PREM 19/166

PART 9

157

Confidential Filing

Public Expenditure and Cash Limits
Public Expenditure White Paper.

ECONOMIC POLIC

Part 1: May 1979

Part 9: March 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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~~2.7.80.~~							
ends —							

PART 9 ends:-

S/S Environment to Home Sec 2.7.80

PART 10 begins:-

HMT to PM 2.7.80.

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

1. Cmnd. 7524: Supply Estimates 1979-80: Memorandum by Chief Secretary to the Treasury
   Published by HMSO, April 1979

2. Cmnd. 7841: Government's Expenditure Plans, 1980-81 to 1983-84
   Published by HMSO, March 1980

Signed J Wayland Date 2 March 2010

PREM Records Team

DG

Econ Pol

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/14880/80

Your ref:

2 JUL 1980

Dear Willie

You wrote to me again on 16 June about the scheme to construct a headquarters building for the UK Warning and Monitoring Organisation.

In view of the importance you place on this scheme in the context of national security, I have agreed to start it this year. The passage of time means it will in fact spend less in 1980/81 than the £331,000 you mention.

I have asked my officials to liaise closely with yours.

I am copying this letter to those who received yours.

Yours ever

MICHAEL HESELTINE

The Rt Hon William Whitelaw CH MC MP

From: The Private Secretary

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Alistair Pirie Esq
PS/Chief Secretary to
the Treasury
HM Treasury
Parliament Street
London SW1

30 June 1980

Dear Alistair,

PUBLIC EXPENDITURE IN NORTHERN IRELAND

... I attach a copy of a Press Statement which my Secretary of State released earlier today. Mr Atkins will be writing shortly to the Chief Secretary about the management of public expenditure in Northern Ireland during the rest of the current year.

Copies of this letter and of the statement go to Michael Alexander at No. 10, Ian Ellison at the Department of Industry and Richard Prescott in the Paymaster General's Office.

Yours sincerely
Mike Hopkins

M W HOPKINS

Northern Ireland Office
Press Notice

Great George Street, London, SW1P 3AJ. Telephone Enquiries 01-930 4300 ext. 276 or 277
Stormont Castle, Belfast, BT4 3ST. Telephone Enquiries Belfast 63011

L6/80

Great George Street
LONDON SW1P 3AJ
Tel:- 01-233-4626
June 30, 1980

PUBLIC EXPENDITURE IN NORTHERN IRELAND

The Secretary of State for Northern Ireland, Mr Humphrey Atkins, has asked Northern Ireland Departments not to enter into any new commitments in respect of capital or current expenditure for the time being. A similar message is being conveyed by Departments to spending bodies for which they are responsible.

Mr Atkins said today that Government is monitoring the public expenditure situation in NI to ensure that, overall, the best possible match is achieved between needs and available resources. This was clearly necessary in view of the continuing need not merely to restrict public expenditure to what the nation can afford, but, most importantly, to get our priorities right. Given the current situation in manufacturing industry it seems appropriate to put more emphasis on support for investment and hence to maintain the flow of new jobs into the economy.

The Secretary of State continued:-

"I have taken this action not because the total level of NI public expenditure as set out in Cmnd 7841 is to be reduced, but because a number of substantial new demands have been identified within the system, some of which - particularly in the economic sphere - may have to be given a priority higher than some other items of expenditure previously planned for 1981.

"We have undoubtedly entered a period when the resources to do all that the various services might wish to do will simply not be available. As new demands arise, we shall have to take stock and, if necessary, make some redistribution of resources in line with the best possible assessment of priorities. It cannot be a pleasant prospect for the services affected but we have to make the best use of the funds that are available to us at any particular time.

"The object of the temporary standstill which I have introduced is to preserve the maximum room for manoeuvre until I am in a position to inform spending bodies of revised allocations for the rest of the financial year. Meanwhile, they are asked not to enter into any new commitments in respect of capital or current expenditure which would restrict their ability to adjust their budgets if this should prove necessary."

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES.

Reference: E (80) 22nd Meeting, Minute 1
Date: 26 June 1980

Signed OWayland Date 2 March 2010

PREM Records Team

CONFIDENTIAL

Top Copy: European Policy, Pt 9 - Community Budget

Econ Pol

10 DOWNING STREET

From the Private Secretary

20 June 1980

Additionality and the Use of Community Funds

The Prime Minister has seen the Chancellor of the Exchequer's minute to her of 17 June on this subject. She has commented that the Government must stick firmly to the principle that the increased receipts resulting from the Article 235 arrangements agreed in Brussels on 30 May must go to substitute expenditure which would otherwise have been nationally financed. The receipts must not go to fund "additional" spending.

I am sending copies of this letter to the Private Secretaries to the other members of Cabinet, to Tony Mayer (Department of Transport) and David Wright (Cabinet Office).

A.J. Wiggins, Esq.,
HM Treasury.

CONFIDENTIAL

Top Copy: European Policy
Pt 9 - Community Budget

(2)

Prime Minister

Agree

We must stick firmly to substituted expenditure. No 'additional' spending. MT

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

PRIME MINISTER

ADDITIONALITY AND THE USE OF COMMUNITY FUNDS

We need to settle how we are going to handle, in relation to our public expenditure programmes, proposals for expenditure financed by the European Community under the Article 235 arrangements which are part of the Budgetary agreement reached in Brussels on 30th May.

2. As you said in the House, it is vital that the increased receipts should go to reducing expenditure, the PSBR and interest rates. We had already said in the public expenditure White Paper that the savings in public expenditure there announced will be increased by the reduction in the EC contribution. We must be sure that this is indeed the result. (This was discussed in my letter of 8th February to OD(E) and my letter of 16th April about briefing MEPs.)

3. Accordingly, Departments should wherever possible follow the existing practice for the Regional Fund, under which grants passed on to spending authorities for infrastructure projects are used in substitution for the borrowing or other finance which would otherwise have been necessary.

4. If however, exceptionally, a Department wishes to propose additional expenditure associated with additional EC receipts, I suggest that the Minister responsible should put forward a bid for the expenditure to be financed from the contingency reserve. Treasury Ministers,

/or in cases

or in cases of disagreement the Cabinet, can then consider whether to accept the claim, given the other prospective calls on the reserve. Such bids must be kept to the absolute minimum.

5. Expenditure within the UK on agricultural price support under the CAP is a separate matter. Any prospective increase will continue to be considered in conjunction with the associated effects on our Budgetary contribution as well as the receipts.

6. The 1980-81 expenditure programmes and contingency reserve are firm, and so my proposal would apply immediately. It is likely however that additional expenditure will be very small in the current year, and should be capable of being absorbed in Departments' existing programmes.

7. For the later years we shall be able, in the 1980 public expenditure survey, to take account of any proposals to increase particular programmes. But when we have taken our decisions in the survey, my proposal would apply to any further bids for additional expenditure.

8. I shall assume agreement unless any of my colleagues wish us to discuss the matter, in which case I should be grateful to hear within a couple of weeks.

9. I am sending copies of this minute to members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

(G.H.)

17 June, 1980

ECON POL. Pt 9

FINAL DRAFT

EMBARGO UNTIL 17.00 HOURS ON THURSDAY, 19TH JUNE 1980

CF
PG.

THE CENTRAL PROBLEM OF PUBLIC EXPENDITURE

A speech to be delivered at Manchester Business School on 19th June 1980, by Professor Douglas C. Hague, Deputy Director, Manchester Business School and adviser to the Prime Minister's Policy Unit at 10 Downing Street.

A basic characteristic of the public sector appears to be that productivity rises more slowly than in the private. It is not easy to measure, or to increase, the "output" of a civil servant, a teacher or a nurse. In parts of the public sector productivity does increase, but there are many where it does not. There statements are tentative because it is so difficult to measure public sector productivity. Official statistics show that the price of a given volume of public sector current output - which comprises central and local administration and services, education, health, defence, etc - rises more quickly than the price of output in general. This is what economists call the relative price effect. The implication is that private sector productivity rises faster than public. These government figures are, however, based on the assumption that there is no increase in public sector productivity, which seems too pessimistic. ?

Another characteristic of the public sector is that there is a limit beyond which taxation cannot be increased. If it is, some people evade it; others restrict the work they do. And electorates look for lower, not higher, taxes. It is economically undesirable and politically impossible to raise tax rates in the UK above present levels.

I here develop a method to indicate what would happen if public sector productivity rose 2% per annum faster than in the private sector, in which I include the nationalised industries. Since we do not know how realistic this assumption is, I then consider what has happened in the UK since 1957, to see whether my conclusions seem plausible.

I assume that, initially, national output is 100. Out of this, 25 is from the public sector and 75 from the private. There is full "comparability" in public sector pay. Everyone is paid the full rate made possible by private sector productivity, but I assume no rise at all in productivity in the public sector.

There are at all times just 100 units of labour. Output per unit of labour is therefore initially one unit per annum, with 25% of the labour force in the public sector and 75% in the private. The only tax is a flat-rate one on all output (expenditure). The rate is initially 25%, that required to pay the 25% of the working population who are in the public sector.

Results

After 20 years, national output has risen from 100 to 136 units per annum. If there has been no movement of labour to or from the public sector, its output will still be 25. Private sector output will have risen by 2% per annum, from 75 to 111. Since everyone gets the full pay increase made possible by the rise in private sector productivity, unit pay rises from 1.00 to 1.48. Total pay is 148, of which the public sector takes 37 (25 x 1.48). The tax rate remains 25%. That rate on the pay of 148 yields the necessary 37 units.

There is, however, an important change. Instead of representing 25% of output as they did 20 years earlier, the 25 units of public sector activity now account for only 18%. This is what keeps the tax rate at 25%, even though the relative price effect has raised public sector costs per unit of "output" to 1.48 times private sector costs.

The electorate may accept this situation, but it may not. Now that the rest of the economy has become more prosperous, people may argue that the public services must match this improvement. It is, I suspect, precisely this kind of feeling which lies behind Galbraith's famous crack about private affluence and public squalor. And discussion in terms of the national income accounts tends to dodge the issue altogether by assuming that the output of a public sector employee is worth exactly what he is paid - a conveniently circular argument.

What happens if the public does not accept the situation? Suppose the electorate insists that the output of the public sector must rise in line with that in the private sector? The public sector will then always account for 25% of national output and, on my assumptions, after 20 years, national output will be only 132 and not 136. This is because, to produce 25% of national output, there would be 33 units of labour in the public sector, producing 33 units of output - 25% of 132. This leaves 67 units of labour in the private sector. With their output of 1.48 units each, total private sector output is 99.

The reason why national output is four units less than on the earlier assumptions is that eight units of labour have moved from the private to the public sector. Since they there produce only one unit each as against the 1.48 in the private sector, output falls by a net 0.48 units for each unit of labour that moves.

This may seem bad enough, but the relative price effect also takes its toll: output has fallen by 3%, but the tax rate has risen to 33% instead of 25%.

After a further decade, the situation is worse still. If we assume that after 30 years only 25 of the 100 units of labour are in the public sector, national output will be 161, 25 from the public sector and 136 from the private. Pay is now 1.81 and the tax rate still 25%, but the public sector now accounts for only 15% of output.

If the Government feels obliged to maintain public sector output at 25% of the total, national output will be reduced to 150, a fall of 7%. There are now 38 units of labour in the public sector, producing 38 units of output. The 62 units in the private sector have an output of 1.81 each, giving them 112 out of the national total output of 150. The reason output has fallen by 7% is again lower productivity in the public sector. The tax rate is 38%.

If the process continued over a full 50 years, and if public sector output was held at 25% of total output, 47% of the labour force would then be in the public sector. The tax rate, at 47%, would be almost twice that of 50 years earlier. Output would be 189, 17% lower than if public sector output had been held at 25 units, but then it would have represented only 11% of total output. And, for the record, after 100 years, the tax rate would be 71%. 71% of the labour force would be in the public sector. Output would be as much as 50% less than if public sector output had been held at 25 units. If this were a real-world economy, it would be in ruins.

Hague's Law, then, is this. If we hold the proportion of output coming from the public sector constant, then, if private sector productivity rises faster than public, pay comparability means that tax rates will rise inexorably. They will ultimately become unacceptable. We have designed an arrangement for destroying the economy.

No one is certain whether there actually is a 2% productivity gap between the public and private sectors. Does experience in the UK suggest that the dangers I have highlighted are real?

Chart I considers the relationship in the UK, between 1957 and 1979, between real GDP per head and the proportion of GDP at market prices accounted for by central and local government current expenditure on goods and services.

For the period 1957-73, the relationship is shown by the trend line in Chart I. Government spending rose fairly slowly, as GDP per head rose. In 1957, 1962, 1967 and 1972 however, things went sufficiently wrong for the government to act. In 1962 and 1972, pay policies were introduced. In 1957 public spending was cut. In 1967 the pound was devalued and the IMF insisted on public spending cuts. Significantly, there is a consistent relationship between all these years. They are on, or just outside, the "danger line" in Chart I. In one way or another, public spending had to be reduced. It may be accidental that the trend line and danger line cross about 1973. What is certain is that after the 1972-74 pay controls were ended, the explosion in public sector pay helped to move us into the "disaster area". We are still struggling to escape from it.

In 1957 to 1959, public expenditure cuts and periods of faster growth have, at intervals, moved us back to lower levels of government spending but, as in 1964 - 67, 1969-72 and 1973-75, government expenditure then grew again.

Since we cannot accurately measure changes in the volume of public sector activity, it is impossible to say exactly how much of explosion in public spending since 1973 was due to rising volumes of activity and how much to the relative price effect. The role played in 1957 to 1979 by the imposition and removal of pay controls suggests that relative price changes between the public and private sectors have been a major influence, as I have predicted.

One can also add that, if the gap between increases in public sector and private sector productivity growth is smaller than my assumed 2%, this means only that the process I have outlined takes longer. It still exists.

This analysis shows how serious the problem of public expenditure really is. Behind all the politics, there is an inexorable economic process at work. We have to recognise it and learn how to halt it. Or it will overwhelm us. Fifty years may seem a long time to wait for serious effects, but the Welfare State was born around 1945. We are already into the fourth decade of a process like that outlined here.

Qualifications

Obviously there are qualifications to such a simple analysis, but in Britain today they may make the situation worse, not better. It is true that the proportion of the working population in the public sector is only around 23% but in 1964 it was only 15%. Moreover, the model ignores transfer payments - pensions, social security benefits, etc. These are an important element in taxation, representing about 24% of current Government expenditure in 1978.

The analysis takes no account of three other important facts. First, as tax rates rise, evasion is likely to increase and taxes have to rise even further. Second, the host of bodies and individuals who set pay in the public sector may raise some pay too far. Third, partly because of the process I have outlined, successive governments have cut public spending. It has often been easier to cut capital rather than current spending, so that less has been spent on railways, roads, hospitals and so on. The result is that Britain looks increasingly down at heel.

The analysis also ignores the fact that many of the services like health-care and education which, with increasing affluence, people demand on an increasing scale, are provided largely by the public sector. A market economy would deal with the consequences by rationing the services through price and/or by forcing radical changes in the way they are provided.

In a market system, people would be provided with the services only if they paid for them. The problem in Britain is that, since public sector services are provided through the tax system, people can separate the choice whether to use the service from choices about taxation. The problem is simple. There is an upper limit to taxes. Yet the taxes pay increasingly for services which are not only becoming more expensive but, with growing affluence, are being demanded on an increasing scale. This inherent contradiction lies at the root of our difficulties.

The discussion so far has ignored inflation, but that is an advantage. One of the biggest obstacles to rational public debate on state spending is that money is no longer a reliable measuring rod. Even those who try to avoid being confused by arguments in terms of "funny money" often fail.

Closer inspection of my results shows that the relative price effect itself generates inflation. Initially, 100 units of output cost 100. After 20 years, on our "worse case", 132 units cost 148. Unit cost has risen by 12% over 20 years. The reason is that public sector pay is linked to productivity in the private sector, and not to average productivity over the economy, including the public sector. Moreover, this inflation accelerates. In years 21 to 30, price increases average less than one per cent per annum. In years 41 to 50, average inflation is 1.4% and it is rising exponentially.

There must be a similar inflationary mechanism at work in the real world. Indeed, it may be stronger. If price increases cause those in the private sector to claim higher pay to offset them, a leapfrogging process may begin. This maybe one cause of our periodic pay explosions.

It may be argued that Hague's Law gives too much emphasis to what happened in the 1950s and 1960s. Slower growth of productivity in the 1970s has held back the process I have described. Yet, even if productivity in manufacturing does not pick up soon, we seem to be on the verge of changes which will bring big increases in productivity in services, like banking through mechanisation. In any case, the government can hardly base its strategy on the assumption that its central policy - the improvement of performance and productivity in the private sector - will fail.

Tentative conclusions about what is going on in France, West Germany, Belgium and the Netherlands can be drawn from Chart II. There seems to be a fairly consistent relationship in these countries between the level of real GDP per head and the percentage of GDP spent by the government on goods and services on current account. The higher GDP per head, the bigger the government's share in total activity. But the rise is a moderate one. The UK seems to be the odd man out: it is trying to get ahead of the game. We have more government spending on goods and services than it seems these countries would have had at our standard of living. Quite simply, we are trying to sustain a German ratio of public to private activity with a much smaller GDP per head.

To move fully into line with these countries would require public expenditure cuts, at present, of at least 15%. This is not, repeat not, a call for an immediate cute of that size. Any transition towards the relationship between public and private spending that has proved so successful for these major partners and competitors would take time. But the figure I have quoted does suggest that the changes required in the structure of the British economy may be dramatic.

Consequences

There are only two possible courses of action and we must pursue them both. We must increase productivity throughout the public sector - even in fields like education where productivity is not so much a dirty word as an unknown one.

Because success in this is at best problematical, we must at the same time start a public debate on the issues raised here. We must convince all but the hard core of the Left, and even them if possible, that if we are to have tolerable rates of tax and acceptable rates of growth, we have to make radical changes. We shall have to abandon ~~many~~ public

secondary

sector activities where productivity cannot be increased; charge for them; or turn them over to the private sector. And even where productivity can be increased, this may not happen unless we move some of those activities, too, into the private sector. We may also need to find ways to alter the tax and social security systems to protect the poor and disadvantaged. But the first priority is to set off a public discussion.

Conclusion

This model shows the remarkable power of an economic process. Hague's Law is not a matter of politics, but of mathematics. The process in practice is less smooth than in the model, but it is equally powerful. As Tim Congdon recently pointed out in The Times, pay policies operate in the UK by enabling us to "con" the public sector. For a year or two, we force public sector pay to fall behind what full comparability with the private sector would give. Then, as in 1974-5 and 1979-80, the inevitable pay explosion occurs, led by the public sector.

The lesson is that we must take a totally new look at the problem of public spending. De-indexing the public sector, though it might represent a holding operation, cannot halt a relentless process like this. The process has to be stopped in its tracks. De-indexing could give us only time, and perhaps not much even of that.

If so, that strengthens the need to transform the public sector. We must raise productivity where we can, and abandon entirely, or make private, those activities where we cannot. Perhaps in education,health and local government services the emphasis should be on raising "productivity" in as humane a way as possible. Since we must also make room for an increase in the Government's capital spending, it is important to begin to dismantle the bureaucracies of central and local government. But the big numbers are employed in health and education, which also have their own bureaucracies. Major changes in the way health and education are provided will be needed as time passes.

~~Without radical action, continuing inflation and rising taxation will destroy us. The White Paper on Government Expenditure is absolutely right: Public expenditure lies at the very heart of our economic difficulties. In creating the Welfare State in its present form we have, with the best of intentions, but with appalling lack of foresight, built the ultimate Doomsday Machine.~~

The lesson is that we must stop regarding cuts in the level of Government activity as isolated events. Where private sector productivity rises faster than public, the volume of public activity must be cut, not once-and-for-all, but progressively. Or tax rates will rise. We must do all we can to increase efficiency in the public sector, but it would be foolish to pin all our hopes on this. My belief is that public expenditure reductions will in future represent a normal and continuing process. This is not a matter of political ideology, but of the facts of life. We have to work out how to live with their consequences.

