PREM 19/987

PART 25

SECRET 4995

MT

CONFIDENTIAL FILING

Public Expenditure & Cash Limits

ECONOMIC POLICY

Pt 1: MAY 1979

Pt 25: NOVEMBER 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~7.11.83~~							
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- Pt Ends							

PREM 19/987

NB Spare copies of the 1983 Autumn Statement may be found in Useful Docs.

PART 25 ends:-

AT to PM 30/11/83

PART 26 begins:-

E(A)(83) 8th Mtg 1/12/83

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
LCA to MISC 99(83) 6th Meeting, Min 2.	1.11.83
C(83) 34	7.11.83
LCA to CC(83) 33rd Conclusions, Min 4	10.11.83
Most Confidential Record to CC(83)	
33rd Conclusions	10.11.83
CC(83) 34th Conclusions, Minute 4	17.11.83
E(A)(83) 17	28.11.83
E(A)(83) 18	28.11.83

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 CWayland Date 15 March 2013

PREM Records Team

Published Papers

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

1. House of Commons Hansard,
   17 November 1983, columns 995 - 1009
   "The Economy"
2. Autumn Statement 1983
   HMSO, 17 November 1983 [ISBN 010 2112843]
3. House of Commons Hansard,
   24 November 1983, columns 466 - 555
   "Autumn Statement"

Signed OWayland Date 15 March 2013

PREM Records Team

10 DOWNING STREET

(2)

Prime Minister

If you have time before E(A) you might look at notes by Policy Unit and Robin Nicholson.

Both in principle favour Treasury approach though both think further detailed work is needed to refine it.

AT

30/11

PRIME MINISTER

POLICY UNIT
30 November 1983

EUROPEAN COMMUNITY EXPENDITURE PROGRAMMES AND CONTROL OF PUBLIC EXPENDITURE

The argument for control is an important one to win. The Policy Unit approaches this subject from the viewpoint that much of the expenditure which is, and will increasingly be under dispute - on overseas aid, regional policy, support for R&D, agriculture - has a dubious value, whether dispensed by the community or by Departments. Decades of regional policy have failed to remove regional unemployment differentials and have misdirected resources; support for agricultural investment has led to yet larger surpluses; support for innovation seems to go largely to the larger companies which would probably have undertaken the supported projects anyway (according to a DTI analysis of the Product and Process Development Scheme which came by chance into our hands). The value of aid is also disputed: isn't it even harder to ensure additionality of aided projects in other countries than it is in our own? Expenditures on these policies have as much, if not more, to do with demonstrating Government's concern than with improving performance.

It is essential therefore to support the Treasury view because:

(i) the Community's fields of interest happen, unfortunately, to be those in which public expenditure seems to be of the least proven value. Community involvement is not a reason for allowing the combined national and Community expenditures to increase;

(ii) no convincing arguments have been offered to demonstrate that the Community's preferred programmes are any less effective than those to which Departments "attach importance". Indeed, what evidence have we that our own policies are effective in a real sense?

(iii) Departments are in effect asking that additional Community expenditure in their own policy areas should be at the expense of expenditure in areas in which the Community has no competence, such as health, social security or defence.

The Departments' strong card is that they would be obstructive in Brussels, to the point of frustrating the Government's overall objectives, if non-additionality applied. This is, unfortunately, a real danger: officials will tend to resist threats to their own Departments' expenditure, even if this undermines the Government's overall policy. However, if Cabinet Ministers put this forward as an argument it would amount to a kind of blackmail: "we will behave badly if our expenditure is controlled". You would be entitled to register your indignation if this is what is claimed. You could then make the point that while we want a suitably questioning approach to Community initiatives - no point in signing up on dotty Community schemes merely to reduce our net contributions position - we do not want obstruction, just because Community schemes are different.

In discussion you might press Ministers on why non-additionality should not apply to them. More specifically:

(i) why are they so convinced that Community programmes, though different from our own, would be significantly less effective? The DTI has consistently argued that the ESPRIT programme for information and technology is a sound one which would benefit UK firms. Is it less effective than DTI's own schemes? And would the same be true of the Community's support for small/medium enterprises in declining industrial areas? Why would multilateral aid be less helpful to backward countries than bilateral aid?

(ii) why should additional Community expenditure in these policy areas be financed by reducing those in, say, health or defence? There is no separate pot of money labelled "general expenditure".

You could aim for a summing up of the meeting along the lines:

(i) it is already our policy to adjust our domestic public expenditure in the light of Community spending. We do so in an informal way. We need now to adopt a more formal procedure, if we are to secure a growing share of Community expenditure and use it to reduce national public expenditure;

(ii) this problem has not been tackled before. Further work is needed to formalise these arrangements, in particular to decide how Community expenditure might be allocated between Departments and whether relief is needed to cope with sudden increases in Community expenditure which are large in relation to departmental budgets, and with programmes which might not be of a kind which Departments are in the habit of supporting;

(iii) this further work needs to be completed as soon as possible, in order that the new system should be in place for the next PES round.

NICHOLAS OWEN

W.0804 30 November 1983

PRIME MINISTER

E(A) DISCUSSION ON EUROPEAN COMMUNITY EXPENDITURE PROGRAMMES AND CONTROL OF UNITED KINGDOM PUBLIC EXPENDITURE

One aspect of the E(A) discussion on European Community Expenditure Programmes concerns the handling of EC Research and Development expenditure in relation to Departmental budgets. A sensible system would:

(a) contribute to the control of EC expenditure through Departments

(i) arguing against adoption of programmes which are of poor technical quality or incompatible with Departmental priorities

(ii) arguing in favour of good programmes while keeping in mind the need to limit EC R & D expenditure.

(b) Provide incentives to maximise UK receipts from approved EC R & D programmes both to public sector and private sector laboratories.

(c) Make some allowance for Departments which, having argued against adoption of a programme, find their views overruled when the UK line is determined principally by political and diplomatic considerations with respect to the overall EC decision-making process.

2. The present arrangements do not meet these criteria. Departments are insufficiently accountable for EC R & D expenditure and there is often no incentive to maximise UK receipts. Therefore change is needed.

3. However, the Treasury proposals on an attribution system also fail to meet my criteria. The incentives to maximise UK receipts are not there, indeed there are sometimes disincentives. In addition Departments are burdened with a degree of accountability without authority which is inequitable.

4. Departments are proposing that the solution lies in modifying the existing arrangements to move a little way towards Treasury requirements. I cannot support this approach. I think that the Treasury proposal for an attribution system is fundamentally sound but requires significant modifications to meet the criteria given in my first paragraph.

5. I therefore advise that you accept the Treasury proposal for an attribution system for EC R & D expenditure as given in paragraph 15(iii) of the Annex to the Chief Secretary's paper. But you should make clear that the detailed arrangements worked out by officials must meet the legitimate objections from Departments to the proposal in its present form.

6. I am copying this minute to Sir Robert Armstrong.

RBN.

ROBIN B NICHOLSON
Chief Scientific Adviser

Cabinet Office
30 November 1983

CONFIDENTIAL

Prime Minister ②

Further objections to the Chancellor's proposals.

AT 30/11

PRIME MINISTER

E(A) 1 DECEMBER 1983: EC EXPENDITURE PROGRAMMES AND CONTROL OF UK PUBLIC SPENDING

I am afraid that I shall not be able to attend the meeting of E(A) on 1 December, to discuss Treasury proposals to change the current treatment of Community Research and ERDF non-quota aid. As you know, I will be attending the European Council of Transport Ministers in Brussels. I am therefore writing to set out my views.

I should point out that the Treasury's proposal on attribution would bear particularly harshly on research, because many of the Community receipts in this area go direct to the private sector. There is no question that the receipts benefit this country, but by a quirk of Treasury accounting they are not recorded as an offset to our gross contribution in programme 2.7 showing our net contribution line. The proper treatment of such receipts, in my view, is that if they are to be attributed to Departmental programmes, they should be added to those programmes, with the appropriate offset appearing in programme 2.7. This would ensure that research was then subject only to the same degree of financial stringency as other cash limited programmes.

I therefore suggest that officials should be asked to look at this further to see how best to account properly for receipts which are passed direct to the private sector.

CONFIDENTIAL

I am copying this minute to the other members of E(A) and to Sir Robert Armstrong.

NICHOLAS RIDLEY

30 November 1983

I/F back to AT
to see & return pl
AT
Public expenditure pt 6

CABINET OFFICE
Central Statistical Office
Great George Street, London SW1P 3AQ Telephone 01-233

30 November 1983

"PUBLIC EXPENDITURE AS A PERCENTAGE OF GDP"

You asked for a reconciliation between the estimate in the Public Expenditure White Paper (44½%) and the OECD estimate (47.3%) quoted in the answer to a recent PQ.

The attached table gives a simplified reconciliation. The OECD treatment of certain pension schemes which inflates the UK public expenditure percentage by 1.3% has a similar effect on all the countries of the Community. The comparative position of the countries shown in the answer to the PQ is not significantly altered by it.

I am copying this to John Graham in the Treasury who has expressed an interest in the reconciliation.

Howard Morrison

HOWARD MORRISON

Mr A Turnbull
10 Downing Street

Enc

Public expenditure as % of GDP
Reconciliation of Command 8789 and OECD estimates

	%
Command 8789 Chart 1.6	
Planning total plus net debt interest[(1)] for 1981/2	44.6
adjustment to gross debt interest	+ 3.2
other national accounts adjustments (net)	- 0.4
(National Accounts) general government expenditure 1981/2	47.4
conversion to calendar year (1981)	- 1.5
adjustment for OECD treatment of certain pension schemes	+ 1.3
other adjustments to OECD basis (net)	0.1
OECD total outlays of government	47.3

(1) includes also local authority payments of VAT and non-trading government capital consumption.

30 NOV 1983

Mr. Biffen: I have been asked to reply.

No. How the police respond to information they receive is an operational matter for each individual chief officer of police.

"Tameside: The Case for Aid"

Q53. **Mr. Pendry** asked the Prime Minister if she will make a statement on the conclusions of the booklet published by the metropolitan borough of Tameside "Tameside: The Case for Aid", a copy of which has been sent to her.

Q54. **Mr. Andrew F. Bennett** asked the Prime Minister if she has studied the booklet published by the metropolitan borough of Tameside "Tameside: The Case for Aid" a copy of which has been sent to her by the hon. Member for Denton and Reddish; and if the Government will now give Tameside the same treatment as other areas with similar problems.

Mr. Biffen: I have been asked to reply.

Tameside's case for assisted area status, and for designation under te Inner Urban Areas Act has been regularly reviewed. My right hon. Friends at the Departments of the Environment and Trade and Industry will assess the material in the booklet "Tameside: The Case for Aid" in relation to other relevant facts and the claims of other areas. It is too early to say what the coverage of a revised assisted areas map might be. The White Paper on regional industrial policy, which my right hon. Friend the Secretary of State for Industry will publish shortly, will seek views on this aspect of regional industrial policy.

NATIONAL FINANCE

European Community (Budget)

Mr. Austin Mitchell asked the Chancellor of the Exchequer how the European Community Commission reached its figure showing that the United Kingdom contribution to the European Community budget was less than Her Majesty's Government had claimed.

Mr. Ian Stewart: The Commission suggested changing the definition of Community expenditure used for calculating budgetary burdens so as to exclude part of administrative expenditure and the part of CAP guarantee expenditure which corresponds to food aid restitutions and sugar imports from ACP countries and India. It also proposed that the remainder of CAP guarantee expenditure should be attributed to member states taking account of shares of production of CAP-supported commodities, rather than by its geographical location. The Government have made clear that they regard these proposed changes in the methodology which has been accepted for the past four years as unsound, unhelpful and unacceptable.

Nationalised Industries (Rate of Return)

Mr. John Browne asked the Chancellor of the Exchequer what was the real rate of return earned by nationalised industries in the last financial year.

Mr. Peter Rees: The information is available only on a calendar year basis and is not yet available for 1982. Figures for previous years were given by my right hon. Friend the Prime Minister on 3 March this year in her reply to the hon. Member for Enfield, North (Mr. Eggar)—[Vol. 38, c. 201].

Value Added Tax

Mr. Rooker asked the Chancellor of the Exchequer if he will set out in the *Official Report* details of where the imposition and impact of value added tax in the United Kingdom differs from European Community requirements and practice.

Mr. Hayhoe: The main European Community requirements are included in the sixth VAT directive which was implemented by United Kingdom legislation in 1977. The directive allows for considerable variations in administrative practice between member states, and it is not practicable to list these.

European Community (Public Expenditure)

Mr. Proctor asked the Chancellor of the Exchequer if he will set out in the *Official Report* the level of public expenditure as a proportion of gross domestic product in each country in the European Community for each of the last five years.

Mr. Peter Rees [*pursuant to his reply,* 18 November 1983, c. *596*]: International comparisons of public expenditure are not available. Total Government outlays* as a percentage of GDP for 1977-1981 are as follows:

	1977	*1978*	*1979*	*1980*	*1981*
Germany	48·1	47·8	47·7	48·3	49·3
France	44·2	45·2	45·5	46·4	48·9
United Kingdom	44·1	43·6	43·4	45·6	47·3
Italy	42·5	46·1	45·2	46·0	50·8
Belgium	46·6	47·9	49·5	51·6	56·1
Denmark	48·9	50·6	53·2	56·3	59·0
Greece†	29·0	29·9	29·7	30·4	36·0
Ireland	45·5	46·6	49·8	54·4	n.a.
Luxembourg	52·7	51·8	52·8	60·1	n.a.
Netherlands	54·6	55·9	58·0	59·7	61·5

* Current expenditure, capital formation and net capital transfers.
† Current expenditure only.
Source: OECD *Economic Outlook* July 1983.
Table R8: Total Outlays of Government as a percentage of GDP.

Personal Taxation

Dr. McDonald asked the Chancellor of the Exchequer what is the cost to the Exchequer of allowing *(a)* all tax reliefs and *(b)* personal tax allowances against higher rates of tax rather than the standard rate only.

Mr. Moore [*pursuant to his reply,* 18 November 1983, c. *596*]: The cost at 1983-84 levels of income of allowing personal tax allowances at rates in excess of the basic rate of income tax is estimated at about £300 million. Information on the similar cost of other reliefs is available only in respect of mortgage interest, retirement annuity premiums and employees' superannuation contributions. These reliefs are estimated to cost about £250 million. It is not possible to estimate precisely the combined yield from restricting these reliefs and personal allowances to the basic rate, but it is thought to be about £600 million.

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Prime Minister ②

His alternative is at para 12. Far from opposing extension of attribution, FCO are seeking to use this debate to withdraw it in aid field AT 30/11

PM/83/96

PRIME MINISTER

European Community Expenditure Programmes and the Control of UK Public Expenditure

1. At EA on 1 December we shall be examining a paper by the Chancellor of the Exchequer designed to ensure that the UK share of Community expenditure is as far as possible contained within existing public expenditure ceilings and replaces, rather than adds to, national expenditure. We shall also have before us a paper by the European Secretariat of the Cabinet Office summarising departmental reactions to the Treasury proposals and, I understand, there may be a further paper by Norman Tebbit.

2. I fully support, of course, Nigel's objective of controlling the growth of public expnediture, whether national or in the European Community. As far as overall levels of Community spending are concerned, we have a particularly strong incentive to insist on restraint because of the size of our net contribution. Indeed effective control of Community spending overall is one of the conditions we have set before we would be prepared to consider any increase in the Community's own resources. (I believe we are beginning to make real progress on this. The latest French paper, proposing strict controls on both agricultural and other spending, is very encouraging.)

3. In addition to overall control of Community spending we have also made it a priority to try to ensure the cost-effectiveness of individual programmes as well as to derive a net benefit from them whenever possible.

/4. As regards

4. As regards the bulk of Community spending, there are three broad categories of programme:

(i) programmes which effectively take the place of or contribute to the financing of a domestic programme;

(ii) programmes which supplement existing UK programmes;

(iii) programmes which in effect create new areas of activity for the United Kingdom

5. All these programmes should be subject to the general constraints I have outlined. But I do not believe they are susceptible to the blanket application of the non-additionality rule, which is what attribution, as proposed by the Chancellor, would amount to. I part company with Nigel on two aspects of his proposal: firstly, his view that each and every piece of Community spending must produce savings in domestic expenditure, and secondly, that attribution is a system that can always be made to work.

6. In many cases, of course, it will. For example, where Community spending clearly takes the place of an existing national programme, it is right that the existing non-additionality rules should apply. But there are many instances where it would not be realistic to expect to make offsetting national savings in response to Community programmes. For example, some Community spending will be in new areas where we have decided that we can best fulfil our national requirement by Community action. That was for instance the case with the JET programme for fusion research.

7. I can see no way in which it makes sense to require offsetting savings for programmes of this kind. They would not be replacing an existing UK project or programme. We should only have agreed to them because of a conscious decision on our part that they are in an area which can better be dealt with at Community rather than at national level. In these cases the Community programme would have been decided because we thought it a better way of proceeding than with a

/national

national programme of some kind. There is no parallel UK saving that can automatically be made. To cut some other programme of proven value would be at best arbitrary and at worst damaging.

8. There are other programmes where Community action supplements and complements national action. ESPRIT is a good example. Although we have an existing UK programme in this field (the Alvey programme), there is no evidence that there will be substantial overlap between the two. To judge from the pilot programme, in which British industry has participated, we are likely to derive significant benefits from the scheme. Despite these benefits, which are recognised by both the DTI and our own industry, the DTI would be bound to reconsider our support for ESPRIT if offsetting savings were required from the Alvey programme.

9. There is another difficulty that would arise if we tried to apply the logic of attribution in such a case. It would run directly counter to one of our main aims, namely that of maximising our receipts from the Community. Taking the ESPRIT programme again as an example, if the DTI were required to find offsetting savings only to the extent that the programme was taken up in the UK, they would be under intense pressure to minimise rather than maximise the UK take-up. This would be an entirely perverse result. For it would leave other co ntries with the lion's share of the programme. But we, of course, should still be contributing our normal full share of the cost of the programme.

10. The position would be quite different, of course, in the case of a Community programme that was designed to replace, or to finance in whole or in part an existing national programme. In such a case the non-additionality

/rule should

rule should clearly apply, ex hypothesi. So far this has been almost the general rule, since so many Community spending programmes have been deliberately (but artificially) designed as a way of providing us with our Budget refunds. But as, hopefully, we move away from this way of reducing our net contributions, this kind of case should become increasingly unusual.

11. The Aid Programme, for which I am responsible, deserves a separate mention. Nearly half Community aid is outside the Budget altogether (the EDF) and is not therefore subject to the overall restraints which the own resources ceiling imposes on other forms of Community spending, and the remainder is not part of the allocated budget, which is the basis for the calculation of our net contribution. None of this expenditure, therefore, has a bearing on the size of our net contribution. Because the Community aid programme stands, in this way, in a world of its own it is also more subject to unforeseen and unavoidable increases than are other programmes. We are often unable to prevent the Parliament increasing Community aid schemes which we would not choose to finance; and we risk disproportionate damage to our interests in third countries if we block proposals in the Council on which we are isolated. In these circumstances, attribution is the main reason why the multilateral part of our aid programme continues to expand - from 25 per cent to 38 per cent over the five years to 1982. As a result, we have been obliged to curtail our bilateral programmes, to the disadvantage of political and commercial objectives which we regard as important. I am sure that this deserves consideration in its own right along the lines suggested in the Cabinet Secretariat paper.

12. In short, therefore, I believe our policy should be:

/(i)

(i) to continue to work in Brussels for effective controls on Community spending as well as for cost-effectiveness in individual programmes;

(ii) to apply to individual programmes a discriminating approach depending on whether those programmes effectively replace national programmes, in which case it would make sense to look for offsetting savings, or on whether they involve supplementary spending or completely new areas of Community spending in which case attribution would not be appropriate. Attribution is not consistent with the only approach which makes practical sense; nor has it yet been shown that it can be made to work in new areas;

(iii) to consider urgently the possibility of a new procedure at home which would consist of taking a forward look at likely Community expenditure in fields where overlap with UK expenditure is possible; a kind of mini-PESC for EC spending;

(iv) to provide for treatment of the aid programme along the lines suggested in the Cabinet Secretariat paper.

