, and that there is a need to get public expenditure on to a better track. As a first step, you are proposing that the Cabinet should commission further studies of the options identified by the CPRS in their paper and that these should be completed and reported back to the Cabinet in the spring of 1983. Your second aim is to secure a moratorium on new commitments (or the renewal of old ones) which would add to expenditure beyond 1985-86. You are also asking your colleagues to have particular regard to the longer-term implications of their decisions in

this year's Public Expenditure Survey and to consider how these issues might best be presented in Parliament and to the country.

Tactics

3. You have said that you are anxious to avoid giving the impression that this is simply another Treasury "cuts" exercise, and your paper seeks to distance the discussion from this sort of approach. We do not know how the Prime Minister will handle the meeting, but the natural order would be to have first a fairly fundamental and broad-ranging discussion about the Government's long-term policy objectives and the size and shape of the public sector, in the course which you would hope to secure your colleagues' acceptance in general terms of the analysis in your paper. If they are agreed on the seriousness of the overall problem, they could then turn to the specific policy options identified by the CPRS as worth further study. We think it is important not to get into the specifics too soon before the general analysis has been discussed and accepted. Discussion of the four specific proposals at the end of your paper would naturally follow on from discussion of the CPRS options. It will be important to emphasis that no Minister is being asked at this stage to sign up for particular cuts or policy changes. All that is proposed is a series of further studies, together with a moratorium on new commitments until that work has been completed in the spring of 1983.

Introductory speaking note

4. In introducing the paper you may like to say something on the following lines:

"I have said in my paper that this discussion is one of the most important we shall have at any time in this Parliament. I do not think that is an overstatement. The decisions we take on these longer term problems will influence what goes into the Manifesto for the next election; and they will affect the performance and shape of the economy for the rest of this decade at least and probably longer. The "lead time" for decisions on public expenditure is a long one: if we want to influence what happens at the end of the decade we need to think about it now and begin to take the necessary decisions next year.

Our starting point is the report of the official group on longer-term trends in public expenditure. But I feel sure that we must not confine ourselves to a narrow discussion of the issues raised in that report. I hope very much that we shall be able to have a fundamental and broad-ranging discussion about our long term policy objectives and the size and shape of the public sector. This means looking at the broader political

context and the longer term prospects for the economy both at home and worldwide. In the light of this, we might look at some of the options discussed by the CPRS in their paper and at the specific proposals at the end of mine. I do emphasise that I am not at this stage seeking any particular set of new cuts or any given level of public expenditure for the future. But I think it is important that we should at this point in this Parliament review our policy objectives pretty fundamentally and consider whether we are on the right track to achieve the sort of society and economic success that we want.

My own conclusion is that we may need to make some quite radical changes of direction, if we are to avoid creating in the longer term an economy - and a society - which is dominated by the demands of the public sector, with all the depressing effects which that entails for individuals and for enterprises. A great deal has been done already. We have had a considerable success in reducing the level of inflation; but the task of reducing the public sector at a time of worldwide recession has proved even more intractable than we expected in 1979. The prospect now revealed by the officials' report would be a grim one for any Government. It is particularly so for us with our firm commitment to reduce the share which the State takes of the nation's income. But it remains essential for us to hold to that objective and achieve it if the economy is to recover and grow as we wish.

The officials' report rightly points out that its two "scenarios" are not forecasts. They simply illustrate what might happen if we maintain our present expenditure policies against two different economic backgrounds, one rather more favourable than the other. Although neither scenario is a forecast, neither of them is at all fanciful: the assumptions on which they are based are reasonable and, if anything, conservative. On the low growth scenario, the report shows that public expenditure might rise to nearly 47 per cent of GDP in 1990-91, a figure which I am sure we would agree is altogether unacceptable. Things are a little better under the more optimistic scenario A, but in real terms public expenditure would still be higher in 1990-91 than in our first year of office or than we planned for this year. In the Annex to my paper I have set out the tax

implications which are equally unwelcome. Even on the more favourable assumptions, there would be little or no room to reduce personal taxation or improve incentives. And we could not make the reductions in company taxation which are essential to recovery and growth. The tax rates implied by the more pessimistic scenario would be positively damaging to industry and crippling to individual incentives.

We cannot borrow our way out of this difficulty. Increased Government borrowing to finance these planned levels of expenditure would simply push up interest rates generally, wipe out our achievement in getting them down and place a further damaging burden on industry. The analysis leads one unavoidably to the conclusion that the way forward to better economic performance can only be through reducing expenditure. I recognise the political difficulty of doing this at a time when people still retain high, unrealistically high, expectations of a steadily improving standard of living and public services. There is a major task of public education to be done and we need to find new ways of permitting some of the demands to be met. We must also give ourselves more room for manoeuvre: we are hedged in at present by too many pledges and commitments covering very wide areas of expenditure. We need to review these in the light of current priorities, and if necessary we must be prepared to make radical changes.

I have been struck at recent Economic Summits by the extent to which Heads of Government and Finance Ministers everywhere are confronted, like ourselves, by major problems of public expenditure, such as untenable commitments to indexation and the large public sector deficits which through their impact on taxation and interest rates create such a threat to economic recovery. This is a continuation of a pattern which has been emerging for many years. If we look backwards at public expenditure in this country over the last 20 years, there is a consistent upward pattern, broken only by the two external crisis of 1967 and 1976. Even then, the upward trend was soon resumed. I believe we need to break this pattern, decisively. As I have said, I am not today seeking any specific cuts, but I believe we must review our long term spending commitments or we shall run into very major difficulties in the

course of the next Parliament. I hope that we shall therefore agree to commission further work on some or all of the main options identified by the CPRS. And until that is done, I hope we could agree not to enter into major new commitments - or renew old ones - which would add to public expenditure in the longer term."

Chancellor's paper - defensive briefing

5. The most likely criticism of the analysis in your paper is that the rising tax burden shown could be substantially reduced by an increase in public borrowing. You may have anticipated this in your opening remarks, but if not you could say:

(a) more borrowing means higher interest rates;

(b) higher interest rates mean less investment and thus, in the longer term, lower growth of output and employment;

(c) borrowing should not be seen an easy way out of avoiding paying for public spending. Nothing is for nothing and borrowing simply transfers the burden to others, including mainly the private sector;

(d) the declining path of Government borrowing has been achieved with great difficulty; it should not be thrown away lightly.

6. The officials' report (LTPE) was generally agreed at official level, so it is unlikely that many technical points will be raised. The Ministry of Defence have, however, questioned in correspondence with Sir Douglas Wass the report's reliance (eg in the final paragraph) on percentage increases in particular programmes. They argue that this ignores the size of the baseline and that the absolute figures would give a truer picture of the changing balance between programmes. In particular defence would appear in a better and social security in a worse light. There is not much in this point. There are a variety of ways of presenting this sort of information and all other departments were content to use percentage increases. If the point is raised, we recommend you to say this, and to take the line that it is the general trend and the increase overall which is the main cause for concern. About this there is no doubt at all.

7. Other technical points are covered in the attached notes as follows:

- the scenarios (Flag X)
- the economic assumptions of the LTPE report (Flag Y)
- the fiscal annex (Flag Z)

The CPRS paper

8. You saw the CPRS paper in draft and discussed it with Mr Sparrow. It has to tread a rather difficult line. On the one hand, the CPRS were commissioned by the Prime Minister to produce a set of policy options for reducing public expenditure in the longer term. On the other hand, you do not want to appear to be seeking a set of "super-cuts". The best approach might be to argue that the CPRS have, as they were asked, produced a wide-ranging set of policy options. At this stage, no-one is seeking specific cuts or changes in policy. But there is much to be said for further study of all the main options identified by the CPRS and, possibly, some of the lesser ones in Annex H to their paper. No Minister is being asked to commit himself to policy changes, but no reasonable approach should be ignored.

9. Some colleagues will no doubt want to comment on the options individually and some may ask to be exempted from the exercise. We would recommend you to argue against this: the exercise will be much more acceptable if all the major departments are seen to be in it together.

10. Notes on the options by Expenditure Divisions are attached. They are (in the order of the CPRS paper):

A. Increased health charges.
B. Private health insurance.
C. Reduced education spending.
D. Charges for compulsory schooling.
E. Charges for higher education.
F. De-indexation of social security benefits.
G. A halt to growth in defence spending after 1985-86.
H. Other options.
J. Public service manpower.
K. Accounting changes.

In each case the notes by Expenditure Divisions suggest a line to take which recognises the scope for savings of each option and some of the difficulties which may be referred to by spending Ministers.

Implementation of future work

11. There has been no discussion at official level of how the future work should be carried out. The load would probably be too great for the CPRS and there is, in any case, an argument that departments (under the direction of their own Ministers) should review their own policies. On the other hand, this may not lead to a sufficiently rigorous examination. An alternative possibility, which combines departmental autonomy with a measure of

independent appraisal, might be to have the studies steered by an interdepartmental group at Permanent Secretary level. Sub-groups on each option - on which the Treasury should be represented - could then report to the Steering Committee. We recommend that you raise this point and suggest that the Secretary to the Cabinet be invited to make proposals to the Prime Minister. You might also emphasise the need for a sense of urgency: if policy changes are to be implemented in the next Parliament, the long term begins now.

Overseas experience

12. Your paper refers to other countries' public expenditure experience. The purpose of this is to show the extent to which other countries have also had to retrench. There are difficulties about linking high economic growth too closely with lower public expenditure. This is a complex field and it is easy enough to produce counter-examples. The US, for example, has had both low public expenditure and low growth. The French and Germans, who have relatively high public expenditure shares, have also typically had reasonably fast growth over the past two decades. Japan has had low public expenditure and high growth, but it is in many ways exceptional. It would seem best to let the logic of your paper speak for itself rather than rely closely for support on overseas experience.

AH

T A A HART

GEP1

RA

FROM: T A A HART
DATE: 1 September 1982

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Anthony Rawlinson
Mr Barratt
Mr Wilding
Mr Kemp
Mr Mountfield
Mr Kelly
Mr Burns
Mr Rayner
Mr Ridley

LONG TERM TRENDS IN PUBLIC EXPENDITURE - PORCUPINE CHART

In my minute of 27 August, I promised to let you have a "porcupine" chart illustrating the effect of "creep" in public expenditure in recent years. This is now attached. It has been produced by Mr Burns and is intended to be Annex A to your paper for Cabinet on 9 September.

2. Because we have taken the period covered by the present administration, it is a slightly bald porcupine with only three quills. (The conversion to cash for earlier years would have been technically too difficult in the time available.) But the lesson is clear. In each successive White Paper the expenditure planned for future years not only rises, but rises above the level planned in the previous White Paper.

3. Being in cash, the chart does not of course show whether the increase results from higher inflation or higher real spending. The other attached chart, which describes the plans in cost terms, shows the upward drift in real terms. It also reveals very starkly the optimistic tendency to assume that expenditure will fall off once the difficulties of the immediately following year have been overcome. In practice it never does: the peak simply moves forward year by year. (In the "cash" chart this is indicated by a flattening in the slope of the paths for future expenditure.)

4. Although the "cost terms" chart is interesting, we have assumed that you would prefer not to attach it to the Cabinet paper but to keep to your general line of describing expenditure plans in cash wherever possible.

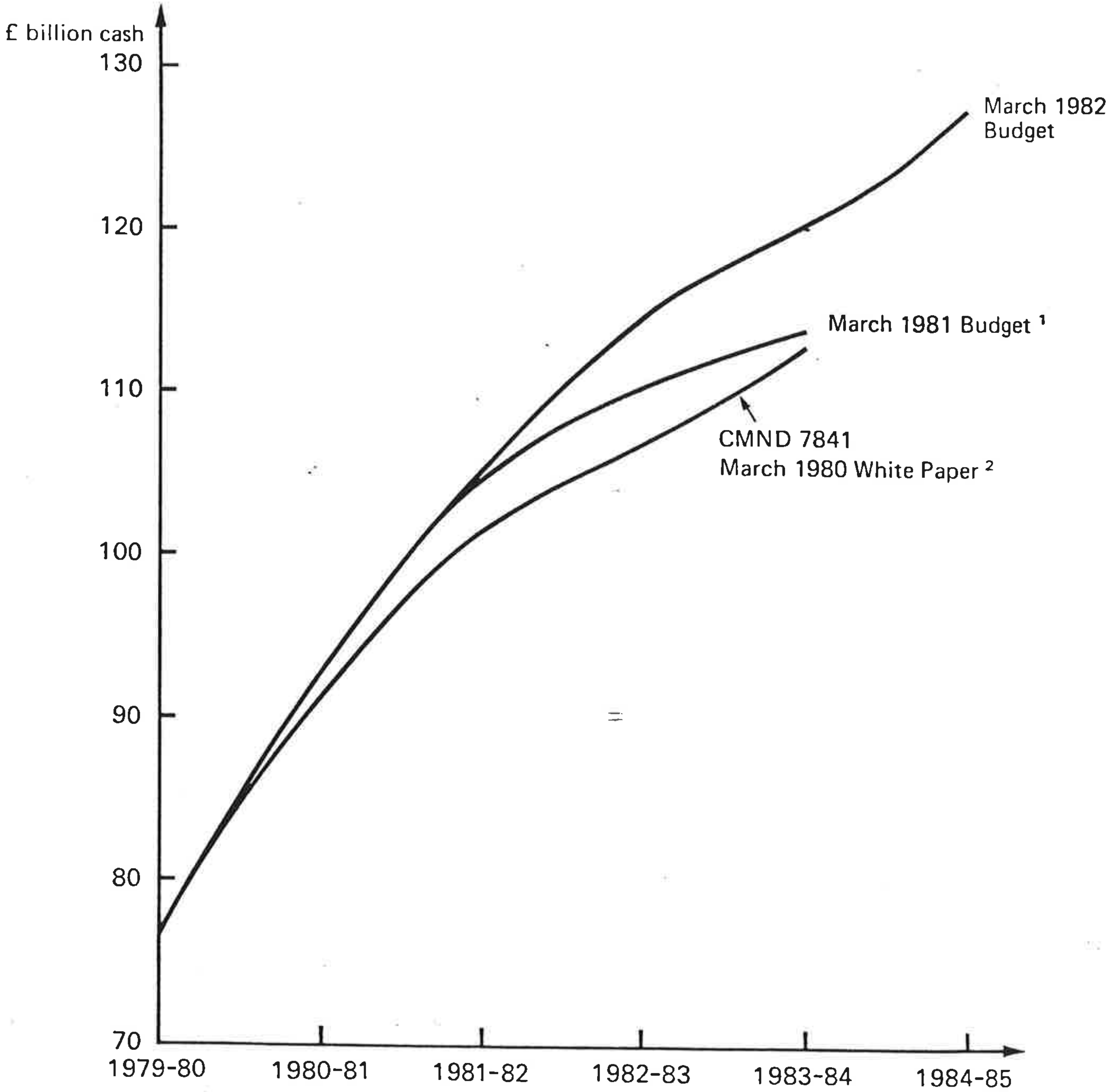
AH

T A A HART

GEP1

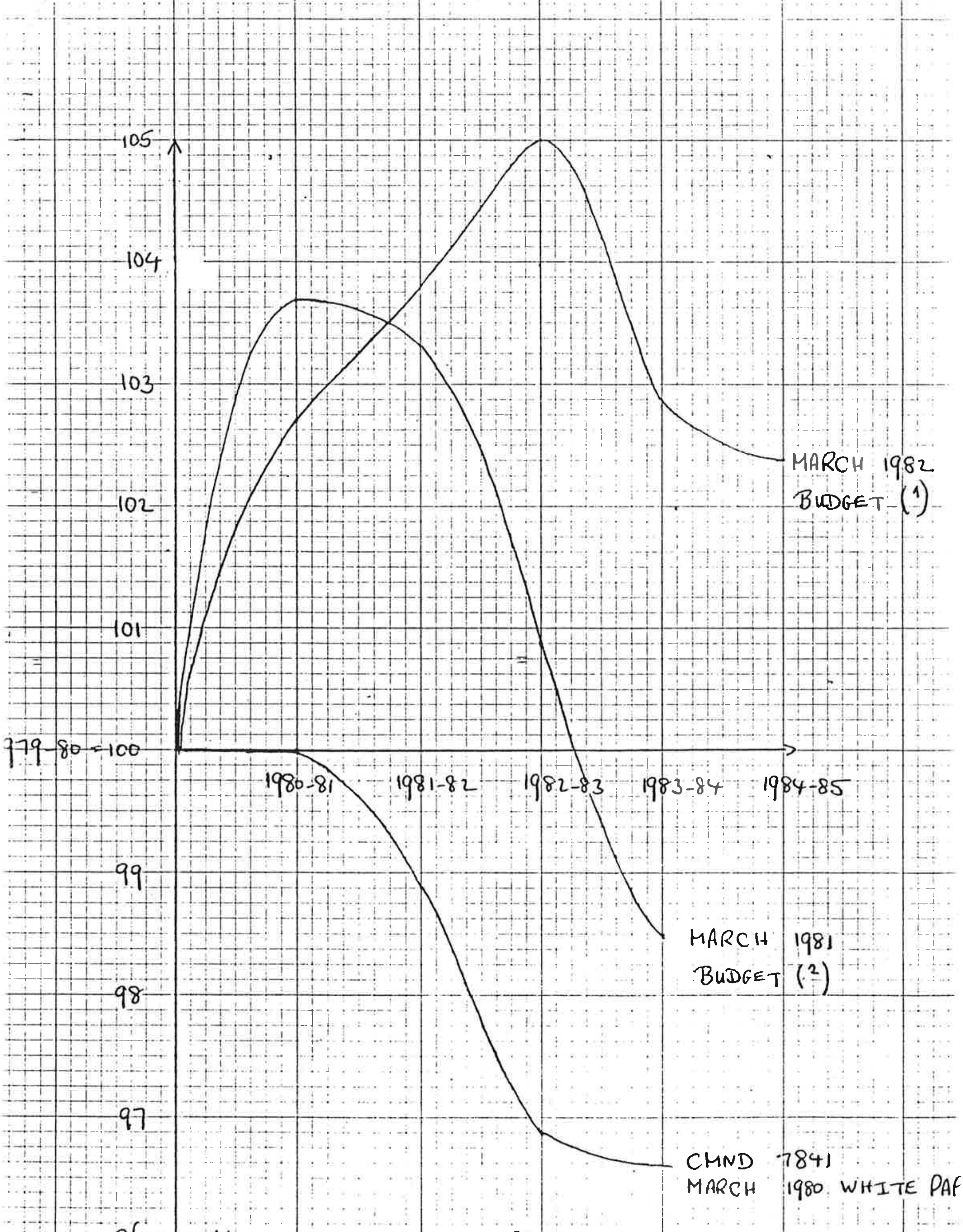
PUBLIC EXPENDITURE PLANNING TOTALS

£ billion cash



Notes: [1]Converted into cash from the plans in 1980 Survey Prices.
[2]Converted into cash using the same inflation assumptions as used for converting the MARCH 1981 BUDGET plans.

EXPRESSED IN 'COST TERMS' 1979-80 = 100



Notes: (1) Cash plans deflated by GDP Deflator assumptions i

(2) Cmnd 8175 'cost terms' adjusted for Budget measures.

CONFIDENTIAL

Mr Rayner. PR

FROM: J.O. KERR

2 September 1982

cc: PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C
PS/Minister of State (F
Sir Douglas Wass (o/r)
Sir Anthony Rawlinson
Sir Kenneth Couzens (o/
Mr. Burns (o/r)
Mr. Barratt
Mr. Byatt (o/r)
Mr. Middleton (o/r)
Mr. Wilding
Mr. Kemp
Mr. Mountfield
Mr. Bottrill
Mr. Hart
Mr. Ridley

PS/CHIEF SECRETARY

"THE LONGER TERM"

The Chancellor spoke to the Prime Minister yesterday about the paper attached to his minute of 27 August, and Mr. Sparrow's letter of 31 August. The Prime Minister was, I understand, concerned about the risk of leaks of some of the specific suggestions in the CPRS paper, and some amendments to it are now being made by Mr. Bailey. It was, however, agreed that our paper could be circulated forthwith subject only to the amendment of paragraph 14(a) which will now read:-

> " .... that (except where work is already in hand) we should as a first step commission further studies along the lines identified by the CPRS in their paper (C(82)) (and in the annexe on minor options) as well as any other possibilities colleagues may care to suggest. These studies should be completed and reported back to the Cabinet in the spring of 1983."