* * * * * *

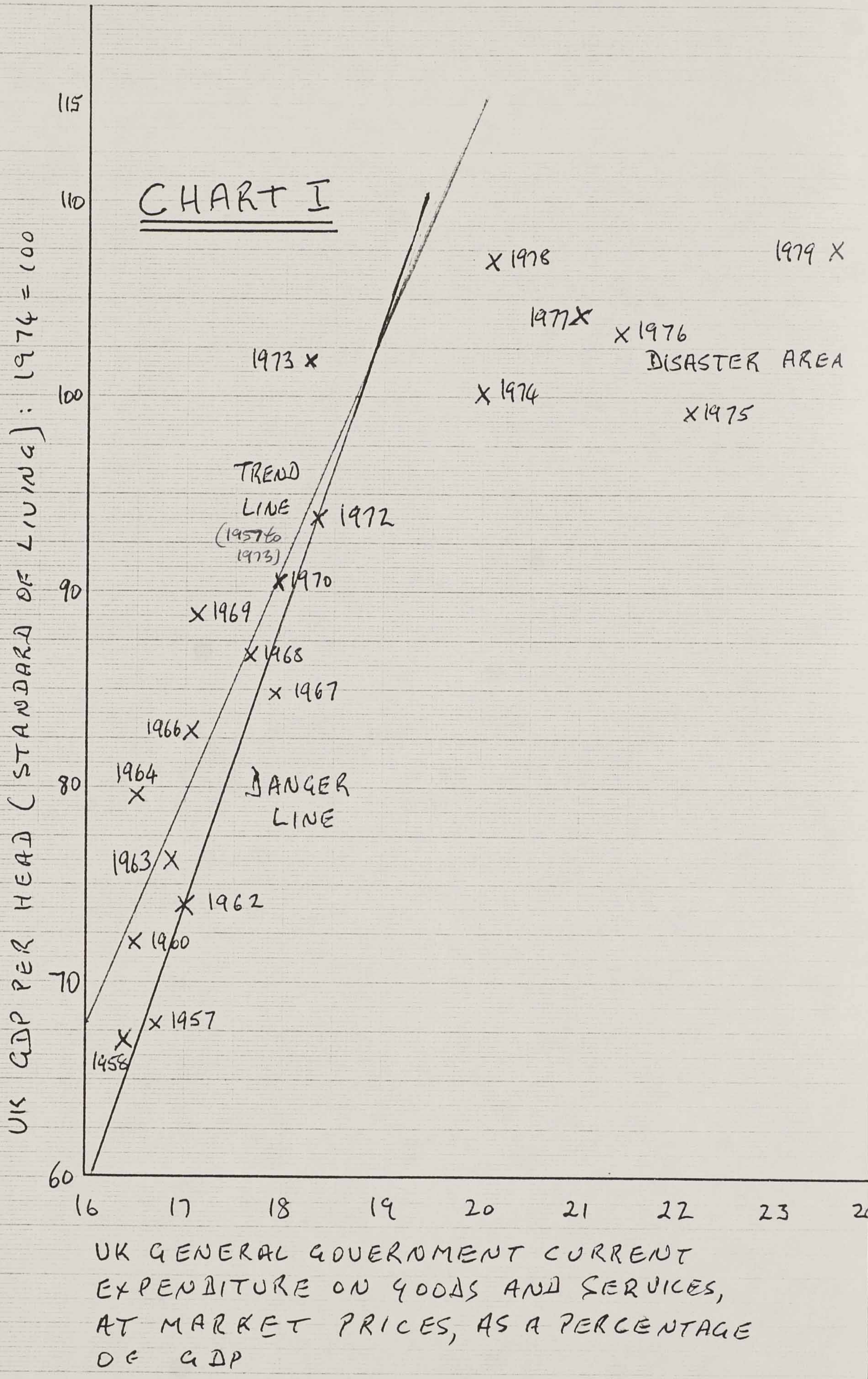
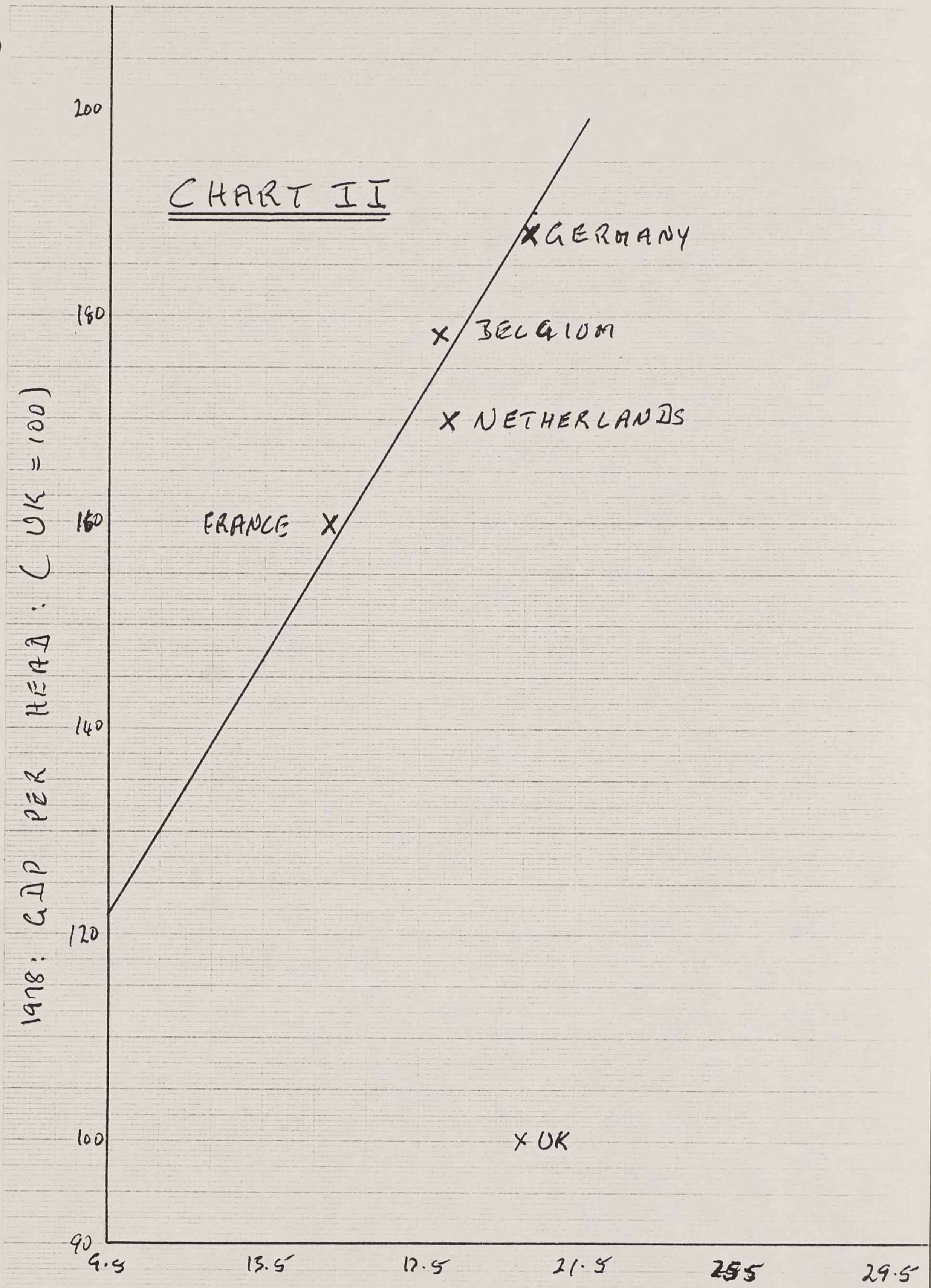
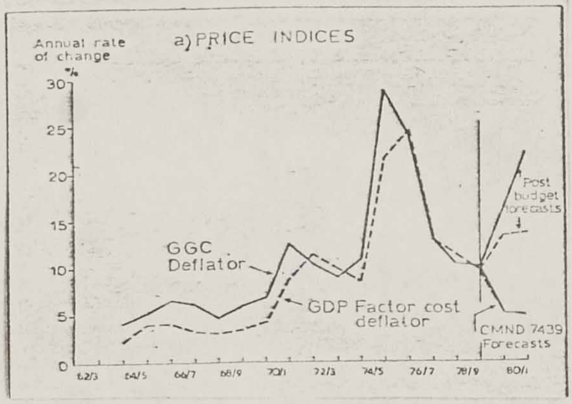


CHART I
UK GDP PER HEAD (STANDARD OF LIVING): 1974 = 100
115
110
100
90
80
70
60
16
17
18
19
20
21
22
23
24
1979 X
X 1978
1977 X
X 1976
DISASTER AREA
1973 X
X 1974
X 1975
TREND LINE (1957 to 1973)
X 1972
X 1970
X 1969
X 1968
X 1967
1966 X
DANGER LINE
1964 X
1963 X
X 1962
X 1960
X 1957
X 1958
UK GENERAL GOVERNMENT CURRENT EXPENDITURE ON GOODS AND SERVICES, AT MARKET PRICES, AS A PERCENTAGE OF GDP



1978: CURRENT GOVERNMENT EXPENDITURE ON GOODS AND SERVICES, AT MARKET PRICES, AS A PERCENTAGE OF GDP

Chart 1. Relative rates of inflation, public authorities' consumption and GDP, 1962–1963 to 1980–1981



Econ Pol.

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SW1H 9AT

16 June 1980

Dear Michael

P.S.A. EXPENDITURE ON NEW WORKS IN 1980/81

R. 17/6

I wrote to you on 16th May expressing concern that there was now doubt as to whether funds were available this year for the headquarters building of the United Kingdom Warning and Monitoring Organization (U.K.W.M.O.). You replied on 29th May that your Department had no money this year to embark on this new building.

requested

I find this disturbing. My letter was written in the context of yours to Paul Channon of 16th April, which accepted that there might be a few schemes, planned for this year, which the Department concerned could not itself finance but which in the national interest could not be deferred, and that any such schemes identified would need to be put to colleagues collectively. I argued strongly that the new U.K.W.M.O. headquarters was such a scheme, and I referred to the operational advantages of the new building, particularly in terms of communications, which the U.K.W.M.O. required to enable it to operate at a high pitch of efficiency. All this was against the background of the present Parliamentary pressure in relation to civil defence.

It may be that an outcome of the current review will be that more money will become available for civil defence, but we have not yet reached that stage. Meanwhile I am convinced that it is in the national interest for the building of the U.K.W.M.O. headquarters to go ahead this year as planned. I understand that the P.S.A. estimate is £331,000 this year and £579,000 in total. If there are priorities to be determined, I think it would be right for the issue to be put to colleagues collectively.

I am sending a copy of this letter, as before, to Cabinet colleagues and Paul Channon, and to Sir Robert Armstrong.

Yours

Willie

The Rt. Hon. Michael Heseltine, M.P.

Econ Pol.

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SWIP 3AG

Tim Lankester Esq
No 10 Downing Street
London SW1

16 June 1980

Dear Tim

1979-80 CASH LIMITS: PUBLICATION OF OUTTURN

You may recall that a White Paper is published each summer setting out the provisional outturn for the previous year's cash limits. These White Papers are factual providing the figures with a minimum of text.

The purpose of this letter is to notify you that July 25 is the proposed date for publication of the White Paper showing the outturn on the 1979-80 cash limits. A draft of the White Paper will be circulated about two weeks before that date.

I am copying this letter to John Stevens (office of the Leader of the House), Richard Prescott (Paymaster General's office), Murdo Maclean (Chief Whip's office) and David Wright.

Yours sincerely

Roger Watts

R J T WATTS
Private Secretary

CONFIDENTIAL

10 DOWNING STREET

From the Principal Private Secretary

F 9.7.80.
Original filed.
Econ Pol: Strategy
pt 5.

SIR ROBERT ARMSTRONG

CABINET MEETING ON ECONOMIC STRATEGY

The Prime Minister discussed your minute A02289 of 9 June 1980 with the Chancellor of the Exchequer and you immediately after the meeting of E this morning.

It was agreed that Cabinet should have a general economic discussion at its meeting on 3 July and that the PES papers should be taken on 10 July. The Prime Minister was anxious that there should be another substantive item for discussion on the agenda for the meeting on 3 July. If we proceeded in this way, there would be no need for the special meeting of the Cabinet on Wednesday 16 July, though nothing need be said for the time being about cancelling this meeting.

You said that you would now discuss the preparations for the meetings on 3 and 10 July with Sir Douglas Wass.

I am sending a copy of this minute to Mr. Wiggins (Treasury).

NMW.

11 June 1980

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

Subject filed on Govt. Bldgs Oct. 79 : International Conference Centre, Broad Sanctuary.

PRIME MINISTER

PSA NEW WORKS PROGRAMME

Since my minute to you of 24 March I have had discussions with John Biffen and Paul Channon about PSA's new works programme. I have also consulted Departmental Ministers about their operational requirements for 1980/81. Some Ministers have agreed to defer their schemes for the present; others have been able to trasfer funds from their own PESC for this purpose; and PSA have been able to reprogramme some of the work. The result is that it should be possible to make a start this year on all schemes considered operationally essential and that were programmed to start this year.

This one item on which agreement has not yet been reached is the International Conference Centre, which is to be considered by E Committee on Wednesday this week. As I explain in my joint paper with the Foreign Secretary on that project, I judge that it could be accommodated within the PSA PESC (it has been in the programme previously) if the Government decides it should go ahead.

This does not mean, of course, that the funds now available for major new works are sufficient to meet all the requirements to which Departmental Ministers may attach importance. Nor can it take account of future needs not yet identified. The programme has always been restricted and it has to be managed flexibly in response to changing priorities. There will now need to be consultations with Departments at official level on the programme for subsequent years in the light of what is known about future requirements. I will then confer again with John Biffen and Paul Channon on the programme of starts for 1981/82.

I am copying this minute to all Cabinet colleagues, to Norman Fowler, to Paul Channon and to Sir Robert Armstrong and Sir Ian Bancroft.

MH

MH

June 1980

PS CONFIDENTIAL

Econ Pol.

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon Michael Heseltine MP
Secretary of State for Environment
Department of the Environment
2 Marsham Street
LONDON SW1

10 June 1980

Dear Michael

PSA EXPENDITURE ON NEW WORKS IN 1980/1

I wrote to you on 7 May about work which is necessary in Unemployment Benefit Offices in 1980/1 to make possible the taxing of short-term benefits in 1982.

In that letter I offered to make available savings I had identified of £350,000 towards the cost of the work. I now have to tell you that unfortunately I cannot make them available because under arrangements made some time ago with the Treasury for financing National Dock Labour Board redundancies, a condition about using any savings in the Department if the cost exceeded a particular figure in 1980/1 has now come into operation. The savings are therefore pre-empted for that purpose.

As you know the work in the UBOs is that to which I attach most importance in the list of new work which you find you will have to curtail. Moreover, this work is essential for staff savings to which I am committed. Although I now find that I have to withdraw my offer, I hope that you will be able to finance the the essential items which our officials are identifying.

I am sending copies of this letter to the recipients of your letter of 16 April.

Yours

Jim

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Ref. A02289

Top copy filed on:- Econ Pol: Strategy: Pt 5

MR. WHITMORE

Cabinet Meeting on Economic Strategy

You asked me to look again at the date of the meeting, at present arranged for Wednesday, 16th July, to discuss the Government's economic strategy.

2. We need to look at this in relation to the arrangements for discussing the 1980 Public Expenditure Survey (PES). The Cabinet will start to consider the 1980 PES in July, and will resume discussion after the Summer Recess. The first meeting is provisionally planned for 3rd July, and there will probably be a second later in the month. As at present envisaged, the meeting on 3rd July will take papers by the Chancellor of the Exchequer on the general economic background, his proposals for the approach to the 1980 Survey, and the main issues. There is a danger that, if the discussion on general economic strategy is known to be coming on 16th July, Ministers will not wish really to begin to tackle the public expenditure problems on 3rd July. On the other hand the Treasury do not wish to lose momentum on the PES exercise by postponing the first discussion from 3rd July.

3. With these points in mind the main options seem to be as follows.

4. First, we could stick to 16th July. The arguments in favour of this are that that date has had some publicity, and any change could be misconstrued by the Press; and that it may be difficult to find another full day convenient to all Ministers.

5. Secondly, the meeting could be scrapped altogether. I think that this would be a pity. A general review of strategy on the lines envisaged would be helpful in preparing the way for policy decisions later in the year.

6. Thirdly, it might be possible to combine the economic strategy discussion with the first public expenditure discussion on 3rd July. This might be done by spending the morning on the general discussion and then turning later in the day, after your Question Time, to the PES papers. Another possibility would be for the PES discussion to be taken on another day shortly afterwards. This would relate the discussion of public expenditure clearly to a preceding discussion of general

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economic strategy. It could be presented as a natural and necessary opening to the PES discussions rather than as a "crisis Cabinet". It would mean that there was less time available for the general discussion than we have been envisaging; and it would lead to an extremely burdensome day.

7. Fourthly the general discussion could be brought forward to 26th June and serve as an introduction to the PES discussion on 3rd July. The PES material will not be available by 26th June; but perhaps this does not really matter. Indeed it might be a good thing if public expenditure considerations were not too much uppermost in Ministers' minds when they discussed general economic strategy.

8. Fifthly it would be possible to defer the discussion until immediately before the Recess - late July or early August. But this does not really seem to make sense: the time for such a discussion is either at the beginning of the first round of PES discussions in early July, or after the Recess, when the second round is about to begin.

9. Sixthly, the general discussion could be deferred until after the Recess. This would give Ministers a useful opportunity for a general stocktaking before the Party Conference. It might also be a useful precursor to the PES discussions which will be resumed after the Recess.

10. The main choices are thus to go ahead with the 16th July meeting as planned; to hold it as part of the regular Cabinet meeting on 26th June; to hold it on 3rd July or thereabouts, so to combine it closely with the opening of the PES discussions; or to defer it until after the Recess.

11. Subject to your decision on the timing, the next step will be to prepare an agenda for the meeting. I suggest that it might start with a presentation by Mr. Burns of the economic strategy. If you agree you might ask the Chancellor to consider this and to let you have more detailed proposals. I think that Mr. Ibbs should also be asked to prepare a contribution.

ROBERT ARMSTRONG

ROBERT ARMSTRONG

9th June, 1980

Econ Pol
Pub Ex Pt 9.

6 June 1980

PRIME MINISTER

DOUGLAS HAGUE'S PAPER

I attach a copy of Douglas' paper and you are seeing him on 17 June at 5pm.

The paper is worth a read. I think Douglas has had an important insight. At first glance it may appear to be a rather long-term subject, but it has important political significance in the context of our drive to reduce public spending. It shows that this drive is imperative not as a matter of political belief alone, but as a matter of economic logic.

As you know, we have been looking at the problem of "economic stabilisation" since the election and have been increasingly concerned with the importance of de-indexing. I mentioned the relative price effect in my summary of the Long Campaign paper which we discussed in January. It now appears that it is an even more powerful destabiliser than we had realised.

I remain personally convinced that both Budgets have been much too little and much too late and that we shall eventually have to consider a "shock package", as I was urging in January.

Since writing the paper, Douglas has done a computer regression analysis on historical figures for several national economies and the results bear out his thesis.

He would like to publish the paper as an article in the Times, once he has done a little more checking and has got second opitions from one or two other people. I think we should encourage that.

JOHN HOSKYNS

THE CENTRAL PROBLEM OF PUBLIC EXPENDITURE

A basic characteristic of public expenditure is that productivity rises more slowly in the public than in the private sector. The "output" of a civil servant, or of a teacher with a given size of class, increases little, if at all, over time. There are obviously parts of the public sector where productivity does increase, but there are many where it does not. Wynne Godley and Christopher Taylor estimate that, over the period 1955-71, the price of public sector current output rose about 2% faster than prices in general.[(1)] This is what economists call the relative price effect. The implication is that public sector productivity rose by some 2% per annum less than in the private sector.

I here develop a simple model to indicate the likely consequences of a relative price effect of this size. The conclusion is that unless public attitudes to Government spending can be radically altered, the present problems over public expenditure will merely be the forerunners of a growing crisis.

Assumptions

I assume that each year productivity in the private sector rises 2% more quickly than output in the public sector, in which I include the nationalised industries. This is reasonable in the light of the Godley and Taylor findings. Since they conclude that we have been experiencing this differential productivity performance for at least 25 years, I consider the effects of a relative productivity difference of this size over periods of 20, 30 and 50 years.

I assume that, initially, national output is 100. Out of this, 25 is from the public sector and 75 from the private. There is full "comparability" in public sector pay. Everyone is paid the full rate made possible by private sector productivity, but I assume no rise at all in productivity in the public sector.

There are at all times just 100 units of labour. Output per unit of labour is therefore initially one unit per annum, with 25% of the labour force in the public sector and 75% in the private. The only

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(1) See "Measuring the effect of public expenditure", in Public Expendi[ture] edited by Michael Posner, Cambridge, 1977, p.126.

tax is a flat-rate one on all output (expenditure). The rate is initially 25%, that required to pay the 25% of the working population who are in the public sector.

Results

With this model, after 20 years, national output rises from 100 to 136 units per annum. If there has been no movement of labour to or from the public sector, its output will still be 25. Private sector output will have risen by 2% per annum from 75 to 111. Since everyone gets the full pay increase made possible by the rise in private sector productivity, unit pay rises from 1.00 to 1.48. Total pay is 148, of which the public sector takes 37 (25 x 1.48). The tax rate remains 25%. That rate on the pay of 148 yields the necessary 37 units.

There is, however, an important change. Instead of representing 25% of output as they did 20 years earlier, the 25 units of public sector activity now account for only 18%. This is what keeps the tax rate at 25%, even though the relative price effect has raised public sector costs per unit of "output" to 1.48 times private sector costs.

The electorate may accept this situation, but it may not. Now that the rest of the economy has become more prosperous, people may argue that the public services must match this improvement. It is, I suspect, precisely this kind of feeling which lies behind Galbraith's famous crack about private affluence and public squalor. And discussion in terms of the national income accounts tends to dodge the issue altogether by assuming that the output of a public sector employee is worth exactly what he is paid - a conveniently circular argument.

What happens if the public does not accept the situation? Suppose the electorate insists that the output of the public sector must rise in line with that in the private sector? The public sector will then always account for 25% of national output and in the model, after 20 years, national output will be only 132 and not 136. This is because, to produce 25% of national output, there would be 33 units of labour in the public sector, producing 33 units of output - 25% of 132. This leaves 67 units of labour in the private sector. With their output of 1.48 units each, total private sector output is 99.

The reason why national output is four units less than on the earlier assumptions is that eight units of labour have moved from the private to the public sector. Since they there produce only one unit each as against the 1.48 in the private sector, output falls by a net 0.48 units for each unit of labour that moves.

This may seem bad enough, but the relative price effect also takes its toll: output has fallen by 3%, but the tax rate has risen to 33% instead of 25%.

After a further decade, the situation is worse still. If we assume that after 30 years only 25 of the 100 units of labour are in the public sector, national output will be 161, 25 from the public sector and 136 from the private. Pay is now 1.81 and the tax rate still 25%, but the public sector now accounts for only 15% of output.

If the Government feels obliged to maintain public sector output at 25% of the total, national output will be reduced to 150, a fall of 7%. There are now 38 units of labour in the public sector, producing 38 units of output. The 62 units in the private sector have an output of 1.81 each, giving them 112 out of the national total output of 150. The reason output has fallen by 7% is again lower productivity in the public sector. The tax rate is 38%.

If the process continued over a full 50 years, and if public sector output was held at 25% of total output, 47% of the labour force would then be in the public sector. The tax rate, at 47%, would be almost twice that of 50 years earlier. Output would be 189, 17% lower than if public sector output had been held at 25 units, when it would have represented only 11% of total output. And for the record, after 100 years, the tax rate would be 70%. As much as 70% of the labour force would be in the public sector and, if this were a real-world economy, it would be in ruins.

This model shows just how serious the problem of public expenditure really is. Behind all the politics, there is an inexorable economic process at work. We have to recognise it and learn how to halt it. Or it will overwhelm us. Fifty years may seem a long time to wait for such a process to have serious effects, but the Welfare State was born around 1945. We are already into the fourth decade of a process like that outlined in the model.

Qualifications

Hague's Law, then, is this. Even if we hold the proportion of output coming from the public sector constant, if private sector productivity rises faster than public, then pay "comparability" means that tax rates will rise exponentially. They will ultimately become unacceptable. We have designed an arrangement for destroying the economy.

Obviously there are qualifications to such a simple model, but in Britain today they may actually make the situation worse, not better. It is true that the proportion of the working population in the public sector is only a little below 25%, but in 1964 it was only 15%. Moreover, the model ignores transfer payments. These are an important element in taxation, since they represented about 24% of current Government expenditure in 1978. The model takes no account of the fact that, as tax rates rise, evasion increases and taxes have to rise even further.

The model also ignores the fact that many of the services like health care and education that, with increasing affluence, people demand on an increasing scale, are provided largely by the public sector. A market economy would deal with the consequences by rationing the services through price and/or by forcing radical changes in the way they are provided. Since we provide these services "free", we have turned the problem into a fiscal one, and so a national one.

This discussion has also ignored inflation, but that is an advantage. One of the biggest obstacles to rational public debate on public spending is that money is no longer a reliable measuring rod. Even those who try to avoid being confused by arguments in terms of "funny money" usually fail.

