Part 15

~~SECRET~~

MT

Confidential filing

Public Expenditure and Cash Limits

Economic Policy

Pt 1: May 79
Pt 15: Oct 81

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~12.10.81~~							
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PART 15 ends:-

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PART 16 begins:-

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TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C(81) 50	14/10/81
C(81) 51	14/10/81
E(81) 101	16/10/81
CC(81) 33rd Conclusions, Item 5	20/10/81
Limited Circulation Annexe CC(81) 33rd Conclusions	
Minute 5	20/10/81
E(PSP)(81) 25	23/10/81

The documents listed above, which were enclosed on this file, have 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

Signed OWayland Date 15 March 2011

PREM Records Team

Prime Minister

(4)

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

MLS 21/10

From the Secretary of State

CONFIDENTIAL

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

20 October 1981

Dear Leon,

BRITISH AIRWAYS' EXTERNAL FINANCING LIMIT 1981/82

will request if required

In my letter to you of 12 October about the investment and financing review I undertook to write to you separately about British Airways' current EFL.

As you know, British Airways' operating results this year have continued to be very disappointing. Their airline revenues remain badly hit by the recession, aggravated by the air traffic controllers' dispute earlier this year, with the result that they are forecasting an operating loss of about £45m this year, compared with a budgeted profit of £38m. You may remember that in July we feared they might breach their EFL by nearly £100m.

British Airways have responded to this by a series of far-reaching measures (announced last month) designed primarily to reduce their costs. The central feature is a planned reduction in manpower of just over 8,000 between now and the end of June 1982; other important measures are a pay freeze between January (the normal start of their pay year) and October 1982 (followed by an increase of only 5%) and withdrawals from unprofitable routes. These measures were explained to E Committee when it discussed the IFR on 23 September; and were welcomed.

I fully support these measures, which show considerable courage and the determination at last to get to grips with the airline's underlying problems. The manpower reductions in particular are vital if BA are to get back on course. The financial benefits are clear: Sir John King estimates the annual savings from these alone as approaching £120m.

On the other hand the measures have their cost; BA expect the severance costs to amount to £75m this year and £44m next year, if the target reductions are to be reached. The other remedial measures which BA are taking are aimed at offsetting their trading losses; but this means they may have no additional financial resources available this year to fund the redundancies. Sir John King proposed to me that one solution might be a temporary borrowing facility outside EFLs, which British Airways would guarantee to repay within a year, by which time the savings from the redundancies should have paid off. However, since the facility Sir John has in mind could not reasonably be regarded as falling outside the EFL, I think that we could only meet his request by a straight adjustment to this year's figure.

However, the BA Board attach great importance to their not appearing to have dealt with their problems simply by breaching their EFL: they argue - I think with much justification - that if it appeared that the Government was allowing them an EFL increase simply to compensate them for their trading losses their bargaining position with the unions over redundancies and pay would be greatly weakened. I think you would agree that we should do all we can to avoid that, not least because of the precedent it could create elsewhere.

I suggest the best way round this would be for us to accept that the increase should be regarded as an addition to this year's EFL, but that it would not be announced until as late into the financial year as is reasonably possible, by which time staff acquiescence should have been more nearly achieved. In addition I would make it clear to Sir John King that the increased borrowing was to be used for no other purpose than the severance payments and was to be repaid in full during 1982/83. We would also make this clear in the eventual announcement (the timing and wording of which I would want to agree with Sir John).

Sir John King has asked me for permission to borrow up to the whole of the £75m severance payments bill over and above his EFL for this year of £101m. However, BA's original budget for 1981/82 included £22m for severance payments. In any case Sir John will only need the full £75m if some of his targetted asset disposals prove impossible to achieve until next year. Admittedly he has suffered a setback in the recent falling through of the sale of the Victoria Air Terminal. But BA still have several months of this financial year left in which to pursue these sales; and to give them every incentive to press on vigorously - and to avoid our having to announce early in 1982 a larger than necessary breach of BA's EFL - I propose to tell Sir John now that I can agree to his borrowing an extra £53m (ie £75m - £22m) this year for severance payments on the terms proposed; I shall go on to say that

From the Secretary of State

CONFIDENTIAL

I hope that by pressing ahead with asset sales he will be able to keep well within his new aggregate EFL (£53m severance plus £101m original) of £154m; and I will review the position with him in January, before I make my announcement.

British Airways would propose to borrow the extra money, in the usual way, on the commercial market, relying on a Treasury guarantee to minimise interest costs. The borrowing will be short-term (364 days) and they would prefer to take up at least part of it in sterling.

I hope you can therefore agree to an increase of £53m in BA's EFL this year to be presented in the way I have described. I should be grateful for a reply as soon as possible.

I am copying this letter to the Prime Minister, to Robin Ibbs and to Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

CONFIDENTIAL

CONFIDENTIAL

cc Mr. Kerr
Mr. Hoskyns
Mr. Duguid
Mr. Vereker

(2)

Prime Minister

Much on the lines of your discussion earlier this evening
MCS 20/10

MR. SCHOLAR

CABINET MEETING ON PUBLIC EXPENDITURE

Among the many misapprehensions that appeared today, one seems to me very important, and it was not identified and rebutted. This is the quite correct belief that the outcome of the PSBR is subject to very large errors does not imply that one should not aim for a precise PSBR.

I believe it is of the utmost importance to have a precise target for PSBR in mind. The outcome being the difference between two very large numbers is bound to have large errors in it. But the purpose of having a precise target for PSBR is not to get a precise outcome, but first to create the appropriate policies, and secondly to indicate those policies to the markets of the world. It is the policies that matter. The outcome will be affected by all sorts of events over which we can have very little or no control.

To emphasise this point, you might observe that we know the average error of the outcome compared with the target PSBR is about four billion. But this does not mean that it does not matter whether a target PSBR is nine billion or 13 billion. Clearly it matters a great deal. It is like shooting at a target. You aim for the bulls-eye in the hope that you will get somewhere near the centre of the target. If, however, you wave your gun around vaguely around the periphery of the target, it is likely that you will be nowhere near hitting it.

20 October 1981

ALAN WALTERS

CONFIDENTIAL

Mr Duguid
Mr Vereker
Mr Walters

Prime Minister (4)

MCS 21/10

01 211 6402

MS

Rt Hon Leon Brittan QC MP
Chief Secretary to Treasury
HM Treasury
Parliament St
London SW1P 3AG

19 October 1981

Dear Chief Secretary

PUBLIC EXPENDITURE - PROPOSED PROVISION FOR DEPARTMENT OF ENERGY

Thank you for your letter of 13 October, with the "make-up sheet" for the Department of Energy, and your subsequent letter of 16 October.

In the Public Expenditure Survey, the lower and upper levels of the option reductions amounted to £72m and £110m respectively over the three Survey years together. The reductions when I offered matched the lower level. You are now proposing reductions amounting to £120m over the three years which is more than even the higher level.

The lion's share of the Department's expenditure (excluding that on coal which is considered as part of nationalised industry financing) is on nuclear R & D: 64 per cent over the three Survey years. Your proposed provision for expenditure by the Department therefore implies extremely large reductions in nuclear R & D. This would inevitably mean very large cuts in the programme on the fast reactor.

As I said in my letter of 9 October, the reductions that I then offered in nuclear R & D were in my view the maximum that could be made without seriously jeopardising our current R & D effort and thus effectively pre-empting a policy decision on international collaboration on the fast reactor.

I think I must therefore accept your offer of further bilateral discussion and reserve the right to put the question of fast reactor expenditure to E Committee in view of the Committee's decision (E(80)46th meeting) that, pending further decisions on international collaboration, funding of present R & D programmes should continue. Perhaps we could discuss the electricity EFL at the same bilateral.

I am copying this letter to the Prime Minister and other Cabinet colleagues.

Yours sincerely

David Lumley

pp NIGEL LAWSON
(approved by the Secretary of State
and signed in his absence)

Pl copy to Govt Mach ~~Future of CSD~~ file

Econ Pol

PRIME MINISTER

Meeting with the Chancellor tomorrow, 20 October

You are seeing the Chancellor twice tomorrow. First, at 9 o'clock, is purely to cover the public expenditure discussions in Cabinet later on. At the 4 o'clock meeting I understand that the Chancellor will wish again briefly to consider how best to handle subsequent discussions on public expenditure in the light of progress at tomorrow's Cabinet. He will also want to make some general points about Cancun. (He was unable to get to today's briefing meeting because of his meeting in Luxembourg.) He is also rather worried about the effect on markets of leaks of the public expenditure discussions and I would expect him to raise this with you. The future of the CSD, in particular the question of who would be the Minister in charge of the enlarged Treasury team, is also on his agenda.

MLS

19 October 1981

Prime Minister
MJS 19/10

SECRET

19 October 1981 3A
Policy Unit

PRIME MINISTER

CABINET 20 OCTOBER: PUBLIC SPENDING

We have discussed the paper with Alan and we agree with Geoffrey's assessment that the Government should aim for total public spending next year of £113.5 billion, and a PSBR of £9.2 billion or 3¼% of GDP. Any substantial increase of public spending over £113.5 billion, even if matched by increased tax rates, would have serious consequences for our strategy. The economic revival, incentives, and the counter-inflationary strategy depend on keeping public spending as low as possible, and certainly no higher than the amount the Treasury propose.

But in proposing £113.5 billion, Geoffrey has set himself two major problems, which ought in our view to intensify the search for other cuts:

(1) A PSBR of £9.2 billion follows from expenditure of £113.5 billion only if there are no real tax changes. That is, there is no room for any reduction in the National Insurance surcharge - and a 1% reduction, costing perhaps £1 billion, is widely expected - and no room for income tax reductions in the next Budget (although the Treasury are assuming indexation of tax thresholds). If we are to make any reduction in the tax burden over the next 12 months, we need therefore to find other spending cuts.

(2) The £113.5 billion target is achievable only if the cuts specified in departmental spending programmes are all agreed. We think it rather unlikely that all colleagues will be prepared to swallow their medicine. In addition, there are two other very optimistic assumptions the Treasury is making: first, that a "volume squeeze" will make up all the difference between actual inflation next year and the rather lower figures (4% for pay, 9% for non-pay) which Cabinet agreed in September; second, that national industries' EFLs can be cut by a further £500m (sponsor Ministers have, of course, already crawled all over the nationalised industry assumptions and written them down substantially). All in all, we think, even if Cabinet agrees

Prime Minister
You will recall that Mr Ibbs' note (attached) argued that further reductions in EFL's were obtainable.
MCS 19/10

SECRET

all but £1 billion of the proposed cuts, the £113.5 billion figure may be exceeded by over £2 billion.

The logic of this seems to us to be clear. As Geoffrey said in his personal note to you covering the drafts of these papers, the only scope for really substantial further savings lies in either the reopening of the decisions on defence, or in acting on the pledged social security benefits. In our view, the public spending picture painted in the Treasury papers is so gloomy that we can only keep up the momentum of the economic strategy, at the centre of which lie progressive reductions in public spending and the PSBR, if we are prepared to grasp the nettles of defence spending and state pensions.

<u>JOHN HOSKYNS</u>

(2)

PRIME MINISTER

I have checked the public expenditure figures you referred to during the talk with the Chief Secretary this afternoon. You are right that total public expenditure as a share of GDP was higher, on the estimated out-turn for 1981/2, than in any year back to 1975/6, i.e. just before the approach to the IMF. The figures are as follows:-

1975/6	46 per cent
1976/7	44 per cent
1977/8	40¼ per cent
1978/9	41 per cent
1979/80	40½ per cent
1980/1	43¾ per cent
1981/2	(estimate 45-46 per cent)

A similar point may be made about the non-North Sea tax burden. The figures for that are as follows:-

1975/6	36½ per cent
1976/7	36½ per cent
1977/8	35½ per cent
1978/9	35 per cent
1979/80	36 per cent
1980/1	37¾ per cent
1981/2	40-41 per cent

Here the point is not so much that we are re-approaching the pre-IMF level, but the current level is high in relation to the level at that time.

MCS

19 October 1981

~~EC~~ ~~J4~~ 3

Prime Minister

MCS 19/10

Ref. A05752

PRIME MINISTER

Economic Policy and Public Expenditure

C(81) 50 and 51

I believe that you will be discussing with the Chancellor of the Exchequer tomorrow morning the handling of the Cabinet discussion, which has of course been much heralded in the media.

2. Part of the background to this is the political situation, following last week's Party Conference. Another part of the background is the situation in the financial markets. These are reported to be sensitive and nervous. Thay have to face trade figures and money supply figures* this week - and the results of the Croydon by-election. It would be helpful to avoid reports coming out suggesting disagreement and disarray in the Cabinet.

and *. unemployment figures

No - there are no new money supply figures out this week. MCS 19/10

3. I gather the Chancellor of the Exchequer may be thinking that against this background it would be better not to drive the Cabinet too hard to reach conclusions, either on particular public expenditure items - it is in any case too soon for that - but even on totals. He will want to try to avoid a situation in which it could subsequently be said that he had tried to get agreement on particular overall figures but had failed to do so.

4. If you accept this - and in the current situation I can see the force of it - it has implications both for the handling of this meeting and for the future timetable.

5. On the handling, you would need to start with an introduction to the effect that this meeting was an opportunity for a general and "second reading" type of discussion, with a view to identifying the general basis on which the public expenditure exercise would go forward but not to deciding upon any specific figures, even totals. At the end of the meeting you would want to say that, particularly in the present state of financial markets, it is very important to avoid any suggestion that there had been "confrontation" at this meeting, that you would be instructing Mr Ingham to give the lobby a low key briefing, and that other Ministers should be at pains preferably not to brief separately or at least to avoid any suggestion of disagreements or confrontations.

6. On the future timetable for the public expenditure exercise, there is bound to be some slippage if there are no specific conclusions at the end of tomorrow's meeting. It will not then be possible to start discussions of particular programmes until there has been another round at Cabinet on Thursday 29 October. I believe that we can accept some slippage, say by a week, provided that decisions on local authority current expenditure totals and on Rate Support Grant percentages are taken on 5 November. If this was the way that things went tomorrow, I would submit revised proposals on timetable for you to consider on your return from Mexico.

RtA

ROBERT ARMSTRONG

19 October 1981

2

Ref No. A05732

PRIME MINISTER

Economic Policy and Public Expenditure

C(81) 50 and 51

BACKGORUND

When the Cabinet discussed the economic strategy on 23 July they agreed that, before reaching a view on the balance to be struck between the Government's taxation and public expenditure objectives, they would need a much fuller evaluation of the options than Treasury Ministers had then offered. The Chief Secretary's paper setting out the Treasury's public expenditure proposals (C(81) 51) is therefore introduced by a paper by the Chancellor of the Exchequer (C(81) 50) which discusses the broad policy options open to the Government on the level of the PSBR, and the balance between tax and expenditure, and the effect which different options would be likely to have on inflation and unemployment.

PSBR £9 bin.

2. The Chancellor's main proposals are: (a) that the Government should continue to aim for a PSBR in 1982/83 no greater than that envisaged in this year's Budget (£9bn); (b) that public expenditure should be limited to levels which will avoid a real increase in the tax burden in the next Budget; (c) that unless public expenditure totals are reduced below those recommended there will be no scope for real tax reductions in the next Budget or a reduction in the National Insurance Surcharge and (d) that, while the recommended totals should leave some scope for tax reduction in 1983 and 1984, the Government should not count on this yet.

The proposed public expenditure totals are:

	£ billion	
	1982-83	1983-84
1981 White Paper (revalued and adjusted for Gas Levy etc)	109.9	113.9
Total bids	117.1	124.5
Proposed	113.5	118.1

For 1984/85 there is a figure of £124.8 bn which results from carrying through to that year the Chief Secretary's proposals for earlier years. However he considers that this total is too high and will have to be looked at again by officials in the interdepartmental Public Expenditure Survey Committee before he is ready to put proposals to the Cabinet; he would hope to do this in late November, so that a figure can be included in the Public Expenditure White Paper.

3. The Chief Secretary has arrived at these totals in the following way:

(a) For local authority expenditure he has assumed, pending a final decision, that the maximum feasible volume cut in 1982-83 is 3 per cent, followed by further volume cuts of 2 per cent in each of the succeeding years, together with some allowance for overspend; this involves increases of £1.4 bn in each of 1982/83 and 1982/84.

(b) For nationalised industry external financing limits he has proposed a figure which implies an excess of £1.18 bn over the 1981 White Paper revalued, compared with the original excess bid of £2.5 bn.

(c) For demand-led programmes which are affected by the level of unemployment, higher interest rates and higher prices there is an additional "estimating allowance" of £1.6 bn in 1982/83 and £3.3 bn in 1983/84.

(d) For departmental programmes he has proposed reductions (as against bids) of £3.6 bn in 1982/83 and £6.3 bn in 1983/84.

4. The details for departments are set out in Annex A to C(81) 51. Apart from defence, universities and prisons, on which policy decisions have already been taken, the proposals are for programmes to be cut by at least 2 per cent compared with the White Paper revalued. This includes a 2 per cent cut in all staff and general administrative expenditure, and is additional to the 1 per cent volume squeeze which will result from the worsening in the prospects for

inflation since the factor of 9 per cent was fixed for non-pay elements in September. For many departments their savings towards the 630,000 civil service manpower target had not been settled at the time of the last White Paper, and their savings towards the target will therefore count for the purposes of the 2 per cent cut in staff expenditure now being sought. Any detailed problems for departments can be fully resolved when the Estimates are settled, and a discussion at this meeting should be avoided.

5. For many Ministers the proposed reductions will be very difficult. The Chancellor of the Exchequer sent to you on 9 October (but not to other Ministers) two lists - List A showing the difficult cuts proposed and List B showing those difficult cuts which would be necessary if further reductions were to be required. For ease of reference these two lists are attached. The following points should be noted in particular:

(a) There is a major dispute over defence expenditure concerning the extent to which allowance should be made for price changes this year and in future years; the sum involved amounts to around £0.5 bn in 1982/83 and around £0.7 bn in 1983/84.

(b) There are some contentious proposals for the DHSS, notably the 5 per cent abatement (to be mentioned orally) of "unpledged" benefits (sums involved: £165m in 1982/83 and £490m in 1983/84) and new health charges for road accidents, hospital beds and exempt groups (£95m in 1982/83 and £205m in 1983/84).

(c) The housing proposals will involve substantial council house rent increases which will have some effect on the RPI (sums involved £50m in each year).

(d) A substantial increase is proposed in parental contributions to student awards (sums involved £40m in 1982/83 and £100m in 1983/84).

(e) The uncommitted road programme is to be cut by half in 1982/83 and substantially thereafter (£50m in 1982/83 and £75m in 1983/84).

(f) There are some potential legal problems over refusing Regional Development Grant for Sullom Voe and Flotta (£122m in 1982/83).

(g) The Foreign and Commonwealth Secretary is likely to see difficulty about the 3 per cent real cut in overseas aid (£30m in each year).

(h) The Minister of Agriculture will be seriously concerned about the proposed cuts in capital grants for farmers (£30m in 1982/83 and £50m in 1983/84).

6. Several of the proposals will involve legislation in the 1981/82 session. It is already clear that primary legislation would be required for the new health charges and for making school leavers ineligible for supplementary benefit, and affirmative resolution orders would be required for some proposals relating to agriculture, regional development grants and Home Office fees; in addition legislation may be required to increase National Insurance contributions so as to balance the National Insurance Fund.

MAIN ISSUES

Outlook for the economy

7. Ministers are likely to be keenly interested in the Chancellor's assessment of the prospects for unemployment and inflation (paras 10-12 of his paper). On unemployment he expects the rise to be slowed in 1982 but not to be reversed. On inflation he sees a lower rate before the end of 1982 but expects progress to be less rapid than assumed in September. He may be willing to offer some quantitative estimates in discussion. Although he sees better prospects for 1983 and beyond, his assessment for 1982 will prompt some Ministers to probe carefully to see whether there is any action which could be taken to improve employment prospects in the short term, particularly bearing in mind the political points which the Chancellor has made in para 3 of his paper.

Level of the PSBR

8. The difficult public expenditure discussions summarised in para 5 above, and the Chancellor's view that no real tax reductions are likely in 1982, follow from his proposal on the PSBR. He argues that the Government should aim for a figure in 1982/83 no greater than the £9 bn announced at the time of this year's Budget. This would assume a reduction in the PSBR as a percentage of GDP from $4\frac{1}{4}$ per cent this year to $3\frac{1}{4}$ per cent next year. Since there is said to be no reason at present for revising the view of the level of output next year from that taken at the time of the Budget, the Chancellor feels that he cannot justify an increase in the PSBR. In para 18 he estimates that an increase in the PSBR of £1 bn would be likely to cause a rise in interest rates of $\frac{1}{2}$ to 1 per cent, and some increase in inflation. Any benefits to employment which would follow from the tax reductions or higher expenditure made possible by this increase would be eroded by the end of 1985. He also argues that an increase in PSBR for 1982/83 beyond that announced would be likely to have a bad effect on market confidence.

9. Some Ministers may argue that the Government should have more regard to the timing. They may prefer to see benefits in 1982/83, even if these are eroded later. On market confidence some may argue that there is no easy option. If

the Government gets into political difficulty by adhering to its plan to reduce the PSBR as a percentage of GDP, this could also affect market confidence. The Chancellor will however no doubt stress the additional constraints which international developments, and particularly those in the United States, place on the Government's freedom of action.

Tax v. expenditure

10. If Ministers agree that the PSBR target should be maintained, they will nevertheless wish to consider whether the Chancellor is proposing the right balance between tax and public expenditure. The argument may turn on the benefits to output and employment which can be expected for a given level of expenditure or tax reduction even in the short term.

11. The benefits from expenditure are discussed in paras 18 to 20 and Annex B of the Chancellor's paper. He argues that, even allowing for savings in unemployment benefit and increased tax receipts, additional public expenditure over time affects the PSBR adversely. Moreover the additional employment which might result from substantial extra expenditure on procurement (at a level which would increase the PSBR by £1 bn) is surprisingly small (eg 30,000 by end of 1982 and 50,000 by end 1983). Some Ministers may nonetheless argue that in political terms the Government cannot afford not to do something on these lines.

12. Other Ministers may argue that this strengthens the case for tax reductions. with P.M. — The Secretary of State for Industry wrote to the Chancellor on 12 October proposing a cut in the National Insurance Surcharge, as favoured by the CBI. The Chancellor has implied in paras 31 and 32 of his paper that this is the kind of tax reduction which he would hope to make in 1983 or 1984. Moreover he argues that, as compared with an equivalent increase in public expenditure, a tax reduction of this kind is preferable because it would tend to bring down inflation. However in terms of reducing unemployment he says that it would have much the same limited effect as an expenditure increase.

13. In considering the case for a reduction in the National Insurance Surcharge (NIS), Ministers will need to bear in mind that, in line with his stance of not altering the real burden of taxation in 1982/83, the Chancellor is proposing (para 27) that National Insurance contributions should rise to balance the National Insurance Fund. This is mentioned only briefly; but it is important that Ministers should be fully aware of it. In relation to the proposal for a reduction in NIS, it cuts both ways. It could be argued that a reduction in NIS is even more desirable to mute adverse reaction from industry to the increase in contributions; on the other side it would be argued that the increase in contributions would cancel any political and presentational benefit from reducing NIS.

14. If Ministers accept that the merits of tax reductions as against expenditure increases (or vice versa) are finely balanced in terms of the effect on employment, they will want to consider whether the particular balance proposed by the Chancellor and the Chief Secretary for 1982/83 and 1983/84 is the right one. Given no change in the PSBR target, failure to achieve the totals proposed by the Treasury is likely to make a real increase in the tax burden inevitable; but tax reductions in 1982 could be achieved only by adopting even more difficult expenditure cuts than those proposed (for example abatement of uprating the "pledged" benefits).

TIMETABLE

15. Treasury Ministers are looking for decisions on the public expenditure totals, and on 1982-83 in particular, by 'mid-November'; that is, in practice, by Cabinet's meeting on 19 November at the latest, and preferably by the 12 November meeting. This is to enable the nationalised industries' EFLs and the RSG settlement to be announced, the work on the Estimates and on the preparation of the March 1982 Budget to go ahead, and decisions on increases in the National Insurance Contribution to be taken. You will need to consider how best within this timescale to deal with the major decisions on the economic strategy, and on particular public expenditure programmes, which now need to be taken. After the meeting on 20 October there are, on present plans, meetings of Cabinet on 29 October, and 5 November as well as on 12 and 19 November.

16. Your aim on 20 October might be to complete a preliminary and provisional discussion of the overall approach proposed by Treasury Ministers. Although Departmental Ministers will undoubtedly make points on their programmes, there will probably not be time to enter into definitive discussions of particular programmes - and in any case it would probably be as well to give the lessons from this discussion time to sink in before going on to the discussion of particular programmes. If the Cabinet were to endorse the aim of entering into further discussions with a view to securing net savings sufficient to bring public expenditure totals down to those proposed by the Chief Secretary, that would not commit spending Ministers to sign up on particular cuts - and it is unlikely that many of them would be prepared to do so at this stage - but it would give the firm steer which is necessary if the further discussions, some of them not in full Cabinet, are to be effective.

17. You could indicate that, in the light of the meeting, you will make arrangements for further discussions of individual programmes. You will wish to do so in consultation with the Chancellor of the Exchequer before you leave for Cancun on 21 October. You might also indicate that the Cabinet would return to discussion of the overall strategy in the light of the outcome of the further discussions on individual programmes and with a view to examining the overall package.