/13. I am

12. I am copying this minute to other members of E(A) and to Sir Robert Armstrong.

GEOFFREY HOWE

29 November 1983

Foreign and Commonwealth Office

Prime Minister ②

AT 30/11

JF4986

CONFIDENTIAL

PRIME MINISTER

EUROPEAN COMMUNITY EXPENDITURE AND THE CONTROL OF UK PUBLIC EXPENDITURE

E(A) is to discuss this issue on 1 December. I have seen Geoffrey Howe's report of the OD(E) discussion on Esprit, where this issue was raised in an acute form, and the official note circulated as E(A)(83)18. I understand Nigel Lawson is also to circulate a paper, but have not yet seen this.

2 My concern is simple. In relation to Esprit, I am faced with the prospect, according to which version of the Treasury argument is applied, of having to find from my Departmental PESC either the total contribution of the UK to the Community Budget for Esprit, or that part of this budget which is actually spent in the UK. (I was not clear from the discussion at OD(E) which approach would be favoured by the Treasury and, as I have said, I have not yet seen the Treasury paper). On either basis, the implications for the UK are bad. On the former basis, my - and others' - Departments would be penalised for having shaped a Community programme in a way which matches British objectives; on the latter, the UK would be directly penalised to the extent to which British firms take up the available budget. Either approach would act as a severe disincentive to what we are

trying to do in the Community, namely to shape programmes to our advantage; to make sure the UK takes up available Communities monies; and to take a positive stance. I should be compelled either to oppose the Esprit programme root and branch (and hence oppose a Community initiative which is generally of the sort we should like to see become more important among the various Community programmes); or to stop British particpation therein (thereby excluding our gaining any benefit from the programme). I have posed the argument in the context of Esprit, but it applies more widely, as E(A)(83)18 makes clear.

3 There are other objections to what is proposed. First, the Treasury proposals presume that Community and national programmes are interchangeable or top up each other - this has been claimed for Esprit and Alvey. Since this interchangeability cannot be demonstrated in this instance and is rarely the case, offset must disrupt coherent Departmental policies and programmes. Second, to calculate offset on the basis that the 'benefit' to Departmental policies can be nicely calculated in advance would be at variance with our experience of the inescapable fluctuations of major Community spending in the course of a year. Third, the Whitehall procedures needed to implement the Treasury proposals would involve complex bureaucratic exercises, themselves of dubious

cost-effectiveness (Esprit, for example, may be deemed to benefit several Departments, and their PESC provisions would have to be penalised to differing extents).

4 For all these reasons, I believe the application of the "attribution" doctrine is misguided, and will harm our interests. Instead, I believe we should adopt a different approach: We should insist that each Community programme is cost-effective in its own right. We should ensure, with our fellow Member States, a proper overview of priorities within total spend, not just random accumulation of projects. We must continue to look for effective management of Community spending within the United Kingdom. And we must have our own priorities for Community spending - not least to secure a maximum 'take' for the United Kingdom from such spending; and a maximum increment for our own industrial base.

5 There are already developments on all these on which we can build. I believe we could do so even more effectively if we resolved to treat programme 2.7 as standing outside the present programme of Departmental budgetary procedures and if we recognised thereby that effective control of Euro-expenditure must proceed from a separate base. I believe this would bring us nearer to effective control and management of our expenditure whether at home or in the

Community - which is the goal to which we are all committed - and would bring to an end an argument which has paralysed our negotiators in Brussels for the sake of a formula which I believe is misleading. Specifically, I would urge that we should now reach agreement that the Treasury's proposals would not apply to Esprit and the ERDF Non-Quota section so that negotiations can go forward with no further uncertainties.

6 I am copying this minute to members of E(A) and to Sir Robert Armstrong.

NT

N T

29 November 1983

Department of Trade and Industry

10 DOWNING STREET

Prime Minister (2)

For Thursday's E(A) meeting. This will be difficult as both sides feel strongly about their positions. The Chancellor will be raising this at his bilateral on Wednesday evening. Without rules on attribution and non-additionality Chancellor feels there is a major loophole in public expenditure controls. (It is difficult to have much faith in the "forward look" when no Minister, other than the Chancellor, has much incentive to keep Community expenditure down.

AT
28/11

MO

Qz.03450

PRIME MINISTER

Community Expenditure Programmes and Control of United Kingdom Expenditure

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References: E(A) 17 (Memorandum by the Chief Secretary ~~Chancellor of the Exchequer~~)
E(A) 18 (Note by the Secretaries)
~~E(A) 19 (Memorandum by the Trade and Industry Secretary)~~
The Foreign and Commonwealth Secretary (and SS/DTI) may also circulate a memorandum or minute.

PURPOSE OF MEETING

1. To consider proposals by the Chancellor of the Exchequer that certain types of Community expenditure programmes should either be paid for by the relevant spending Departments out of their PESC allocations, or should be matched by off-setting savings in the Department's budget.

BACKGROUND

2. With the exception of the United Kingdom share of Community aid programmes (which is directly financed by the Overseas Development Administration out of its budget), the United Kingdom share of Community expenditure programmes is financed out of PESC Programme 2.7 under the heading "net payments to the Community". For the major expenditure programmes and in accordance with existing Government policy, a system has been evolved to ensure that the broad principle of "non-additionality" is applied, ie that Community expenditure should not add to United Kingdom domestic public expenditure. Thus the Common Agricultural Policy replaces a domestic agricultural support system, and the bulk of the receipts from the European Regional Development Fund (ERDF) quota section and the Social Fund are paid into the Consolidated Fund to offset United Kingdom payments to the Community. It is also agreed policy that public sector bodies receiving funds from Regional and Social Funds should use these to finance existing programmes rather than additional expenditure.

/3.

3. For some smaller Community programmes and for future programmes, however, arrangements for non-additionality have not been fully worked out. This is the main element of the present disagreement. In particular, in the case of Community receipts going to help small and medium-sized enterprises and Community finance for certain research and development programmes there has hitherto been no specific agreed system to ensure non-additionality. As Community programmes of this sort, expecially in the research field, are on the increase, the Chancellor would like to establish a system to ensure that they do not add to public expenditure.

4. The Chancellor's proposals contain three main elements:

a. The present system for ERDF quota-section and Social Fund receipts should remain unchanged, as should the present system of attribution to the budget of the Overseas Development Administration (ODA) of the United Kingdom share of Community aid programmes.

b. Non-quota receipts from the European Regional Development Fund (ERDF) going to the private sector should be matched by offsetting savings in the budgets of the Department of Trade and Industry and the territorial Departments concerned.

c. In the case of new Community expenditure programmes, particularly in the research field, the United Kingdom share of the costs (or in certain cases the receipts) should either be borne on the budget of the Department concerned (instead of on PESC Programme 2.7), or where this is inappropriate be matched by off-setting savings in the Department's budget. A number of new programmes on which decisions are about to be taken in the Community would be affected; one of these is ESPRIT, for which the European Council on 4-6 December will be asked to agree a financial provision.

5. Other Ministers do not dispute the need for public expenditure control but consider that the Chancellor's proposed system would have very serious drawbacks. Their arguments are based on three main points:-

/(i)

(i) since Community expenditure is not wholly within their control (the European Parliament, for example, can increase some expenditure and there is nothing that we can do about it), it is wrong that higher Community expenditure should result in an automatic cut in their departmental budgets which reflect their priorities;

(ii) if higher Community expenditure is going to lead to an automatic cut in a departmental budget, there will be no incentive to support such Community programmes even if the United Kingdom gets a disproportionately high return from them. At the extreme, Departments will try to minimise the amount of money available to private industry or research establishments, since higher amounts would mean a greater cut in the Department's own budget. Thus we would not be maximising receipts from the Community;

(iii) if the United Kingdom automatically opposes every Community proposal for more expenditure, we shall be seen to be not judging proposals on their merits and other member states will take less notice of our views.

The objections, as voiced at official level, are set out in E(A) 18. The Trade and Industry Secretary has also recorded his own strong objections in E(A) 19 and the Foreign and Commonwealth Secretary may also put in a paper recording the objections he sees in terms of Community policy.

May appear as a minute

6. More specifically, the DTI and the territorial Departments object to the proposal for ERDF non-quota section receipts going to the private sector to be matched by off-setting savings on their budgets. The ODA objects to the continuation of the existing policy, ie the attribution principle for Community aid expenditure, and want the costs of such expenditure to the United Kingdom to be met from Programme 2.7 rather than from the ODA budget.

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7. It should be noted that in terms of overall Community expenditure, the sums involved are small. Most of the new programmes are in the research field. Research and development is expected to rise only from 2.5% to 4% of the total as a result of the Commission proposals currently on the table (and these proposals could well be whittled down). The current Commission proposals on ERDF non-quota receipts for the private sector involve only some £10 million per annum over a five year period, compared to total annual United Kingdom ERDF receipts of some £300 million in 1983 and probably more in later years.

MAIN ISSUES

8. The main issues therefore are:-

(i) Whether Community expenditure programmes should be treated in the same way as departmental domestic expenditure programmes for the purposes of public expenditure control.

(ii) Whether Departments would be given an incentive by the Chancellor's proposals not to maximise United Kingdom receipts from the Community.

(iii) What the impact would be of the Chancellor's proposals on Community policy.

(iv) Whether there are acceptable alternative ways of controlling Community expenditure.

Community expenditure programmes versus domestic programmes

9. The arguments on the principle of whether Departments should be expected to bear the cost of Community expenditure programmes on their own budgets, or whether Community expenditure should be seen as a whole not appropriate for division between the individual Departments, have been fully set out in the various papers. The spending Departments argue that most of the Community expenditure programmes concerned do not replace domestic programmes, and are not of a sort which they would necessarily choose to implement, even in cases where they are of benefit to the United Kingdom. In many cases programmes are adopted because of

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a process of political or financial bargaining; because an expected net benefit to the United Kingdom will help offset our net budget contribution; or because the United Kingdom is outvoted. It can therefore be argued that it is wrong to expect individual Departments to bear the costs of programmes that are beyond their control or which have been accepted for wider political or budgetary reasons. In particular, if individual Departments had to bear the cost of or find off-setting savings for such programmes, there would undoubtedly be some distortion of Government priorities, as they would have to cut domestically financed programmes to which they attach priority in favour of lower-priority Community programmes. The Foreign and Commonwealth Secretary is likely to refer to the fact that, in the one case where a system of attribution applies (the Overseas Development Administration), Government policy of increasing the proportion of bilateral aid expenditure has been thwarted by the rise in Community aid expenditure, as the latter has had to be financed by squeezing out bilateral programmes. There could also be problems of financial management, given the mis-match between Community and United Kingdom financial years and financial management, and the difficulties of forecasting likely Community expenditure and receipts over more than a very short period. A certain amount of extra administrative work could also be involved in the system proposed by the Chancellor, because of the need to decide in each case whether the new programme should be dealt with under the proposed new system, and how the burden of off-setting savings or attribution should be shared between responsible Departments - for instance, a single Community research programme can involve the Departments of Trade and Industry, Energy, and Education and Science.

Is 'Esprit' lower priority than bilats?

10. The Chancellor accepts that Departments cannot always control Community expenditure in their areas. He takes the view, however, that this is a price of Community membership which must be accepted by the individual Departments, and that the uncertainties are no different in kind from other uncertainties that Departments have to take into account in their domestic public expenditure planning. It may also be argued that many of the new Community expenditure programmes,

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eg in the research field, are in practice similar to domestically financed activities, and that public expenditure constraints dictate that where the United Kingdom is forced to accept Community programmes we should cut the relevant domestic programmes, even though given the choice we would give higher priority to the latter. As for cases where Community funds are paid direct to the private sector, this undoubtedly does add to overall domestic public expenditure, and it can be argued that the fact that these funds go via Brussels does not mean that they should be treated differently from other taxpayers' money being paid in the form of domestic subsidies by individual Departments to the private sector.

The problem of maximising United Kingdom receipts from the Community budget

11. If the principle of off-setting savings/attribution at the level of individual Departments were accepted, there would be various ways in which it could be implemented. The Chancellor is likely to opt for savings to offset the net United Kingdom contribution for new Community programmes involving public sector programmes (1); and savings to offset the forecast of receipts for ERDF non-quota aid to the private sector and for other Community support for the private sector (2), eg in programmes such as ESPRIT. The results of using the second method, however, are likely to be perverse, as it will give an incentive to reduce the amount of receipts which the United Kingdom receives from individual Community programmes, while leaving unchanged the level of the United Kingdom contribution. This is a point which the Trade and Industry Secretary has already made very strongly in OD(E) when the question of finding off-setting savings from his budget for ESPRIT was inconclusively discussed.

Impact on Community policy

12. The Foreign and Commonwealth Secretary is likely to express concern about the effect of the Chancellor's proposals on the United Kingdom's overall Community policy. If Ministers know that they will invariably have to find off-setting savings for any Community expenditure programme which is adopted, they are

/likely

likely to judge Community programmes almost entirely on this basis (except in rare cases where the programme directly replaces a domestic one) rather than on their merits. This could make the United Kingdom's general negotiating position in the Community harder, as our partners will see our procedures as basically inimical to Community principles. This could make more difficult our attempts - which are now having some success - to push Community expenditure in more acceptable directions.

Other approaches

13. It can be argued that there are two basic problems which need to be dealt with. First, there is that of keeping Community expenditure under control so that the public expenditure burden on the United Kingdom is kept to a minimum. Second, in cases where new Community expenditure is agreed, there is the need to ensure that it does not add to United Kingdom public expenditure. The Chancellor's proposals address chiefly the second problem. On the other hand, if we are successful in dealing with the first, the second could be minimised. Ministers have already endorsed proposals for improving financial planning and control at the Community level, and proposals are also being discussed at official level within Whitehall for improvement in the United Kingdom system for co-ordinating policy on different Community expenditure programmes (the "forward look"), so that we can keep these within a generally agreed level. Spending Ministers may argue that these proposals should be a main plank in the fight to minimise the impact of Community programmes on public expenditure.

14. All are likely, however, to accept that such methods will never be totally successful, and there will continue to be occasions when the United Kingdom has to accept Community programmes which are basically additional to domestic ones, and which Ministers see as of lower priority than existing or planned domestic programmes. In such cases, as suggested in E(A)18, the alternative way of achieving non-additionality would be to do so at the level of Programme 2.7, with any unavoidable increases in Programme 2.7 being met at the overall level of United Kingdom public expenditure.
There is likely to be strong pressure from a number of Ministers for this sort of approach to be adopted.

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HANDLING

15. You will wish to ask the Chancellor of the Exchequer to introduce his proposals, and the Trade and Industry Secretary to outline his objections, as his Department will be the one chiefly affected by the Treasury proposals. A number of other spending Ministers have a direct interest and will wish to comment: the Energy Secretary as a large proportion of Community research is in the energy field; the Environment Secretary because of his interest in the ERDF and because the Chancellor's proposals would affect a proposed Community expenditure programme on the Environment; the Minister of Agriculture because some Community research programmes are in his area; and the Secretaries of State for Scotland, Wales and Northern Ireland as some of the Community expenditure concerned would be in their areas and they would need to find the necessary offsetting savings (for instance for Community regional expenditure in Northern Ireland). The Foreign and Commonwealth Secretary will want to speak about the problems of the Overseas Development Administration and the likely impact of the Chancellor's proposals on general Community policy. Finally, a number of other members of the Committee may wish to comment because of the potential impact of the Treasury proposals on their Departments should new Community activities be proposed in their areas.

CONCLUSIONS

16. You will wish the Committee to reach conclusions on the following:-

(i) whether the present system of attribution for Community aid expenditure should continue unchanged;

(ii) whether ERDF non-quota receipts going to the private sector should be matched by off-setting savings on the budgets of the relevant Departments;

(iii) whether the Chancellor's proposals on new Community programmes are acceptable. A specific decision is also needed on the treatment of ESPRIT, given the possibility of a decision on it at the Athens European Council;

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(iv) if the Chancellor's proposals are not acceptable, whether the question should be remitted for fuller study by officials of ways in which the basic principle of non-additionality could be maintained without necessarily having an automatic cut in a departmental budget when Community expenditure rises; or whether the matter should now be taken to full Cabinet (the Trade and Industry Secretary has warned that he would not be prepared to accept the Chancellor's proposals unless they were endorsed by Cabinet).

17. It is possible that you may be able to reach agreement on the following basis:

- no change for the present in the arrangements for existing programmes, including attribution of Community aid expenditure to the ODA budget;

- instruction to officials to work out the "forward look" procedures for better control of Community expenditure;

- officials to report back to Ministers whether the non-additionality principle should be applied to new programmes by application to a departmental budget or alternatively at the level of all public expenditure (after exhausting any savings under programme 2.7);

- in the interim no absolute rule for new programmes. For ESPRIT (the only important Community programme on which a decision is imminent), financing to be settled without requirement of off-setting savings from DTI budget but without prejudice to attempt to find such savings as the programme develops. For other programmes, savings to offset wholly or substantively new Community programmes to be negotiated ad hoc between the Chancellor and the departmental Ministers concerned.

Given away

Sophie Lambert

pp D F WILLIAMSON

28 November 1983

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull Esq
No. 10 Downing Street
LONDON SW1

28 November 1983

Dear Andrew

ATTRIBUTION E(A)(83)17

I attach an advance copy of the Chief Secretary's E(A) paper on "European Community Expenditure and the Control of UK Public Expenditure", for you to forward to the Prime Minister by tonight's bag. It will be circulated to the Committee tomorrow.

I understand that the Chancellor will want to have a word with the Prime Minister on Wednesday evening to tell her of the importance he attaches to those proposals.

Yours sincerely

J.G. Gieve

JOHN GIEVE
Private Secretary

CONFIDENTIAL

Briefing Note

THE CHANCELLOR'S AUTUMN STATEMENT

No. 36
24.11.83

In his Autumn Statement, delivered to the House of Commons on 17th November 1983, the Chancellor of the Exchequer, Mr Nigel Lawson, gave an encouraging account of economic recovery:

> 'For the first time for many years we are now enjoying low inflation combined with steady growth. This is a winning combination. Our task is to keep that winning combination by sticking to - and indeed reinforcing - the policies which have brought it about' (Hansard, Col. 996).

Output is rising at a healthy three per cent per annum. Inflation is well down into single figures, and trending further downwards. Productivity is still improving fast. Investment is rising. New jobs are being created, although not yet rapidly enough to make significant inroads into the number of unemployed.

The one cloud on the horizon is public expenditure. The Chancellor foresees the Public Sector Borrowing Requirement (the budget deficit, in old-fashioned parlance) overrunning its target by nearly £2 billion this year. In July he introduced some corrective measures; more are now planned. But Mr Lawson has made clear that he will not flinch from raising taxes in the 1984 Budget if he thinks it necessary in the short run for the sake of keeping the economy on an upward path.

The Economic Background

The American economy is recovering from its recession - almost too fast, some experts would argue. This is good for world trade and therefore for British exports. Demand for British goods at home is buoyant, too, despite the severity of unemployment in many areas. The British economy is growing at the rate of three per cent per annum. That rate is expected to continue next year. In that event, UK growth during the three years 1982-4 will have exceeded that of our major competitors - an achievement without precedent for decades.

Inflation and Interest Rates; Investment, Productivity and Unemployment

As a result of the firm monetary policies pursued by Sir Geoffrey Howe, and continued by Mr Lawson, inflation is being brought under control. From a peak of 26.9 per cent under Labour in 1975, the year-on-year rate of price increases was brought down to below 5 per cent this summer. It has since risen slightly, but the Chancellor hopes for a further decline to 4½ per cent by the end of 1984. He went further in a recent speech:

> 'Only two decades ago an inflation rate of 5 per cent would have been considered too high. It *is* too high. The Government's ultimate objective is price stability' (Mansion House, 20th October 1983).

In company with inflation, interest rates are coming down. Bank base rates are now 7 per cent below their 1981 peak. This is good for investment, and for small and new businesses in particular. Contrary to general belief, investment in the British economy has been growing ever since the autumn of 1981. The 1984 estimate is 4 per cent.