2. I have passed this amendment to Mr. Hart: the paper, as amended, will be forwarded to the Cabinet Office today. The Chancellor has agreed that it should include the first of the two charts attached to Mr. Hart's minute of 1 September.

3. The Prime Minister thinks it important that there should be some prior lobbying of Cabinet colleagues. Given his absence in Toronto until next Wednesday morning, the Chancellor would be

6/188.

/grateful

grateful if ~~you~~ the CST would take on the bulk of this. While he thinks that a fairly widespread lobbying exercise is required, he is particularly concerned to defuse in advance any possible dissent from the Secretaries of State for Trade, Industry and Scotland, and from the Lord President.

JOK.

J.O. KERR

CONFIDENTIAL

FROM: MISS J M SWIFT

DATE: 6 September 1982

PA

Mr Rayner.

PRINCIPAL PRIVATE SECRETARY

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass o.r.
Sir A Rawlinson
Sir Kenneth Couzens o.r.
Mr Burns o.r.
Mr Barratt
Mr Byatt o.r.
Mr Middleton o.r.
Mr Wilding
Mr Kemp
Mr Mountfield
Mr Bottrill
Mr Hart
Mr Ridley

"THE LONGER TERM"

The Chief Secretary has seen and noted your minute of 2 September.

2. The Chief Secretary will be speaking to the Secretaries of State for Trade and Industry and the Lord President about the Chancellor's paper, in advance of the Cabinet meeting. But not to the Secretary of State for Scotland, who will not attend Cabinet on Thursday.

MISS J M SWIFT

2/194

CONFIDENTIAL

add to 'Long Term' pp3

FROM: E P KEMP
8 September 1982

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Anthony Rawlinson
Mr Barratt
~~Mr Mountfield~~
Mr Hart
Mr Hall

CABINET TOMORROW

We have perhaps belatedly come on one matter which may be relevant to Cabinet discussion of the longer-term tomorrow, which you may like to have in mind.

2. This is the remit given by the Prime Minister at Cabinet towards the end of July (CC(81)40th Item 6) that every Minister in charge of a Department should arrange for the preparation of a Report on a "Forward Look" at the Departments' programmes for the next 5 years, such Reports to be sent to her not later than 24 December 1982. As far as we can make out no action has yet been taken on this rather bald remit (certainly nothing has been done within the Treasury) because Departments, and ourselves, are expecting some kind of amplification and fleshing out of what precisely is wanted, before putting work in hand.

3. This remit clearly could have some interaction with tomorrow's discussion. Insofar as colleagues agree with your paper, and are pursuaded that something meaningful should be done, then clearly there would have to be changes in the policies and programmes of some, if not all, Departments, which should ideally be reflected in the Forward Look which the Prime Minister has asked for. Indeed it may be that depending on how tomorrow goes, the return submitted in respect of the Forward Look will turn out to be an interesting indication of how far Ministers' thinking has really been affected by your paper.

4. There seems no need for you specifically to refer to this Forward Look remit tomorrow, unless you wish to do so; but we thought you should be reminded of it in case others raise it.

EPK

E P KEMP

Mr Rayner.
RA

From: M G Richardson
8 September 1982

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Byatt
Mr Mountfield
Mr ~~Hart~~ 9/6/3
Mr O'Donnell

LONG TERM PUBLIC EXPENDITURE: DEFENCE

In preparation for the Cabinet discussion tomorrow, GE are providing briefing on the papers C(82)30, 31 and 32. This minute offers advice on C(82)33, the memorandum from the Secretary of State for Defence.

2. Many of the arguments advanced by Mr Nott are as relevant to forthcoming PES discussions as to Cabinet consideration of the longer term. For this reason it might be preferable for the Chief Secretary to take the lead on detailed points about the defence programme.

3. Defensive speaking notes are at Annex A. I also attach, at Annexes B and C, material on the current defence budget being prepared for the forthcoming bilateral.

4. The Defence Secretary's position is epitomised by the last sentence of C(82)33: it is not defence spending that needs curbing but the rest of public expenditure. If other Cabinet Ministers take a broad rather than a parochial view of public spending, Mr Nott will have overreached himself; his position will be isolated. If on the other hand the Cabinet endorses the Defence Secretary's line he will be irrepressible in 1982 PES; and the prospects for curbing public expenditure in the longer term will be severely diminished.

5. Treasury Ministers' aim should be to keep all options open for the later years (it seems unrealistic to try to secure agreement now to no growth in defence spending after 1985-86). There is no need to enter into any commitments now about defence spending in the late

16/200

/ 1980's.

1980's. Equally there is no reason why the CPRS proposal on defence should not be further pursued. It is not claimed that restraining the growth of defence expenditure would carry no disadvantages. It might be for later consideration whether simply not increasing defence spending is less painful or less visible than other options for reducing public expenditure. This is why all options should remain available.

6. Hitherto, defence spending has not been curbed. Despite economic difficulties (negative GDP growth in 1980 and 1981) it has been increasing in real terms. The Government's affirmed intention is to provide in 1985-86 for a level of defence spending 21% higher in real terms than it was in 1978-79. The CPRS have not questioned that commitment. Their proposal is simply that after 1985-86, defence spending levels should not increase further; that is, they should be held at a level 9% higher in real terms than in 1982-83.

7. How much real growth defence spending has enjoyed since 1978-79 is open to debate. The doleful figures quoted in Mr Nott's seventh paragraph are based on MOD's own me hodology for calculating pay and price increases. This system has recently been subject to joint review (the Unwin report, which Mr Nott seems reluctant to circulate). That review exposed widespread shortcomings in the MOD's system and recommended fundamental changes. It also found that the MOD methodology consistently overestimated defence inflation, and so understated "volume" and real growth. Calculations based on the CSO defence procurement index, for example, indicate that real growth from 1979-81 was 11% - well in excess of the NATO target and top of the European league.

8. The 1982-83 defence budget provided for 3.7% real growth over the previous year.

9. The level of spend is more important than rates of growth. In absolute terms (and excluding the Falklands) UK defence spending is second only to the USA; as a percentage of GDP it is second only to the USA and Greece.

10. In short the UK's defence contribution compares favourable with that of any of its European allies; it is most depressing that the Defence Secretary is not prepared to say so. The Government's defence effort continues to receive less than its full credit because of lack of positive presentation by MOD.

/ 11.

11. Treasury Ministers should not follow Mr Nott into detailed arguments about defence capabilities. But the following points are relevant:

(a) The CPRS proposal in effect is for an annual defence spend of £15-16bn at today's prices. Mr Nott's assertion - in his paragraph 5 - that this level of expenditure would lead to a "rapid diminution of our defence capabilities" - is amazing;

(b) the phenomenon of cost growth (paragraph 6) is due almost entirely to the increasing sophistication - and thus greater capability - of defence equipment. Simplistic comparisons of numbers of platforms are/less meaningful than military capability. In the words of Cmnd 8288 (The Way Forward), "the balance of our investment between platforms and weapons needs to be altered so as to maximise our real combat capability."

(c) On the alleged relative price effect (rpe) on non-pay expenditure, the MOD position (paragraph 4) is equivocal. In the 1981 PES Mr Nott claimed advance provision for a 2% rpe. In this year's Survey MOD are claiming that the defence rpe, on average over the Survey period, will be nearly 3% (ie that defence prices will increase at a rate 50% higher than forecast inflation generally). The firm Treasury line is that there should be no advance provision for rpe; that would become a self-fulfilling prophecy. The LTPE exercise used two rpe assumptions - a 2% rpe on non pay expenditure and a nil rpe. As Mr Nott says, with no rpe the figures are lower, but the defence share of public expenditure would be only 1.0% less; the 1990-91 defence programme would still be 26% higher in cost terms than it is today.

M G Richardson

M G RICHARDSON

Annex A

SPEAKING NOTES

1. As the Chancellor's paper says, nobody today is proposing specific cuts or long term planning totals. There is certainly no need to take decisions now on defence spending in the latter half of the decade. The level of defence budget the country can afford will be decided nearer the time. It is essential however to keep all options open for that period. No Government should bind itself with commitments that might be impossible to fulfil.

2. Restraint in defence spending is not without military disadvantages, just as restraint in other sorts of spending carries penalties. We might wish to consider at a later date whether maintaining a level defence spend is more or less painful than other public expenditure options.

3. The CPRS proposal in Annex K of their paper is a modest one; it does not recommend a cut in defence spending. No reduction on current plans is mooted. The proposal is simply to hold the 1985-86 level of annual defence expenditure; that is, to maintain the defence budget for the second half of the decade at a level 9% higher, in real terms, than it is today.

4. The Government's intention is that defence spending in 1985-86 will be 21% higher than when we came to office. The CPRS proposal would simply require that, thereafter, defence spending should take account of other Government objectives (notably to reduce public expenditure); even so, they proposal a constant, not a declining, level of spend.

5. One great advantage of the CPRS proposal for defence is its ready feasibility (and relatively low visibility). Current MOD planning assumes exactly this path of future provision. So there should be no adverse operational or industrial penalties caused by a disruption of current plans. MOD say their current planning assumptions are intended to allow for flexibility. This presumably means flexibility to increase or reduce the programme; it remains essential that MOD do not reduce that flexibility by starting to plan for increases in spending after 1985-86.

1981-82

The review of the 1981-82 cash limit was not settled until the end of November. The in-year changes were as follows :

	£m
1981 AFPRB award	+82
Accounting Adjustments	+1
General addition	+300
	+383
Deduction for 1980-81 overspend	-64
Net increase	+319

2. The most controversial addition was the enhancement of £300m agreed at the end of November. MoD claimed that £300m was needed to avert an overspend, and was warranted by excessive increases in 1981-82 defence prices. The Treasury have always believed MoD price forecasts to be overstated; the addition was part of a package to ease the adjustment of the defence programme following Cmnd 8288, and to avoid the general damage to the cash limits system of a substantial overspend.

3. It transpired that the real problem facing the 1981-82 defence budget was of a substantial underspend. MoD would say this stemmed from the effectiveness of their cash control, and from the lateness of the £300m addition. The Treasury believe the potential underspend resulted from overestimation of pay and prices, and point to Mr Nott's statement to the Prime Minister, "If I agree to anything less than £300m the MoD is bound to overspend."

4. In the event, MoD averted a major (£500m) underspend in two ways :

a. addback measures to accelerate spend (eg on fuel and works maintenance)

b. advancement of a monthly bill-paying date from April to March (and thus from 1982-83 to 1981-82).

It is not possible to quantify the effect of these measures, but just under £300m of bills were advanced, and at least £100m must have been accelerated elsewhere. The final outturn showed a small £5m underspend.

5. There is still argument about the level of defence price movement in 1981-82. According to MoD's own methodology, non-pay prices in 1981-82 were 12.3% higher than in 1980-81 (the original cash provision was based on a factor of 11%). But

a. the Unwin report indicated that the MOD system leads to an overestimation of "pay and price"; for example two exceptionally high assessments were land systems (14.1% compared with 9.5% on an alternative MoD index) air systems (13.3% compared with the DOI aerospace index of 10.9%).

b. The extra payments at the end of the year (when prices are highest) will have distorted the average price movement.

6. An increase in non-pay prices of 12.3% would have postulated an addition to the defence budget of some £100m. Even on his own calculations, Mr Nott received an over-generous addition in 1981-82.

ANNEX C

1982-83

1. In the 1981 Survey, the following additions were made to the 1982-83 defence budget:

	£m
Carry-through of 1981 AFPRB award	+85
Transitional addition	+375

including non cash limited pensions
This gave a defence budget/of £14088m and a cash limit of £13288m. Following the NIS clawback in April, the defence cash limit is now £13253m.

2. On the assumption the prices would increase in line with the factors used in drawing up the initial cash baseline (4% pay, 9% non-pay), the 1982-83 budget provided for real growth of 3.7% over 1981-82. This is well in excess of the NATO aim. MoD have subsequently been asked to absorb the cost of pay settlements (civil service, AFPRB, TSRB, DDRB) in excess of 4%. But HMT's latest forecasts of general inflation on the RPI show the 9% non-pay factor to be generous.

3. The generosity of 1982-83 defence provision derived from the severe difficulties Mr Nott perceived last winter. He claimed that during the preparation of estimates cuts of over £1000m had been imposed. Even then, he alleged, there remained a "programme gap" - an excess of the planned programme over agreed provision - of some £200m. His memorandum OD(82)2 recommended that no measures be imposed to reduce that gap, because the ensuring operational and industrial penalties would be severe; OD accepted this recommendation.

4. Falklands apart, the real MoD problem in 1982-83 - just as in 1981-82 - has been to avert a potential underspend. In the first four months of the year the spend on the equipment vote has averaged £450m; this needs to be £620m each month if the cash limit is to be spent. Although it is impossible to assess the full extent of the potential underspend, it might be £500m: roughly enough to accommodate 1982-83 Falklands costs.

5. MOD have taken and are planning measures to absorb the shortfall. They have forgone the £100m receipts provided for the sale of "Invincible". Addback measures already taken exceed £200m; more addbacks are being prepared. In addition, MOD are contemplating for a second year the advancement of a monthly bill-paying date. The payment previously planned for 1 April 1983 might now be shifted to FY 1982-83. As a result of all these endeavours it is quite likely that an underspend on "normal" expenditure will be averted; this will enable MOD to claim the full amount of extra Falklands expenditure. It is for consideration whether an attempt should be made to persuade Mr Nott to avoid taking all these measures and to aim for an underspend on "normal" expenditure.

6. In PES 1981 Mr Nott claimed that the 9% cash factor was inadequate and that a relative price effect (rpe) of 2% was inevitable on non-pay expenditure. All the evidence to date suggests that the 9% factor was generous. Finance staff for Vote 2 (equipment) and Vote 4 (works) believe 9% to be adequate; on the non-pay part of Vote 1, price rises of only 7.5% are forecast. Given the tendency of the MOD system to overestimate the pay and price element, the underlying trend of defence prices might be expected to be lower than these estimates (that is, nearer to the general inflation rates now being predicted in the Treasury). So the "volume" programme - and real growth - achieved could be even higher than envisaged during the 1981 Survey.

P/A

FROM: T A A HART
DATE: 8 September 1982

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr Burns
Mr. Barratt
Mr Wilding
Mr Kemp
Mr Mountfield
Mr Bottrill
Mr Culpin
Mr Faulkner
Mr Goldman
Mr Hall
Mr N King
Mr O Donnell
Ms Seammen
Mr G P Smith
Mr I Wilson
Mr Rayner
Mr Ridley

THE LONGER TERM - BRIEFING FOR CABINET ON 9 SEPTEMBER (C(82)30-32)

This is an updated and revised version of the brief I submitted on 1 September. It takes account of comments made on the earlier version, and the CPRS paper (C(82)31) which has now been circulated. The main additions to the brief are new paragraphs indicating which of the CPRS options look most promising (para 12), a paragraph on public service manpower (para 13), and a section on "presentation" (para 15) following up paragraphs 7d and 14d of your own paper.

2. The Annexes to the brief have been slightly amended, and re-numbered to accord with the final version of the CPRS paper: there is a new one on local government manpower. The Annexes on smaller programmes (A), NHS manpower (B), social security (J) and defence (K) suggest a rather more positive line than was taken in the earlier briefing.

The aim

3. Your main aim will be to obtain your colleagues' agreement that the long-term prospects suggested by the officials' reports are unacceptable, and that there is a need to get public expenditure on to a better track. As a first step, you are proposing that the Cabinet should commission further studies of the options identified by the CPRS in their paper and that these should be completed and reported back to the Cabinet in the spring of

1983. Your second aim is to secure a moratorium on new commitments (or the renewal of old ones) which would add to expenditure beyond 1985-86. You are also asking your colleagues to have particular regard to the longer-term implications of their decisions in this year's Public Expenditure Survey and to consider how these issues might best be presented in Parliament and to the country. Some strands of the argument are common to this discussion and that of the Family Policy Group for which Mr Kemp is submitting a separate brief.

Tactics

4. You have said that you are anxious to avoid giving the impression that this is simply another Treasury "cuts" exercise, and your paper seeks to distance the discussion from this sort of approach. We do not know how the Prime Minister will handle the meeting, but the natural order would be to have first a fairly fundamental and broad-ranging discussion about the Government's long-term policy objectives and the size and shape of the public sector, in the course which you would hope to secure your colleagues' acceptance in general terms of the analysis in your paper. If they are agreed on the seriousness of the overall problem, they could then turn to the specific policy options identified by the CPRS as worth further study. We think it is important not to get into the specifics too soon before the general analysis has been discussed and accepted. Discussion of the four specific proposals at the end of your paper would naturally follow on from discussion of the CPRS options. It will be important to emphasise that no Minister is being asked at this stage to sign up for particular cuts or policy changes. All that is proposed is a series of further studies, together with a moratorium on new commitments until that work has been completed in the spring of 1983.

Introductory speaking note

5. In introducing the paper you may like to say something on the following lines:

"I have said in my paper that this discussion is one of the most important we shall have at any time in this Parliament. I do not think that is an overstatement. The decisions we take on these longer term problems will influence what goes into the Manifesto for the next election; and they will affect the performance and shape of the economy for the rest of this decade at least and probably longer. The "lead time" for decisions on public expenditure is a long one: if we want to influence what happens at the end of the decade we need to think about it now and begin to take the necessary decisions next year.

Our starting point is the report of the official group on longer-term trends in public expenditure. But I feel sure that we must not confine ourselves to a narrow discussion of the issues raised in that report. I hope very much that we shall be able to have a fundamental and broad-ranging discussion about our long term policy objectives and the size and shape of the public sector. This means looking at the broader political context and the longer term prospects for the economy both at home and worldwide. In the light of this, we might look at some of the options discussed by the CPRS in their paper and at the specific proposals at the end of mine. I do emphasise that I am not at this stage seeking any particular set of new cuts or any given level of public expenditure for the future. But I think it is important that we should at this point in this Parliament review our policy objectives pretty fundamentally and consider whether we are on the right track to achieve the sort of society and economic succes that we want.

My own conclusion is that we may need to make some quite radical changes of direction, if we are to avoid creating in the longer term an economy - and a society - which is dominated by the demands of the public sector, with all the depressing effects which that entails for individuals and for enterprises. A great deal has been done already. We have had a considerable success in reducing the level of inflation; but the task of reducing the public sector at a time of worldwide recession has proved even more intractable than we expected in 1979. The prospect now revealed by the officials' report would be a grim one for any Government. It is particularly so for us with our firm commitment to reduce the share which the State takes of the nation's income. But it remains essential for us to hold to that objective and achieve it if the economy is to recover and grow as we wish.

The officials' report rightly points out that its two "scenarios" are not forecasts. They simply illustrate what might happen if we maintain our present expenditure policies against two different economic backgrounds, one rather more favourable than the other. Although neither scenario is a forecast, neither of them is at all fanciful: the assumptions on which they are based are reasonable and, if anything, conservative. On

the low growth scenario, the report shows that public expenditure might rise to nearly 47 per cent of GDP in 1990-91, a figure which I am sure we would agree is altogether unacceptable. Things are a little better under the more optimistic scenario A, but in real terms public expenditure would still be higher in 1990-91 than in our first year of office or than we planned for this year. In the Annex to my paper I have set out the tax implications which are equally unwelcome. Even on the more favourable assumptions, there would be little or no room to reduce personal taxation or improve incentives. And we could not make the reductions in company taxation which are essential to recovery and growth. The tax rates implied by the more pessimistic scenario would be positively damaging to industry and crippling to individual incentives.