18. The proposals for some programmes, notably social security, are politically contentious and of sufficient general interest to call for discussion in full Cabinet. Others might be dealt with by the Economic Strategy Committee and others might be left either to further bilateral discussions between Treasury and Departmental Ministers or, in cases where it is thought that this would not be worthwhile or where it is tried and agreement cannot be reached, to a small group under you or the Chancellor of the Exchequer. Provisionally the plan might be as follows:

(a) Cabinet on 29 October and 5 November might:

(i) Confirm the local authority current expenditure totals and, either not later than 5 November, agree on the Rate Support Grant percentage and other details. (NB The overall total has already been provisionally agreed by Cabinet; the split of that total between services has now been agreed by the Home Secretary's MISC 21 Group; MISC 21 will make recommendations to Cabinet, following the meeting of the Group on 22 October, on the RSG settlement though it is not yet clear whether they will be able to do so in time for discussion on 29 October rather than 5 November.)

(ii) Discuss the options for the Social Security and Health programmes, perhaps on the basis of a paper by the Secretary of State for Social Services. (NB The Chancellor of the Exchequer's Sub Committee on Public Sector Pay (E(PSP)) will consider further the provision for NHS pay at a meeting on 27 October.) It might also be necessary at the same time or more probably on 12 November to consider the recommendations of the Chancellor of the Exchequer and of the Secretary of State for Social Services for increases in the National Insurance Contributions: depending on their level, these increases could require urgent legislation; they are relevant to any discussion of decreases in the National Insurance Surcharge.

(b) Ministerial Committee on Economic Strategy

(i) On 2 November E Committee is already planning to consider papers by the Secretary of State for Employment on employment and training schemes. At the same time they can deal with the Chief Secretary's proposals for some offsetting savings, mainly by way of reduced allowances.

(ii) In the week beginning 9 November E could deal with:

- the proposals for Regional Development Grants on the basis of a paper by the Secretary of State for Industry. (Note that the Scottish and Welsh Secretaries are likely to be opposed to any percentage reduction and that Treasury Ministers want a bigger reduction than the Secretary of State for Industry will propose; the Attorney General may need to be brought into the discussion on Sullom Voe and Flotta.)
- Any remaining issues on the nationalised industries' totals, though the aim should be for the Chief Secretary and the sponsor Ministers to deal with this in bilaterals.

(c) Either bilaterals or small group

(i) Given the current deadlock between Treasury Ministers and the Secretary of State for Defence on the cash provision for 1981-82 and for the later years, you will wish to deal with the Defence budget yourself; this might be in a small ad hoc meeting with the Chancellor of the Exchequer, the Secretary of State for Defence, the Foreign and Commonwealth Secretary, and (perhaps) the Secretary of State for Industry, who has a legitimate interest.

(ii) On the remaining programmes the Chief Secretary may be able to make further progress in bilaterals between 20 and 29 October. He could then report the outcome to you and the Chancellor of the Exchequer on your return from Cancun. You might then wish either to deal with any outstanding problems in a small ad hoc meeting under your chairmanship or (perhaps preferably, in view of the other pressures on you during this period) to ask the Chancellor of the Exchequer to convene a small group. In either case it might be desirable to have two or three "neutral assessors" (eg the Home Secretary, the Lord President and perhaps the Paymaster General or the Chancellor of the Duchy of Lancaster). The outcome from the bilaterals and/or discussion in a small group would be reported to Cabinet by 5 or 12 November for endorsement or, in the event of continuing disagreement, resolution.

HANDLING

19. The two papers hang closely together and, before opening up the discussion, you will wish both the Chancellor of the Exchequer and the Chief Secretary to speak. You might then yourself suggest that the best course at this meeting would be to discuss Treasury Ministers' analysis and proposals in general terms with a view to preparing the way for more detailed discussion of individual programmes later. The intention would be for Cabinet to return to discussion of the overall economic strategy and the emerging package at later meetings in the light of progress on reaching agreement on particular programmes with a view to getting final and overall agreement by mid-November.

20. Most Ministers will then wish to speak; those whose programmes are mainly affected by the proposed cuts are the Secretaries of State for Social Services, Industry, Education and Science, Environment, Transport, Scotland and Wales and the Minister of Agriculture. The Secretary of State for Employment's programme will be discussed in detail by E on 2 November. The Secretary of State for Defence is unable to attend the meeting because of a NATO commitment. You might ask the Chancellor of the Duchy of Lancaster to deal with any questions on the proposed 2 per cent cut on general administrative expenses.

CONCLUSIONS

21. On the assumption that the Cabinet will not wish at this meeting to reach conclusions on all the recommendations in the Chief Secretary's paper (C(81) 51), you will, in the light of the discussions, wish to record conclusions:

1. Taking note of the general considerations affecting public expenditure set out in C(81) 50 and 51.

2. Agreeing to further discussions of individual programmes with a view to securing reductions sufficient to bring public expenditure totals down to £113.5 bn in 1982-83 and £118.1 bn in 1983-84 as proposed by the Chancellor of the Exchequer and the Chief Secretary in C(81) 50 and 51.

3. Noting that arrangements have already been made for the Economic Strategy Committee to discuss employment and training measures and Regional Development Grants and that you will make arrangements for discussion of other programmes in full Cabinet or elsewhere, in which cases the outcome would be reported to Cabinet.

4. Inviting the Chief Secretary to arrange for officials in the Public Expenditure Survey Committee to consider further the totals for 1984-85.

5. Agreeing to resume discussion on 29 October and at further meetings in November.

D J Wright

Robert Armstrong

(approved by Sir R Armstrong and signed on his behalf).

16th October 1981

(Revise : 7 October 1981)

A. DIFFICULT CUTS PROPOSED

Reductions to which it will be difficult to secure agreement in full

		£ million 1982/83	1983/84	1984/85
1.	Ministry of Defence			
a.	Reject bids for validation of inflation, and future relative price effect, which Secretary of State will argue were needed to keep NATO pledge. But allow transitional provision of £250 million this year, £150 million next.	379	767	1050
b.	Do not allow transitional provision (see a above)	150		
2 and 3.	Foreign and Commonwealth Office			
a.	Overseas aid real cut by about 3%. (Note : this is in addition to taking back windfall gain from revaluation factors.)	30	30	30
5.	Intervention Board for Agricultural Produce			
a.	End beef premium scheme. (End may be supported by FCO on EEC grounds.)	-	37	37
6.	Ministry of Agriculture Fisheries and Food			
a.	Reject hill livestock compensatory allowances bid - causing some fall in real income of hill farmers.	53	60	66
b.	Cut rate and/or coverage of capital grants to farmers to produce reduction in costs of 40%.	30	50	50
8.	Department of Industry			
a.	Reduction regional development grants from 15%/22% to 12%/18%.	36	90	90
b.	Refuse payment of RDG for Sullom Voe and Flotta. Secretary of State may agree, but could nevertheless be contentious because of retrospection.	122	9	
9.	Department of Energy			
a.	10-14% cut in cash limited expenditure on the AEA and non-nuclear research.	31	42	47
	Total c/f	831	1,085	1,377

A. DIFFICULT CUTS PROPOSED (Continued)

		1982/83	1983/84	1984/85
			£ million	
	Total b/f	832	1,085	1,377
12.	**Department of Employment**			
a.	Associate introduction of comprehensive YOP with cut in allowance to £8 a week and ineligibility for Supplementary Benefit.	-	170	230
b.	Make no provision for Layard type scheme or increase in Community Enterprise programme.	100	150	130
c.	Bring in earlier cut in allowance for YOP to £8 a week and ineligibility for Supplementary Benefit.	110		
13.	**Department of Transport**			
a.	Motorways and Trunk Roads. Cut uncommitted capital expenditure by half in 1982/83 and substantially thereafter.	50	75	75
14.	**DOE - Housing**			
a.	Larger rent increases, requiring about £4 a week (35%) in 82/83; £3.50 a week (23%) in 83/84; £1 a week (5%) in 84/85	50	50	50
15.	**DOE - PSA**			
a.	20% cut in minor works and maintenance.	20	20	20
16.	**DOE - other**			
a.	12% cut in water capital.	85	100	100
17.	**Home Office**			
a.	Reject bid for second new prison start in 1984-85.	1	1	9
19.	**Department of Education and Science**			
a.	Increase parental contributions to student awards (increase % of income at margin from 14 to 20, abolish minimum grant).	40	100	100
	Total c/f	1,287	1,751	2,091

A. DIFFICULT CUTS PROPOSED (Continued)

		£ million		
		1982/83	1983/84	1984/85
	Total b/f	1,287	1,751	2,091
20.	Department of Health and Social Security - Health			
a.	New charge for road accidents (requires legislation).	80	80	80
b.	Hospital Service revenue. No "volume" growth in 1982-83. (Exact description under discussion - probably by refusing bids for RPE and validation.)	134	142	149
c.	New charges (eg hotel charges and half-price charge for presently exempt groups).	15	125	181
21.	Department of Health and Social Security - Social Security			
a.	Changes in supplementary benefit rules.	50	150	160
b.	Confine eligibility for death grant and Christmas bonus to those on supplementary benefit, but double amount.	57	57	57
c.	Abate Nov.1982 uprating by 5% for "unpledged" benefits - eg unemployment, sickness, child, short-term supplementary benefits.	165	490	490
d.	Defer phasing out of earnings rule for pensioners.	-	31	96
	TOTAL	1,788	2,826	3,304

B. DIFFICULT CUTS NOT PROPOSED (Revise : 7 October 1981)

Reductions which would be necessary if further reductions in totals required.

		£ million	
	1982/83	1983/84	1984/85
1. Ministry of Defence			
a. Reject bid to carry through cost of 1981 AFRB award. Secretary to State will argue that this reduction re-open earlier decisions. May argue that it cannot be achieved.	85	88	92
2 and 3. Foreign and Commonwealth Office			
a. Overseas aid. Cut deeper than 3% proposed above. Say 3%. (Note: maximum technically possible in 1982-83 would be £87 million.)	30	30	30
8. Department of Industry			
a. Abolish RDGs	120	300	300
b. Reduce further "wedge" allowed for future industrial support.	10	7	10
9. Department of Energy			
a. Further reductions in research expenditure which would require end of fast-breeder reactor programme.	30	50	65
10. Department of Trade			
a. Reductions in some, or all, of Selective Assistance for Tourism Export Promotion Shipping In each case reductions would be small in relation say, to opposition caused.	16	18	21
12. Department of Employment			
a. Make no further increase in YOP, and its successor.	100	300	525
b. Raise JRS age limit to 62 for disabled men.	-	-	50

B. DIFFICULT CUTS NOT PROPOSED (Continued)

		1982/83	1983/84	1984/85
13.	Department of Transport			
a.	Motorways and Trunk Roads, Moratorium on new starts in 1982-83. (See A.13a)	50	25	25
14.	DOE - Housing			
a.	Further rent increases, bringing 1982-83 increase to £4.40 (39%).	65	65	65
14.	Home Office			
a.	Cut police overtime	70	70	70
19.	Department of Education and Science			
a.	Cut Universities cash limit by 2%.	24	25	26
20.	Department of Health and Social Security - Health			
a.	Cut hospital service revenue so that volume falls (see A.20.b).	?	?	?
21.	Department of Health and Social Security - Social Security.			
a.	Abolish death grant and Christmas bonus.	67	67	67
b.	Abate uprating of "pledged benefits" by 5% in November 1982.	300	800	800
23.	Scotland			
a.	Reduction in Scottish programmes on basis of needs assessment study.	75	75	75
26.	Other Departments			
a.	Civil superannuation. Abate uprating in November 1982 by 5%.	50	150	150

FROM:

THE RT. HON. LORD HAILSHAM OF ST. MARYLEBONE, C.H., F.R.S., D.C.L.

HOUSE OF LORDS,
SW1A 0PW

CONFIDENTIAL

16th October, 1981

The Right Honourable
The Prime Minister

My dear Margaret:

Unfortunately the pardonable desire of the Foreign and Commonwealth Office to send me to Washington to celebrate Britain's defeat at Yorktown in 1781 in the company of Presidents Reagan and Mitterrand is likely to prevent me attending at Cabinet to hear the discussion of Geoffrey's paper C(81)50 on Economic Policy and Public Spending. It is a powerful document and both the arguments and the supporting figures need to be widely publicised in a more popular form.

At the same time, lest I be wholly silent, I would like to put some thoughts on paper. These are not intended to question the general drift of the argument. But in politics success or failure often depends on marginal considerations, and I am concerned with some of these.

In the first place I am deeply concerned by the bitterness of some of our critics, and since we have such a powerful case, I am driven to suppose that there is to some extent a failure of advocacy in its presentation, and for this we ourselves must be to blame, at least in part.

In the second place, I believe there are factors which the paper tends to overlook. I begin with these, because they are the least important; but precisely because they are marginal, they may enable us, when they are taken into account, to make a disproportionately large contribution to our advocacy.

The paper quite rightly emphasises that we cannot go on borrowing more and more money with the consequent result that the service of debt becomes an ever increasing, and unrewarding, item in our expenditures.

It also emphasises quite rightly that, if we do the borrowing, it must have an adverse effect on the terms on which private firms can borrow in competition with us.

I was also glad to see an acknowledgement of the fact that, as we do our sums, the money saved on benefit must be treated as a credit, and to this must be added the increased receipts from revenue. But are there not other items which ought also to be

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CONFIDENTIAL

considered? Take for instance the road programme which has been badly savaged in the interests of economy. It is possible to calculate the savings on otherwise wasted fuel of removing bottle necks, and, in the shape of expense avoided, the cost to the National Health Service and police of accidents which might be avoided by the elimination of black spots. There must, I believe, be a large number of capital projects not now being undertaken which will be arguably cost effective even with present interest rates. They might collectively add up to a sizeable sum.

There are also items which will have to be undertaken anyhow within the next few years. In addition to the credit items I have described, the inflationary cost of postponing them is surely also a factor which has to be taken into account. I hope we are never going to sacrifice real costs to apparent costs as they appear in annual books of account. This would be to confuse appearance with reality.

I now come to the question of advocacy. Our policy is constantly being described by entirely respectable persons as "deflationary" and to our economies the objectionable word "cuts" is being constantly applied. The reality appears to be somewhat different. Our expenditure is rising in real terms and in absolute terms with both taxation and borrowing going up in proportion, while our GDP is falling. We are trying desperately to control the increase and we are not even attempting to cut existing expenditures below what they are. The real situation is inflationary and it is going on being inflationary. What passes nowadays for deflation is not deflation, but a desperate effort to hold back to a tolerable level what is going in any event to be a rise in prices.

The second point I want to raise on advocacy is our apparent inability to get across the crucial extent to which restrictive practices and excessive wage settlements have brought about unemployment. As you know, I am far from advocating 'union bashing' either as a policy exercise or as an experiment in propaganda. On this particular issue, though not positively wet, I am at least not an advocate of drought. But it is really too bad when I see the Trade Unions pounding away at us (and of course in particular you) for hard heartedness in the face of unemployment without at least candidly admitting the extent to which their own wage demands and restrictive practices are directly responsible for the situation which they ask us to shed tears over. The contrast in productivity between us and our predecessors is at least mainly due to Luddism (the spiritual kind being worse than physical) on the part of their own leadership. When one comes to observe the relative rises in the wages of public servants and nationalised industries compared with private industries and small firms one is really made to squirm with indignation.

The last point I want to raise is a sin of omission on our part. I long for an appeal for a return to real self-sacrifice and service and patriotism after 35 years of things never being so good. You complained to me the other day that I was not making enough of my speeches. In the last two weeks alone I have spoken at Eastbourne (Ian Gow, whilst in Melbourne), Blackpool (Europe), and the Croydon by election, and I plan to speak internationally at Yorktown. It is not my fault or that of central office that very little has appeared in the press. The texts were written and circulated. I am driven to the conclusion that nothing that I say outside the field of law is nowadays news worthy. But if economics colleagues put a little bit about the need for those in work (particularly the secure work afforded by public employment) to make sacrifices for those who are not (unemployed, sick, pensioners, one parent families) and for Britain is it beyond hope that there would be some response from the media? Of course the ground will have to be prepared. We must be in a position to show that, for the first time since the post-war boom when anything was saleable at almost any price then conceivable, we are operating in a cold climate. But is it too much to hope that patriotism is only sleeping, and not finally extinct?

Parsimony leads me to send this in the first place only to you and Geoffrey. If you think it worth circulating more widely to other Cabinet colleagues by all means do.

yrs:

Q.H.

Your Ref

with compliments

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1

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
PEX
Sir Kenneth Couzens
Mr Burns
Mr Ryrie
Mr Middleton
Mr Quinlan
Mr Kemp
Mr Kitcatt
Mr Dixon
Mr Hansford
Mr Monger
Mr Lovell
Mr Burgner
Mr Mountfield
Miss Kelley
Mrs Case
Mr Norgrove

C(81)51 : PUBLIC EXPENDITURE

This is your own paper, complementing the Chancellor's C(81)50.

Objective

2. At the first meeting on 20th discussion will probably be focussed on Chancellor's paper and the general aspects of yours. The objective must be to secure sufficiently general acceptance of the totals proposed by you and the Chancellor for useful discussions on programmes to start. Other Ministers may not want to commit themselves irrevocably to the total before discussion on programmes. But discussion on those programmes will not reduce differences unless there is a fairly clear view on what totals are acceptable first. There is an unavoidable element of chicken and egg. A process of iteration between consideration of totals and of programmes is inevitable. But some provisional commitment to totals is an essential first step. (See section on procedure at the end.)

3. It is also desirable that agreement should be reached soon, if at all possible at the first meeting on the remit to PESC to reconsider 1984-85.

4. The ultimate objective is to secure agreement on the departmental figures and nationalised industry figures in Table 2 and Annex B with only minor adjustment to the total (ie not more than £½ billion). But a conclusion on that will not be reached until 12 November (or later).

5. While many of the general points in your paper can be taken as a background for discussions on particular programmes and EFLs there are some which it is either necessary, or might be useful, to discuss and agree explicitly, namely:

(i) treatment of 1984-85 (paragraph 9);

(ii) acceptance of 1% "squeeze" from the inflation factor (paragraph 19);

(iii) 2% general cut - especially for staff and g.a.e. (paragraphs 20-21);

(iv) local authority current expenditure in the later years (paragraph 23).

Opening remarks

6. You will probably be asked to speak to your paper, immediately after the Chancellor has spoken, and before general discussion. A speaking note is attached : Annex A.* You will presumably wish to adjust this to suit the mood of your colleagues after conference.

Briefs

7. CU are submitting a set of general briefs on the Chancellor's paper, including one on public expenditure. For ease of reference, that is also attached as Annex B to this.

8. This brief comments on a series of general points arising on your paper. There are also annexed to it:

Annex C : Capital and Current, including list of capital cuts.

Annex D : Relative Price Effect : Defence and Health.

Annex E : Legislative Requirements.

Annex F : Price Effects.

Annex G : Industrial Effects (to follow).

LG, PE and SS are submitting separately briefs on local authority current expenditure, nationalised industry EFLs and social security respectively.

* To follow

9. We presume that you will not need briefing on individual departments for Tuesday, given that you have already worked through the Annexes and the briefs for the earlier bilaterals. A set of briefs department by department is being assembled and will be ready on Monday: it will be ready for you for further discussions in detail, however quickly they may start after Cabinet on the 20th.

The totals (paragraphs 2 and 3 and Table 1)

10. See general brief F (Annex B to this minute).

Freedom to departments to switch (paragraphs 5 and 6)

11. The paper offers Ministers the opportunity to suggest alternative ways of achieving your proposals. This is subject to certain safeguards, against subsequent backsliding:

(i) securing the necessary policy clearance as part of this operation - you do not want savings to be offered and written into the figures, only to be negated by Ministers collectively rejecting the necessary policy change later;

(ii) the costings being agreed with the Treasury: you need to avoid switches of cuts which increase a cash-limited programme and reduce a demand-led one not subject to a cash limit, by an amount which later proves to have been over-estimated for the latter;

(iii) not switching to or from local authority current expenditure, as that is being determined as part of the realism exercise.

GENERAL POINTS IN THE PAPER

(a) Status of the figures

1982-83 (Paragraph 7)

12. We took the liberty of a last minute amendment to this paragraph, to leave an opening for reductions as part of normal Estimates scrutiny. This may prove important in relation to staff. That apart the presumption of the cash figures for programmes translating straight into cash limits, where they exist, remains.

1983-84 (Paragraph 8)

13. You will probably wish to emphasise the point in this paragraph. Some of the troubles over 1982-83 in this round almost certainly stem from the fact that not enough attention was given to that year last time: some of the further bids might have been avoided if departments had first really addressed themselves in last year's survey to what they would need in 1982-83, and then had taken steps since to live within the totals, rather than piling in extra bids. It makes a farce of public expenditure planning, to have new bids on the scale of this year for the immediately coming year.

1984-85

14. Mr Littler has made a separate submission about the points raised by the PFOs on this. There would appear to be three main potential lines of attacks:

(i) It is silly to plan in cash this far ahead: not true. It is admittedly necessary to use a stylised inflation assumption this far forward. Clearly plans will have to be changed if inflation proves to be markedly different - how far they should be changed would be a matter for decision when the time came. Lead times for many programmes show the need to look this far ahead.

(ii) The figures generated are a hybrid, because they allow for price movements in excess of the inflation factor, particularly in relation to social security. If this were removed, then the prospect for 1984-85 would look distinctly better. Again this is a confusion. For 1982-83, the projection for public expenditure does allow for the divergence between the actual movement of prices and that allowed for in the cash factors. This is nothing new, realism is habitually adopted for expenditure not subject to cash limits. The figure for the social security adjustment is particularly large because of the catch-up in the November 1982 uprating for under-provision in the November 1981 uprating. But from there forward we have applied consisten inflation factors to cash-limited and uncash-limited programmes alike. So there is no distortion on that account. The size of the price adjustment under "economic prospects" (Table 1, Line 4(iii)(al) is larger in

1983-84 than in 1982-83 because that is when the full effect of the 1982 uprating comes through.

(iii) The margins of error for 1984-85 are such that the apparent slight "real rise" in 1984-85 is not worth bothering about at this stage. What is the evidence for it? You may wish to quote the "cost terms" sequence given in Annex B to make the point that your proposal for 1982-83 and 1983-84 merely bring public expenditure and cost terms back to the level which are inherited. You cannot accept that they should then start on an upward trend again.

15\.
It would seem desirable to seek to avoid getting drawn into a discussion of the technicalities underlying the figure. It may be easier to get across to your colleagues the following general propositions:

(i) because a number of major programmes have an in-built tendency to rise eg Defence because of the NATO commitment, social security because of demography, and because there will always be new initiatives or claims on expenditure arising, there is a built-in tendency for public expenditure to rise over time;

(ii) that tendency can only be countered by a series of decisions, cutting back on existing programmes, some of which may have outlived their original purpose, others not, to create room for the additions and by sustained pressure over the years to secure savings from improved efficiency in the delivery of the public services;

(iii) your proposal for 1982-83 and 1983-84, if accepted, provide for a break in that trend. But if it were just left at that, public expenditure would once again return to an upward trend, admittedly at a somewhat lower level because of the action for the next 2 years; (but it would still be much the same percentage as GDP as when the present Government took office - see Annex B);

(iv) this Government's whole approach to the public sector is predicated on the presumption that it is desirable to reduce the scale of the public sector, and one measure of this is public expenditure in relation to GEP. Some reduction will come from the growth of GDP as the economy recovers once inflation is under control. It is also necessary to act on public expenditure directly by continuing the process of reducing it;

(v) there is a need to look at this now, because most of the cuts which can be brought about quickly will have already been taken. What may be necessary
with longer lead times. Many of them may need to be initiated (but not necessarily announced) soon if they are to have their effect in full by 1984-85. It is therefore not acceptable to wait until the next public expenditure survey exercise;

(vi) you therefore propose a further study by officials to identify a range of alternative ways of achieving a substantial reduction in public expenditure in 1984-85 - some policy changes which had to be ruled out for the earlier years on the grounds of either practical or political feasibility might be possible on a longer timescale;

(vii) it is desirable that the report from PESC should be available in 2 or 3 weeks so that Ministers could return to the subject of 1984-85 at the concluding stages of the series of discussions on public expenditure. (This is not essential.)

(b) <u>Nationalised Industries external finance</u> (Paragraphs 10 - 11)

16. This is covered by the separate PE brief.

(c) <u>Capital and current expenditure</u> (Paragraphs 12 - 14)

17. See Annex C.

18. You will presumably wish to emphasis the extent to which you were constrained on the one hand by the scale of the bids for current expenditure, and on the other by the nature of the cuts which appeared

to be feasible as a result of the discussions first at official level between departments and the Treasury on the options, then in your rounds of bilaterals.

19. If pressed by your colleagues on this, you should emphasise that since the total which you are proposing is too high already the capital cuts could only be avoided if fewer bids for current expenditure were accepted or further cuts in current expenditure were accepted. (In this connection, for the reasons I gave earlier, Mr Heseltine's idea of depressing the pay figure to an unrealistically low level which could not be achieved would be no way out.