In the ordinary way, all this would be reducing the unemployment figures as old jobs were revived and new ones created. The bitter-sweet truth is that productivity has risen so fast that unemployment has failed, so far, to fall. Since 1980 productivity in British manufacturing industry has risen by 15 per cent.

Public Spending

Against a target for the borrowing requirement of £8.2 billion for 1983-4, set at the time of this year's Budget, the forecast is for a figure of £10 billion. This is mainly a result of over-runs on public expenditure. The Chancellor is determined to prevent this prejudicing the general recovery of the economy. So he has announced measures which are designed to bring the 1984-5 borrowing figure back to £8 billion. Within the total figures, certain programmes are, nevertheless, going to receive extra public money in 1984-5. The changes now made are broadly as follows:

Expenditure up on education, social security, the Home Office, health and personal social services.
Expenditure down, compared with Budget time plans, on nationalised industries, housing benefit, defence.

Nationalised Industry Prices. A total of £666 million is to be deducted from the amount of taxpayers' money going to the nationalised industries in 1984-5. Part of this will be recouped by the electricity and gas industries in the form of higher prices to the consumer. Indications are that gas will go up by just less than five per cent and electricity by about three per cent. These increases would be below the expected rate of inflation and they would be justified by the facts:

* They would still leave gas and electricity prices at or below the level at which they would stand in a competitive market.
* They will not put British industry at an unfair disadvantage.
* They will mean that gas and electricity industries are still generating very low returns on their capital employed - 4½ per cent in gas and under 2 per cent in electricity.
* They will help to finance the future investment programmes of the electricity and gas industries.

This Government has taken numerous measures to help the less well-off with energy bills: the new disconnection codes; abatement of standing charges for small consumers; and very substantial increases in the assistance given to the needy through 'heating addition' and other Supplementary Benefits. Meanwhile, under this Government, the retirement pension has gone up faster than inflation.

Housing Benefit. The Housing Benefit scheme is administered by local authorities. There are at present seven million recipients, about one in three of British households; most people on supplementary benefit have their rent and rates met in full by housing benefit. The Government intends, from April 1984, to cut back some of the benefit going to relatively better-off households and those with non-dependants in work (usually young people) who will in future be expected to make a higher contribution towards housing costs. Also affected will be 18-20 year olds receiving supplementary benefit and living at home. About £180 million will be saved in a full year, together with about £50 million a year from lower rate rebates.

Tax Increases in the 1984 Budget?

The Chancellor electrified the commentators by saying that, if revenue and expenditure continued to move as now forecast, and if the borrowing requirement for 1984-5 were to be held on target, there could be a 'need for some net increase in taxes in next year's Budget'. He emphasised the uncertainties involved in a forecast made five months ahead of time, but was clearly determined that public expenditure should not put the inflation and growth targets at risk.

Conservative Research Department,
32 Smith Square, London S.W.1.

PJC/ACS

SECRET

cc NO

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Prime Minister ④

Agreement that increases in programmes between surveys are undesirable but Treasury surely right to say cannot be avoided altogether. Where happens colleagues should be fully informed re colleagues whose programmes are not rising since it is they who have to find the offsetting savings.

AT 23/11

Treasury Chambers, Parliament Street, SWIP 3AG

Rt Hon Viscount Whitelaw CH MC MP
Lord President of the Council
Privy Council Office
Whitehall
LONDON
SW1A 2AT

22 November 1983

Agreed

Dear Willie

Thank you for your letter of 10 November about the handling of increases in public expenditure between expenditure Surveys.

Nigel and I certainly agree with the general principle set out in your final paragraph. It is clearly desirable that as a general rule major decisions on expenditure should be taken in the expenditure Surveys. To do so makes for a better management of resources and for a clearer view of priorities overall.

That said, there may, be exceptional circumstances, I hope you will accept, when decisions have to be taken outside this framework. The economic background may change; urgent action may need to be taken to correct a deviation from planned spending; there can be compelling political pressures. Moreover, some decisions on expenditure (Child Benefit is an example) may need to be considered in relation to decisions on taxation taken at the time of the Budget. In these exceptional cases, where increases are agreed, we shall certainly aim to ensure that colleagues are fully aware of any possible consequences for Departmental programmes generally.

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

PETER REES

SECRET

Econ Pol,
Public Exp,
pt 25

NBPM

CHANCELLOR OF THE EXCHEQUER

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

22 November 1983

Murdo MacLean Esq
No 12 Downing Street
London SW1

Dear Murdo,

We spoke about the Motion for Thursday's Debate. The Chancellor would be content with the following wording:-

> "That this House approves the Autumn Statement presented to Parliament by the Chancellor of the Exchequer on 17 November; welcomes the continuing prospect of low inflation and steady growth; and congratulates Her Majesty"s Government on keeping the public expenditure planning total for 1984-85 unchanged at the level published in the 1983 Public Expenditure White Paper (Cmnd 8789)."

Equally, if the Chief Whip were to prefer a shorter Motion, the Chancellor would be content if only the first two lines of this formula were used.

Copies of this letter go to David Hayhoe and Andrew Turnbull.

Yours ever,

John Kerr.

J O KERR

Lib/SDP Leave out from House to end and add "deplores the Autumn Statement on the economy; regrets the widespread hardship caused by cuts in housing benefit; notes with concern the continuing failure to maintain, let alone improve, public assets; and urges the Government to foster sustained recovery by lower interest rates, competitive energy charges, increased capital expenditure and a realistic sterling exchange rate.

Steel Owen.

Public expenditure file

WEEKEND WORLD

Sunday November 20, 1983

Lawson's Recovery Plan.

Fading from view.

Live interview with Nigel Lawson, Chancellor of Exchequer.

PART ONE

BRIAN WALDEN:

hello and good afternoon. Rarely can a newly-appointed and seemingly confident Chancellor have received such a buffeting, as did Nigel Lawson, following his announcement on Thursday of next year's plans for the economy. The burden of the attack he faced was that having raised expectations of tax cuts, he now warned that taxes in the next budget might rise. For the Chancellor, the criticism alone must have been painful enough. But, in the view of many the episode has a much broader significance. It indicates they say that the whole strategy for economic recovery to which Mr Lawson is committed is being blown off course. And that's because more and more of his government colleagues seem unprepared to support the tough measures needed to make it work. It's all contributing to a growing suspicion that on the central issue of economic policy, the government is losing its way. So why has the Government apparently come unstuck ? And how do they intend to deal with the economy in the future ? The Chancellor of the Exchequer is here with us today, and shortly we'll be hearing his views. But first, let's hear the latest news headlines from ITN and Alistair Stewart.

ITN NEWS HEADLINES

BRIAN WALDEN:

Few people observing Nigel Lawson preparing his statement on the economy this week, would have imagined that he might have been sewing the seeds of serious political difficulties for himself. For the Chancellor was known to have grounds for optimism about the future. New treasury forecasts show that econimic growth, having picked up this year, would continue next. They showed also that employment was set to start rising, and that inflation, already low by recent standards, was likely to edge down even further. And when the Chancellor delivered his statement to the Commons on Thursday, he made much of the good news.

NIGEL LAWSON (SPEAKING IN THE HOUSE OF COMMONS):

"The past year has seen falling inflation, renewed growth, and solid evidence of our continuing recovery from world recession".

BRIAN WALDEN:

Unfortunately for Nigel Lawson, however, those remarks lingered barely minutes in the memory. For they were promptly overshadowed by the bad news he'd brought.

NIGEL LAWSON:

"For the next year 1984-85, the forecast implies the need for some net increases in taxes in next year's budget".

BRIAN WALDEN:

The announcement that taxes may have to rise next year must have seemed extraordinary to anybody acquainted with Nigel Lawson's view of how the economy should be managed. And it was almost bound to lead to trouble. For, since he he was appointed Chancellor in June this year, Mr Lawson has made it quite plain that tax increases are precisely the opposite of the economic remedy he favours. The truth is that his statement to the Commons reflects the fact that almost from the moment he took up his job he's had a struggle on his hands. Both within the Cabinet, and within his own party, he's met resistance to the policies which he must have thought he'd been appointed to carry out.

Mr Lawson's always believed that sustained economic growth can only be achieved by creating conditions in which free enterprise can go unhampered about its business. And he's made very plain what he believes those conditions to be. The first condition he thinks free enterprise requires to produce growth is for inflation to be cut and ultimately eliminated. Only with stable unchanging prices, he argues, will businessmen take the vital decisions on which growth depends. And Nigel Lawson's second condition for growth is to cut taxation. Only this, he believes, creates sufficient incentive for employers to invest, and workers to become more productive. In view of that, Nigel Lawson must have found it a particularly bitter experience on Thursday, to have to warn of tax increases. The only consolation for him may be that he's known from the start that his strategy for permanent recovery was always going to be difficult to carry through. For to realise his twin aims of cutting inflation and taxes required him to face a particularly daunting challenge. Curbing inflation, in Mr Lawson's view, is crucially a job for governments. The way they should do it is be controlling their borrowing. If governments borrow less, the overall amount of borrowing in the economy is reduced. The overall amount of money in the economy is then controlled, and when that happens, inflation falls. So in his view, to achieve his first aim, Nigel Lawson would have to reduce government borrowing. But reducing borrowing has other implications for him. For the purpose of borrowing is to help finance public spending. Public spending is paid for either by borrowing or by taxation. If a government reduces borrowing, then to make up the funds necessary to finance its spending, it has to increase taxation.

Similiarly, if a government reduces taxation, to cover its spending, it has to increase borrowing. But Mr Lawson wants to reduce both taxation and borrowing. So its only by cutting public spending that he can satisfy the conditions he's set for economic growth.

MALCOLM ROBERTS - SENIOR ECONOMIST, STOCKBROKERS, LAING AND CRUIKSHANK

Mr Lawson has to cut public spending in order to met two other objectives of his economic policy. Firstly, he wishes to reduce the level of taxation as a means of improving incentives, as a means of increasing the rewards for work effort. Secondly, he wishes to cut the level of public sector borrowing, because he thinks this is directly related to the rate of inflation. If he's cutting borrowing and tax, then he's obliged to cut expenditure.

BRIAN WALDEN:

Cutting public spending was always likely to be a formidable task. For since Mrs Thatcher first came to power, it's actually taken an even larger share of national income, under pressure from the defence budget and rising demand for social services. In 1979, it took just over a 40% share of total national income. This year, however, it's risen above a 43% share. That's a very considerable rise. To pay for this, taxation over the same period has risen too. In 1979 it stood at 39% of national income. This year, taxation is taking more than 42%. That's a similiarly substantial increase. So, for Nigel Lawson, to bring taxes down merely to where they stood in 1979 would involve major cuts in spending. Public expenditure which this year totals 119 billion pounds, would have to come down to 107 billion pounds. That would mean cuts of 12 billion pounds. And that's something like 1 % of the

total. To make matters even harder, Nigel Lawson knew that public expenditure, far from falling, was under pressure to rise further still, requiring yet more borrowing and taxation. So, in early July, almost as soon as he was appointed, he's believed to have asked the Cabinet to agree to revise downwards the plans for future public spending. For he strongly suspected that the government's existing plans, announced at the previous Budget, were too high to permit major tax cuts.
But the Cabinet refused. A majority of his colleagues, it seemed, took the view that such a decision would be most unpopular, and would breach election pledges, like that to the Welfare State. And they feared that the danger of public opposition far outweighed the benefits that the cuts might eventually bring.

COLIN BROWN - POLITICAL JOURNALIST - 'THE GUARDIAN':

There is no doubt that when the Chancellor first took office a deep rift appeared between the Chancellor and his allies in the Cabinet on the one hand, who believed that deep and lasting cuts in the public expenditure were essential and their Cabinet colleagues on the other, who believed that to take such a course would be politically disastrous.
Those colleagues thought that, rather than cutting public expenditure they should be protecting it, and there was an ominous sign for the Chancellor at that point because he realised that to carry out his wishes, he would have to have a battle with his colleagues and win that battle.

BRIAN WALDEN:

The result of that clash was a compromise. Nigel Lawson was allowed to make cuts this year totalling 500 million pounds only to prevent expenditure from exceeding the total planned at thelast Budget. And he was given permission to start talks with spending ministers to find 2½ billion pounds worth of cuts next year,to offset anticipated over-spending then. But the protest that this year's cuts aroused caused further opposition within his party to his attempts to control next year's spending. Norman Fowler, the Health and Social Services Secretary, felt strengthened in resisting proposals that he introduce new health charges and reduce the value of unemployment and supple-mentary benefits. Patrick Jenkin, the Environment Secretary fought hard against the proposal to make savage cuts to grants to local authorities. And Michael Heseltine, the Defence Secretary ,struggled against the Chancellor's attempts to make deep inroads into his budget. The result of this struggle was that by the time of the Conservative Party Conference in October, Nigel Lawson had failed to get agreement event to measures to keep spending in line with planned totals. And, in a blunt article in the Sunday Express, he showed his frustration, as he trenchantly re-argued the case for his strategy. He wrote: 'High growth will be achieved only by lower government spending. We need to look carefully at all our government programmes to see whether we can afford all that we are providing'. But, on that very same day, John Biffen, the Leader of the House Of Commons, delivered the heaviest blow yet to Nigel Lawson's aims. In a forthright statement, here on Weekend World, he attacked the notion that tax cuts were a high priority, and argued that the major areas of public expendi-ture should be preserved. He said: 'The Tory Party has a very well established tradition of the protective role of the State, and that very often means an expensive role. It is consistent with Tory traditions, with realism and with a sense of responsibility.

JAMES NAUGHTIE - CHIEF POLITICAL CORRESPONDENT - 'THE SCOTSMAN':

The signifcance of the remarks made by John Biffen, was that here was in an intervention by someone on whom Nigel Lawson must have thought he could rely on spending matters. Someone who'd never been associated with the wets in Cabinet. Someone who didn't have an axe to grind as a spending minister, and above all, someone whose economic views had been very close to Mrs Thatcher's own in the past, a former Treasury chief secretary, after all. And so when John Biffen entered the debate, I think there was a sense that somehow the centre of gravity in the argument was moving away from Nigel Lawson. And when those remarks had been made and when they'd been absorbed by the ministers, I think Nigel Lawson, must have felt very isolated in the Cabinet.

BRIAN WALDEN:

It was Lord Whitelaw, the leader of the House of Lords, who was given the task of adjudicating between the Chancellor and his colleagues over next year's spending levels. Presiding over a committee of senior Cabinet Ministers earlier this month, Lord Whitelaw listened to the arguments between the Treasury and the spending departments. It's the agreements he forged in that committee that formed the basis for Nigel Lawson's autumn statement to the House of Commons on Thursday. At first sight, the Chancellor might seem to have done better out of Lord Whitelaw's committee than he may feared would be the case. For he told the Commons that he'd prevented any possible overspending, and that the balance between expenditure and revenue announced at the last budget would be maintained. A closer look at the figures, however, suggests that the picture, from Nigel Lawson's point of view, was rather worse. Mr Lawson agreed to spending increases above next year's target, of about 2 billion pounds, mainly in social security, agriculture and education. To offset these, he managed to get cuts below the target of only 700 million pounds, mostly in defence and housing. So, he in fact allowed the overall planned total to be breached by 1.3 billion pounds. And that's not at all the sort of result he was looking for. So, Mr Lawson had to adjust revenue to be able to present his total package as staying on target. He announced the sale of an extra 400 million pounds worth of state assets - like parts of nationalised industries. He also said he would take additional revenue from the sale of council houses, to the tune of about 250 million pounds. And to make up the remainder of the spending excess, the Chancellor forced up the prices of gas and electricity to help raise 650 million pounds. The revenue changes totalled 1.3 billion pounds. So overall, the books balanced. But this wasn't, from Nigel Lawson's point of view, an ideal resolution of the Cabinet battle. For he knew well, that many would regard it as short-sighted to use the disposal of an asset that can be sold only once, to pay for public spending that's set to continue indefinitely. Worse still, for Nigel Lawson, was the fear that even existing tax levels wouldn't be sufficient to meet spending commitments. As a result, he had to announce increased national insurance contributions and give his hint of tax rises to come in the Spring. So, in the view of many commentators the autumn statement signalled another defeat for the Chancellor.

MALCOLM ROBERTS:

The Chancellor's statement must be regarded as a failure in the light of the objectives he set himself earlier this summer. At that time, he planned for reductions in the level of public expenditure. That's quite clear from his statement, that public expenditure is set to rise in the future. He

He also held out the hope of a reduction in the level of taxation, and yet now he's holding out the prospect of a small increase in the level of taxation. So judged against this objectives, this statement has to be considered a failure.

BRIAN WALDEN:

Friday's press bore out the assessment that Mr Lawson had failed. He came under heavy criticism even from papers that always have been his party's strongest supporters. The Daily Express, in a front page editorial, angrily told the Chancellor: 'This government was voted back to axe not to tax'. And Walter Goldsmith, Director General ofthe Institute of Directors, must have hurt Mr Lawson most of all when he said: 'The government's credibility as a tax-cutting administration is at an all time low'. So Nigel Lawson's predicament now looks grim. In essence the problem he faces is that his party seems to have committed itself in two opposing directions. They've said they'll protect the Welfare State, and other main areas of public spending. And many in the party believe it would be political suicide to go back on that. Their view is that tax cuts are to be welcomed, only if they are made possibly by any economic growth that may occur, to give the government more revenue. Alongside these people, however, the party has, in Nigel Lawson, a Chancellor who's committed to a plan for economic recovery that appears quite incompatible with the spending pledges. And who believes that sustained growth will only become possible tax cuts come first. What appears to have happened since the election is that the contradiction between the two camps has become ever more plainly exposed. In view of that, the Chancellor's options would seem limited.

He could of course, decide that the game's up, that he's fought hard, he's fought honestly, but he's lost. To bow to the wishes of a clear majority of his Cabinet colleagues would undoubtedly make the remainder of his period in office far more congenial. And, were he to do so, he need probably not despair of achieving some measure of control over public expenditure. Limited trimming to the huge social security and education budgets might be possible.

BRIAN WALDEN

And only on Thursday Michael Heseltine announced that he'd end, in 1986, the pledge that defence spending would increase by 3% a year above the rate of inflation. But the cost to Nigel Lawson of falling in line with his cautious colleagues is all too plain. Measures of this kind would be most unlikely to produce anything but the most limited tax cuts. And Mr Lawson would have to accept that the really large tax cuts that only deep inroads into public spending could produce would be beyond him. It would be tantamount to admitting that his whole strategy for economic recovery couldn't be implemented and that he was abandoning it. So that approach might well be impossible for Nigel Lawson to contemplate. Instead he might prefer to look for a way of breathing new life into the strategy he's always believed in. And to do that he might turn to the ideas of some of his most radical supporters. A number of prominent Conservative thinkers like Lord Harris of High Cross, director of the Institute of Economic Affairs, believe that there is a solution. The aim of the radicals is to bypass the politicians and make a direct appeal to the public. The public, they believe could be converted to an acceptance of expenditure cuts once the benefits of such a strategy are made plain to them. On this view, Nigel Lawson could hope to cut the ground from under the feet of his Cabinet opponents, who invoke public opinion in their cause, to do this he'd have to campaign to change the public mood.

LORD HARRIS OF HIGH CROSS - DIRECTOR, INSTITUTE OF ECONOMIC AFFAIRS

What is required is to take a fresh hard look at the whole range of Government activities, with a view to getting rid of a large number of them, Now politicians are naturally nervous because they think that the public is against them, and of course the public have been fed the illusion that they can have their government spending without paying the full cost in taxes and a variety of other ways. And what is therefore required is in my view a massive public, political educational campaign to persuade individuals of the reality that they can't have it both ways. And I believe that the great mass of individuals and voters are sensible surely enough to be prepared to accept large reductions in the range of Government activities to get the advantages of much lower taxes a much better performance of the economy and indeed a lower level of unemployment in the coming years.