We cannot borrow our way out of this difficulty. Increased Government borrowing to finance these planned levels of expenditure would simply push up interest rates generally, wipe out our achievement in getting them down and place a further damaging burden on industry. The analysis leads one unavoidably to the conclusion that the way forward to better economic performance can only be through reducing expenditure. I recognise the political difficulty of doing this at a time when people still retain high, unrealistically high, expectations of a steadily improving standard of living and public services. There is a major task of public education to be done and we need to find new ways of permitting some of the demands to be met. We must also give ourselves more room for manoeuvre: we are hedged in at present by too many pledges and commitments covering very wide areas of expenditure. We need to review these in the light of current priorities, and if necessary we must be prepared to make radical changes.

I have been struck at recent Economic Summits by the extent to which Heads of Government and Finance Ministers everywhere are confronted, like ourselves, by major problems of public expenditure, such as untenable commitments to indexation and the large public sector deficits which through their impact on taxation and interest rates create such a threat to economic recovery. This is a continuation of a

pattern which has been emerging for many years. If we look backwards at public expenditure in this country over the last 20 years, there is a consistent upward pattern, broken only by the two external crisis of 1967 and 1976. Even then, the upward trend was soon resumed. I believe we need to break this pattern, decisively. As I have said, I am not today seeking any specific cuts, but I believe we must review our long term spending commitments or we shall run into very major difficulties in the course of the next Parliament. I hope that we shall therefore agree to commission further work on some or all of the main options identified by the CPRS. And until that is done, I hope we could agree not to enter into major new commitments - or renew old ones - which would add to public expenditure in the longer term."

Chancellor's paper - defensive briefing

6. The most likely criticism of the analysis in your paper is that the rising tax burden shown could be substantially reduced by an increase in public borrowing. You may have anticipated this in your opening remarks, but if not you could say:

(a) more borrowing means higher interest rates;

(b) higher interest rates mean less investment and thus, in the longer term, lower growth of output and employment;

(c) borrowing should not be seen an easy way out of avoiding paying for public spending. Nothing is for nothing and borrowing simply transfers the burden to others, including mainly the private sector;

(d) to the extent that the PSBR is allowed to rise, the consequences will be higher interest rates and/or increasing inflation, both of which would be deplorable. To allow either to rise again would make it look as if all the earlier sacrifices had been in vain.

7. The officials' report (LTPE) was generally agreed at official level, so it is unlikely that many technical points will be raised. The Ministry of Defence have, however, questioned in correspondence with Sir Douglas Wass the report's reliance (eg in the final paragraph) on percentage increases in particular programmes. They argue that this ignores the size of the baseline and that the absolute figures would give a truer picture of the changing balance between programmes. In particular defence would appear in a better and social security in a worse light. There is not much in this point. There are a variety of ways of presenting this sort of information and all other departments were content to use percentage increases. If the point is raised, we recommend you to say this, and to take the line that it is the general

trend and the increase overall which is the main cause for concern. About this there is no doubt at all.

8. Other technical points are covered in the attached notes as follows:

- the scenarios (Flag X)
- the economic assumptions of the LTPE report (Flag Y)
- the fiscal annex (Flag Z)

The CPRS paper

9. You saw the CPRS paper in draft and discussed it with Mr Sparrow. It has to tread a rather difficult line. On the one hand, the CPRS were commissioned by the Prime Minister to produce a set of policy options for reducing public expenditure in the longer term. On the other hand, you do not want to appear to be seeking a set of "super-cuts". The best approach might be to argue that the CPRS have, as they were asked, produced a wide-ranging set of policy options. At this stage, no-one is seeking specific cuts or changes in policy. But there is much to be said for further study of all the main options identified by the CPRS and, possibly, some of the lesser ones in Annex A to their paper. No Minister is being asked to commit himself to policy changes, but no reasonable approach should be ignored.

10. Some colleagues will no doubt want to comment on the options individually and some may ask to be exempted from the exercise. We woud recommend you to argue against this: the exercise will be much more acceptable if all the major departments are seen to be in it together.

11. Notes on the options by Expenditure Divisions are attached. They are (in the order of the CPRS paper):

A. Smaller programmes.
B. Public service manpower.
C. Accounting changes.
D. Increased charges for health services.
E. Private health insurance.
F. Cutting Education spending.
G. Charging for schooling.
H. Charging for higher education.
J. De-indexing social security benefits.
K. A halt to growth in defence spending after 1985-86.

12. In each case the notes by Expenditure Divisions suggest a line to take. The front-runners for the Treasury are undoubtedly Defence (a comparatively modest proposal

to halt the growth in spending after 1985-86), and (despite the great political difficulty) the de-indexation of social security benefits and charging for higher education. We would urge you to go strongly for further work in all these fields. There are good possibilities for change too in increased charges for health services and private health insurance. Charging for schooling ought, perhaps, to be examined because of the size of the potential savings but politically it may be a non-starter. Cutting education spending seems less hopeful, and we see nothing to be gained from the largely cosmetic "accounting changes" in Annex C. Among the smaller programmes (Annex A) we recommend you to press hard for further work on a review of all housing subsidises and a study in the field of other environmental services.

13. You may face particular questions on public service manpower. On civil service numbers after 1984, we recommend you to say that a paper is already in hand and will be coming forward to Treasury Ministers shortly. A further study, reporting back in the Spring is, therefore, unnecessary and would only cause delay. We recommend you to press for further work to be done on NHS numbers (Annex Bii), but to suspend judgement on local government manpower (Annex Biii). It would be premature to reach a view on this before Ministers have considered the Chief Secretary's recent paper on capping local authority rates.

Implementation of future work

14. There has been no discussion at official level of how the future work should be carried out. The load would probably be too great for the CPRS and there is, in any case, an argument that departments (under the direction of their own Ministers) should review their own policies. On the other hand, this may not lead to a sufficiently rigorous examination. An alternative possibility, which combines departmental autonomy with a measure of independent appraisal, might be to have the studies steered by an interdepartmental group at Permanent Secretary level. Sub-groups on each option - on which the Treasury should be represented - could then report to the Steering Committee. If this seems too cumbersome, the Steering Committee might remit the work on each option to the responsible Department, it being understood that the Treasury and the CPRS would be associated with the work. We recommend that you raise this point and suggest that the Secretary to the Cabinet be invited to make proposals to the Prime Minister. You might also emphasise the need for a sense of urgency: if policy changes are to be implemented in the next Parliament, the long term begins now.

Presentation

15. Paragraph 14(d) of your paper invites colleagues to consider further how these difficult issues might best be presented to the Government's supporters in Parliament and to the country at large. There are two separate issues here:

(a) Simply getting the facts across. Either the Government could publish some of the relevant information itself or some reputable outside body or individual might be persuaded to do the same work and reach the same conclusions. The latter course would take longer. But it has the advantage of distancing the Government from some of the more awkward hypotheses of the exercise (eg on long-term unemployment). The timing would need careful consideration (should it be before or after the further studies?) as well as the various channels through which the facts might be channelled.

(b) Changing attitudes. The task here is a major one and primarily political - to alter the way in which very many people now regard public spending, stimulating discussion about its macro-economic disadvantages and encouraging a preference for greater private provision.

In both (a) and (b) the aim would be to try to avoid the sort of "auction" of promises which the next election might otherwise precipitate, which could well undo any Cabinet decision this week about not making further pledges.

Overseas experience

16. Your paper refers to other countries' public expenditure experience. The purpose of this is to show the extent to which other countries have also had to retrench. There are difficulties about linking high economic growth too closely with lower public expenditure. This is a complex field and it is easy enough to produce counter-examples. The US, for example, has had both low public expenditure and low growth. The French and Germans, who have relatively high public expenditure shares, have also typically had reasonably fast growth over the past two decades. Japan has had low public expenditure and high growth, but it is in many ways exceptional. It would seem best to let the logic of your paper speak for itself rather than rely closely for support on overseas experience.

AJH

T A A HART
GEP1

CONFIDENTIAL

FROM: J O KERR
DATE: 10 September 1982

PA

cc Sir A Rawlinson
Mr Mountfield
Mr Hart
Mr Spackman

MR RAYNER GEP1

LONG-TERM PUBLIC EXPENDITURE

I told you that Lord Cockfield yesterday challenged in Cabinet some of the LTPE figures, claiming that if they were re-worked on a cash rather than a cost basis the differential growth in programmes was quite different from the picture we described. I now attach the table which was in Lord Cockfield's brief. If it is clear that these figures are wrong, the Chancellor ought I think to drop him a note saying so. Perhaps you could let me have some advice by 22 September?

J O KERR

ANNEX B
(revised)

PUBLIC EXPENDITURE IN CASH TERMS

(£bn)

		Scenario A		Scenario B	
	1982-83	1990-91	Change	1990-91	Change
Defence (assuming [illegible] non-pay relative price effect)	14.1	30.2	+16.1	41.8	+27.7
Overseas Aid and Other Overseas Services	2.1	4.6	+2.5	5.1	+3.0
Agriculture, Fisheries, Food and Forestry	1.5	2.6	+1.1	3.6	+2.1
Industry, Energy, Trade and Employment (excluding grants to nationalised industries)	5.8	7.5	+1.7	11.5	+5.7
Transport (excluding grants to nationalised industries)	4.2	6.4	+2.2	7.4	+3.2
Housing	3.5	6.4	+2.9	14.0	+10.5
Other Environment Services	3.7	5.5	+1.8	7.1	+3.4
Law, Order and Protective Services	4.1	7.5	+3.4	10.2	+6.1
Education, Science, Arts and Libraries	12.8	19.1	+6.3	26.0	+13.2
Health and Personal Social Services	13.6	25.9	+12.3	33.9	+20.[illegible]
Social Security	32.0	52.6	+20.6	69.6	+37.6
Other Public Services	1.4	2.2	+0.8	2.8	+1.4
Common Services	1.6	2.2	+0.6	2.8	+1.2
Scotland, Wales and Northern Ireland	12.0	20.6	+8.6	28.0	+16.0
Nationalised Industries	1.1	3.5	+2.4	4.8	+3.7
Asset sales, contingency provision and other adjustments	1.5	3.9	+2.4	5.4	+3.9
	115.0	200.7	+85.7	274.0	+159.0

Inflation assumptions 1980-81 to 1990-91 – Scenario A – 84%
Scenario B – 155%

857) 20.60 (24
17 14
3460

85.7) 15.10 (17
857
6530

(1) Perm Sec. (2) JMB
(LCA)

CONFIDENTIAL

2419

B/F

(with LCA)

From: P Mountfield
Date: 15 September 1982

371/9

Sir A Rawlinson

cc -
PS/Chancellor
Mr Hart
Mr Spackman

LONG TERM PUBLIC EXPENDITURE

We have now seen "the limited circulation annex" to the minutes of the 9 September Cabinet. Much of it was predictable. What matters are the conclusions.

2. The key ones (and I do not have the text in front of me when dictating) are these:

a. Agreement to avoid, so far as possible, any new public expenditure commitments; no further action seems necessary on this. But the price of economy is eternal vigilance.

b. A request to the Chancellor to make proposals on publising the ideas in the LTPE Report. You may like a word about this: we might start at COGPEC on Friday.

c. An instruction to all departmental Ministers to consider ways in which their departmental expenditure might be reduced in the longer-term, by substantial amounts; they are to make proposals on this to the Chancellor, and to report to Cabinet. This is less than precise; you might like to discuss with Sir Robert Armstrong, at a convenient moment, whether any timescale should be given to this remit; how if at all the Treasury is to be associated with the work; and how the results are to be brought together before being reported back to Cabinet.

d. A remit to the Chancellor, which I did not properly understand, to think about ways in which the future budgets might encourage the recovery of the economy. In this he is to be guided by some ideas which Mr Heseltine is to set down. I think it is for Private Office to decide how this remit should be discharged.

PM

P Mountfield

FROM: T A A HART
DATE: 20 September 1982

PA

cc: Sir A Rawlinson
Mr Mountfield
Mr Spackman
Mr Stannard
Mr Rayner or wpps

PRINCIPAL PRIVATE SECRETARY

LONG TERM PUBLIC EXPENDITURE

I am replying to your minute of 10 September to Mr Rayner who has been on leave.

2. We have gone through the figures which were in Lord Cockfield's brief and have been in touch with their author in the Department of Trade (Mr Alec Berry). The inflation assumptions quoted in what is called Annex B (revised) are not quite the same as those assumed in the LTPE economic scenarios. But the LTPE paper was deliberately vague about its inflation assumptions and did not give the year to year path of assumed inflation. Mr Berry has explained what he did and his assumptions and calculations were sensible. There is no need to write, therefore, challenging the figures.

3. The point at issue is not so much the figures themselves as whether it was right to work in cost terms for the long-term exercise (as we did), or in cash (as Lord Cockfield apparently prefers). The case for working in cash was examined by officials in the LTPE Group and their conclusion is set out in paragraph 10 of the report (copy attached). Briefly, they took the view that figures which included speculative inflation assumptions over such a long period would not be helpful as a means of illustrating the growth in the resources which each programme may demand on how this compares with other programmes and the total resources available.

4. I do not know what use Lord Cockfield made of his cash figures in Cabinet and the minutes do not record his intervention. He may, however, have argued that it is more instructive to look at the increases in absolute rather than percentage terms (a point also made by MOD); if the increases in individual programmes are then expressed in cash they will take a different share <u>of the total increase</u> than if they are expressed

in cost terms. Social Security, for example, would take in cash terms 24 per cent of the total increase in expenditure in Scenario B rather than 6 per cent in cost terms. The effect is simply a matter of arithmetic: the bigger the programme the more the absolute amount of cash added when a forward projection is made in cash terms. The larger this cash addition, the greater the share it will take of the total increases. It is, of course, a rather odd comparison to make: what is far more interesting is the absolute or percentage increase in the programme compared with its original level.

5. Which presentation one prefers is a matter of judgement. Perhaps the best single yardstick is public expenditure, both total and by programme, as a percentage of national income. This is, of course, just the same whatever assumptions we make about general inflation. But there is also value in having a measure of absolute expenditure. Figures in cost terms serve this purpose well since they include the effects of relative price changes and so measure the cost of the expenditure to the rest of the economy. Cash comparisons which also include assumed long-term inflation rates tend to direct attention away from those expenditure policies which are increasing the underlying costs.

6. I would not recommend the Chancellor to write to Lord Cockfield about all this. No errors have been made on either side and the difference of opinion is a legitimate one (though we still think our own approach is right). And to some extent it is now water over the dam in view of the decisions reached by the Cabinet on 9 September.

E. Davies

pp

T A A HART
GEP1

hence in total public expenditure as a proportion of GDP.

The Public Expenditure Projections

8. In making the public expenditure projections it has been assumed that the Government will continue to constrain the size of the public sector by privatisation and restraint on expenditure. Firm intentions to privatise have been reflected in the expenditure figures, but no account has been taken of any substantial further privatisation. Allowance has been made for changes in expenditure as a result of demographic changes, and, for some economic services such as transport, for the likely growth in national income. But only limited allowance has been made for the likely increase, if national income grew as assumed in Scenario A, in the public's demand for some of the public services, notably health, education, and environmental services, and for increasing real social security benefits. (Social security benefits, for example, are assumed to increase by less than earnings). International evidence suggests that this demand could increase on a significant scale. The Government is not obliged to meet it and may decide to divert it into privately provided services. But the scope for such diversion is limited over this period. And local authority expenditure, although projected to continue its relative decline, may continue to be difficult to control.

9. The projections have been combined with the two economic scenarios to show what could happen to public expenditure as a proportion of GDP. This proportion is also a measure of the ratio of taxation and government borrowing to GDP; although to the extent that this is reduced by privatisation resources will not be released for expansion elsewhere. Privatisation of a corporation for example will move its borrowing from the public to the private sector, but this will not reduce interest rates.

10. The inflation assumptions in the two scenarios are very different, so it is not easy to interpret differences in expenditure between the scenarios when the figures are set out in current prices. The figures have therefore also been deflated by the inflation indices assumed in the two scenarios. This avoids measurement problems caused by changes in the value of money,

but takes account of changes in the relative costs of different elements in the various programmes. This means that the programmes, and the totals are expressed both in what are called "cost terms" and as a proportion of GDP.

11. The projections assume that levels of services over the period to 1990 will not, taking one year with another, be squeezed on account of inflation. The levels of service at which it would be appropriate for Ministers to aim if inflation were high is a matter for future decisions.

12. Figure 1 shows how, compared with 1979-80 and 1982-83, total public expenditure could develop on the basis of the two economic scenarios.

13. In cost terms, the 1990-91 programme total✓ in Scenario A is 20% higher than it was in 1979-80. In Scenario B it is 18% higher. As a percentage of GDP the total in Scenario A falls, compared with 1979-80, by a little over 1 percentage point, taking it back to where it stood in 1971-72. In Scenario B it increases by nearly 6 percentage points.

14. Comparison of 1990-91 with 1982-83 shows the programme total in cost terms at nearly 14% higher in Scenario A and 13% higher in Scenario B; as a percentage of GDP the total is nearly 4 points lower in Scenario A and 3 points higher in Scenario B. But this is in part because public expenditure in 1982-83 as a percentage of GDP has been increased by economic recession; this has reduced GDP and increased social security expenditure. It may therefore be a less satisfactory basis for comparison.

15. Figures 2 and 3 show how the various major programmes could contribute to these changes, expressed both as a proportion of GDP and in cost terms. In both scenarios the share of GDP devoted to

✓ The term programme total is used here to describe total public expenditure as defined in Cmnd 8494 and previous public expenditure White Papers. Also shown in figure 1 is the wider total including debt interest and some other adjustments, often used for comparisons with GDP. The figures for 1979-80 are outturn and those for 1982-83 are Cmnd 8494 adjusted for the changes in public expenditure announced in the Budget.

defence would be higher in 1990-91 than in 1979-80; although with no non-pay relative price effect there would in Scenario A be no increase over 1982-83. [illegible] and social security are shown as a broadly constant proportion in Scenario A, and a rising proportion in Scenario B. Education is shown as a declining proportion in both cases. The share of economic services (agriculture, industry, transport, nationalised industry borrowing), tends to fall, as does that of environmental services (housing, water and sewage, etc)

16. In cost terms, increases in major programmes from 1979-80 to 1990-91 on the basis of the assumptions in this report would be

- 35 to 50 per cent in defence expenditure, depending in part on the assumed non-pay relative price effect
- 30 to 35 per cent in the law and order programmes
- 25 to 35 per cent in expenditure on health due largely to demographic pressures
- 20 to 25 per cent in the social security programme, even though demographic changes are relatively favourable for this programme in the 1980s, compared with the 1970s or the 1990s.

The cost of education would be slightly higher in Scenario A than Scenario B if economic growth increased the real earnings of teachers. Different economic situation could affect infrastructure and industry programmes; higher growth is taken, for example, to involve more road buildings; a sluggish economy could involve more assistance to industry and employment and housing expenditure.

From: The Rt. Hon. Peter Shore, M.P.

HOUSE OF COMMONS
LONDON SWIA OAA

13

24 September 1982

Rt Hon Sir Geoffrey Howe MP
Chancellor of the Exchequer
Treasury
Gt.George Street
LONDON SW1

EXCHEQUER
24 SEP 1982
Mr Kemp
CST
FST
EST
MST(C)
MST(R)
J. ? (UM)

Sir A Rawlinson
Mr Byatt
Mr Quinlan
Mr Wilding
Mr Monger
Mr Mountfield
Miss J. Kelley
Mr Hall
Mr R.I.G. Allen
Mr Ridley
Mr Harris

Dear Chancellor,

Now that you are back from Washington, it really is necessary that you answer some questions which have been widely discussed in your absence and which now appear to be the subject of open debate between your Cabinet colleagues.

When I first read the report in the Economist just over a week ago, describing in some detail the CPRS Report that apparently came before Cabinet on 9 September, I could scarcely credit it. But, as you will know, its account was both confirmed and elaborated by other newspapers, including The Observer last Sunday.

There seems therefore to be no doubt whatever that such a paper exists and that it came before you and your colleagues in Cabinet. The Economist account also alleges that the Think Tank paper was given broad backing by Treasury Ministers.