Closer inspection of the model does, however, show that, on our assumptions, the relative price effect itself generates inflation. Initially, 100 units of output cost 100. After 20 years on our "worse case", 132 units cost 148. Unit cost has risen by 12% over 20 years. The reason is that public sector pay is linked to productivity in the private sector, and not to average productivity over the economy, including the public sector. There is, I suspect, a similar inflationary mechanism at work in the real world. In the model, the important point is that this inflationary element accelerates. In years 1 to 20, inflation averages only 0.6% p.a. In years 91 to 100, it averages 3%, and is rising.

It may be argued that this model is based on what happened in the 1950s and 1960s. Slower growth of productivity in the 1970s has held back the process I have described. This may be true. Yet, even if productivity in manufacturing does not pick up soon, we seem to be on the verge of changes which will bring big increases in productivity in services, like banking, through mechanisation. In any case, we cannot base our policies on the assumption that our central policy - the improvement of performance and productivity in the private sector - will fail.

Consequences

There are only two possible courses of action and we must pursue them both. We must increase public sector productivity even in fields like administration and education where productivity is not so much a dirty word as an unknown one.

Because success in this is at best problematical, we must at the same time start a public debate on the issues raised here. We must convince all but the hard core of the Left, and even them if possible, that if we are to have tolerable rates of tax and acceptable rates of growth, we have to make radical changes. We shall have to abandon many public sector activities where productivity cannot be increased; charge for them; or turn them over to the private sector. And even where productivity can be increased, this may not happen unless we move those activities, too, into the private sector. We may also need to find ways to alter the tax and social security systems to protect the poor and disadvantaged. But the first priority is to set off a public discussion.

Conclusion

This model shows the remarkable power of a basic economic process. This is not a matter of politics, but of the mathematics of compound growth. The process in practice is less smooth than in the model, but it is equally powerful. As Tim Congdon recently pointed out in The Times, pay policies operate in the UK by enabling us to "con" the public sector. For a year or two, we force public sector pay to fall behind what full comparability with the private sector would give. Then, as in 1974-5 and 1979-80, the inevitable pay explosion occurs, led by the public sector.

The lesson is that we must take a totally new look at the problem of public spending. De-indexing the public sector, though a useful holding operation, cannot halt an inexorable process like this. The process has to be stopped in its tracks. De-indexing can give us only time, and perhaps not much even of that.*

We must, quite simply, begin to dismantle the public sector as we know it. We must raise productivity where we can, and abandon activities entirely where we cannot. Otherwise, continuing inflation and rising taxation will destroy us. The White Paper on Government Expenditure is absolutely right: public expenditure lies at the very heart of our present economic difficulties.

Increasing the Welfare State in its present, bureaucratic, form, we have, with the best of intentions, but appalling lack of foresight, built the ultimate Doomsday Machine.

DOUGLAS HAGUE

* I think Douglas is confused on this point. De-indexing is necessary for transition from high to low inflation. It is a completely different issue from that of cutting P.E. in real terms. It will only do that if the de-indexation is more savage than the monetary targets call for.

Telephone
01-212 8001

DEPARTMENT OF THE
ENVIRONMENT
2 MARSHAM STREET
SW1P 3EB

SECRETARY OF STATE FOR THE ENVIRONMENT

With the Compliments of the
Private Secretary to the Secretary of
State for the Environment

COPY AS REQUESTED

FILE - D SIAFONS

cc MR JOHNSTON.

2 MARSHAM STREET
LONDON SW1P 3EB 56.

My ref: H/PSO/14131/80

Your ref:

29 MAY 1980

Dear Secretary of State

You wrote to me on 16 May about the scheme to construct a headquarters building for the UK Warning and Monitoring Organisation.

I realise that you have been waiting a long time for this project, but the facts are that we can renew the lease of the present buildings and neither your Department nor mine have any money this year to embark on a new building.

I am sure that the right answer is for us to negotiate an extension of the lease, and to defer the new building until funds are easier - which I hope will prove to be the case in later years.

Yours sincerely

Paul Burstin

(Private Secretary)

MICHAEL HESELTINE
(agreed by the Secretary of State and signed in his absence)

The Rt Hon William Whitelaw MC MP (HOME)

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Econ Pol

QUEEN ANNE'S GATE LONDON SW1H 9AT

16 May 1980

NBPM
PL 16/5

Dear Michael

P.S.A. EXPENDITURE ON NEW WORKS IN 1980/81

I am responding to your copy letter of ~~16~~ April to Paul Channon. I would have done so sooner but my officials have only very recently heard from yours in the Property Services Agency that there is now doubt as to whether funds can be made available for the construction of a headquarters building for the United Kingdom Warning and Monitoring Organisation (UKWMO), the latest estimated cost of which is £579,000 (including £331,000 due to fall in 1980/81 and £30,000 spent on preliminaries in 1979/80). The contract was due to be let last March.

This is disturbing, and puts this project on a par with those which were the subject of your letter of 16 April. I do not see how this expenditure can be accommodated within Home Office PESC allocations - I am already trying to live within the White Paper figures - but I feel bound to urge that, in the national interest, the project should not be deferred.

The UKWMO is a vital part of home defence arrangements. It is the one part of the civil defence programme which was exempted from the cuts of 1968, because of its key importance in giving warning of impending attack. It works through a network of posts and controls throughout the country, and provides the framework for the wartime function of the Royal Observer Corps (ROC). It has a small headquarters with about 40 people who provide the training and technical backup for the field staff - mainly ROC volunteers. This headquarters is at present in rented accommodation in Banbury (the lease of which expires next year), and in 1972 it

The Rt. Hon. Michael Heseltine, M.P. CONFIDENTIAL /cont ...

was agreed that they should be housed in a new building at Cowley Barracks, Oxford. The site is adjacent to a war-time operational unit (HQ No. 3 Group, ROC), with access to the UKWMO communications network and improved facilities for operational research, for the preparation of national and NATO exercises, and for training.

With the increasing Parliamentary pressure on civil defence, and in the light of the discussion in OD on 15 May at which you were present, it would make no sense to defer the building of UKWMO headquarters and to put their staff into makeshift accommodation. But even stronger than the political case for not deferring this project is the case on grounds of national security: the building is needed to enable the UKWMO to operate at a high pitch of efficiency.

I am sending a copy of this letter to the Prime Minister, other members of the Cabinet and Paul Channon, and to Sir Robert Armstrong.

Yours
Willie

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1

15 May 1980

Dear Michael,

PSA CUTS

You copied to me the correspondence which you have been having with Paul Channon and John Biffen about the further cuts in PSA's resources, and your ability to provide for the new starts which were previously in the programme. You asked colleagues to consider whether there were any schemes which were important in the national interest and which could not be deferred, or whether there were any schemes which they judged to be so important that they could find the necessary funds for a start from within their own resources.

Since our estimating has been done on the basis that PSA would provide our accommodation services under the normal rules, I am not able to predict confidently that any resources would be available to be diverted to finance the major schemes. However I am seriously concerned that once again we are unable to maintain the impetus in our programme of local office improvement. Conditions in many of our local office buildings are really deplorable and lead to inefficiency and high turnover - points on which Sir Derek Rayner has already commented. There is no doubt in my mind that the Staff Side will react very unfavourably to a further deferment of the programme and for this reason I am considering whether I might be able to find a small sum (certainly no more than £½M) this year which might enable me to do something to secure some progress at for example Berwick ILO, Bell Hill AO and Holyhead ILO. If I find that this is possible we would of course be needing moneys for the completion of those programmes which extend into 1981/82.

But this means that the programmes for the local office computerisation of benefits (Camelot), the much overdue upgrading of Alexander Fleming House, and an urgent new provision for accommodation in Newcastle to provide for the scheme for automatic credit transfer (ACT) of pensions and other benefits through the banking system (a Rayner scrutiny proposal) would fall. Most immediately I am concerned to see progress in the provision of the accommodation for ACT at Newcastle so that we can introduce, in June 1982, a scheme on which I, and our colleagues, set great

.R.

store as a major move towards promoting further efficiency and economy in the costly area of Government activity for which my Department is responsible and which should realise actual cash savings of some £7M. I hope therefore that you will be able to consider the provision of what PSA estimate to be some £400,000 in 1980/81 (with a balance in 1981/82) to enable this new but important project to move forward.

I hope that our officials might find some solution to the problems of Alexander Fleming House, which if solved should enable me to give up some 50,000sq ft of office space.

But I have a major concern for the implications for 1981/82. Not only would I hope that some provision might be made to enable me to alleviate the atrocious conditions in many of our offices but I would like to be certain that resources will be available for the critical Camelot project (which occupies a key role in my overall social security strategy and even after the introduction of ESSP offers savings of over 3000 staff), for the new computer building at North Fylde Central Office which has been the subject of joint planning for some years and must be ready in 1982/83, and for a similar building at Livingston where the effective life of our computers is also coming to an end.

Finally, could I mention the OPCS project at Titchfield. PSA are discussing an alternative and more economical approach to this, but OPCS require a small sum, £65,000, this year for preliminary work on the scheme, without which the success of the census processing cannot be assured.

Yours ever

Patrick

CS

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Econ Pol

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NA

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Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marshamm Street
London SW1

7 May 1980

Dear Michael

PSA EXPENDITURE ON NEW WORKS IN 1980/81

You asked in your letter of 16 April for savings to be identified which could be used for new works in 1980/1 since PSA was not able to meet more than a small part of the items listed in the table attached to your minute to the Prime Minister of 24 March. John Biffen has suggested in his letter of 30 April that colleagues aim to let you have comments by 2 May.

In your list of new work I am most concerned about that which is necessary at Unemployment Benefit Offices to make possible the taxing of short-term benefits in 1982. That item was shown as £2.3m in the list but we have since heard from the PSA that a later estimate is £3.7m.

Discussions are taking place between my officials and yours about this programme of new work. I have been able to identify savings of £350,000 which could be made available. John Biffen suggests stopping two schemes which are underway. Since that would ease the position somewhat in 1980/1 I support his proposal.

I am sending copies of this letter to the recipients of yours.

Yours

Jim

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

MO 8/14 6th May 1980

Dear Michael,

R 8/5

PSA EXPENDITURE ON NEW WORKS
IN THE CIVIL ESTATE

You sent me a copy of your letter of 16 April to Paul Channon about the public expenditure provision for the PSA for new works in the civil estate, and I have also seen a copy of John Biffen's letter to you of 30th April.

There are two Defence projects which are shown in Part D of the table attached to your minute to the Prime Minister of 24th March. Both are associated with new computer schemes which are urgently required: the schemes involve the Defence Situation Centre and the Defence Data Processing Service.

New computer equipment has already been ordered for the Defence Situation Centre to assist with crisis management. Delay in providing the £160,000 required for the works services will mean that not only a much-needed operational improvement will be delayed but also that a system costing more than £500,000 will lie idle, and we shall be unable to make use of the opportunity provided by a major crisis management exercise in early 1981 for testing and evaluating it. I hope

The Rt Hon Michael Heseltine MP

very much therefore that funds can be found to enable this operational Defence project to start on time.

The Defence Data Processing Service is a computer bureau which processes a variety of Defence data, including intelligence information. Its present computers are becoming increasingly unreliable and must be replaced urgently. I could, however, accept a delay of not more than one year in the works associated with the replacement scheme, provided that we can agree to give the works a firm place in the 1981/82 programme and that PSA can find enough money to enable the new computers to be installed on a temporary basis in the existing accommodation (which is inadequate and has only a temporary life). I am afraid there is no prospect of my being able to fund this project from the Defence Budget given the cuts I am already having to make in the defence programme to meet the new financial targets we have agreed.

I am copying this letter to the Prime Minister, Cabinet Colleagues, Norman Fowler, Paul Channon and Sir Robert Armstrong.

Yours ever
Francis

Francis Pym

Econ Pol

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
2 Marsham Street
London
SW1 3EB

R 2/5

2 May 1980

Dear Secretary of State,

ACCOMMODATION FOR THE SCOTTISH OFFICE COMPUTER SERVICE (SOCS) EDINBURGH

You sent me a copy of your letter of 16 April to Paul Channon about the public expenditure provision for the PSA on new works.

The position seems to be that, having acceded to your proposals for cuts in total PSA expenditure, the Ministers who are the PSA's clients are now stuck with the consequences for their Departments. I must say this does not seem a very satisfactory way of, in effect, changing the role of the PSA; but I can understand John Biffen's views on reopening the public expenditure package. We will certainly have to be clearer on the next round about the consequences of any further cuts you may propose in this area.

As you know, my interest is in the provision of an urgently needed replacement computer hall for our Scottish Office Computer Service at a total cost of £750,000. Of that PSA now agree that only some £100,000 would be incurred in 1980-81 (not the £550,000 listed in the enclosure to your minute of 24 March to the Prime Minister.) You will recall that its provision within the existing building was a compromise solution you put to me on 27 September last, involving a deferment of a new building which would have cost £8.3 million. You offered your interim compromise solution because conditions in the out-of-date computer hall are so inadequate for the up-to-date computer equipment it houses, which is essential to the services we provide and our own administrative functions: the earlier correspondence contains the details. There is no doubt that a new computer hall is urgently required, the present one having had a detailed adverse report in March from the CSD's Central Computer and Telecommunications Agency.

I am very reluctantly prepared to find from within my own PESC allocation the £100,000 needed in 1980-81 to start work on the new computer hall. Conditions in the present hall make an early start imperative. It would be very difficult for me to accept the potential liability to complete the work in 1981-82. Since there seems to be less demand on your resources in 1981-82, I would be grateful if you could bear at least part of the 1981-82 share of the cost. I shall do my best to find the balance.

I am sending copies of this letter to recipients of yours.

Yours sincerely.

G.S. Wilson

Approved by the Secretary of State
and signed in his absence

= 2 MAY 1960

2

PRIME MINISTER

MS

2/5

PUBLIC EXPENDITURE

It is hoped that Members will find the following notes helpful in the debate on Wednesday, 7th May 1980.

Contents

Conservative Research Dept.,
32 Smith Square, London SW1

AB/RH/CM/JV/FL
1.5.80

I. EXPENDITURE PLANS

1. The Government's Strategy

Publication of the Public Expenditure White Paper on Budget day enabled the Chancellor of the Exchequer this year for the first time to review both together in his Budget statement. Presentation with the Budget of the Medium Term Financial Strategy was another new departure, setting out the central element of the Government's economic policy around which policies for spending and taxation will be shaped for the rest of this Parliament.

The Chancellor said:-

> "At the heart of the medium term strategy is the need to return to a sensible level of public spending and to see taxes and Government borrowing reduced. The spending plans which this Government inherited were too high and were set to grow considerably faster than production. Most aspects of public spending are worthwhile if the nation can afford them. But, too often, we have endorsed plans for rising expenditure that we cannot afford. In the last 20 years the ratio of public expenditure to GDP has risen by a quarter.
>
> It would be all too easy for this ratio to go on rising indefinitely, unless we addressed ourselves to fundamentals. This is what we have done in the most far-reaching review of medium-term expenditure plans since they began 20 years ago. This review is crucial to the strategy. Crucial to success in reducing the PSBR, lowering interest rates, and bringing down inflation. And crucial if we are to find room for lightening the tax burden and so to provide scope and encouragement for enterprise and initiative.
>
> ... In today's circumstances any Government would have to check the size and growth of public spending. This does not mean, and has not meant, that public expenditure should be cut indiscriminately. Our choices have been guided by the belief that Government should provide efficiently and realistically those services which it alone is able, and best fitted to provide. The role of the State can sensibly be reduced when it has taken over what private initiative can better achieve; and where it has been reducing incentives increasing bureaucracy and distorting markets" (Hansard, 26th March 1980, Col. 1451-3).

Expenditure on defence, law and order and health will, therefore, continue to grow - health exactly as planned by the Labour Government, the cost being partly offset by an increase in charges. Provision for private and nationalised industries, for housing, and for education is reduced - the latter by less than the decline in the school population. Spending on social security will increase by nearly 4 per cent between 1979-80 and 1983-84, despite some reductions.

2. Curbing Public Expenditure - The Third Round

In his June Budget, Sir Geoffrey Howe announced the steps to be taken after the Government's first, rapid review of public expenditure. It resulted in proposals to cut spending by £1½ billion and in eliminating the Labour Government's planned increases for 1979-80 to hold total spending at about the same level as in 1978-79.

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The White Paper published on 2nd November (Cmnd. 7746) carried this process further. It eliminated planned increases of £3½ billion, to hold total spending for 1980-81 at approximately the same level as in the previous two years, at 1979 prices.

Since November further net reductions of £900 million have been made to take account of the worsening economic situation here and abroad. £325 million of this will be set aside for the contingency reserve. Actual spending will be reduced by at least £575 million at current prices.(The £1bn. contingency reserve for 1980-81 is precautionary: the aim is to leave as much as possible unspent.)
The overall effect will be to reduce public spending by over £5 billion in 1980-81 compared to Labour proposals - equivalent to 7p on the basic rate of income tax.

By 1982-83, the last year for which the Labour Government published plans, spending will be 11½ per cent, or some £11 billion at today's prices below the level proposed in their last White Paper (Cmnd. 7439 January 1979).

By 1983-84, the last year covered by the present White Paper, expenditure will be some 4 per cent lower in real terms than in 1979-80. This will be, as the Chancellor said, "for the first time ever, a progressive reduction in total expenditure throughout the lifetime of this Parliament" (Col. 1452).

3. The Medium Term Financial Strategy (published in the Financial Statement and Budget Report - the Red Book)

The objectives for the medium term are "to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment". To this end the growth of the money stock is to be progressively reduced from the target range of 7-11 per cent for growth in M3 set for the 14 months February 1980 to April 1981, to 6 per cent (mid-point of a 4-8 per cent range) in 1983-84. The Government does not intend to achieve this reduction by excessive reliance on interest rates: to avoid doing so the aim is progressively to reduce the public sector borrowing requirement as a percentage of GNP from the 4¾ per cent estimated for this year to 1½ per cent in 1983-84. This would be a little below the average ratio in the 1960s.

As Mr. Nigel Lawson, Financial Secretary to the Treasury, emphasised to the Finance Committee on 22nd April, the financial strategy for the reduction of inflation is the essential element in the Government's policy. Proposals for public spending, borrowing and for taxation are shaped around it. The cuts in public expenditure are the key element in the strategy for reducing the level of Government borrowing and so for relieving pressure on interest rates and on resources for the private sector.

4. Effect of public expenditure cuts on the cost of living

Exaggerated estimates have been put about by Labour Members and others of the effects of the spending cuts on the cost of living. The Chancellor of the Exchequer gave the official estimate in his evidence to the Select Committee on 14th April. Only 16 per cent of the £4 billion reduction in public spending in 1980-81 is derived from increases in charges. In total, decisions on public expenditure taken by the present Government have to date added less than ¼ per cent to the Index of Retail Prices.

5. Public Expenditure as a percentage of GNP

There were, during the years of the Labour Government, four re-definitions of public expenditure. Its relationship to national output was also changed quite substantially by the revaluation of production onto a 1975 base instead of 1970. The effect of these

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changes has been to reduce the apparent share of GNP accounted for by the public sector from a peak of 59 per cent on an earlier definition in 1975 to approximately 42 per cent at the present time. Changes over the past six years on present definitions, are shown in the following table:-

Ratios of public expenditure to GDP at market prices (1)

	Total public expenditure including debt interest	General government expenditure on goods and services
1973-74	41½ (2)	24½
1974-75	46½	26
1975-76	46½	27
1976-77	45	25½
1977-78	41	23½
1978-79	42½	23
1979-80 (estimated)	42	23

(1) These ratios are based on the expenditure figures in the White Paper including debt interest, net overseas and market borrowing by nationalised industries and special sales of assets. The expenditure totals also include non-trading government capital consumption, to make them comparable with gross domestic product (expenditure estimate) at market prices.

(2) Excluding nationalised industries' short term borrowing and capital value of leased assets.

(Source: Government Expenditure White Paper 1980-81 to 1983-84, Cmnd. 7841).

It is expected that there will be a further reduction in the ratio of public expenditure to GNP over the period covered by the White Paper.

6. Labour cuts, plans and criticisms

The Labour Party have been loud in their condemnation of the Government's spending proposals over the past year. The criticisms must be set against the Labour Government's own record in office. After an 8.5 per cent increase in spending in its first year, at the behest of the IMF it cut expenditure by 2.5 per cent in 1976-7 and 6 per cent in 1977-8 (at constant 1979 survey prices). This compares with the Government's proposals in the present White Paper to cut spending by 4 per cent in real terms over 4 years: to a total of £67.1bn. in 1983-4 compared to the estimated £69.9bn. in 1979-80.

By far the greater part of the cuts are being made against the inflated spending plans left by the Labour Government. The 5.6 per cent increase in 1978-9 would have been followed by a further increase of over 2 per cent a year over succeeding years. The plans were clearly based on the assumption of a rate of growth in GNP of 3 per cent a year made in the Labour Manifesto - following on the achievement of barely ½ per cent a year over the Labour Government's five years in office.

Mr. Healey had himself warned that cuts in spending would be necessary to offset the cost of comparability wage increases (Hansard 25th January 1979). The Clegg awards are expected to cost £2 billion in 1980-81, and the full year effects of the staged settlements for civil servants and local authority white collar workers will add about a further £1 billion (Cmnd. 7841, para. 33 page 10).

..../

Mr. Healey frequently blamed his inheritance for the problems he faced in office. In particular it may be remembered that, in answer to a question from Lord (then Mr. Robert) Carr on 30th December 1975 on the increase in the rate of inflation over 3 months from his own 8.4 per cent statement in September 1975 to 23 per cent in November, said:

> "The main reason for this change is that in the last three months the index has reflected 11 threshold payments which had to be made under legislation introduced by the Conservative Government". (Hansard, Col. 600)

The pay commitments entered into by the Labour Government have been substantially larger.

7. Public Sector Pay

Much currency has been given to the figure of 25 per cent for the year-on-year, 1979-80/1980-81, increase in the central government paybill. As the Chancellor emphasised to the Select Committee, the figure (25 per cent covering the civil service, the national health service and the armed forces; 23 per cent over the whole of the public services including local authority employees) relates to the total increase in cost, not to settlements. About a third of it results from delayed 'catching up' awards from commitments entered into by the last Government.

Cash limits on central government expenditure in the present year provide for an annual increase in the pay bill of 14 per cent through new settlements from their due settlement dates. Rate support grants and transport supplementary grants provide for a 13 per cent increase in local authorities' costs between 1979-80 and 1980-81 for price increases and new pay awards.

The 18¾ per cent Pay Research award to the civil service will be brought within the 14 per cent cash limit by reducing manpower by some 2½ per cent and by delaying implementing the award from 1st April to 7th May, so that it is paid for less than a full year. The 16½ per cent award to the armed forces is of a similar order.

Manning levels in the civil service have already been substantially reduced. There were 25,000 fewer in post in April than when the Government took office: and establishment levels (to which manning levels will be reduced over the next year) have been set at 60,000 lower than they were then.

8. Nationalised industries

There has been considerbale discussion, in the Select Committee and in the press, of the turnround in nationalised industries' finances envisaged in the White Paper of £2½ billion in external finance; and the £3½ billion increase expected in internally-generated finance by 1983-4.