BRIAN WALDEN

Ideas like this might well find favour with Nigel Lawson. For he himself has hinted in the past at something similar. And now, the opportunities for such a plan are starting to look favourable. It was announced only last Friday that the Government is likely to launch a national debate on the spending cuts needed to cut taxes. And the Government plans to publish a discussion paper - listing options early next year. If Nigel Lawson could use such a debate to change public opinion whole new opportunities might open up for him. His difficulties in Cabinet could disappear. And deep cuts might be possible in areas of public expenditure now closed to him. In the area of welfare for instance, the Government might privatise large parts of the Health Service, in other words require people to make their own provision. Similarly they might much reduce the role of state funded education. They might require people to make private arrangements for pensions, and other social benefits. And finally they might bring to an end certain major defence commitments such as the Trident missile programme, the British Army of the Rhine or the Falklands garrison. In short a revolution in public spending could take place. Cuts on this scale would produce massive financial savings. And beyond doubt they would permit the tax cuts that, in Nigel Lawson's view, would lay the basis for a sustained growth. So the radical approach would seem, from his point of view infinitely preferable to caution. But Nigel Lawson would have to be bold to try it. For he'd be arguing for nothing less than a

BRIAN WALDEN CONTD

complete public rethink of people's expectations of what Government should provide. And there's no doubt that costs attach to this course of action also. On the most optimistic assumption there would have to follow a period of government disunity, during which the radicals campaigned openly against the advocates of caution. But worse than that, for Nigel Lawson, the campaign could fail, so that within the Cabinet the Chancellor could find himself utterly isolated. That in itself would be a bad thing for any government. And worse still, the disunity and strife might rage on until the next election, threatening the party's chances. So Nigel Lawson's got a choice. He could throw in the towel and admit that his strategy for recovery is over. Or he could keep faith with it, and bend every sinew, despite the risks to make it work. Well, he's with me here in the studio now, and we'll be back in a moment to hear what he has to say.

END OF PART ONE.

PART TWO

BRIAN WALDEN

Chancellor does it still remain your view that a sustained recovery vitally depends upon tax cuts, and that those cuts must come about through cuts in public spending.

NIGEL LAWSON - CHANCELLOR OF THE EXCHEQUER

Well certainly a sustained recovery depends on getting taxation down, that is vital. We have got a very good recovery going now, a recovery bolstered partly by the falling inflation, inflation is now down to 5% the lowest figure since the 1960's and our forecast suggests that it is going to go down further next year. And the economic recovery in this country is stronger than in any other country in the European comunity and again we see that continuing into next year. But to sustain that and to build on it and keep that going through a number of years, we're going to need to reduce taxation. But I would like to say this if I may - that although it is true that it depends entirely on public expenditure we'll come on to that, there isn't this great gulf in the Cabinet which you sought to portray. When I went to my Cabinet colleagues on the 21st of July, I don't know whether I should be telling you what happened in the Cabinet meeting or not.

BRIAN WALDEN

Do, do.

NIGEL LAWSON

But when I went to my Cabinet colleagues on the 21st July, I wasn't asking them at any time, to go lower than the figures for public expenditure set out by Geoffrey Howe in the public expenditure white papers set up earlier this year. Because we had campaigned during the General Election very clearly that that was the level of public expenditure that we consider appropriate and that was an election pledge which we said that we would keep Now it's quite true after the election a number of colleagues, thought it might be nice for their programmes to go up a little bit, but the Cabinet agreed - no we should stick to the figures that were published earlier this year, and that is what we have done, and not only stick to them for 84 - 85, the coming year, but of course we have a 3 year review as you know which covers 1985 - '86 and 1986 - '87. And that means that for 3 years, we had a satisfactory outcome of that review and that means now for the next 3 years public expenditure will be at this same level approximately in real terms. Now if public expenditure is staying at a steady level and the economy is growing which it is now, and I trust will continue to do, and our policies are designed to secure that, then that means that there is scope for progressive tax cuts.

BRIAN WALDEN

Well Chancellor, that was quite a long, and justifiably long statement, because it's only right that you should set these things out in your own terms. Let me however question you on some of it, for instance, let me quote you something, that you wrote in your own Sunday Express article, because you say public expenditure is now stablised at agreed levels for 3 years, but in the Sunday Express you wrote "indeed if Government continues to provide all the same services functions and benefits as it does at present state spending is likely to rise even higher in relation to the size of our economy." Now doesn't that reflect the voice of experience that one does not stabilise public expenditure by having deals with one's colleagues, there is an immense impetus all the time for it to rise, and how can you guarantee that for the next 3 years, now you know it will be stabilised.

NIGEL LAWSON

Well of course there is a constant tendency for it to rise. Constant pressure, pressures from pressure groups, from the ageing of the population, from the development of new technologies which are more expensive in many areas that are in the public sector and so on. But we can curb these as we have during this public expenditure curbed the consequences of these and find savings elsewhere to accomodate the consequences of these as we have done in this year's public expenditure review. Now the constant vigilance - constant vigilance is required. It is a constant struggle I don't pretend anything else but we can, there is no reason whatever why we should not succeed in holding these totals, and we have got to hold these totals. Now what I was talking about in that newspaper article was the longer perspective looking ahead way into the 1990's and if you project those trends there then I think you can see that there, you have probably got to do more, than simply these sort of things that we did in this particular public expenditure round. But looking to the next 3 years, which is what we did in this round, I'm satisfied that the totals we've got are totals which will enable, will give scope for reductions in taxation. Now that doesn't mean to say in every budget, we have reduced taxation, this is sometimes forgotten in the last two budgets in the 1982 budget, Geoffrey Howe reduced taxation, in the 1983 budget he did it again, and I can see on the future budgets a scope if we hold the public expenditure totals which we have to for further reductions in taxation. I have just said to the House of Commons that the prospect for the 1984 budget doesn't look too good.

BRIAN WALDEN

All right, now let's I want to come to what you have said about the long term, that what you said in the Sunday Express related to that and that there you think there must be some cuts, but before we do that, let's get clear about these next 3 years. You see a lot of people say that you fudged this review anyway that in fact you did permit an overspend but that you balanced the books by pouring money back by taking of increase revenue, that's one point that ought to be considered, a lot of people say.

NIGEL LAWSON

Shall I answer that point?

BRIAN WALDEN

Well yes, I suppose we'll take that one first.

NIGEL LAWSON

Yes, yes, that's quite untrue, on the energy prices, these are economic prices, that's to say to give a reasonable rate of return a very, still a very low rate of return less than 2% on assets for the electricity industry economic prices and in gas indeed there was a report published only a few months ago, which showed that the British Gas Corporation was actually losing money on a lot of its sales, sales at the margin as the economists call it. And no sensible business does that, so it was a question of getting prices at realistic levels and what I, those who want them lower, are calling for, in something of an orchestrated campaign is energy subsidies, now that is a legitimate thing to ask for - and he's wrong but if people are asking for subsidies that is public expenditure and by ruling out those subsidies I am genuinely ruling out public expenditure, and on the other thing, the sales of assets, the government all the time, is acquiring new assets , new capital assets of one kind or another and it is reasonable to some extent to finance these by disposing of assets it doesn't need.

BRIAN WALDEN

Yes, I accept a good deal of that Chancellor actually, unlike many critics of your policy, but you see the trouble is it isn't that in fact all of this is going into savings, this is going for spending you are going to spend all this money away aren't you?

NIGEL LAWSON

No the, the, of course public expenditure is what it is, but the

BRIAN WALDEN

Which is going up.

NIGEL LAWSON

But, no it's not going up public expenditure in real terms this year will be very much, in the next year, will be very, very much the same as it turns out this year, even though this year it's turned out a little bit a little big higher than we'd anticipated for various reasons.

BRIAN WALDEN

Alright, let me bring you to what I regard as a much more fundamental case than that, though one, for some amazing reason that I don't understand very, very seldom put in the press or indeed put by commentators. What you're telling me about the next 3 years is this. If we get some growth and it's my belief as Chancellor that we shall, that I might be able to do something in respect to tax cuts, but you're whole theory has always been exactly the reverse of that. It's always been you have got to have the tax cuts in order to produce a sustained growth hasn't it?

NIGEL LAWSON

It's a question of what the rate of growth is. If we are to have the rate of growth of which I believe we as a country and as a economy is capable of, if we're going to have that and have the rise in living standards that we all want to see, and also looking further ahead and to have money to which we can afford to pay in the essential public services because there are essential public services but you've got to earn the money first before you can start spending it. If we're to have that sort of economic performance that sort of dynamic economy then we've got to have the incentives through tax cuts. However, even if we don't have the tax cuts we will have a rate of growth, what I am anxious to do is to get us the best rate of growth of which we are capable. Our record in the past has not been a very good one in this field, and may I say this too, I do think that it is really fundamentally wrong as well as being bad for the economy that poor people should have to pay such a high proportion of what they earn in taxation.

BRIAN WALDEN:

Well, I can well accept that, and a lot of poor people will agree with you, indeed a lot of people who aren't poor will think that they are paying too much. But you've said something very interesting there. What you have said is, and I am admittedly putting it in very crude terms, and you will tell me if I have misrepresented you, what it is that it is you are saying 'I Nigel Lawson would like a lot more tax cuts than are possible at this level of public expenditure. Sooner or later I shall be able to do something about that, and I will then get genuinely dynamic growth in the economy. For the moment, however, Mr Walden, be realistic. I must struggle along with what I can get at this level of public expenditure. Now is that an accurate representation of what you are saying?

NIGEL LAWSON: MP

Not quite. What I am saying is that if we can hold public expenditure in real terms, hold it, as a constant level in real terms, then with a growing economy that will give scope for tax cuts and the tax cuts in turn will enable the economy to grow faster. So you're into a virtuous circle. If I can take you back to 1979.....

BRIAN WALDEN;

Can I interrupt you there before you take me back to 1979. Let me ask you then, I suppose, I mean one puts these things in a way that one knows or hopes that the Chancellor will understand. Well let me ask you the blunt question then, that the Express put to you, and which no doubt is being asked in the pubs this morning. You say if one contains the public expenditure at its given level, why don't you just cut public expenditure. Then you would get your tax cuts, wouldn't you?

NIGEL LAWSON:

Well, as I was suggesting to you we will get our tax cuts this way. And it is a question of a balance that always has to be struck. I don't think even you would suggest that the level of public expenditure should be zero. Clearly not. Clearly there is going to be a large bill for the old-age pension. Clearly there is going to be a large bill for defence. And clearly there is going to be a large bill for the National Health Service. So there are a whole lot of items of public expenditure which are there and it is a question of a balance - how high, how big does this burden have to be? And to prevent it from getting it so high...too high. Now what I am saying......

BRIAN WALDEN:

So you are saying you are satisfied at the level of public expenditure at the the moment.....

NIGEL LAWSON:

Now I'll take you back to 1979 which I was trying to do a few moments ago.

BRIAN WALDEN:

Alright. Let's have 1979.

NIGEL LAWSON:

In 1979, what we said then, very clearly, is that what we believed in was tax cuts, and we were going to achieve that by having public expenditure as a steadily smaller proportion of the total national wealth.

BRIAN WALDEN:

And you're nowhere near that, are you..

NIGEL LAWSON:

...And that is what is happening. It reached a peak in 1981, at I think 44%. It has been edging down since then; 1982 was less than 1981, this year less than 1982, and next year will be lower still. And clearly it follows that if public expenditure isn't rising - if it is staying constant in real terms - and the rest of the economy is growing, the whole of the economy is growing, then clearly it follows that we are achieving public expenditure as a steadily lower proportion of the total economy.

BRIAN WALDEN:

Chancellor, after all you brought 1979 up, I was going to spare you that unhappy reminiscence.....

NIGEL LAWSON:

.....Not unhappy at all.....

BRIAN WALDEN:

because think what you have told me this morning. You have told me this morning that for the next three years there is going to be, at real prices, a stabilization of public expenditure. That you think that eventually something has got to be done about that level and it would be done in the 1990's. That will mean that the pledges that you gave in '79 on the then levels of taxation of getting them as a lower proportion of national income won't even have been met by the end of two periods of Conservative government. Even the levels that existed in 1979, and that one will expect another period of Conservative government to get taxation perhaps down back to, or lower than, the proportion of national income that it first was when you came to power with this brand new plan. Now Chancellor, that is not exactly a marvellous achievement.

NIGEL LAWSON:

I am all in favour of another period of Conservative government, but I don't share your exact confidences, particularly when we are going ...particularly what date we are going to get a particular percentage of taxation. Look at what we have done already. We have got the level of income tax down for everybody. But other taxes have had to go up - and why?... Because when we came in, again in '79, when we came in we inherited an absolutely appalling state of affairs, in which government borrowing was grossly excessive and set to rise still further. Government spending on a sharp upward path and it took time to correct that and one of the ways in which we had to correct the huge public borrowing, that is to say the dishonest financing of government spending, was to replace it by honest financing. The level of expenditure we kept it as tight as we could but it had to be financed more by taxation, less by borrowing. But they've bought borrowing down now. We have achieved that. And we are now in a period when we can look forward to the benefits of a tight control of public expenditure being reflected in lower taxation.

BRIAN WALDEN:

Alright Chancellor, let me conclude this section by putting back to you what I think it is that you have told me, and then move on to the other section of future spending cuts. What you've told me in respect to the next three years is this. That you are confident that you will infact be able to stabilize public expenditure in real terms. That you anticipate quite reasonable levels of growth, not as high as you would like or you believe you could indeed get if you could have all the tax cuts you wanted, but nevertheless in historic terms reasonable levels of growth, that out of that growth you think there in fact will be some tax cuts, but for a really dynamic turn around we must wait further than that. That is about what you have said, isn't it?

NIGEL LAWSON;

No, Not quite. On the last point let me just modify it in this way. There are fundamental trends in the economy and in society which if we are not careful are going to lead to a resurgence in public expenditure further ahead....

BRIAN WALDEN:

...I'll say....

NIGEL LAWSON:

And it is to prevent that resurgence that I believe more radical thinking is necessary.

BRIAN WALDEN:

Alright. Well now Chancellor you are not going to get any argument with me about that. The only thing I might have some doubts about is whether you are going to hold it as easily as you think in the next three years.....

NIGEL LAWSON:

I said it would be a struggle....

BRIAN WALDEN:

I accept that you will win it.... Let us now move on, however, to as you say - not me - the vital need to come to terms with these pressures that keep forcing spending up. Let me ask you, now forget about this period of Conservative government. Let us anticipate a glorious Conservative victory in '87 or '88 and you're back to the Exchequer. What areas of public spending do you then want looked at for a long-term reduction?

NIGEL LAWSON:

We've got to look at all areas of public expenditure. But obviously the ones that we have got to look at hardest are those that are the biggest programmes. And if you take the...there are five areas of public expenditure which account for two thirds of the total - just those five. One of them is the interest on the national debt. That is not something which is controllable independently. But obviously the more we can get government borrowing down by cutting other forms of public expenditure the less the burden on the interest on the national debt - so there is a bonus there to be gained. The other four are Social Security, and I'm putting them in order of size (that is the biggest) Social Security, Defence, Health and Education. So clearly those are the areas that have to be looked at the hardest simply because they are the biggest programmes. But of course there is the other one third and that will have to be looked at hard as well.

BRIAN WALDEN:

Sure. Let me take some of those then, Chancellor. No one expects , because this is a matter which as you say yourself has not even been discussed as yet in those terms-what has been discussed is a stabilization, when the Conservative government gets around to discussing actual cuts, what sort of options as Chancellor will you put up, and let's take the things you mentioned - the National Debt covers itself. Your option there is clear enough - don't borrow much. That will cover that one. What about Social Security. What will you suggest to your colleagues they might do there to cut the burden on the Treasury of having to pay for it?

NIGEL LAWSON:

I think that one of the general principles we have got to apply in all those areas, with the exception of Defence - in other words in the Social Security, health and in education - is this. Look at what we have done in housing. Housing is a basic need. And the need for housing will go up as the country gets wealthier, people's aspirations get higher. But the big question is who is to provide the housing. Is it to be provided by the State or the municipalities, by the public sector, or is it to be provided by the private sector. And it has been a cardinal policy of the Conservative party that more and more should be provided by the private sector. People like to own their own homes, and so on, and we have this big programme of council house sales which is making a big shift of this kind. Now I think that what we need to do is to apply that sort of philosophy, that sort of agrument to these other areas and say how ... what is the scope for greater private provision in all these areas.

BRIAN WALDEN:

That's an interesting point, and not altogether a surprising one of course because one would have expected you to say that. What is it in regard to...by the way let's be clear what exactly what we're talking about... you are saying that the state share of Social Security, of health and of education shouldn't disappear but that far more should be taken off. People should provide more for themselves. OK. I can see how you might believe that in say 1990, why don't you believe it and do it now?

NIGEL LAWSON:

We have... What we have got to do is to take a hard look at these areas now. And maybe take some decisions now or fairly soon in order to effect what is going to be the pattern some years hence in the 1990's.

BRIAN WALDEN:-

... I understand ....

NIGEL LAWSON:

So we have got to start thinking about it now and we have got to start opening up the public debate on these issues now, in my opinion, and I think it is very helpful that someone like Ralph Harris of the Institute of Economic Affairs.Say they ought to, and other institutes of that kind, open up the public debate, because in many ways it is much easier for them to do it. Because people find it very difficult to grasp the idea of the government having a public debate. As soon as a government says anything they assume that it is a firm, hard decision written in stone and set in concrete, and so on. And so I hope that they will do a lot too but I accept that it would be desirable for us, who have done something already, for us to do more - to set out the likely trends, as we see them, we don't know for certain but as we see them, and what the sort of problems are , what the sort of choices are.

BRIAN WALDEN:

And you are going to do that, presumably, in the Green Paper that you are going to publish.

NIGEL LAWSON:

I am not committed to a Green Paper. I was asked in the House when we had it whether we would produce a Green Paper on this, and I said I would certainly consider the matter. I hope that we will be able to produce, after we have discussed it amongst ourselves first, obviously, that is the first stage, a document of some kind.

BRIAN WALDEN:

And I gathered from you rather to my surprise, I must be frank, that you regard these kind of discussions with your colleagues as something that has got to be got on with pretty urgently - certainly long before the next General Election.

NIGEL LAWSON:

Oh yes. Certainly. If we are going to effect the decisions in the longer run we have got to start thinking hard about it and reaching the decisions of what we are going to do quite soon.

BRIAN WALDEN:

Alright. Make a huge leap in imagination, Chancellor, and assume that I was one of your colleagues and was sitting with you in that Cabinet. And I said well I've got a lot to do in my own department you know, Nigel, I don't entirely understand exactly what you are saying. What do you want us to do on the National Health Service? What do you want to have happen in regard to Health in terms of privatisation?

NIGEL LAWSON:

Well, you're not one of my colleagues. I regret that, Brian, I'm sure you'd be a great acquisition and an embellishment to a government which is already full of stars. But nevertheless, since you are not I don't think it would be right for me to discuss it with you now before I have discussed this fully with my colleagues.

BRIAN WALDEN:

Ah. So that you are going to put some pretty radical proposals on all of these areas - and let's repeat them - Social Security, Education and Health - and you are going to ask for a greater degree of what is called privatisation. That is that the citizen should pay for a lot of this himself, and not dump the burden on the State. But you aren't prepared to tell me what sort of suggestions you intend to make to you colleagues.

NIGEL LAWSON:

No because it doesn't begin with suggestions, anyway. What we've got to do first of all is to get an appreciation of the nature and scale of the problem. Once, we haven't really got that yet, there is a sort of lurking feeling that there is a problem, we have got to get a rather more precise appreciation of the nature and scale of the likely problem.

BRIAN WALDEN:

But Chancellor, you haven't got a lurking feeling that there's a problem have you..?

NIGEL LAWSON:

No. I'm talking about it more widely because, as you say, mu colleagues are busy-they have their problems in their own departments and we have not had a collective discussion on this except in the most general terms. We have got to get down now to more precise terms. Then when we have established the nature and scale of the problem then we can start suggesting what possible solutions there are.

BRIAN WALDEN:

Well, let's suppose.....

NIGEL LAWSON:

And incidentally, if I may add something. The shift from the public provision/State provision to private provision is one obvious route that we would want to go - that I would want to go, and I think the Conservative Party would want to go. Another is to say well even where things are necessarily within the State sector, do they have to be entirely financed out of taxation. Are there other more desirable more sensible methods of financing.