You will also know that your colleague the Chief Secretary spoke two days ago to Conservatives in West Derbyshire, confirming "that we did talk about the very disturbing long term trend in public expenditure........ it should come as no surprise that we are looking at various options. That does not mean that the decisions on these matters have been pre-judged. They have not been. But radical options have not been ruled out either. The whole area of Government expenditure has to be re-examined to see if we can identify ways in which we might reverse the past inexorable rise in public expenditure".

6/6

Since the "radical options" , according to press accounts, include the demolition of the National Health Service, the re-introduction of fee paying in both the nation's schools and higher education establishments, and the de-indexation of retirement pensions and other benefits, what you and your colleagues are talking about is the demolition of the post-War welfare state, an economic counter revolution in Britain.

You will also have seen the speech made by your other Cabinet colleague, Norman Fowler yesterday saying that there was no question of the Government changing its commitment to a public service which placed patients before politics and asserting:- "we need continued commitment and support for the National Health Service from the Government and those who work in it."

You yourself, as the Senior Economic Minister, have said nothing so far. I believe you have a duty to make plain whether your colleague Mr Brittan or your colleague Mr Fowler has given the correct interpretation of the Government's thinking.

You have done already, more than any other Chancellor in post-War Britain, to damage and divide this country. But I warn you now that if you are contemplating the pursuit of these wrecking and destructive policies, you will meet with a national protest, the character of which you have not even begun to understand.

Yours ever,

Peter Shore

P.S. I am releasing this to the Press.

FROM: MISS J M SWIFT 16

DATE: 27 September 1982

cc Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Quinlan
Mr Wilding
Mr Monger
~~Mr Mountfield~~ 95/3
Miss J Kelley
Mr Kemp
Mr Hall
Mr R I G Allen
Mr Ridley
Mr Harris

PRINCIPAL PRIVATE SECRETARY

LETTER FROM THE RT HON PETER SHORE MP

The Chief Secretary has seen Mr Peter Shore's letter of 24 Septembe[r] to the Chancellor about long-term public expenditure.

2. The Chief Secretary has commented that his and Mr Fowler's remarks are all reconcilable and no doubt a "consolidating" draft can be prepared!

MISS J M SWIFT

47/10.

FROM: E P KEMP
27 September 1982

CHANCELLOR OF THE EXCHEQUE

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Middleton
Mr Quinlan
Mr Wilding
Mr Monger
Mr Mountfield
Miss Kelley
Mr Hall
Mr Allen
Mr Norgrove
Mr Ridley
Mr Harris
Mr French

TM

MR PETER SHORE'S LETTER

Here is a draft reply to Mr Peter Shore's letter of 24 September. This has been prepared in the light of the indications you have given, and follows discussion with Mr Harris.

2. I am a little unhappy about paragraph 6, which I have put in square brackets. This is included to meet your idea that the letter to Mr Shore might be used not just to defuse the "welfare state row", but also to cut back the expectations running round in the Press about tax reductions in the next Budget. But as I have it now it looks rather obviously dragged in, and in fact it is dragged in; although a link has been made in some sections of the Press Mr Shore most certainly does not make it himself, and it is of course a nonsense when one considers the timescales - the "welfare state row" is all about the longer-term, while the tax reductions canard is about next March. Moreover to bring the tax reductions argument into the letter to Mr Shore might, it seems to me, be a tactical error; it could reinforce the suspicion that there was a link, and it could get in the way of the effort which the draft below otherwise makes to put the debate the right way round, and start with arguments about the

need for a responsible Government to keep an eye on the long-term. It would be much better if a separate way of dealing with stories about the next Budget could be found.

3. Turning to the draft itself, this is I hope self-explanatory. As I say, it seeks to get the argument back to the question of diagnosis, and the job of any responsible Government to keep an eye on the longer-term, and away from the current emotional argument about remedies said to be under consideration. If the diagnosis can be put properly before the public, then there is obviously a better chance of a sensible discussion about a possible way forward. The ground for debate needs to be shifted to the problem itself before there can be any proper talk about remedies. In this context, indeed, it seems to me that there could be something to be said for publishing the long-term work which was done within the Treasury, or at least the gist of it, setting it out simply as a matter of arithmetic - which in large part it is - in order to try to get people to see the picture clear. Obviously there are a number of problems one would have to consider if one was thinking of publication, not least how one would deal with the CPRS paper which presumably one would not want to publish, but if you felt it worthwhile no doubt these could be looked at urgently.

have reminded Mr Kemp & Mr Kerr of the outstanding comment from Cabinet on 7 Sept.

4. For the rest, the draft seeks to steer the tricky course between on the one hand keeping the various options open and on the other making it clear that the Government is not about to "abolish the welfare state"; that is, reconciling what the Chief Secretary and the Secretary of State for Social Services said. You will want to consider whether the balance is right. Paragraph 4 is the key. This debate is presumably going to rumble on and on; no doubt it will come up in Brighton next week, it will be natural to say something about it in your speech to the NCVO on 11 October, and you have already indicated that you would like to touch on the long-term exercise, and take credit for it, in the Mansion House speech on 21 October. But in a sense this letter to Mr Shore will set some of the ground rules, and thus it is necessary to get it right.

5. As requested I also attach (for you only) a copy of the Letter of Intent of 15 December 1976, some information about public expenditure as a percentage of GDP back to 1971-72, and some key figures from the

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long-term expenditure exercise. (Please note that these last two are not on precisely the same bases).

E P KEMP

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DRAFT LETTER FOR THE CHANCELLOR OF THE EXCHEQUER TO SEND TO :

MR PETER SHORE MP

Thank you for your letter of 24 September. I am glad to have a chance of dealing with the points you raise.

2. There is an inbuilt tendency for public expenditure to grow. We all want more spending on things like pensions, health and education. But as you know of course - if only from the experience of your own Government with the IMF in 1976 - the well is not bottomless. Equally the IMF experience, and experience on many other occasions, has proved how painful and disruptive it is, not least from the point of view of the beneficiaries of these services, to have to make changes at short notice.

3. We need to know, therefore - indeed all responsible people, including yourself, should want to know - what the long-term costs of present policies are, so that if these look as though they are going beyond what we can afford we can consider what might be done while there was still time to take any necessary action in a sensible way.

4. Thus I support and agree with what both Leon Brittan and Norman Fowler said, as you quote them. It is right and proper that a responsible Government should look ahead and consider where things are going in the longer-term. Equally we maintain our commitment to support for the disadvantaged and the less well off, and I confirm our view that where services are best provided publicly they should be provided to a proper standard and as efficiently as possible.

5. It is because of this commitment, and entirely and necessarily consistent with it, that we are engaged in the present work. How to secure the provision of adequate

social and other services, at a time when, world wide, economic growth is slowing up, and what the right balance between public and private provision should be, are among the most difficult questions facing us, and not just in this country. These are questions which should concern all thinking people, and which deserve serious public debate.

[6. Our policies are to bring down inflation and interest rates, and to reduce the burden of taxation particularly for the lower paid, all with a view to securing a sustainable growth in output and employment. Inflation and interest rates are coming down. And while it is far too early to take any view about the next Budget, real reductions in taxation were effected in the last. In the longer-term progress on all these, and hence as I say on output and employment, has to depend on the public expenditure position].

7. Joel Barnett, writing of when he was Chief Secretary in your Government, has said ".... overall we failed to achieve the right balance between public and private expenditure because we stuck with levels of public expenditure decided on assumptions of growth in resources that were never achieved". It was that failure which necessitated your appeal to the IMF, and it is that sort of failure we are determined to avoid for the future.

[Inside the Treasury" page 58].

8. As I say, there is an important public debate to take place on these issues but I am afraid I do not think that the ostrich-like attitude displayed in your letter is much of a contribution to it.

GENERAL GOVERNMENT EXPENDITURE

at current prices

	% GDP	Rounded
1971	41.0	41
1972	41.5	41½
1973	41.8	42
1974	47.2	47
1975	49.2	49
1976	46.9	47
1977	43.0	43
1978	43.6	43½
1979	44.2	44
1980	46.0	46
1981		

PUBLIC EXPENDITURE (1)

at current prices

	% GDP	Rounded
1971-72	37.8	38
1972-73	38.9	39
1973-74	40.8	41
1974-75	46.2	46
1975-76	46.2	46
1976-77	44.5	44½
1977-78	40.3	40½
1978-79	41.2	41
1979-80	41.0	41
1980-81	43.4	43½
1981-82	44.8 (2)	45
1982-83	44.3 (2)	44½

(1) Public expenditure ie public expenditure planning total plus net debt interest, capital consumption, local authority VAT payments and market and overseas borrowing of nationalised industries. Market and overseas borrowing of nationalised industries for 1971-72 to 1974-75 is estimated.

(2) Estimate from Financial Statement and Budget Report 1982-83 (HC 237)

KEY FIGURES FOR LONG-TERM EXPENDITURE

£bn 1980-81 prices

	1982-83	1990-91 Scenario A	1990-91 Scenario B
Public Expenditure			
Total (inc debt interest)	103.0	116.0	115.0
Percentage GDP	44.0	39.3	46.8
Total (excl. debt interest)	95.5	109.0	107.5
Percentage GDP	40.7	36.9	43.8
Tax yield			
Total	92.1	109.9	97.4
Percentage GDP,	39.4	37.2	39.7
of which			
Income tax	25.7	32.3	29.4
Percentage GDP	11.1	10.9	12.0

RESTRICTED

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FROM: J O KERR

DATE: 28 September

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Middleton
Mr Quinlan
Mr Monger
Mr Mountfield
Mr Ridley
Mr Hall

MR KEMP

THE REPLY TO MR SHORE

The Chancellor was grateful for the draft answer to Mr Shore which you submitted yesterday. He agrees with you that it would be best to omit the argument at paragraph 6 of your draft, and he has infact prepared the attached, slightly amended, version, on which I should be grateful for comments by 3.00 p.m. today.

2. He would if possible like to include, perhaps in paragraph 4, a quotation from Mr Fowler's speech of 23 September. (You agreed last night to try to get hold of a complete text.) Alternatively, the Chancellor could draw on Mr Fowler's Answer in the House on 28 July about the pattern of NHS financing.

J O KERR

3/21

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DRAFT LETTER FOR THE CHANCELLOR OF THE EXCHEQUER TO SEND TO

MR PETER SHORE MP

Thank you for your letter of 24 September. I am glad to have a chance of dealing with the points you raise.

2. There is, as Leon Brittan said, an inexorable tendency for public expenditure to grow. We all want more spending on things like pensions, health and education. But there are limits to what it is reasonable to demand of the taxpayer; and borrowing - as the last Government found in 1976 - is no alternative. That is why that Government, of which you were a member, gave an undertaking to the IMF "to reduce the share of resources taken by public expenditure", and did indeed succeed in reducing public expenditure from 46 to 41 per cent of GDP, a figure below the present level. Your own experience with the IMF proved indeed how painful and disruptive it is, not least from the point of view of the beneficiaries of these services, to have to make changes at short notice.

3. That is why we need to know - indeed why all responsible people, including yourself, should want to know - what the long-term costs of present policies are, so that if these look as though they are going beyond what we can afford we can consider what might be done while there was still time to take any necessary action in a sensible way.

4. Thus I support and agree with what both Leon Brittan and Norman Fowler said, as you quote them. It is right and proper that a responsible Government should look ahead and consider where things are going in the longer-term. Equally we maintain our commitment to support for the disadvantaged and the less well off, and I confirm our view that where services are best provided publicly they should be provided to a proper standard and as efficiently as possible.

5. It is <u>because</u> of this commitment, and entirely and necessarily consistent with it, that we are engaged in the present long-term work, looking to the 90's, and beyond. How to secure the provision of adequate social and other services, at a time when, world wide, economic growth is slowing up, and what the right balance between public and private provision should be, are among the most difficult questions facing all of us, and not just in this country. These are questions which should concern all thinking people, and which deserve public debate at a rather more serious level than is represented by your own [hysterically misleading] letter. The absurdity of your suggestion that we are

contemplating "the destruction of the post-war welfare state" is demonstrated by the fact that we have increased expenditure on the Health Service, after allowing for inflation, by no less than 5 per cent.

6. Joel Barnett, writing of his experience as Chief Secretary in the last Government, has said " .... overall we failed to achieve the right balance between public and private expenditure because we stuck with levels of public expenditure decided on assumptions of growth in resources that were never achieved". It was that failure which necessitated your appeal to the IMF, and it is that sort of failure we are determined to avoid for the future.

[redacted]

Mr Hart Mr Mountfield.
To see the latest moves, & return Pl

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FROM: E P KEMP R1
28 September 1982

MR KERR

cc Chief Secretary
Mr Mountfield - 94/3
Mr Monger

THE REPLY TO MR SHORE

Quick points on the redraft.

2. First, on paragraph 2 Mr Mountfield has let Miss O'Mara have a point about the phraseology concerning the reduction in public expenditure referred to there.

3. On Mr Fowler's speech, the most devastating (from the point of view of dealing with Mr Shore) quote comes half way down page 2 of that speech, and could be reflected in the Chancellor's draft, by adding at the end of paragraph 5 of the letter something like :-

> "As Norman Fowler said in the speech you quote from (though no doubt inadvertently you overlooked this particular phrase) "The Government is committed to the future of the National Health Service"."

But, I should emphasise that Mr Monger in ST is most unhappy with any further quotation from the Fowler speech, and indeed is going to propose that the first sentence of paragraph 4 (where the Chancellor has registered agreement with Mr Fowler) be deleted. The point as I understand it is that Mr Fowler's speech (of which I understand you have now been sent a copy) was drafted and delivered without any consultation with the Treasury, and does not at all reflect Treasury thinking.

4. The Chancellor will want to consider these points, and perhaps discuss them with the Chief Secretary. One can see problems and attractions both ways. On the one hand we do not want to recreate pledges etc just when we are trying to get rid of them. On the other it is clearly difficult for the

3/12.

Chancellor to disown Mr Fowler, even if only by silence, and a repetition of Mr Fowler's "commitment to the future of the National Health Service" - whatever this can be taken to mean - could be useful politically at least in the short-run, even if in the longer-run very much less so.

Clayton

pp E P KEMP

Mr Hart PA 43
Mr Rayner.

MR KERR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State C
Minister of State R
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Middleton
Mr Quinlan
Mr Kemp
Mr Mountfield
Mr Ridley
Mr Hall
Mr Goldman

THE REPLY TO MR SHORE

The new draft reply dated today.

2. I am very doubtful about the sentence at the beginning of paragraph 4 saying "... I support and agree with what ... Norman Fowler said, as you quote (him)". As quoted by Mr Shore, Mr Fowler said "we need continued commitment and support from the NHS from the Government". Another sentence in Mr Fowler's speech was: "the Government is committed to the future of the NHS". It seems to me that agreement with these sentiments would make it very hard to apply the CPRS idea of replacing the NHS, for most patients, by a system of compulsory private insurance. I assume that the Chancellor would like to leave this option open.

3. The point can be easily dealt with by the omission of the first sentence of paragraph 4 of the draft. It is not essential to the structure of the letter. For the same reason, I think it would be better not to include a reference to Mr Fowler's speech, or his answer in the House on 28 July. This used, at our insistence, a rather weaker formulation - that the Government "has no plans" to change the structure of the NHS - but it still goes further than we would like.

4. The fact is that Mr Fowler's speech was deliberately designed to rule out the option of radical change and it is not in our interest to endorse it if we want to maintain that option.

4/12

Mr Hart
I had no further comments

RESTRICTED

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FROM: J.O. KERR
28 September 1982

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Burns
Mr. Middleton
Mr. Quinlan
Mr. Kemp
Mr. Mountfield
Mr. Ridley
Mr. Hall
Mr. Goldman

MR. MONGER

THE REPLY TO MR. SHORE

Thank you for your comments earlier today on the second draft of the Chancellor's reply to Mr. Shore.

2. The Chancellor showed that draft to Mr. Fowler. His office has since reported that he had no substantive comment on it, but that if we wished to include a quotation from his recent speeches we might add the following words:-

> "As Norman Fowler said on 30 July, the Government have no plans to change the present system of financing the NHS largely from taxation, and will continue to review the scope for introducing more cost consciousness and consumer choice, and for increasing private provision."

In the light of your advice, this is clearly an offer which we must decline.

...... 3. I attach the third, and I hope final, version of the draft, which you have seen, and with which you are content. It reflects comments from Sir Anthony Rawlinson, and from Mr. Mountfield. If there are any further comments on it, could they reach me by 9.30 a.m. tomorrow morning? The Chancellor now intends to release the text of the letter at noon.

J.O. KERR

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CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

28 September 1982

The Rt. Hon. Peter Shore, MP
House of Commons

Thank you for your letter of 24 September. I am glad to answer the points you raise. There is of course no incompatibility between what Leon Brittan and Norman Fowler have said, as you quote them.

As Leon Brittan pointed out, there is an inexorable tendency for public expenditure to grow. We all want more spending on things like pensions, health and education. But there are limits to what it is reasonable to demand of the taxpayer; and borrowing - as the last Government found in 1976 - is no alternative. That is why that Government, of which you were a member, gave an undertaking to the IMF "to reduce the share of resources taken by public expenditure", and did indeed succeed in reducing the ratio of public expenditure to GDP from 46 to 41 per cent, a figure below the present level. Your own experience in 1976 proved indeed how painful and disruptive it is, not least from the point of view of the beneficiaries of these services, to have to make changes at short notice.

That is why we need to know - indeed why all responsible people, including yourself, should want to know - what the long-term costs of present policies are, so that if these look as though they are going beyond what we can afford we can consider what might be done while there is still time to take any necessary action in a sensible way. It is right and proper that a responsible Government should look ahead and consider where things are going, looking to the 90s, and beyond.

Meanwhile, as Norman Fowler has said, our primary purpose, in relation to health and personal social services, must be to develop - to the very best extent that resources allow - those services which attend to individuals in need, which help to prevent suffering or ill-health, and which care for those who are handicapped or ill. I confirm our view that

/where services

where services are best provided publicly they should be so provided, to a proper standard and as efficiently as possible.

It is because of this commitment, and entirely and necessarily consistent with it, that we are concerned about these long-term questions. How to secure the provision of adequate social and other services, at a time when, world wide, economic growth is slowing up, and what the right balance between public and private provision should be, are among the most difficult questions facing all of us, and not just in this country. These are questions which should concern all thinking people, and which deserve public debate at a rather more serious level than is represented by your letter. The absurdity of your suggestion that we are contemplating "the destruction of the post-war welfare state" is demonstrated by the fact that we have increased expenditure on the Health Service, after allowing for inflation, by no less than 5 per cent.

Joel Barnett, writing of his experience as Chief Secretary in the last Government, has said " .... overall we failed to achieve the right balance between public and private expenditure because we stuck with levels of public expenditure decided on assumptions of growth in resources that were never achieved." It was that failure which brought about the crisis of 1976, and it is that sort of failure which we are determined to avoid for the future.

Like yours, this letter is being released to the press.

GEOFFREY HOWE

RESTRICTED

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FROM: J O KERR

DATE: 28 September 1982

cc Sir A Rawlinson
Mr Mountfield
Mr Spackman
Mr Stannard
Mr Rayner

P/A.

MR HART

LTPE: COCKFIELD CASH v HOWE COST TERMS

The Chancellor has seen your minute of 20 September to me about the Cockfield figures. He agrees with your advice that we should let the matter drop.

J O KERR

CST FST EST MSTC
MSTR Sir D Wass
Sir A Rawlinson Mr Burns
Mr Middleton Mr Quinlan
Mr Kemp Mr Mountfield
Mr Ridley Mr Hall Mr Goldman
Mr Monger

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Mr Hart

Mr Rayner

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PA

28 September 1982

The Rt. Hon. Peter Shore, MP
House of Commons

Dear Peter

Thank you for your letter of 24 September. I am glad to answer the points you raise. There is of course no incompatibility between what Leon Brittan and Norman Fowler have said, as you quote them.