The Chancellor pointed out to the Select Committee that the forecast drop of £2½ billion was smaller than the fall of £3 billion in total external finance of the nationalised industries in the 3 years from 1974-5. The improvement in the industries' finances was expected to come:

a) from removal of underpricing, especially in energy industries. Achievement of the gas and electricity industries' medium term financial targets (set in January 1980) would provide about 25 per cent of the turnround.

b) from improvements in efficiency and cost-cutting. About 40% of the turnround should come from improved performance in the main loss-makers -shipbuilding, steel, coal and rail.

c) the remaining third of the turnround would come from a variety of factors - the unwinding of the Post Office billing delays of 1979-80; and increased profitablity from cashflow from BNOC.

II SPENDING PROGRAMMES

1. Nationalised Industries

For too long the nationalised industries have been a drain on the profitable, private sector of industry, through the taxation levied to subsidise operating losses and under-used investment, through higher interest rates and through the process of "crowding out". This the Government is determined to reduce. Consequently total net borrowing by the nationalised industries is projected in Cmnd. 7841 to fall from £1900 million in 1979-80 to £550 million in 1983-4. The industries covered will be expected to generate their own internal resources and indeed move a substantial net repayment at the end of the period.

The ways in which this turn-around should be achieved were set out by the Chancellor of the Exchequer (see above paragraph). First by economic pricing policies adopted in order to see that nationalised industries act, in so far as possible, subject to market, commercial discipline; secondly by improvement in performance by industries which, like British Steel, have in the past generated heavy losses, will be required. It is worth noting that already most of the nationalised industries have been set performance targets.

Total net borrowing in Cmnd. 7841 is £100 million less than the figure given in Cmnd. 7746. This is because of a number of factors: principally the removal of British Aerospace borrowing (British Aerospace is being turned into a limited company with about half the shares sold to the private sector), improved BNOC receipts, a change by the NCB from borrowing to grants and a reduction in the short-fall allowance to £100 million. Apart from British Aerospace, the sale of assets has not been taken into account in these figures.

2. Industry Department Spending Programmes

There has been growing concern that the effect of much "aid" given to industry, under the 1972 Industry Act, through the NEB and by other means, has in fact chanelled resources away from profitable growth centres of the economy to other less successful areas, aborting perhaps as many jobs as it destroys. By curbing the powers of the National Enterprise Board and continuing regional aid in areas of most need the Government has shown its recognition of this problem.

Provision for Department of Industry spending thus falls by about 50 per cent by 1983-4 from the 1979-80 level of £1,017 million, and most of this reduction comes from spending on the NEB and on Regional Development Grant. However, the policy is a gradual one and sudden, disruptive changes have been avoided. The Government's flexibility has been shown by its willingness to give assisted status to areas with special problems, such as Corby.

The Government has also made clear its priorities within the reduced budget for spending on industry by continuing with support for Research and Development (principally through the Product and Process Development Scheme, the reduced Micro-Electronics Industry Support Programme and the Micro-Processor Applications Project).

SOCIAL SECURITY

The social security programme will cost £19,354 in 1980-81 (Cmnd. 7841, March 1980; figures at 1979 survey prices), which will be about one quarter of all public expenditure. As the Chancellor told the House of Commons in the budget statement:

> "Its volume has grown by about 50 per cent in the last ten years, allowing both for inflation and the switch from family allowance and child tax allowances to child benefit. That rate of growth is more than three times the 15 per cent increase in GDP over the same period". (Hansard 26/3/80 Cols. 1457-8)

As the Chancellor acknowledged, part of this increase has been due to demographic factors (for example, in the last seven years the number of pensioners rose by 1 million) and to the increase in the number of disabled people. However the social security budget has also been affected by real increases in benefits in anticipation of a growth in output which was not actually achieved.

The main reductions in expenditure are as follows:

1. The reduction of earnings-related supplements for the unemployed, sickness and injury benefit and maternity allowances in 1981 and their abolition in 1982.

2. A 5% cut in unemployment benefit, sickness benefit, industrial injury benefit and invalidity pensions (i.e. to be achieved by raising these benefit by 11½ % in November compared with a 16½% expected increase in prices) Additional cuts of 5% in these benefits may be made in 1981, with a further 5% cut in 1982, under the provisions of the Social Security (No. 2) Bill.

3. Responsibiltiy for providing an income for the first eight weeks of sickness will be transferred from the state to the employer.

However it should be noted that supplementary benefits - the "safety net" - are being increased fully in line with prices and those on very low incomes are therefore being fully protected.

One reason for singling out unemployment benefit and sickness benefit for cuts is that both are tax-free and this confers an unexpected bonus on the recipients. Both Parties are committed in principle to taxing them and the Government intends to do so in 1982. Mr. Jenkin has also announced that when invalidity pensions are brought into tax the Government would wish (resources permitting) to restore them to the level of the retirement pension.

Mr. Jenkin has emphasised that:

"Even after making the savings that I have announced the social security budget is still programmed to grow at about 2 per cent a year". (Hansard 31/3/80 Col.49).

This will go towards meeting the expected increase in the number of pensioners and the unemployed.

Mr. Jenkin concluded:

"If I am supposed to be murdering the Welfare State I am setting about it in a pretty rum way". (Hansard 31/3/80 Col. 54).

NATIONAL HEALTH SERVICE

The Conservative Election Manifesto confirmed that

"It is not our intention to reduce spending on the Health Service".

and this was re-affirmed by Mrs Thatcher during the General Election campaign.

The Public Expenditure White Paper shows that total expenditure on health services (excluding the personal social services) will rise from £7688m in 1978-9 to £8140m by 1983-4.

The Labour Party has criticised the increase in prescription charges to £1 later this year, but:-

1. As early as 1976 Conservatives warned that:-

   "When the service is short of funds for priority tasks, there is no case for holding down prescription and other charges". (The Right Approach 1976).

2. The last Labour Government increase dental and optical charges on a number of occasions.

3. Six out of ten prescriptions do not carry a charge because the recipient is exempt - e.g retirement pensioners, children under 16 those receiving supplementary benefits and others.

HOUSING

From the financial year 1981-82, all housing grants from central government will be allocated on one block. Total public expenditure on housing (including central government grants and local contributions) in 1980-81 will be £4,700m at 1979 survey prices. (£1,916m capital and £2783 current). This is £672m less than the 1979-80 estimated outturn of £5,372 and most of the reduction will be capital expenditure. In real terms, public expenditure on housing will fall gradually to £3840m in 1981-2, to £3,250 in 1982-83 and to £2,790m in 1983-84.

EDUCATION

The Government's expenditure plans provide for a fall of about nine per cent in expenditure on education over the five years 1979-84.

This reduction reflects the fall in the school population which will total 1½ million over this period, school meals which will amount to one-third of the savings and full-cost tuition fees for those overseas students who begin courses in September 1981.

Provision for special education has been protected, expenditure on colleges of further education, which have a critical role to play in supplying skilled man power and technicians, has been increased by seven per cent over the next year and allowances for the improvement of school buildings have been increased by nearly 50% to encourage the adaption and more efficient use of existing facilities.

These savings will not directly affect the provision of education in the classroom. The Government remains committed to improving basic standards of achievement, and despite the restraints on public spending has given local authorities every opportunity to concentrate resources on the essentials of the education service.

LAW, ORDER AND PROTECTIVE SERVICES

Expenditure on this programme is planned to increase reflecting the Conservative Government's priority for law and order services. This was foreshadowed in the 1979 General Election Manifesto which specifically exempted law and order programmes from the general policy of cutbacks in public spending. Total spending in 1980-81 is expected to reach £2,530 million at 1979 survey prices against a projected ultimum of £2,446 million for 1979-80 , again at 1979 survey prices. It should rise to £2,670 million in 1982-3.

The main additions are for the running of the police and supporting services (£1,469 million in 1980-1 against £1,426 million in 1979-80), and the prisons (projected to increase from £284 million in 1979-80 to £301.2 million in 1982-3). Figures for the prisons in Cmnd. 7841 do not take into account the recommendations of the May Committee Report on prisons.

Extra spending (£90 million in 1983-4 against £76 million in 1979-80) is projected for the probation and after-care services. The number of probation officers should rise to 5,200 by 1983-4 against 4,800 in 1979-80.

Numbers of police officers available should also rise. The full implementation of the Edmund Davies recommendations on police pay by the Government has meant a substantial rise in police man power. The programmes allow for an increase to 133,800 by the end of March 1984.

Capital Expenditure:

It has been alleged that these reductions will mean an end to further capital expenditure on local authority housing, but several factors must be borne in mind.

1. Block Allocations

   As funds are to be treated as one block, local authorities will be free to spend their allocations as they wish. If they consider long scale council housebuidding necessary, the government has no policy to stop them.

2. Housing need

   The levels of expenditure on housing reflect the overall economic background and the need to reduce the massive burden of public expenditure. Also housing policies and expenditure need to recognise the significant general improvement in housing conditions over the last 30 years. Not only has the condition of our housing stock improved tremendously, nationally the demand and supply of housing are in better balance (there is an overall surplus of approximately 400,900 dwellings households.)

   The emphasis of public sector policy should shift to meeting particular needs such as those of the elderly and single people. Both in the public and private sectors there needsto be a better use made of our existing housing stock.

3. Cost saving Schemes

   Since there will be severe restraints on local authority expenditure on housing, the Government has suggested cost saving schemes to lower the cost of priority homes while encouraging home ownership.

   a) Building stata (one bedroom) homes for sale to single people.

   b) Selling council houses.

   c) Securing land release for private builders and encouraging partnerships schemes between local authorities and private builders.

   d) Low cost building for sale

   e) AIM (Acquisition Improvement and Sale) schemes eligible for exchequer background.

   f) Shared ownership schemes.

   g) Help with mortgages for priority homebuyers using the mortgage guarantee powers in the housing bill.

4. Use of capital recipients

   In future local authorities will be able to supplement their capital allocations by keeping 50% of the capital receipt from sale of assets, repayment of principle on loans etc. The remaining 50% will be distributed at a national level through the HIP allocators. Selling local authority assets will enable local authorities to spend more on capital projects, yet it it is Labour local authorities who are rejecting this policy and at the same time complaining about cuts in government growth.

5. Other opposition criticisms

Opposition criticism has concentrated on the extent of the reduction and whether comparison with free cost outturns is misleading. The main defensive points are:

- It is usual to compare allocations with outturn in earlier years. The last government's Public Expenditure White Paper of January 1979 did this.
- The housing policies of the last Labour Government were unrealistically high. The budget cuts of the present government remained £300m from the 1979/80 allocators yet the lower cash limit will not be reached even though inflation of building costs was higher than expected last year.
- In real terms, reductions in HIP allocators for 1980-81 against the cost outturns for 1979-80 are 21% (31% against Labour's original provision).
- Net capital expenditure on housing fell under Labour from £4,202m in 1974-5 to £2,077m in 1979-80. The present reduction reflecting the trend started under Labour.

Current expenditure

Levels of current expenditure in 1980-81 are expected to fall by £45m from the estimated outturn for 1979-80. In November 1979 the government announced a rent increase guideline of £1.50 per week on average for 1980-81 and a supplementary net increase guideline of 60p a week for the second half of 1980-81. This averages up to £1.80 per week increase over the whole year and is a 28% increase ofer the average local authority rent of £6.50 a week. This brings rent into line with the Labour Government stated intention to keep the rise in local authority rent broadly in line with increased earnings. This will ease the burden on the rate payer and will enable local authoritiesto use more funds for capital investment.

LOCAL GOVERNMENT SERVICES

The Government has called for reductions in local government spending in 1980-81 of 1% in addition to the cuts requested in 1979-80. This will represent a cut of 4 per cent over four years from the increased local government expenditure levels advocated by Peter Shore in the autumn of 1978.

Since 70% of local government spending goes on wages and salaries and related expenditure it is vitally important that the local authorities emulate the example of central government and reduce staff levels. The latest quarterly returns for the quarter ended December 1979 show a fall of only 0.3% over the quarter ended December 1978. It is clear from the figures published this time for individual authorities that Labour councils are less willing to reduce staff numbers than Conservative councils.

The consequence of continuing overmanning in local government coupled with substantial pay awards to local government staff will be increased costs borne by ratepayers. The Government has made it clear that no additional money will be available to pay for the recent Clegg award to teachers, should the employers agree to pay it in full.

Rate increases are already running ahead of the rate of inflation. According to the report in the Times of 10 March 1980 average rate increases in 1980-81 are 22%. As with control of staff numbers, Conservative councils are shown to be more prudent than Labour authorities. There are no Conservatives among the 20 highest rate increases in England and Wales and no Labour councils among the 20 lowest.

Conservative Research Department,
32 Smith Square, London SW1

AB/RH/CM/JV/FL
1.5.80

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Prime Minister

I believe much of this is niggling and unjustifiably negative. But I think you should read: I have marked the key passages.

TL
2/5

HOUSE OF COMMONS

Second Report from the

TREASURY AND CIVIL SERVICE COMMITTEE

1979-80

THE BUDGET AND THE GOVERNMENT'S
EXPENDITURE PLANS 1980-81 to 1983-84

Together with the Proceedings of the
Committee, the Minutes of Evidence
and Appendices.

Ordered by the House of Commons to be
printed 30th April 1980

584

The Treasury and Civil Service Committee is appointed under S.O. No. 86A to examine the expenditure, administration and policy of the Treasury, the Civil Service Department, the Board of Inland Revenue, and the Board of Customs and Excise and associated public bodies, and similar matters within the responsibilities of the Secretary of State for Northern Ireland.

The Committee consists of a maximum of eleven members, of whom the quorum is three. Unless the House otherwise orders, all Members nominated to the Committee continue to be members of the Committee for the remainder of the Parliament.

The Committee has power:

(a) to send for persons, papers and records, to sit notwithstanding any adjournment of the House, to adjourn from place to place, and to report from time to time;

(b) to appoint persons with technical knowledge either to supply information which is not readily available or to elucidate matters of complexity within the Committee's order of reference.

The Committee has power to appoint one sub-committee and to report from time to time the minutes of evidence taken before it. The sub-committee has power to send for persons, papers and records, to sit notwithstanding any adjournment of the House, and to adjourn from place to place. It has a quorum of three.

MONDAY 26TH *NOVEMBER* 1979

The following were nominated as members of the Treasury and Civil Service Committee:

Mr Kenneth Baker
Mr Anthony Beaumont-Dark
Dr Jeremy Bray
Mr Edward du Cann
Mr Timothy Eggar
Mr Michael English
Mr Terence Higgins
Mr Robert Sheldon
Mr Richard Shepherd
Mr Richard Wainwright
Mr Ken Woolmer

Mr Edward du Cann was elected Chairman on 29 November 1979.

TABLE OF CONTENTS

LIST OF WITNESSES

LIST OF MEMORANDA INCLUDED IN THE MINUTES OF EVIDENCE

LIST OF APPENDICES TO THE MINUTES OF EVIDENCE

Second Report

The Treasury and Civil Service Committee have agreed

to the following Report:

THE BUDGET AND THE GOVERNMENT'S EXPENDITURE PLANS

1980-81 to 1983-84

Scope of this Report

1. This report has had to be prepared promptly after we completed taking oral evidence from the Chancellor of the Exchequer on 28th April so that we could publish to the House in time for the debate on the Public Expenditure White Paper (Cmnd 7841) and for the Second Reading of the Finance Bill.

2. The Government's main objectives, as described in the Financial Statement and Budget Report 1980-81, are to reduce inflation and to create conditions in which sustainable economic growth can be achieved. The Committee endorses these objectives. To this end, the government has set out a declining path for the rate of growth of the money stock (measured at present in terms of sterling M3) from 7-11% in 1980-81 to 4-8% in 1983-84. The Government has stated that there is no question of departing from this money supply policy, which it considers essential to the success of any anti-inflationary strategy. Since we will shortly be embarking on a wide ranging enquiry into monetary policy we do not in this report examine this firm conviction of the Government that limiting the money supply must be the main pillar of policy and that there are certain definite relationships between the PSBR, the money supply, inflation and economic growth. We plan to report on these crucial aspects of monetary policy at a later date. Here we have concentrated on the following four main areas:-

(a) The need for more information about the assumptions on which policy is based;
(b) Output and Unemployment;
(c) Public Expenditure and Revenue estimates;
(d) The outlook for the corporate sector.

(a) The need for more information about economic policy assumptions

3. In this year's Financial Statement and Budget Report the prospects for expenditure and revenue for the next four years have been brought together. While we question below the plausibility and consistency of some of the assumptions on which the Government is basing its policies, we welcome this development, which was recommended by the former Expenditure Committee in its Report in 1979 on the Government's Expenditure Plans (Cmnd 7439).[1]

4. We questioned Treasury officials before our discussion with the Chancellor. Our purpose was to establish a basis of fact from which to develop our questioning. On several occasions officials said they were unable to answer our questions on grounds of confidentiality. As a result, this process was not as successful as we would have wished. Also it was a surprise to the Committee that the Chancellor laid such heavy stress on the need for confidentiality in his opening statement to the Committee. We understand the difficulties of the Bank of England, as the Governor described them to us, and are sympathetic to his view that it will be necesary for him on occasion to respond to the Committee's enquiries with discretion, having regard to the role of the Bank of England, and to the need for reticence about potentially market sensitive information. There may also be occasions when the Chancellor or Treasury officials find it difficult to expand in public on various subjects when there are similar considerations. Furthermore, the Committee sympathised with the Chancellor when he drew our attention to the dangers that may result if his comments at any time on politically sensitive and topical matters (e.g. unemployment) are taken out of context. The Committee appreciates the inevitable uncertainty of forecasts and the tentative nature of assumptions, and the need to take such uncertainties into account in deciding policy. It is only to be expected that a Select Committee of the House which includes in its membership of 11 no fewer than 5 former Ministers, including 3 former Treasury Ministers, would readily understand these points and guard against them.

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1 Fourth Report, Expenditure Committee 1978-79, HC237

5. It remains the responsibility of the Committee to do its best to see that Parliament, and through Parliament the nation, is better informed about economic matters, about the judgements of Ministers and why they are made. The Leader of the House gave the undertaking when the new departmentally-related Select Committees were set up that Ministers would make every effort to ensure that the fullest possible information is made available to the Committee[1]. It is the responsibility of the Committee continuously to monitor the work of the Treasury in its management of the economy, and to report to the House as it thinks appropriate. To do this it is necessary for the Committee itself to be properly informed not only about policy but about the reasons why policy decisions are made and the information available to Ministers on which they are based. We are fortunate in being advised by Dr. Alan Budd, Dr. Paul Neild and Mr. Terry Ward, to whom we would wish to pay a tribute. Their guidance and help is greatly appreciated. We also had useful papers from the National Institute and the Economist Intelligence Unit which are published with the evidence. We have in fact received ample material from our own advisers and other sources to enable us to make our own judgements. But that is not the point. It must be right for the Committee to be made aware of the basic information upon which the judgements of Ministers are made and the Committee must be put in a position to discover any gaps in the official calculations. Without this it will not be possible to comment on Ministers' judgements in a way that will invariably be fair to those who make them. Nor will it be possible consistently to give to the House of Commons the advice which the House will rightly expect to receive. We endorse the comments of our Chairman, made in reply to the Chancellor's observations, that Governments tend to be obsessive about secrecy.[2] The Commitee therefore intends to discuss further with the Chancellor ways of ensuring that our work is not hampered on future occasions.

1. Official Report, 25 June 1979, col. 45.
2. Q.344

6. We also had considerable difficulty in assessing the feasibility of the Government's expenditure plans up to 1983-84, as the White Paper does not provide a break-down by economic category, or indeed other details, of the totals of expenditure after 1980-81. "Breakdown by economic category" is a technical phrase which covers the difference between, for example in the case of housing, raising rents and not building subsidised houses. Both cut public expenditure as it is defined but one affects the price index and the other affects employment in the building industry. Other examples could, of course, be chosen: the point is that without the table it is impossible for the House to assess the economic implications of these reductions in public expenditure, for employment, for investment and so on. We were even told by Treasury witnesses that no table showing this breakdown existed.[1] Thus it is quite impossible to assess the major programmes, such as housing and the external financing requirements of the nationalised industries, on which the whole expenditure strategy largely depends. This breakdown has been supplied in previous White Papers. Para 6, page 4 of the White Paper suggests that this information, which we would regard as essential for our assessment of all expenditure plans, is not likely to be provided in the future. This would be a major retrograde step.

7. Although the method of presentation of White Papers on Expenditure has varied somewhat over the years there has been a clear trend towards providing more information. We are therefore disappointed that without previous announcement and without consultation with the House it should have been arbitrarily decided to abandon the customary practice of forecasting expenditure in broad detail for some years ahead. Forecasting expenditure - or indeed anything else - has always been hazardous. The Chancellor in his evidence to us, suggested that such forecasts would include a catalogue of meaningless figures[2]. We do not agree. We believe that the arguments advanced by Plowden in favour of giving the House of Commons and the nation more rather than less information about future spending plans are as valid now as they were at the time they were advanced. This applies in particular to capital expenditure, where projects take a number of years to complete and often a long interval between the initial decision being taken and the bulk of the expenditure being incurred. We trust that the policy of spelling out the Government's expenditure plans in some detail will be restored next year.

1. Q. 72
2. Q.392

(b) Output and Unemployment

(i) Output

8. The assumption about output growth used to construct projections of Government revenue and expenditure is that GDP will increase by an average of 1 per cent a year from 1980 onwards. This is said to be a 'deliberately cautious' assumption (Financial Statement, para.9, p.18). When combined with the government's short-term forecast of a fall in GDP of 2½% in 1980, it implies that real output will be only marginally higher in 1983 than in 1979.

9. However, the Treasury has made it clear to us that it regards the assumption of 1% per annum growth in the years following 1980 as not having the same status as a forecast. Much has been made of this distinction between an assumption and a forecast. It is still permissible to question the validity of an assumption just as it is the likely accuracy of a forecast. It is in this sense that the Committee puts forward its views whether this particular assumption is realistic.

10. Our advisers suggest that, far from being "cautious", this assumption may well turn out to be optimistic, especially since it implies a major turn round in the economy from mid-1981 onwards. Thus the short-term forecast envisages GDP falling by 2½ per cent in 1980 and continuing to fall in the first half of 1981. Although no information is given in the Financial Statement on the assumed year-to-year growth path from then onwards, the Treasury suggested in evidence that output would need to increase by 2 per cent or slightly more in 1982 and 1983.[1] We were provided with little convincing evidence as to why a turn-round of this size should take place and it sems to depend to a significant extent on world trade growing at a much higher rate over the medium-term than over the short-term[2].