BRIAN WALDEN:

Sure. Let us suppose, Chancellor, I mean this may not be the case but let us suppose that these somewhat monkish colleagues of yours who only have a lurking suspicion that there is a great problem about public expenditure, let us suppose that after you have bent their ears a bit they fully grasp that there is an appalling problem about public expenditure. Does that then mean that you will be able as Chancellor, to participate in the public debate that Lord Harris says we all need. Because that's what strikes me if you the most important man in the whole business are not going to give any details in the public debate I don't see how that public debate is going to be very effective. Is it?

NIGEL LAWSON;

When the time is right I shall take part in the public debate.

BRIAN WALDEN:

And when do you think that time will be right?

NIGEL LAWSON:

I don't know. I don't know. But I hope we can get down to it fairly soon. I think it is something certainly to be done in the early years of this parliament, even though what we are talking about is a problem which is going to emerge later on.

BRIAN WALDEN:

Chancellor, if I may say so, maybe a compliment from me is not something that you would look for, but what you've told me this morning I think is a courageous decision on your part. However, there are obvious costs to it. What about those members of the cabinet who will say to you well this is all very well, Nigel, But you're stirring up a hornets nest here. The last thing in the world we want to do is to start talking about cutting public expenditure or privatising Health, or any thing like that. For goodness sake forget about it. What would you say to them?

NIGEL LAWSON:

I don't think that is the way that this government has conducted itself ever since it came into office in 1979. What this government has been doing, and of course Margaret Thatcher is the supreme exponent of this, is telling people the truth. Saying one or two things that maybe don't sound very agreeable because they depart from the normal platitudes, but which have the ring of truth about them, and we have done a number of unpopular things and we have said why we have had to do them, why it has been necessary to do them. And what has happened is that the public have responded to this new approach. THey have responded to a government that tells them the truth, tells it warts and all and takes unpopular decisions when they have to be taken. And I think that that is the way we should continue.

BRIAN WALDEN:

Well. Let's take an example not of what is called a Cabinet Wet, and I won't even in fact name any, let us take someone who has always been known as a very sound man on finance, but who plainly completely disagrees with you on the necessity for cuts in public expenditure to lead to tax cuts. What if Mr Biffen says to you I don't regard this as traditional Toryism at all. I believe what I told Brian Walden, that we have got to keep these spending programmes high and if they go higher that's alright, we must raise it in extra taxation. And you should keep quiet about it, Nigel, Because that is the safe Tory course. What would you say if Mr Biffen did say that.?

NIGEL LAWSON:

Well I didn't watch the programme so I don't know whether he said that or not ....

BRIAN WALDEN:

.... But you read the transcript, though, didn't you....

NIGEL LAWSON:

But you know the level of public expenditure which we are talking about, the level of the moment of something like £150 million, £150 billion, £150 thousand million, a massive sum in today's prices , that is not peanuts, that is a very substantial programme of public expenditure, and a Conservative government - which quite rightly does believe that there has to be public expenditure for Defence, for Law and Order, for looking after the needy - can still fulfil all those obligations and be true to the traditions of the Conservative party within a total of that size

BRIAN WALDEN:

Alright. Chancellor of the Exchequor, thank you very much indeed.

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From the Secretary of State for Social Services

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17 November 1983

Dear Margaret

AUTUMN STATEMENT: DHSS PRESS NOTICES

As promised, I attach advance copies of the Press Notices we will be issuing this afternoon on National Insurance contributions and the National Health Service. I also attach a copy of the latest draft of the notice covering the social security changes. This may, however, change significantly before it is finalised and I shall be grateful if you make sure that it is not copied or fed into the system in such a way that it gets used!

Our Press Office will be supplying you with copies of the Press Notices themselves as instructed. I am sending a copy of this letter and enclosures to Andrew Turnbull.

Yours

Steve

S A Godber
Private Secretary

CONFIDENTIAL

83/246 17 November 1983

GOVERNMENT HONOURS PLEDGES ON THE NHS - £800 MILLION INCREASE IN HEALTH SPENDING

Norman Fowler, Secretary of State for Social Services, today announced planned spending on the NHS for 1984/85. Mr Fowler said:

"We have honoured our pledges on the NHS. Next year we plan to spend £800 million more on the NHS in Great Britain - just as pledged by the Prime Minister. These resources should provide real growth of over 1% for the NHS. In the hospital and community health services the growth should cover the expected increase in the number of very old people. We are already treating more patients than ever before and these extra resources will enable us to treat still more patients in the future.

Hospital and Community Health Services

"The English position is this. Next year we are planning to increase public expenditure on hospital and community health current services in England by £400 million over spending this year. That means a total of some £9 billion for 1984/85. These figures provide scope for real growth of some 1% over this year's spending. We are therefore planning to provide the extra resources needed next year to cope with the increasing numbers of very old people in our society. These pressures will run at just under 1% in the next few years and we are fully aware of the importance of coping with these demands.

"Next year we plan to increase NHS capital spending by some £50 million - 7% over this year's amount - getting on for 2% over forecast general inflation. The new total is £760 million, some 15% larger in real terms than when we took office.

"Extra resources are just one aspect. It is the patient care that we get from these resources that is the real test for the NHS. The Griffiths Inquiry gives us a clear path to modernising the management of the NHS. We are looking to a major cost improvement programme to enable us to make real progress in service development. We need to increase our efficiency to cope with continuing medical advance and the need we all recognise to improve services in vital areas. We are determined to see this through.

The Family Practitioner Services

"We are budgeting for an increase in public expenditure on these services of some £190 million next year, after taking full account of this year's increase of some £100 million over our 1983 White Paper plan. This brings the planned total for 1984/85 to some £2.86 billion for England. We are discussing with the representatives of the industry the scope for further savings on the drugs bill next year."

Priority for health

Mr Fowler added:

"These spending plans show the high priority the Government attaches to the NHS. Together with the resources which can be saved by cost improvement programmes and greater efficiency, these plans will enable the NHS to meet the growing pressures that it faces."

The detailed figures were given in reply to a Parliamentary Question by Mr Robin Squire, MP for Hornchurch:

"Planned public expenditure on the HPSS for 1984/85 is £15,414 as announced earlier today by my rt hon Friend, the Chancellor.

"We will be maintaining our planned total expenditure on the NHS in England at the level given in Cmnd 8789 for 1984/85, an increase of over £650 million on expected spending this year. Next year we are planning to increase hospital and community health services current public expenditure by some £400 million over this year's level to

£8.97 billion. NHS capital expenditure is planned to increase by some £50 million to £0.76 billion and FPS current expenditure by some £190 million to £2.86 billion. Centrally financed current spending in 1984/85 will be broadly as planned in Cmnd 8789. These increased resources should provide scope for real growth in resources of over 1% for the NHS on the basis of the Government's pay and price projections for next year."

83/245 17 November 1983

NATIONAL INSURANCE CONTRIBUTIONS FROM APRIL 1984 -
NO INCREASE IN RATES FOR EMPLOYEES OR EMPLOYERS

National Insurance contribution changes from April 1984 were announced today by Norman Fowler, Secretary of State for Social Services.

Four main elements in the announcement:

* There will be no change in the rates for Class 1 contributions, which employed people and their employers pay, or for the Class 4 contributions which are paid by some self-employed people.

* The lower and upper earnings limits for Class 1 contribution liability are being raised to £34 and £250 a week respectively. The earnings limits are increased each year in line with the requirement in law to relate them to the basic pension rate.

* The Treasury Supplement to the National Insurance Fund is being reduced by 2% from 13% to 11%. This will help to restore the balance of spending on social security between contributions and general taxation. In recent years, an increasing share of spending has come from general taxation.

* The balance in the Fund for 1984/85 will still be well above the level of 16.6% of annual benefit expenditure which the Government Actuary has suggested as a minimum.

Commenting on the changes, Mr Fowler said:

"I am very glad that next April, for only the third time since earnings related contributions began in April 1975, there is to be no increase in National Insurance contribution rates for employers and employees. The earnings limits will, of course, go up next April. But that is normal practice to increase them each year in line with the requirement in law to relate them to the basic pension rate."

In reply to a question from Mr Robert McCrindle, MP for Brentwood and Ongar, Mr Fowler said:

"I have completed the annual review under section 120 of the Social Security Act 1975 and I have today laid two draft Orders which require the approval of both Houses, the Social Security (Contributions, Re-rating) Order 1983 providing for contribution rates and profits limits to take effect from 6 April 1984, and the Social Security (Treasury Supplement to Contributions) Order, which provides for a reduction in the Treasury Supplement from 13 per cent to 11 per cent. I have also laid the Social Security (Contributions) Amendment (No. 5) Regulations 1983, which set out new earnings limits for employees' and employers' contributions. A report by the Government Actuary (Cmnd 9092) which accompanies the Orders and Regulations explains their effect on the National Insurance Fund.

EMPLOYEES AND EMPLOYERS

"As my right hon Friend the Chancellor of the Exchequer said in his statement earlier today I do not propose to raise the rate of contribution for either employees or employers. In line with the requirements of the Social Security Pensions Act 1975, the lower earnings limit for Class 1 contributions is to be increased to £34 a week, just below the new basic retirement pension rate, and the upper earnings limit is to be raised to £250 a week, which is about 7.3 times the new basic pension rate. These new earnings limits replace the existing ones of £32.50 and £235 a week respectively. The effects of these changes are as follows:

NOT CONTRACTED-OUT EMPLOYEES

"Neither the employee nor his employer will have to pay a contribution if his earnings are less than £34 a week. For people earning between £34 and £235 (the old upper limit) there will be no increase for either the employee or the employer. For those with earnings between £235 and £250 (the new upper limit) the maximum increase will be £1.35 a week for the employee and £1.71 a week for the employer.

CONTRACTED-OUT EMPLOYEES

"Contributions payable by contracted-out employees and their employers will rise slightly. Where earnings are less than £235 the increase will be very small, reflecting the fact that the increase in the lower earnings limit reduces the band of earnings on which the lower contracted- out rate is paid; the increase on earnings between £34 and £235 will be 4p for the employee and 6p for the employer. Additional contributions will be payable on earnings between £235 and £250 (the new upper limit); the maximum increase will be £1.07 for the employee and £1.17 for the employer.

THE SELF-EMPLOYED

"The flat-rate Class 2 contribution will be raised to £4.60. Strict application of the formula for calculating self-employed contributions which has operated since 1977 would have meant a Class 2 rate of £4.80 but I have thought it right to continue a modest relief to the small businessman while remaining within the broad framework of the formula. The rate of the Class 4 contribution is not being increased and the annual limits of profits between which Class 4 contributions are paid are being raised from £3,800 and £12,000 to £3,950 and £13,000, the latter figure being in line with the new upper earnings limit for employees.

"The effect of these changes is that for self-employed people who only pay Class 2 contributions there will be an annual increase of £10.40 but for those with profits between £3,950 and £12,000 the increase will be less - 95p per year. For those with profits of or above £13,000, the new upper profits limit, the increase will be £63.95 a year.

CLASS 3 (VOLUNTARY) CONTRIBUTIONS

"The rate of Class 3 contributions is to be raised from £4.30 to £4.50.

RATE OF TREASURY SUPPLEMENT

"The Treasury supplement to the National Insurance Fund is being reduced from 13 per cent to 11 per cent. This will help to restore the balance of expenditure between the Consolidated Fund and the National Insurance Fund. In recent years the Consolidated Fund has been meeting an increasing share of social security expenditure."

NOTES FOR EDITORS

Table A attached sets out the changes proposed for 1984/85 and Table B shows their effect on individual liability on a range of earnings or profits between £32.50 a week (the old lower earnings limit) and £250 a week (the new upper earnings limit). Table C shows total payments by employees and employers expected for 1984/85. The Class 1 and Class 4 percentage contribution rates are not being changed but the Class 2 rate and the lower and upper earnings and profits limits, which are expressed in cash terms, have been increased to take account of inflation.

As the Class 1 rate is not changing, most employees will be unaffected, although their contributions rise automatically if their earnings rise. Employers with earnings between £32.50 and £34 will now be exempt from contributions. Those with earnings above £235 will now pay contributions on the next £15 of earnings up to the new earnings limit of £250. In addition, there will be an increase of 4p a week in the contributions of people who pay at the contracted-out rate on earnings between the earnings limits.

The same considerations apply to the employer's share of the Class 1 contribution. In most cases the increase will be nil or, for contracted-out employers, 6p a week.

A similar pattern applies to self-employed people. Only those with profits above the present upper profits limits will be significantly affected by the new limits. Most self-employed people who have profits between the lower and upper limits will experience little change, with a slight increase in Class 2 liability being largely offset by a reduction in Class 4 liability.

JP

TABLE A

CHANGES IN CONTRIBUTION RATES PROPOSED FOR 1984/85

	1983/84*	Increase on account of inflation	1984/85*
Class 1			
Lower earnings limit (LEL)	£32.50 a week	£ 1.50	£ 34.00 a week
Upper earnings limit (UEL)	£235 a week	£15.00	£250.00 a week
Employed earner's rate			
Not contracted-out	9.0%	-	9.0%
Contracted-out	9.0% to LEL	-	9.0% to LEL
	6.85% between LEL and UEL	-	6.85% between LEL and UEL
Reduced rate	3.85%	-	3.85%
Employer's rate*			
Not contracted-out	11.45%	-	11.45%
Contracted-out	11.45% to LEL	-	11.45% to LEL
	7.35% between LEL and UEL		7.35% between LEL and UEL
Class 2 rate	£4.40 a week	£0.20	£4.60 a week
Small earnings exception - where earnings below	£1775 a year	£75	£1850 a year
Class 4 rate	6.3%	-	6.3%
Lower limit of profits or gains	£3800 a year	£150	£3950 a year
Upper limit of profits or gains	£12000 a year	£1000	£13,000 a year
Class 3 rate	£4.30	£0.20	£4.50

* Inclusive of NI surcharge rate of 1% as introduced by the 1983 Finance Act from 1 August 1983. Before the 1 August 1983 the surcharge was 1.5%

TABLE B

EFFECT OF PROPOSED CHANGES ON INDIVIDUAL LIABILITY

EMPLOYED EARNERS

WEEKLY EARNINGS	EMPLOYEE		EMPLOYER		TOTAL	
	AMOUNT	CHANGE	AMOUNT	CHANGE	AMOUNT	CHANGE
NOT CONTRACTED-OUT						
£ 32.50	Nil	-2.92	Nil	-3.72	Nil	-6.64
£ 34.00)						
£100.00)						
Ø £180.00)	NO	CHANGE	NO	CHANGE	NO	CHANGE
£235.00)						
£250.00 or more	22.50	+1.35	28.62	+1.71	51.12	+3.06
CONTRACTED-OUT						
£ 32.50	Nil	-2.92	Nil	-3.72	Nil	-6.64
£ 34.00	3.06	+0.04	3.89	+0.06	6.95	+0.10
£100.00	7.58	+0.04	8.74	+0.06	16.32	+0.10
Ø £180.00	13.06	+0.04	14.62	+0.06	27.68	+0.10
£235.00	16.83	+0.04	18.66	+0.06	35.49	+0.10
£250.00 or more	17.86	+1.07	19.77	+1.17	37.63	+2.24
REDUCED RATE*						
£ 32.50	Nil	-1.25	)			
£ 34.00	1.31	0.00	)			
£100.00	3.85	0.00	)			
Ø £180.00	6.93	0.00	)As Above			
£235.00	9.05	0.00	)			
£250.00 or more	9.62	+0.57	)			

SELF-EMPLOYED

Annual Profits or Gains	Yearly Contribution	Change
£1775 - £1849	Nil	-228.80
£1850 - £3800	239.20	+ 10.40
£3950	239.20	+ 0.95
Ø £9360	580.03	+ 0.95
£12000	746.35	+ 0.95
£13000 or more	809.35	+ 63.95

Ø Anticipated average earnings 1984/85

* Payable by opted-out married women and widows (3.85%)

TABLE C

Estimated Total Payments in 1983-84 and 1984-85 by Employees and Employers in National Insurance Contributions and National Insurance Surcharge(1)

Great Britain (£ million)

	National Insurance Contributions			NI Surcharge	Total	Total
	Employees	Employers	Total Employees + Employers	Employers	Employees + Employers Contributions + NIS	Employers contributions + NIS
Contributions in 1983-84	9210	10310	19520	1670	21200	11980
1984-85 change from increased earnings etc(2)	590	620	1210	380(3)	830	240
1984-85 change from increases in earnings limits	70	80	150	10	160	90
Total contributions in 1984-85	9880	11010	20890	1300	22190	12310

(1) Figures are rounded to the nearest £10 million and may not sum. Detailed figures for National Insurance Contributions are included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-ratings) Order 1983.

(2) Including population and employment changes.

(3) The net decrease in NIS receipts between 1983-84 and 1984-85 reflects the fact that the rate for local authorities is 2½ per cent throughout 1983-84 and for other employers was 1½ per cent until 1 August, 1983, when it was lowered to 1 per cent. The table assumes that the surcharge remains at 1 per cent for all employers in 1984-85.

Note: Figures in this table are on a receipts basis, excluding self-employed and voluntary contributions. Figures include NHS and Employment Protection Allocation contributions. Employers contributions have not been adjusted to take account of deductions in respect of statutory sick pay.

SECRET

DRAFT PRESS NOTICE

SOCIAL SECURITY CHANGES: SPENDING INCREASES TO GO UP, CONTRIBUTION RATES TO BE HELD DOWN, BUT SOME CHANGES TO CONTAIN CONTINUING GROWTH;

Norman Fowler, the Secretary of State for Social Services, today gave details of changes in the social security programme reflected in the Chancellor's Autumn Statement. He said:

"The cost of the social security programme is forecast to rise, even after the changes announced by the Chancellor in his Autumn Statement. In 1984-85 the Government will spend £36,850 million on social security benefits, about half going to pensioners.

The increase in 1984-85 is over £150 million compared with the total in the Public Expenditure White Paper after adjustment for the changes announced at the Budget.

* benefits are being increased this November as announced. This means that pensions and other linked long-term benefits are going up in line with the increase in prices during the year to May 1983, thus fulfilling the Government's pledge to protect these benefits against rising prices. The retirement pension will go up by £1.20 a week for a single person (from £32.85 to £34.05) and by £1.95 a week for a couple (from £52.55 to £54.50).

* Moreover all the other unpledged benefits are also being increased in line with inflation, some by considerably more. Child benefit goes up by 65p, from £5.85 to £6.50 a week for each child - an 11 per cent increase, far above the rate of inflation. Unemployment benefit, too, is getting a bigger rise - about 8 per cent - from £25.00 to £27.05 a week for a single person.

* Altogether these increases will cost over £1,500 million in a full year.

* The benefit uprating in November 1984 will be based on price rises in the twelve months up to May of that year; this protection will apply not only to pensions and other linked long-term benefits, but also to other benefits - including unemployment benefit, supplementary benefit and child benefit.

In spite of the strains which the extra costs of the social security programme impose, National Insurance contribution rates are being held at their present level and we are maintaining the key elements of the social security programme. However, with a programme of this size which is constantly rising and which now accounts for well over a quarter of all Government spending, some changes will have to be made next year in order to contain the rising costs within overall public expenditure targets.

We are proposing to save bout £180 million in a full year by reducing public expenditure on assistance with housing costs. In addition, about £50 million will be saved from lower rate rebates. These changes will take effect in April 1984. For housing benefit recipients they will be concentrated generally on households with relatively higher incomes and on those with non-dependants in work who will in future be expected to make a higher contribution towards housing costs. They also affect 18-20 year olds receiving supplementary benefit and living at home.

Details of the changes which were set out in response to a Parliamentary Question from Nicholas Budgen MP for Wolverhampton South West are attached.

"Very substantial help worth nearly £4 billion a year is now given with housing costs, through rate and rent rebates and through rent allowances. It goes to about 1 household in 3, getting on for half the population.

The scope of housing benefits has grown over the years and its growth needs to be constrained. The aim of the Government's proposals has been to do so but in a way that ensures that help continues to go to those households that need it most.

"The housing benefit changes will reduce expenditure on housing benefits by less than 5%. Even after the changes, about 6¼ million households will still be helped. Those who cease to receive benefits or have them reduced will, in general, be those with relatively higher incomes or those with non-dependants in the household who will - if not on supplementary benefit - be expected to contribute rather more towards housing costs.