As Leon Brittan pointed out, there is an inexorable tendency for public expenditure to grow. We all want more spending on things like pensions, health and education. But there are limits to what it is reasonable to demand of the taxpayer; and borrowing - as the last Government found in 1976 - is no alternative. That is why that Government, of which you were a member, gave an undertaking to the IMF "to reduce the share of resources taken by public expenditure", and did indeed succeed in reducing the ratio of public expenditure to GDP from 46 to 41 per cent, a figure below the present level. Your own experience in 1976 proved indeed how painful and disruptive it is, not least from the point of view of the beneficiaries of these services, to have to make changes at short notice.

That is why we need to know - indeed why all responsible people, including yourself, should want to know - what the long-term costs of present policies are, so that if these look as though they are going beyond what we can afford we can consider what might be done while there is still time to take any necessary action in a sensible way. It is right and proper that a responsible Government should look ahead and consider where things are going, looking to the 90s, and beyond.

Meanwhile, as Norman Fowler has said, our primary purpose, in relation to health and personal social services, must be to develop - to the very best extent that resources allow - those services which attend to individuals in need, which help to prevent suffering or ill-health, and which care for those who are handicapped or ill. I confirm our view that

/where services

24/14

where services are best provided publicly they should be so provided, to a proper standard and as efficiently as possible.

It is because of this commitment, and entirely and necessarily consistent with it, that we are concerned about these long-term questions. How to secure the provision of adequate social and other services, at a time when, world wide, economic growth is slower, and what the right balance between public and private provision should be, are among the most difficult questions facing all of us, and not just in this country. These are questions which should concern all thinking people, and which deserve public debate at a rather more serious level than is represented by your letter. Your suggestion that we are contemplating "the destruction of the post-war welfare state" is frankly absurd. We have in fact increased expenditure on the Health Service, after allowing for inflation, by no less than 5 per cent.

Joel Barnett, writing of his experience as Chief Secretary in the last Government, has said " ..... overall we failed to achieve the right balance between public and private expenditure because we stuck with levels of public expenditure decided on assumptions of growth in resources that were never achieved." It was that failure which brought about the crisis of 1976, and it is that sort of failure which we are determined to avoid for the future.

Like yours, this letter is being released to the press.

GEOFFREY HOWE

Mr Hart

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[redacted]

MR KERR

FROM: E P KEMP
29 September 1982

cc PS/Chief Secretary
Mr Monger
Mr Mountfield
Mr Hall
Mr Norgrove

94/3

THE REPLY TO MR SHORE

Your minute and draft of yesterday evening.

2. I think this exercise is reaching, if not already beyond, the point of diminishing returns, but here are three pernickety points, and one rather less pernickety, for you to consider.

3. First, in the fourth line if you are retyping the document the words "as you quote them" could now come out. They were originally put in when we were positively agreeing with what Messrs Brittan and Fowler said - now we are just saying that there is no inconsistency between them. These four words have a rather qualificatory air about them, and could be dispensed with.

4. Second, as a result of reordering, the words "this commitment" in the third line on the second page are now a bit lost. Previously we had the word "commitment" in the previous paragraph; this has now gone, and its survival in the next paragraph is a bit odd. I would suggest that the word "commitment" here be simply deleted.

5. Third, as I mentioned to you, in the seventh line of the second page, the expression "is slowing up" is perhaps not quite right (though I invented it and it seems to have survived the first three drafts!) and could better be replaced by something like "is slow and likely to remain so".

6. Finally my not quite so pernickety point. This is simply to note that the first two lines of the third paragraph, which read "That is why we need to know - indeed why all responsible people, including

15/12

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yourself, should want to know - what the long-term costs .... are" could be seen, and indeed are, a promise to publish something about those costs. I floated the idea of publication in my minute of Monday, not knowing (not having I am afraid seen the LCA) that Cabinet had already issued a remit to the Chancellor in that direction, and that GE were preparing advice in the matter. However these words in the letter to Mr Shore do amount to a public promise to say something, and if they are retained we shall I think have to go through with it (as I think is right and inevitable anyway); and, perhaps more important, if IDT are telephoned this afternoon asking whether these words do mean that there will be some publication, they will have to say that this is so, but no doubt they will want to add that the precise scope, form and timing is still under consideration.

E.P.K

E P KEMP

From: P Mountfield
Date: 30 September 1982

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1. Sir Anthony Rawlinson
2. Chancellor of the Exchequer

copies attached for:

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State(C)
Minister of State(R)
Sir Douglas Wass

cc -

Mr Wilding
Mr Byatt
Mr Kemp
Miss Brown
Mr Hart
Mr Spackman
Mr M A Hall
Mr Rayner
Mr Ridley
Mr R Harris

LONG-TERM PUBLIC EXPENDITURE

You have an outstanding remit from Cabinet on 9 September to make proposals for a campaign of publicity about the problems of public expenditure in the longer term. No date was set on this remit. Such a campaign will obviously be a long drawn out one. But the Economist leaks, the Chief Secretary's speech in Derby, and the exchange of letters with Peter Shore, have given the early stages new urgency. What action should be taken in the next few weeks?

2. We have assumed that you will not want to publish the LTPE Report as it stands (which would involve a long process of clearance with Departments, and certainly an argument with the Ministry of Defence). You need not rule this option out for all time. In fact, we shall probably come under Parliamentary pressure once the House resumes, to publish the Report, or something like it. There will certainly be PQs: the TCSC, for example, may decide to investigate.

3. But it would be timely to say something before then. There are two immediate opportunities: in the Chief Secretary's speech to the Institute of Bankers on 13 October, where he intends to make public expenditure the main theme; and in your Mansion House speech on 21 October. The skeleton for that speech already submitted by Mr Kemp includes provisionally a section on public expenditure. The "long term" theme would fit in well there.

4. The object at this stage, in advance of any fuller publication, should be to shift the debate away from specifics ("the threat to the National Health Service", for example) on to the problem of the growing total of public expenditure, and its implications. We suggest, therefore, that in either or both of these speeches, the theme might be: "What will happen unless.........". This could be illustrated with a few key figures about the trends, on specified asssumptions. If you and the Chief Secretary agree, we could do this in some detail in the IOB speech and more briefly in the Mansion House one. We could avoid overlap between the two.

5. May we proceed on these lines please?

PM

P Mountfield

[redacted]

FROM: MISS J M SWIFT

DATE: 1 October 1982

7C

PRINCIPAL PRIVATE SECRETARY

cc Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Wilding
Mr Byatt
Mr Kemp
Miss Brown
Mr Mountfield
Mr Hart
Mr Spackman
Mr M A Hall
Mr Rayner
Mr Ridley
Mr R Harris

LONG-TERM PUBLIC EXPENDITURE

The Chief Secretary has seen Mr Mountfield's minute of 30 September to the Chancellor (attached below).

2. The Chief Secretary agrees with Mr Mountfield's recommendatic as endorsed by Sir Anthony Rawlinson, to deal with the LTPE theme in some detail in his IOB speech and more briefly in the Chancell Mansion House speech. The Chief Secretary notes that the timing is quite good, as there will be about the right distance between the CPRS link and further substantive discussion on the subject.

MISS J M SWIFT

1. Mr Mountfield
2. Mr Rayner
see below

FROM: M E DONNELLY
6 October 1982

PA

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Byatt
Mr Kemp
Miss Brown
Mr Mountfield
3 — Mr Hart
Mr Spackman
Mr M Hall
Mr Rayner
Mr Ridley
Mr Harris

LONG TERM PUBLIC EXPENDITURE

The Financial Secretary has seen Mr Mountfield's minute of 30 Septembe and the Chief Secretary's comments on it recorded in Miss Swift's note of 1 October.

The Financial Secretary considers it very important to give as many of the facts of the LTPE survey as possible in public.

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CHIEF SECRETARY	
REC.	13 OCT 1982
ACTION	Mr Hart
COPIES TO	PPS FST EST MST(C) MST(R) Sir D. Wass Sir A. Rawlinson

CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

Qa 06089

13 October 1982

Mr Wilding
Mr Mountfield
Miss Kelley
Miss Seammen
Mr Monger
Mr Faulkner

Mr Goldman
Mr Salveson

Douglas Board Esq
Lord Privy Seal's Office
Old Admiralty Building
Whitehall
SW1

Dear Douglas,

I enclose material for Lady Young's use in replying to tomorrow's question from Lord Wells-Pestell about the CPRS report.

The material in sections B-D of the supplementaries and background notes have been supplied by DHSS and DES and seen by the Treasury. Part of the material in section A has been prepared on the advice of the Treasury but they may have further comments on it.

Mr Bailey and Miss Mackay will be available to attend the oral briefing which you plan to arrange for lunchtime tomorrow.

I am sending copies to Willie Rickett (No 10), David Clark (DHSS), Imogen Wilde (DES), John Gieve (Chief Secretary's Office), Richard Mottram (Defence), and Richard Hatfield (Cabinet Office), who should pass any comments direct to your office.

In view of the sensitivity of this subject, I should be grateful if recipients of the enclosed material would restrict its distribution to a minimum.

Yours ever

Gerry Spence

G B Spence

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House of Lords

Parliamentary Question for Oral Answer on 14 October

Lord Wells Pestell (Labour)

To ask HMG whether they will publish the recent report of the CPRS on the future of the welfare state.

SUGGESTED ANSWER

I assume that the noble Lord is referring to an analysis undertaken by the Central Policy Review Staff of possible ways of restraining the growth of public expenditure in the longer term. This was a confidential analysis prepared for Ministers and will not be published.

NOTES FOR SUPPLEMENTARIES

A THE CPRS REPORT AND PUBLIC EXPENDITURE

1. Why not publish report in view of extensive leaks and press discussions?

Government agree that debate about the long term problems of the welfare state and public spending should not take place on the basis of leaks and press speculation. But this CPRS document would not provide an appropriate vehicle for a public debate. (This is because it was not a self-contained fully worked out report but simply a list of possible options.) Moreover to publish a confidential document because it had already been leaked would encourage more leaks.

2. Will the Government prepare a document for public discussion?

It is for my rt hon Friend the Chancellor of the Exchequer, in consultation with my rt hon Friend the Prime Minister, to decide whether to initiate a public debate on the problems of public expenditure in the longer term, and if so how this might be conducted.

3. General questions about contents of the report.

Since no further action is to be taken on the CPRS document, the question of what it recommended or discussed has no practical significance for Government policy. For the record, however, the report did not make policy recommendations It discussed a number of possible options for restraining expenditure (as a basis for deciding whether further work should be done).

4. Has CPRS report been shelved?/What action does Government plan to take on the report?

The CPRS document has not been discussed by Ministers and no discussion is planned. But the Government will continue to seek ways of restraining the growth of public spending.

5. Chancellor of Exchequer's Weekend World interview (10 October) shied away from major cuts in spending programmes. Have these been dropped?

I understand my rt hon Friend made very clear the need to restrain the growth of public spending and over time to reduce public expenditure as a percentage of national output.

6. Why is it necessary to reduce public spending? (Other countries spend more as a percentage of national output.)

The present level of taxation is oppressive on the great mass of working people. In order to foster economic growth it is important to get tax levels - and interest rates - down. The only way of doing this, while keeping a grip on inflation, is to reduce the share which public spending takes of national output.

7. Government split about need to cut public spending?

There is no disagreement on the need to restrain public spending, nor on the need to provide an adequate minimum level of care and standards for those in our society who cannot fend for themselves.

NOTES FOR SUPPLEMENTARIES

B. NATIONAL HEALTH SERVICE

1. Did report suggest abolishing/privatising NHS?

[As I have already made clear] the report made no recommendations and has no significance for Government policy.

2. Will the noble Lady confirm that the Government have no plans to abolish the NHS?

I can certainly confirm this. As my rt hon. Friend the Prime Minister said to the Party Conference last week "the National Health Service is safe with us ... the principle that adequate health care should be provided for all, regardless of ability to pay, must be the foundation of any arrangements for financing the health service."

3. Will the noble Lady reaffirm the Government's commitment to the NHS?

Yes. We have shown our commitment to the NHS by planning an increase in services of 5% in real terms between 1978-79 and 1981-82, and further growth is planned for this year.

4. Why are the Government considering alternatives?

This Government, like any other responsible Government, have a duty to make sure that every penny is properly spent. We would be failing in our duty if we were not to look at other ways of financing health care to see if they offered any improvements on the present system. That is why the former Secretary of State for Social Services set up a study to look at methods of financing, drawing on the experience of other countries. But as the present Secretary of State said on 30 July in another place

"The Government have no plans to change the present system of financing the National Health Service largely from taxation ....."

5.	Is not the Government encouraging private provision by stealth?	We welcome the growth in private health insurance. But there is no contradiction between this and supporting the National Health Service. Private insurance brings in more money, helps to reduce waiting lists, and stimulate new treatments and techniques. Our full commitment to the NHS is demonstrated by our record.

NOTES FOR SUPPLEMENTARIES

C. SOCIAL SECURITY BENEFITS

1. Does the Government intend to de-index the uprating of social security benefits as suggested in the CPRS report?

[As I have already made clear, the report made no policy recommendations and its contents have no significance for Government policy.] So far as social security benefits are concerned, there has been no change in the Government's position. Our policy has been to maintain the value of retirement pensions and other related benefits and that we have done. Next month's uprating, which will add some £3 billion to the cost of social security benefits, will protect the value of all weekly benefits.

2. If there are no present plans to de-index the uprating of benefits will a future Conservative Government - if re-elected - make this change?

I emphasise that there are no plans to alter the present arrangements. As to the future, all I can say is that, whatever Government is in power, - [and I expect it to continue to be this one for some time to come] - it will be the country's ability to meet the cost of public expenditure programmes which will be the determining factor in deciding their size and scope.

3. Will the Government restore the 5 per cent abatement of unemployment benefit?

Our position on this has been made clear. We reviewed the possibility of restoring the abatement when the benefit was brought into tax in July but concluded that we could not afford to do so. The matter is being kept under review and I have nothing more to add.

/4. Will there be an "overshoot" on this year's uprating and do the Government intend to claw it back?

4. Will there be an "overshoot" on this year's uprating and do the Government intend to claw it back?

Next month's uprating of benefits is based on a 9 per cent forecast movement in prices between November 1981 and November 1982. In addition, an extra 2 per cent has been added to compensate for the shortfall in last November's uprating. Inflation has been falling faster than was forecast at the time of the Budget and it is likely that the outcome will be lower than the 9 per cent forecast. We will not know the extent for a couple of months yet. The November 1982 uprating will, of course, go ahead as planned. The 1983 uprating will be decided nearer the time. It will depend on the forecast movement in prices, which will be made around the time of next year's Budget, and whether the Government decides to take account of any overshoot this year. No decision on this has yet been taken. Consideration of the outcome of the prices forecast is normal every year.

NOTES FOR SUPPLEMENTARIES

D. HIGHER EDUCATION

1. Is the Government considering any scheme for charging for higher education?	We are not considering any specific scheme, but it is naturally sensible that we should continue to review whether higher education is being organised in the best possible way in terms of the aspirations of the student, the economic and social needs of the country, and the burden that higher education provision places on the taxpayer.
2. Wouldn't any system of charging for higher education be unfair on the less well off?	This would of course mainly depend on the extent to which assistance in the form of scholarships or loans was available. Higher education currently directly benefits its recipients at the expense of the taxpayers - many of whom will never earn as much as most of the graduates they are helping to educate.
3. Shouldn't opportunities for free higher education be expanded?	The Government has to consider priorities right across the spectrum of provision, including for example the balance of expenditure between full-time higher education and opportunities for further education and training for those who leave school early.
4. Is the Government committed to introducing a loan scheme for student grants?	The Government has reached no decision on the introduction of a scheme but Ministers are currently considering ways in which a loans element might be incorporated into the financing of student maintenance.

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(.ells Pestell's question refers to the CPRS Cabinet paper on public expenditure whose main contents were leaked to the press .oer and which has prompted widespread speculation about the .nt's plans for the future of the welfare state, notably the National Service. (A selection of the main press comments is attached at . 1). Lord Wells Pestell is a former Labour DHSS Minister and it seems .ible that his questioning will concentrate on the implications for the .S.

2. The existence of a report has been admitted. The suggested answer gives the minimum of information about the document necessary to dispel the impression that the CPRS presented the Government with recommendations on "the future of the welfare state". The refusal to publish the document is in line with the practice of successive Governments in declining to publish CPRS work which gives confidential advice to Ministers. (Some CPRS reports are published - see Annex 2).

3. Refusal to publish this document still seems appropriate, notwithstanding the argument (e.g. Guardian 12 October) that it would be better to publish it than to allow debate to proceed on the basis of press leaks and speculation. This point is dealt with in the notes for supplementaries (A1).

4. The notes for supplementaries and the remaining background notes are arranged in four sections:

A. The CPRS report and public expenditure in general.

B. The National Health Service.

C. Social security benefits.

D. Higher education.

5. A background note on the CPRS is at Annex 2.

BACKGROUND NOTE

A. THE CPRS REPORT AND PUBLIC EXPENDITURE IN GENERAL

1. The CPRS analysis was commissioned in July this year, at the request of the Chancellor of the Exchequer, to complement the report which Cabinet had commissioned in March from a Treasury-led group of officials, on the likely pattern of public expenditure over the next decade.

2. Both papers were intended to be discussed at Cabinet on 9 September. In the event, the CPRS paper was not discussed. The Economist article of 9 October (Annex 1) purports to give an account of the Cabinet's handling of the issue.

3. The Treasury paper outlined two scenarios for growth and public expenditure over the next decade. It concluded that on a pesimistic (but not unrealistic) scenario public expenditure would consume nearly 6 per cent more of GDP than in the Government's first year of office, while on a more favourable scenario public spending's share of GDP would be only slightly below the 1979-80 level. The Treasury paper identified four main programmes (health, social security, education and defence) as accounting for over 60 per cent of all spending. Against this background, the CPRS was asked to identify possibilities for making "major structural changes" affecting the larger programmes. The resulting CPRS paper identified a number of possible major options (defined as options offering savings at least £1 billion per annum) in these four main programmes, as well as some other approaches. The main options in the CPRS paper are reasonably accurately outlined in the side-lined portions of the Economist article of 18 September reproduced in Annex 1.

4. While a fair amount of the subsequent press comment was speculation, it is evident that the Economist at least has a very accurate and comprehensive knowledge of the contents of the CPRS paper while it is known that the Times has a full copy of the Treasury report. Government Ministers have not denied the existence of either report. There has been no formal statement on the status of the CPRS document or its contents. However, the fact that the report has been "shelved", has not been discussed and will not be discussed by Ministers has been made widely known both through unattributable briefing and through press comments attributed to the Chancellor of the Exchequer and the Chancellor of the Duchy. At the Conservative Party Conference at Brighton on 9 October the Prime Minister, without referring to the report or the press controversy, made clear the Government's continuing commitment to the National Health Service (see Section B of this note and notes for supplementaries).

5. There may be supplementary questions about the "Weekend World" television programme in which the Chancellor of the Exchequer participated on 10 October. In this programme Professor Alan Budd gave his own projections of public expenditure, which showed public expenditure increasing as a ratio to GDP throughout the 1980s. The programme then discussed ways in which large cuts in public spending might be made. (A transcript of this section of the programme is not yet available.) According to the Treasury, the basis of the

figures used in the programme do not tally exactly with officially accepted figures. There seems no need for the Minister to be drawn into discussion about the programme's public expenditure projections.

6. In the second half of the programme the Chancellor of the Exchequer stressed the Government's intention to secure a reduction in the percentage of GDP being taken by public expenditure. He refused to be drawn on individual options and the general flavour of the interview was to play down the idea of spectacular cuts. There was no direct reference to the CPRS report. In planning public expenditure he also advocated public debate on how reduced public spending could be brought about. He hinted at savings through privatisation (mentioning the sale of council houses as an example) and emphasised that savings of considerable significance could be achieved through the pursuit of greater efficiency, eg in the NHS.

BACKGROUND NOTE

B. NATIONAL HEALTH SERVICE

1. Health services are planned to increase by 5% in real terms between 1978-79 and 1981-82 (cash provision up from £6½ billion in 1978-79 to over £11 billion in 1981-82). Further growth planned in current year.