11. Yet output growth of at least this rate is crucial if there is to be scope for tax reductions or increases in expenditure in future years. The figures presented in the Financial Statement suggest that there could be a fiscal adjustment of £3½bn at 1978-79 prices in 1983-84 (table 9, page 19, Financial Statement). It only takes a small reduction in the growth of GDP below the 1% assumed by the Treasury to eliminate the scope for this adjustment in the years up to 1983-84.

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1. Q.92
2. Q.97

12. The apparent implications of the assumed growth in GDP for the growth of the different sectors of the economy merit comment. Slightly less than ½% of the 1% a year growth in GDP consists of the growth in oil production.[1] According to Treasury officials, manufacturing output could be expected to fall by ½ per cent a year, on the basis of its past relationship to GDP. If there is also a decline in public expenditure as is planned, this means that there would have to be a significant growth of the private service sector[2] in order to achieve an overall growth in GDP of the rate assumed. It is open to question event whether private services will be able to absorb the additional unemployment resulting from a decline in manufacturing output and in the public sector.

13. The prospects for manufacturing industry are particularly depressing. It was stated in evidence to the Committee that manufacturing output was estimated to decline by about 4½% in 1980[3], which with an average fall of ½ per cent a year over the next three years, would imply that manufacturing production might be over 6 per cent lower in 1983 than in 1979.

(ii) Unemployment

14. Although the Treasury does not provide forecasts of unemployment some assumptions have to be made in order to estimate future expenditure on social security benefits and other variables. The assumption adopted in the White Paper is that registered unemployment increases to 1.8 million in 1981-82 and then remains at that level up to 1983-84. The Treasury declined to state the basis upon which this assumption was made. The Chancellor stated that the figures in the White Paper were internally consistent. However he also confirmed that, because of the differences in dates of preparation, there was not a common set of assumptions between the White Paper and the Financial Statement. In particular he agreed that the implications for unemployment of the growth rates assumed in the medium-term strategy might be higher than the level assumed in the White Paper.[4] Our advisers estimated that registered unemployment could lie between 2.2 and 2.5 million by 1983. Higher unemployment means higher expenditure on social security benefits and, whether this is financed through higher National Insurance contributions or through general taxation, the scope for tax reductions in future years will be significantly lower than appears in the medium-term strategy if the PSBR targets are to be met.

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1. Q.15
2. Q.204
3. Q.10
4. Q.495

(c) Public Expenditure and Revenue estimates

15. The Government is planning a radical change in direction. Expenditure on defence, law and order, health and social security is to rise over the survey period while the plans for industry, energy, trade and employment, housing, education, and the nationalised industries' borrowings are substantially reduced. Overall the White Paper states that the Government intends to reduce total public expenditure progressively in volume terms over the next 4 years to a level in 1983-84 about 4% lower than in 1979-80. Expenditure in 1982-83, which was the last year covered by the previous Government's White Paper (Cmnd. 7439) is planned to be 11½% lower than those plans indicated. This is a reduction of £9 billion at 1979 survey prices.

16. In our discussions with the Chancellor and the Treasury on the medium-term estimates for public expenditure, we were principally concerned to ask questions about:

(i) nationalised industry finances;
(ii) housing;
(iii) public sector pay;
(iv) the relative price effect;
(v) the balance between capital and current spending.

We discuss these below in order. It was plain to the Committee that much of the assumed reduction in public expenditure over the medium-term was to be derived from an improvement in the position of the nationalised industries' finances and from a reduction in housing expenditure. Nationalised industries' financing alone represents about half the projected expenditure savings.

(i) Nationalised Industries

17. The improvement in nationalised industries' finances assumed in the White Paper is approximately £2½bn between the 1979/80 and 1983/84 fiscal years. This seems an optimistic assumption. 40% of the savings over the period are expected to come from better performance, such as increased productivity and a rationalisation of operations in the loss-making industries, 25% from increased prices in real terms in gas and electricity and the rest from a variety of sources - for example the catching up with underbilling

in 1979-80 as a result of the Post Office strike[1]. We question whether improvements in efficiency and performance, particularly in the loss-making industries, can be expected to produce the turn-round assumed of them. The Committee believes that the Treasury's break-down may prove unrealistic. A greater proportion of any turn-round that occurs may have to come from increasing charges in these areas. Such increases in nationalised industry charges will make it more difficult to bring down the rate of inflation in the medium-term, not only from the direct impact of higher prices themselves, but also from the knock-on effects likely to result in the form of higher pay settlements. Rather than reducing the size of the public sector, the public expenditure "cuts" may well merely take the form of higher charges to the community of existing public sector services. In the absence of further detailed information, for which we asked,[2] we regard the targets for the nationalised industries to be questionable. We therefore propose to enquire further into this matter.

18. No detailed plans are presented for the housing programmes beyond 1980-81, but a significant part of the £2½ bn total reduction in housing expenditure over the medium-term may well take the form of reduced council house subsidies. To put this figure in perspective, it would be roughly equivalent to the virtual ending of capital expenditure on housing or the total elimination of subsidies. From the evidence gathered by the Committee the Treasury showed extreme reluctance to say how this cut in housing expenditure would be brought about[3]. Apparently, the government would prefer that the detailed decisions were either left to a later date or taken by the local authorities. However, in subsequent discussions it became clear that the Chancellor was of the opinion that a real increase in rent levels was necessary[4]. The Chancellor also recognised that any increase in the real burden of rents would pose a problem regarding its effect on pay settlements and inflation[5].

1. Q 345
2. See letter from the Chancellor to the Chairman of the Committee, 29th April 1980; Evidence, p.
3. Q.311
4. Q.397
5. Q.398

(iii) Public Sector pay

19. The Committee were concerned to hear that although the cash limit for the Civil Service pay settlement this year had been set at 14% the actual Central Government pay bill in 1980-81 was going to be 25% above 1979/80[1], and 23% for Central Government and local authorities combined. The Committee finds it difficult to draw from this the conclusion that the government is being firm on public sector pay. The Chancellor has argued that much of the discrepancy between the 14% figure and the 23% or 25% pay increase is due to the Clegg awards together with the staged settlements for civil servants and some local authority employees.[2] We also received a note from the Treasury setting out the position in more detail.[3] Since these awards were made as a result of a comparability exercise begun by the previous government, the present government is disposed to argue that the responsibility rests with the previous administration. Nevertheless, a serious question must be raised whether, given the framework of the Government's overall policies, it was prudent to allow the Clegg awards to be paid almost in full. The Chancellor has assured the Committee that the cash limits for 1981/82 will not encompass a substantial element of staged settlements, and will therefore in percentage terms more nearly reflect the actual percentage increase in next year's ordinary pay settlements. This remains to be seen. We are not convinced that cash limits are fully effective in controlling public sector pay. We are therefore pursuing the matter with the Chancellor.

20. If settlements in commerce and industry, including the nationalised industries, continue rising in 1980-81, and then exceed central and local government settlements, there may well be pressure for further catching up payments. We discuss below the elements of the cash squeeze on industry. It is often argued that increases in private sector pay are amongst the main contributors to the cash squeeze on industry. In so far as large public sector pay increases adversely affect the climate in which private sector pay negotiations occur when each sector suspects the other of stealing a march, the government cannot escape responsibility for what it has paid its employees and the example it appears to set.

1. Q.336
2. Q.373; see also letter from the Chancellor to the Chairman of the Committee, Evidence, p.
3. Evidence, p.

(iv) The Relative Price Effect

21. The movement of public sector pay relative to that in the private sector contributes to the relative price effect. Roughly speaking, this allows for the differential betwen the growth in public sector costs as opposed to costs in the other areas of the economy. Table 5.12 on page 182 of the White Paper shows that an allowance of £550 million at 1978/79 prices has been made for the relative price effect in 1980/81[1]. This represents a 0.7% relative price change over the previous year. In view of the large increase in public sector pay that has been revealed in the evidence to the Committee and further developments such as substantial increases in the pay of the Armed Forces, this allowance may be on the low side. That is to say the cost of the government's programmes in 1980/81 may be higher than that shown in the White Paper on account of the differential between the large increase in public sector pay compared with private sector pay for the 1980/81 financial year.

22. Turning now to the medium-term, no details are provided about what is expected to happen to the relative price of public expenditure after 1980/81. Nevertheless an assumption about relative costs must have been made in order to relate the expenditure plans to projections of government revenue. The medium-term financial strategy incorporates the assumption that the average price of expenditure in each of the three years 1981/82 to 1983/84 rises at the same rate as the general rate of inflation. Although this conforms with the experience since 1975/76, this particular period was affected by the Labour government's incomes policy which held down public sector pay, so that by 1979 average wages in the public sector had been reduced by 12% relative to earnings in the private sector. Since a formal incomes policy is not part of present government strategy, it would seem more appropriate to assume that the relative price of public expenditure will resume its long-term trend. Over the period 1960-1978, the relative price effect added an average of around 0.8% a year to the cost of public expenditure (excluding debt interest), which is about the same as is assumed for 1980/81 in the White Paper itself. If this assumption is incorporated in the projections set out in the medium-term financial strategy, it would add £2½bn, at 1978/79 prices, to the cost of the expenditure plans by 1983/84, and thereby reduce significantly the fiscal adjustment assumed for that year.

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1. Further details are given in the memorandum submitted by the Treasury; Evidence, p.

(v) Capital and Current spending

23. Finally, we turn to the balance in the government's spending proposals between capital and current spending, on the assumption that cuts are to be made to total expenditure on the scale set out in the White Paper. While we take the Chancellor's point that low growth may reduce the need for some forms of capital spending now, we feel that too much emphasis has again been given to cutting investment expenditure rather than current expenditure, at least in 1980/81. We have received disquieting written evidence to this effect[1]. The failure to provide a detailed breakdown of expenditure by economic category makes it virtually impossible to assess the impact on the economy of the spending plans and of the split between investment spending and current spending in later years. From the piecemeal information given, it would appear that capital expenditure undertaken by local authorities, and other bodies such as water authorities, will bear a large part of the future reductions which are planned. In the Education programme, for example, capital spending is forecast to fall by 20% in real terms between 1980/81 and 1983/84, and it looks as if there is going to be a much greater fall in housing construction.

24. The shorter-term split is somewhat clearer. Mainly because of the government's actions, a drop of some 17½% in general government expenditure on fixed investment in 1980 compared with 1979 is planned.[2] In financial years, we find that the reduction is 10% between 1979/80 and 1980/81, with the result that the volume of spending in this area will be some 40% below the level in 1974/75. The Committee recognises that the Chancellor has proposed custs in the social programmes of current expenditure which will produce savings in future years, but in 1980/81 current spending on goods and services is planned to remain more or less unchanged and transfers, excluding child benefits (where account has to be taken of the offsetting reduction in child allowances), are forecast to rise by 2%. These figures produce an overall effect on the government's total spending of a 1% reduction in 1980/81 compared to 1979/80, before allowing for the special sales of assets, (although in cost terms spending will be much the same this fiscal year as last). Although we recognise that all modern governments find it easier to reduce capital rather than current expenditure, the Committee is concerned about the implications for the economy inherent in the planned reductions in capital expenditure.

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1. See memorandum submitted by the National Federation of Building Trades Employers and the Federation of Civil Engineering Contractors; Evidence, pp 70-73.
2. Q.417

(vi) Public Sector Revenue

25. On the basis of the Treasury's medium-term assumptions regarding the growth of overall economic activity, the financial strategy set out in the Financial Statement provides figures for the path of public sector revenue. (These are shown in table 8, page 18 of the Financial Statement). Taxes on income, expenditure and capital are projected to move from £52½ billion, at 1978-79 prices in 1980-81 to £52 billion in 1981-82, £54 billion in 1982/83, and £55½ billion in 1983/84. The non-oil and oil components of these overall figures need to be examined separately. In evidence to the Committee, the Treasury revealed that the assumptions relating to North Sea taxes (from oil and gas activities) were that they would yield £2¾ bn in 1980/81, £3¼ bn in 1981/82, £4¾ bn in 1982/83, and £4¾ bn in 1983/84.[1] This implies non-oil tax revenue of £49¾ bn in 1980/81, £48¾ bn in 1981/82, £49¼ bn in 1982/83, and £50¾ bn in 1983/84, a profile which largely reflects the fluctuations in real GDP growth from one fiscal year to the next. Clearly, the movement in this non-oil revenue series is highly dependent upon, and very sensitive to, the underlying GDP assumptions - revenue falls in 1981/82 because of the assumed fall in output and increases in 1982/83 and 1983/84 as output expands. To the extent that we have doubts about the GDP growth profile, we must have doubts about these revenue figures. In particular, we question whether there will be a significant increment to non-oil revenue in the years following 1981/82, especially in view of the doubt that exists over the possible turn-round in the economy at that stage. To reiterate, the elimination of this increment to revenue would limit the scope for tax cuts in the later years.

26. The figures mentioned above for oil and gas revenues include government receipts from royalties, corporation taxes, and petroleum revenue tax. Unfortunately, it is impossible to assess properly the likely accuracy of these estimates without much more detailed information than the Chancellor was prepared to supply. The calculation of the size of these revenues depends crucially on the precise assumptions regarding the output and price of North Sea oil and the movement of the exchange rate, most importantly against the US dollar. We were able to gain some information, namely that the oil price assumption for future financial

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1. Q.253

years is that the dollar oil price increases in line with world export prices from 1980-81 onwards. Since oil prices are currently fixed in dollar terms, a rise in the exchange rate will tend to cut the revenue from North Sea oil in sterling terms, whilst a depreciation of the currency relative to the US dollar will tend to raise it. On the available evidence, we cannot judge conclusively whether these revenue estimates from North Sea oil and gas are too pessimistic. However, we are advised that the revenue profile for North Sea oil and gas receipts err on the side of caution, assuming as it does not only an unchanged real price of oil, but seemingly also very little change in the dollar/sterling exchange rate and a relatively low growth in production. We believe that the revenue arising from North Sea oil production may well have been underestimated, possibly considerably so. The tone of the Treasury's evidence confirmed this opinion.

(d) The Corporate Sector

27. The Committee feel that there are several factors which together tend to indicate that the corporate sector will face a substantial liquidity squeeze not only in the short-term, but probably in the medium-term as well. Amongst these, we may cite the projected slow growth in overall economic activity, high interest rates, the squeeze on profitability from the effects of a continuing strong pound (which adversely affects exports while boosting imports), and the difficulty in resisting high pay settlements in the private sector when public sector earnings growth and interest rates are both high. The comments made to us by the Governor of the Bank of England did not remove our concern on this score.[1]

28. The Chancellor has not felt able to supply the Committee with the Treasury's central forecasts of either the short-term industrial and commercial sector deficit or the possible position in the medium-term. The Committee recognises there may be good reasons for the Chancellor not publishing such quantitative estimates. However, he has indicated that the deficit is likely to be substantial[2]. Our own advisers have suggested that the short-term outlook for this deficit in the non-oil sector will be a minimum of £6bn this calendar year. Other forecasts indicate that the deficit in 1980 could be considerably larger.

1. Q.437
2. Q.413

29. Apart from some relief for small businesses mentioned in the Budget, which the Committee welcomes, the economic environment as described above will provide little help to the corporate sector - rather the reverse. The advice the Committee has received suggests that the cash squeeze on industry will not be a short-term phenomenom given the medium-term financial strategy. Indeed, it may well be that the corporate sector has to bear a large proportion of the overall burden of adjustment in order to meet the targets proposed in the financial strategy. In particular, the adverse corporate sector deficit likely to be experienced this year may well persist, if not grow, over the medium-term. Although the one year effect ofa large corporate sector deficit can probably be adequately accommodated by industry, especially in view of its low gearing now compared with 1974/75, the cumulative effect of persistently high deficits may well be very damaging especially in times of high interest rates. In general, we are convinced that the government should not only take a very active interest in what is happening to the corporate sector, but should have measures ready to relieve what could become a very damaging deficit.

Consequences of the medium term strategy for the economy

30. To assess objectively the impact of the government's medium-term financial strategy on the UK economy, it is necessary to have a detailed view of the likely or possible course of various economic variables. Specifically, we should like to know what the strategy implies for the future course of bank lending to the corporate and personal sectors, external flows, and institutional cash flows. Unless we have some idea of these, it is not possible to say with any degree of confidence whether the medium-term strategy is consistent with a substantial fall in interest rates.[2] This is a very complex subject, as is the relationship between growth of the money supply and inflation.

31. As already indicated the Committee will shortly be embarking on a wide ranging enquiry into Monetary Policy as it has evolved both in this country and abroad with a view to reporting to the House at a later date. We want to explore in some depth current thories about such crucial relationships as those between the P.S.B.R., money supply, inflation and economic growth and to test such theories against the available evidence. We would hope then to be better equipped to comment on the government's current economic policies. In the meantime we have thought it right to record our reservations and anxieties.

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1. QQ.48-52 and QQ.412-413.
2. Financial Statement and Budget Report 1980-81, page 16, paras 3-4.

PROCEEDINGS OF THE COMMITTEE RELATING TO THE CONSIDERATION OF THE REPORT

WEDNESDAY 30th APRIL 1980

Members present:

Rt Hon Edward Du Cann, in the Chair

Mr Kenneth Baker
Mr Anthony Beaumont-Dark
Dr Jeremy Bray
Mr Timothy Eggar
Mr Michael English
Rt Hon Terence Higgins
Rt Hon Robert Sheldon
Mr Richard Shepherd
Mr Richard Wainwright
Mr Ken Woolmer

Draft Report, proposed by the Chairman, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraph 1 agreed to.

A paragraph brought up and read the first time, as follows:

"1A: Before discussing the Government's policy in any detail and offering our observations on the Budget and Public Spending White Paper, it is right that we should acknowledge certain basic issues which affect both Government policy and our assessment of it. First, one must recognise that we live in circumstances of exceptional uncertainty. This means several things. Conventional economic models are of limited and diminishing use in providing forecasts, and the policies of any Government must necessarily rest on the judgement of Ministers to a greater extent than in the past. Second, the thrust of much of this Government's monetary and fiscal policy is directed towards changing patterns of behaviour. It is wrong to put too much weight on judgements about the plausibility or otherwise of policy which rest implicitly or explicitly (as most economic model-building does) on the assumption that relationships remain as they were in the past. Third, there will be matters on which it is appropriate that Ministers and officials should observe a certain reticence. Interest and exchange rate policy are obvious examples. Fourth, the basic issues which this Committee, the House and the country at large are most concerned about are the policies the Government are pursuing rather than the fine detail of the documents they publish. In seeking to assess those policies what really matters is to understand the reasoning behind them, the determiniation and realism with which they are being pursued and the consistency of the objectives and instruments of policy. The Committee stresses that it has not, in the short time available to it, found it possible to consider matters of policy as much as would have been desirable."

-(Mr Anthony Beaumont-Dark.)

Motion made, and Question put, That the paragraph be read a second time.

The Committee divided.

Ayes, 1	Noes, 9
Mr Anthony Beaumont-Dark	Mr Kenneth Baker
	Dr Jeremy Bray
	Mr Timothy Eggar
	Mr Michael English
	Rt Hon Terence Higgins
	Rt Hon Robert Sheldon
	Mr Richard Shepherd
	Mr Richard Wainwright
	Mr Ken Woolmer

Paragraph agreed to.

Paragraphs 2 to 5 read and agreed to.

Paragraph 6 read.

An Amendment proposed, to leave out the words "without the table it is impossible for the House to assess the economic implications of these reductions in public expenditure, for employment for investment and so on" and insert the words "it seems remarkable to us, not merely that this breakdown by economic category was omitted from the White Paper but that the Government did not have it prepared for itself and consequently did not know all the consequences of its own actions."-(Mr Michael English.)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 1	Noes, 7
Mr Michael English	Mr Kenneth Baker
	Mr Anthony Beaumont-Dark
	Mr Timothy Eggar
	Rt Hon Terence Higgins
	Rt Hon Robert Sheldon
	Mr Richard Shepherd
	Mr Richard Wainwright

Paragraph agreed to.

Paragraphs 7 and 8 agreed to.

Paragraph 9 read.

An Amendment proposed, in line 5, after "forecast", insert the words "to some extent this is a distinction without a difference, neither are prophecies."-(Mr Michael English.)

Question, That the Amendment be made, put and negatived.

Paragraph agreed to.

Paragraphs 10 to 17 read and agreed to.

Another paragraph brought up and read the first time, as follows:

"17A. We are also concerned that no objective standards seem to be supplied to the Treasury to enable them to determine the treatment of nationalised industries. For example, in the case of monopolistic corporations, where the nationalised corporation is practically the entire industry, the only yardstick as to how far its prices should be allowed to rise must be a comparison with prices in other countries for the same commodity, allowing for all the various factors which may influence costs in the relevant industry. Such an assessment was apparently not available to the Chancellor who referred Your Committee to the several Departments concerned with nationalised industries[1]. With non-monopolistic industries, the market can be allowed to determine their pricing but then it would seem reasonable that normal commercial policy should be allowed to determine their investment policy, i.e. an investment designed to increase productivity sufficiently to finance the capital required at current interest rates should proceed and others should not. Fixing an arbitrary External Financing Limit has, of course, no relevance to this whatsoever. Its only relevance is to the quite artificial fact that some, though far from all, nationalised industry investment is classified as public expenditure under the present artificial definitions."-(Mr Michael English.)

Motion made and Question, That the proposed paragraph be read a second time, put and negatived.

Paragraph agreed to.

Paragraphs 18 to 23 read and agreed to.

Paragraph 24 read.

An Amendment proposed, after words "special sales of assets", to insert a footnote as follows:

"[2]Although such sales are regarded as a reduction in public expenditure on the current definitions, they do not really have any permanent effect on it and cannot be assumed to continue at the same rate since eventually the country, like a bankrupt company, would end up with public expenditure, no further assets to sell, and a reduced income from the assets already sold."
-(Mr Michael English.)

Question, That the Amendment be made, put and negatived.

Paragraph agreed to.

Paragraphs 25 to 31 read and agreed to.

Ordered, That this be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No.85 (Select Committees (Reports)) be applied to the Report.

Copy to Mr Priestley

MAP 4/v.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

cc Econ Pol: Pub. Ex. Pt. 9.

Top Copy filed.
Gvt Mach: Efficiency and waste.

PS/ Secretary of State for Industry

30 April 1980

Tim Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

Dear Tim

My Secretary of State has been thinking about your letter of 31 March to David Edmonds about public expenditure provision for the PSA on new works. He has noted that Mr Channon, Mr Heseltine and Mr Biffen are examining the issue further and will be reporting back in due course.

My Secretary of State hopes that the reconsideration of the issues can take account of what he regards as the unsatisfactory features of the present PSA arrangements. At present responsibility for the construction, leasing and maintenance of office and other accommodation rests with the PSA and is carried out on their vote. Individual Departments, therefore, do not meet the costs of the accommodation they occupy and in many cases are not even aware of the expenditure they incur. There is no incentive for individual Ministers to economise in the use of accommodation.