(d) Validation of inflation (Paragraph 15)

20. The case on this in relation to pay is clear-cut. A carry forward is allowed in respect of this year's award for the armed forces and the police. For the rest, the squeeze resulting from any pay settlements greater than 6% ought to be carried forward. Organisations concerned (including the Civil Service) made the settlement accepting the squeeze. Moreover it is only fair to those who have settled at 6%.

21. You may get more difficulty in respect of validation for inflation in respect of price changes other than pay. You are in fact allowing it in respect of the family practitioner service, which is not at present cash limited, on the grounds that to do anything else would just produce an unrealistic figure. So you will need to say that you are rejecting validation of inflation in respect of prices for all cash limits.

22. The two difficult cases where it may be argued with you are health and defence. In many ways, it would be better if those were argued bilaterally rather than in full Cabinet. But if the health case is put you should accept/refusing that it does imply a reduction in volume, but that you are proposing a further reduction in volume any way. It would not make any difference if you allow validation and then just proposed a larger cut. In the case of defence procurement, they have just not made out a case which satisfies our economists. Price increases during the last year have been very uneven ranging from about 6½% for the prices charged by manufacturing industry to about 20% of the prices charged by the nationalised industries. The 11% price factor is not proving very far

out for the average. You could tell the Secretary of State that you would reconsider his case if the Department could establish that they are facing exceptional costs: prima facie this seems unlikely given that a significant proportion of the defence budget goes on purchases from manufacturing industry.

(e) Future relative price movements. (Paragraphs 16 - 18)

23. The general arguments on allowing relative price changes are that:

(i) relative price movements are notoriously hard to predict - significantly more so than general price movements;

(ii) if, exceptionally, a case can be made, it should be allowed for only one year at a time - in the case of health you are proposing for one year's relative price movement, including its carry-through into later years, but not any compounding of relative price effects in those later years at this stage.

24. Here again you may be questioned about allowing something for health but not for defence. Annex D sets out the arguments, but it would be better to deploy these bilaterally than in full Cabinet.

25. You have also provisionally allowed £100 million addition for pay for the National Health Service. If questioned about this you might make the point that:

(a) the 4% factor was not a norm, and cash adjustments of this kind were specifically provided for in the original announcement;

(b) Mr Fowler had assured you that, if this cash addition were made, then the NHS pay settlements would have to be accommodated within the hospital cash limit: this is in contrast with the situation in respect of the Civil Service as a result of the undertaking given to the Civil Service unions;

(c) that apart, the merits of making allowance in respect of the medical staff, and the amount of that allowance, should be looked at in E(PSP) before a decision is taken in relation to public expenditure. That discussion has been arranged.

26. Paragraph 18 essentially keeps all options open in respect of the Pay Review Boards, either accepting their recommendations or rejecting them, also either adjusting cash limits to allow for the award or requiring them to be absorbed,or some combination of the two.

27. It will probably be argued, with justification, that the combined effect of carrying forward this year's cash limit squeeze on civil service numbers and the cut now proposed in their cash limits will make it impossible to absorb any extra cost of the Civil Service settlement within the cash limit on the basis now proposed. That is almost certainly true. We would advise you to be ready to acknowledge this if it is necessary to secure acceptance of the 2% cut.

(f) <u>General cut in administrative expenditure and other cash limits</u> (Paragraphs 19 - 21)

28. The strong general case for this cut, together with the carry forward of the squeeze from this year's pay settlement in the case of the Civil Service, is argued in your paper. You will probably, in particular, want to emphasise the point about the CBI experience.

29. However, the severity of the proposal will vary from department to department depending on how far the reduction in numbers required to be on path for the 630,000 target had been translated into cash last winter and the PESC baseline adjusted appropriately. The CSD said that in general departments should be able to achieve what is required of them but they are seeking to identify which are likely to be the hard cases. (We will let you know on Monday if we hear the result.)

30. It seems important to secure general agreement to this proposition and not to allow the decision to be swayed by a few Ministers whose departments will have a special difficulty. Securing agreement in these circumstances will almost certainly require an indication of willingness on the part of the CSD and the Treasury to make a few limited exceptions in cases where the case for it can be proved under rigorous examination by the CSD. Such determination ought to take place in the lead-up to the Estimates. The aim therefore should be to secure general agreement to the proposition, on the understanding that the CSD will look at hard

cases and if they are established, and if there is no scope for a switch from elsewhere in the programmes affected, in the last resort some addition might be allowed. (It would be a charge on the contingency reserve if that is constituted by then.)

OTHER POINTS

31. While you will doubtless wish to speak to the general proposition, the CBI case, it may be appropriate for Lady Young to talk about the implications for departments.

(h) Economic assumptions (paragraphs 25 - 26)

32. You will want to consider with the Chancellor how much you should say about future price prospects. This would turn to some extent on the Chancellor's view on what might be published in the Industry Act forecast, the submission on which is going forward today.

Timing and future handling

33. Much will depend on the Prime Minister's views: Sir Anthony Rawlinson's submission to the Chancellor of 9 October.

34. The Cabinet Office is working in the meantime on the basis that some specific topics will be dealt with in other Ministerial committees appropriate to the subject concerned. The main group are the employment measures, on which Mr Tebbit is just about to circulate papers to E and regional development grants which are also due to go to E. Mr Fowler's proposal on health service pay will go to E (PSP).

35. Mr Kemp's brief to the Chancellor has appended to it a brief on the timing problems. They point to the need for Cabinet discussion to reach the stage by 12 November of it being fairly clear what the total and mix of measures is going to be, if the Chancellor is going to take his decisions on the NIS/NIC in time for the legislation (those decisions may turn to some extent on the outcome of the public expenditure exercise). Decisions are also needed then to be fed into the Industry Act forecast which ought to be published before the end of November. This would allow some marginal decisions on 1982-83, and decisions on later years being left over until 19 November.

36. We understand that the Cabinet Office will be suggesting that Cabinet on the 29th should take local authority current expenditure (if MISC 21 has completed its work in time) and health and social security, on the grounds that those programmes would have to be discussed in Cabinet any way. The sequence of the other programmes depends very much on what arrangements for bilaterals, small groups etc are set up.

Conclusion

37. If you wish to discuss this with us on Monday, or want further material on particular points, please let us know.

J.M.B.

J M BRIDGEMAN
16 October 1981

ANNEX B

F. PUBLIC EXPENDITURE

(N.B. There are separate briefs on the Chief Secretary's paper C(81)51)

1. The proposals (Reference Table 1 to C(81)51)

The proposals by Treasury Ministers involve a substantial addition to public expenditure - which prejudices tax objectives and could, of itself, upset confidence in the financial markets.

They are not proposals for cuts in total - they are the reverse.

They involve a relatively modest reduction (under £½ billion in 1982-83 and £1.1 billion in 1983-84) compared with the present degree of overrun of the White Paper produced by decisions already taken and external factors.

The cuts in existing programmes proposed are mainly required to offset further bids outstanding, which Treasury Ministers recommend should be accepted. Some of the cuts in existing programmes could be avoided if colleagues were ready to reject more of the outstanding bids.

		£ bn		
	81-82	82-83	83-84	84-85
Last White Paper revalued etc	104.5	109.9	113.9	119.6
Present position	107.3	114.0	119.2	125.7
Further bids		+ 3.1	+ 5.3	+ 5.9
Result if all accepted		117.1	124.5	131.6
Reductions in bids		- 1.7	- 3.6	- 3.8
Cuts		- 1.9	- 2.7	- 3.0
Proposal		113.5	118.1	124.8

/ 2. Comparisons

Comparisons

(a) Earlier plans

If bids were accepted the result would be that the growth rate of public expenditure would be fairly close to that in last Labour White Paper (March 1979), but on a path about £2 billion lower. It would be markedly higher than original Conservative White Paper (March 1980). Proposals do at least produce a change in the upward trend in relation to GDP for first two years.

	£ bn (cash)					
	78-79	79-80	80-81	81-82	82-83	83-84
March 1979 White Paper (L)		79	97	110	120	
March 1980 White Paper (C)		77	92	101	106	113
Expected Outturn	66	77.2	94.2	107.3		
"All Bids"					117.1	124.5
Proposal					113.5	118.1

(b) GDP

Total public expenditure (planning total plus debt interest) has risen sharply as a % of GDP. If "all bids" were accepted it might fall by nearly 1 percentage point in 1982-83. If proposals accepted it would instead fall by over 2 points. Proposals for later years would bring it back to about the inherited level.

	%				
	78-79	79-80	80-81	81-82	82-83
Public expenditure as % of GDP	41	$40\frac{3}{4}$	$43\frac{1}{2}$	$45\frac{1}{4}$	43 (proposal)

(c) Cost terms

The comparison in cost terms (using the inflation factors for 1983-84 and 1984-85 as index of prices generally) is:

	£bn. Cost terms (1980-81 prices)						
	78-79	79-80	80-81	81-82	82-83	83-84	84-85
Outturn/Expected outturn	91.1	91.0	94.2	96.6			
"All Bids"					95.5	95.8	96.3
Proposal					92.6	90.9	91.4

The surge in public expenditure in cost terms up to 1980-81 reflects the public service pay explosion. The decline now projected allows for some reversal of this. The point to emphasis is that the proposals for 1983-84 do no more than get back in cost terms to 1979.

3. Changes since last White Paper (See Table 1 of C(81)51).

A. Decisions. Add £1¾ - 2 billion a year.

(a) Nationalised industries : so far £0.75 billion a year added.

(b) Employment package added around £0.7 billion a year.

(c) Defence decisions added £0.5 billion in 1984-85.

About £¾ billion of these might be met from contingency reserve.

B. Changed economic prospects

The addition for this (£1.7 billion in 1982-83, £3 billion in 1983-84) is only to a small extent a revised view on unemployment. A significant element in both years is higher interest rates - lower expenditure on programmes generally would help to reduce this. The other main element is the revised outlook on prices particularly affecting the November 1982 social security uprating, but also affecting other demand-led programmes.

C. Total

The exercise therefore starts with an excess over the White Paper of £4 billion next year and £5⅓ billion in 1983-84.

Capital and Current Expenditure

Your paper (paragraphs 12 - 14) gave the broad picture. Table 4 attached shows the figures on which the proportions for central and local government expenditure were based.

Table 5 attached lists the capital bids and cuts, and shows which have a high construction element, since that is the real interest to private industry. The main point is that a substantial proportion of the "capital" bids are just grants and loans. Of the bids which have a high construction element, you are rejecting the main ones - housing capital - and indeed seeking a small cut in that area and larger cuts in some other areas affecting construction (roads, water, etc). But, in accordance with your priorities, you are deliberately limiting the cut in housing capital.

PUBLIC EXPENDITURE CHANGES : CAPITAL

TABLE 4

	1982 - 83 (1) Public Exp Total	(2) Public Exp Excl NIs	(3) Capital Exp Within 2	(4) 3 as a % of 2	1983 - 84 (1) Public Exp Total	(2) Public Exp Excl NIs	(3) Capital Exp Within 2	(4) 3 as a % of 2
	£ bn	£ bn	£ bn	%	£ bn	£ bn	£ bn	%
White Paper Revalued	109.40	108.36	10.93	10.1	113.34	113.28	10.89	9.6
3. Starting Point	109.93	108.46	11.03	10.2	113.91	113.39	11.00	9.7
Agreed bids (excl NIs)	+ 0.87	+0.87	-	-	+ 0.95	+ 0.95	-	-
Other Changes	+ 2.42	+2.42	-	-	+ 3.63	+ 3.63	-	-
NIs	+ 0.75	-	-	-	+ 0.75	-	-	-
4. Present Position	113.97	111.75	11.03	9.9	119.24	117.97	11.00	9.3
5. Further Bids								
NIs	+ 0.91	-	-	-	+ 1.80	-	-	-
Other	+ 2.24	+ 2.24	+ 0.42	18.4	+ 3.45	+ 3.45	+ 0.36	10.4
6. Total including all bids	117.12	113.99	11.45	10.0	124.49	121.42	11.36	9.4
7. Reductions								
NIs	- 0.48	-	-	-	- 1.2	-	-	-
Reductions in bids	- 1.26	- 1.26	- 0.30	23.8	- 2.44	- 2.44	- 0.32	13.1
Cuts	- 1.86	- 1.86	- 0.62	33.3	- 2.71	- 2.71	- 0.60	21.1
8. Resultant Total	113.52	110.93	10.53	9.5	118.14	116.27	10.44	8.9

SECRET

CAPITAL BIDS/CUTS

SHOWING CONSTRUCTION CONTENT

TABLE 5

	1982-83 GROSS BID	1982-83 Of Which ACCEPTED BID	1983-84 GROSS BID	1983-84 Of Which ACCEPTED BID
	£m	£m	£m	£m
1. BIDS WITH RELATIVELY HIGH CONSTRUCTION ELEMENT				
Housing (incl Wales)	218	-	218	-
Home Office (prisons + local authority capital)	49	20	61	22
PSA (unemployment benefit offices and DHSS offices)	10	-	14	-
	277	20	293	22
2. OTHER CAPITAL BIDS (mainly grants and loans)				
MAFF (mainly capital grants)	41	41	37	37
Industry (mainly financial support, net of reduced requirements)	18	18	-53	-53
Employment (mainly loans)	29	20	18	12
Other (mainly formula consequences for Scotland, Wales, N. Ireland)	51	20	67	27
	139	99	69	23
	416	119	362	45
3. CUTS WITH RELATIVELY LARGE CONSTRUCTION ELEMENT		CUT		CUT
Transport (mainly roads, central and local)		-100		-120
DOE Other (local authority and water capital)		-110		-150
Housing capital		- 43		- 46
Home Office (various)		- 22		- 16
		-275		-332
4. OTHER CAPITAL CUTS				
INDUSTRY (RDGs)		-158		- 99
ECGD (Refinance)		- 50		-
PSA (minor works and maintenance)		- 20		- 20
MAFF (capital grants)		- 38		- 62
OTHER (mainly formula consequences for Scotland, Wales, N. Ireland)		- 80		- 91
		-346		-272
		-621		-604

Future Relative Price Movements: Health and Defence

The bulk of the health relative prices bid is in respect of the Hospital and Community Health Services, which is cash limited, and in that respect similar to the defence case. (The remainder of the health bid is in respect of the Family Practitioners' Services, which is not cash-limited.)

The evidence is clear that the price of goods bought by the hospital services has continued to increase relative to other prices in recent years, whereas defence procurement prices have fallen in the last three years relative to other prices. MOD have argued that the past trend suggests an RPE of 2%, but this ignores the recent history, and they have also put forward an econometric equation which suggests an RPE of 5% but the Treasury consider the equation to be fundamentally unsound.

Moreover, health expenditure is mainly on goods such as fuel and drugs, so that if the extra provision for relative prices became known publicly it would not influence the price paid by hospitals, whereas it could influence defence contract negotiations. Also there are several factors which should continue to keep defence procurement prices down. As industrial non-defence activity increases the burden of overheads on defence contracts should fall; the increasing profitability of non-defence manufacturing should raise non-defence prices relative to defence prices (where for non-competitive contracts the return is fixed); and the returns on non-competitive contracts, which at present assumes inflation of 15%, is due for renegotiation and should be reduced in line with lower inflationary expectations.

PROPOSED REDUCTIONS REQUIRING LEGISLATION IN 1981-82 PROGRAMME

I. PRIMARY LEGISLATION

Department of Employment

Cut requiring legislation

Introduce ineligibility for Supplementary Benefit for those who leave school at the minimum leaving age, and are within a year of doing so.

Comment

Mr Tebbit's proposals will in any event require such legislation to be effective by September 1983: your proposals would require the legislation to be effective by September 1982. The Social Security Bill to be introduced in November would be a possible vehicle for this change, but with the risk of congestion in the legislative timetable.

[See also under Social Security, where the proposed cuts require the same legislation].

DHSS - Health

Cut requiring legislation

Introduce new NHS charges (including charges for road traffic accidents and sight testing, GP consultation charge and hotel charge); introduce half price charging for some groups (primary legislation required for some charges only).

Comment

There is no proposed Bill to which this could naturally be added.

DHSS - Social Security

Cuts requiring legislation

(a) Restrict eligibility for Christmas bonus to Supplementary Benefit recipients, double rate.

(b) Changes in Supplementary Benefit rules, principally to remove entitlement from 16-18 year olds.

Comment

The Social Security Bill to be introduced in November would be a possible vehicle for this change, but with the risk of congestion in the legislative timetable.

[See also under Employment, where the proposed cuts require the same legislation as that for (b)].

Local authority current expenditure

Cut requiring legislation

Your proposals assume the introduction of Mr Heseltine's proposals to curb local authority rate increases.

Comment

Ministers have agreed that the necessary legislation should be introduced as soon as possible in the next Session.

II. PROPOSALS REQUIRING AFFIRMATIVE RESOLUTION ORDERS

Agriculture - MAFF (+ DAFS and WOAD)

(a) Reductions in bids requiring order

Reject bid for hill livestock compensatory allowances.

Comment

Rejection of the bid would involve not only rejecting any uprating of allowances; it would also involve a reduction in money terms from the level of allowances currently in payment to hill farmers. As such, the proposal is likely to be highly controversial.

(b) Cut requring order

Cut rate and/or coverage of capital grants to farmers to produce reduction in costs of 40%.

Comment

In order to cut expenditure by reducing the rates of grant or the coverage of the two major schemes an order would be required under the affirmative resolution procedure. In theory some changes could probably be made to one Scheme without an affirmative resolution, but this course has never been adopted before, and MAFF consider affirmative resolutions necessary for any changes to either scheme. The proposals are likely to be opposed by the agricultural lobby, but this may be mitigated if the analogous cuts in regional development grant rates are approved.

Department of Industry

Cut requiring order

Reduce regional development grant rates from 15% to 12% in development areas and from 22% to 18% in special development areas.

Comment

The order would have to be introduced as soon as possible after the announcement of the new rates. The proposal is likely to be very controversial.

Home Office

Cut requiring order

Increases in fees (naturalisation, firearms, and London taxis).

Comment

It is intended to increase fees to a level which will cover costs in full.

It is accepted that action on naturalisation fees should await the passage of the British Nationality Bill through the Lords. The increases are likely to be opposed by opponents of the Nationality Bill. Increases in firearm licence fees will be opposed by members representing rural constituencies. The licensing costs on London taxi cabs will be large, but will be passed on to customers. All three will be controversial.

DHSS (Social Security)

Cuts requiring orders

(a) Changes in details rules for supplementary benefit.

(b) Abate November 1982 uprating of unpledged benefits by 5%.

Comment

Both proposals are likely to be highly controversial - the Opposition must be expected to present them as the Government being vindictive to the poor.

III. Scotland, Wales, Northern Ireland

Block treatment means that the territorials will decide themselves how to achieve the public expenditure figures resulting from the Survey. It is therefore not possible to say confidently what legislation will be required. Northern Ireland are likely to wish to keep in line on Social Security, employment measures and health. Anything requiring legislation in GB would require NI legislation (which is by Order in Council) to be put into effect also in Northern Ireland.

2. Wales will largely be covered by English legislation. The Scots intend to include provisions on local authority current expenditure in pursuit of similar objectives to Mr Heseltine in a Bill already planned for next session. Employment and DOI legislation should be on a GB basis and although there is separate Scottish legislation on Health, there are precedents for matters of charges being settled by GB legislation.

Price effects of proposals

Summary

The proposals listed below would add roughly 0.27 (net) to the RPI.

Agriculture (IBAP - EEC expenditure)

1. Abolish beef premium.

   Would increase retail beef prices by about 5p/lb. Would add about 0.25 to the Food Prices Index and 0.05 to RPI.

Department of Industry

2. Reduce RDG rates.

   Indirect effects only, difficult to quantify, but may occur as follows:

   a) firms may forego the investment and remain less efficient: any price reductions resulting from increased efficiency will be lost

   b) the investment may go ahead, in which case the additional financing costs are likely to be passed on in prices.

Department of Transport

3. Earlier abolition of new bus grants.

   Indirect effect only - so small as to be unlikely to result in additional fare increases.

Housing

4. Higher rent increases.

   The proposal is for rent increases in 1982-83 of £4/week, rather than the £3.50/week increase that Mr Heseltine has indicated he would otherwise have been likely to propose. Figures for later years are unchanged. The extra RPI increase resulting from the £0.50/week higher proposal would be 0.12. the total RPI increase resulting from the £4/week increase would be about 1.0.

(other environmental services)

5. Cuts in local authority and water authority capital expenditure.

The cuts will have indirect effects in reducing local authority and water rates by reducing debt charges in the case of local authorities, and by reducing the asset base on which the financial target is calculated in the case of water authorities. But any effect on the RPI would be negligible.

Home Office

6. Increases in certain fees.

The Home Office have not yet decided on the charging structure they would propose if the overall increases were agreed. But for naturalisation fees, the increase might be of the order of 75-100%; for firearms, of the order of 33%. On taxis, the existing charging system is hopelessly archaic, but in the year of change each taxi would pay an additional £60. The effect of this on fares and the RPI would be negligible.

DHSS (Health)

7. Increase existing charges: introduce new charges.

The charges proposed are:

Prescriptions £2 (currently £1)

Half prices prescriptions for currently exempted groups £1

Maximum dental charge £12 (currently £9)

Sight test £2

Hotel charge £29/week

Road Traffic Act charge £6/year on insurance premiums

GP consultation charge £2

The increase in existing charges would add 0.1 to the RPI. The increase in the RPI resulting from the increase in insurance premiums is negligible. The introduction of the other charges will have no visible effect on the RPI: they will only be picked up when the RPI is reweighted, but since it is rebased at the same time, any change would not show.

8. Cuts in arts support

Whether there were price increases would depend upon the way the Arts Council allocated the cuts, but some theatres etc might well have their support reduced and increase prices to compensate. This would feed through to the RPI, though the effect is likely to be negligible.

Nationalised Industries

9. Reduce EFLs.

None of the proposals to cut EFLs agreed up to 6 October entail tariff increases in the monopoly or quasi-monopoly industries. Nor do the further proposals in Annex B to C(81)51 assume any additional tariff increases. Although the final decisions rest with the industries, there is a good chance that tariff increases as a means of achieving target external financing reductions can be avoided.

ANNEX A

The International Background

1. The United Kingdom is not alone in suffering stubborn inflation, sluggish output and rising unemployment. It is also not alone in the hard decisions it is having to take on public spending in order to deal with them.

2. Consumer prices in the major seven OECD economies continued 10 per cent higher in July than a year ago. France and Italy suffered appreciably higher rates - 13 per cent and 19 per cent respectively. The OECD Secretariat's latest forecasts suggest that all the major European economies will have lower output this year than last year with even such traditionally strong countries as Germany showing a fall in GDP. Unemployment, too, has been rising in all Europe's big economies and, after a short pause, there has also been a further rise in unemployment in the United States.

3. The world's money and currency markets have shown sharp fluctuations in recent months with steep increases in interest rates and large movements in exchange rates. Short-term interest rates in the United States which rose to over 18 per cent in the summer, have since eased back but remain historically high at 15½ per cent, reflecting the conflicting pressures for funds between the private sector and a Federal Budget deficit still apparently too high. Prime industrial borrowers are paying 18-19 per cent. Interest rates in other countries which rose in the wake of American rates, have so far eased back only gradually and in many cases remain very high in real terms.

4. There have been increasing signs of readiness on the part of most governments to persevere with firm policies to halt and then reverse these worrying trends. In particular, governments are continuing with their efforts to control monetary growth, curb their budget deficits and keep public spending in check to lay the basis for renewed growth without inflation.

5. It is not easy to reverse the trends of the 1950s and 1960s which saw an increasing share of national income in many countries taken by public spending. It is also not popular - though victories by parties committeed to curbing public spending in the United States, Sweden, Norway and Australia in the

past two years suggest that electorates, too, are increasingly aware of the need to curb public spending. The French choice of a Socialist government with radically different policies is the main exception, although even there an important group in the French Cabinet is arguing for prudence, and F Fr 15 billion of public investment projects for next year have been frozen.

6. In most industrial countries budgetary measures in the current year have reflected determination to prevent the recession adding to deficits. The OECD Secretariat's analysis of the policies of 22 members shows that about two-thirds have been trying to cut public spending plans this year. Only a handful (5 including France) announced higher spending.

7. Looking to next year and beyond many countries are seeking to secure a lasting reduction in their budget deficits. President Reagan has repeated his determination to keep the federal government's deficit down to $43 billion in the 1982-83 fiscal year and to balance the budget by 1984. The governments of Germany, and the Netherlands are seeking to reduce their budget deficits next year as a percentage of GNP. The Irish and Swedish governments have announced plans to put their deficits on a declining trend over the medium-term. The recent Australian budget introduced measures to eliminate the federal deficit entirely next year.

8. The drive to reduce budget deficits has involved many governments in hard decisions on public spending. The US Administration is seeking further reductions of $13 billion next year in planned spending in addition to the $35 billion cuts already agreed by Congress in the summer. The German government has announced cuts of DM 10 billion in spending plans. The Italians are seeking cuts of 9,700 billion lire. The Swedes have proposed budget savings of Kr 6 billion and the new coalition in the Netherlands is seeking cuts of 4.5 billion guilders.

9. Countries have of course chosen different priorities in seeking economies. However, in many countries programmes once considered sacrosanct have come under keen scrutiny in the new situation:

> Spending on <u>social security</u> is being curbed in a number of countries, with tougher eligibility rules for unemployment pay, food stamps and other benefits in the United States,

restrictions on child benefits in Germany and Belgium, and proposals for cuts in planned social security spending in the Netherlands.