2. Prime Minister reaffirmed commitment to NHS in speech to Party Conference on Friday 8 October. She said:

> "We have a magnificent record on the NHS. Naturally we have a duty to make sure that every penny is properly spent. That is why we are setting up a team to examine the use of manpower in the NHS. Of course we welcome the growth of private health insurance. There is no contradiction between that and supporting the NHS. It brings in more money, helps to reduce waiting lists, and stimulates new treatments and techniques. But let me make one thing absolutely clear: the NHS is safe with us. As I said in the House of Commons on 1 December: 'the principle that adequate health care should be provided for all, regardless of ability to pay, must be the foundation of any arrangements for financing the health service'."

3. Patrick Jenkin, when Secretary of State for Social Services, set up a working party of officials with two private sector consultants to explore ways of financing health care. Working party reported to Ministers earlier this year. Norman Fowler announced Government's decision in PQ on 1 July:

> "Between 1978-79 and 1981-82 the Government provided for increases in National Health Service services of 5 per cent. There should be some further growth in services this year. The Government have no plans to

change the present system of financing the National Health Service largely from taxation, and will continue to review the scope for introducing more cost-consciousness and consumer choice and for increasing private provision which is already expanding."

4. Government have taken a number of steps to improve efficiency and accountability in National Health Service. Examples include: reorganisation of Health Service, introduction of annual reviews of Regions at high level, development of statistical indicators to assist in monitoring performance. Two recent developments: planned introduction of quarterly manpower returns from Regions; announcement of a small team, led by senior representative of private industry, to examine ways in which NHS uses manpower and to make recommendations.

BACKGROUND NOTE

C. SOCIAL SECURITY

1. The fact that the CPRS document discussed deindexation of pensions and social security benefits was picked up and discussed in several papers. At Brighton the Prime Minister pointed out that the Government had kept its pledge to protect pensions fully from inflation. But she gave no commitments as to the future. This line is reflected in the notes for supplementaries.

2. Question C4 in the notes for supplementaries (possible clawback of this year's uprating of benefits) may well come up, given the imminence of the uprating and the controversy which always surrounds the issue.

BACKGROUND NOTE

D. HIGHER EDUCATION

While publicity for the CPRS proposals was mostly focussed on the suggestion that there might be an increased measure of private financing for the health service, a scheme under which students would pay full cost fees for higher education courses, assisted in some cases by state scholarships, also received attention. A leader in The Times on 11 October discussed the possibility of charging and noted that some of the issues had been aired at the time of the Robbins report. The CPRS scheme is now shelved, but naturally ways of improving the organisation of higher education without increasing the burden on the taxpayer continue to be examined. The Secretary of State is particularly interested in exploring ways of encouraging diversity and fiscal independence in the university sector. DES is also currently discussing with the Treasury a scheme by which 50% of maintenance awards could be met by state financed loans. The details and timing of any such scheme have yet to be settled, and there is no Government commitment to its introduction.

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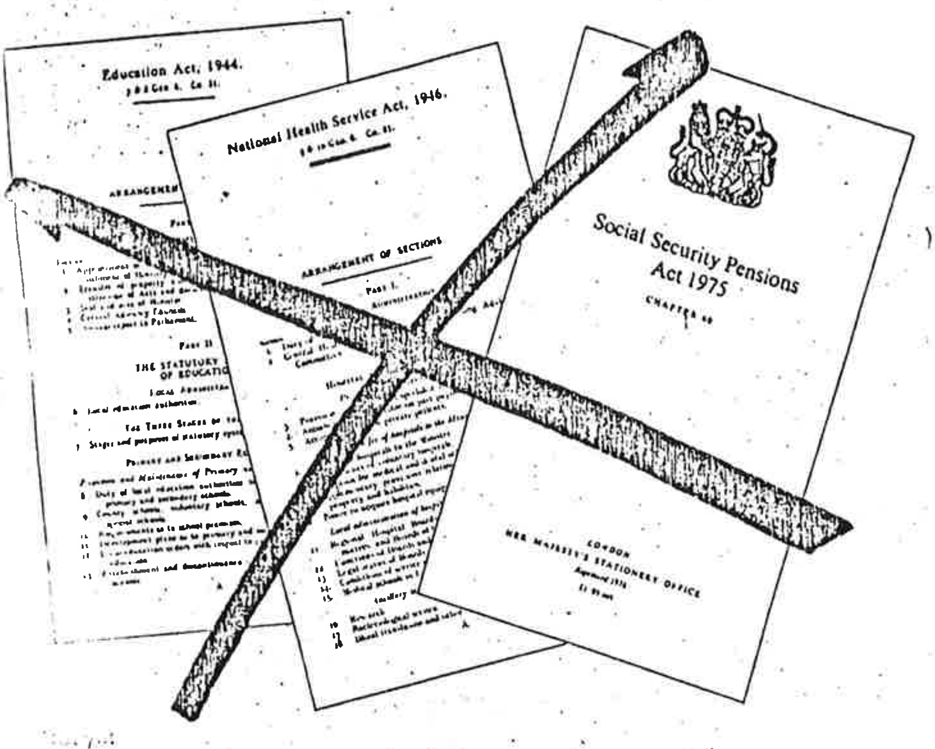
ANNEX 1

PRESS REPORTS

BRITAIN



Thatcher's think-tank takes aim at the welfare state

The special meeting of Mrs Thatcher's cabinet on September 9th was devoted to a long discussion on the problems of controlling public spending. Far more intriguing, however, is what was not discussed: a paper from the Central Policy Review Staff, the government's think-tank, outlining options for radical cuts in public spending, many involving the dismantling of huge chunks of the welfare state. Cabinet wets were so appalled at the think-tank's suggestions that they argued successfully that it would be wrong for the cabinet to give it serious and instant consideration. But that will not be the end of the matter.

The think-tank's paper was circulated along with other cabinet papers on September 7th. It came with the seal of approval of the treasury, which recommended that it form the basis of a six-month study of a public spending strategy for the rest of the decade. This means that its ideas were not pulled out of the ether and that it has more significance than most think-tank papers. Here are details of its contents.

The paper begins by saying that, on present plans and assuming low annual economic growth, public spending will continue to gobble up at least its present 45% of gross domestic product for the foreseeable future. That is only 1% less than its peak under the last Labour government. If the Thatcher government is serious about cutting public expenditure, argues the paper, then it must consider some radical alternatives in the four areas that account for the lion's share of public expenditure: education, social security, health and defence.

The think-tank then deals with each one in turn:

● Education. Its most controversial suggestion is to end state funding for all institutions of higher education. Instead, fees would be set at market rates, at present around £12,000 for the average three-year course. About 300,000 state scholarships could be made available, along with student loans for those with the entry qualifications but without scholarships. The paper also says that there would be great savings if the state no longer had to provide for primary and secondary school education, but it acknowledges the political difficulties of abolishing state schooling. It considers moving to a system of educational vouchers for parents, which they could cash at schools of their choice to pay for their children's education. The idea has long been popular with free-market Tories and its supporters include Sir Keith Joseph (the education secretary) and Mr Ferdinand Mount (who recently became the head of the prime minister's policy unit in Downing Street). But the think-tank points out that vouchers would not cut spending and might even increase it, since parents at present footing the bill for their children's private education would qualify for state vouchers too. There are, however, some savings to be made in the school system by allowing the teacher-pupil ratio to rise. It has been falling, argues the paper, without any rise in the quality of state education.

● Social security. Big savings can be made, says the paper, if all social security payments—from pensions to supplementary benefits—no longer rise in line with inflation. There are echoes here of the Reagan administration's budget battles in the United States. The task of cutting federal spending in Washington has been made harder because of the political difficulties of abolishing the indexation of pensions.

● Health. The paper suggests replacing the national health service with private health insurance: this could save £3 billion-4 billion a year from a 1982-83 health budget of £10 billion. The problem is that the less well-off might underinsure, so the paper suggests that there might have to be a compulsory minimum of private insurance for everyone. In the meantime savings could be made by charging for visits to the doctor and more for drugs.

● Defence. The think-tank is short of bright ideas on how to curb the £14 billion now spent annually on the armed forces. It recognises that Mrs Thatcher does not want to budge from Britain's commitment to Nato to raise defence spending by 3% a year in real terms until 1986. It suggests, however, that beyond the mid 1980s defence's share of the nation's resources should be frozen. It points out that Britain spends a higher proportion of its gdp on defence than its

European allies and says that, in the long run, it would be to the country's advantage if defence was funded from the budget of the European community.

The think-tank's paper was circulated by Mr John Sparrow, the CPRS director and former merchant banker who is now widely regarded in Whitehall as a stalking horse for the treasury. A key drafter was Mr Alan Bailey (a treasury deputy secretary on loan to the CPRS, an expert on public spending and Mr Sparrow's deputy). In his own paper to the same cabinet meeting, Sir Geoffrey Howe, the chancellor of the exchequer said that a failure to shift social spending from its present trend would have severe consequences for the government's fiscal strategy. On the worst economic growth assumptions, and present welfare-state policies, the state's share of gdp could rise to almost 60% before 1990.

Treasury ministers were furious when the wets lined up en masse to block discussion of a paper which owed its inspiration to them. So was Mrs Thatcher. There is to be no record of the matter in cabinet minutes. The September 9th cabinet meeting produced the first wet-dry clash for over a year. It could be a harbinger of cabinet meetings to come. Mrs Thatcher sympathises with the think-tank's drift. But she is now in no doubt that to pursue such a radical course risks splitting her party wide open. Many of the think-tank's suggestions for health and education would be as unpopular with middle-class Tories as with Labour voters. But Tory wets expect that the think-tank's ideas will soon resurface in another guise.

Observer 19 September

Storm over secret Think Tank report

by AURIOL STEVENS

A FAMILY of four would have to pay £600 a year in health insurance and £950 a year for each child's school fees, if radical changes in public services, outlined by the Government's Think Tank were to be introduced.

It would also cost, on average, £12,000 to put a child through university, and all State benefits, including pensions, would be worth 10 per cent less than they are now.

The figures come from a discussion document circulated to members of the Cabinet this month by the Central Policy Review Staff. News of the document, which has been seen by THE OBSERVER, has caused a storm among both Conservative 'wets' and opposition politicians.

The report was drafted during the summer as a result of gloomy long-term economic forecasts drawn up by Treasury officials. Working on the most pessimistic projection for economic growth, the planning documents showed that maintaining public services at their present level would cost £12,000 million to £13,500 million more by 1990, an increase of around 10 per cent.

Since it is Government policy to reduce both borrowing and taxation, the Chancellor, Sir Geoffrey Howe, asked the Think Tank to devise ways of bridging the gap by cutting spending.

The report suggests that savings could be made by an 11 per cent across-the-board cut in all services. But this, it says, would be unpopular and impractical.

The Think Tank suggests instead a series of radical options, but warns throughout of the difficulties of carrying these through. The options are set out under three headings. The first, 'Partial Change,' suggests charging for higher education to save an estimated £1,000 million and increasing and extending charges for health services, to save another £1,000 million.

Under the second heading, 'Comprehensive Changes', they suggest charging for schooling, saving £3,000 million to £4,000 million; switching to a private insurance scheme in place of the National Health Service, saving £4,000 million; and de-indexing social security benefits, saving £3,000 million.

The third heading, 'Less Resources' suggests a cut of £1,000 million in education—and abandoning the present commitment to increase defence spending, to produce a saving of £1,500 million.

If the 'comprehensive changes' were introduced, the report warns, radical changes in the taxation and benefits system would be needed and these could be costly. 'If even the poorest had to pay full charges, this would exacerbate poverty to a level which we assume Ministers would judge unacceptable.'

It also warns that while public spending would be reduced, the proportion of 'the community's wealth' being spent on education and health would not be reduced.

Of all the options the two under the heading 'partial' are thought by Whitehall to be most feasible.

For higher education, savings of £1,000 million would be made if students were charged the full cost of courses. Means tested scholarships would be available for 300,000 students, or about three-fifths of the number of students now in higher education. Loans would be available for others.

Under health, the report says charges would have to be introduced for people now treated free — children and the elderly—for visits to GPs and for hospital places to produce savings of £1,000 million.

The Cabinet did not discuss the Think Tank's report in detail at the 9 September meeting, a meeting for which there are — exceptionally — no minutes. The departmental Ministers affected by the proposals have been asked to undertake further study of the suggestions and report back to the Cabinet.

Strenuous efforts have been made to prevent news of the exercise seeping out. When the first reports of it appeared in *The Times* two months ago, all copies of the relevant documents circulating in Whitehall were called in. Some members of the Cabinet are said to be anxious about the effects knowledge of such plans could have upon the party's electoral prospects.

HEALTH AND EFFICIENCY

The "Think Tank" to the right of them, the Labour Party Conference to the left: between the Scylla of a state-engineered takeover by private medicine and the Charybdis of a ban on private medicine altogether, what future for the National Health Service? The Central Policy Review Staff reportedly envisages up to a third of NHS activity being lured or pushed into the private sector: the Labour conference is committed to an annual rise of 3 per cent in its monopoly service's expenditure, regardless of the state of the national economy.

No future Labour Government could be bound by that commitment, of course. Meanwhile, the present Conservative cabinet is displaying in the most uninhibited way its own conflicts over the "Think Tank's" report. But the political options on either side do seem potentially more divergent than they have been for many years.

The travail within the Cabinet derives from a simple and grim piece of arithmetic (arithmetic being a factor wholly negligible to the Labour conference). Unless the whole economy grows at a rate of roughly 2½ per cent (we should be so lucky), public expenditure will take a larger and larger share of gross domestic product, even after all the painful economies of the last three years. Without many fresh sacrifices, the promise to roll back state sector growth, will never be fulfilled.

The same dilemma involves social security, education, law enforcement, defence, and so on. Health spending has historically risen less fast than the first two, and the latter two are officially destined to rise faster than all the rest. The "Think Tank" report is said to make radical proposals in these other fields too. These deserve attention on their own account. But health is a particularly interesting case, because of the drastic changes proposed, and because the NHS is the principal embodiment in Britain of a particular ideal of social provision: the strong tang of ideology constantly attracts the flies of debate.

In addition, this week sees the publication of a notable addition to the debate, a public service contribution from the private sector a study of health provision across the world commissioned by the Nuffield Provincial Hospitals Trust. If pitched battle is joined over the future of the NHS, the study offers a salutary corrective to the prejudices of both sides. Its editors' eventual conclusion that the NHS "constitutes a unique and precious national asset" even the "Think Tank" envisages the survival of two thirds of the free service. All civilized nations, whatever their system of financing health, accept that a large proportion of the population cannot afford to pay for their own treatment. Today half the population are exempted from prescription charges, for instance, and they account for 60 per cent of NHS expenditure. Exemptions from an insurance-based system would have to be at least as wide. They represent a minimum obligation for any community to bear. The "Think Tank" reportedly proposes, perhaps only as an extreme case, a free service virtually confined to this category. The rest of the nation would negotiate for its health care with doctors and insurance agencies.

The arithmetic on which all this is based is not inexorable, but it is too threatening not to be frankly faced. At the outset, there is need for careful clarification of terms and objectives. There is an argument about public and private expenditure, and another about efficiency of service – related, but distinct. Endless muddle results from confusing the two. First of all, there is a presumption, generally well founded, that public expenditure is apt to rise at the expense of the productive investment (mostly private) which creates the growth that pays for all future investment.

The broad objective of restraining public sector growth to keep pace with the growth of the economy is a necessary and urgent one. It does not follow that the shifting of every service from public to private is equally helpful to that objective. Spending on health is not principally an earning activity whether it is in the public or private sector: it is a kind of investment in the national infrastructure, with some opportunity for invisible exports on the side. The case for a major shift into the private sector needs to show not only that it can be done without unacceptable harm to the disadvantaged, but also that it will facilitate the supply of care more effectively for a given cost to the whole economy.

Unfortunately, nobody has ever succeeded in defining wholly waterproof measures of effectiveness in health provision. There are too many outside factors, and too many subjective ones. There is no calculus for offsetting one pain removed here against another pain endured there. Much thought has gone into the defining of objectives in the NHS in recent years, and there have been advances, and consequential savings, though contribution of the Nuffield study is to demonstrate how limited is the sense in which that is true. You cannot shop around intelligently for a kidney transplant. Insurance distorts the classical market, making the agency, not the patient, the effective customer. Monopoly distorts it even more – not the often-proclaimed "monopoly" of the NHS, which is a fiction till the Labour conference has its way, but the monopoly of skill and knowledge by the health professions used to protect themselves. Almost everywhere, the state is progressively moving into insurance-based systems to act as arbiter and planner.

If the objective of the "Think Tank" is to reduce overall spending on health, its proposals are either irrelevant or misconceived. The evidence from other developed countries is that the level of spending is related less to financial structure than to prosperity: legitimately, societies pay for as much in medical services as they can afford. There is also widespread evidence that with insurance-based systems costs, and particularly administrative costs, are not easier to control but more difficult. For all its defects, the NHS seems to provide a service at least as effective for the price as any other.

This is no consolation to ministers faced with that harsh arithmetic of growth and resources. The NHS is a system well fitted for hard times, and there are hard times to come. While the economy is marking time, subsidy to health must necessarily mark time too. Even if tax incentives could engineer the huge transfer of custom envisaged by the "Think Tank", the prospect of gains outweighing the administrative upheaval is remote. But private medicine does hold out the prospect of gains at the margin for the NHS, in response to demand. Private treatment can bring hospitals worthwhile income which can be applied to the benefit of all patients. The demand exists, and there is much to be gained by taking advantage of it by partnership with the private sector. The closer the partnership, the less the danger of that "two-tier" system which Labour's pay-bed policies did so much to foster in the 1970s.

In an imperfect world, the ideology of the market and that of unrationed free supply are equally unreal, and pursuing them is to pursue mirages.

"For forms of health supply
let fools contest:
Whate'er is best administered is best"

Pope's formula begs many ques-

Economist 9 October 1/24 Annex. Keg 11

Mountains out of molehills?

The Thatcher government has botched its response to the think-tank report leaked to *The Economist*. It should publish the document as the start of a proper debate on the real dilemmas facing welfare spending in the 1980s.

The think-tank report, which suggested dismantling chunks of the welfare state, hung over the Tory conference like a dark cloud. In the run-up to Brighton, the prime minister's press office attempted what is known in Washington as a "damage-limitation exercise". The official line emerged that when Mrs Thatcher returned from her trip to the Far East she was so appalled by the reports that her government was seriously considering the think-tank's ideas that she immediately issued instructions for the report to be thrown into the rubbish bin. Since this involves a rewrite of recent history, it is worth reconstructing what really happened.

The think-tank report was circulated to ministers along with the rest of the cabinet papers on the evening of September 7th. The gist of its argument was that, on present spending plans and assuming low growth (½% to ¾% a year on gross domestic product), public spending would take 47% of gdp by 1990. That would be 6% above the share inherited by the Thatcher government in 1979.

The think-tank then outlined several options in health, education and social security for cutting the growth on public spending, so that the government could meet the 1979 manifesto pledge to reduce the share of the nation's resources controlled by the state. The most controversial suggestions were replacing the national health service with private health insurance (saving £4 billion a year); ending state financing of higher education except for 300,000 state scholarships; and limiting social security payments, including no longer raising pensions automatically in line with inflation (that could save £3 billion a year).

The think-tank report was circulated with an additional treasury recommendation that it might form the basis of six months' study of strategy on public spending. When Mrs Thatcher and Sir Robert Armstrong, the cabinet secretary, discussed the agenda for the special cabinet of September 9th, they decided to devote the morning to the more pressing problems of public spending for 1983-84 and discuss the think-tank report in the afternoon.

The day before that cabinet meeting, senior civil servants in each department briefed their ministers on what they might say about the paper. One minister said there were 18 civil servants at his briefing. On the eve of September 9th, several cabinet "wets" plotted how to kill the paper at the next day's cabinet.

Mrs Thatcher's first shock came before lunch during the cabinet meeting. She was surprised to discover that the think-tank paper had come with the usual cabinet papers. It should have been distributed separately to ministers only. It was feared that, as a result of its wide distribution within Whitehall, there was a strong chance of a leak. At least four cabinet ministers (all wets) said they did not want a formal cabinet discussion about its contents anyway.