If, on the other hand, rental and maintenance costs, and possibly construction costs as well, were carried on the votes of individual Departments, there would be a clear incentive for Ministers to economise in the use of office space. A reduction in a Department's expenditure on rent and maintenance would reduce that Department's overall expenditure and might well reduce its claim on the taxpayer.

My Secretary of State has noted that Sir Derek Rayner has proposed ideas on very similar lines in his letter of 22 February to the Home Secretary about the scrutiny of Departmental costs. My Secretary of State realises therefore that Mr Channon, Mr Heseltine and Mr Biffen will be aware of the benefits which might be obtainable by transferring expenditure on rents, maintenance and construction to the votes of individual Departments.

/I ...

I am sending copies of this letter to the private secretaries to members of the Cabinet, including the Minister of Transport, David Wright (Cabinet Office) and David Laughlin (CSD).

Yours ever

Ian Ellison

I K C ELLISON
Private Secretary

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London SW1

30 April 1980

Dear Michael.

You sent me a copy of your letter of 16th April to Paul Channon about the funding of new works (in the office and general accommodation programme) due to start in 1980-81.

So far as starts in 1980-81 are concerned, there are no new works of concern to my Department included in the table circulated with your minute of 24th March to the Prime Minister.

In 1981-82 it will be necessary for work to start on a new computer building at my Department's Guildford office. This is a project which is essential to the efficient running of my Department, and a start must be made in 1981-82 if our computer facilities are to be kept operational in the years ahead. However, I assume that we need not consider the funding of this project until you have a clearer picture of the claims on your resources for 1981-82.

I am copying this letter to the Prime Minister, Cabinet colleagues and Sir Robert Armstrong.

Peter

PETER WALKER

-1 MAY 1980

Econ Pol

MAP

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

30 April 1980

Dear Michael,

PSA EXPENDITURE ON NEW WORKS IN 1980-81

Thank you for sending me a copy of your letter of 16 April to Paul Channon. I agree that it accords with the decisions we reached at our meeting on 2 April. I should however like to record the following points.

You will obviously wish to have decisions quickly on the contracts which are to be let in 1980-81. I suggest that colleagues aim to let you have comments by 2 May so that we can move soon to the next stage to consider any residual schemes for which departments cannot find resources either in whole or in part from within their own allocations.

When we get to that stage, I agree with you that there should be very few residual schemes. I think it only fair to warn colleagues that at a time when our public expenditure decisions have had painful effects in the services provided to the public I expect them to take a very restrictive view of the sort of schemes which must be allowed to go ahead this year in the national interest. If we are to preserve the decisions already taken to secure the public expenditure savings and to seek reductions in the PSA programme of the order agreed, any expenditure on such schemes must be found from within existing public expenditure totals. This means that, if individual departments cannot find resources for their own schemes we must look for contributions from other programmes. If that is not possible I agree with you we can only conclude that the projects should be postponed.

In that context, I note that, in the schedule you circulated with your minute to the Prime Minister of 24 March, you listed two schemes (Richmond Terrace and the International Conference Centre) among others which are classified as contracts for the continuation or completion of schemes already under way. Given that we are to be faced with very difficult decisions on the PSA programme, I think we shall have to consider whether we should allow further work on these projects to continue in 1980-81. I believe that both are at a stage where, after appropriate weather proofing etc, work could be suspended until the public expenditure situation improves. That might release some resources for expenditure in 1980-81 on projects which are arguably of higher priority. I accept that the result would be unsatisfactory. But it is the inevitable consequence of the decisions Cabinet have agreed.

I am sending copies of this letter to the Prime Minister, other members of the Cabinet, Paul Channon, Norman Fowler and Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

CONFIDENTIAL

Econ Pol

SECRETARY OF STATE
FOR
NORTHERN IRELAND

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Rt Hon Michael Heseltine MP
Secretary of State for the
Environment
Department of the Environment
2 Marsham Street
London SW1

24 April 1980

Dear Michael,

R.

28/4

PSA NEW WORKS

Thank you for sending me a copy of your letter of 16 April to Paul Channon about public expenditure provision for the PSA on new works.

I am very glad that you have felt able to find resources in 1980/81 for defence and security projects including the project for the Northern Ireland Office to which I attach priority.

I am copying this letter to the recipients of yours.

Yours ever

Humphrey

CONFIDENTIAL

CONFIDENTIAL

Top

Econ Pol

18 April 1980

The Prime Minister has seen and noted your Secretary of State's recent minute about the PSA new works programme.

I am copying this letter to Alastair Pirie (HM Treasury), Geoffrey Green (Civil Service Department) and David Wright (Cabinet Office).

N. J. SANDERS

SP

D.A. Edmonds, Esq.,
Department of Environment.

CONFIDENTIAL

2.

SECRETARY OF STATE FOR THE ENVIRONMENT

PRIME MINISTER

Mr Heseltine, Treasury, & CSD have now resolved the 1980/81 PSA programme without a large ministerial meeting. MAP 17/4

PRIME MINISTER

I have now discussed with John Biffen and Paul Channon the PSA new works programme, following your Private Secretary's minute of 31 March. In reply to the five points raised in that minute:-

(a) and (b): I have agreed to find savings on the rest of PSA's current expenditure to meet the expected increase of £4m on fuel costs. But I cannot finance major new works in this way. PSA's Administration costs for 1980/81 already show a 12% reduction on last year.

(c) We agreed that Departments who want new schemes to start in 1980/81 should be asked to reconsider whether those schemes are really essential and, if so, to consider whether the cost can be met by the transfer of funds from programmes of lesser priority. We recognised that some Departments might find this easier than others. But it should mean that the remaining schemes that cannot be funded in this way, and which colleagues regard as essential, are few in number and warrant individual consideration. John Biffen, Paul Channon and I will review that short list and put forward proposals.

(d) So much of PSA's expenditure is committed to work in progress under existing contracts, rents, landlord charges etc, coupled with the increased fuel bill, that there is now very

SECRETARY OF STATE FOR THE ENVIRONMENT

little scope for reducing the cut on new works. There are however three items on the list of uncommitted schemes which I am prepared to meet from within the programme in view of their high priority: they are GCHQ, Box 500 and Northern Ireland Office. These schemes amount to £1.2m over the next two years. We will try to accommodate them by some rephasing of other work, but this is as far as I can go in extending the major new works commitment for 1980/81.

(e) We agreed that I should now write to colleagues on the lines proposed in (c) above, and this I have done.

I am sending copies of this minute to John Biffen, Paul Channon and Sir Robert Armstrong.

MH

YD

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/12837/80

Your ref:

16 April 1980

Dear Paul

We discussed with John Biffen on 2 April the question of public expenditure provision for the PSA on new works in the light of your letter of 27 March and the subsequent comments from the Prime Minister. I am reporting the outcome separately to the Prime Minister, but we agreed that it would be helpful in parallel to put colleagues on warning of how we now see the position.

It is clear following the last round of cuts that the PSA programme can in no way accommodate the priority new works schemes that Departments want set out in the list attached to my minute to the Prime Minister of 24 March. I am in all the circumstances prepared to find resources for the projects under Defence and Security for GCHQ, Box 500 and the Northern Ireland Office, which are relatively small and which I acknowledge stand rather on their own. I have also agreed to absorb within my cash limit the additional costs, amounting to £4m, arising from the high level of fuel increases expected this year. This leaves me with £5m less still to manage the existing civil estate and to carry out new building projects.

Given this background, we agreed that we must put it to colleagues that, if schemes to which they attach importance really must be started this year, the first and safest option is for them to find the resources from within their own PESC allocation, by adjustment of their present priorities. This would mean transferring funds for 1980/81 and accepting a potential liability for subsequent years, from within existing public expenditure ceilings, to complete the scheme. This letter accordingly asks colleagues as a matter of urgency to identify what they can do here, and let me know as soon as possible so that we can take the necessary decisions on the programme.

We accept that there may be some schemes - and they will have to be very few indeed - that for one reason or another Departments will be totally unable to finance, but which in the national interest must go ahead this year, and cannot be deferred. If such are identified, we will need to put them to colleagues collectively with our recommendations. But colleagues will understand that, if they cannot find the money themselves, the conclusion may well be that the project does not have sufficient priority to warrant its proceeding.

I am copying this letter to the Prime Minister, to Cabinet colleagues, to Norman Fowler and to Sir Robert Armstrong.

Yours ever

MICHAEL HESELTINE

Paul Channon Esq MP

Econ Pol

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

MINISTER OF TRANSPORT

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1

12
8/4

3 April 1980

Dear Michael,

You sent me a copy of your minute of 24 March about the public expenditure provision for the PSA on new works. I have also seen a copy of Paul Channon's letter of 27 March and that from the Prime Minister's Private Secretary of 31 March.

I support Paul's proposal for further discussion between Ministers. But I thought I should draw attention to one of the projects which is very urgent from my point of view - the provision of driving test centre accommodation. In the schedule attached to your minute, there is no scope for this to begin in 1980/81 within the PSA's PESC allocation.

The problem is urgent because of the huge backlog of driving test applications which we inherited when we took office. We have already increased the number of examiners substantially, and we are bringing down waiting periods in many areas. But we need to provide more accommodation for the many more examiners we still need if our efforts are to succeed. The problem is especially acute in London where waiting periods are much longer than elsewhere, and the need for some new centres there is urgent.

As PSA funds are now so tight, my officials have been considering whether we could find about £1 million from my public expenditure provision to enable a start to be made this year on some new centres. If the Treasury agree, this would at least enable the PSA to put the work in hand immediately, and avoid the public criticism that will certainly arise if shortage of accommodation prevents us from deploying the extra examiners we have specially recruited.

I hope that, in the circumstances, it will be possible for the discussions to deal with this problem quickly so that the work can go ahead. Copies of this letter go to the recipients of yours.

Yours ever
Norman

NORMAN FOWLER

CONFIDENTIAL

JS

~~BIF~~

Econ Pol.

10 DOWNING STREET

From the Private Secretary

31 March 1980

Dear David.

The Prime Minister has now considered your Secretary of State's minute of 24 March about public expenditure provision for the PSA on new works. She has also read Mr. Channon's letter of 27 March.

The Prime Minister agrees with Mr. Channon that this issue is not yet ready for collective discussion. She suggests that Mr. Channon, Mr. Heseltine and Mr. Biffen should examine the issue further and report back. She has asked that the following points should be covered:

(a) the scope for finding the necessary savings from within PSA's current expenditure, including administration;

(b) the implications for expenditure of increased fuel costs;

(c) the scope for other departments to find savings to enable PSA to maintain its capital programme;

(d) what is the irreducible amount which has to be cut from the PSA programme of major capital works;

(e) what recommendations should be made to Ministers on the resulting programme.

I am sending copies of this letter to Private Secretaries to members of the Cabinet, including the Minister of Transport, David Wright (Cabinet Office) and David Laughrin (CSD).

Yours ever.

Tim Lankester.

D.A. Edmonds, Esq.,
Department of the Environment.

JS

PRIME MINISTER

PSA EXPENDITURE ON NEW WORKS

The minute at Flag A from Mr. Heseltine explains that Departments' bids for expenditure by the PSA on new buildings far exceeds the provision which is included in the Public Expenditure White Paper. Excess claims amount to £12 million in 1980/81 and £71 million over the PESC period. Mr. Heseltine suggests that Departments should consider re-allocating resources from other activities to building work. He concludes by proposing a collective discussion.

!

Mr. Channon's letter at Flag B argues that a good deal of work is needed before this issue is ready for collective discussion. He suggests a meeting between himself, Mr. Heseltine and the Chief Secretary. I am sure this is right. I suggest we write supporting Mr. Channon and asking that the three Ministers and their officials examine the following before the matter is discussed collectively:

Agreed

(a) the scope for finding the necessary savings from within PSA's current expenditure, including administration;
(b) the implications for expenditure of increased fuel costs;
(c) the scope for other departments to find savings to enable PSA to maintain its capital programme;
(d) what is the irreducible amount which has to be cut from the PSA programme of major capital works;
(e) what recommendations should be made to Ministers on the resulting programme.

Agree?

Yes MT.

TL

28 March 1980

CONFIDENTIAL
CONFIDENTIAL B

Minister of State

Civil Service Department
Whitehall London SW1A 2AZ
Telephone 01-273 3000

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
LONDON SW1

27th March 1980

Dear John.

I have seen Michael Heseltine's minute of 24 March to the Prime Minister about the implications of the further cut in the public expenditure provisions for the PSA on new work.

I believe we need to think carefully about his proposal for transferring resources within the basic allocations already made for 1980-81. The Estimates which are about to be submitted to Parliament have been very thoroughly scrutinised. If there were significant spare resources available for redeployment it would be a serious criticism of the effectiveness of our public expenditure exercises. In fact I cannot believe it is the case - certainly not in the Estimates controlled here - but if it were, the possession of such spare resources would be no sensible basis on which to determine building priorities.

It is not simply a matter of what happens in 1980-81. Some Departments might perhaps be able to find the relatively small sums necessary to finance a start on their projects in that year but they would presumably be unable to undertake to find the much larger resources required for completion in later years. An important part of the PSA's limited resources in 1981-82 and beyond would therefore be pre-empted without any proper examination of priorities.

The reallocation of resources suggested in Michael Heseltine's minute would in effect be a form of repayment. There are many arguments for putting PSA on repayment (and the feasibility of doing so is now being studied). I think that this should be done, however, only after the implications for government accounting as a whole have been properly examined and on the basis of fair treatment between one Department and another.

I think it would be helpful if you, Michael Heseltine and I could have a discussion of his proposals before they are considered by colleagues more widely. I would be very ready to join such a meeting if you called one.

CONFIDENTIAL

CONFIDENTIAL

What I am sure we want to achieve is a rational decision, within the financial resources available, as to which government building projects should have priority in the national interest. This must surely be better than a series of haphazard decisions based on the chance that some departments (but not others) quite fortuitously had some spare money available.

I am sending copies of this to the Prime Minister, to Cabinet colleagues, to Norman Fowler and to Sir Robert Armstrong.

Yours

Paul

PAUL CHANNON

28 MAR 1989

PERSONAL AND CONFIDENTIAL

Elwn PT

pa.

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

26/3

Tim Lankester Esq
10 Downing Street
London SW1

25 March 1980

Dear Tim

PSA

We spoke on the telephone this morning about the Secretary of State for Environment's minute to the Prime Minister of ~~24~~ March about the consequences for PSA of the public expenditure savings agreed by Cabinet on 31 January.

We agreed that the issue was not yet in a form in which the Prime Minister or Ministers collectively could sensibly take a decision. A reasonable way forward might be that you recommend the Prime Minister to reply that the Secretary of State and the Chief Secretary should consider this further before the matter is put to collective Ministerial discussion.

They and officials might specifically be asked to examine:

a) the scope for finding the necessary savings from within PSA's current expenditure, including administration;

b) the implications for expenditure of increased fuel costs;

c) the scope for other departments to find savings to enable PSA to maintain its capital programme;

d) what is the irreducible amount which has to be cut from the PSA programme of major capital works;

e) what recommendations should be made to Ministers on the resulting programme.

Yours ever

Roger Watts

R J T WATTS
Private Secretary

PERSONAL AND CONFIDENTIAL

A

Prime Minister

Cabinet decided on 31 January 1980 (C(80) 4th minutes) to reduce further the public expenditure provision for the PSA on new works. The agreed line over the PESC period for major new works is now:

1980/81	1981/82	1982/83	1983/84
£23m	£25m	£19.2m	£25.2m

I have prepared as a consequence of that decision the attached table which shows, first, the existing commitments - ie work under current contracts and other schemes already in progress - and, second, all the presently-known schemes that seem to be of high priority (this excludes many other schemes to which colleagues may attach importance but which are perhaps less urgently needed). As you will see, the resources available are far outweighed by the claims on them. In 1980/81 the PESC provision is £23.15; the resources available after deducting work in progress and schemes which are already under way, is £0.167m. The claims on that by Ministerial colleagues amount to £11.899m over that available sum. For later years, as the table shows, there is still a considerable shortfall, although the amount will, of course, depend on the ongoing expenditure of schemes started this year.

Faced with this shortfall there is no possibility of my finding the resources from within other PSA programmes. Indeed, it may be that because of the constraint of present cash limits on our fuel bills, we could be faced with cancellations of schemes which are already under way. I hope that this will not be necessary and that we reach sensible agreement with the Treasury on cash limits to reflect the true increase in fuel costs.

I suggest, therefore, that my colleagues who are making the claims shown in Part D of the table should consider how pressing is the need for a start to be made in 1980/81. If it is their conclusion that the work to be done for their Department is essential it would be for them to find the necessary public expenditure resources from within the allocations made for their Departments elsewhere. We should of course need to consider the implications of such decisions in the carrying through of expenditure into future years.

You may wish to consider a collective discussion of the problems facing us in this area. I am, therefore, copying this minute to all Cabinet colleagues, to Norman Fowler, to Sir Robert Armstrong and to Sir Ian Bancroft.

MH

MH

24th March 1980

2F

24 MAR 19[illegible]

CONFIDENTIAL

PSA: OFFICE AND GENERAL ACCOMMODATION 1980/81 - 1983/84

(£million 1980 SP)
September '79 prices

(CLASS XIV VOTE 1 SUBHEAD A1
PART 1 NEW WORKS)

		1980/1-1983/4	1980/1	1981/2	1982/3	1983/4	TO FINISH
A.	PESC	92.55	23.150	25.000	19.200	25.200	
		TOTAL COST OF SCHEMES OVER PERIOD					
B(i)	WORK IN PROGRESS (ie FULLY COMMITTED CONTRACTS)	23.500	19.500	3.900	0.100		
(ii)	CONTRACTS NOT YET LET BUT WHICH ARE TO CONTINUE OR COMPLETE SCHEMES ALREADY UNDER WAY						
	St Johns House, Bootle	2.800	2.000	0.800			
	Richmond Terrace	11.592	0.250	1.000	4.124	4.000	2.218
	Cathays Park, Cardiff	0.130	0.130				
	Conference Centre, Substructure and TE	2.230	1.030	1.200			
	Farnborough, Accident Investigation Branch	0.073	0.073				
	Sub Total	16.825	3.483	3.000	4.124	4.000	2.218
	Total (B(i) and (ii))	40.325	22.983	6.900	4.224	4.000	2.218
C.	RESOURCES AVAILABLE (A - (Bi and ii)	52.225	0.167	18.100	14.976	21.200	
D.	CLAIMS (ie SCHEMES DUE TO START IN 1980/81 OR AFTER)						
	Conference Centre Superstructure	23.700			2.200	7.900	13.600
	DEFENCE AND SECURITY						
	MOD Defence Data Processing Service	2.600	1.100	1.300	0.200		
	MOD Defence Situation Centre	0.160	0.150	0.010			
	GCHQ	0.750	0.290	0.460			
	Box 500	0.100	0.075	0.025			
	Northern Ireland Office	0.350	0.350				
	NEW GOVERNMENT PROGRAMMES						
	Computerisation of PAYE	18.680		0.750	4.830	6.190	6.910
	Unemployment Benefit Offices (Taxation of Benefits)	2.300	1.000	1.000	0.300		
	DHSS Local Offices (Computerisation of Benefits)	9.000	1.000	2.000	3.500	2.500	
	Department of Transport (New Driving Test Centres)	7.000	2.000	1.500	1.500	2.000	
	REPLACEMENT OF PREMISES TO BE DEMOLISHED						
	IR Dartmouth Rd, Forest Hill	0.200	0.040	0.140	0.020		
	C&E Road Examination Station, Londonderry	0.382	0.191	0.191			
	DEPARTMENTS OPERATIONAL REQUIREMENTS						
	C&E Dover Harbour	0.500	0.300	0.200			
	DE/DHSS, Corby	0.150	0.150				
	OPCS, Titchfield	2.160	0.700	0.980	0.460	0.020	
	C&E Dovercourt, Harwich	1.200	0.300	0.850	0.050		
	C&E Avonmouth	1.160	0.500	0.620	0.040		
	DE Livingstone	0.334	0.284	0.050			
	Scottish Office Computer Suite	0.750	0.550	0.200			
	OVERCROWDING AND WORKING CONDITIONS						
	DTp, LVLO Birmingham	0.250	0.240	0.010			
	DHSS Bell Hill, Glasgow	0.110	0.110				
	DE/DHSS Houghton Le Spring	1.004	0.502	0.502			
	DHSS Berwick	0.249	0.094	0.151	0.004		
	DHSS Alexander Fleming House	0.930	0.930				
	DE Steel House	0.850	0.850				
	Four leased Buildings Requiring Fitting Out	0.365	0.360	0.005			
	OTHER KNOWN PROJECTS OF HIGH PRIORITY	47.800		10.300	11.200	10.200	16.100
	SUB TOTAL (D)	123.034	12.066	21.244	24.304	28.810	36.610
	TOTAL: COMMITTED AND CLAIMS (B+D)	163.359	35.049	28.144	28.528	32.810	38.828
	SHORTFALL (EXCESS OF CLAIMS OVER RESOURCES: ie D - C)	70.809	11.899	-3.144	9.328	7.610	

2

Prime Minister

This explains why the Chief Secretary's memorandum giving the detailed Supply Estimates can't be published on Budget Day.

(Apart from X, the main decisions for 1980/81 were taken much later this year than usual - because of the January review).

TL 21/3

Treasury Chambers, Parliament Street, SW1P 3AG

Tim Lankester Esq
No. 10 Downing Street
London SW1

21 March 1980

But the paper is that much later. ~~aro.~~

Dear Tim

CHIEF SECRETARY'S MEMORANDUM ON THE ESTIMATES

You told me on the telephone this afternoon that the Prime Minister had asked what precisely had prevented publication of the Chief Secretary's Memorandum as usual on Budget Day.

This year there were a number of special circumstances which taken together meant that the information was just not available in time. Perhaps the most important was that Ministers decided certain features of the November Social Security uprating - notably the new scheme to provide assistance with fuel costs - only this week.

This could perhaps have been overcome if the cost of the upratings could have been taken in supplementary estimates as in previous years. Ministers had already decided however that the cost should be included this year in the main supply estimates and therefore in the Chief Secretary's Memorandum.

You asked if it were possible to see a draft copy of the Memorandum. I'm afraid that the best we can do at present is to send you a copy of last year's document (enclosed).

Yours ever

Roger Watts

R J T WATTS
Private Secretary

Excamped,

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Rupy

20 March 1980

Your letter of 5 March to Norman Fowler about the cash limit on the English trunk road programme in 1980-81 offered an adjustment should there be more claims on completed contracts than have been allowed for.

My position is exactly the same as Norman's, and I assume you would allow me the same facility. After setting aside £10m for payment of claims (out of £19m claims submitted) and allowing for expenditure on schemes in progress, I am letting no more trunk road contracts in 1980-81. Of the £74.7m (at outturn prices) available to me on Subhead A1 of Vote Class VI, 1 in 1980-81 I have a reserve of only £2m for emergency works and possible inflation above levels we have discussed.