The US government is cutting planned spending on health and Medicaid, as well as the training of doctors and nurses. Hospital beds are being reduced in the Netherlands and Belgium, who are also raising prescription charges and cutting hospital building programmes. Germany, too, is raising prescription charges and seeking economies in other treatment costs. Italy is increasing charges, and has halted recruitment to the national health service. Ireland, too, is seeking savings on health programmes with higher hospital and prescription charges.

Planned spending on education is being lowered in the Netherlands, Belgium and Italy. The US has placed tight ceilings on education spending, including curbs on student loans and restrictions on the funds available to subsidise school meals. Ireland has increased university fees.

Housing budgets are being cut back in Sweden and the Netherlands. Mortgage subsidies are being reduced in Ireland.

Transfers from central government to local authorities are being restricted in a number of countries including the United States and Sweden. In Sweden this is designed specifically to affect authorities that fail to keep to spending targets.

Staff savings in public administration are a common objective of many governments. President Reagan is seeking to reduce the number of public employees by 75,000 in 1982. The German government is looking for a 1 per cent reduction in public servants. The Dutch are seeking a real reduction in public sector salaries as well as changes to public pension arrangements.

Defence spending, which is being given priority by many governments, has not been exempt from retrenchment plans. The ambitious US defence programme has been trimmed. Sweden is reducing its planned defence budget, and the Belgians have proposed a moratorium on defence projects. Germany has abandoned the NATO 3 per cent target.

10. Among countries which have announced their budgets for next year, only the Danes and the French have overtly adopted expansionary policies. In both these countries, this year's budget deficits already seem likely to be significantly greater than planned and next year's deficits are projected to increase by around 25 per cent. The French have in addition tacitly abandoned the monetary targets of the previous administration.

11. The risks of these strategies are evident. In both Denmark and France, inflation is running well above the OECD average. The French have been forced to devalue. Price controls are being reintroduced in France. There are now signs that the Mitterand government is having second thoughts about its spending plans even before the Budget has passed the National Assembly with the freezing of investment projects.

ANNEX B

THE IMPLICATIONS FOR PUBLIC FINANCES OF ADDITIONAL PUBLIC EXPENDITURE ON MANPOWER

B1 Because the cost to the government of unemployment is so high it is sometimes asserted that additional public expenditure that creates employment has a very low cost if the resulting savings on unemployment benefit etc. are taken into account. The converse has been asserted also, namely that cuts in public expenditure that involve an immediate and direct loss of employment produce little benefit for public finances. This Annex therefore considers the implications for public finances of additional public expenditure.

B2 Estimates of the total cost of additional public expenditure of a particular type will vary according to its precise nature and whether it is offset by an increase in taxes. Paragraph 22 of the above paper assessed the implications if there is an offsetting change to tax rates. This Annex extends the analysis in paragraph 18 which assessed the consequences to the economy if there is no such offsetting increase to tax rates.

B3 Expenditure on manpower has a greater initial impact on unemployment than the other main categories of public expenditure. To illustrate the implications of extra public expenditure that has a favourable direct effect on unemployment, this Annex therefore examines the effects of additional expenditure on manpower. It should be remembered, however, that this is a category of expenditure the government are committed to reduce. (It is claimed that certain categories of special employment measures have lower net public expenditure and PSBR costs than expenditure on wages and salaries, but there is considerable uncertainty as to the precise effects of these measures in reducing unemployment. In addition most of them seriously distort the labour market in ways that it is not possible to quantify, but which reduce their attractiveness.)

B4 The calculations summarised here assess the overall economic effects and the impact on public finances - especially the effect on total public expenditure and the PSBR - of an additional £1 billion of central government expenditure on manpower (ie wages and salaries). It is assumed that the extra expenditure is, in the first instance, on extra employment and not on higher pay, though, as paragraph B9 shows, one of the many possible side effects of the extra expenditure is higher wages and prices. It is assumed that the extra central government employment is maintained in later years. In practice an increase in expenditure on employment would almost certainly involve a related increase in public expenditure on procurement and possibly on capital expenditure as well. The calculations below assume that there is no such increase in public expenditure. They are therefore likely to overstate the direct gain to employment of an extra £1 billion of public expenditure.

B5 Most analysis of the costs of unemployment, and therefore of the benefits of measures that reduce it, concentrates on certain easily identified direct consequences for public finances. Thus the Treasury article "Costing unemployment" (Economic Progress Report, February 1981) presented estimates of the effects of a change in unemployment on receipts of

(i) income tax,
(ii) National Insurance and other contributions,
and(iii) the National Insurance Surcharge,

and expenditure on

(i) National Insurance and other social security benefits,
(ii) rent and rate rebates,
and (iii) other administrative costs.

B6 As the article recognised, these readily identified direct effects do not give the full picture. There are other components of receipts and expenditure that vary with the state of the economy. An increase in public expenditure on manpower will have implications for the behaviour of the economy - eg on interest rates, the levels of wages and prices, the exchange rate etc. Not all these effects will be strong in the first year in which the additional public expenditure takes place, but will build up through successive years. For this reason estimates of the direct effects on public finances in the first year will not show the full consequences of additional public expenditure. Table B1 summarises the effects of the assumed additional public expenditure on interest rates, the RPI, GDP and total unemployment.

B7 Table B2 compares the direct effects in the first year of an additional £1 billion of central government expenditure on manpower with estimates of the total effects over a four year period. The estimates of the total effects assume:-

(a) No change in the growth of the money supply; interest rates will therefore rise in response to increases in the demand for money;

(b) A freely floating exchange rate;

(c) Average earnings in the economy determined by the supply of and demand for labour;

and (d) Fixed real tax rates and allowances (ie nominal tax allowances and specific duties are raised retrospectively in line with increases in the RPI).

B8 There are certain obvious differences between the estimates of the total and direct costs.

(i) the debt interest cost of the additional expenditure rises steadily over the four years, reflecting both the higher PSBR and the higher interest rates.[1] There is no allowances for this in the direct costings;

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(1) If the calculations in Tables B1 and B2 were on the assumption of fixed interest rates rather than fixed money supply the debt interest cost of the extra public expenditure would not rise as much as in Table B2. However, with unchanged interest rates extra public expenditure would entail a higher money supply and therefore higher inflation.

(ii) By increasing activity and pressure in the labour market higher public expenditure will tend to raise both prices and wages. Although this adds to tax and National Insurance receipts, it also raises the price of public expenditure (and causes social security upratings to be higher than they would otherwise have been);

(iii) the calculations of the total effects of higher public expenditure assume that the receipts and outgoings of the National Insurance fund are balanced by varying rates of contribution. Lower expenditure on unemployment benefit will therefore lead to lower contribution rates than would otherwise have been the case. The alternative assumption of unchanged contribution rates, which is made in the direct costings in Table B2 and in the Economic Progress Report, would lower the PSBR cost of extra employment by £180m in 1982-83, and by a similar absolute amount in later years. This alternative assumption would imply an excess of receipts over expenditure for the National Insurance Fund. In practice contribution rates would change to offset this, hence the conventional assumption.

(iv) Average earnings in central government are approximately 11 per cent higher than in the private sector. The calculations in the table assume that the additional central government employees receive average central government pay. If the pay of the additional staff were lower an additional £1 billion of expenditure would have a greater initial effect on employment(1). One consequence would be greater savings on unemployment and social security benefits. With lower than average central

(1) At the extreme it has been suggested that public works jobs could be created paying wages equal to the benefit rate grossed up for tax flow backs. Whatever the political feasibility of this proposal, it would not be possible to attract people to work unless some premium over their benefit rate was paid. Indeed the people who would have most incentive to take these jobs would be those with low entitlement to benefit. Any feasible scheme would therefore have a significant PSBR cost.

government earnings for the additional manpower, and hence a larger fall in unemployment there could, however, be a stronger tendency for earnings - including those of public sector workers - to rise.

B9 The estimates in the table clearly depend crucially on how prices and wages react to higher public expenditure. The assumption is that cash planning factors hold in the first year, but that thereafter they are set broadly to reflect the prospects for inflation in the economy. Any increase in public expenditure on manpower will cause an immediate stimulus to output and a reduction in unemployment. Table B1 shows, however, that this effect will diminish over the four year period as a result of higher interest rates on the one hand, and higher prices and earnings on the other. While employment by the central government is, by hypothesis, higher and has an immediate impact on unemployment this is offset, by an amount that increases through the period, by lower private sector output and employment which reduces the fall in unemployment. By the end of the period the addition to GDP has almost disappeared. Because employment and unemployment adjust with a lag to changes in output the table does not show the full extent to which the erosion of the increase in GDP would eventually have a similar effect on the fall in unemployment. The estimates in Table B2 would be different if it could be assumed that the extra public expenditure and borrowing had no effect on the prices of the various categories of public expenditure. The adverse effects on public finances of the extra public expenditure would be much reduced. Such an assumption would, however, be unrealistic in the light of past experience.

B10 Table B2 shows, on the assumptions set out above, the estimated direct and indirect effects on public finances of additional public expenditure. These estimates indicate that after taking account of all the consequences for public finances of the additional public expenditure,

(a) the increase to total public expenditure in the first year is <u>higher</u> than the increase in expenditure on manpower;

(b) the PSBR cost in the first year is less than the direct increase to public expenditure (though greater than the PSBR cost in the direct estimate);

and (c) both the total public expenditure cost and the PSBR cost rise steadily through the four years; by the end of the period the PSBR cost (in cash) <u>exceeds</u> the initial direct increase in public expenditure.

TABLE B1

IMPACT OF £1 BILLION HIGHER CENTRAL GOVERNMENT EXPENDITURE ON MANPOWER ON THE ECONOMY IN 1982-83, SUSTAINED IN SUBSEQUENT YEARS*

Changes to the level of	1982 Q4	1983 Q4	1984 Q4	1985 Q4
Unemployment ('000s)				
:direct effect	-105	-105	-105	-105
:total effect	-100	-100	-90	-70
Short-term interest rates (% points)	0.5	0.7	1.0	1.3
RPI (%)	0.2	0.5	0.9	1.3
GDP (%)	0.5	0.5	0.3	0.1

*The cash increase in expenditure is £1 billion in 1982-83. In subsequent years the initial increase in expenditure is raised in line with inflation to maintain the initial stimulus to Central Government employment.

TABLE B2: THE EFFECT ON PUBLIC SECTOR EXPENDITURE, REVENUE, AND BORROWING OF HIGHER EXPENDITURE ON MANPOWER

£ million CHANGES TO	DIRECT COSTINGS 1982-3	DIRECT AND INDIRECT COSTINGS 1982-3	1983-4	1984-5	1985-6
General government wage & salary bill	1000	1000	1365	1680	1975
Other final consumption (1)	-	15	115	260	405
Unemployment & social security benefits	-160 (4)	-140	-150	-130	-80
Other current grants & subsidies (2)	-5	60	185	390	635
Debt interest expenditure (3)	-	95	285	455	625
Other expenditure	-	40	15	40	55
Total Public Sector Expenditure	835	1070	1815	2695	3615
Employers NIC & NIS	115	25	55	90	130
Employees NIC	60	-30	0	45	105
Income tax	245	325	565	790	930
Indirect taxes	-	85	230	380	530
Other receipts	-	20	140	245	415
Total Public Sector Receipts	420	425	990	1550	2110
PUBLIC SECTOR BORROWING	415	645	825	1145	1505
Memorandum item:					
Public Expenditure Planning Total + Debt interest		995	1615	2320	3020

(1) includes GDFCF and stocks
(2) includes capital grants.
(3) interest payments by consolidated Public Sector.
(4) These estimates assume that registered unemployment changes by 80% of the change in employment. The figure used in the February EPR article was 75%.

Explanatory Notes to Table B2

NB All the rows except the final one are national accounts and not PES definitions.

General government wage and salary bill. In 1983-84 and subsequent years, the initial increase in expenditure is raised in line with inflation to maintain the stimulus to Central Government employment. The general government wage and salary bill will however increase by more than this, because higher wage inflation will increase cash expenditure on existing manpower plans. (For the first years, however, because cash limits hold this effect from higher wage inflation is offset by a squeeze on manpower.)

Other Final Consumption Higher costs and prices will lead to increased cash expenditure on an unchanged volume of current consumption in years after 1982-83. (See paragraph
As paragraph B4 makes clear there is no allowance for higher expenditure on procurement or capital that an increase in expenditure on manpower would probably involve. Similarly there is no allowance for saving on administrative costs that lower expenditure on unemployment and social security benefits would make possible. (This effect was included in the February EPR costings.)

Unemployment and Social Security Benefits. Over time the initial improvement in unemployment tends to be offset by the adverse second-round effects of higher interest rates and inflation, thus reducing the initial savings on these benefit payments.

Other Current Grants and Subsidies. Higher inflation increases the costs of benefit upratings.

Debt Interest Expenditure. This increases because

(a) the outstanding volume of government debt is growing due to the cumulative impact of higher PSBRs;

(b) interest rates are higher to finance the higher PSBR without expanding the money supply.

<u>National Insurance Contributions.</u> Contribution rates are adjusted in order to keep the balance in the National Insurance Fund unchanged. Savings on national insurance benefits to the unemployed are therefore passed on in the form of lower contribution rates.

<u>Income Tax and Indirect Taxes.</u> These increase due to increases in the tax base from the higher numbers employed and increases in consumers' expenditure and also because prices and wages are higher.

DRAFT (Revise - 9 October 1981)

C(81) N + 1

PUBLIC EXPENDITURE

Memorandum by the Chief Secretary to the Treasury

Introduction

This paper contains specific proposals for the various expenditure programmes which would achieve the totals suggested in the parallel paper by the Chancellor of the Exchequer (C(81)N).

The proposal

2. The Chancellor and I propose the public expenditure planning total for 1982-83 and later years should be, compared with the White Paper revalued:

			£ billion		
	1980-81	1981-82	1982-83	1983-84	1984-85
1981 White Paper (revalued and adjusted for Gas Levy, etc)		104.5	109.9	113.9	119.6
Expected outturn	94.2	107.2			
Proposal			113.6	118.7	127.1

3. The relationship of these proposed totals to the White Paper, to the present position and to the additional bids are shown in Table 1 attached. The proposals in general fall short of what is proposed by departments but are still substantially higher than

those in the last White Paper. The problems that even this proposed increase of spending would present are discussed in the Chancellor of the Exchequer's paper (C(81)N).

The allocation to departments

4. I propose that the allocation to departments should be as in Table 2. Table 3 shows these allocations in relation to expenditure in 1978-79, to show the relative growth of expenditure by different departments. The Annex sets out for each department:

(i) How the proposed provision compares with that provided for in the White Paper and that sought through the bids.

(ii) An explanation of the main considerations leading to my proposal for that department.

5. Departmental Ministers have received details of how expenditure could be kept to the level I propose. In several cases the scale or significance of the policy change will be such that it requires collective endorsement, and in some cases legislation. We should need to give that endorsement before or as part of agreement to the figures. The cases where such policy changes appear to be required are identified in the Annex.

6. If departmental Ministers see such difficulty about my detailed proposals that they would prefer to adopt some other ways of keeping

to the figures I have proposed for them, with different changes in policy, it will of course be open to them to suggest such ways.

But we shall need to satisfy ourselves that the ways proposed will indeed achieve the required level of expenditure, and similarly endorse any major policy changes involved In any event, however, if the provision for local authority current expenditure in programmes is fixed this year on the basis of realism, it would not be appropriate for departmental Ministers to switch their programmes to or from that provision.

General points

(a) Status of the figures

6. The figures which we decide for 1982-83 are to be regarded as firm, subject only to the adjustments to demand-led elements for changed economic assumptions (paragraph) below. They will be translated directly into detailed Estimates and cash limits. Any subsequent decisions to add to them will be charged to the Contingency Reserve.

7. The figures for 1983-84 will be subject to review next year. But we must avoid repeating then what has happened last year and this - namely increasing substatially the amount provided. The regular repetition of substantial upward revision to our published public expenditure plans brings discredit on our administration of public expenditure. In so doing it contributes to a loss of confidence - particularly in financial markets - in the government's economic policy.

We need to ensure that the figures are realistic, and that departments take the necessary action during the coming year so that they can live within them in 1983-84, rather than make additional bids next year.

8. The figures in paragraph 2 for 1984-85 is the product of carrying through to that year departments' bids and my proposals for the previous years. But it is so unacceptable - an increase of 7% on the previous year on the basis of an inflation assumption of 5% - that I propose that we remit it back to officials to study how the growth can be brought down to a more realistic level.

(b) Nationalised industries

9. The industries originally bid in total for £2,500 million for 1982-83, in addition to the £1,470 million provided for in the White Paper. The increases sought were even larger in later years. E Committee agreed in July to aim to restrict extra provision to £750 million a year. The further series of consultations since then have successively resulted in a prospective further excess over the £750 million for 1982-83 of £1,310 million and most recently £975 million. I propose that the increase in the EFLs in 1982-83 should be held to £495 million over what we agreed in July; making total extra provision compared with the White Paper of £1,245 million. My proposals for individual industries are set out in Annex B.

10. The further consultations between department and industries to reduce the larger excesses in the two later years has not yet been completed, so that I cannot yet make a proposal. But in considering our plans for other programmes and the total, it would be prudent to proceed on the

basis that some of the further excess in the later years will have to be accepted, say one third. That would add respectively £600 million and £550 million in those years bringing the total increase over the White Paper provision to £1,350 million and £1,300 million respectively. This temporary provision is without prejudice to what I will propose when the examination is complete.

(c) Capital and current expenditure

11. We agreed in our discussions this summer that it would be desirable to increase the proportion of capital expenditure in the total. The last White Paper provided for central and local government capital expenditure (excluding finance to nationalised industries) for 1981-82 and 1982-83 which was only 10% of total public expenditure. Although that statistic is of limited significance (since capital as conventionally defined in public expenditure statistics, is by no means the same as either expenditure on productive investment or procurement from the private sector), I would nevertheless have wished to improve the preparations.

12. However, excluding the financing of the nationalised industries, only some 5% of the bids that were put forward by departments were for capital. The bids agreed so far, such as for employment measures, the increased provision for local authorities and the various estimating changes have all been current. Of the outstanding bids of £2¼ billion for 1982-83 and £3½ billion for 1983-84, % and % respectively, are for capital expenditure. Consequently, in putting forward proposals to bring the prospective excess over the White Paper back from £7¼ billion and £11½ billion in the two years to half that, I have not been able to make the desired shift. The net outcome is that control and local government capital expenditure will be 9⅓% in 1982-83 and 9% in 1984-85.

13. There is no direct correspondence between the changes in finance provided to nationalised industries (EFL's) and their capital investments My proposals to limit the increase in the nationalised industry EFLs to £1,245 million in 1982-83 will probably mean that nationalised industry fixed investment will be little different in total that year than provided for in the last White Paper.

(d) "Validation of Inflation"

14. We have already decided not to attribute any of the increases which may be made in the provision in local authority current expenditure to the continuing effect of price increases above 11% during the current year or pay increases above 6%, except in the case of the police. For them I propose adding to the programmes provision for the continuing cost in later years of this year's settlement over the 6% factor. The Armed Forces pay increase should be treated in the same way. But we should not allow for the carry forward of any other pay settlements in excess of the 6% factor. The experience of price movements during the current year does not justify carrying forward any extra costs on that account.

(e) Future relative price movements

15. The only case where there is sufficient evidence so far that future price movements affecting a particular block of expenditure are likely to be so significantly higher than average as to warrant our deciding now to make increased provision for them is health. But I am proposing a policy reduction that more than offsets this.

16. The Secretary of State for Social Services is bidding for additional cash for NHS pay. I propose that the implication of this for pay policy should be considered by E(PSP) before we take a view on whether to allow extra, and if so at what stage. I have allowed for it provisionally in

the totals.

17. Where pay increases are recommended by Pay Review Boards or arbitration, we shall have to consider at the time both how far such recommendations can be accepted and how far excess increases which are agreed can be absorbed within existing programmes or should be financed by additional cash allocation, which would be a charge on the contingency reserve.

(f) General cut in administrative expenditure and other cash limits

18. The prospect for inflation has worsened since the inflation factors were chosen in September. Their effect is now likely to be a volume squeeze on non-pay elements of 1% or a little more. The factors were put forward in good faith on the information at the time. In the present circumstances, I ask colleagues to accept the possible consequences for their programmes, and not seek a cash adjustment.

19. In addition I propose cash reductions, compared with the White Paper as revalued, in virtually all cash-limited programmes, except defence, ? universities and prisons. I propose cutting all staff and general administrative expenditure by 2% from the White Paper revalued. In the case of programmes involving other types of expenditure, I propose a variety of specific and general cuts (included in the details given to individual Ministers) amounting to at least 2% in the case of each programme.

20. I think it is right that we should bear severely on central

government salaries and general administrative expenditure, and encourage the National Health Service and local authorities to do the same. In this connection I draw the attention of colleagues to the report published by the CBI in September on ways of reducing government expenditure, particularly costs of manpower. The CBI study supports the Government's own policy of reducing the costs of public administration; especially relevant is the evidence of the experience of private sector companies that force of circumstances has often brought about manpower savings previously judged by those concerned impracticable, and that those savings have been shown to be tolerable.

Other points

(a) Local authorities

21. We decided on 24 September that the Secretary of State for the Environment should have authority to discuss with local authority leaders the means of securing the maximum feasible reduction in real expenditure next year; (CC(81) - Conclusions, Item). He will shortly be reporting to us. Meanwhile, for internal purposes departments are working on the basis of a total addition to cash programmes, compared with the White Paper revalued, which implies total reductions in real terms of 7%, 4% or 3%. My proposals provide for the highest of these three levels, a volume reduction of 3%, implying cash expenditure in 1982-83 some £850 million higher (GB) than allowed for in the White Paper revalued. The allocation to individual programmes is on the basis agreed in MISC 21 on 9 October 1981.

22. We must maintain the pressure on local authorities to reduce expenditure, so that over a period of years they come back closer to the level of expenditure earlier envisaged. I propose that the provision

for local authority current expenditure in 1983-84 and 1984-85 should be increased from the White Paper revalued only to the extent necessary to allow for a 2% fall in real terms each year, if we decide on the highest level of the three options for this year.

23. Even allowing for a change in programme figures on grounds of realism, local authorities will still probably overspend them to some extent. This is partly because of the difficulty in cutting some types of expenditure quickly, partly because of the limited impact of the new legislation, important though that is, and partly because, unless we cut the RSG percentage substantially, local authorities will have considerable scope for increasing expenditure in 1982-83 beyond what we provide for in our present discussions without increasing their rates by more than the rate of inflation. I regard it as essential that the RSG percentage next year should be reduced substantially to reinforce the effects of the forthcoming legislation, and prevent local authorities actually increasing spending further without levying very high rates. My allowances for their overspend are on the basis that the percentage of RSG will be cut in this way: if it is not the overspend could be considerably greater.

(b) Economic assumptions

24. The proposals in this paper use the same economic assumptions for unemployment and interest rates as in the March White Paper. The price assumptions are in line with the inflation factors: 9% (non-pay) for the change to 1982-83, and 6% and 5% respectively for the following 2 years. The latest economic prospect is that we will have to allow,

in estimating the costs for demand led programmes, for slightly higher unemployment, higher interest rates and higher prices. The programmes affected will have to be adjusted for this on the best assumption which we can make when we come to settle the White Paper. It seems undesirable to adjust the actual programmes now on this account, and again in a few months time. I have accordingly included in the totals, but not in the specific programmes, an "estimating allowance" for this and for the local authority overspend referred to above of £2.1 bn. in 1982-83 and £4.6 bn. in 1983-84.

25. The substantially higher figure for 1983-84 is because of the November 1982 social security uprating. It now seems certain that we will have to make good then the under-provision this year: the RPI will be 1 to 2% higher this November than the 10% annual increase allowed for in fixing the 1981 uprating. Further, the annual increase in the RPI to November 1982 will be higher than the 9% factor allowed for in the revaluation: as noted above the general level of price increases now appears likely to be somewhat higher than 9%, and the increase in the RPI will probably be somewhat greater. I am, however, proposing that the extra cost of these upratings should be offset in part by abating the uprating of those benefits not covered by specific pledges by 5% - in line with the general average fall in real incomes we are expecting over the two years.

Timing and announcement

26. If we are to get the RSG settlement made before Christmas, so that the new legislation on local authority rates has a better chance of affecting local authority expenditure next year, we need to decide the provision in programmes for local authority current expenditure

in 1982-83 on 29 October. The timing of the disclosure of that decision to local authority associations, and its announcement, would then be for the Secretary of State for the Environment.

27. For the rest we must complete our decisions, at least for 1982-83, by mid-November so that departments and others can prepare their Estimates and budgets for next year. I propose that, as last year, the decisions for the coming year should be announced in broad terms probably about 10 days later. The full public expenditure White Paper would be published on Budget day.

Conclusion

28. I invite colleagues:

(i) to agree that the public expenditure allocation for departments for 1982-83 and 1983-84 should be as set out in Table 2;

(ii) to agree to the proposals for local authority current expenditure in later years in paragraph 22;

(iii) to remit back to officials for further study ways of reducing the prospective figures for 1984-85;

(iv) to agree to the arrangements for announcements set out in paragraphs 25 and 26 above.