When the cabinet broke for lunch, there was much intrigue. At one stage, Mrs Thatcher was closeted downstairs with treasury ministers, while upstairs the rest of the cabinet sat round the lunch table deciding how to kill the paper. When the cabinet reassembled, Mrs Thatcher was faced with a clear majority in favour of ditching the paper without further ado. Sir Geoffrey Howe and his chief secretary, Mr Leon Brittan, attempted a rearguard action to save the paper they had inspired. They were backed by Lord Cockfield, the trade minister, and Mr John Biffen, the leader of the house. Almost every other cabinet minister registered his disapproval. The prime minister expected the usual wets, such as Mr Jim Prior and Mr Peter Walker, to take fright. But more centrist figures (such as Mr Francis Pym) and respected veterans (like Lord Hailsham) were also opposed to considering it.

Mrs Thatcher argued that the cabinet should not shirk any paper that came before it. She was told by several of her colleagues that the think-tank exercise should have been done by the Tory party's own research department, so that there was less chance of it being branded as a indication of government policy. At this stage, Mr Cecil Parkinson, the party chairman, agreed that that might be the best way to proceed. In the end, an angry Mrs Thatcher bowed to the majority and ended the meeting without there being any discussion of the substance of the document. Next day the newspapers carried Downing Street lobby reports that the cabinet had simply considered public spending.

On September 17th, details of the think-tank paper appeared in *The Economist*. At Brighton, Mrs Thatcher was saying bitterly that it had been passed to us "within hours". In fact it took several days to leak out and was pieced together from a variety of sources.

Tory party managers were afraid that a think-tank controversy might overshadow a party conference which was supposed to celebrate the Falklands victory and the Tories' lead over Labour in the polls. Mrs Thatcher was aware of the troubles brewing at home while she was in Hongkong. On her return, she was told bluntly by Mr Parkinson that drastic steps had to be taken to dissociate the government from the think-tank's thoughts.

On Friday, October 1st, Downing Street briefed Sunday newspaper correspondents on Mrs Thatcher's supposed reaction to the think-tank. She was said to be against its report and had shelved it. Several Sunday and Monday papers carried a story along these lines, though some added their own caveats. In reality, Mrs Thatcher had shelved a report because she had met a cabinet brick wall.

The government's response to *The Economist's* original report should have been to publish the document as a basis for debate. There is a genuine quandary on how to finance welfare spending in the stagnant 1980s. In Brighton, Mrs Thatcher said she would not do that because the "think-tank language was too extreme". If so, she needs a more politically astute think-tank. If the report is to be shredded, then the government should mount a fresh exercise. It needs first a paper explaining how public spending will soak up more and more of the nation's resources in a low-growth Britain. A second paper should take a radical, but more comprehensive, look at public spending, embracing industrial as well as social policy. It is, as Mrs Thatcher herself says, absurd that these matters cannot be freely discussed. Why then is she trying to stifle them?

Thatcher's think-tank takes aim at the welfare state

The special meeting of Mrs Thatcher's cabinet on September 9th was devoted to a long discussion on the problems of controlling public spending. Far more intriguing ... details of its contents.

The paper begins by saying that, on present plans and assuming low annual economic gro... spending will contin...

THE GUARDIAN FRIDAY OCTOBER 8 1982

Tackling the fiscal crisis of the welfare state

Peter Jenkins

"Think Tank" affair — a chapter of accidents, a Thatcherite conspiracy dismantle the Welfare ...e — has had the useful ...equence of opening up a ...ate about the future of public sector. At the ...e time it has opened the ...vernment to a new line of attack from the "wets" whose buzz word this week has been "compassion." It has also illustrated the Prime Minister's remarkable capacity to be as resolute in retreat as she is in advance.

What happened was this. The Treasury about a year ago came to the conclusion that the dismal international outlook boded ill for domestic economic growth in the eighties. It made an internal analysis based on two rough and ready assumptions: the first (optimistic) took a growth rate around the average for the late sixties and early seventies; the second (pessimistic) projected the recent poor performance of the economy.

On the first assumption there would be a tricky problem in financing public expenditure; on the second the problem became horrendous. According to the leak in the Economist, public expenditure — on the worst assumption — could rise from 45 per cent of GDP to 60 per cent by the end of the decade.

The Treasury's assessment was passed to the "Think Tank" for comment. One of the functions of the "Think Tank" is to point up the wider policy implications of possible lines of action. What it pointed up in this case was that there was no way of balancing the books without radical policy change. In practice that meant radical change within the big four spending areas — health, social security, education and defence.

The "Think Tank's" thinking of the unthinkable was leaked by an outraged "wet." The Prime Minister returned from the Far East to find she had an embarrassing row on her hands. She went swiftly into retreat and repudiated the "Think Tank" paper.

The Treasury's analysis remains on the table, and the problem it exposes remains to be tackled by whoever forms the next government. One effect of the attention focused on the "Think Tank's" ruminations has been to obscure the Government's concern about defence expenditure which is at least as great as its worry about financing the NHS. Ministers are being taken to the cleaners by the Joint Chiefs of Staff who are taking ruthless advantage of the "Falklands Factor."

They have put in a huge bill — both for capturing and for the future defence of the Falklands — which they want settled over and above the defence budget. In addition they are demanding the indexation of the standard defence budget on the most generous terms plus the right to carry forward the huge sums which each year they are unable to spend.

The slogan of this Conservative Party conference is "The Resolute Approach." It is going to be intriguing to see how resolute the Prime Minister will be against the overweening military.

There are three courses this government, or any government, can take in trying to tackle what is becoming a fiscal crisis of the Welfare State. It can try to find the elixir of faster growth, in time to pay the bills. It can make radical alterations to the edifice of the post-war Welfare State. Or it can simply do the best it can in difficult circumstances, which would mean a good deal of privatisation and charging while the total of public expenditure as a proportion of GDP rose nevertheless.

This last approach was presumably what Mr James Prior had in mind yesterday when he joined in the argument and said: "We should not be too surprised or panic-stricken if, in the depths of recession, high unemployment pushes up the cost of a compassionate social policy."

The Prime Minister and the Treasury are unlikely to take so relaxed a view of the matter; nevertheless, ministers are already conceding that piecemeal measures—the privatisation of hospital cleaning, increase in health and educational charges for those who can afford to pay, and so on—are not going to take the measure of the problem if it presents itself on the scale envisaged on the Treasury's more gloomy assumption.

Even on that basis the arguments will be fierce. The "Think Tank" leak has given Mr Edward Heath, Sir Ian Gilmour and other dissidents the chance to accuse the Thatcher government of neglecting its social responsibilities, thereby departing from the true Tory tradition.

The accusation has some sting because the party managers know well from the opinion polls that a reputation for unconcern is the Prime Minister's weakest suit. Resolute she may be, and bold too, but does her Government have to be quite so bloody? Beyond the electoral considerations, and the moral considerations too, it is pledged within two terms of office to push back the frontiers of the state.

But those frontiers are defended by determined forces of vested interest, the public employees whose power and patronage has grown so in the last decade or so. They have in large part succeeded in hitching the Labour Party and trade union movement to their sectional cause.

The public v. private issue, which this Conservative Party conference has brought to the fore, is one which cuts across the lines of class and traditional allegiance to pare the public sector. It looks as if it will be the chief battleground of British politics in the years to come.

SINKING THE UNTHINKABLE AT BRIGHTON

OBSERVER

Sunday 10 - October 1982

Beneath the placid surface of last week's Tory conference, a genuine doctrinal battle was being fought out over the future of the Welfare State. ADAM RAPHAEL and SIMON HOGGART assess the significance of a debate that began with a defeat for Mrs Thatcher in the Cabinet room at No. 10 last month.

THE CONSERVATIVE Conference chairman, Donald Walters, remarked plaintively at lunch one day: 'We try to get people to dissent, but nobody seems to want to.' The fact is that all Tory conferences are ruthlessly stage-managed. Motions are specially selected so that virtually every single delegate can agree with the wording. Speakers have to apply on a printed slip for their place at the lectern, so that they can be vetted by the platform first. As an official from the Soviet Embassy remarked with a smile in the tearoom last week, 'This is just how we organise *our* conferences.'

Beneath this glossy surface, however, the chasm which exists between the two different wings of the Tory Party gaped wider than ever. This time the wets believed that they were defending the whole concept of their Tory 'One Nation.' Mrs Thatcher tried to douse fears of a threat to the National Health Service in her conference speech, but by then the damage was done. The noise of battle over the future of the Welfare State echoed all round Brighton.

Mrs Thatcher can take some of the blame for this herself. She was warned by one of her closest allies: 'If we have got to think the unthinkable, for goodness' sake let us do it in private.'

In the interval between the anodyne debates in the conference hall itself, a parade of Tory wets, speaking in pubs and the private rooms of expensive hotels, launched their counter-attack on Thatcherism. They included Cabinet members such as Peter Walker and Jim Prior and members of the Government-in-exile, such as Ted Heath and Sir Ian Gilmour.

One Minister spoke privately of a 'monumental cock-up'; another talked bitterly about 'a botched attempt to dismantle the Welfare State.' Considering that the row is now likely to haunt the Tory Party right up to

Minister, decided that the Cabinet ought to have a wide-ranging discussion about the implications of accelerating growth in public expenditure, in an economy which was not expected to expand by more than 5 per cent over the next decade. The consequences would not seem just unpleasant —they would be disastrous. If nothing was done, according to a paper the Chancellor presented to the Cabinet on 9 September, the basic rate of tax would have to rise by half from 30p to 45p, and VAT would have to go up to 25 per cent.

Sir Geoffrey himself began the debate on the future of the Welfare State during the summer when he made a heavily coded speech in Cambridge. In it he set out the priorities for a future Conservative Government, and suggested that radical options would have to be examined if the Tories were to make good the pledge in their 1979 manifesto to reduce the share of the nation's income taken by public spending.

But it was not until Ministers received their Cabinet papers on 7 September, two days before the crucial meeting, that most of them realised that the Chancellor was now determined to force a swift examination of truly radical cuts in public spending.

In their official red boxes that evening, Ministers found three papers, one from the Chancellor, one from the Central Policy Review Staff, commonly called the Think Tank, and one from the Treasury on current public expenditure trends. All three made distinctly unpleasant reading. Sir Geoffrey's paper reinforced his threats of sharp tax increases by warning that public spending was set to grow to 47 per cent of Britain's gross domestic product by the end of the decade, much higher than when the Tories came into office. The consequences, he warned, were 'unacceptable and crippling disincentives to

for radical cuts in the Welfare State. Among its most controversial recommendations — which would save a total of £10 billion—were the introduction of compulsory private health insurance to replace the National Health Service, ending virtually all state funding of higher education, and going back on the Tory commitment to increase Social Security payments, including pensions, in line with inflation.

'I couldn't believe my eyes when this absurd paper came round,' said one Minister, a well-known wet. Another claimed he hadn't even bothered to read it, as it was so obviously 'a waste of time and energy.' Other Ministers, however, were carefully briefed by their officials on the options which the Think Tank had outlined.

The wets deny that they plotted together in advance of the 9 September Cabinet, but when the Prime Minister called the meeting to order that morning they were clearly fully prepared.

As soon as the Prime Minister read out the proposed agenda, suggesting that the Cabinet should spend the morning discussing the Chancellor's paper and devote the afternoon to the Think Tank, there were immediate protests. The wets, led by Peter Walker, the Agriculture Minister, said that the Think Tank's proposals were presented in far too vague and dangerous a form for the Cabinet to discuss. Others warned that the paper had had wide distribution throughout Whitehall. This was because the paper had been marked 'confidential,' a lower classification than 'secret' and much lower than 'top secret.' When Mrs Thatcher heard this, she was furious and demanded an explanation from the Cabinet Secretary, Sir Robert Armstrong.

As the morning passed, the

inisters saying that they ought the Chancellor's own aper unduly pessimistic id lacked any vision. At one oint she exploded when Michl Heseltine, who has been eading the case for more xpansion, said drily that he ished for once that the Treasy would address its tiny llective mind to the question promoting growth rather ian always bewailing the lack growth.

When the Cabinet broke up or lunch, the Prime Minister id Chancellor could clearly see iat they faced a tricky after-... According to one ver-, after a fairly tense lunch, Cabinet broke into two with Mrs Thatcher, Sir ...ey Howe and Leon Brit-... retiring downstairs to ncert their tactics against the ets. But when the Ministers assembled round the Cabinet ble, it was quickly evident ... the Prime Minister and the ...ellor had once again lost ...port of a majority of their colleagues. It was not just the wets, but also the 'greys' and even some of the drys who indicated they thought it both futile and dangerous to proceed with a discussion of the Think Tank report.

The Health Secretary, Norman Fowler, said that the Think Tank proposals on the NHS were neither helpful nor relevant when the Government had already committed itself against alternative systems of financing.

Mrs Thatcher argued just as strongly that the issues were too important to be shelved and that the Cabinet had to face the facts on public expenditure, however difficult and unpleasant they might be. But the sense of the Cabinet had been caught by the wets, whose leader, Peter Walker, argued that while it was right for the issues to be debated, it should not be on the basis of an obviously flimsy, inadequate and ill-prepared paper. The correct place to start such a sensitive examination was in the party's research department. Lord Hailsham, who has been known to leave Cabinet meetings singing 'Oh God our help in ages past,' was heard to mutter instead that the paper had been the most damaging single episode of the past three years.

The argument — the first important wet victory for more than a year — was carefully omitted from the Cabinet minutes, But Mrs Thatcher's fears that details of the Think Tank report would soon leak out were confirmed eight days later when the *Economist* published a detailed account.

By then the Prime Minister was in the Far East, but she read with mounting anger reports cabled to her of the bitter political controversy caused by the leak. On her return, she summoned a crisis meeting and was advised by her party chairman, Cecil Parkinson, to cut her losses and disown the Think Tank report as 'politically inept.' This delicate operation, which inevitably involved a certain amount of glossing over what had actually happened, went wrong. Too many people knew what had been said and too many people were outraged by what they saw as a flagrant attempt to rewrite history.

So, when the party conference opened in Brighton last week, the wets were in no mood for submission. They know they cannot afford a full-scale Cabinet conflict so close to an election. On the other hand, they are not prepared to go into the election with a manifesto committed to dismantling the Welfare State at a time of massive unemployment. As Jim Prior told the Tory Reform Group: 'We shall not deal with these daunting problems by adopting the over-simplifications of those who like to call themselves nineteenth-century liberals ... for us to take up nineteenth-century liberalism would have about as much appeal to the voters and as little sense as taking up Marxism has for the Labour Party.'

The wets can publicly protest, but their position is not strong. Mrs Thatcher has entrusted the vital job of co-ordinating the manifesto to Sir Geoffrey Howe, who together with Cecil Parkinson is in charge of the party's policy groups. With the Falklands factor still helping her, and with her party 12 points ahead in the polls, Mrs Thatcher still holds almost all the levers of Tory power.

But the issues raised by the row over the Think Tank report will not just die away. Mrs Thatcher has now been placed in a position where she has been publicly forced to admit that her Government cannot keep its pledge at the last election: to sustain the Welfare State while cutting tax at all levels of income. In the run-up to the election, Ministers are certain to have a difficult job facing questioners who will want to know which bits of the Welfare State are to be dismantled in order to prevent taxes increasing. As the Chancellor himself admits, the dilemma of accelerating public expenditure in a no-growth economy will not go away. Neither will the argument, which now seems set to dog the Tory Party throughout this crucial pre-election year.

The Tories may try to keep the wraps on this debate. But even if the unthinkable has now become the unspeakable, the voters will want to know precisely what the Government

12 OCTOBER 1982

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Slicing a cake full of fallacies

"The intention must be," Sir Geoffrey Howe told Weekend World this Sunday, "to secure a reduction in the percentage of gross domestic product (national income) being taken by public expenditure. It is now at 45-46 per cent, depending on how you measure it." A certain logic follows from the Chancellor's commitment. Either the share of public spending in national income can be cut by increasing national income, or it might be cut by reducing spending. The first course he effectively ruled out by promising years of low growth. The second is difficult. Sir Geoffrey inherited an economy where public spending took only 41 per cent of national income, and his recession has succeeded in creating enough unemployment to drive that share up. For the future, he murmured gently about the hopes of improving the efficiency of the public sector, but the truth is that such savings would amount to relatively little. Sotto voce, Sir Geoffrey was once again confirming that the Cabinet's dries may have "shelved" the Think Tank's proposals for education and the health service but they have not yet disavowed them.

More's the pity, then, that this report, evidently regarded by Mrs Thatcher and her Treasury ministers with intense seriousness, should not be regarded as serious enough to merit publication. Not serious enough even to be released for the examination of the Treasury committee of the House of Commons. Not yet serious enough to withstand the sort of scrutiny which our fiscal experts would like to give it.

It is highly contentious to suggest, for example, that the continuation of current policies and low rates of growth might lead to an expansion of the share of public spending to 60 per cent of national income, with consequent increases in income tax rates. Constant tax rates should be enough to fund a constant real level of public services, unless the number of recipients of pensions or supplementary benefit increases. The former is in fact unlikely, on present demographic trends. The latter will only occur if the economy is run for the foreseeable future at such a low pressure of demand and output that unemployment continues to grow. It then becomes not a public spending problem, but a problem of misguided government policies. If the economy does grow fast enough to reduce unemployment, then it is true that public spending may still rise as a proportion of national income. But that is the political result, observable in every developed economy for three decades, of the fact that the demand for public services increases disproportionately with rising income. It is a consequence of prosperity, not an obstacle to it.

From its analysis of a non-problem, the Think Tank glides effortlessly to counterproductive solutions. Most of its ideas would in fact entail the same or worse services taking a larger share of the national cake. Take, for example, health care. A brutal free market in health care would certainly reduce spending, but it would also leave poor people without care and has therefore been ruled out. "Privatisation" means instead a compulsory insurance scheme. But why does it make any difference, if the service remains the same, whether it is funded from tax or from compulsory insurance? In practice, the burden on the individual would increase. The costs of collection of premiums would be greater than the costs of collecting tax which has to be collected anyway. The Government's control over health costs would vanish, to be replaced by a system where doctors effectively decide the level of service and where consumers, their payments spread in thousands of premiums, are powerless to resist a steady increase in charges.

The same argument does not apply to private funding of higher education. The cost per student of perhaps £12,000 for a three year course would simply prohibit able working class students from going to university, for fear that the indefinitely rising unemployment which the Think Tank seems to posit would deprive them of an opportunity to repay the loans. "Education vouchers" for secondary schools, however, would certainly increase public expenditure. They would be a direct subsidy to those parents currently paying school fees and presumably they would also require the expansion of popular state schools if any meaning was to be given to Sir Keith Joseph's promise of greater consumer choice. Nor would standards necessarily improve. More middle class parents would vote with their children's feet for the private system, leaving many state schools deprived of resources or pressures for improvement. Like compulsory health insurance, "education vouchers" would be a way of spending more money on worse services. Can that really be the apotheosis of Sir Geoffrey's

The CPRS

1. The Central Policy Review Staff (CPRS) was founded in February 1971 as an advisory and analytical unit within the Cabinet Office, serving the Cabinet and the Prime Minister. Its primary functions are to provide collective briefing for the Cabinet and its Committees; to prepare longer term studies and reports; and to monitor the Government's central strategy.

2. The CPRS currently comprises 14 advisers and 6 senior staff (including the Head of the CPRS, Mr John Sparrow and the Cabinet Office Chief Scientist) and 17 support staff. All advisers and senior staff are on secondment, mostly for about 2 years: there are no permanent appointments. About half come from outside central government (e.g. industry, local government).

3. It is not normal practice to reveal details of the CPRS' activities. Most of its work takes the form of confidential advice to Ministers. Some of its reports are published, however, and some of its activities are public knowledge.

4. Since its inception in 1971 the CPRS has published 13 reports, none between 1971 and 1973, 10 between 1974 and 1978, and 3 since 1979. This reflects changes over time in the balance of work as between reports for publications and confidential advice to Ministers. The latter is now the principal activity.