Many of the poorest working families with children will benefit in real terms from the increase of £1 in the dependent child's needs allowance which comes into effect from April like the other changes. For those affected by the other changes, the increase will help to offset any reduction in benefit.

As to the supplementary benefit change, most 18-20 year olds living at home will continue to benefit from parental support and we think it reasonable to place them in the same position as 16-17 year olds and not pay them the non-householder housing contribution. However, where the householder is receiving housing benfit or supplementary benefit there will be a corresponding increase in the householder's benefit, so that total household income will be maintained.

Overall:

* some measures need to be taken to contain the overall growth in social security expenditure. These measures seek to do this by concentrating on those households who are in less need of help.

* typically, the households affected will have relatively higher incomes or more than one earner.

* poorer families are protected.

* help with housing costs generally continues on the same basis for families on supplementary benefit".

Other housing benefit changes

Mr Fowler also announced other changes in housing benefits which he was making in response to proposals from the Local Authority Associations. He said:

> "I am glad we have also been able to meet a number of suggestions for simplifications to the administration of housing benefit and for minor improvements in benefit, which have been put forward by the Local Authority Associations after discussions with my Honourable Friend Dr Boyson, the Minister for Social Security. I am arranging for details of the agreed proposals to be sent to the Local Authority Associations".

In addition, the £1 increase in the dependent child's needs allowance announced in the summer will provide further help for the poorer working families.

Has the Prime Minister seen the figures quoted by the Chief Secretary that public sector capital expenditure has fallen by 50% in cost terms between 1973-74 and 1982-83?

If my hon. Friend had read the speech in full he would have noticed the substantial qualifications which the Chief Secretary made to the figures. On the very next page he said:

> "... what is meant by "capital" spending in the public sector differs from capital spending as it is understood in commercial accounting. Ignoring these differences can be misleading both about the amount of public sector investment which is actually going on and about the merits and demerits of different types of spending."

For example, the figures net of sales of council houses which reduced overall capital spending last year by over £2 billion and the White Paper figures do not include capital spending by the nationalised industries, merely their borrowing.

Autumn Statement
17 November

THE ECONOMY

1. With permission, Mr Speaker, I should like to make a statement.

2. As my predecessor did last year, I am laying before the House today an Autumn Statement which brings together certain matters customarily announced at this time of the year. The Statement contains the Government's outline public expenditure plans for 1984-85, proposals for National Insurance Contributions for next year, and the forecast of economic prospects for 1984 required by the Industry Act.

/In response

3. In response to firm monetary policies the past year has seen falling inflation, renewed growth and solid evidence of our continuing recovery from world recession. Progress both on inflation and on growth this year has been better than expected at the time of the Budget.

4. Since the low point of the recession in early 1981, output has grown by about 5 per cent, inflation has fallen from double figures to around 5 per cent, and there have been significant gains in productivity, competitiveness and profitability. Employment appears now to be rising, and unemployment to be levelling off.

/Output

5. Output this year is expected to be about 3 per cent higher than in 1982, and the Industry Act Forecast points to continuing growth next year. Recovery in the rest of the world, so far hesitant outside North America, is now widely expected to show some improvement. With higher exports offsetting some slow-down in the growth of domestic demand, overall UK output is forecast to rise by a further 3 per cent in 1984. With inflationary pressures remaining weak, inflation is likely to edge down again next year to a rate of around 4½ per cent by the fourth quarter.

/Downward

6. Downward pressure will continue to be exerted on public borrowing. Despite the measures I announced on 7 July it is clear that this year's PSBR is likely to be above the £8.2 billion expected at the time of the Budget. The outturn is, of course still uncertain but is now forecast to be £10 billion, mainly as a result of public expenditure running higher than expected, as I indicated to the House on 7 July.

7. For next year, 1984-85, the forecast makes the conventional assumptions that the direct taxes and excise duties are both revalorised

/in line

in line with prices, and that the PSBR is held next year to the £8 billion assumed at the time of the last Budget in accordance with the Medium Term Financial Strategy. On this basis the forecast implies the need for some net increase in taxes in next year's Budget.

As the House will recognise, this is, of course, at this stage, subject to a wide margin of uncertainty, and will need to be reviewed, with other relevant factors, in the light of more up-to-date information, before I come to make my Budget judgement.

/Following

8. Following this year's public expenditure review, the public expenditure planning total for next year, 1984-85, will remain at £126.4 billion. The House will recall that that was the provisional figure for 1934-85 published in the Public Expenditure White Paper in February this year. It is also broadly the same in real terms as the likely outturn for this year, 1983-84. So, with the economy expanding, public expenditure should continue to fall as a percentage of GDP next year.

/Within the

9. Within the unchanged total for 1984-85 there have inevitably been changes in both directions in individual programmes. The details are contained in the Autumn Statement itself. In broad terms, it shows increases in spending for health and personal social services, education, law and order, agricultural support, arts and libraries, and for a number of other programmes. Social security spending will also increase, although there will be reductions in the coverage of help with housing costs, particularly housing benefit. The social security programme provides for an uprating in November 1984 based on the rise in prices in the 12 months to May 1984.

/These increases

10. These increases are offset by higher receipts from the sale of council houses and the like, and by a reduction in planned spending on home improvement grants, defence, employment, trade and industry, and several other programmes - including the aggregate external financing limits of the nationalised industries. Net receipts from special sales of assets are forecast to increase by some £400 million reflecting, among other things, the fact that the privatisation of Enterprise Oil is now expected not this year but in 1984-85.

/As the House

11. As the House will be aware, the February White Paper provided for a provisional Contingency Reserve of £3 billion. That figure remains intact.

12. The 1983 review of expenditure plans has, of course, also covered 1985-86 and 1986-87. Details of the plans for both those years will be published in next year's Public Expenditure White Paper.

13. The Government has also reviewed its manpower requirements for theyears up to 1988. My RHLF the CST is today publishing details

/of our

of our new plans for a continued steady reduction in the size of the Civil Service. Numbers will come down to 593,000 by 1988, a fall of 6 per cent below the existing target of 630,000, which we expect to be achieved on or before 1 April 1984.

14. I come, lastly, to National Insurance Contributions. As the House knows, these are reviewed every autumn in the light of advice from the Government Actuary on the prospects for the National Insurance Fund in the coming financial year.

/As usual,

15. As usual, the earnings limits will need to be increased. The lower earnings limit will rise to £34 a week, in line with the single rate retirement pension, and the upper earnings limit will rise to £250 a week, broadly in line with the increase in prices and earnings. The taxpayers' contribution to the fund - the so-called Treasury Supplement - will be reduced from 13 per cent to 11 per cent. Finally, in each of the last four years we have had to increase the Class I National Insurance contribution rate itself.

/I am glad

I am glad to say that we shall not need to do so for 1984-85. So the full Class 1 rate will remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

16. As is customary, my rt hon Friend, the Secretary of State for Social Services will this afternoon announce details of the changes in the Social Security (Contributions, Re-rating) Order and will lay before Parliament the accompanying report by the Government Actuary.

/As my RHF

17. As my RHF the Leader of the House has already announced, the House will have an opportunity next week to debate the Autumn Statement, which is now available from the vote office.

18. Mr Speaker, for the first time for many years we are now enjoying low inflation combined with steady growth. This is a winning combination. ∴ Our task is to keep that winning combination by sticking to - and indeed reinforcing - the policies which have brought it about.

CHANCELLOR OF THE EXCHEQUER

With the Compliments

of

ADAM RIDLEY

Special Adviser

Treasury Chambers,
Parliament Street,
S.W.1.

AUTUMN STATEMENT [AS]

NOVEMBER 18 1983

As in 1982 an Autumn Statement is being published to present to the House speedily and conveniently the Government's decisions about public spending, national insurance rates for 1984-5 and the short-term economic forecast required twice a year by the Industry Act.

Numbered references in brackets are to paras, tables or charts in the AS text.

THE ECONOMY: PERFORMANCE AND PROSPECT

General

2. Part 1 of the AS describes the economy's recent development and the outlook to the end of 1984. The picture is of continued progress in the battle against inflation; and better-than-expected output growth, as the following comparison shows:

Successive Treasury
Projections of real GDP growth in 1982, '83;
% increase year on previous year

	AS 1982	1983 Budget	AS 1983
1982	+ ½	+½	+2
1983	+1½	+2	+3

(all figures rounded to nearest ½%)

However, the immediate fiscal prospect has become more difficult. Whereas the Budget forecasts suggested a positive £½ billion fiscal adjustment in 1984-5 and, therefore, scope for modest tax cuts over and above indexation, the latest estimate is negative, suggesting real net tax increases of the same size.

Main features of the Industry Act Forecast

3. World trade and output, which fell in 1982 and the earlier part of 1983, appear to be expanding and should match or exceed their 1975-82 growth rates in 1984 (Table 1.1).

Demand in the UK economy will continue to expand briskly (3% up in 1984) as it has done since the second half of 1981. (Table 1.3).

Output in the UK in 1984 is also set to grow by around 3%, as in 1983. This will mean that for the three years 1981-4 UK growth will have been close to or faster than that of our major competitors. An achievement without precedent for decades. (Tables 1.1 and 1.4).

Consumption spending is likely to continue to grow, though less quickly than in 1983, with a further small fall in the savings ratio and growth in real incomes after tax. (Chart 1.9 and Table 1.3).

Total investment which, contrary to general expectation, has been growing since 1981 Q 3, is expected to grow by 4% in 1984, with manufacturing contributing to that increase. (Table 1.3).

Trade: Total Exports, which grew in 1982 and 1983 despite the fall in world trade, are also projected to grow by 4% as world trade recovers. Imports of manufactures will continue to grow strongly as the economy expands.

The current account is expected to be in modest surplus in 1983 and broad balance in 1984.

This picture of continuing recovery is confirmed by the CBI's surveys of industrial trends and the DTI's surveys of investment intentions.

4. Turning to costs, employment and monetary developments:

Inflation, as measured by 12 monthly increases in the Retail Price Index will be about 5% by the end of 1983, less than the 6% projected at Budget time; and is forecast to rise briefly to about 5½% before falling to around 4½% by the end of 1984.

Relative unit labour costs in manufacturing fell by over 20% between their peak in the first half of 1981 and the first half of 1983. This was due partly to the fall in the exchange rate, reductions in the National Insurance Surcharge, and to a 15% increase in productivity which has gone well beyond what is normal as output recovers. (Chart 1.3 and Table 1.6).

Business finance and profitability have strengthened considerably from their very low 1981 base. With the domestic recovery and growth in overseas demand, they should continue to do so. Excluding the oil sector, industrial and commercial company profits (less stock appreciation) rose by no less than 22% between the first halves of 1981 and 1982, and 24% between the first halves of 1982 and 1983. In the year to mid 1983 companies ran a substantial financial surplus and their borrowing requirements fell sharply. In addition companies have been able to raise substantial sums in new equity and bond issues for the first time in many years - nearly £3 billion by the end of the third quarter of 1983.

Monetary growth in the target period February 1983 to April 1984 has slowed significantly and has been coming back toward the target range, thanks in part to a successful funding programme.

Interest rates have continued to fall. At the short end Bank base rates are 7% below their October 1981 peak and at their lowest level for 5½ years. Long rates have also moderated and, strikingly, have recently been lower than in the USA, in marked contrast to past experience. (Chart 1.11).

Employment prospects are getting better. Manufacturing employment is declining much more slowly. The numbers in work outside manufacturing are rising and the fall in total employment seems to have ended. These trends, and indicators such as job vacancies, suggest that unemployment may be levelling off. (Para 1.38).

REVIEW OF NATIONAL INSURANCE CONTRIBUTIONS

5. The main points to note about the review and the decisions arising from it are:

- No change in the employer and employee contribution rates, for the first time since 1979-80.

- As the law requires, the upper and lower earnings limits have been reviewed. When inflation is high, these adjustments lead year by year to substantial increases in contributions in cash, if not in real terms. But as inflation is now low, the extra cash burdens on employees and employers attributable to the changes in the earnings limits are very small (£70m and £80m next year respectively). Nearly all of such cash increases as there are will be the direct consequence of higher earnings. (Table 3.1).

- The burden on employers of National Insurance Contributions and Surcharge payments in 1984-5 is expected to rise by less than 3% in cash terms, and therefore to fall significantly in real terms.

The effects of the changes now proposed are clearly summarised in Part 3 of the AS; and described in greater detail in the order the Secretary of State for Social Services is laying before Parliament on November 17.

6. Further points to note are that:

- the lower earnings limit is to rise from £32.50 to £34 a week, in line with the uprating of the single person's basic retirement pension;
- the upper earnings limit is to rise by 6½% from £235 to £250 a week, broadly in line with the increase in prices and earnings.
- the "Treasury supplement", a general subsidy from the taxpayer to the National Insurance Fund, is to be reduced from 13% to 11%. As spending on non-contributory social benefits (which are financed from general taxation) has long risen faster than on the contributory benefits financed from the National Insurance Fund, this reduction helps restore the balance between the proportion of total social security spending met by the general taxpayer and by contributors;
- the overall effect of the changes proposed is expected to add about £200 million to the accumulated balance in the fund. This will leave its size unchanged in real terms;
- in preparing his annual report on the prospects for the NI Fund, the Government Actuary has been instructed to adopt as working assumptions figures of 2.85 million unemployed (excluding school leavers) in 1983-4 and 1984-5.

PUBLIC SPENDING

General

7. As far as the outlook and decisions for 1984-5 go:

(1) The decisions on individual programmes have been kept within the £126.4 billion cash total in the February 1983 Public Sector White Paper (Cmnd 8779). This is the second successful survey in which the planning total has not been added to in the subsequent survey.

(2) Given this unchanged cash planning total, the level of real spending (measured in constant prices, in 1984-5 is likely to be little different from what it was in 1983-4; while the GDP share of the planning total should fall, from around 42½% to 42%, making 1984-5 the third financial year in succession in which the share has fallen from its 1981-2 peak of 44%.

(3) In confirming the 1984-5 planning total of £126.4 billion, the Government has not, as some suggested, increased the risks of spending ultimately overshooting, by drawing on the contingency reserve set out in the March White Paper. It remains at £3 billion.

8. Turning to developments in 1983-4;

(1) As was already clear in the summer, the level of public spending in 1983-4 is above that expected at the time of the Budget. This is due principally to extra outgoings on demand-determined programmes such as assistance to Agriculture under the CAP, Health & Social Security, debt interest, and Local Authority overspending on current account.

(2) With little change in projected revenues, the result is a PSBR now put at £10 billion, some £2 billion above the Budget estimate. However wide margins of error surround estimates of both revenue and spending and hence the PSBR until very late in the financial year.

Detailed changes

9. The figures agreed for programme totals in 1984-5 (and the 1983-4 figures corrected for Budget and other changes) are set out fully in Table 2.1 and Chapter 2 of the AS. The major changes in programme totals are:

REDUCTIONS IN PLANNED SPENDING

	£m cash
Nationalised Industry External Financing limits (EFLs)	-666
Environment - Housing	-497
Defence	-260
Employment	- 68
Trade & Industry	- 60

INCREASES IN PLANNED SPENDING

Agriculture - Intervention Board (IBAP)	+422
Education	+175
Social Security	+163
Home Office	+ 92
Health & Personal Social Services	+ 86
Energy	+ 86
Environment - Property Services Agency	+ 24

Such totals are net figures which reflect a variety of increases and reductions in programme constituents. In programmes such as Local Authority spending, the planning total figure is net of receipts from sales of assets such as council houses. So neither the level nor year-to-year trend is necessarily a good guide to the underlying level of gross spending, or changes in it.

10. Turning to individual programmes, it should be noted that for 1984-5:

Defence: cash provision is 8.2% up on 1983-4, allowing both for real growth of 3% over that year plus a substantial addition for Falklands costs.

FCO: extra spending on the BBC External Services and the British Council.

Agriculture: the increase in IBAP spending is uncertain (depending on weather, markets, etc), and mainly on activities entirely financed by the European Community.

EC Contribution: the unchanged figure is the conventional estimate shown in the February White Paper.

Trade & Industry: extra spending on launch aid, R & D and redundancy, more than offset by lower regional aid and reduced spending on individual industries and BL.

Energy: most of the £86 million increase is extra support for the Coal Industry.

Employment: the net reduction of £68 million reflects lower costings of the Youth Training, Job-Splitting and Young Workers' Schemes; and the extension of the Enterprise Allowance.

Housing: gross capital spending will be much the same next year as this in cash terms. The reduction in net provision is mainly due to higher receipts for council house sales; and the ending of the temporary home improvement grant measures introduced in the 1982 Budget.

Other DOE programmes: provision for higher PSA spending will assist the special programme to up-grade Unemployment Benefit offices and other substandard Government offices.

Home Office: the increase provides an extra £32 million for prisons and £19 million for the police, as well as for the start of the Cable Authority.

Education & Science: the increase is mainly Local Authority current spending.

Health and Personal Social Services: the increases honour Election and other pledges, and provide for extra capital spending. They also provide resources to meet fully demographic pressures on the NHS and the growing demand for Family practitioner services.

Social Security: the £163 million increase is the net effect of substantial demand-determined increases (mainly Supplementary and Housing Benefit), only partly offset by policy changes, principally on Housing Benefit. The latter now goes to some 7 million households - no less than 1 in 3 - some of which will have incomes above average earnings. The changes proposed are designed to limit to this better-off group the bulk of the reductions in benefits.
N.B. Benefit upratings come into effect on November 21 at a cost of around £1½ billion, including the 11% increase in child and one-parent benefits announced in the Budget.

Local Authorities' current spending: the £600 million increase provided in current spending relevant for RSG support reflects continued overspending by the authorities. At the same time provision has also been made for grant hold-back where authorities exceed their targets.

11. Other noteworthy features of the latest review are:

Asset Sales: estimates are particularly uncertain and reflect a variety of changes since the February White Paper, including the slippage of the sale of "Enterprise Oil" into 1984-5. Sale of shares in BT is still scheduled in the Autumn of 1984.

Manpower: the new targets for the size of the Civil Service in the year to 1988 provide for a further reduction of 37,000, from the 630,000 target which will be achieved for April 1984 to 593,000. Almost half of this 6% drop will be accounted for by the change proposed in the status of the Royal Ordnance factories. Detailed figures are given in the written PQ answered by the Chief Secretary on November 17.

Nationalised Industry EFLs: increases are provided for the NCB, BSC, CAA and British Shipbuilders. All the other industries have lowered requirements. Details of the industries' investment and policy plans are not yet settled. But overall their price rises in 1984-5 are expected to be at or below the rate of inflation, and the levels of investment achieved in 1982-3 and 1983-4 should be maintainable hereafter provided current costs are properly restrained. Further fuller notes on the Gas and Electricity industries are in the Annex.

Tax Ready Reckoners

13. As in 1982 the last part of the AS includes a "ready reckoner" for the direct revenue effects of possible tax changes in the financial year 1984-5. The effects of indexing income tax thresholds, allowances and bands and revalorising excise duties are set out in some detail, assuming an illustrative 5% inflation. In using these estimates it needs to be borne in mind that:

- the first-year and full-year costs often differ;
- some changes illustrating indexation and valorisation will differ slightly from 5% due to conventional rounding to convenient cash sums;
- income tax changes are costed separately, but interact if several are undertaken at once;
- most changes can be scaled up or down proportionately within a reasonable range, but not for "large" changes;
- direct revenue effects are not the same as fully-worked out PSBR costs. These are not unique for a given tax change, since they depend on other assumptions about economic policy, particularly monetary control.

PJC/ANR/SN
November 17 1983

ANNEX

BACKGROUND NOTE ON EFLs IN THE GAS AND ELECTRICITY INDUSTRIES

1. When the Government negotiates and agrees EFLs with the industries, two basic principles are followed: that the industries should achieve demanding but realistic targets for costs and productivity; and that prices should be set in line with the prices a competitive market would generate ("economic pricing"). The industries decide their prices themselves.

2. Economic pricing means covering all the costs of meeting additional demand, including a 5 per cent return on capital. When prices are set in this way, there is no sense in which they can be said to contain an element of taxation. This approach has been endorsed by successive Governments, including the last Labour Government.