SUMMARY

PUBLIC EX[illegible] [illegible]ITURE SUMMARY TABLE

9 October 1981

TABLE 1

	1981-82		1982-83		1983-84		1984-85	
1. LAST WHITE PAPER (Cash equivalent)		103.95		109.39		113.34		119.00
2. Adjustments (eg for Gas levy)		+ 0.53		+ 0.54		+ 0.57		+ 0.59
3. STARTING POINT		104.48		109.93		113.91		119.59
4. PRESENT POSITION								
(i) Additional bids already agreed								
a) Nationalised industries	+0.56		+0.75		+0.75		+0.75	
b) Employment package	+0.16		+0.69		+0.69		+0.53	
c) Other	+0.35		+0.18		+0.25		+0.72	
		+ 1.07		+ 1.62		+ 1.69		+ 2.00
(ii) Contingency Reserve		- 0.38		- 0.75		- 0.75		- 0.75
(iii) Estimating changes etc								
a) Economic prospects -								
- social security uprating	-		+0.4		+1.9		+3.0	
- other price effects	-		+0.2		+0.6		+1.5	
- other	+0.3		+1.0		+1.4		+1.4	
b) Other	+0.26		+0.12		-0.30		+0.30	
		+ 0.56		+ 1.72		+ 3.60		+ 6.20
iv) Local authorities								
a) Increases in provision (on grounds of realism) (highest option)	-		+0.93		+0.67		+0.24	
b) Expected overspend	+1.5		+0.5		+0.7		+0.7	
		+ 1.50		+ 1.43		+ 1.37		+ 0.94
PRESENT TOTAL		107.23		113.95		119.82		127.98
(Change on 3)		(+ 2.75)		(+ 4.02)		(+ 5.91)		(+ 8.39)
5. FURTHER BIDS								
i) Nationalised industries (revised)			+0.97		+1.8		+1.65	
ii) Other, excluding local authority current			+2.23		+3.44		+4.63	
				+ 3.20		+ 5.24		+ 6.28
6. TOTALS INCLUDING ALL BIDS				117.15		125.06		134.26
(Change on 3)				(+ 7.22)		(+11.15)		(+14.67)
7. REDUCTIONS								
i) Nationalised industries reductions in bids			-0.48		[-1.2]		[-1.1]	
ii) Other								
a) reduction in bids			-1.20		-2.37		-3.04	
b) cuts			-1.88		-2.79		-3.04	
				- 3.56		- 6.36		- 7.18
8. RESULTANT TOTAL				113.59		116.70		127.08
(change on 3)				(+ 3.66)		(+ 4.79)		(+ 7.49)

TABLE 2
9 Oct 1981

PROPOSALS FOR DEPARTMENTS

(NB. 1981-82 figures in "Proposal" lines are present provision or current estimate.)

£ bn cash

			1981-82	1982-83	1983-84	1984-85
1.	DEFENCE	White Paper Revalued	12.27	13.62	14.88	15.63
		Proposal	12.27	13.71	14.97	16.20
2 & 3.	FCO	White Paper Revalued	1.56	1.58	1.68	1.76
		Proposal	1.56	1.53	1.63	1.71
5.	IBAP	White Paper Revalued	0.53	0.59	0.62	0.65
		Proposal	0.67	0.62	0.65	0.67
6.	MAFF	White Paper Revalued	0.97	0.98	0.94	0.99
		Proposal	1.00	0.98	0.91	0.93
7.	FORESTRY COMMISSION	White Paper Revalued	0.06	0.06	0.07	0.07
		Proposal	0.06	0.06	0.06	0.06
8.	INDUSTRY	White Paper Revalued	1.97	1.46	1.01	1.06
		Proposal	1.97	1.35	0.85	0.87
9.	ENERGY	White Paper Revalued	0.35	0.39	0.40	0.42
		Proposal	0.36	0.38	0.39	0.42
10.	TRADE	White Paper Revalued	0.27	0.28	0.26	0.28
		Proposal	0.27	0.27	0.25	0.26
11.	ECGD	White Paper Revalued	- 0.06	0.08	-0.04	- 0.05
		Proposal	-0.01	0.14	0.04	0.22
12.	EMPLOYMENT	White Paper Revalued	2.32	1.91	1.88	1.97
		Proposal	2.43	2.74	2.83	2.70
13.	TRANSPORT	White Paper Revalued	2.82	3.04	3.24	3.40
		Proposal	3.24	3.18	3.30	3.38
14.	HOUSING	White Paper Revalued	4.12	3.87	3.37	3.54
		Proposal	4.14	3.78	3.27	3.21
15.	PSA	White Paper Revalued	0.44	0.45	0.48	0.51
		Proposal	0.44	0.44	0.46	0.48
16.	DOE (Other)	White Paper Revalued	3.51	3.67	3.88	4.07
		Proposal	3.59	3.64	3.76	3.91
17.	HOME OFFICE	White Paper Revalued	3.26	3.53	3.79	3.97
		Proposal	3.41	3.63	3.92	4.18
19.	EDUCATION	White Paper Revalued	11.32	11.67	12.10	12.71
		Proposal	11.79	11.95	12.28	12.68
20.	HEALTH	White Paper Revalued	10.79	11.61	12.40	13.02
		Proposal	10.79	11.61	12.11	12.67
20A.	PSS	White Paper Revalued	1.66	1.79	1.93	2.03
		Proposal	1.91	1.96	2.03	2.40
21.	SOCIAL SECURITY	White Paper Revalued	27.57	30.20	31.82	33.41
		Proposal	27.50	29.64	30.87	32.89
23.	SCOTLAND	White Paper Revalued	5.59	5.88	6.12	6.43
		Proposal	5.79	5.90	6.07	6.30
24.	WALES	White Paper Revalued	2.24	2.33	2.42	2.54
		Proposal	2.28	2.35	2.4	2.5
25.	NORTHERN IRELAND	White Paper Revalued	3.22	3.42	3.63	3.81
		Proposal	3.27	3.48	3.65	3.87
	TOTAL CARRIED FORWARD	White Paper Revalued	96.77	102.39	106.86	112.20
		Proposal	98.71	103.28	106.68	112.10

SECRET

		1981-82	1982-83	1983-84	1984-85
Total carried forward	White Paper Revalued	96.77	102.39	106.86	112.20
	Proposal	98.71	103.28	106.68	112.10
26. NATIONALISED INDUSTRIES	White Paper Revalued	2.80	1.47	0.52	0.53
	Proposal	3.36	2.72	1.87	1.83
27. OTHER DEPARTMENTS	White Paper Revalued	3.38	3.61	3.90	4.09
	Proposal	3.45	3.67	3.96	4.19
Other (not for decision now)					
EUROPEAN COMMUNITY	White Paper Revalued	0.46	0.50	0.53	0.56
	Current estimate	0.34	0.69	0.53	0.59
CONTINGENCY RESERVE	White Paper Revalued	2.00	2.85	3.06	3.21
	Proposal	1.62	2.10	2.31	2.46
SPECIAL SALES OF ASSETS	White Paper Revalued	-0.23	-0.18	-0.19	-0.20
	Current estimate	-0.05	-0.46	-0.75	-0.23
ESTIMATING CHANGES (allowance for changes in economic prospects, local authority over-spend, etc)	Current estimate	0.30	2.10	4.60	6.60
SHORTFALL	White Paper Revalued	-0.70	-0.71	-0.76	-0.80
	Current estimate	-0.50	-0.50	-0.50	-0.50
PLANNING TOTAL	White Paper Revalued	104.48	109.93	113.91	119.59
	Proposal	107.23	113.59	118.70	127.08

The "White Paper revalued" figures include certain PSBR - neutral adjustments as well as classification changes.

CONFIDENTIAL

DRAFT

C(81)N

ECONOMIC POLICY AND PUBLIC SPENDING

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

PART I

Introduction

We now need to take decisions about public expenditure for 1982-83 and later years. This paper describes the framework: the Chief Secretary's paper C(81)(   ) gives detailed proposals for the main programmes.

2. The background against which we have to take our decisions is complex, with political and social factors no less important than the economic considerations. Unemployment is now at the centre of the stage. And we are more than half way through the Parliament, and will face a general election within the next two years or so. Various critics call for various changes of course. I have tried in this paper to set our consideration of public expenditure in this wider context.

3. Our objectives have not of course changed: nor should they. We must continue to work to restore the health of the economy, with higher productivity, greater competitiveness, lower inflation realistic pay-bargaining, and hence more jobs. This is inevitably a long-run operation, and we must resist short-term expedients which would run counter to the long-term aims. But it would be equally short-sighted to miss any sensible way of improving our chances of remaining in a position, in two or three years time, to ensure that these aims are still pursued. In short, we must:-

/continue to follow the

continue to follow the treatment which alone can restore health in the long-run; but

try to strike the balance most likely to secure our chances of being allowed to complete the treatment.

4. We must also take account of the international context. I have described, in a minute of 8 October to the Prime Minister, how current developments in the US economy affect our policies and prospects. The overall aim of the US administration is very similar to our own. The risk is that their uncertain performance so far - and particularly the failure to get on top of their deficit - may not only add to our difficulties but tend in some quarters to discredit the policy instruments themselves. Yet in all essential respects, the fundamentals of US policy, and ours, are the same as those of virtually all our major Western partners. In annex A to this memorandum I describe how most countries - including even France under the Mitterrand Government - are having to tighten their fiscal policies and cut their public expenditure plans. It is quite wrong to suggest that we are in some way out of step in attaching particular priority to the long-term defeat of inflation, or in the methods we are using.

/5. The latest

PART II

The UK Economy

(a) The Present Position

5. The latest indicators suggest that the fall in UK output has now come to an end. Total output (GDP) is now expected to be about 2 per cent lower this year than in 1980, in line with the forecast published at Budget-time, following a fall of about the same amount in 1980. Between the second half of 1979 and the first half of 1981 GDP fell by about 5 per cent and manufacturing output by 16 per cent. The recession has thus been the deepest since the 1930s.

6. I described the reasons for this in my Cabinet paper in June (C(81)29). It is of course not a UK, but a world, recession. But its depth here springs largely from sharp increases in pay which, together with a high exchange rate, have reduced profits and competitiveness. In each of the three pay rounds from 1977-78 to 1979-80 money earnings increased by more than 15 per cent while productivity showed little increase. The resulting pressures on business finances contributed to substantial reductions in stocks, and export volumes declined. Firms shed labour extensively to protect their financial position.

7. Virtually the whole burden of adjustment has so far been borne by the private sector, particularly manufacturing. Output and employment in the public services showed little change between mid-1979 and mid-1981; output in the private sector fell sharply, and employment there fell by almost 1½ million. This contrast in employment trends, together with higher public sector pay increases, was reflected in a marked rise in the pay bill of the public sector in relation to the pay bill of the private sector. Over the three

/years 1978-79

years 1978-79 to 1981-82 the public services' pay bill is likely to have risen by more than 60 per cent, or one-and-a-half times as fast as the private sector's. This has played a big part in the growth of public expenditure and in the consequent increases in the tax burden. The figures are as follows:-

TABLE A

% change on preceding year	1978-79	1979-80	1980-81	1981-82 (estimate)	% change over period 1978-79-1981-82
Wage and Salary Bill					
Private Sector	16¼	18½	13½	4½-5	41¼
Nationalised Industries	17½	17	19½	6½-7	49½
Public Services	11½	18½	27½	8-9	64
Total Public Expenditure	15½	18¼	22¾	14½-15½	66½
Nominal GDP	14¼	19¾	13¾	10-11	50¼
Retail Prices Index	8¼	15¾	16¼	11½-12½	50¾
% of GDP					
Share of Total Public Expenditure in GDP (inclusive of debt interest)	41	40½	43¾	45-46	
Non-North Sea tax burden	35	36	37¼	40-41	

8. Nonetheless, we have made progress this year towards a more soundly based economy. The growth of money national income and the rate of inflation have both been halved in the past eighteen months. Unemployment, though much too high and still rising, is now rising more slowly. Pay settlements in the 1980-81 pay round averaged about 9 per cent, half the level in the 1979-80 round. There have also

been some impressive improvements in productivity in both the public and private sectors, with considerable evidence of a change in attitudes to management and work practices, and a new readiness to behave flexibly and realistically. These developments, combined with the fall in the exchange rate, have eased the financial pressures on business. The serious imbalance between the real disposable income of persons and companies that developed in 1979 and 1980 as wages raced ahead of prices has been partly corrected. Probably more than half the loss of competitiveness between late 1979 and early 1981 has now been regained.

9. The general picture is thus of one of the economy adjusting to a lower rate of inflation - but at a pace that is frustratingly slow, especially in political terms.

(b) Prospects for the Coming Year and Beyond

10. The latest forecast suggests a slow recovery in output from mid-1981 onwards, with GDP in 1982 about 1 per cent above the level expected this year. This should slow the rise in unemployment, but is unlikely to reverse it. The immediately dominant influence on output is likely to be the improvement in company finances, reflected in a slower run-down in stocks - though the recent increases in interest rates could have some adverse effect on this. Though personal real income is likely to fall, as pay increases keep below the rise in retail prices, consumption should be broadly maintained because of a further fall in the savings ratio from the exceptionally high levels reached at the end of 1980. Some recovery in investment could be seen as the year goes on.

11. There should be a lower rate of inflation before the end of 1982. However, mainly because of the fall in sterling, progress over the coming year seems bound to be slower than had earlier been expected. Wholesale input prices have risen rapidly recently. The 12-month increase in the retail prices index may not fall to single figures until early 1983. The precise timing, and what happens thereafter, will obviously depend crucially on the coming pay round, and on the avoidance of further sharp falls in sterling or further increases in the mortgage rate. The general outlook for inflation is thus a little worse than was assumed in September, though the worsened prospect for retail prices should not be reflected in full in the prices paid by the public sector. But in the key areas of productivity, pay, competitiveness and profitability, 1982 should produce further movement in the direction indicated by our strategy.

12. Looking further ahead, this promises a better prospect for growth in 1983 and beyond. There are, of course, serious risks. We could be affected by events overseas over which we have no control - e.g. in the US, the Middle East, or even in Poland. The prospect could also be put in jeopardy by events at home, in particular a failure of pay to adjust to lower monetary growth, or a break in confidence that forced interest rates higher or brought a further sharp fall in sterling. These domestic risks we can, and must, guard against. In this context our decisions on public expenditure are of crucial importance.

Part III

The Framework for Policy

PART III

The framework for policies and the level of the PSBR

13. Clearly we must do all we can to maintain the momentum towards lower inflation and to assist the adjustment of the economy. We need to go on reducing the growth of money supply and money income. To ease domestic pressures on the financial markets, this will entail a substantial reduction in the public sector borrowing requirement (PSBR) next year. But the adjustment of the economy would be greatly eased if public expenditure were held to a total that not only permitted a low PSBR and thus lower interest rates, but also provided room for tax cuts which would reduce the upward pressures on costs and prices. The faster inflation can be brought down within the growth of nominal income, the greater the scope for increases in real output and employment.

14. If money supply is to be controlled without excessive interest rates, and if productive private sector investment is not to be squeezed out, the Government must borrow less. This is why a reduction in the PSBR (as a proportion of GDP) must remain a central part of our strategy. More immediately the strength of personal demand for credit, and the pressures imposed on our own interest rates by high rates overseas, provide further compelling reasons for seeking a PSBR next year substantially below this year's.

15. Recent figures for this year's PSBR have been distorted by the civil servants' strike. Adjusting for this, it would appear that the PSBR has been broadly on the course expected at Budget time. Public expenditure higher than expected has been broadly balanced by higher revenues which, for a variety of reasons which may not be repeated, is also bigger than expected.

16. For 1982-83 we envisaged at the time of the last Budget a PSBR of just over £9 billion (at current prices), or about 3¼ per cent of GDP. This compares with the 1981-82 figures of about £10½ billion and 4¼ per cent of GDP. The figure we then looked for in 1982-83 made allowance for the fact that economic activity is lower and inflation rather higher than had been expected in March 1980 when the path for reducing the PSBR over the medium-term was first set out. Not until the time of my next Budget will I be able to take a final view as to what we should aim for. But having regard to the risks on interest rates and the effects on market confidence, I am convinced that we cannot now plan for a 1982-83 PSBR bigger than we envisaged in March; indeed the possibility cannot be excluded that when final decisions have to be made interest rate pressures will call for something lower.

PART IV

Unemployment

17. Unemployment is clearly the most important political problem which we face. Our firm belief on taking office, and drawing on the experience of the most successful industrial countries, was that sustainable growth in employment could only come about through sustainable growth in output, which in turn depended on defeating inflation and improving the performance of our industries - our two basic policy aims. But faced with progress towards our objectives that has been slower than we hoped, partly because the world recession has been so sharp, some, understandably, now seek speedier remedies and short-term solutions. I wish there were one that made sense, but I don't believe there is. I discuss below the two main suggestions that are now made.

(a) Spend More and Borrow More

18. It is frequently argued that a higher PSBR would help employment. But any such help would be marginal and temporary. It is possible in the short-run to increase employment by higher Government spending or lower taxes, but only at the cost of sharply higher interest rates or worsened inflation prospects that would before long cancel out the additional employment. Recent Treasury estimates - and others have done similar analyses, and reached similar conclusions - suggest that additional spending on Government purchases that raised the PSBR by £1 billion in 1982-83 would increase GDP by about ½ per cent in 1983 and reduce unemployment by about 30,000 by end 1982 and 50,000 by end 1983. Interest rates, however, would rise by ½-1 percentage point and the prospect for inflation would be worsened. These adverse effects would become greater over time. Largely for these reasons, the gains to output and employment would be eliminated

by the end of 1985. These figures assume that market confidence would not be seriously shaken; if, as is more likely, the markets reacted badly, the effects on interest rates, inflation and perhaps the exchange rate could be substantially bigger. Fiscal reflation would bring no lasting political or social gains in terms of unemployment. It would damage the prospects for sustainable growth and put at risk the benefit of the efforts we have already made. It would, in short, be a high risk policy with a very uncertain and very short-term possible reward.

19. The above calculations take account of the "second round" effects including indirect effects on social security payments, tax receipts, etc. For any change in fiscal policy the relationship between the gross cost of the measures, its PSBR cost and the effects on interest rates is complex. As a general rule the PSBR might be expected to rise less than the gross amount of the additional expenditure, because of savings in unemployment benefit and additional receipts of taxes as a result of the expenditure. However the additional expenditure would also raise costs and prices and the cost of debt servicing. This increased debt servicing cost would reflect both the higher volume of public sector debt outstanding and the higher level of interest rates needed to keep the growth of money supply on track. When all this is taken into account it substantially reduces, and in time may outweigh, the beneficial secondary effects of expenditure on the PSBR. I include a more detailed analysis of this point at Annex B to this memorandum.

20. When account is taken of these indirect effects on the PSBR and their implications for future years, the notion that extra

public expenditure can largely be self-financing would appear unfounded. Similarly a cut in public expenditure, even in a labour intensive category, will usually significantly reduce the PSBR or within a given PSBR leave room for tax savings. The assertion frequently made that the Government could create more employment, or protect existing employment, at relatively small cost is unhappily not supported by the facts.

(b) Spend More and Tax More

21. Within a given PSBR there is of course scope for a trade-off between tax and expenditure. Given our limited room for manoeuvre this trade-off is of critical importance. In present circumstances there is particular advantage in tax cuts that lower prices or costs. In the short-run these would be likely to have much the same effect on employment as equivalent increases in public spending on goods and services (unless that spending were concentrated on increasing public service manpower, which is the reverse of our policy). In neither case would the addition to employment be more than marginal. But the tax route would bring immediate and lasting benefits to inflation and industry.

/ 22.

22. Recent Treasury analysis of policy options implies that an increase of £1 billion in expenditure would require an increase of more than £1 billion in tax to neutralise its effects on interest rates. The precise trade-off would depend on the type of expenditure and tax being changed. The ratio would be highest for tax changes that would have a direct effect on prices or industrial costs. A reduction of £1 billion in public expenditure would permit a reduction of considerably more than this amount in these taxes - provided, of course, that the reduction in public expenditure was not achieved by higher charges for the same volume of services.

23. These estimates suggest that £1 billion extra Government spending on goods and services, or a cut in indirect taxes such as the National Insurance Surcharge (NIS) having broadly the same effect on interest rates, would reduce unemployment by about the same amount. But the tax cuts route would help to bring down prices whereas increases in public spending would tend to put them up. This is because the adverse effects of higher activity on the exchange rate and pay would not be compensated for by any reduction in labour costs or retail prices of the sort that would be produced by the tax cuts. There would thus be more upward pressure on interest rates. For this reason, and because they will be subject to a market test, increases in employment generated by tax cuts should be more sustainable than those generated by higher public spending.

(c) Conclusion

24. There are thus no quick or easy answers to the unemployment problem. If we were to go for either (a) or (b) above, we would be creating new difficulties on inflation and interest rates, without

making any significant impact on the unemployment totals during the life-time of this Parliament. That being so, the better course is to stick to policies aimed at long-term solutions. The root causes of unemployment lie in low productivity, competitiveness, and incentives. I am sure that we have to continue to attack the problem at its roots. To throw money at it would not help, though we must take care to ensure that our unwillingness to do so is not misconstrued as unwillingness to help.

PART V

Tax and expenditure

25. Against this background we have to balance tax and expenditure considerations. Within a given PSBR more public expenditure means more taxation and less public expenditure less taxation. We came to office pledged to reduce both, but we have found, like all our predecessors and all Governments overseas, that progress this way is enormously difficult. The table in paragraph 7 above illustrates how we have been forced to go in the wrong direction on both, and how private sector employment has borne the brunt of the recession.

26. The rise in the tax burden can be illustrated in terms of its effects on individuals:-

- a married man on average earnings now pays 48½ per cent of his income in taxes and contributions of all kinds compared with 45 per cent when we took office.
- The income tax threshold for a married man has dropped to just over a quarter of average earnings; at £41 per week it is only £3 above the supplementary benefit rate.

And we have done less than we hoped to ease the tax burden on company costs and profits.

27. Our starting point must be a determination not to increase the real burden of taxation; to do so would be an obviously retrograde step, not least in the context of unemployment. My present forecasts assume that in my next Budget income tax thresholds will be raised in line with inflation, as will indirect taxes and duties; and National Insurance contributions will rise to balance the National Insurance Fund. I certainly would not want to do less on the thresholds or more on the indirect taxes. Naturally I should also like to be able to make some reduction in the real burden. There are two areas which are particularly pressed upon me; the company sector, where a reduction in the National Insurance Surcharge would ease the strain on costs and prices and would make for greater output and more jobs; and income tax thresholds, where in my last Budget I was unable to give any increase in line with inflation, and where action would also help with unemployment, by increasing the incentive to work.

28. Within a given PSBR the key lies in the public expenditure totals. As explained in the Chief Secretary's paper C(81)(N+1) our present public expenditure plans, starting from the Public Expenditure White Paper Cmnd 8175 of earlier this year, imply the following expenditure totals:-

Planning totals £ billion cash		
1982-83	1983-84	1984-85
110.0	114.5	120.2

If we were able to achieve these totals we could lighten the tax load on industry, enterprise and endeavour. Apart from that, we said in Cmnd 8175 that the totals it set out were higher than we would wish: any increase in them would be politically difficult. More important, it could well be damaging to confidence. The economic and political imperatives points towards keeping our plans within these figures.

29. Nevertheless, I recognise the pressures which spending colleagues face. I recognise too the difficulties posed by decisions we have already taken and announced (such as the unemployment measures announced in the summer) and the way certain programmes (e.g. Defence and parts of the Social Security programme) have been regarded as substantially immune from the search for economies. Elsewhere we are faced with problems not of our making. The problem with the local authorities, for example, is to contain overspend rather than to get spending lower than we had planned.

30. The Chief Secretary has had discussions with all spending Ministers. In the light of these discussions he and I are prepared to accept that the political and other costs of getting back to the White Paper revalued would not be tolerable. On the other hand, I am sure that we cannot go forward on a basis which implies now a further real increase in the tax burden in my next Budget. We cannot, therefore, go anywhere near accepting all the additional bids which spending colleagues have made - they would lead to an increase of over £7 billion for 1982-83. Balancing

these tax and expenditure considerations, we therefore propose the following totals as the maximum to which we could agree:-

Planning totals £ billion cash

1982-83	1983-84	1984-85
113.6	118.7	127.1

31. We recognise that the decisions required to reach these totals will cause difficulty and some unpopularity. But this has to be balanced against the adverse effects in the market and on confidence in our policies caused by an even greater excess over Cmnd 8175; and also by the unpopularity of the consequent increases in taxes. I should emphasise that even these totals leave us with some risk on the interest and tax front, and certainly make it quite impossible for me at this stage to hold out any realiable hope of tax reductions - for instance on the NIS and a real increase in tax thresholds - in my next Budget. We should have to be a lot nearer Cmnd 8175 for us to have any confident expectation that these would be feasible.

32. The implications of these totals for tax changes in 1983 and 1984 are necessarily still less certain. But, consistent with the overall improvement in economic prospects foreseen in paragraph 12 above, on present forecasts these totals should leave room for useful tax reductions in those later years. If such scope materialises - and we cannot yet count on it - I would aim to take fiscal action of a type which would further assist our fight against inflation and our efforts to improve the efficiency and competitiveness of our industries.