As in England, there has been a speeding up in the rate at which claims on completed schemes are being presented, and while I hope to settle for no more than a total of £10m there is a risk that payments of up to £15m might have to be made.

I would therefore ask that an adjustment of my cash limit should be made, with a Winter Supplementary Estimate, and within a maximum of £5m, if claims above £10m have to be met in 1980-81.

GEORGE YOUNGER

Why have they been 'slow' – should they have had a lot more time than usual? MT

File with Tim 2

Prime Minister

To note. (This document simply can't be produced in time – some Depts. have been slow in sending in the necessary information).

TL. 20/3

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Tim Lankester
10 Downing Street
London SW1

20 March 1980

Dear Tim

CHIEF SECRETARY'S MEMORANDUM ON THE ESTIMATES

The Chief Secretary's Memorandum is a routine, technical document which expands on certain aspects of the Supply Estimates. It is published traditionally on Budget day in the form of a White Paper as one of the Budget documents.

This year we will be unable to publish the Memorandum on Budget day and we intend to arrange for an inspired PQ to be tabled tomorrow for answer on Monday 24 March informing the House of the delay.

The Chief Secretary has agreed that the White Paper should now be published on Wednesday 2 April.

I am sending a copy of this letter to John Stevens (Chancellor of the Duchy's office), Murdo Maclean (Chief Whip's office) and to Richard Prescott (Paymaster General's office).

Yours sincerely

Roger Watts

R J T WATTS
Private Secretary

20 MAR 1980

Econ Pol

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

19/3

J. Chilcot, Esq.,
Private Secretary to the
Home Secretary,

cc Arlington

JL 20/3

Dear John,

PRESS NOTICES RELATING TO THE BUDGET AND PUBLIC EXPENDITURE WHITE PAPER

I have been asked to clarify one point about the distribution of press notices, further to the arrangements set out in my letter to you of 12th March.

All press notices received by the Treasury will be distributed at the end of the Budget speech to the major national and provincial newspapers, to the main broadcasting networks, to Lobby journalists and to overseas journalists who attend the Ministerial Budget briefing at the House of Commons. As I said in my earlier letter, your Department will need to make its own arrangements for covering special journalists and interested bodies and of course for putting copies of PEWP press notices for which it is responsible in the libary of the House.

There has also been a revision in the number of copies of press notices we require. The Treasury should receive 425 copies of each press notice. 75 of these should be sent to Mr. D. Barton and 350 to Mr. A. Batchelor.

I am copying this letter to the recipients of my earlier one.

Yours sincerely
Louise

MISS L.E. BIRNIE
Assistant Private Secretary

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET
SW1P 3EB

MINISTER OF TRANSPORT

With the Compliments of the
Minister of Transport

SECRET

Econ Pol

5

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

MINISTER OF TRANSPORT

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
LONDON
SW1

17/3

17 MAR 1980

Dear Patrick.

PUBLIC EXPENDITURE WHITE PAPER

Thank you for sending me a copy of your letter of 4 March to John Biffen about the reference in the proposed text of the White Paper to further measures to recover road accident costs.

You will be aware from my letter of 3 December 1979 to Gerard Vaughan of my misgivings about such measures and I am glad to note that you do not see the reference as implying a commitment to any particular scheme - or indeed to any measures to generate more money from motorists under the Road Traffic Act.

will respect if required

I have to say that I remain very doubtful about further measures - beyond those already taken to update existing charges - and I hope that you agree that in responding to enquiries from the Press and others after the White Paper is published Departments should avoid saying anything on the details of possible measures.

SECRET

SECRET

I am copying this letter to the recipients of yours.

Yours ever
Norman

NORMAN FOWLER

17 MAR 1980

SECRET

PJ

CONFIDENTIAL

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
London SW1

14 March 1980

R

14/3

Dear Geoffrey,

NATIONAL HEALTH SERVICE CASH LIMIT

I delayed replying to your letter of 27 February about the Health Services cash limit until we knew that colleagues were content with the proposals for handling the problem of nurses' hours. Without those proposals, the cash limit would have been unacceptably tight. As it is, health authorities will remain under great pressure if inflation rises to the extent we expect. I recognise the importance however of maintaining the standard 14 per cent limit recommended in your paper. I accordingly confirm my agreement to your proposal. These have been incorporated in the detailed figures which have been agreed between our officials, who are also keeping in close touch on the announcements to be made.

Copies go to Prime Minister and Sir Robert Armstrong.

Yours ever

Patrick

CONFIDENTIAL

cc Press Office

T. Tolstoe
L.PA

MS

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

cc Budget file

12th March, 1980

Dear Mr Chilcot

PRESS NOTICES RELATING TO THE BUDGET AND PUBLIC EXPENDITURE WHITE PAPER

I am writing to seek your and copy recipients co-operation in dealing with the press releases relating to the Budget and the Public Expenditure White Paper, which this year will be published on Budget Day. As far as the White Paper is concerned, this letter amplifies the guidance already given on press notices associated with it in PESC(N)(80)4.

I should be grateful if you and other recipients of this letter could let me know in writing by noon on Tuesday, 18th March:-

Whoops

(a) what, if any, Budget press notices are proposed by your Department,

(b) what if any Public Expenditure White Paper press notices will be issued by your Department, and

(c) who in each Department might act as a contact point for those press notices.

Where appropriate, please send a nil return. Could you please also make arrangements for me to be informed if there are any subsequent changes to your Department's arrangements.

The Treasury (correct address: Treasury Chambers, Parliament Street) should receive 410 copies of each press notice, whether on the Budget or the Public Expenditure

/White

J. Chilcot, Esq.,
Private Secretary,
Home Department

White Paper, by close of play on Monday, 24th March at the latest. 60 of these should be send to Mr. D. Barton, room 82/2, and 350 to Mr. A. Batchelor, care of Committee Section, room 74/G. Additionally, 750 copies of Budget, but not, repeat not, Public Expenditure White Paper press notices, should reach the Treasury Parliamentary Section, room 128/2, by the same deadline (to be placed in the Vote Office for distribution with other Budget documents to Members of the House on Budget Day).

If this timetable looks likely to cause acute problems anywhere, could you or the Departmental contact point please contact me before 18th March. Otherwise we shall assume that the deadline will be met. This is obviously of great importance, given the huge volume of paper which will have to be handled.

All press notices will be distributed by the Treasury to bodies on their mailing list, including the major national and provincial press. If you need further details of our distribution, these can be supplied by Stanley Godfrey (233-7676). Your Department will need to make its own arrangements for informing specialist journalists, and of course, for putting copies of Public Expenditure White Paper press notices for which it is responsible in the Library of the House (Budget press notices will of course be distributed through the Vote Office).

We should be grateful if all press notices, both on the White Paper and on the Budget, could be cleared in draft with the relevant Treasury division. The final version of each press notice should be sent as a separate exercise to the relevant Treasury division.

I should be grateful if you could distribute this letter widely in your Department.

I am copying this letter to the Private Secretaries to all Cabinet Ministers, the Minister of Transport, and the Minister of State for the Civil Service.

Yours sincerely

L E Birnie

(MISS L.E. BIRNIE)

CONFIDENTIAL

Econ Pol

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Great George Street
London SW1

10 March 1980

Dear John,

PUBLIC EXPENDITURE SURVEY 1980

I agree with the proposals in your minute of 28 February for commissioning work on the 1980 public expenditure Survey. In particular, as you know, I am strongly in favour of pursuing the work on the territorial split of expenditure to which you refer in paragraph 11 of your minute.

I am glad that you have scaled down the options for reductions that are to be identified initially to two per cent in 1981-82 and three per cent thereafter. Even so this will mean we have to look for cuts rising to £600 million a year on social security, on top of those that will be presented in the next White Paper.

I agree that we should move to a uniform price base for the Survey and that this should be "Year - 1". This principally means changing the price base of the social security programme (at present "Year + 1") and will have the advantage of reducing its cost relative to other programmes by some £3 billion, at a stroke. I am happy to be able to make this contribution to the abatement of public expenditure!

I am copying this letter to the Prime Minister and to recipients of your minute.

Yours ever
Patrick

CONFIDENTIAL

Econ Pol

CONFIDENTIAL

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

6 March 1980

PUBLIC EXPENDITURE SURVEY 1980

Thank you for sending me a copy of your minute of 28 February to the Prime Minister about some changes in the procedure for the 1980 Survey and about the size of the options for reductions which officials will be asked to identify.

2. I agree with the proposed procedural changes, but I assume that proposal (ii) - restructuring the Survey report to show more clearly the Departmental spending programmes for which individual Ministers are responsible - will not prevent the presentation of a single chapter showing expenditure by all the agricultural and fisheries Departments on agriculture, fisheries, food and forestry. The arrangements set out in your letter of 3 March to George Younger and Nick Edwards about new PES programmes covering expenditure within their responsibilities made clear that there would be no change in the arrangements for determining and managing expenditure on agriculture, fisheries, food and forestry. It follows that we should continue to have a single chapter on that expenditure in the Survey report.

3. As regards options for reductions, I accept that all Departments should be asked to identify what they see as the least difficult options for further reductions of 2 per cent in 1981-82 and 3 per cent in subsequent years. But I suggest that the report to Cabinet should distinguish the options which would be likely to diminish the prospects of growth in output and in productivity from the options which would not have harmful economic effects. When we review our expenditure plans it is essential that we take full account of our central economic objectives.

4. I am sending copies of this letter to all members of the Cabinet, to the Minister of Transport and to Sir Robert Armstrong and Sir Kenneth Berrill.

PETER WALKER

- 7 MAR 1980

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

Rt Hon Nicholas Edwards MP
Secretary of State
Welsh Office
Gwydyr House
Whitehall
London SW1A 2ER

R 6/3

6 March 1980

Dear Nick,

WELSH OFFICE PES AND VOTE STRUCTURE

I have read with interest your letter of 13 February 1980 to John Biffen, and his reply of 3 March.

I have no comment to make on your arrangements as such but I should like to remove any possibility of future misunderstanding as regards the reference to Northern Ireland in paragraph 8 of the Note which accompanied your letter. This mentions the 'established population formula' applied to Northern Ireland for determining reductions or additions to the Northern Ireland expenditure "block".

It is true that this formula (the comparability formula as it is termed) has been used for the purposes of the 1979 Survey but its use beyond that has yet to be agreed. Over the next few weeks I shall be reviewing experience in its working this past year and will then be in touch with John Biffen. It may well be suitable (with or without modification) for continued use but I would prefer to suspend judgement until (now that we appear to have reached the end of the current series of public expenditure exercises) I have had an opportunity to consider the point.

I am copying this letter to the recipients of yours.

Yours ever

Humphrey

Econ Pol

JS

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary 6 March 1980

Dear Alistair,

PUBLIC EXPENDITURE WHITE PAPER

The Prime Minister has now considered the Chief Secretary's minute of 4 March and, subject to colleagues' views, she is content with his proposals on shortfall and the contingency reserve - as well as with his minor drafting amendments.

I am sending a copy of this letter to Private Secretaries to members of the Cabinet, the Minister of Transport and Sir Robert Armstrong.

Yours ever

Tim Lankester.

Alistair Pirie, Esq.,
Chief Secretary's Office.

JS

Econ Pol

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

PL 7/3

The Rt Hon Norman Fowler MP
Minister of Transport
Department of Transport
2 Marsham Street
London SW1P 3EB

5 March 1980

Dear Minister,

You wrote to the Chancellor of the Exchequer on 27 February about the implication of the proposals in C(80)14 for the cash limit on the English road programme in 1980-81. This morning, in accordance with the Cabinet decision when they approved those proposals, you and I discussed the problems that arise on the road programme.

I was glad to hear that, now that the Department had re-calculated the likely outturn of expenditure on new construction on the basis of our agreed forecast of the increase in costs, the situation was less intractable than it had seemed at an earlier stage. You thought that, with careful management, and by delaying work on three by-passes, the Department could get by without announcing a virtual moratorium on all new contracts. You were therefore no longer pressing for the cash limit to be set at a higher level in 1980-81.

You asked however for consideration to be given to the special problem that you had inherited, of the backlog of contractors' claims for payments on past contracts; some of those payments went back several years and were reflected in underspending on the road programme. You explained that, partly because some companies were threatened with liquidation, there had recently been a sudden speeding up in the rate at which claims on old schemes were being presented. In consequence, although there was provision for the payment of £26 million in 1980-81 for old schemes, there was now a risk that payments of up to £40 million might have to be made.

As agreed, I have now given further thought to that problem. I think the way to deal with it is as follows. First, as you intend, your Department should manage the whole motorway and trunk road programme so as to stay within the cash limit while allowing for payments on old schemes up to the provision of £26 million. Secondly, if for the next few months (while there is still some flexibility in your 1980-81 programme) it looks as though claims on those schemes are being presented at a rate beyond that allowed for in the £26 million, your Department should take all steps that are reasonably practicable to make room elsewhere for these extra payments. If nevertheless the claims continue to go through at a faster rate, to an extent that it is in practice impossible to offset e.g. by delaying further work on the M25 or on the by-passes, I should be willing to consider whether the cash limit could be adjusted, with a Winter Supplementary Estimate, to deal with the limited remaining overspending (within a maximum of £14 million) on account of this item.

I am sending copies of this letter to the Prime Minister, the Secretaries of State for Scotland and Wales and Sir Robert Armstrong.

Yours sincerely,

A.C. Pirie

PP JOHN BIFFEN

[Approved by the Chief Secretary and signed in his absence]

SECRET

ℓ/b 4

10 DOWNING STREET

From the Private Secretary

5 March 1980

As I told you, the Prime Minister has considered the Chancellor's minute of 5 March, and in the light of the arguments set out in that minute, she has agreed that the figures for our contribution to the EEC should be published in the way originally planned. She agrees that the presentation will be improved if the figures for future years are shown in italics, and with the amendments to the text which the Chancellor proposes. She has asked that, if possible, there should be a footnote against the EEC contribution line in table 1.6 explaining why the figures are in italics.

I understand that the Lord Privy Seal is content with the Chancellor's latest proposals.

I am sending a copy of this letter to the Private Secretaries to members of the Cabinet and to David Wright (Cabinet Office).

T. P. LANKESTER

A. J. Wiggins, Esq.,
H.M. Treasury.

SECRET

3

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

PRIME MINISTER

PUBLIC EXPENDITURE WHITE PAPER : EEC CONTRIBUTION

I have seen your Private Secretary's letter of 3rd March, and must at once put on record that I would be very concerned about the idea of changing the presentation of the EEC contributions in the way suggested in it.

2. My overriding concern is with the impact of the totals for public expenditure. We have very substantial reductions to show over the period, even without allowing for the reductions in our EEC contribution. To omit these contributions altogether would mean that we could not show planned public expenditure totals directly comparable with the totals in past years. That would reduce the impact of the cuts we have made and would obscure the progressive reduction in the plans shown for the future years compared with past levels.

3. We cannot avoid including in the Financial Statement and Budget Report some figures for our net EEC contribution. We have to publish a short-term forecast and to exclude any provision for the EEC would give a misleadingly favourable impression of our position which would mean that, for example, the PSBR projections would look unduly optimistic. If we go ahead with publication of the medium-term financial strategy,

/in which

in which I see substantial advantage, the Governor and I have been concerned that the figures should be on a prudent basis: to exclude provision for the EEC would be inconsistent with that.

4. In any case, exclusion of these figures from the White Paper would be bound to attract questions about what our EEC contributions would be if existing arrangements were not changed. I did in fact say in reply to a Parliamentary Question in November that we expected to publish those figures in this ...... White Paper (copy attached).

5. As regards the wider presentational significance of the figures, our approach had been that to show the full rising trend would be helpful rather than the reverse. It would show the British public and our EEC partners what we are really up against. This thought lay behind my recommendation (in my minute of 29th February) to ask the Commission to update their calculation of net contributions in 1980.

6. I should also explain that to change the approach we agreed in Cabinet in January would involve substantial rewriting of the White Paper. A large number of tables, and the commentaries on them, would be affected, including the presentation of the totals in Part 1. There would be real difficulties about accomplishing these changes, including the consequent resetting by the printer, in the time now available. There must be a considerable risk that publication of the White Paper would be delayed until after Budget Day.

7. I therefore strongly recommend that we should not now change course over including the figures for the EEC contribution in the White Paper. But I certainly agree with you that we should look again at the presentation in an effort to

/bring out

bring out more strongly that the figures are not what we expect to spend. The best change I can think of at this stage is to show the forecast in italics. Also I suggest some amendments to Part 1 as shown in the attached note.

8. Because of the implications for the timing of the White Paper, this needs to be settled urgently. I fully understand why you would like to find a different way of presenting these disagreeable figures. But I do not believe we can do better than I have suggested. I hope that in the circumstances you would agree that we should continue to include the figures, with the amendments I have suggested. If you still see difficulty, however, I should be grateful for a very urgent word with you and Peter Carrington.

9. I am copying this minute to Cabinet colleagues and to Sir Robert Armstrong.

for (G.H.)

5 March 1980

(approved by the Chancellor and signed in his absence)

PROPOSED AMENDMENTS TO PUBLIC EXPENDITURE WHITE PAPER

Page 2, paragraph 4, line 7

Add after third sentence:

> "(The forecasts in the tables in the White Paper are accordingly shown in italics.)"

The tables affected are table 1.6 on page 14 and table 2.2 on page 23. The forecasts for the EEC contribution in the years 1980-81 onwards would be shown in italics.

Page 4, paragraph 10, lines 8-9

Rewrite fourth and fifth sentences as:

> "The reduction under negotiation in the net contribution to the European Community will bring a further saving. Even without allowing for this, expenditure in 1982-83, .."

Extract from Hansard Reference Vol 973 - No 63
Cols 279-280

Friday 9th November 1979.

tax.

European Community Budget (United Kingdom Contribution)

34. **Mr. Stoddart** asked the Chancellor of the Exchequer what is the likely United Kingdom net contribution to the European Economic Community budget for 1980, 1981 and 1982.

Sir Geoffrey Howe: The latest forecast for the net contribution to the Community budget in 1980 at 1979 prices is over £1 billion ; on present trends it will continue to increase in subsequent years.

A forecast of our net contributions to the European Communities and to the European Investment Bank of about £1 billion in 1980-81 was published in "The Government's Expenditure Plans 1980-81", Cmnd. 7746, on the same basis as in earlier public expenditure White Papers. The Government expect to publish estimates of contributions for later years on that basis in the next public expenditure White Paper.

CODE 18-78

RH

CONFIDENTIAL

5 March 1980

Public Expenditure Survey, 1980

The Prime Minister has considered the Chief Secretary's minute of 28 February, and is content with all of his proposals for the conduct of this year's public expenditure survey.

I am sending copies of this letter to Private Secretaries to members of the Cabinet including the Minister of Transport and to David Wright (Cabinet Office) and Gerry Spence (CPRS).

A C Pirie Esq
HM Treasury

CONFIDENTIAL

B

File

cc CPRS

CONFIDENTIAL

RH

MR D WRIGHT
CABINET OFFICE

You will see from my letter of today's date to the Treasury that the Prime Minister has agreed all of the proposals put forward by the Chief Secretary for the conduct of this year's public expenditure survey.

The Prime Minister considered the points in Sir Robert Armstrong's minute of 4 March, but decided she did not want to set in hand a special study on the level of teaching and non-teaching staff in primary and secondary education; nor did she think it necessary for the programme of "special studies" to be the subject of Cabinet endorsement. Although she has not objected to the Chief Secretary's proposition that in future years some policies may need to be reviewed in greater depth, she does not in fact believe that there is much point in such studies being conducted on an interdepartmental basis: she believes that departments ought to be able to conduct such policy reviews of their own accord.

T. P. LANKESTER

5 March 1980

CONFIDENTIAL

HOUSING PUBLIC EXPENDITURE (IN ENGLAND), 1980/81

Mike

This note gives defensive material for use against the main criticisms which are likely to be made of the announcement made by the Secretary of State for the Environment on 21 February.

TL 4/3

General

The levels of expenditure for 1980/81 reflect the overall economic background and the need to reduce the massive burden of public expenditure. However Housing policies and expenditure levels need, too, to recognise the significant general improvement of housing conditions in the last 30 years both in terms of the condition of the housing stock and of the fact that nationally the demand and supply of housing are now in much better balance. Home ownership has grown over the period from 31 to 55%.

In these circumstances, the emphasis of public sector housing policy must now be to meet particular needs such as those of the elderly and the handicapped; and we must concentrate on making better use of the existing housing stock. Local authorities need to make full use of the various ways in which they can encourage low-cost home-ownership. Measures in the Housing Bill will help here, in particular in fulfilling our promises to give public sector tenants the right to buy their homes. Provisions in the Bill will encourage the private rented sector.

CAPITAL EXPENDITURE

The Housing Investment Programmes (HIP) allocations for local authorities for 1980/81 amount to £2,199m at expected outturn prices; the Housing Corporation will be allocated £420m for the work of Housing Associations; and the New Towns building for rent programme will be £157m.

Opposition criticism is at present concentrating on the extent of the reductions and whether the comparison with forecast outturn for 1979/80 (the figures so far given by DOE) is misleading. The main defensive points are that

- in presenting public expenditure plans it is usual to compare allocations with outturn in earlier years, as was done in the last Government's Public Expenditure White Paper published in January 1979; the level of spending actually being achieved is obviously the proper basis of comparison with future provisions.

- the housing expenditure plans of the last Government were unrealistically high, the Budget cuts of the present Government removed £300m for 1979/80 and yet the lower cash limit will not be reached even though inflation of building costs has run faster than was expected last summer.

The percentage reductions in real terms of the three programmes both against the last Government's provisional allocations and against forecast outturn for 1979/80 are in Table 1.

Further defensive points

(a) Net capital expenditure on housing fell under the last Government by over a half from £4202m in 1974/5 to £2077m in 1979/80.

(b) The present reductions therefore reflect the trend under the previous Government.

(c) A major factor in the reduction has been the fall in new housebuilding since 1975, particularly by local authorities (see table 2). This is the product of local authorities' own decisions. It reflects a shift in emphasis towards improvement; the high cost for local authorities of servicing earlier high levels of capital expenditure on housing; and changing perceptions of local housing needs with increasing emphasis on mortgage lending.

CURRENT EXPENDITURE

In his statement on 21 February, the Secretary of State announced a supplementary rent increase guideline of 60p a week on average to apply to the second half of 1980/81. This is additional to the rent increase guideline for 1980/81, announced on 16 November, of £1.50p per week on average.

The main lines of attack from the Opposition are:-

a. the two guidelines are an increase of £2.10p a week;

b. this comes to £1.80p a week increase over the whole year and is a 28% increase over the average local authority rent of some £6.50 a week.