3. Where prices are below economic levels, the investment (eg a power station) will make a loss; or materials are bought in and sold on for less than they cost, as BGC already have to do with expensive Norwegian gas. There is a clear waste of resources in either case. The borrowing requirement and interest rates will be higher as a result.

4. Across-the-board restraint of prices below economic levels (eg to help firms whose international competitiveness is sensitive to energy prices) is not only wasteful but inefficient, as those helped will only account for a small part of total energy consumption.

5. The Electricity industry was investigated by Coopers & Lybrand in 1982. Their findings suggest that electricity prices are now approaching economic levels, but are not above them. The Gas industry was studied by Deloitte's in 1983. They showed that even in 1982/83 most gas prices were well below economic levels. The shortfall has since widened considerably because costs of energy production have continued to rise both here and abroad.

6. There is a widespread but incorrect belief that the costs of energy to British firms are generally higher than on the continent. Yet UK industrial gas prices should be in line with continental ones in 1984/85. So, too, will be industrial electricity prices for most consumers, except in comparison with France which has a lot of low cost nuclear capacity. Prices to domestic consumers will remain lower in the UK, for gas very markedly so.

7. Much nonsense is talked about the "enormous profits" of the energy industries. In truth what is enormous is the amount of capital invested: £9 billion in Gas and a staggering £32 billion in Electricity. The profitability of these assets is in fact rather poor. Though the profit figures for the industries are large in absolute terms, the 4½ per cent return on capital in gas - let alone the return of under 2 per cent in electricity - are modest by normal private sector standards.

8. Even more nonsense is talked about the "need" for low energy prices to industry. Every firm and household would like to pay less for what it purchases. But to say as much tells us nothing about what to do when a good or service is scarce and expensive to produce. To ensure the supply purchasers need, economic pricing is necessary. And subsidising supply to make it possible to hold prices below proper levels inevitably imposes costs and burdens which hold back profits and growth in the rest of the economy.

9. The increases in gas and electricity prices over the coming year are expected to be below the rate of inflation.

10. Domestic Gas prices have not increased since October '82. Industrial gas prices have gone up by less than 4 per cent since the end of 1980. Electricity prices have not increased since the spring of 1982.

11. It is also worth recalling that since 1979 many important measures have been taken to help the less well-off with energy bills: the new disconnection codes; the provisions for abatement of standing charges for small consumers; and very substantial increases in real terms in the assistance given to the needy through "heating addition" and other Supplementary Benefits.

10 DOWNING STREET

Prime Minister

The main subject of the bilateral will be the Autumn Statement. The draft is very clear. The points of difficulty could be

(i) higher PSBR, though market expects this
(ii) hint of higher taxes
(iii) energy prices - Chancellor could report state of play.

Other items for meeting, if not resolved before

(i) black economy
(ii) offshore life assurance.

AT 16/11

PRIME MINISTER

Autumn Statement

Attached are a draft of the statement the Chancellor will make in the House tomorrow and a copy of the printed document.

To note:

(o) Growth of 3 per cent in 1983 and 1984.

(i) The PSBR in 1983/84 is put at £10 billion (Para.1.49).

(ii) Public expenditure in 1984/85 is shown as £126.4 billion, and a further fall in public expenditure as a percentage of GDP is projected (Page 23). The contingency reserve is intact at £3 billion (Para. 2.32).

(iii) Taxes might have to be raised next year by £½ billion, though the Chancellor stresses the small size of the judgment in relation to the margin of error and the fact that this does not preempt his budget judgment (Para. 1.45).

(iv) Inflation should be around 5½ per cent in May, 1984, the relevant month for uprating pensions (Para. 3.04). By the 4th Quarter inflation should be down to 4½ per cent (Para. 1.50).

(v) Unemployment is assumed to remain stable at 2,850,000 (Para. 3.04).

(vi) No change in NIC rates (Para. 3.02).

(vii) Current account ½ billion in surplus this year and in balance next (Para. 1.50).

AT

16 November, 1983

ANDREW TURNBULL

cc BZ
T/F
Backup

No need to return

17

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

16 November 1983

Andrew Turnbull Esq
No 10 Downing Street
London SW1

Dear Andrew,

AUTUMN STATEMENT: 17 NOVEMBER

You have a copy of the proof of the printed Autumn Statement. I am not sure that I shall be in a position to send you tonight a copy of the final corrected version: I shall try, and if I fail I shall certainly send copies early tomorrow morning.

... Meanwhile, I attach a copy of the latest draft of the Chancellor's oral statement in the House tomorrow afternoon. The Chancellor has already devoted a good deal of attention to it, and I am fairly clear that any further changes are likely to be pretty minor.

Yours ever,

John

J O KERR

THE ECONOMY

1. With permission, Mr Speaker, I should like to make a statement.

2. As my predecessor did last year, I am laying before the House today an Autumn Statement which brings together certain matters customarily announced at this time of the year. The Statement contains the Government's outline public expenditure plans for 1984-85, proposals for National Insurance Contributions for next year, and the forecast of economic prospects for 1984 required by the Industry Act.

3. In response to firm monetary policies the past year has seen falling inflation, renewed growth and solid evidence of our continuing recovery from world recession. Progress both on inflation and on growth this year has been better than expected at the time of the Budget.

4. Since the low point of the recession in early 1981, output has grown by about 5 per cent, inflation has fallen from double figures to around 5 per cent, and there have been significant gains in productivity, competitiveness and profitability. Employment appears now to be rising, and unemployment to be levelling off.

5. Output this year is expected to be about 3 per cent higher than in 1982, and the Industry Act Forecast points to continuing growth next year. Recovery in the rest of the world, so far hesitant outside North America, is now widely expected to show some improvement. With higher exports offsetting some slow-down in

the growth of domestic demand, overall UK output is forecast to rise by a further 3 per cent in 1984. With inflationary pressures remaining weak, inflation is likely to edge down again next year to a rate of around 4½ per cent by the fourth quarter.

6. Downward pressure will continue to be exerted on public borrowing. Despite the measures I announced on 7 July it is clear that this year's PSBR is likely to be ~~well~~ above the £8 billion expected at the time of the Budget. The outturn is, of course, still uncertain but is now forecast to be £10 billion, mainly as a result of public expenditure running higher than planned, as I indicated to the House on 7 July.

7. For next year, 1984-85, the forecast makes the ~~usual~~ conventional assumptions that the direct taxes and excise duties are both revalorised in line with prices, and that the PSBR is held next year to the £8 billion assumed at the time of the last Budget in accordance with the Medium Term Financial Strategy. On this basis the forecast implies the need for some net increase in taxes in next year's Budget. As the House will recognise, this is, of course, at this stage, subject to a wide margin of uncertainty, and will need to be reviewed, with other relevant factors, in the light of more up-to-date information, before I come to make my Budget judgement.

8. Following this year's public expenditure review, the public expenditure planning total for next year, 1984-85, will remain at £126.4 billion. The House will recall that that was the provisional figure for 1984-85 published in the Public Expenditure White Paper

in February this year. It is also broadly the same in real terms as the likely outturn for this year, 1983-84. So, with the economy expanding, public expenditure should continue to fall as a percentage of GDP next year.

9. Within the unchanged total for 1984-85 there have inevitably been changes in both directions in individual programmes. The details are contained in the Autumn Statement itself. In broad terms, it shows increases in spending for health and personal social services, social security, education, law and order, agricultural support, arts and libraries, and for a number of other programmes. The social security programme provides for an uprating in November 1984 based on the rise in prices in the 12 months to May 1984; but there will be reductions in the coverage of help with housing costs, particularly housing benefit.

10. These increases are offset by higher receipts from council house sales and by a reduction in planned spending on home improvement grants, defence, employment, trade and industry, and several other programmes - including the aggregate external financing limit of the nationalised industries. Net receipts from special sales of assets are forecast to increase by some £400 million reflecting, among other factors, the fact that the privatisation of Enterprise Oil is now expected not this year but in 1984-85.

11. As the House will be aware, the February White Paper provided for a provisional Contingency Reserve of £3 billion. That figure remains intact.

12. The 1983 review of expenditure plans has, of course, also covered 1985-86 and 1986-87. Details of the plans for both years will be published in next year's Public Expenditure White Paper.

13. The Government has also reviewed its manpower requirements for the years up to 1988. My RHLF the CST is today publishing details of our new plans for a continued steady reduction in the size of the Civil Service. Numbers will come down to 593,000 by 1988, a fall of 6 per cent below the existing target of 630,000, which we expect to be achieved on or before 1 April 1984.

14. I come, lastly, to National Insurance Contributions. As the House knows, these are reviewed every autumn in the light of advice from the Government Actuary on the prospects for the National Insurance Fund in the coming financial year.

15. As usual, the earnings limits, which define the range of earnings on which contributions are payable, will need to be increased. The lower earnings limit will rise to £34 a week, in line with the single rate retirement pension, and the upper earnings limit will rise to £250 a week, broadly in line with the increase in earnings. We are also taking this opportunity to reduce the taxpayers' contribution to the fund - the so-called Treasury Supplement - from 13 per cent to 11 per cent. Finally, in each of the last four years we have had to increase the National Insurance Contribution rate itself. I am glad to say that we shall not need to do so for 1984-85. So the full Class 1 rate will remain at 9 per cent for employees and 10.45 per cent for employers.

16. As is customary, my rt hon Friend, the Secretary of State for Social Services, will this afternoon announce details of the changes in the Social Security (Re-rating Contributions) Order and will lay before Parliament the accompanying report by the Government Actuary.

17. As my RHF The Leader of the House has already announced, the House will have an opportunity next week to debate the Autumn Statement, which is now available from the vote office.

18. Mr Speaker, for the first time for many years we are now enjoying low inflation combined with steady growth. Our task now is to sustain this [illegible] beneficent combination, by holding - and indeed reinforcing - the policies which have brought it about.

Public expenditure file

SPEECH BY THE CHIEF SECRETARY TO THE TIMES/COOPERS & LYBRAND CONFERENCE ON PUBLIC INVESTMENT AND ECONOMIC RECOVERY, LONDON NOVEMBER 15

I welcome this opportunity to participate in the debate about public investment and economic recovery. The subject was considered in some detail in the course of the last Parliament and several parties examined the problems at that time including the Treasury, the Treasury and Civil Service Select Committee, the NEDC and the industries themselves. Now is a timely moment, following the Government's re-election in June, to look at this cluster of issues again. They range from the central questions of macroeconomic policy addressed this morning by Christopher Foster and Patrick Minford to examination of particular projects - for example prisons and the Channel Tunnel, which you will be looking at later. I do not intend to speak today on the macroeconomic issues. These will be the focus of debate following the publication of our Autumn Statement shortly. I will concentrate rather on some other important aspects of the issue.

Public capital expenditure, as the conference programme rightly observes, has fallen as a proportion of GDP during recent years. What public capital spending means in this context I shall come to in a moment but I will start with the basic figures. Between 1973-74 and 1982-83 public sector capital expenditure increased in cash terms from £6.4 billion to £11.1 billion which was equivalent in cost terms to a reduction of about 50 per cent. It fell also as a proportion of the public expenditure planning total.

This fall occurred of course during a time of severe shocks to the world economy which resulted in a rapid surge in inflation and two recessionary troughs in activity. Over the same period private sector investment in Britain also declined in relation to GDP, although I recognise that much the larger fall was in the public sector. Naturally if the rate of growth declines the need for many forms of public investment also declines, for example in transport or electricity generation. At the same time the growth in public programmes to deal with the effects of the recession has put pressure on all the other parts of the public sector given the need to constrain public expenditure as a whole.

But the numbers I am talking about when I refer to public capital expenditure have to be understood for what they are. And what they are is not altogether what they may seem. First of all what is meant by "capital" spending in the public sector differs from capital spending as it is understood in commercial accounting. Ignoring these differences can be misleading both about the amount of public sector investment which is actually going on and about the merits and demerits of different types of spending. For example, virtually all expenditure on defence is classified, by United Nations convention, as current expenditure. The tanker built in one berth for BP scores as capital expenditure; its neighbour in the next berth built for the Navy counts as current. With a defence equipment programme running at about £7 billion a year this makes quite a lot of difference to the figures; and it even makes a difference to the trend, because defence has been increasing as a proportion of public expenditure since 1979.

We must also remember that the figures for public sector capital expenditure are expressed net of certain asset sales. Sales of council houses, for instance, reduced the overall capital spending figure last year by over £2 billion. Some of the published aggregates are reduced also by the proceeds of the privatisation programme.

An even more potent source of misunderstanding is that public sector capital expenditure as defined in the White Paper does not include capital spending by the nationalised industries. Borrowing by the industries counts as public expenditure, but capital spending financed by own resources does not. So when you hear the statement that capital spending has fallen in relation to current in the public sector this tells you nothing about the fate of railway electrification plans, investment in water and sewerage facilities or power station building.

Ian MacGregor

In fact nationalised industry investment, adjusted for privatisation and certain changes in accounting treatment, has increased by around 43 per cent since 1979-80 which means that it has been broadly maintained in real terms. If this year's plans are fulfilled investment will increase by a further 12 per cent over last year's outturn, an increase in real terms. In the past, nationalised industries have underspent their investment allocation - by about £900m in 1981-82 and by over £1 bn. last year - but the prospect this year is that they will spend closer to target.

I think I have already said enough to demonstrate that public capital expenditure is not all of a piece, and that when we speak of the trend in capital spending in relation to current we need to be very careful about the definition of the totals we are talking about. We also need to be aware of the very different character of different investment programmes within the public sector. An investment programme such as the present one on prison building has no easily measurable return. That does not make it any the less important but it does make it different in kind from an investment in, say, new aircraft by British Airways where fairly precise calculations can be made about the expected rate of return.

Public investment in hospitals and schools also produces a social return which cannot easily be measured, but here the notion of an economic return - in terms of fitness for work or of training - is more realistic. Investment in infrastructure such as roads and sewers produces a very clear economic return. But still it is not simple to measure since the goods are provided free at the point of use and the return cannot be measured directly in terms of what consumers are prepared to pay. Finally there is investment by the public trading sector where the returns on investment in a new telephone exchange or the exploitation of a new coalfield can be measured in terms of what people pay for the goods or services produced as a result. So there is a range of different types of investment, stretching if you like from prisons to post vans, which are very different.

In assessing investment plans over this wide range of different types of capital project can we simply operate on the formula: capital spending good; current spending bad? Of course we cannot. Capital investment is only desirable if it produces a worthwhile return. Post Office chairman Ron Dearing made that point at the CBI Conference in Glasgow last week. But with a sizeable part of public sector capital spending the worthwhileness of the investment is not easy to measure. The choices to be made are more political than economic. In these cases the economic virtue of productive investment, the belief that a sensible Government should hoard the seed corn rather than spend it, is rather difficult to establish.

[illegible]

Where we can measure the return the history of past investment decisions in the public sector is far from reassuring. We all know of striking examples: Power stations are built but not used, oil rig facilities constructed which never build oil rigs. In

[illegible]

aggregate - and I stress in aggregate - the nationalised industries have not earned an adequate rate of return for many years. Given the lamentable outcome of so may plausible investment proposals over the years the Government is right to examine new proposals rigorously and with healthy scepticism.

That scepticism is properly reinforced by the discipline of having to finance the expenditure once decisions are made. Under any government extra capital spending can only be financed in three ways by extra taxation, by savings on current spending, or by higher borrowing.

I need not emphasise how unattractive the first route is to this Government. We are determined to reduce taxes during this Parliament in order to foster the enterprise and initiative in the private sector which is vital to the nation's future.

The second route - cuts in current spending - has more appeal at least in principle. But the Government cannot rest on the principle; it has to look at each programme in detail and decide where economies are to be made. In certain areas we have made great progress for example in reducing the size of the Civil Service to its lowest total since the War. We will certainly keep up the pressure. But don't let us fool ourselves - there are no easy options. Education, health, social security, defence, law and order - just to list the main areas of spending is enough to bring home the difficulties involved in retrenchment. And don't think that these are merely 'political' in a pejorative sense and that a strong government should sweep them aside. It is by no means clear, for example, that spending on hospital building is always a better use of money than spending directly on staff and services. Moreover in many fields higher capital spending brings higher current expenditure in its train.

But, say the protagonists of more public investment, companies borrow to invest, why should not the Government? The answer is that it can and does do so but in deciding how much it must take account of the effects of its borrowing on the private sector. Under a policy designed to prevent a resurgence of inflation, every extra £100m. borrowed by the Government is liable to raise the cost of borrowing for the private sector. And, as I have said, the record is not reassuring that the Government and the nationalised industries are better at picking winners than the private sector. Exactly by how much extra Government borrowing drives up the cost of all borrowing is a matter for ~~discussion~~. debate As I said at the start, I do not propose to discuss this central issue of macroeconomic policy here. I would say only that in the end the Government has to make a judgement on the appropriate level of borrowing. Our judgements on this are clearly set out in the Medium Term Financial Strategy.

I wish to deal finally with another suggestion which will doubtless be made today. Cannot, public sector investment projects compete on equal terms for finance with the private sector, funding their requirements direct from the market outside the PSBR? Ingenious minds have looked at many possible ways of doing this, but I am afraid that no-one has yet solved the fundamental problems. The NEDO Working Party which examined joint financing during the last Parliament identified two important conditions of fair competition with the private sector

Investors should not be offered a greater degree of security than that available on private sector projects. Secondly, such schemes should yield benefits in terms of improved efficiency. and profit from additional investment commensurate with the extra costs of raising risk capital from financial markets. But with the taxpayer standing behind them - whether explicitly or not - it is difficult to see how the Government or the nationalised industries can borrow on level terms with the private sect What we do not want to see is bureaucratic investment decisions funded at the expense of market investment decisions. Nor, on the other hand, do we want public investment financed unnecessarily expensively.

By far the best solution is to transfer, so far as possible, these investment decisions from public sector to private sector by privatising the industries concerned. Capital spending decisions can then be taken under the same disciplines as the private sector where there are penalties for failure and rewards for success. This, I suspect, is not the solution which many of those urging the virtues of higher public sector investment envisage. It is, however, the solution, where it can be applied, which will produce the most efficient allocation of resources for investment in the economy as a whole and will do this at the lowest level of interest rates consistent with the Government's objectives for inflation. For one thing is clear: this Government will not finance an investment programme at the expense of its policies for sound money.

AT.

72 17A

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FROM: M T FOLGER
16 November 1983

1983 AUTUMN STATEMENT BRIEFING: FINAL VERSION

I attach the final version of thebriefing for tomorrow's statement. This supersedes all previous drafts which should now be destroyed.

M T FOLGER

5 L.

Distribution list for briefing attached to Mr Folger's 16 November submission to the Chancellor

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PS/Chancellor of the Duchy of Lancaster

PS/Governor, Bank of England

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NOVEMBER 1983 AUTUMN STATEMENT: BRIEFING

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A1 KEY POINTS AND SUMMARY

This brief is divided into the following sections:

I KEY POINTS

1. 1984-85 Total of Public Spending Plans Held to £126.4 Billion Previously Published. The Government has again succeeded in stopping plans creeping up. Essential part of the Medium Term Financial Strategy to keep inflation under control and set conditions for sustainable economic growth. Public spending as percentage of GDP expected to fall back further in 1984-85, to 42 per cent, continuing downward path since 1981-82 peak of 44 per cent.

2. Forecast shows economic growth of about 3 per cent for both 1983 and 1984. Recovery in output which began in 1981 will continue into 1984. And this consistently with inflation edging down: 12 month figure for RPI expected to be about 4½ per cent by end 1984.

3. Possibly less room for maneouvre now on fiscal policy for 1984-85. So net reduction in tax burden in 1984 Budget now less likely. Current forecast (highly uncertain) is that there may need to be a small net increase in taxes, of £½ billion. But picture could change a good deal by the Spring. Fruitless to speculate now on 1984 Budget judgment.