PART VI

Conclusion

33. This note seeks to set out the factors relevant to decisions about public expenditure in 1982-83 and later years. Notably these must turn on our overall economic strategy and prospects. On strategy, we must continue to maintain a sound monetary and fiscal line, so as to contain inflation and interest rates. It is a delusion to think that any alternative economic strategy would, within the life-time of this Parliament, lead to any substantially better outturn. Relaxing our policies would only harm confidence at home and abroad. The immediate economic prospects are for a slower improvement than we had hoped, with inflation coming down more slowly than expected, and unemployment remaining disturbingly high. There are, however, encouraging signs on output and the longer-term prospects give ground for guarded optimism. Immediately we should plan for a PSBR for 1982-83 provisionally set at the number we foresaw in this year's Budget. We cannot go for public expenditure totals which imply a real rise in the tax burden in the next Budget. Although there will be some political damage in it, I reluctantly accept that some increase in the public expenditure plans announced in Cmnd 8175 is inevitable. But the totals I propose in paragraph 30 above are the maximum we can afford if we are not on course for certain increases in taxes in the next Budget. Indeed even figures as high as my proposals leave some risk on this score. If we want to have a reasonable chance of being able to make some useful reduction in real taxes - e.g. a cut in the NIS - we should need figures substantially nearer Cmnd 8175. But I accept the serious problems this would give my spending colleagues.

34. I invite my colleagues to endorse the public expenditure planning totals set out in paragraph 30 above.

Annexes

Annex A - The International Background

Annex B - The Implications for Public Finances of additional Public Expenditure on Manpower

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ANNEX A

The International Background

1. The United Kingdom is not alone in suffering stubborn inflation, sluggish output and rising unemployment. It is also not alone in the hard decisions it is having to take on public spending in order to deal with them.

2. Consumer prices in the major seven OECD economies continued 10 per cent higher in July than a year ago. France and Italy suffered appreciably higher rates - 13 per cent and 19 per cent respectively. The OECD Secretariat's latest forecasts suggest that all the major European economies will have lower output this year than last year with even such traditionally strong countries as Germany showing a fall in GDP. Unemployment, too, has been rising in all Europe's big economies and, after a short pause, there has also been a further rise in unemployment in the United States.

3. The world's money and currency markets have shown sharp fluctuations in recent months with steep increases in interest rates and large movements in exchange rates. Short-term interest rates in the United States which rose to over 18 per cent in the summer, have since eased back but remain historically high at 15½ per cent, reflecting the conflicting pressures between the government and the private sector for funds in the face of the Federal Reserve's stringent monetary policy. Prime industrial borrowers are paying 18-19 per cent. Interest rates in other countries which rose in the wake of American rates, have so far eased back only gradually and in many cases remain very high in real terms.

4. There have been increasing signs of readiness on the part of most governments to persevere with firm policies to halt and then reverse these worrying trends. In particular, governments are continuing with their efforts to control monetary growth, curb their budget deficits and keep public spending in check to lay the basis for renewed growth without inflation.

5. It is not easy to reverse the trends of the 1950s and 1960s which saw an increasing share of national income in many countries taken by public spending. It is also not popular - though victories by parties committed to curbing public spending in the

United States, Sweden, Norway and Australia in the past two years suggest that electorates, too, are increasingly aware of the need to curb public spending. The French choice of a Socialist government with radically different policies is the main exception, although even there an important group in the French Cabinet is arguing for prudence.

6. In most industrial countries budgetary measures in the current year have reflected determination to prevent the recession adding to deficits. The OECD Secretariat's analysis of the policies of 22 members shows that about two-thirds have been trying to cut public spending plans this year. Only a handful (5 including France) announced higher spending.

7. Looking to next year and beyond many countries are seeking to secure a lasting reduction in their budget deficits. President Reagan has repeated his determination to keep the federal government's deficit down to $43 billion in the 1982-83 fiscal year and to balance the budget by 1984. The governments of Germany, and the Netherlands are seeking to reduce their budget deficits next year as a percentage of GNP. The Irish and Swedish governments have announced plans to put their deficits on a declining trend over the medium-term. The recent Australian budget introduced measures to eliminate the federal deficit entirely next year.

8. The drive to reduce budget deficits has involved many governments in hard decisions on public spending. The US Administration is seeking further reductions of $13 billion next year in planned

spending in addition to the $35 billion cuts already agreed by Congress in the summer. The German government has announced cuts of DM 10 billion in spending plans. The Italians are seeking cuts of 9,700 billion lire. The Swedes have proposed budget savings of Kr 6 billion and the new coalition in the Netherlands is seeking cuts of 4.5 billion guilders.

9. Countries have of course chosen different priorities in seeking economies. However, in many countries programmes once considered sacrosanct have come under keen scrutiny in the new situation:

Spending on social security is being curbed in a number of countries, with tougher eligibility rules for unemployment pay, food stamps and other benefits in the United States, restrictions on child benefits in Germany and Belgium, and proposals for cuts in planned social security spending in the Netherlands.

The US government is cutting planned spending on health and Medicaid, as well as the training of doctors and nurses. Hospital beds are being reduced in the Netherlands and Belgium, who are also raising prescription charges and cutting hospital building programmes. Germany, too, is raising prescription charges and seeking economies in other treatment costs. Italy is increasing charges, and has halted recruitment to the national health service. Ireland, too, is seeking savings on health programmes, with higher hospital and prescription charges.

Planned spending on education is being lowered in the Netherlands, Belgium and Italy. The US has placed tight ceilings on education spending, including curbs on student loans and restrictions on the funds available to subsidise school meals. Ireland has increased university fees.

Housing budgets are being cut back in Sweden and the Netherlands. Mortgage subsidies are being reduced in Ireland.

Transfers from central government to local authorities are being restricted in a number of countries including the United States and Sweden. In Sweden this is designed specifically to affect authorities that fail to keep to spending targets.

Staff savings in public administration are a common objective of many governments. President Reagan is seeking to reduce the number of public employees by 75,000 in 1982. The German government is looking for a 1 per cent reduction in public servants. The Dutch are seeking a real reduction in public sector salaries as well as changes to public pension arrangements.

Defence spending, which is being given priority by many governments, has not been exempt from retrenchment plans. The ambitious US defence programme has been trimmed. Sweden is reducing its planned defence budget, and the Belgians have proposed a moratorium on defence projects.

10. Among countries which have announced their budgets for next year, only the Danes and the French have overtly adopted expansionary policies. In both these countries, this year's budget deficits already seem likely to be significantly greater than planned and next year's deficits are projected to increase by around 25 per cent. The French have in addition tacitly abandonned the monetary targets of the previous administration. In the six months to June, money supply was rising at annual rate of 16 per cent.

11. The risks of these strategies are evident. In both Denmark and France, inflation is running well above the OECD average. The French have been forced to devalue. Price controls are being reintroduced in France. There are now signs that the Mitterand government is having second thoughts about its spending plans even before the Budget has passed the National Assembly. Projects worth Fr 15 billion have been frozen.

ANNEX B

THE IMPLICATIONS FOR PUBLIC FINANCES OF ADDITIONAL PUBLIC EXPENDITURE ON MANPOWER

.1 Because the cost to the government of unemployment is so high it is sometimes asserted that additional public expenditure that creates employment has a very low cost if the resulting savings on unemployment benefit etc. are taken into account. The converse has been asserted also, namely that cuts to public expenditure that involve an immediate and direct loss of employment produce little benefit for public finances. This Annex therefore considers the implications for public finances of additional public expenditure.

.2 Estimates of the total cost of additional public expenditure of a particular type will vary according to its precise nature and whether it is offset by an increase in tax rates or allowances. Paragraph 21 of this paper assessed the implications if there is an offsetting change to tax rates. This Annex extends the analysis in paragraph 20 which assessed the consequences to the economy if there is no such offsetting increase to tax rates.

.3 Expenditure on manpower has a greater initial impact on unemployment than most other categories of public expenditure. In order to illustrate the implications for public finances of extra public expenditure that has a favourable direct effect on unemployment, this Annex examines the effects of additional expenditure on manpower. (It should be remembered, however, that this is a category of expenditure the government are committed to reduce. It is claimed that certain categories of special employment measures have lower net public expenditure and PSBR costs than expenditure on wages and salaries, but there is considerable uncertainty as to the precise effects of these measures in reducing unemployment. In addition most of them seriously distort the labour market in ways that is not possible to quantify, but which reduce their attractiveness.)

.4 The calculations summarised here assess the overall economic effects and the impact on public finances - especially the effect on total public expenditure and the PSBR - of an additional £1 billion of central government expenditure on manpower (ie wages and salaries). It is assumed that the extra expenditure is, in the first instance, on extra employment and not on higher wages, though, as paragraph A9 shows, one of the many possible side effects of the extra expenditure is higher wages and prices. It is assumed that the extra Central Government employment is maintained in later years. In practice an increase in expenditure on employment would almost certainly involve a related increase in other public expenditure on procurement and possibly on capital expenditure as well. The calculations in this Annex assume that there is no such increase in other public expenditure. They therefore tend to overstate the direct gain to employment of an extra £1 billion of public expenditure.

5 Most analysis of the costs of unemployment, and therefore of the benefits of measures that reduce it, concentrates on certain easily identified direct consequences for public finances. Thus the Treasury article "Costing unemployment" (Economic Progress Report, February 1981) presented estimates of the effects of a change in unemployment on receipts of

(i) income tax,
(ii) National Insurance and other contributions,
and(iii) the National Insurance Surcharge,

and expenditure on

(i) National Insurance and other social security benefits,
(ii) rent and rate rebates,
and (iii) other administrative costs.

6 As the article recognised these readily identified direct effects do not give the full picture. There are other components of receipts and expenditure that vary with the state of the economy. An increase in public expenditure on manpower will have implications for the behaviour of the economy - eg on interest rates, the levels of wages and prices, the exchange rate etc. Not all these effects will be strong in the first

year in which the additional public expenditure takes place, but will build up through successive years. For this reason estimates of the direct effects on public finances in the first year will not show the full consequences of additional public expenditure. Table A1 summarises the effects of the assumed additional public expenditure on interest rates, the RPI, GDP and total unemployment.

7 Table A2 compares the direct effects in the first year of an additional £1 billion of Central Government expenditure on manpower with estimates of the complete effects over a four year period. The estimates of the complete effects assume:-

(a) No change in the assumed growth of the money supply; interest rates will therefore rise in response to increases in the demand for money;

(b) A freely floating exchange rate;

(c) Average earnings in the economy determined by the supply of and demand for labour;

and (d) Fixed real tax rates and allowances (ie nominal tax allowances and specific duties are raised retrospectively in line with increases in the RPI).

8 There are certain obvious differences between the estimates of the total and direct costs.

(i) the debt interest cost of the additional expenditure rises steadily over the four years, reflecting both the permanently higher PSBR and the higher interest rates.[1] There is no allowance for this in the direct costings;

(1) If the calculations in Tables A1 and A2 were on the assumption of fixed interest rates rather than fixed money supply the debt interest cost of the extra public expenditure would not rise as much as in Table A2. With unchanged interest rates extra public expenditure would entail a higher money supply and therefore higher inflation.

(ii) Higher public expenditure by increasing activity and pressure in the labour market will tend to raise both prices and wages. Although this adds to tax and National Insurance receipts, it also raises the price of public expenditure (and causes social security upratings to be higher than they would otherwise have been);

(iii) The calculations of the complete effects of higher public expenditure assume that the receipts and outgoings of the National Insurance fund are balanced by varying rates of contribution. Lower expenditure on unemployment benefit will therefore lead to lower contribution rates than would otherwise have been the case. The alternative assumption of unchanged contribution rates, which is made in the direct costings in Table A2 and in the Economic Progress Report, would lower the PSBR cost of extra employment by £180m in 1982-83, and by a similar absolute amount in later years. This alternative assumption would imply an excess of receipts over expenditure for the National Insurance Fund. In practice contribution rates would change to offset this, hence the conventional assumption of a balanced fund.

(iv) Average earnings in central government are approximately 11 per cent higher than in the private sector (defined to exclude Public Corporations). The calculations in the table assume that the additional Central Government employees are paid average Central Government earnings. If the wages of the additional staff recruited were lower an additional £1 billion of expenditure would have a greater initial effect on employment(1). One consequence for public finances would be greater saving on unemployment and social security benefits. With lower than average Central

(1) At the extreme it has been suggested that public works jobs could be created paying wages equal to the benefit rate grossed up for tax flow backs. Whatever the political feasibility of this proposal, it would not be possible to attract people to work unless some premium over their benefit rate was paid. Indeed the people who would have most incentive to take these jobs would be those with low entitlement to benefit. Any feasible scheme would therefore have a singificant PSBR cost.

Government earnings for the additional manpower, and hence a large fall in unemployment there could, however, be a stronger tendency for earnings - including those of public sector workers - to rise as a result of lower unemployment. This would tend to increase the total net public expenditure cost.

9 The estimates in the table clearly depend crucially on how prices and wages react to higher public expenditure. The assumption is that cash planning factors hold in the first year, but that thereafter they are set broadly to reflect the prospects for inflation in the economy. Any increase in public expenditure on wages and salaries will cause an immediate stimulus to output and a reduction in unemployment. Table A1 shows, however, that this effect will diminish over the four year period as a result of higher interest rates on the one hand, and higher prices and earnings on the other. While employment in the Central Government sector is, by hypothesis, higher and has an immediate impact on unemployment this is offset, by an amount that increases through the period, by lower private sector output and employment which reduces the fall in unemployment. By the end of the period the addition to GDP has almost disappeared. Because employment and unemployment adjust with a lag to changes in output the table does not show the full extent to which the erosion of the increase in GDP would eventually have a similar effect on the fall in unemployment. The estimates in Table A2 would be different if it could be assumed that the extra public expenditure and borrowing had no effect on the prices of the various categories of public expenditure. The adverse effects on public finances of the extra public expenditure would be much reduced. Such an assumption would, however, be unrealistic in the light of past experience.

10 Table A2 shows, on the assumptions set out above, that after taking account of all the consequences for public finances of the additional public expenditure,

(a) the increase to total public expenditure in the first year is higher than the increase in expenditure on manpower;

(b) the PSBR cost in the first year is less than the direct increase to public expenditure, though greater than the PSBR cost in the direct estimate;

and (c) both the total public expenditure cost and the PSBR effect rise steadily through the four years; by the end of the period the PSBR cost (in cash) exceeds the initial direct increase in public expenditure.

TABLE A1

IMPACT OF £1 BILLION HIGHER CENTRAL GOVERNMENT EXPENDITURE ON MANPOWER ON THE ECONOMY IN 1982-83, SUSTAINED IN SUBSEQUENT YEARS*

Changes to the level of	1982 Q4	1983 Q4	1984 Q4	1985 Q4
Unemployment ('000s)				
:direct effect	-105	-105	-105	-105
:total effect	-100	-100	-90	-70
Short-term interest rates (% points)	0.5	0.7	1.0	1.3
RPI (%)	0.2	0.5	0.9	1.3
GDP (%)	0.5	0.5	0.3	0.1

*The cash increase in expenditure is £1 billion in 1982-83. In subsequent years the initial increase in expenditure is raised in line with inflation to maintain the initial stimulus to Central Government employment.

TABLE A2: THE EFFECT ON PUBLIC SECTOR EXPENDITURE, REVENUE, AND BORROWING OF HIGHER EXPENDITURE ON MANPOWER

£ million CHANGES TO	DIRECT COSTINGS 1982-3	DIRECT AND INDIRECT COSTINGS 1982-3	1983-4	1984-5	1985-6
General government wage & salary bill	1000	1000	1365	1680	1975
Other final[(1)] consumption	-	15	115	260	405
Unemployment & social security benefits	-160[(4)]	-140	-150	-130	-80
Other current grants & subsidies[(2)]	-5	60	185	390	635
Debt interest[(3)] expenditure	-	95	285	455	625
Other expenditure	-	40	15	40	55
Total Public Sector Expenditure	835	1070	1815	2695	3615
Employers NIC & NIS	115	25	55	90	130
Employees NIC	60	-30	0	45	105
Income tax	245	325	565	790	930
Indirect taxes	-	85	230	380	530
Other receipts	-	20	140	245	415
Total Public Sector Receipts	420	425	990	1550	2110
PUBLIC SECTOR BORROWING	415	645	825	1145	1505
Memorandum item:					
Public Expenditure Planning Total + Debt interest		995	1615	2320	3020

(1) includes GDFCF and stocks
(2) includes capital grants.
(3) interest payments by consolidated Public Sector.
(4) These estimates assume that registered unemployment changes by 80% of the change in employment. The figure used in the February EPR article was 75%.

Explanatory Notes to Table A2

NB All the rows except the final one are national accounts and not PES definitions.

General government wage and salary bill. In 1983-84 and subsequent years, the initial increase in expenditure is raised in line with inflation to maintain the stimulus to Central Government employment. The general government wage and salary bill will however increase by more than this, because higher wage inflation will increase cash expenditure on existing manpower plans. (For the first years, however, because cash limits hold this effect from higher wage inflation is offset by a squeeze on manpower.)

Other Final Consumption Higher costs and prices will lead to increased cash expenditure on an unchanged volume of current consumption in years after 1982-83. (See paragraph
As paragraph A4 makes clear there is no allowance for higher expenditure on procurement or capital that an increase in expenditure on manpower would probably involve. Similarly there is no allowance for saving on administrative costs that lower expenditure on unemployment and social security benefits would make possible. (This effect was included in the February EPR costings.)

Unemployment and Social Security Benefits. Over time the initial improvement in unemployment tends to be offset by the adverse second-round effects of higher interest rates and inflation, thus reducing the initial savings on these benefit payments.

Other Current Grants and Subsidies. Higher inflation increases the costs of benefit upratings.

Debt Interest Expenditure. This increases because

(a) the outstanding volume of government debt is growing due to the cumulative impact of higher PSBRs;

(b) interest rates are higher to finance the higher PSBR without expanding the money supply.

National Insurance Contributions. Contribution rates are adjusted in order to keep the balance in the National Insurance Fund unchanged. Savings on national insurance benefits to the unemployed are therefore passed on in the form of lower contribution rates.

Income Tax and Indirect Taxes. These increase due to increases in the tax base from the higher numbers employed and increases in consumers' expenditure and also because prices and wages are higher.

FILE

CONFIDENTIAL

VLB

Ecm Pol

cc: Mr. Walters.

12 October 1981

The Prime Minister was grateful for the Chancellor's minute of 9 October on economic policy, tax and public expenditure.

As I told you on the telephone this morning, the Prime Minister is content that the Chancellor and Chief Secretary circulate the papers which were enclosed with the Chancellor's minute.

I am sending a copy of this letter to Terry Mathews (Chief Secretary's Office) and David Wright (Cabinet Office).

MICHAEL SCHOLAR

John Kerr, Esq.,
H.M. Treasury.

CONFIDENTIAL

RW

Prime Minister

You asked me to let you have these papers back in Blackpool.

MCS 13/10

PRIME MINISTER

ECONOMIC POLICY, PUBLIC EXPENDITURE, ETC.

I hesitate to add to this formidable quantity of paper.

It seems to me that your principal decision this weekend on these papers is the tactical question - do you wish to abandon from the start the possibility of getting back to the White Paper totals: is the Chancellor's judgement, that it would be "wholly impossible" to get back to £110 billion for 1982-83, unassailable?

The arguments for sticking to Cmnd. 8175 totals are:

(i) there were strong words in Cmnd. 8175 about these totals being too high and that the Government's aim was to work on them and get them down before this year's White Paper. There must be a real problem about credibility (matching, perhaps, the problems with the pledges in index-linking social security?) if this is seen to have proved too difficult.

(ii) Market and confidence points, perhaps bearing on the exchange rate, arise from (i).

(iii) The fact that we will be demonstrably off course on the public expenditure objectives (with the increased share of total public expenditure in GDP since 1979 rising still further) will help those who argue that the Government's policies are causing the burden of the recession to fall, via high interest rates, NI surcharge, etc., mainly on the private sector.

I recognise that the list of cuts needed to get back to £113.5 billion is serious enough.

/But

But, clearly, if the Treasury papers are circulated in their present form, £113.5 billion not £110 billion will be the floor from which the argument will start - upwards.

If I can be of any help today I of course stand ready to come in any time.

Michael Scholar

11 October 1981

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

PRIME MINISTER

ECONOMIC POLICY, TAX AND PUBLIC EXPENDITURE

As you know, we now need to take decisions about public expenditure for 1982-83 and the two later years. We are due to begin discussing this in Cabinet on 20 October, and it is important that the process should be through by around the middle of November.

2. The decisions we take will be difficult and extremely important. They will affect the whole of our economic and political strategy for the rest of this Parliament. They must inevitably be seen in the light of a General Election within the next 2½ years.

3. I propose, therefore, that in putting proposals to our colleagues I should set these in the broad economic and political context. I attach a draft of the paper I propose to circulate together with a draft of a paper by the Chief Secretary which sets out the proposals for public expenditure in more detail. We are both still working on these.

My general message

4. The general message I shall want to convey to our colleagues, in my paper and orally, is broadly as follows:-

- what we are doing is well in line with the international environment

- our policy for getting inflation down and for stimulating industry is a long-term one, and gives grounds for guarded optimism

- unemployment is serious, but there are no realistic alternative policies which, within the life-time of this Parliament, would make any substantial difference to the way in which the numbers would move

- the public/private sector balance, which we sought to correct, has gone in the wrong direction. The private sector has borne virtually the whole brunt of the recession. Largely this is due to individual spending Ministers defending their corner at the expense of the wider picture. As a result our record on public expenditure and tax is a great disappointment.

5. None of this is particularly new. But it needs reaffirming, particularly against the sort of remarks that are going to be made at the Party Conference next week and elsewhere about the need for some change of course. It is because of these sounds that our colleagues will have been hearing, and in line with what I think was looked for at the 23 July Cabinet, that my paper is deliberately full. It is important for our colleagues to understand - particularly perhaps on unemployment - just what limitations and shortcomings alternative policies have.

My overall proposals

PS/IR

6. The core of the matter lies in the PSBR which we should seek for next year. There is no single demonstrably "right" figure we should look for. But a higher PSBR adds to pressures on interest rates and a lower one reduces them. In my view at this stage we cannot plan to go above the PSBR for 1982-83 which we looked for at the time of my last Budget, and even this points to serious risks on interest rates. But it is a known starting point, and I think it would be difficult to persuade our colleagues now that we should work from a lower figure.

Exp. depends on finance

7. We now come to the tax and public expenditure picture. Our basic approach, of course, is that finance should determine expenditure, rather than vice versa. This would mean setting tax objectives, and, in the light of the chosen PSBR, determining public expenditure totals accordingly.

8. Such an approach, coupled with the need not to damage confidence in the markets and the political desirability of doing what we said we were going to do, would point to public expenditure totals at or below those implied by the last Public Expenditure White Paper (Cmnd 8175) - thus about £110 billion for 1982-83. However the Chief Secretary and I regard this as wholly impossible. There is no realistic way in which we can make cuts or reject bids on that scale. On the other hand, we cannot possibly afford - whether in economic or political terms - to accept all the bids which our colleagues have made. For 1982-83 this would make the totals some £8 billion above those implied by Cmnd 8175.

£113.5 bn.

9. In my view we should not look for a figure which would imply now the need for real tax increases in my next Budget. On the other hand we must go to our spending colleagues with proposals which we think are achievable. Balancing these desiderata, the Chief Secretary and I feel that the figure we should look for is some £113.5 billion for 1982-83, or some £3.5 billion above Cmnd 8175.

10. Even this will require some tough decisions from the spenders. But against that, it assumes no real tax changes in 1982 - that is, merely the indexing of rates and allowances and increases in the National Insurance Contribution to balance the Fund. In particular expenditure at this level makes it most unlikely that we should be able to make any move on two areas where, from the point of view of our counter-inflation and industrial strategy, we ought to do something - some reduction in the National Insurance Surcharge and some restoration of the income tax

thresholds frozen in the last Budget. Against that, any higher public expenditure figures would almost certainly make tax increases necessary.

11. I am aware how disappointing this picture is. Market confidence will anyway be eroded by our failing to hold the Cmnd 8175 totals, and the further off we are from them the greater the effects will be. And I should not even be able to sugar the pill by hinting at the possibility of any real reductions in the tax burden next March. On the other hand the figures I propose should give a reasonable prospect of real reductions in 1983 and 1984.

Public expenditure in more detail

(a) 1981-82

12. Public expenditure this year could turn out to be as much as £2½ billion higher than envisaged at the time of the Budget. That was £0.8 million higher than provided in the White Paper.

£2½ b.

13. The main increase since the Budget is the prospective local authority overspend of about £1½ billion on their current expenditure. Changes in economic circumstances, particularly higher interest rates, have added some £0.3 billion. Finally, it now seems prudent to write down by about £½ billion the deduction for short-fall, so increasing the total.

LA £1½ b.
£0.3 b

14. The more directly controlled programmes are holding well; we should be able to keep increases in them within the Contingency Reserve, provided we take a consistently tough line with all further proposals.

(b) 1982-83 onwards - present position

15. The position is well illustrated by Table 1 attached to the draft of the Chief Secretary's paper.

16. The starting point is the White Paper revalued, and adjusted for items such as the Gas Levy, which are exactly matched by revenue and so have no PSBR effect. We have to add for agreed additions, the effect of changed economic prospects and higher local authority spending. So at the outset of these discussions the expenditure total is £4 billion higher than the starting point for 1982-83 and £6 billion higher for 1983-84. And we are faced with further bids for £3¼ billion and £5¼ billion in these 2 years respectively.