The main defensive points are:-

a. While capital spending on housing fell under the last Government, housing subsidies rose sharply (from £628m in 1973/74 to £1,386m in 1978/79 at 1979 Survey prices).

b. Over the whole year 1980/81, the guideline amounts in fact to an increase of £1.80p a week on average, not £2.10p because the additional 60p only applies in the second half of the year.

c. It is essential to look not at one year in isolation but at a run of years. The last Government said in the Housing Green Paper that it intended to keep the rise in rents broadly in line with the rise in earnings. This it failed to do. The present increases in the guideline should recover some lost ground. (see Table 3).

d. The poorer tenants will be sheltered from the increases; recipients of supplementary benefit will not have to pay any increase; recipients of rent rebates will typically receive in rebate £1.08 of a £1.80 increase.

e. Low rents have made it difficult for authorities both to sustain capital expenditure (because the rates have to meet part of the shortfall against costs) and to maintain their existing stock properly.

POSITIVE POINTS

Increased flexibility for local authorities

Local authorities are being helped by being given maximum flexibility in the use of their allocation. This is being achieved by making the HIP allocation for 1980/81 as a single housing block - previously it was in 3 separate blocks.

7-point programme for promoting low cost home ownership

The Government has urged local authorities in the HIPs allocation letter to promote low cost home ownership in the following ways:

1. selling council houses
2. securing of land release for builders
3. encouraging starter homes
4. low cost building for sale
5. schemes for improving and selling houses such as AIMS (acquisition improvement and sales) and homesteading
6. shared ownership schemes
7. help with mortgages for priority home buyers using new mortgage guarantee powers in Housing Bill.

Making better use of existing stock for rent

Three initiatives in the Housing Bill for the private sector to encourage more lettings by private owners. In the case of new lettings:-

- shorthold: fixed term lettings of 1-5 years (with landlords' right to repossession at the end)

- resident landlord lettings, with quicker repossession than at present. This should encourage lettings in some of the 900,000 or so houses with 2 or more spare bedrooms.

- assured tenancies; bodies specifically approved by the Secretary of State to be able to let new housing at market rents.

In the public sector

- in the Housing Bill the right to sublet; the right of secure tenants to take in lodgers or to sublet part of their home (at no extra cost to public funds).

The Paymaster General's Office
Privy Council Office
68 Whitehall
London SW1

4 March 1980

TABLE 1

HOUSING PUBLIC EXPENDITURE, ENDLAND

ALLOCATIONS FOR 1980/81 COMPARED WITH LABOUR'S PROPOSED

PROVISION, AND OUTTURN NOW FORECAST FOR 1979/80

	Against last Government's Provisional Allocations for 1979/80	Against Forecast outturn for 1979/80
Local authorities HIPs	- 33.4%	- 24%
Housing Corporation	- 17.6%	- 7%
New Towns	- 25%	- 11%
Overall	- 31.1%	- 21%

(£540m at 1979 SP)

TABLE 2

APPROVALS (THOUSANDS OF DWELLINGS)

	1975	1976	1977	1978	1979
Local authorities	107	106	64	60	40
New Towns	16	11	8	9	5½
Housing Associations	24	34	23	18	13
Total public sector	147	151	95	87	58

TABLE 3

RENTS AND EARNINGS 1974/5 TO 1979/80

Year	AVERAGE* WEEKLY RENT £	AVERAGE** WEEKLY EARNINGS £	RENT AS A PERCENTAGE OF EARNINGS
1974/75	3.81	47.70	7.99%
1975/76	4.28	60.80	7.04%
1976/77	4.91	71.80	6.84%
1977/78	5.58	78.60	7.10%
1978/79	5.90	89.10	6.62%
1979/80	6.49	101.40	6.40%

Sources: * Based on unrebated rents as published in Housing and Construction Statistics.

** Based on gross earnings of full-time men (21 years and over) engaged in all occupations for all industries and services (excluding those whose pay was affected by absence) as published in the Department of Employment Gazette - Great Britain.

DOE Department of the Environment
2 Marsham Street
London SW1P 3EB
Telephone 01-212 3434

Press Notice 61 21 February 1980

HOUSING PUBLIC EXPENDITURE

In a Parliamentary statement today on housing public expenditure Michael Heseltine, Secretary of State for the Environment, said:-

"With permission, Mr Speaker, I will make a statement on housing public expenditure.

"The background to the decision I am announcing today is well known to the House.

"This Government faces the task of setting public expenditure at levels which the nation can afford.

"If we fail, the problems with which we are all familiar will continue - a public sector consuming a disproportionate share of the nation's resources, high interest rates and declining investment in the private sector.

"The harmful effects of the policies of recent years can be clearly seen in housing. By 1979 for the average new council house, taxpayers and ratepayers were contributing towards a subsidy of £30 per week. Council rents had fallen to an average of 6.4 per cent of income - despite a commitment in the last Government's Green Paper to increase rents in line with earnings. The net result of Labour's housing policy was to make new building for local authorities so expensive that in every year after 1976 local authorities of both political complexions responded by reducing their programmes.

"And the rent policies of the last Government have been a major factor in the inability of local authorities adequately to meet housing costs, finance investment and maintain their stock.

"Against this background, we have reassessed our housing policy. The Government's expenditure plans for 1980/81 and later years will be published in a White Paper next month but the local authorities, the Housing Corporation and the New Towns need to settle their programmes now.

cont'd/........

"For these reasons, this year, I am, exceptionally, making an oral statement.

"Our reassessment of objectives must recognise the significant general improvement of housing conditions in the last 30 years. Home ownership has grown from 31 per cent to 55 per cent over that period, and we recognise the desire of most people to own their own home. In national terms, the supply of housing and demand are in better balance.

"Needs and problems have become increasingly specific and local. The emphasis of public sector housing policy now must be to meet particular needs, such as those of the elderly and the handicapped. We have to concentrate on modernising, improving and making better use of the existing stock, rather than on the general provision of new houses. Ane we must encourage home ownership and the private rented sector.

"We need therefore to adopt new priorities - priorities which are reflected in the Housing Bill and which are critical given the economic background.

"I come now to the programme for 1980/81. The housing investment programmes for local authorities in 1980/81 will be allocated £2,199 million at expected outturn prices. The Housing Corporation will be allocated £420 million for the work of housing associations. And the New Towns building for rent programme will be £151 million. In New Town development, the proportion of owner occupation is below the national average, yet the demand is high. In future, growth must be based increasingly on the private sector and homes for sale.

"Taken together, these three housing capital allocations for 1980/81 will in real terms, at 1979 Survey Prices, be about £540 million or 21 per cent lower than the forecast outturn for 1979/80.

"These figures are for England. My Scottish and Welsh colleagues are making separate announcements.

cont'd/........

"In the new circumstances, it is even more important that local authorities should use available resources in the most effective way to meet local needs.

"In order to encourage this, the housing allocation to each authority from April 1980 will be in a single block and they will have much greater ability to decide their own priorities. They will also have the new opportunities opened up by the Housing Bill.

"There is a range of ways to promote low cost home ownership - selling council houses; securing land release for builders; encouraging starter homes; low-cost building for sale, especially for tenants and those on the waiting lists; schemes for improving and selling houses such as acquisition, improvement and sale (AIMS) and homesteading; promoting shared ownership; and by helping priority home buyers with mortgages. In these ways people can be helped to become owners.

"Full details are in the allocation letter to authorities, copies of which are in the Vote Office.

"The priorities now must be value for money and concentration, under the more flexible arrangement, on the problem areas. In the private sector, the introduction of shortholds and the other provisions in the Housing Bill will improve the availability of rented accommodation without additional public expenditure.

"Exchequer subsidy to local authorities for housing last year amounted to £1,148 million in 1979 Survey Prices. The rent levels of recent years have not only prejudiced the abilities of local authorities to maintain adequately their housing stock but have contributed to the enormous burden of public expenditure.

cont'd/........

"I have therefore concluded that it would be right to issue a supplementary rent increase guideline of 60p a week on average over the second half of 1980/81.

"Mr Speaker, I have announced today a reappraisal which reflects our assessment of national economic and housing priorities. This is a necessary response to a situation in which the scale of housing subsidies increased under the previous Government to levels far beyond those the nation could afford. From now on we shall concentrate resources where they are needed; and I have today set out realistically what the nation can afford."

Telephone Nos: 01-212 3490/1/2/3/4/5/6

Night Calls: (6.30 pm to 8.00 am)
Weekends and holidays: 01-212 7071

1

Prime Minister

This all seems reasonable - including the minor drafting amendments.

Yes Content, subject to colleagues' views?

(The duty clerk will bring up the bulky White Paper draft if you wish to see it again).

TL 1/3

CHIEF SECRETARY TO THE TREASURY

PRIME MINISTER

PUBLIC EXPENDITURE WHITE PAPER

I circulated a draft of the White Paper with my minute of 26 February. I said in that minute that I should want to review two matters - the general allowance for shortfall in the light of our decision on cash limits on 28 February, and the provision for the contingency reserve. Some other minor amendments are required, particularly to take account of the decision to publish the White Paper with the Budget. (To clear up one point left open in my minute of 26 February, the White Paper will be published on Budget Day itself, 26 March, rather than the day after.)

Shortfall

As I said in my minute of 26 February, the shortfall allowance of £750 million (at 1979 Survey Prices) for 1980-81 did not take account of the effect of cash limits on the volume of expenditure. For the purposes of the White Paper a cash limits squeeze appears as shortfall in volume terms. We have now confirmed the cash limits decisions, and the White Paper is likely to be published alongside a Budget forecast showing a slightly higher forecast of inflation than in the forecast we published last November. I propose therefore to increase the shortfall allowance in 1980-81 to £1000 million (at 1979 Survey Prices).

We should explain in the White Paper that there are two new factors, roughly offsetting each other: the greater stringency in programmes, likely to reduce shortfall, and the effect of cash limits, which will be to increase it in volume terms.

We cannot and should not attempt precise prediction here: £1000 million has the further merit of being a good round number.

Contingency reserve

If we were simply to increase the allowance for shortfall, this would reduce pro tanto the total expenditure we are envisaging. In view of the uncertainties facing us, notably as to the nationalised industries, it will be wise, instead of reducing the total further, to increase the contingency reserve for next year from £750 million to £1000 million. It does not follow that we will spend it all. We should strive not to do so. The move would be entirely precautionary. It does not imply any relaxation in our rigorous attitude to proposals for additional expenditure.

I also propose one consequential adjustment to 1981-82. At present the Contingency Reserve for 1981-82 is £1000 million, the same figure as now proposed for 1980-81. It rises to £1500 million in 1982-83 and £2000 million in 1983-84. To provide a plausible progression of the figures, I propose that we increase the contingency reserve in 1981-82 to £1200 million.

Other Points

I attach a list of some drafting amendments which, unless I hear to the contrary by 7 March, I propose to make to the text of the White Paper to cover the points above and some other minor drafting amendments, partly required by the decision to publish the White Paper with the Budget.

I shall be minuting you separately about the latest position on the EFLs for nationalised industries. The net effect, mainly as a result of BSC's involuntary shortfall this year (due to its inability to pay its 1979-80 bills), is likely to be an increase in public expenditure of about £100 million at Survey prices in 1980-81.

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

WJB

JOHN BIFFEN

4 March 1980

Amendments proposed to the White Paper

Paragraph 2: first sentence:- Redraft: "The Government intend to reduce public expenditure progressively in volume terms over the next four years". A similar amendment would be made in the first of the main points on the facing page.

Paragraph 5: Redraft: "Since the White Paper is being published this year simultaneously with the Financial Statement and Budget Report, no separate statement of the economic background to the public expenditure plans is included in this White Paper."

Paragraph 12, first sentence: Redraft: "The main changes in 1980-81 since Cmnd. 7746 are in housing, debt interest (see paragraph 30) and the contingency reserve (see paragraph 28)".

Paragraph 26: Redraft: "The Government intend to hold the cash limits determined at the start of the financial year. Unless costs are contained within the provision in the 1980-81 cash limits for cost increases, these limits will require a reduction in the planned volume of expenditure in that year. In any case, the cash limits provide a further stimulus to greater efficiency, in line with the Government's objectives, in the use of resources. Account has been taken of the possible effect of the cash limits in 1980-81 in the general allowance for shortfall (see paragraph 31)."

Paragraph 28: Add at the end: "In view of the stringency of the plans for 1980-81 as now proposed and of the uncertainties of the economic outlook, the Government have decided to increase the 1980-81 contingency reserve from £750 million to £1000 million at 1979 Survey prices. This is, however, precautionary: the Government will aim to avoid or minimise any additional expenditures from the reserve and to keep as much as possible of the reserve unspent.

Paragraph 31: Redraft: "31. One effect of the stringency of the plans is that it is expected that shortfall in the forward years covered by the White Paper will be lower than in recent years. In 1980-81, the further cuts since the Government's November White Paper will tend to reduce shortfall from the allowance in that White Paper, but this effect is offset by the cash limits which are likely to exert some downward pressure on the volume of expenditure. After taking account of these two conflicting influences, the allowance for shortfall in 1980-81 is put at £1000 million, as in the November White Paper. The allowance for shortfall in 1981-82 to 1983-84 is tentatively put at about 1 per cent of expenditure, i.e. £¾ billion. Shortfall in 1979-80 seems also likely to be at about that level, though much of it is now reflected in the revised estimates of expenditure - see paragraph 50".

Agree Chief Secretary's proposals Prime Minister
MT.

Ref: A01584

Would you like to agree the Chief Secretary's proposals subject to Robert Armstrong's points at x and y below?

PRIME MINISTER

NO SPECIAL studies - they are PAR under another name
MT

Public Expenditure Survey 1980

Flag A

The Chief Secretary's minute of 28th February to you reports recommendations from a group of officials on which the Cabinet Office and the CPRS have been represented.

TL
4/3

2. It is common ground among Ministers and officials that the present PESC machinery is unduly cumbersome, its reports too long and complicated, and that some streamlining is needed.

3. In general, I think the main proposals in the report, summarised in paragraph 4, are sensible and should be adopted. There are no points on which I think other Ministers are likely to raise objections. That leaves four questions.

4. Should the 'long' report go to Ministers in future? Paragraph 6 suggests it should. I doubt if many of them will read it, but it is useful for them to know that it is available for reference.

5. Should local authority expenditure be regarded as a 'block' or should there be separate functional programmes? While you continue to have a separate Minister of Transport and Secretary of State for Education, I think the functional blocks are unavoidable. This does not correspond very closely with the way in which expenditure is controlled, as you have found this year. I think the recommendation in paragraph 7 is correct.

6. The next problem is 'options for reductions' (paragraph 8). Departments are understandably reluctant to list the scope for possible further reductions. When asked, they tend to come up with terrifying lists of the most damaging possible cuts. Nevertheless, I am sure that it continues to be a useful discipline. The Chief Secretary proposes that, for this year only, the 'option cuts' should only be small ones. I think you could accept this.

No

7. Finally, there is the question of 'special studies'. You agreed to dismantle the old PAR system. I believe this was right. PAR was altogether too slow and cumbersome. But equally, I think it is wrong that Ministers should be asked to take far-reaching policy decisions, involving major political

They don't. They ought to know their departments' own work- [illegible] going on. MT.

issues, on the basis of two or three lines in the Chancellor's annual Public Expenditure paper. This may be inevitable at the start of a new Administration, or in the face of an urgent 'cuts' exercise. But in general the ground should be prepared better in advance. When we discussed this with the Treasury, we thought the best way was to identify a few topics each year which could be made the subject of 'special studies' which would be ready at the time Ministers considered the survey each summer. Sometimes these would deal with loose ends left over from the previous survey. Sometimes there would be new problems identified in the course of the year. Because of the departmental resistance to any such investigation, we thought such studies would need a degree of collective authority. But they will be small-scale quick operations, done with existing resources, and with the minimum of heavy committee work.

No

8. The Chief Secretary does not propose (paragraphs 9 and 10) to introduce this system this year. Nor does he propose that, when it operates, it needs any Cabinet discussion in advance. I am not sure he is right. I think there is at least one topic left over from the last round which needs some careful preparation before this summer: the level of teaching and non-teaching staff in primary and secondary education. You will remember that you are not wholly convinced by the arguments put foward by the Secretary of State for Education this year. I think a 'special study' on this subject, if you chose to ask for one, would be useful.

No. it won't help.
X

9. Similarly, when the system is working, I am sure it would be useful to have collective Cabinet endorsement (possibly in correspondence rather than at a meeting) for the programme of two or three 'special studies'. I do not think that the selection of these topics should be left to officials. Otherwise, the defence mechanisms will operate too easily. I think you should ask that the CPRS should bring a list of potential topics each year, following the end of the 1980 survey, in preparation for the 1981 survey.

No
Y

10. With those two reservations, I commend the proposals in the Chief Secretary's minute to you.

11. I have discussed this note with Sir Kenneth Berrill, who agrees.

RA

(Robert Armstrong)

4th March 1980

Prime Minister

2

2

PL 5/3

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Great George Street
LONDON
SW1

4 March 1980

Dear Chief Secretary,

AT.

PUBLIC EXPENDITURE WHITE PAPER

In your minute of 26 February to the Prime Minister you invited comments by 3 March upon the proposed text of the White Paper, I apologise for failing to meet the deadline.

I am content with Part 1 and with my Chapters which reflect amendments agreed with the Chancellor. However I should perhaps draw attention to paragraph 10 in Chapter 2-11 where a reference is made to further measures to recover road accident costs. A number of colleagues have expressed reservations about including this but in my view it is necessary. The net expenditure figures set out in paragraph 10 as 'new plans' show a substantial reduction over inherited plans. A very large element in that reduction is the saving which Cabinet colleagues asked me to seek by generating additional income under the Road Traffic Act. Without some indication of where the additional income is to come from (and no-one will expect some £100 million from foreign visitors, the only other example given) we shall raise again speculation about hotel charges for hospital patients or other new charges for medical treatment.

The reference does not of course commit us to any particular scheme. If after discussion in H committee, Cabinet concluded that further measures to recover road accident costs should not be undertaken, then that could be said: the financial consequences would then need to be reviewed. But for the present I am sure that the White Paper must give an indication of the areas we are studying.

I am copying this to the Prime Minister and other members of the Cabinet, to Norman Fowler and to Sir Robert Armstrong.

Yours sincerely

Don Brereton
Private Secretary
(Approved by the SofS

SECRET

10 DOWNING STREET

From the Private Secretary

3 March, 1980.

Dear Martin.

Public Expenditure White Paper

The Prime Minister has read the Chief Secretary's minute of 26 February with which he enclosed the draft of the Public Expenditure White Paper.

The Prime Minister has asked me to say that she is content with the draft subject to one important point. This is that she does not want there to be any figures in the White Paper for our net contribution to the EEC. She believes that the inclusion of figures based on the existing budgetary arrangements will be politically and tactically damaging. She suggests that there should be an asterisk against the EEC contribution line to the effect that our contribution is currently subject to renegotiation, and it is not therefore possible to provide forecasts of what it is likely to be over the PESC period.

I am sending copies of this letter to the Private Secretaries to Members of the Cabinet including the Minister of Transport, and to David Wright (Cabinet Office).

Yours ever

Tim Lankester.

Martin A. Hall, Esq., M.V.O.,
HM Treasury.

SECRET

CONFIDENTIAL

BK

Fue

10 DOWNING STREET

From the Private Secretary

3 March 1980

Copy on Defence P+3
Defence Budget + Statement on
Defence Estimates

Public Expenditure White Paper

The Chancellor minuted the Prime Minister on 26 February to the effect that he was now proposing to publish the Public Expenditure White Paper either on Budget Day or the day after the Budget. The Chancellor has since spoken to the Prime Minister about this, and has told her that he intends to publish the White Paper on Budget Day itself. The Prime Minister is quite content.

The Prime Minister has also read Brian Norbury's letter of 26 February, and agrees that the Statement on the Defence Estimates should be published in the week beginning 31 March; and she is content for the Secretary of State for Defence to announce this by means of an early, arranged PQ. She has no objection to the proposal that the Defence debate should take place in the week beginning 14 April; she assumes that this will be settled between the Secretary of State for Defence and the Chancellor of the Duchy.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet, Murdo Maclean (Chief Whip's Office), Charles Cumming-Bruce (House of Lords) and David Wright (Cabinet Office).

TPL

Martin Hall, Esq.,
HM Treasury

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nicholas Edwards MP
Secretary of State
Welsh Office
Gwydyr House
Whitehall
London SW1A 2ER

3 March 1980

Dear Nick,

WELSH OFFICE PES AND VOTE STRUCTURE

will request if required

You wrote to me on 13 February, seeking my agreement to the proposal that a new Wales PES programme and matching Class of Estimates should be established to cover all expenditure within your responsibility. You also proposed that expenditure within the programme, with the exception of agriculture, fisheries, food and forestry (AFFF) and industry energy, trade and employment (IETE) (save for tourism) should be treated as a "block" and that your Votes and cash limits should be re-aligned in order to provide you with more flexibility for financial management.

I am happy to agree these proposals on the terms agreed between officials and between us in correspondence. These include agreement that there will be no change in the arrangements for determining and managing expenditure on AFFF and IETE and that, until Ministers collectively decide otherwise, the new programme will operate with the existing baseline and the existing (population) formula for deciding changes at the margin of the "block".

I would be content for the changes to be announced next month by a Written Answer to a Parliamentary Question, as you suggest, and for officials to discuss the text.

I am sending a copy of my letter the recipients of yours, to other Cabinet colleagues, and to Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

3 March 1980

Dear George,

SCOTTISH OFFICE PES AND VOTE STRUCTURE

Will request if required

Following Nicholas Edwards' letter of 13 February proposing a new Wales PES programme you wrote to me on 22 February seeking my agreement to the parallel proposal that a new Scotland PES programme and matching Class of Estimates should be established to cover all expenditure within your responsibility. You also proposed that all expenditure within the programme with the exception of agriculture, fisheries, food and forestry (AFFF), industry, energy, trade and employment (IETE) (save for tourism) and other public services should be treated as a "block" and that your Votes and cash limits should be re-aligned in order to provide you with more flexibility for financial management.

I am happy to agree to the proposals on the terms worked out between officials and summarised in your letter, including no change in the arrangements for determining and managing expenditure on AFFF and IETE.

You referred to paragraph 8 of the memorandum enclosed with Nicholas Edwards' letter and the circumstances in which you could make a claim on the Contingency Reserve. I do not think there is any difference of view between us. We do not wish to suggest that different criteria should apply to Scotland (or to Wales for that matter) with respect to claims on the Contingency Reserve. We expect, however, that the variety of expenditure in the block, the greater scope for "swings and roundabouts" than in a purely functional programme and your discretion to transfer funds within the block will combine to make it less likely that the criteria will apply.

I assume that like Nicholas you will wish to announce the changes by Written Answer and that your officials will be in touch with mine to settle its terms.

I am sending a copy of this letter to the recipients of yours, to other Cabinet colleagues and to Sir Robert Armstrong.

John Biffen

JOHN BIFFEN

PART 8 ends:-

Ch/Ex to PM 29/2/80

PART 9 begins:-

CST to S/S Scot 3/3/80