CONFIDENTIAL

1022/156/10

FROM: ROBIN HARRIS
DATE: 22 October 1982

Sir Anthony Rawlinson

~~MR MOUNTFIELD~~

cc PS/Chancellor
(Miss Rutter)

LIAISON WITH OTHER DEPARTMENTS CONCERNING REPLIES ON LTPE/CPRS PAPER MATTERS

... I attach a copy of my minutes of the Chancellor's morning meeting on 20 October. Unfortunately, I have not been able to contact you earlier by 'phone, so perhaps I could now bring the Chancellor's wishes on the above matter, as minuted there, to your attention.

RH

ROBIN HARRIS
22 October 1982

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CONFIDENTIAL

FROM: ROBIN HARRIS
20 October 1982

CHANCELLOR'S MORNING MEETING

Note for the Record

236th meeting

Present: Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Mr Brooke MP
Mr Stewart MP
Mr Ridley
Mr French
Mr Harris

1. Inland Revenue Stamp Duty Review

Ministers discussed the Stamp Duty Review. The Chancellor asked the Minister of State (R) to write a foreward to it. There was also discussion about whether it should be issued as a Treasury or an Inland Revenue Paper. The Chancellor and the Minister of State (R would give further consideration to this.

2. Public Preception of Role of Treasury Ministers, Inland Revenue and Customs and Excise

Ministers discussed the problems which arose from widespread misunderstanding of the responsibilities of Treasury Ministers, the Inland Revenue and Customs and Excise. The Chancellor observed that present arrangements were not always ideal from the point of view of either Ministers or the Departments. In particular they sometimes served to reinforce the misapprehension that the Inland Revenue or Customs and Excise were responsible for tax policy and Treasury Ministers for tax administration Such problems needed careful consideration when deciding who should write to the press or in whose name policy documents should be issued.

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3. Meeting with Party Tax Advisers

The Chancellor asked Mr French to arrange a meeting with the Conservative tax advisers.

4. Purchase of Own Shares

The Financial Secretary would investigate whether the measures to permit the purchase of own shares by companies had yielded sufficiently encouraging results to warrant publication.

5. Ministerial Correspondence Unit

Ministers discussed the work of the Correspondence Unit and noted that important progress had been made. The Chancellor asked for a report on outstanding correspondence. He also observed that it was important that the Unit should in certain cases classify key correspondence by subject as well as by sender/recipient so that standard letters could be retrieved.

6. Letters on LTPE/CPRS Paper Issues

The Chancellor stressed the importance of ensuring that replies sent by the Treasury, the DHSS and No.10 to letters concerning the recent controversy on long term public spending, the NHS and the CPRS Paper were not contradictory. He asked that the necessary liaison should be established with No.10 and the Departments affected.

7. Mansion House Speech

The Chancellor asked those present to submit comments on the Mansion House Speech by 4.00pm today (Wednesday).

8. Letters Concerning Improvement Grants

The Chancellor said that official advice was needed about what,

if anything, could currently be said in reply to letters complaining about shortage of local authority funds for payment of improvement grants.

9. IFS Proposals for a New, Unified Benefit

The Chancellor noted the importance of Ministers being well briefed as soon as the IFS's alleged proposals for a new unified benefit were published. He asked the Minister of State (R) to take the lead in urgently examining the issues and the Government's proper reaction to them.

RH

ROBIN HARRIS
20 October 1982

Circulation:

Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Burns
Sir L Airey
Sir D Lovelock
Mr Ridley
Mr French

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PA

1. SIR A RAWLINSON
2. CHIEF SECRETARY

Chancellor
Economic Secretary
Financial Secretary
Minister of State C
Minister of State R
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Mountfield
Mr Goldman
Ms Seammen
Mr Monroe, Inland Revenue

STUDIES ON LONG-TERM PUBLIC EXPENDITURE 28/10

I have been talking to DHSS officials about the work to be done on long-term public expenditure in the health and social security areas.

Health

2. Ministers agreed in July that studies should be set in hand on the scope for:

- i raising more income from charges;
- ii privatising some parts of the NHS, particularly the Ophthalmic, Dental and Pharmaceutical Services;
- iii introducing the French system of charging patients the f cost of treatment and reimbursing them subsequently;
- iv giving further encouragement to the private health secto through fiscal concessions.

3. DHSS have been dragging their feet on this work, partly becaus of genuine pressure on staff resources, partly because the July conclusions were quickly overtaken by the discussion of the CPRS paper. They have now however agreed, subject to confirmation with Mr Fowler that the work should be done and I hope it will not be necessary for you to press Mr Fowler on the point.

4. The CPRS study put forward two ideas on health. The first was for more charging. This will be covered by the work already referred to. The second was for the replacement of the NHS, for

most people, by a system based on private insurance. DHSS officials say there is no chance that Mr Fowler would agree to further study of this idea. I imagine that in the circumstances, and especially given the Prime Minister's speech at Brighton it is difficult to press them.

5. If you agree with this general approach, the public line might be that given in the answer by Mr Fowler in July, which we agreed:

> "The Government have no plans to change the present system of financing the NHS largely from taxation, and will continue to review the scope for introducing more cost-consciousness and consumer choice and for increasing private provision which is already expanding".

I think that this is not too bad from our point of view. In practice, vigorous pursuit of the ideas we discussed in July is likely to move the system away from State towards private provision.

Social security

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G W MONGER

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1. SIR A RAWLINSON
2. CHIEF SECRETARY

PA

Chancellor
Economic Secretary
Financial Secretary
Minister of State C
Minister of State R
Sir D Wass
Sir A Rawlinson
Mr Widding
Mr Mountfield
Mr Goldman
Ms Seammen
Mr Monroe, Inland Revenue

STUDIES ON LONG-TERM PUBLIC EXPENDITURE

25 10

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Health

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5. If you agree with this general approach, the public line might be that given in the answer by Mr Fowler in July, which we agreed:

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G W MONGER

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not sent

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From: P Mountfield
Date: 22 October 1982

1. SIR ANTHONY RAWLINSON
2. CHANCELLOR OF THE EXCHEQUER

copies attached for

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State(C)
Minister of State(R)
Sir Douglas Wass

cc -

Mr Wilding
Mr Byatt
Mr Kemp
Miss Brown
Mr Hart
Mr Spackman
Mr M A Hall
Mr Rayner
Mr Ridley
Mr R Harris

LONG-TERM PUBLIC EXPENDITURE

I put proposals to you about publicity for the LTPE exercise in my minute of 30 September (copy attached). The Chief Secretary agreed that the right tactics were to deal with the subject in some detail in his Institute of Bankers speech, and more briefly in the Mansion House speech.

2. In the event, it was decided not to include material in either speech. Meanwhile, public interest continues. We have had a number of questions from journalists. There was an article in the Guardian last Monday, which challenged the social security figures (the largest single element in the picture shown in the LTPE report). Lady Young answered a question in the Lords last week, from Lord Wells-Pestell, mainly about the NHS, but also touching on the existence of the LTPE report.

3. We understand the Prime Minister does not want any further action on the outstanding Cabinet remits for a few weeks. But eventually we shall have to return to the subject. In considering this, it is useful to distinguish between:

a. Putting the facts on record, in as neutral a way as possible;

b. The political conclusions to be drawn from them.

The Chancellor's concern at this stage is, I think, with the first: to get the facts across as clearly as possible. The water is now rather muddy, following the 'Weekend World' programme (which used figures which the authors now recognise were inaccurate) and the various press speculations. We have identified a number of options for publication, both short and long term.

i. Publish the LTPE report in full. This has the advantage that it is ready, and could be reproduced quite easily. It would mean a row with the Ministry of Defence. It might also involve trouble with other departments, with whom it would need to be cleared at Ministerial level.

ii. An Economic Progress Report article, based on the LTPE report. EPR is fully subscribed up to the December issue. This means leaving it until the New Year.

iii. A Press Statement. This could be done quite quickly, though it would need a lot of drafting and a lot of clearance with departments.

iv. A document placed in the library of the House. This seems to have no advantages over the other courses.

v. A memorandum to the TCSC. We may well find that we are asked for this anyway. No doubt we could find a way of volunteering it, if this were wished. It carries the risk of subsequent cross-examination. We would not be able to control the timing or presentation of the results.

vi. Farming out the operation to an academic or research institution, like NIESR. This would probably take too long for present purposes, and it might not be easy to control.

vii. A Treasury research paper. This would give us time to rewrite the original report, in a form acceptable to departments, but making the points which the Chancellor wants to get across. But it would take some time.

4. There is no need for an immediate decision. But some indication of the Chancellor's wishes would help us to plan, and give us a line to take in dealing with press enquiries, PQs etc in the next few weeks. Meanwhile, we have dodged the issue in the reply which Mr Hart has just submitted to a PQ by Mr Michael Meacher today.

E. Davies

PP P Mountfield

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FROM: MISS J M SWIFT
DATE: 28 October 1982

APS/MINISTER OF STATE (C)

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (RO
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Wilding
Mr Monger
~~Mr Mountfield~~
Mr Goldman
Ms Seammen

STUDIES ON LONG-TERM PUBLIC EXPENDITURE

The Chief Secretary has seen and noted your minute of 25 October recording the Minister's views on Mr Monger's minute of 22 October. The Chief Secretary is sure that we can take account of all the constraints and still proceed with the work.

MISS J M SWIFT

14/a2

CONFIDENTIAL

CONFIDENTIAL

From: T A A Hart
Date: 18 November 1982

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[CHI]EF SECRETARY

cc -

Chancellor
Sir D Wass
Sir Anthony Rawlinson
Mr Wilding
Mr Kemp
Mr Mountfield or
Mr Hall
Mr Rayner
Mr Ridley

PUBLIC EXPENDITURE IN THE LONGER TERM

18/11/82

Mr Gieve's minute of 15 November asked for a report on progress with the review of departmental programmes which the Cabinet decided on in September.

2. Following the September Cabinet meeting, the Secretary to the Cabinet put forward proposals to the Prime Minister for following up this remit. The Prime Minister decided, however, that no formal action should be taken until after the Cabinet discussions of the Public Expenditure Survey (and the recent by-elections).

3. These obstacles are now removed and we understand that Sir Robert Armstrong is about to re-submit to the Prime Minister his proposals on how the exercise might be handled. The revised timetable he is likely to put forward is:-

a. a series of early meetings with the main spending Ministers, under the Prime Minister's chairmanship, to resolve any immediate political anxieties;

b. formal launching of the exercise by a minute from the Prime Minister to the Chancellor in late November or (more likely) early December;

c. colleagues to report back to the Prime Minister by the end of February/beginning of March; and

d. these reports to be discussed by Ministers between mid-March and end-April in time for the results to be fed, as necessary, into the 1983 Survey.

4. This timetable is convenient from out point of view. An earlier date for departmental reports would clash with work on Estimates, the FMI and the exercise on departmental running costs. A later date would be too close to the Budget, work on manpower after 1984 and the arrangements for setting up the 1983 Survey. The Cabinet Office will consult us on the detail of the timetable and the

drafting of the Prime Minister's minute launching the exercise. We shall try to ensure then that departments are asked to clear their replies in draft with the Treasury before sending them in.

5. It is a pity that the timetable has had to slip, but that was probably inevitable after the leaking of the Cabinet papers and discussions. We are generally content, however, with the administrative arrangements which the Cabinet Office are now proposing and we will report further to you when the Prime Minister's wishes are known.

AJ3

T A A Hart
GEP1

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CHIEF SECRETARY

cc Chancellor of the Exchequer
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Wilding
Mr Kemp
Mr Hart
Mr Hall
Mr Rayner
Mr Ridley

PUBLIC EXPENDITURE IN THE LONGER TERM

We discussed this with you on 22 November, following Mr Hart's minute of 18 November. I have since had another word with the Cabinet Office (Mr Buckley) to clarify the plans recorded in Mr Hart's minute.

2. The proposals have now gone to the Prime Minister, and she will probably respond within the next two days (Sir Anthony Rawlinson tells me that Sir Robert Armstrong has just made the same point to him). I suggest we await her comments.

3. We secured the following useful clarifications of the plans set out in Mr Hart's minute:

a. "a series of early meetings with the main spending Ministers, under the Prime Ministers Chairmanship, to resolve any immediate political anxieties". The Ministers concerned are Defence, Social Services and Education. The Chief Secretary, and possibly the Chancellor too, will be invited to each meeting. There will be no special papers, beyond the existing LPPE report and the CPRS report. The objective is to "sell" the operation to the ministers concerned. Your aim will no doubt be to ensure that no options are ruled out at this stage.

b. "formal launching of the exercise by a minute from the Prime Minister to the Chancellor in late Novermber (or more likely) early December." We are promised that we shall be shown this in draft, and we shall of course show it to you before clearing it. The draft will say that departmental responses to the exercise should be discussed with Treasury Ministers. This would meet your anxieties. I still think there is a risk that this will commit you too early, and

that you might do better to limit this to "discuss with the Treasury". Officials would keep you informed, and you could intervene where you judge this necessary. But you could keep your powder dry to a later stage if you thought this best.

c. "Colleagues to report back to the Prime Minister by the end of February/beginning of March". This does not specify a parallel report by you; but you would be able to submit one if you wished: this might cover both the overall position revealed by departmental reports, and any points of disagreement with departmental ministers. When we see the draft instruction from the Prime Minister, you might want to consider whether to suggest one addition: that she will look to you for an analysis of the results. On the whole, it might be better to leave this unspoken for the moment.

d. "These reports to be discussed by ministers between mid-March and end-April, in time for them to be fed, as necessary, into the 1983 survey." Cabinet Office have deliberately not specified how this would be organised. It might go straight to full Cabinet; or there might be a series of separate discussions with one or more groups of individual spending ministers. I think this is right: keep the option open until we see what the results look like.

This seems to me (and to Sir Anthony Rawlinson, whom I have discussed it briefly) pretty satisfactory. You might like to discuss with us again once we have the Prime Minister's comments on Sir Robert Armstrong's submission.

PM

P MOUNTFIELD

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Chancellor of the Exchequer

cc -
Chief Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Wilding
Mr Byatt
Mr Monger
Mr Kitcatt
Miss Kelley
Miss Brown
Mr Hart

FOLLOW-UP OF CABINET DISCUSSION OF LONG TERM PUBLIC EXPENDITURE

The Prime Minister has arranged a series of meetings with the main spending Ministers to discuss the follow-up to the discussion in Cabinet on 9 September. The Ministers involved are Sir Keith Joseph (7 Dec,11am) Mr Fowler and Mr Nott (14 Dec, 9.30 and 15 Dec 5.30. The sequence of the last two may be reversed). You and the Chief Secretary will be invited to each meeting. This is by way of a general background brief. The Chief Secretary asked for it well in advance. Specific briefs on the four subject areas (Education; Health; Social Security; and Defence) will be prepared well ahead of each meeting, so that further material can be commissioned if required.

2. Papers. The only paper formally before the meetings will be the original interdepartmental report on long term trends in public expenditure (which you circulated to Cabinet in July).The CPRS paper on options is technically a non-paper, but will be in everyone's minds (and no doubt in their briefing folders too). Both are in some respects slightly out of date, and the detailed Divisional briefs will comment on any changes. No 10 have asked us for a sight of your briefing, and an edited version of the Divisional notes will be sent separately to Mr Scholar.

3. Purpose. Strictly, these meetings are unnecessary. There has already been a Cabinet decision that each departmental Minister should review his own programmes, and report to you, by an unspecified date, on the results. With the Chief Secretary's approval, Sir Robert Armstrong has suggested to the Prime Minister that she issue further instructions to Ministers about the preparation of their report. These will contain two points: a timetable (end-March suggested) and a requirement that they consult Treasury Ministers on the preparation of their report. This is satisfactory.

Objective

4. This series of meetings is designed to soften up the three big spenders. Without their support, the operation will not work. Your main aim, I suggest, should be to ensure that no sacred cows are prematurely identifed. Given the Prime Minister's concern about the NHS, this may be difficult. But we want to make sure that the Ministers concerned:

a. do not close off any options at this stage, and

b. if possible put their personal weight behind the exercise and encourage their officials to cooperate fully with the Treasury.

Background

5. Since the September meeting, there has been no real action. The Prime Minister (we understand privately) did not want to stir this up before the Cabinet discussions on the 1982 Survey, nor to risk any adverse publicity while the two last by-elections were pending. The leaks of the CPRS Report did not help. Nevertheless, even the first stage achieved one success: the speeches at Brighton contained no fresh pledges which would limit the scope for reducing public expenditure in the next Parliament. We suspect that it also helped in creating the right atmosphere for the 1982 Survey.

The General Picture

6. Since then there has been one further round of press comment, based on a leaked version of the LTPE report which got into the hands of the Times. The main argument was that the Treasury had cried "wolf" too soon. We had over-estimated the burdens of defence and education and exaggerated the size of the tax gap. I attach an earlier note by Mr Hart analysing and refuting these arguments.

Public Education

7. Cabinet also gave you a remit to consider how to conduct a campaign of public education on the subject. You and the Chief Secretary have both considered public speeches on the subject, but have on each occasion decided that the time was not yet right. You may now feel that the issue has been sufficiently ventilated, and that for the moment enough has been said in public. If so, you might like to use the opportunity of one of these meetings to secure the Prime Minister's agreement (which will probably be given readily). We could then "sign off" the Cabinet remit. Meanwhile, we have a ready-made speech on the stocks which could be used on some suitable future occasion if you wished.

Timetable

8. Sir Robert Armstrong's proposal is that the reports should come in at the beginning of March, and be discussed in Cabinet between the Budget and say end April. The idea would be (depending on the timing of the Election) to feed the results into the 1983 Public

Expenditure Survey. Alternatively, the material would be available for any post-Election) to feed the results into the 1983 Public Expenditure Survey. Alternatively, the material would be available for any post-Election review of policies and expenditure plans.

PM

P Mountfield

FROM: G W MONGER
DATE: 30 NOVEMBER 1982

MR KERR

cc PS/Chief Secretary
Mr Mountfield

STUDIES ON LONG-TERM PUBLIC EXPENDITURE

The Chancellor might find it useful to see again before his discussion with the Prime Minister this note about work on long-term public expenditure on health and social security. I understand that this subject was mentioned at his meeting this afternoon. I would suggest that it is important that the Ministerial exchanges about to take place should confirm that the work described in the note should go ahead.

G W MONGER

ENC.

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1. SIR A RAWLINSON
2. CHIEF SECRETARY

cc Chancellor
Economic Secretary
Financial Secretary
Minister of State C
Minister of State R
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Mountfield
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STUDIES ON LONG-TERM PUBLIC EXPENDITURE

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G W MONGER

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Mr Hart

MR. MOUNTFIELD

FROM: MISS M. O'MARA
30 November 1982

cc: Chief Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Wilding
Mr. Byatt
Mr. Monger
Mr. Kitcatt
Miss Kelley
Miss Brown
Mr. Hart

FOLLOW-UP OF CABINET DISCUSSION OF LONG TERM PUBLIC EXPENDITURE

At the Chancellor's meeting this afternoon, it was agreed that the Treasury should take every opportunity to build up the long term public expenditure argument but that the whole picture should not be revealed on any one occasion. A Parliamentary debate on the Public Expenditure White Paper would provide a very suitable occasion for pressing the message home. There would be problems in publishing an article on the subject spontaneously, in the EPR or elsewhere, since this would require clearance with other Departments, but the Treasury could well produce much of the same material without such difficulties in response to requests from Select Committees.

2. The Chancellor said he thought it would be helpful if he were to have a preliminary run over the ground with the Prime Minister before she held her meetings with the main spending Ministers. He would therefore be grateful if he could see the briefing supplied for these meetings sufficiently well in advance to enable him to do this. More generally, he would be grateful if officials could provide him and the Chief Secretary with a selection of points to make to colleagues in the big spending Departments on every suitable occasion. It would also be important to identify areas in which Ministers should avoid entering commitments in the pre-Election period. On defence in particular, the Chancellor thought it should be possible to enlist support from other Finance Ministers to ensure that the commitment to 3 per cent growth in defence programmes not extended beyond 1985-86. He would be grateful if the point could be covered in his briefing for future international meetings.

MOM

MISS M. O'MARA