(c) 1982-83 onwards - proposals

17. The Chief Secretary and I fear that we have to accept some of the bids in whole or part - for example the carry forward of the Armed Forces pay award, the assistance with redundancy costs in the steel and shipbuilding industries, the introduction of the comprehensive Youth Opportunities Programme, some expenditure on prison building and staff. But we recommend rejecting just over half of the bids for 1982-83, and two-thirds of them for the following year. 3-4 We also propose cuts in existing programmes of nearly £2 billion in 1982-83, and £2¾ billion in 1982-83.

3-4 ?

18. We are still faced with bids for nationalised industry EFLs in 1982-83 of nearly £1 billion more than the £750 million increase we agreed to in July. We propose that the excess should be cut to £495 million, bringing the total increase to £1,245 million.

19. We are reasonably confident colleagues can be persuaded to accept in this difficult situation about half our proposals - mainly the ones at the fringes of programmes, which are small individually, but cumulatively significant.

20. In particular we hope to get agreement to a reduction in all cash limits including staff and general administrative expenditure. Taken with the carry forward of the cash limits squeeze resulting from this year's Civil Service pay settlement,

this will require a reduction in numbers (or in related expenditure) $3\frac{1}{2}$ per cent greater than already allowed for in last year's White Paper figures. We are proposing a reduction in the NHS programmes for improved efficiency. Colleagues will justifiably consider these measures severe and in some cases difficult to achieve - they will be for my departments. But we think that it is right that we should be severe - the CBI evidence and recommendations point to it.

21. Some proposals will be much more difficult for the Ministers responsible for departmental programmes. They are set out in the attached List A. But we must secure agreement to virtually all of them if we are to avoid tax increases in the next Budget.

22. The most contentious proposal may be the reduction by 5 per cent in the uprating of the social security benefits on which there is not a specific pledge - including unemployment, sickness, child and short-term supplementary benefits. The justification for this cut is the fall in real incomes of those at work this year and next - which is expected to be greater than that.

23. Nor have we been able to spare capital programmes. We would have liked to spare them - or even to increase capital - but it is just not on in these circumstances. Our proposals for nationalised industry EFLs will mean that their investment in total will be little different from that envisaged in the last White Paper.

Further reductions

24. As I say, these proposals even if achieved would on present forecasts leave no prospects for tax cuts in the next Budget. We have therefore considered the possibility of further reductions. (List B attached gives some examples.) The only scope for really substantial further savings lies in either re-opening the decisions on Defence or in acting on the pledged social security benefits. If we could do either, or both, of those it could make a very real difference to the tax and interest rate prospect, or

possibly leave some room for a slightly more accommodating line on other expenditure programmes. But in spite of the help it would give on tax we would not wish to put these proposals to colleagues unless they had your full backing and we were reasonably confident of success.

Procedure

25. One thing you will wish to consider is how to pursue the discussions after the initial discussion on 20 October, which itself might have to spill over to the next meeting.

26. Copies of this minute go to the Chief Secretary and to Sir Robert Armstrong.

(G.H.)
9 October 1981

Mr. Scholar (PERSONAL)

SECRET

As promised JMB

Draft 9 October 1981 9/10

Annex A to C(81)n+1

PUBLIC EXPENDITURE

Proposals for Departments' Expenditure

Contents

1. MINISTRY OF DEFENCE

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	12270	13624	14881	15625
	~~Annual change~~ Percentage change from previous year	%		+11.0	+9.2	+5.0
2.	Changes already agreed	£m	-	-	-	+480
3.	Present total	£m	12270	13624	14881	16105
	~~Annual change~~ Percentage change from previous year	%		+11.0	+9.2	+8.2
4.	Further bids etc	£m	~~+368~~ –	+277	~~+487~~ 500	~~+744~~ 747
5.	Result if bids accepted	£m	12270 12638	13901	~~15368~~ 15381	~~16849~~ 16852
	~~Annual change~~ Percentage change from previous year	%		~~+10.0~~ +13.3	+10.6	+9.6
6.	Proposed provision	£m	~~12538~~ 12270	~~13659~~ 13709	14969	~~16197~~ 16200
		%		~~+10.8~~ +11.7	~~+8.0~~ +9.2	+8.2
7.	Changes from White Paper revalued (6 less 1)	£m	~~+218~~ –	~~+235~~ +85	+88	~~+572~~ +575
		%	~~+1.8~~ –	~~+1.7~~ +0.6	+0.6	+3.7

We have already taken the main decisions on this programme. I do not propose to re-open them at this stage. But the Defence Secretary has proposed further increases for "validation of inflation" and to allow for future relative price effects. For the reasons given in the main paper, I accept validation for this year's AFPRB award (some £90 million a year), but do not consider there is evidence to support validation for other prices. It would be fuelling inflation to make contingency provision for future RPE now. ~~But the Secretary of State faces a transitional problem in bringing commitments back within the provision we agreed. I recommend a transitional addition of £250 million this year (including £50 million for the ROFs) and £150 million next to allow for this.~~

(the Defence Secretary has bid for £170 million in 1982-83 rising to £660 million in 1984-85)

(which the Defence Secretary puts at £300 million in 1981-82)

SECRET

2 & 3 FOREIGN & COMMONWEALTH OFFICE (INCL. ODA)

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	1556	1575	1675	1759
	Annual change	%		+1.2	+6.3	+5.0
2.	Changes already agreed	£m	-	-1	+8	+6
3.	Present total	£m	1556	1574	1683	1765
	Annual change	%		+1.2	+6.9	+4.9
4.	Further bids etc	£m	-	+22	+22 ~~+23~~	+2~~4~~0
5.	Result if bids accepted	£m	1556	1596	170~~6~~5	178~~4~~5
	Annual change	%		+2.6	+6.8	+4.7
6.	Proposed provision	£m	1556	1528 ~~1518~~	1633 ~~1623~~	1711 ~~1701~~
	Annual change	%		-1.8 ~~-2.4~~	+6.9	+4.8
7.	Change from White Paper (6 less 1)	£m	-	-47 ~~-57~~	-42 ~~-52~~	-48 ~~-58~~
		%	-	-3.6	-3.1	-3.3

~~We need~~ Some reductions can reasonably be expected here. Cuts in the overseas aid programme are undoubtedly feasible technically, and I propose a cut of £30 million (3%) a year. This is in addition to the saving of 2% (£18 million rising to £20 million) which can be made by withholding the benefit, not required by the aid programme, of the change in the revaluation factor from 7% to 9%. Smaller cuts are also possible on overseas representation and information and other external services. (These cuts all imply a reduction in the cash limits.) I am however prepared to accept an addition to public expenditure of £10 million a year to allow for commercial borrowing abroad by the Commonwealth Development Corporation. (£10 million in 1982-83)

4. EUROPEAN COMMUNITY

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	460	501	531	558
	Annual change	%		+8.9	+6.0	+5.0
2.	Forecast change in EC Budget contributions	£m	-120	+175	+25	+60
3.	Present total	£m	340	676	556	618
	Annual change	%		+98.8	-17.8	+11.2
4.	Proposed provision *	£m	340	692	526	586
	Annual change	%		+103.5	-24.0	+11.4
5.	Change from White Paper revalued (4 less 1)	£m	-120	+191	-5	+28
		%	-26.1	+38.1	-0.9	+5.0

We have to accept the forecast increase in costs resulting from our membership of the European Community. But we can achieve savings in this programme by ending the beef premium scheme (see IBAP Programme).

* Subject to estimating changes

5. INTERVENTION BOARD FOR AGRICULTURAL PRODUCE

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	530	593	620	651
	Annual change	%		+11.9	+4.6	+5.0
2.	Changes already agreed	£m	+140	-	-	-
3.	Present total	£m	670	593	620	651
	Annual change	%		-11.5	+4.6	+5.0
4.	Further bids etc	£m	-	+37 ~~+63~~	+40 ~~+71~~	+30 ~~+114~~
5.	Result if bids accepted	£m	670	630 ~~656~~	660 ~~691~~	651 ~~765~~
	Annual change	%		-6.0 ~~-2.1~~	+4.8 ~~+5.3~~	+3.2 ~~+10.7~~
6.	Proposed provision *	£m	670	616 ~~656~~	645 ~~654~~	665 ~~728~~
	Annual change	%		-8.1 ~~-2.1~~	+4.7 ~~-0.3~~	+3.1 ~~+11.3~~
7.	Change from White Paper revalued (6 less 1)	£m	+140	+23 ~~+63~~	+26 ~~+34~~	+14 ~~+77~~
		%	+26.4	~~+10.6~~ +3.9	~~+5.5~~ +4.0	~~+11.8~~ +2.2

We have to accept the forecast increase in costs, which are mainly in the CAP beef premium scheme. We ~~should consider~~ could however end~~ing~~ this scheme, and I have assumed that we do this.

* Subject to estimating changes resulting from revised estimates of EC programmes

6. MINISTRY OF AGRICULTURE (+DAFS/WOAD)

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	970	976	940	987
	Annual change	%		+0.6	-3.7	+5.0
2.	Changes already agreed (including local authority current expenditure)	£m	+27	+6	+1	-1
3.	Present total	£m	997	982	941	986
	Annual change	%		-1.6	-4.1	+5.0
4.	Further bids etc (excluding local authority current expenditure)	£m	-	+129 ~~+72~~	+139 ~~+75~~	+84 ~~+63~~
5.	Result if bids accepted	£m	997	1111 ~~1053~~	1080 ~~1016~~	1070 ~~1050~~
	Annual change	%		+5.6	-3.5	+3.3
6.	Proposed provision *	£m	997	978 ~~988~~	912 ~~917~~	926 ~~945~~
	Annual change	%		-0.9	-7.2	+3.1
7.	Change from White Paper revalued (6 less 1)	£m	+27	+2 ~~+12~~	-28 ~~-23~~	-61 ~~-42~~
		%	+2.8	+1.2	-2.4	-4.3

* Subject to estimating changes resulting from revised estimates of EC programmes, and to final decisions on local authority current expenditure.

// We have to accept the forecast estimating increases on EC-funded schemes (£25m and £30m in 1982-83 and 1983-84 respectively). And I agree that we should ~~I am also prepared to~~ accept the forecast cost of implementing the Common Fisheries Policy (£20 million in 1982-83). In the event of no agreement on the CFP, if there were any national measures of assistance to the fishing industry, these would have to be financed within the amount available for CFP measures.

// I am not prepared to accept the bid for hill livestock compensatory allowances (£53 million in 1982-83). ~~that we should provide for full indexation of~~ There is no clear evidence about the latest incomes of hill farmers, but following the introduction of the EC sheepmeat regime, their position should be substantially eased by comparison with the last two years, when it was necessary to provide exceptional increases in the allowances. Nor can I accept the bids for additional provision for marketing & capital grants (£2 million & £30 million respectively in 1982-83).

A significant offset to the~~se~~ substantial increases must ~~however~~ be made, by cutting the rates of capital grant to farmers (£30 million in 1982-83), by reducing expenditure on land drainage (£8 million in 1982-83) and by cuts in research etc (£9 million in 1982-83). This will mean some cuts in cash limited expenditure, possibly in the case of land drainage including a small element of local authority capital. ~~I recognise that~~ The cuts in capital grants ~~may reduce agricultural investment. But the projects in operation~~ are mainly in respect of long-term schemes, so agricultural productivity should not be affected in the short-term.

7. FORESTRY COMMISSION

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	59	64	66	69
	Annual change	%		+8.5	+3.1	+5.0
2.	Changes already agreed	£m	-	-	-	-
3.	Present total	£m	59	64	66	69
	Annual change	%	-	+8.5	+3.1	+5.0
4.	Further bids etc	£m	-	+5	+4	-
5.	Result if bids accepted	£m	59	69	70	69
	Annual change	%		+16.9	+1.4	-1.4
6.	Proposed provision	£m	59	62	64	64
	Annual change	%		+5.1	+3.2	-
7.	Change from White Paper revalued (6 <u>less</u> 1)	£m	-	-2	-2	-5
		%	-	-3.1	-3.0	-7.2

I recommend a reduction in the cash limit on planting and land acquisition to offset the bid for compensation for the fall in timber prices and to produce a modest net saving (£2 million in 1982-83). The Ministers concerned are prepared to agree.

8. DEPARTMENT OF INDUSTRY

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%), (excluding nationalised industries	£m	1970	1460	1006	1056
	Annual change	%		-25.9	-31.1	+5.0
2.	Changes already agreed	£m	+2	+14	+15	-
3.	Present total	£m	1972	1474	1021	1056
	Annual change	%		-25.2	-30.7	+3.4
4.	Further bids etc (excluding nationalised industries expenditure)	£m	-	+90	+28	~~-5~~ -4
5.	Result if bids accepted	£m	1972	1564	1049	1050
	Annual change	%		-20.7	-32.9	-
6.	Proposed provision	£m	1972	1353	854	874
	Annual change	%		-31.4	-36.9	+2.3
7.	Change from White Paper revalued (6 less 1)	£m	+2	-105	-152	-182
		%	+0.1	-7.2	-15.1	-17.2

I recommend accepting the Secretary of State's bids for additional finance for Rolls Royce next year and for steel and shipbuilding redundancy costs. The Secretary of State has made a number of other bids which I cannot recommend accepting in their entirety. Instead, I propose that the Secretary of State should have net additions of £29 million, £10 million and £25 million to his departmental "wedge" - the provision for future industrial support. These funds could then, with the Treasury's agreement, be allocated to specific projects when priorities are clearer. But we should make such savings as we can: ~~I hope it will be possible~~ favour not ~~to~~ paying Regional Development Grant (£122 million in 1982-83) in respect of Sullom Voe and Flotta (£15 million in 1982-83), and cuts in the rates of these grants (£36 million in 1982-83) and in other areas (including cash limits) ~~would yield substantial savings.~~ are needed and assumed to yield the savings that I recommend.

9. DEPARTMENT OF ENERGY

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (excluding nationalised industries)	£m	354	385	398	418
	Annual change	%		+8.8	+3.4	+5.0
2.	Changes already agreed	£m	+8	+15	+15	-
3.	Present total	£m	362	400	413	418
	Annual change	%		+10.5	+3.3	+1.2
4.	Further bids etc (excluding nationalised industries)	£m		+50	+75	+107
5.	Result if bids accepted	£m	362	450	488	525
	Annual change	%		+24.3	+8.4	+7.6
6.	Proposed provision	£m	362	381	393	422
	Annual change	%		+5.2	+3.1	+7.4
7.	Change from White Paper revalued (6 less 1)	£m	+8	-4	-5	+4
		%	+2.3	-1.0	-1.3	+1.0

The proposed provision allows for a substantial increase in the cost of the miners' redundancy scheme (£10 million in 1982-83) and for the continuation of the current publicity campaign on energy conservation (£3 million/year). These increases over the last White Paper need to be offset by reductions in the cash limits for the Atomic Energy Authority, non-nuclear research, and Departmental administration (£31 million in 1982-83).

SECRET

10. DEPARTMENT OF TRADE

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	269	284	264	277
	Annual change	%		+5.6	-7.0	+5.0
~~2.~~ 4.	Further bids etc	£m	-	-4	+4	+8
~~3.~~ 5.	Result if bids accepted	£m	270 ~~269~~	280	268	285
	Annual change	%		+4.1	-4.3	+6.3
~~4.~~ 6.	Proposed provision *	£m	270 ~~269~~	270	249	263
	Annual change	%		+0.4	-7.8	+6.0
~~5.~~ 7.	Change from White Paper revalued (6 <u>less</u> 1)	£m	+1	-13 ~~-14~~	-15	-14 ~~-13~~
		%	+0.4	-4.6	-5.7	~~-4.7~~ -5.1

I am prepared to agree to some of the Secretary of State's bids; including part of the proposed increased allowance for capital expenditure on local authority airports (£5 million in 1983-84). But I propose that cash-limited CAA investment should be reduced in line with the reductions in nationalised industry investment which we are having to make (£5 million in 1983-84)

* Subject to final decisions on local authority current expenditure

2.	Expected increase in local authority current expenditure	£m	+1	+1	—	-1
3.	Present total	£m	270	285	264	276
	Annual change	%	—	+5.6	-7.4	+4.5

11. EXPORT CREDITS GUARANTEE DEPARTMENT

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	-57 ~~4~~	80	-43	-45
2.	Changes already agreed	£m	+45	-9	-4	-
3.	Present total	£m	-12 ~~49~~	71	-47	-45
4.	Further bids etc	£m	-	+117	+92	+226
5.	Result if bids accepted	£m	-12 ~~49~~	188 ~~188~~	45 ~~48~~	181 ~~180~~
6.	Proposed provision	£m	-12 ~~49~~	135 ~~131~~	39 ~~42~~	220
7.	Change from White Paper revalued (6 less 1)	£m	+45	+55 ~~+51~~	+82 ~~+85~~	+266 ~~+265~~

X We have to accept the large forecast increase in the cost of this programme, which mostly represents existing commitments. But I am hoping that we can negotiate a reduction in the margin paid to banks on fixed rate lending, which will produce a small offsetting saving of £3 million in 1982-83, + transfer some refinance to Trustee Savings Banks (£50 million in 1982-83). Further savings may accrue if international agreement can be reached on increases in minimum export credit rates. I am also pursuing possible unilateral action to contain these costs.

12. DEPARTMENT OF EMPLOYMENT

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	2320	1911	1875	1969
	Annual change	%		-17.6	-1.9	+5.0
2.	Changes already agreed	£m	114 +~~116~~	649 +~~656~~	643 +~~650~~	493 +~~500~~
3.	Present total	£m	243~~6~~4	2560 ~~2569~~	2518 ~~2528~~	2462 ~~2472~~
	Annual change	%		+5.2	-1.6	-2.2
4.	Further bids etc (excluding local authority current expenditure)	£m	-	+503 ~~+995~~	+998 ~~+1219~~	+894 ~~+1036~~
5.	Results if bids accepted	£m	243~~6~~4	3063 ~~3562~~	3516 ~~3744~~	3356 ~~3505~~
	Annual change	%		+25.9 ~~+46.2~~	+14.8 ~~+5.1~~	-4.5 ~~-6.4~~
6.	Proposed provision *	£m	243~~6~~4	2740 ~~3028~~	2828 ~~3065~~	2700 ~~2827~~
	Annual change	%		+12.6 ~~+24.3~~	+3.2 ~~+1.3~~	-4.5 ~~-11.3~~
7.	Change from White Paper revalued (6 less 1)	£m	+11~~6~~4	+829 ~~+1117~~	+953 ~~+1190~~	+731 ~~+858~~
		%	4.9 +~~5.0~~	~~+58.5~~ +43.4	~~+63.5~~ +50.8	~~+43.6~~ +37.1

We agreed substantial increases in July. Some further increases seem justified, but not on the scale suggested by the ~~former~~ Secretary of State: next year would be nearly ~~50~~ 36 per cent higher than this. We have to allow for increased costs of existing policies (£290 million next year). The only major further initiative should be the comprehensive Youth Opportunities Programme. But its introduction should be deferred; ~~and its extra~~ the timing of the programme cost should be limited by reducing the rate of allowance to £8 a week and by making the relevant age group ineligible for Supplementary Benefit from September 1983. ~~[We should also make some additional provision for the long term unemployed].~~ We should also make further savings, mainly by phasing out the Temporary Short-time Working Compensation Scheme by April 1984 (saving £57 million in 1984-85) and holding back increases in allowances as far as possible (£25 million in 1982-83).

* Subject to final decisions on local authority current expenditure

13. DEPARTMENT OF TRANSPORT

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued to 5%)*	£m	2819 ~~2972~~	3036 ~~3181~~	3237 ~~3387~~	3400 ~~3556~~
	Annual change	%		+7.7 ~~+7.0~~	+6.6	+5.0
2.	Changes already agreed (including local authority current expenditure)	£m	+412	+156 ~~+189~~	+119 ~~+107~~	+85 ~~+13~~
3.	Present total	£m	3231 ~~3384~~	3192 ~~3370~~	3356 ~~3494~~	3485 ~~3569~~
	Annual change	%		~~-0.4~~ -1.2	~~+3.7~~ +5.1	~~+2.1~~ +3.8
4.	Further bids etc (excluding nationalised industries and local authority current expenditure)	£m	-	+95	+69	+16
5.	Result if bids accepted	£m	3231 ~~3384~~	3287 ~~3465~~	3425 ~~3563~~	3501 ~~3586~~
	Annual change	%		+1.7 ~~+2.4~~	+4.2 ~~+2.8~~	+2.2 ~~+0.6~~
6.	Proposed provision †	£m	3231 ~~3384~~	3182 ~~3360~~	3300 ~~3402~~	3381 ~~3466~~
	Annual change	%		-1.5 ~~-0.7~~	+3.7 ~~+1.2~~	+2.5 ~~+1.8~~
7.	Change from White Paper revalued (6 less 1)	£m	+412	+146 ~~+179~~	+63 ~~+15~~	-19 ~~-90~~
		%	~~+13.9~~ +14.6	~~+5.7~~ +4.8	~~+0.4~~ +1.9	~~-2.6~~ -0.6

The proposed increase in planned local authority current expenditure (£156 million in 1982-83) which we have no power to prevent this year means that on grounds of realism the provision that we make has to be increased. ~~will put this programme's costs up significantly;~~ and We shall probably also have to give substantial extra support to the Ports of London and Mersey (£92 million in 1982-83). We should offset these increases as far as possible, by reductions in expenditure on roads (central and local both capital and maintenance), and driver and vehicle licensing, and by ending new bus grants (totalling £105 million in 1982-83). These would include cuts in all cash limits, including local authority capital (£35 million/year).

*Excluding central government grants to nationalised industries: including classification change on local authority leasing

† Subject to final decisions on local authority current expenditure

14. DOE - HOUSING

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	4124	3869	3372	3540
	Annual change	%		-6.2	-12.8	+5.0
2.	Changes already agreed (local authority current expenditure)	£m	+10	– ~~-4~~	-4 ~~-4~~	-8
3.	Present total	£m	4134	3869 ~~3865~~	3368 ~~3372~~	3532 ~~3540~~
	Annual change	%		-6.4	-12.8	~~+5.0~~ +4.8
4.	Further bids etc (excluding local authority current expenditure)	£m	-	+200	+200	-226
5.	Result if bids accepted	£m	4134	4069	3568 ~~3572~~	3306 ~~3314~~
	Annual change	%		-1.6	-12.3	-7.4
6.	Proposed provision *	£m	4134	3776	3272 ~~3274~~	3208 ~~3216~~
	Annual change	%		-8.7	-13.3	-2.0 ~~-1.8~~
7.	Change from White Paper revalued (6 less 1)	£m	+10	-93 ~~-97~~	-100 ~~-98~~	-332 ~~-324~~
		%	+0.3	-2.4	~~-2.9~~ -3.0	-9.4

~~Regrettably,~~ We cannot afford the ~~proposed~~ bid seeking a substantial increase in the total housing programme in the next two years; indeed we must look for some reductions. But only a modest cut (2% [£143 million in 1982-83]) need be made (through a cut in the cash limit for local authority housing capital) compared with the real levels of housing investment in 1981-82, provided substantial real rent increases are made in the next two years (about £4/week in 1982-83, & £3.50/week in 1983-84).

* Subject to final decisions on local authority current expenditure & possible revised economic assumptions on interest rates.

15. DOE - PSA

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 6%)	£m	439	453	482	506
	Annual change	%		+3.2	+6.4	+5.0
2.	Changes already agreed	£m	+2	+5	+1	-
3.	Present total	£m	441	458	483	506
	Annual change	%		+3.9	+5.5	+4.8
4.	Further bids etc	£m	-	+10	+14	+10
5.	Result if bids accepted	£m	441	468	497	516
	Annual change	%		+6.1	+6.2	+3.8
6.	Proposed provision	£m	441	438 ~~448~~	463 ~~473~~	481 ~~491~~
	Annual change	%		-0.7 ~~+2.5~~	+5.7	+3.9
7.	Change from White Paper revalued (6 less 1)	£m	+2	-15 ~~-5~~	-19 ~~-9~~	-25 ~~-15~~
		%	+0.5	-3.3 ~~-1.1~~	-3.9	~~-3.0~~ -4.9

I ~~believe~~ consider that none of the additional bids to be of urgent priority except perhaps relief on overcrowding at unemployment benefit offices (£4 million in 1982-83) and dispersal of MOD to Glasgow (£3 million in 1982-83 building up to £11 million in 1984-85). But these should both be financed by transfers from the programmes of the sponsoring departments. I believe there is scope to achieve a modest net reduction by a combination of accelerated disposals and savings in expenditure on minor works and maintenance (£20 million/year).

16. DOE - OTHER

		1981-82	1982-83	1983-84	1984-85
1. White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)*	£m	3506	3669	3875	4069
Annual change	%		+4.6	+5.6	+5.0
2. Changes already agreed (including local authority current)	£m	+85	+86 ~~+90~~	+54 ~~+49~~	+5 ~~+6~~
3. Present total	£m	3591	3755 ~~3759~~	3929 ~~3924~~	4074 ~~4075~~
Annual change	%		+4.6	+4.6	+3.7
4. Further bids etc	£m	-	-	-	-
5. Result if bids accepted	£m	3591	3755 ~~3759~~	3929 ~~3924~~	4074 ~~4075~~
Annual change	%		+4.6	+4.6	+3.7
6. Proposed provision ~~*~~ †	£m	3591	3635 ~~3689~~	3764 ~~3819~~	3909 ~~3970~~
Annual change	%		+1.2 ~~+2.7~~	+3.5	~~+4.0~~ +3.9
7. Changes from White Paper revalued (6 less 1)	£m	+85	-34 ~~+20~~	-111 ~~-56~~	-160 ~~-99~~
	%	+2.4	~~+0.5~~ -0.9	~~-1.4~~ -2.9	~~-2.4~~ -3.9

The proposed increase in provision for ~~planned~~ local authority current expenditure on grounds of realism will add significantly to this programme, and we should look for offsets. ~~the proposals include~~ ~~Possibilities~~ include cuts in all cash limits including local authority capital (£25 million in 1982-83), and water capital (£85 million in 1982-83) and minor cuts in administration, ~~the Countryside Commission, etc.~~ research, the Sports Council etc. (£10 million in 1982-83).

Any increases in expenditure to which we agree following the Merseyside study will be charged to the contingency reserve.

*excluding nationalised industry finance: including classification change on local authority leasing.

† subject to final decisions on local authority current expenditure.

17. HOME OFFICE

		1981-82	1982-83	1983-84	1984-85
					£m
1. White paper revalued	£m	3263	3529	3785	3974
Annual change	%		+8.2	+7.3	+5.0
2. Changes already agreed (including local authority current)	£m	+148 ~~+103~~	+141 ~~+103~~	+153 ~~118~~	+155 ~~131~~
3. Present total	£m	3411 ~~3366~~	3670 ~~3632~~	3938 ~~3903~~	4129 ~~4105~~
	%		+7.6	+7.3	~~+5.2~~ +4.9
4. Further bids (excluding Local Authority current)	£m		+64	+82 ~~82~~	+109 ~~132~~
5. Result if bids accepted	£m	3411 ~~3366~~	3734 ~~3695~~	4020 ~~3985~~	4238 ~~4237~~
	%		+9.5 ~~+10.0~~	+7.7	+5.4
6. Proposed provision *	£m	3411 ~~3366~~	3631 ~~3590~~	3912 ~~3887~~	4103 ~~4079~~
	%		+6.4	+7.7 ~~+8.3~~	+4.9
7. Change from White Paper revalued (6 <u>less</u> 1)	£m	+148 ~~+103~~	+102 ~~+61~~	+127 ~~+102~~	+129 ~~+105~~
	%	~~+3.2~~ +4.5	~~+1.7~~ +2.9	~~+2.7~~ +3.4	~~+2.6~~ +3.2

The ~~agreed~~ increase in planned local authority current expenditure for police pay and manpower adds well over £100 million a year to this programme. Moreover, we may have to accept some additional expenditure on ~~pensions~~ prisons.

We cannot offset all of this, but savings identified by the Home Office (eg taking steps to improve prison industry trading) and other cuts (eg in local authority building) would ~~affect some part~~ limit the extent of the increase.

These cuts proposed would include cuts in cash limits excluding local authority capital, and prisons.

* Subject to final decisions on local authority current expenditure.

19. DEPARTMENT OF EDUCATION AND SCIENCE

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	11315	11667	12104	12709
	Annual change	%		+3.1	+3.7	+5.0
2.	Changes already agreed (local authority current)	£m	+470	+365 ~~+249~~	+329 ~~+135~~	+125 ~~+17~~
3.	Present total	£m	11785	12032 ~~11916~~	12433 ~~12239~~	12834 ~~12726~~
	Annual change	%		+2.1 ~~+1.0~~	+3.3 ~~+2.7~~	+3.2 ~~+4.1~~
4.	Further bids etc (excluding local authority current expenditure	£m	-	+55 ~~+105~~	+71 ~~+145~~	+87 ~~+170~~
5.	Result if bids accepted	£m	11785	12087 ~~12021~~	12504 ~~12384~~	12921 ~~12896~~
	Annual change	%		+2.6 ~~+1.9~~	+3.5	+3.3 ~~+4.1~~
6.	Proposed provision *	£m	11785	11952 ~~11886~~	12284 ~~12164~~	12680 ~~12655~~
	Annual change	%		+1.4 ~~+0.8~~	+2.8	+3.2 ~~+4.0~~
7.	Change from White Paper revalued (6 less 1)	£m	+470	+285 ~~+219~~	+180 ~~+60~~	-29 ~~-54~~
		%	+4.2	~~+1.9~~ +2.4	~~+0.5~~ +1.5	-0.2

The provision under [This programme] has to be very substantially ~~will be drastically~~ increased on grounds of realism to reflect ~~by the proposed increase in~~ planned local authority current expenditure, as well as ~~plus~~ the increase already agreed in further education: the total addition will ~~could~~ be around £½ billion a year. We cannot accept further bids on top of this but should look for such offsets as seems feasible. An increase in parental contributions to student awards (£40 million in 1982-83 and £100 million in 1983-84)~~, and a 5% reduction in the 1982 uprating of those awards,~~ would produce some savings, and a small cut could be made in ~~the~~ cash limited ~~on Research Councils' expenditure.~~ expenditure other than for universities (£19 million in 1982-83).

* Subject to final decisions on local authority current expenditure

20. DHSS - HEALTH

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	10791	11612	12398	13018
	Annual change	%		+7.6	+6.7	+5.0
2.	Changes already agreed	£m	-	+3	-	-
3.	Present total	£m	10791	11615	12398	13018
	Annual change	%		+7.6	+6.7	+5.0
4.	Further bids etc	£m	-	+461	+684	+993
5.	Result if bids accepted	£m	10791	12076	13082	14011
	Annual change			+11.9	+8.4	+7.1
6.	Proposed provision	£m	10791	11605 ~~11520~~	11212 ~~12131~~	12668 ~~12738~~
	Annual change	%		~~+6.8~~ +7.5	~~+5.3~~ +4.4	~~+5.0~~ +4.6
7.	Change from White Paper revalued (6 less 1)	£m	-	-7 ~~-92~~	-286 ~~-267~~	-350 ~~-280~~
		%	-	– ~~-0.8~~	-2.3	-2.7

The Secretary of State is bidding for increases in respect of prices both in 1981-82 and in later years, and for a further increase in the volume of hospital services. [All of the price bids would need to be accepted if we were to stick to our pledge to maintain previously planned levels of gross spending up to and including 1982-83. (There is no commitment to growth in the later years but about 1 per cent a year would be needed to maintain existing standards of health provision.)] We should be able to achieve net savings by seeking greater efficiency in the NHS, by raising existing NHS charges, by introducing a new charge for road traffic accidents during 1982-83, and by a cut in health service expenditure [method by which to be achieved under consideration]. This would curb the increase in the net hospitals cash limit. Also, the Family Practitioners Services (non-cash limited) seem to be growing more slowly than forecast hitherto.

The Secretary of State is also bidding for an additional 3 per cent on the standard pay factor for NHS pay. I do not think that this is the right way to deal with the problem, and I propose to reject the bid.

DRAFT

DHSS - HEALTH

The Secretary of State is bidding in respect of price increases in 1981/82 and 1982/83, for additional volume in 1982/83 (previous plans already include growth for that year of 1.7% in the hospital services), and for 2% a year volume growth in the hospital services in the later years. There is also provision in the baseline for 3% a year volume growth in the Family Practitioner Services.

2. ~~I do not believe we can now afford to maintain the previously planned volume of health spending in 1982/83.~~ We should be able to achieve net savings from increased efficiency, by raising existing NHS charges, and by introducing ~~a~~ new ~~new~~ charges~~ for road traffic accidents in 1982/83~~. It also seems probable that demand determined expenditure on the Family Practitioner Services may grow by rather less than 3%. But these savings will not be enough. I propose, in addition, therefore that we should keep the volume of spending on the hospital services in 1982/83 and in the later years at the level for 1981/82.

3. The proposed provision for health includes, ~~provisionally~~, a maximum extra amount ~~provision~~ of £100 million in respect of NHS pay. This is subject to further discussion with colleagues.

SECRET

20A. DHSS - PERSONAL SOCIAL SERVICES

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	1657	1787	1933	2030
	Annual change	%		+7.8	+8.2	+5.0
2.	Changes already agreed (local authority current expenditure)	£m	+270	+140 ~~+171~~	+63 ~~+92~~	+20 ~~+11~~
3.	Present total	£m	1927	1927 ~~1958~~	1996 ~~2025~~	2050 ~~2041~~
	Annual change	%		– ~~+2.1~~	+3.6	~~+0.8~~ +2.7
4.	Further bids etc	£m	-	-	-	+42
5.	Result if bids accepted	£m	1927	1927 ~~1958~~	1996 ~~2025~~	2092 ~~2083~~
	Annual change	%		– ~~+2.1~~	+3.6	~~+2.9~~ +4.8
6.	Proposed provision *	£m	1927	1927 ~~1958~~	1996 ~~2025~~	2050 ~~2041~~
	Annual change	%		– ~~+2.1~~	+3.6	~~+0.8~~ +2.7
7.	Change from White Paper revalued (6 less 1)	£m	+270	+140 ~~+171~~	+63 ~~+92~~	+20 ~~+11~~
		%	+16.3	+7.8 ~~+9.6~~	+3.3 ~~+4.8~~	~~+0.5~~ +1.0

The proposed increase in provision for planned local authority current expenditure on grounds of realism ~~with~~ affects this programme, & there seems no scope for offsets.

* Subject to final decisions on local authority current expenditure

21. DHSS - SOCIAL SECURITY

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (for 1984-85, 1983-84 total revalued by 5%)	£m	27565	30197 ~~30302~~	31819 ~~32029~~	33410 ~~33630~~
	Annual change	%		+9.5	+5.4	+5.0
2.	Changes already agreed:	£m	+80	-14	+35	+25
3.	Present total	£m	27645	30183 ~~30288~~	31854 ~~32064~~	33435 ~~33655~~
	Annual change	%		+9.2	+5.5	+5.0
4.	Further bids etc					
	a) reduced/increased requirements on existing policies	£m	~~-143~~	-227	-168	+356 ~~+310~~
	b) other bids etc	£m	-	+81	+231	+245 ~~+645~~
5.	Result if bids accepted	£m	27645 ~~27502~~	30037 ~~30142~~	31917 ~~32127~~	34036 ~~34610~~
	Annual change	%		+8.7 ~~+9.6~~	+6.3	~~+7.7~~ +6.6
6.	Proposed provision *	£m	27645 ~~27502~~	29638 ~~29794~~	30273 ~~31238~~	32891 ~~33237~~
	Annual change	%		+7.2 ~~+8.3~~	+4.2	+6.5
7.	Change from White Paper revalued (6 less 1)	£m	+80 ~~-63~~	-559 ~~-508~~	-946 ~~-791~~	-519 ~~-393~~
		%	+0.3	-1.9	-3.0 ~~-2.5~~	-1.6

This is by far the largest programme and it is growing inexorably because of demography and the pledge on the real value of retirement pensions and some other benefits. But we must get what savings we can. I cannot therefore accept any of the additional bids (although I could accept the restoration of the 5 per cent abatement of invalidity benefits if it were accompanied by an extension of the qualifying period). Given the prospective fall in real incomes for those at work, it would be fair to abate by 5 per cent the November 1982 uprating of benefits not subject to the pledge (nearly £500 million in a full year). This would cover inter alia unemployment, sickness and child benefit, maternity allowance and short-term supplementary benefit adult rates. We could save by increasing the size of death grants and the Christmas bonus (the latter to £20) but restricting their availability to those on Supplementary Benefit. Certain other changes in the rules and rates of supplementary benefit, and deferring the phasing out of the earnings rule for pensioners should produce further savings. There could be some further useful cuts, including a squeeze of 2 per cent on administrative costs.

* Subject to possible revised economic assumptions on unemployment

SECRET

23. SCOTLAND (EXCL. DAFS)

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued (excluding nationalised industries)	£m	5592	5879 ~~5857~~	6124 ~~6042~~	6430 ~~6396~~
	Annual change	%		~~+4.6~~ +5.1	+4.82	+5.0
2.	Changes already agreed (including local authority current expenditure)	£m	+210	+111 ~~+100~~	+86 ~~+70~~	+48 ~~+31~~
3.	Present total	£m	5802	5990 ~~5950~~	6210 ~~6162~~	6478 ~~6427~~
	Annual change	%		~~+2.6~~ +3.2	+3.67	+4.3
4.	Further bids etc (excluding nationalised industries and local authority current expenditure)	£m	-	+85 ~~+85~~	+115 ~~+113~~	+105 ~~+104~~
5.	Result if bids accepted	£m	5802	6075 ~~6035~~	6325 ~~6275~~	6583 ~~6531~~
	Annual change	%		+4.87	+4.01	+4.1
6.	Proposed provision+	£m	5802	5874 ~~5869~~	6041 ~~6042~~	6277 ~~6281~~
	Annual change	%		+1.2	+2.88	+3.9 ~~+4.0~~
7.	Change from White Paper revalued (6 less 1)	£m	+210	-5 ~~+19~~	-83 ~~-50~~	-153 ~~-115~~
		%	+3.8	~~+0.3~~ -0.1	~~-0.8~~ -1.4	~~-1.8~~ -2.4

+ Subject to final decision on local authority current expenditure.

The proposed increase in planned local authority current expenditure and the increases calculated on the basis of the formula, in respect of the July employment package and the police, will produce a substantial increase in this programme. I recommend that for other expenditure we also use the formula, and accept the consequences of the increases and reductions agreed on English programmes. The figures above are thus provisional.

The Secretary of State has agreed to make the maximum reduction on the Scottish "block" over and above formula consequentials that he considers he can present as consistent with formula treatment. In view of the substantially higher per capita expenditure in Scotland than in England and Wales, I recommend that the Scottish contributions over and above formula should be £50m in each year.

related to population (by which adjustments to Scottish Welsh and Northern Irish totals are made in parallel with changes agreed for comparable expenditure by other departments)

24. WALES (EXCLUDING WOAD)

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	2235	2326	2415	2536
	Annual change	%		+4.1	+3.8	+5.0
2.	Changes already agreed (including local authority current)	£m	+40	+49 ~~+47~~	37 ~~+28~~	+17 ~~+8~~
3.	Present total	£m	2275	237~~3~~5	2452 ~~2443~~	2553 ~~2544~~
	Annual change	%		+4.~~8~~4	+3.2 ~~+2.9~~	+4.1
4.	Further bids etc (excluding local authority current expenditure	£m	-	+67 ~~+39~~	+83 ~~+54~~	+64 ~~+57~~
5.	Result if bids accepted	£m	2275	2442 ~~2412~~	2535 ~~2495~~	2617 ~~2601~~
	Annual change	%		+7.3 ~~+6.6~~	+3.~~4~~8	+3.2 ~~+4.2~~
6.	Proposed provision †	£m	2275	2349 ~~2351~~	240~~6~~4	250~~7~~2
	Annual change	%		+3.3	+2.3	+4.~~2~~1
7.	Change from White Paper revalued revalued (6 less 1)	£m	+4	+2~~5~~3	-11 ~~-9~~	-34 ~~-29~~
		%	+0.2	+1.0	-0.~~4~~5	-1.3

As for Scotland and England, the provision for local authority expenditure is increased ~~this programme is increased by the proposed increase in planned local authority current expenditure, and the July package calculated on the basis of the formula.~~ I propose that we also use the formula for other expenditure changes on English programmes, and so the above figures are provisional.

~~The programme~~

As for Scotland, the programme is increased for the July package, calculated on the basis of the formula (see Scotland)

† Subject to final decisions on local authority current expenditure

SECRET

25. NORTHERN IRELAND

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	3223	3417	3630	3811
	Annual change	%		+6.0	+6.2	+5.0
2.	Changes already agreed	£m	+45	+58	+39 ~~+36~~	+27 ~~+23~~
3.	Present total	£m	3268	3475	3669	3838
	Annual change	%		+6.4	+5.5	+4.6
4.	Further bids etc	£m	-	+72	+89	+162
5.	Result if bids accepted	£m	3268	3547 ~~3548~~	3758 ~~3755~~	4000 ~~3996~~
	Annual change	%		+8.6	+5.8	+6.4
6.	Proposed provision	£m	3268	3478 ~~3492~~	3645 ~~3659~~	3867 ~~3881~~
	Annual change	%		+6.4	+4.8	+6.1
7.	Change from White Paper revalued † (6 less 1)	£m	+45	+61 ~~+75~~	+15 ~~+29~~	+56 ~~+70~~
		%	+1.4	+1.8 ~~+2.2~~	+0.4	+1.5

I propose that we accept the formula consequentials for N Ireland of all changes in GB programmes. In addition, I recommend acceptance of the Secretary of State's modified bid for additional resources to fulfil the agreed policy on electricity tariffs in Northern Ireland. The above figures are provisional, being subject to the changes we agree for other programmes.

† Subject to final decisions on local authority current expenditure and to possible ~~of~~ revised economic assumptions on unemployment.

27. OTHER DEPARTMENTS
(INCLUDING LORD CHANCELLOR'S AND CIVIL SUPERANNUATION)

			1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued	£m	3382	3611	3897	4093
	Annual change	%		+6.8	+7.9	+5.0
2.	Changes already agreed	£m	+30 ~~+75~~	+35 ~~+56~~	+26 ~~+28~~	+20 ~~+4~~
3.	Present total	£m	3412 ~~3457~~	3646 ~~3667~~	3923 ~~3925~~	4113 ~~4097~~
	Annual change	%		+6.~~1~~9	+7.~~0~~6	+4.~~4~~8
4.	Further bids etc.	£m	-	+53 ~~+48~~	+80 ~~+78~~	+141
5.	Result if bids accepted	£m	3412 ~~3457~~	3699 ~~3715~~	4003 ~~4003~~	4254 ~~4238~~
	Annual change	%		+8.4 ~~+7.5~~	+8.2 ~~+7.8~~	+6.3 ~~+5.9~~
6.	Proposed provision	£m	3412 ~~3457~~	3653 ~~3669~~	3955	4204 ~~4188~~
	Annual change	%		+7.1 ~~+6.1~~	+8.3 ~~+7.8~~	+6.3 ~~+5.9~~
7.	Change from White Paper revalued (6 less 1)	£m	+30 ~~+75~~	+42 ~~+58~~	+58	+111 ~~+95~~
		%	+0.9 ~~+2.2~~	+1.~~8~~2	+1.5	+2.~~3~~7

This represents a large number of Departments with relatively small expenditure. We have to accept the forecast increase in rates payable on Government property, the cost of UK and European Elections in 1983-84 and 1984-85, and the forecast increase in the cost of pensions in 1984-85.

I also recommend accepting the House of Commons bid for increased expenditure, the cost of computerising PAYE and taxing unemployment benefit (policies which we have already agreed), and some other very small bids.

But we should take offsetting action: a 2% cut in all cash limits (~~more~~ about twice this amount in the case of OAL), on top of the carry-forward of this year's squeeze, could be met in part by the civil service manpower reductions now being negotiated. Another possibility is an abatement in the 1982 uprating of public service pensions. ~~but we may decide instead to increase contributions (the report of the Valuation of Pensions Committee [is under consideration])~~ The Official Committee on the Value of Pensions has now reported, & the Chancellor of the Exchequer & the Chancellor of the Duchy of Lancaster are considering its advice.

Issues to which it will be difficult to secure agreement in full

		1982/83	1983/84	1984/85
		£ million		
1.	**Ministry of Defence**			
a.	Reject bids for validation of inflation, and future relative price effect, which Secretary of State will argue were needed to keep NATO pledge. But allow transitional provision of £250 million this year, £150 million next.	379	767	1050
b.	Do not allow transitional provision (see a above)	150		30
2 and 3.	**Foreign and Commonwealth Office**			
a.	Overseas aid real cut by about 3%. (Note : this is in addition to taking back windfall gain from revaluation factors.)	30	30	
5.	**Intervention Board for Agricultural Produce**			
a.	End beef premium scheme. (End may be supported by FCO on EEC grounds.)	-	37	37
6.	**Ministry of Agriculture Fisheries and Food**			
a.	Reject hill livestock compensatory allowances bid - causing some fall in real income of hill farmers.	53	60	66
b.	Cut rate and/or coverage of capital grants to farmers to produce reduction in costs of 40%.	30	50	50
8.	**Department of Industry**			
a.	Reduction regional development grants from 15%/22% to 12%/18%.	36	90	90
b.	Refuse payment of RDG for Sullom Voe and Flotta. Secretary of State may agree, but could nevertheless be contentious because of retrospection.	122	9	
9.	**Department of Energy**			
a.	10-14% cut in cash limited expenditure on the AEA and non-nuclear research.	31	42	47
	Total c/f	831	1,085	1,377

SECRET

A. DIFFICULT CUTS PROPOSED (Continued)

		£ million		
		1982/83	1983/84	1984/85
	Total b/f	832	1,085	1,377
12.	Department of Employment			
a.	Associate introduction of comprehensive YOP with cut in allowance to £8 a week and ineligibility for Supplementary Benefit.	-	170	230
b.	Make no provision for Layard type scheme or increase in Community Enterprise programme.	100	150	130
c.	Bring in earlier cut in allowance for YOP to £8 a week and ineligibility for Supplementary Benefit.	110		
13.	Department of Transport			
a.	Motorways and Trunk Roads. Cut uncommitted capital expenditure by half in 1982/83 and substantially thereafter.	50	75	75
14.	DOE - Housing			
a.	Larger rent increases, requiring about £4 a week (35%) in 82/83; £3.50 a week (23%) in 83/84; £1 a week (5%) in 84/85	50	50	50
15.	DOE - PSA			
i.	20% cut in minor works and maintenance.	20	20	20
16.	DOE - other			
a.	12% cut in water capital.	85	100	100
17.	Home Office			
a.	Reject bid for second new prison start in 1984-85.	1	1	9
19.	Department of Education and Science			
a.	Increase parental contributions to student awards (increase % of income at margin from 14 to 20, abolish minimum grant).	40	100	100
	Total c/f	1,287	1,751	2,091

SECRET

A. DIFFICULT CUTS PROPOSED (Continued)

		£ million		
		1982/83	1983/84	1984/85
	Total b/f	1,287	1,751	2,091
20.	**Department of Health and Social Security - Health**			
	a. New charge for road accidents (requires legislation).	80	80	80
	b. Hospital Service revenue. No "volume" growth in 1982-83. (Exact description under discussion - probably by refusing bids for RPE and validation.)	134	142	149
	c. New charges (eg hotel charges and half-price charge for presently exempt groups).	15	125	181
21.	**Department of Health and Social Security - Social Security**			
	a. Changes in supplementary benefit rules.	50	150	160
	b. Confine eligibility for death grant and Christmas bonus to those on supplementary benefit, but double amount.	57	57	57
	c. Abate Nov.1982 uprating by 5% for "unpledged" benefits - eg unemployment, sickness, child, short-term supplementary benefits.	165	490	490
	d. Defer phasing out of earnings rule for pensioners.	-	31	96
	TOTAL	1,788	2,826	3,304

B. DIFFICULT CUTS NOT PROPOSED

Revise : 7 October 1981

Reductions which would be necessary if further reductions in totals required.

		£ million		
		1982/83	1983/84	1984/85
1.	Ministry of Defence			
a.	Reject bid to carry through cost of 1981 AFRB award. Secretary to State will argue that this reduction re-open earlier decisions. May argue that it cannot be achieved.	85	88	92
2 and 3.	Foreign and Commonwealth Office			
a.	Overseas aid. Cut deeper than 3% proposed above. Say 3%. (Note: maximum technically possible in 1982-83 would be £87 million.)	30	30	30
8.	Department of Industry			
a.	Abolish RDGs	120	300	300
b.	Reduce further "wedge" allowed for future industrial support.	10	7	10
9.	Department of Energy			
a.	Further reductions in research expenditure which would require end of fast-breeder reactor programme.	30	50	65
10.	Department of Trade			
a.	Reductions in some, or all, of Selective Assistance for Tourism; Export Promotion; Shipping. In each case reductions would be small in relation say, to opposition caused.	16	18	21
12.	Department of Employment			
a.	Make no further increase in YOP, and its successor.	100	300	525
b.	Raise JRS age limit to 62 for disabled men.	-	-	50

SECRET

B. DIFFICULT CUTS NOT PROPOSED (Continued)

		1982/83	1983/84	1984/85
13.	Department of Transport			
a.	Motorways and Trunk Roads, Moratorium on new starts in 1982-83. (See A.13a)	50	25	25
14.	DOE - Housing			
a.	Further rent increases, bringing 1982-83 increase to £4.40 (39%).	65	65	65
14.	Home Office			
a.	Cut police overtime	70	70	70
19.	Department of Education and Science			
a.	Cut Universities cash limit by 2%.	24	25	26
20.	Department of Health and Social Security - Health			
a.	Cut hospital service revenue so that volume falls (see A.20.b).	?	?	?
21.	Department of Health and Social Security - Social Security			
a.	Abolish death grant and Christmas bonus.	67	67	67
b.	Abate uprating of "pledged benefits" by 5% in November 1982.	300	800	800
23.	Scotland			
a.	Reduction in Scottish programmes on basis of needs assessment study.	75	75	75

PART 14 ends:-

Extract from mtg record 16 Sept

PART 15 begins:-

IBBS to MCS 8.10.81

~~Public Expenditure Papers 9.10.81~~