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II SUMMARY OF EXPENDITURE AND CHANGES IN NATIONAL INSURANCE

		Change in 1984-85 £ million
Public expenditure		
Public Expenditure Planning Total		
- in 1983 PEWP (Cmnd 8789)	126,400	
- 1983 PEWP with Budget changes etc	127,100	
- as now announced	126,400	
- net charge since Cmnd 8789		nil
National Insurance Contributions		
Additional revenue to Fund from increases in earnings limits		150
National Insurance Surcharge		
Additional tax revenue from increases in earnings limits		10

III INDUSTRY ACT FORECAST (see also brief B3)

	1983 on 1982	1984 on 1983
(i) Output		
GDP (% change)		
- 1983 Budget Forecast	2	$2\frac{1}{2}$*
- Autumn IAF	3	3

*first half to first half

Points to make

(a) UK output has been growing at about $2\frac{1}{2}$ per cent a year since low point in first half of 1981. Initially led (as in past recoveries) by consumer spending; increasing future contribution expected from investment and exports. So recovery becoming more broadly based. Note that total investment has already increased 7 per cent between 1981 first half and 1983 first half.

(b) Recovery in output since early 1981: steady and soundly based; views of the more pessimistic commentators on 1981 Budget and since are now seen to be without foundation. Recovery has come without artificial fiscal stimulus.

(c) Recovery stronger than rest of Europe.

(d) Recovery in UK since 1981 has come despite disappointing performance in rest of world. Better prospects for UK now that world is showing signs of recovery.

(e) Current account of balance of payments to remain broadly in balance.

(ii) Inflation

	1983Q4 on 1982Q4	1984Q2 on 1983Q2	1984Q4 on 1983Q4
RPI (% increase)			
1983 Budget Forecast	6	6	Not forecast
Autumn IAF	5	$5\frac{1}{2}$*	$4\frac{1}{2}$

*(the assumption for May 1984 given to Government Actuary)

Points to make

(a) 1983 again likely to see inflation in UK below previous forecast. Now forecasting further decrease to below 5 per cent by the end of 1984. Inflation rate lowest since 1960s.

(b) Good news for consumers and business, and the right background for further progress on interest rates. Interest rates already 7 percentage points below 1981 peak.

(c) Clear success in breaking inflationary expectations. An important condition for achieving sustainable growth. Ultimate aim is stable prices; shows Government determination to end problem of inflation

(iii) Unemployment

No government has published forecasts for unemployment. Government Actuary has been instructed to adopt working assumption of average level of 2.85 million for both 1983-84 and 1984-85 (GB excluding school leavers etc)

Points to make

(a) Unemployment may now be levelling off (see para 1.38 of the AS). Underlying increase in 6 months to October averaged 9000 per month compared with 28,000 per month in previous six months.

(b) Outside manufacturing (which is about 25 per cent of total employment) there has already been some increase in employment.

(c) Second quarter of this year saw estimated 18,000 increase in employed labour force (employees and self-employed) the first for four years. Vacancies rising.

(d) Most effective contribution towards lower unemployment will be lower inflation and continued deceleration in pay settlements.

IV PUBLIC FINANCES (see briefs A2, C1)

	£ billion 1983-84	1984-85	
PSBR			
1983 Budget	8	8	(as indicated in MTFS, after fiscal adjustment + ½)
Autumn IAF	10	8	(as indicated in MTFS, but now implying fiscal adjustment -½)

Points to make

(a) Figures take account of measures announced in AS and assume conventional revalorisation of direct taxes and specific duties by 5 per cent. For further discussion see brief A2.

(b) No simple reason for £1 billion deterioration in 1984-85 fiscal outlook since Budget FSBR:

- General government receipts up £½ billion to £137½ billion.
- General government expenditure up £1½ billion to £146½ billion. Reflects less central government underspending than previously expected, new estimates of demand-determined programmes and higher interest payments consequent on increased borrowing in previous years.
- Note how small changes have been in relation to big flows on both sides of account. Present assessment subject to error (average error from previous forecasts is £5 billion on autumn forecasts of PSBR for following financial year).

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A1 Cont.

V PUBLIC EXPENDITURE AND MANPOWER (see briefs E1, E2)

(i) Public Expenditure (£ billion)

	1983-84	1984-85
Planning total (cash)	119.8	126.4
Cost terms	114.1	114.6
(percentage of GDP)	(42 ½)	(42)

Points to make

(a) Spending in 1984-85 and 1985-86 to be held to planned figures in last PEWP (Cmnd 8789); and for 1986-87 to about same level in real terms; ie keeping to totals on which Election was fought.

(b) Intend to maintain firm control of public spending.

(c) Capital expenditure. Too early to give figures: no current/capital breakdown by programme will be available until PEWP.

(d) RPI implications of economic pricing policy for energy are small and have been taken fully into account in Industry Act Forecast (see brief F3). ~~[Other public spending decisions have not implications for RPI.]~~

(ii) Manpower

	1984	1985	1986	1987	1988
Target (thou)	630	608	605	601	593

NB Figures will be published in a written PQ reply on 17 November and not given in the Statement itself.

Points to make

(a) 14 per cent reduction in Civil Service will be achieved by April 1984. Total will then be 630,000, down from 732,000 in 1979. Have already achieved smallest Civil Service since WWII.

(b) Programme 1984-88 will be further reduction of 6 per cent taking numbers down from 630,000 to 593,000.

(c) During 1984-85 numbers will be reduced by 22,000 (3.5 per cent); of this 18,500 is because of change of status of Royal Ordnance Factories to Companies Act Company.

(d) Manpower figures for later years take into account spending plans to 1986-87, which will be published in the PEWP, once finalised.

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VI **NATIONAL INSURANCE CONTRIBUTIONS AND NATIONAL INSURANCE SURCHARGE** (see briefs D1, D2)

(i) NIC

	1983-84	1984-85
Lower earnings limit £ per week	32.50	34
Upper earnings limit £ per week	235	250
Treasury Supplement	13%	11%
Class I standard rates of contribution:		
employee	9%	9%
employer	10.45%	10.45%

Points to make

(a) No increase in contribution rates for employees or employers.

(b) LEL being increased, as required by statute, in line with pension uprating.

(c) UEL rising broadly in line with earnings. Right that contributions should rise so that better off contribute appropriately to growing benefit expenditure.

(d) UEL remains within statutory boundary of between 6½ and 7½ times LEL ~~(and in fact UEL ratio falls from 7.35 to 7.25 times the LEL)~~.

(e) No deficit on Fund, no need to raise contribution rates.

(f) (if pressed). Increase in UEL will raise subsequent entitlements to pensions ~~and benefits.~~

(g) Reduction in Treasury Supplement stabilises projected balance in the Fund, which would otherwise rise. Helps to contain shift to taxpayer of overall burden of benefit expenditure. (Non-contributory benefits, financed by taxpayers and not through Fund, have been growing fast.)

(ii) NIS

Since 1982 Government has reduced NIS rate from 3½ per cent to 1 per cent (worth about £2 billion a year to private sector). Would like to go further, but not prepared to take risks on borrowing, with the implications of that for interest rates. (Increase in UEL leads to small (£10 million) increase in NIS payments. Regrettable but unavoidable.)

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A1 Cont.

VII IMPLICATIONS FOR BUSINESS (see also D1, D2, F3)

Points to make

(a) Changes in limits within which NIC and NIS are paid in 1984-85 will raise private sector employers' liabilities by only some £90 million. This minor change and should be compared with the way in which NIS has been cut and business largely protected from NIC increases in recent years.

(b) NIS payments by private sector now running £2 billion a year lower as a result of previous cuts in rate. Since 1979 employee NIC has risen by 2½ percentage points, whereas employer NIC has risen by only 0.45 percentage points.

(c) 1984-85 payments of NIC by employers are projected to rise, by some £620 million, reflecting assumed increase in earnings. But this is in effect only "indexation" of employer payments. Total contribution from employees also goes up as earnings increase.

(d) Government intends to stick to Medium Term Financial Strategy for reduction of public borrowing and progressive restraint of monetary growth. Offers best prospect for continuing reduction of inflation, increasing profits and sustainable increase in output and employment.

(e) Looking ahead to 1984, economic prospects for industry are encouraging. Increase in exports and home demand expected to sustain recent increase in profits and lead to 3 per cent increase in GDP over 1983. This follows expected 3 per cent increase in GDP 1983 over 1982. Investment expected to increase, with total fixed investment (economy-wide) rising 4 per cent.

(f) Nationalised energy industries will keep to "economic pricing". No "tax" on industry arises from decisions on 1984-85 EFLs.

VII IMPLICATIONS FOR PERSONS

Points to make

(a) Living standards and tax burden will depend on progress of the economic recovery and tax decisions in 1984 Budget. Most employees unaffected by the NIC changes.

(b) Increase in NIC payments (through higher UEL) only affects on those on high earnings (over £12,00 per year). Reasonable that those in work should support those not. Maximum increase in NIC payments is £1.35 per week.

(c) Public spending decisions, affect different groups in different ways. Not possible to standardise for "average effect."

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A2 AUTUMN STATEMENT IN RELATION TO THE BUDGET

1. General

(i) The Autumn Statement this year again brings together a number of announcements which fall to be made in the autumn. It is not an occasion for a general restatement or updating of the economic strategy, which is primarily for the Budget. But it does allow the public spending plans for the year ahead to be set in the context of a fresh economic forecast.

(ii) The 1983-84 borrowing figures and the fiscal prospect for 1984-85 are likely this year to attract particular attention. However the large margin of error and the limited role of the Autumn Statement in relation to the Budget need to be kept in mind.

(iii) Monetary developments are discussed in Brief C2.

2. 1983-84 PSBR

1983 Budget forecast	£8 billion (2¾% GDP)
1983 AS forecast	£10 billion (3¼% GDP)

Reasons for change in the forecast

Higher expenditure, despite July 7 measures, arising from lower than expected shortfall and higher service of the national debt, as well as more overspending by LAs. Receipts slightly down (higher North Sea receipts being offset by lower customs taxes, LA rates, etc).

Line to take

(i) The forecast PSBR is higher than we would have liked, though the July 7 measures will have helped to reduce it.

(ii) As always, there is a wide margin of error around the PSBR forecasts, and the eventual outturn could well be different from the figure being published.

(iii) The higher forecast reflects in part some of the same factors that accounted for the late surge in last year's public expenditure - ie reduced shortfall on central government programmes and higher borrowing by local authorities.

(iv) Although the PSBR is forecast to be higher than originally expected, growth in the monetary target aggregates has moderated since earlier in the year. Other indicators suggest monetary conditions consistent with policy. [See brief C2 on monetary conditions.]

(v) The important thing is to keep the trend of borrowing moving down over a period of years; that matters more than the outturn for any individual year.

(vi) Note continuing progress on inflation (12 month rate now about 5 per cent, compared with 7 per cent a year ago) and interest rates (bank base rates down 2 points this year). Government maintaining firm financial policies and objectives of progressive reduction of public borrowing over medium term.

3. 1984-85 PSBR

Forecast incorporates the assumption in the 1983 MTFS of a PSBR next year of £8 billion or 2½ per cent GDP. At the time of the Budget this was expected to allow a positive fiscal adjustment of £½ billion. It is now expected to require a negative fiscal adjustment - net increase in tax in real terms - of £½ billion. (Figures already take into account 5 per cent revalorisation of personal allowances and specific duties.)

Reasons for change in the forecast

Much the same as in 1983-84. Higher expenditure due to lower estimate of underspending, higher interest payments (itself in part a reflection of higher than forecast levels of borrowing in 1982-83 and 1983-84). Receipts in total little changed (higher N Sea taxes; lower customs taxes + LA rates).

Line to take

(i) Much too early to say what 1984 Budget will contain, but will need to look at AS alongside Budget measures in assessing fiscal position for 1984-85.

(ii) Prospects for borrowing, and hence size and direction of implied fiscal adjustment, affected by uncertainties on both sides of account. Present forecast suggests that net reduction in the tax burden next year now less likely, and that some increase may be necessary. But

(iii) Note that even though the forecast already includes the small real terms increase in taxes to bring PSBR projection back to the MTFS path, it still shows a continuing healthy recovery (GDP up about 3 per cent in both 1983-84 and 1984-85) so there is no question of knocking the recovery on the head.

(iv) It is much too early to conclude that taxes will need to rise next year; forecasts can change substantially.

(v) Decisions to be taken - including the MTFS path and the tax decisions - are for the Budget; no point in trying to anticipate them now.

(vi) Important not to see the AS and 1984-85 in isolation, but set in the context of the MTFS, which is designed to reduce inflation and create conditions for sustainable growth of output and employment.

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B1 RECENT DEVELOPMENTS IN UK ECONOMY

Factual

(i) Monetary developments, policy (Brief C2); PSBR (Brief C1); World developments (Brief B2).

(ii) Inflationary pressures remain subdued. Retail price inflation (5 per cent Oct) slightly above Major 6 OECD average (4.5, September) but a little below EC average (7¼, August).

UK, year on year percentage changes.

	1980 on 1979	1983 Q1	1983 Q2	1983 Latest Month	
Underlying whole economy average earnings	21	8	7½	7¾	(Sept)
Unit wage costs) whole economy	20.9	3.5	2.5		
) manufacturing	21.5	2.7	3.4	2.8	(3 mths) (to Sept)
Producer output prices	14	5.3	5.6	5.5	(Oct)
RPI	18	4.9	3.8	5	(Oct)

(iii) Basic wage settlements on downward path; average earnings still rising in real terms. In manufacturing, output per head up by around 20 per cent since end 1980, unit wage costs rose only 2½ per cent between 1982 Q3 and 1983 Q3 cost competitiveness improved over 20 per cent between 1981Q1 and 1983Q2 (NB. mostly because sterling fell).

(iv) Profits and finances of companies improved since last year. ICC profits (oil and non-oil) up 25 per cent between 1982 H1 to 1983 H1, after similar rise 1981H1 to 1982H1 (from very low base). ICC's pre-tax real rate of return (excluding North Sea) 4½ per cent in 1982 (4 per cent in 1981); rate for manufacturing 3½ per cent in 1981 and 1982. Over year to mid 1983 ICC's ran financial surplus of over £5 billion, reflecting stock run down in 1982H2 and increase in profits. Net borrowing requirement fallen sharply. ICC's have cut back bank borrowing, increased equity issues and overseas borrowing.

(v) Recovery since 1981 H1 trough has been dominated so far by consumers' expenditure (lower inflation, lower savings ratio, HP relaxations), and stock turnround.

Percentage contributions to growth 1981 H1 to 1983 H1.

Consumers Expenditure	+	Public Consumption	+	Invest-ment	+	Stocks	+	Net Trade	=	GDP(E) growth
+2.5		+1.0		+1.1		+2.7		-2.1		+5.2

Consumers' expenditure up further ½ per cent in Q3. Retail sales three months to October (prov) up 1½ per cent on previous three months and 5½ per cent up on year earlier. Total investment up 7 per cent since 1981 H1. Manufacturing investment increased 2 per cent in Q3. Destocking by manufacturing, distributors in Q3 still provisional, partly associated with high car sales in August.

(vi) Output (GDP(A)) up around 5 per cent from 1981H1 to 1983H1. Growth in UK (GDP(A)) faster than average of major 6 overseas economies 1982H1 to 1983H1. Output of production industries up 2 per cent Q3 on Q2. Most sectors of manufacturing recovered since 1981 Q1, but none yet back to previous peaks. Oil/gas extraction up 32 per cent between 1981 Q1 and 1983 Q3. Construction output remains below 1981 trough. Service sector output less affected by recession, now above previous peak.

(vii) UK current account in estimated surplus of £½ billion in first 9 months of 1983 (cf FSBR forecast £1½ billion for whole year).

(viii) Labour market responding to continued recovery. Service sector employment up over 140,000 in 1983 H1, more than fall in manufacturing employment. Employed labour force rose in 1983 Q2, first time for four years. Adult unemployment (s.a.) fell 10,000 in October to 2.941 million (12.3 per cent). Underlying trend may be levelling out. Vacancies risen steadily since mid-1981; short time working less than a quarter of level two years ago.

(ix) October quarterly CBI Survey of manufacturing showed continued increase in business confidence, expectation of increased output with little upward pressure on prices. Investment expected to increase 5 per cent during 1984.

(x) CSO cyclical indicators (to September) point to continued recovery into 1984 [NB. New figures released 18 November; given uncertainties, best not to stress existing figures].

Positive

(i) Inflation now below EC average, but still well above Germany (2.6 per cent) and Japan (0.7 per cent) who are important competitors.

(ii) Recovery firmly underway; on latest CSO figures (11 November) GDP(A) growing 2½ per cent a year since 1981H1.

(iii) GDP growth over year to 1983 H1 faster than average of major six overseas economies.

(iv) Labour market conditions improving; service sector employment rising, vacancies up, underlying unemployment may be levelling out.

Defensive

(i) Recovery faltering, too narrowly based?

Pace of recovery consistent; GDP(A) up 2½-3 per cent in year to 1983 H1, after 2 per cent rise in previous year. Quite usual for consumers' expenditure to take leading role in early stages of recovery. Indications are that increasingly broad based recovery will continue - CBI see 5 per cent increase in manufacturing investment in 1984. Institute of Directors see recovery 'firmly in progress'.

(ii) But why isn't unemployment falling?

Unemployment always responds to activity with a lag. Underlying adult unemployment may be levelling out. Employment has increased in many industries (service sector + 144,000 in 1983 H1), and vacancies have risen steadily since mid-1981.

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(iii) Government should act to strengthen, sustain recovery?

Under powerful influences of lower inflation, lower interest rates signs are that recovery will continue into 1984. No shortage of demand. Government will maintain firm monetary, fiscal policies - only viable policy for sustainable non-inflationary growth, and will encourage efficiency and enterprise.

(iv) Follow US example and reflate?

If US recovery to prove durable and not to be dissipated in rising inflation and interest rates, US budget deficit will need to be curbed. US Administration committed to achieving that.

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B2 RECENT DEVELOPMENTS IN THE WORLD ECONOMY

Factual

(i) World trade and output fell last year. Output rose in all major economies in first half 1983. US GNP is estimated to have risen about 4¾ per cent since end 1982 but growth slowed slightly in the third quarter. Recovery in continental Europe more subdued.

(ii) Recovery forecast to continue in 1984. IAF forecasts stronger growth next year, sees world trade and UK markets continuing to recover. Overall GNP in 6 major industrial economies expected to rise 3½ per cent, following 2½ per cent this year.

(iii) Unemployment in major European countries has stabilised recently; it continues to fall in North America. For 1984 OECD expect unemployment in US to continue to fall, but further though slower rise in Europe.

(iv) Consumer price inflation in major countries declined from 12 per cent in 1980 to about 4 per cent in year to September. Depressed demand led to lower oil prices earlier this year. Non-oil commodity prices have risen from their low point late in 1982. Inflation may pick up slightly through next year but no rapid acceleration expected.

(v) Reduction in short-term interest rates in US last year followed by other countries though to lesser extent. US interest rates rose in summer as Fed tightened policy, reaching nearly 10 per cent in August. Since then interest rates have eased back slightly. Rates in Japan also fallen recently, but rates in Germany have risen.

(vi) Exchange rates remain volatile. Dollar strengthened until August reaching new highs against European currencies. It then weakened slightly, particularly against the DM and yen, but has strengthened again most recently. Large emerging US trade deficit could put further downward pressure on dollar. Japan's trade surplus and recent US/Japan accord could help strengthen yen.

(vii) Monetary policy complicated by distortions/shifts in velocity. US Fed tightened policy mid year to curb rapid monetary growth. All aggregates now back within target (rebased for M1 and M2). In Europe monetary growth is still towards the top or above target range.

(viii) General government budget deficits forecast by OECD in July to rise to 4½ per cent of GDP this year from 2½ per cent in 1981, partly reflecting low level of activity in major countries and expansionary policies in US, and then fall slightly in 1984. Policy directed towards reducing structural budget deficits in Europe and Japan but not so far in US.

(ix) OECD estimated in July that about half of its members have decided to cut planned expenditure. Many also planning to increase taxes, contributions and charges.

Positive

(i) World recovery now underway helped by lower inflation and interest rates. Firm fiscal and monetary responses to second oil price rise vindicated. As a result prospects for sustainable growth now better than for many years.

(ii) Widespread agreement among forecasters that world recovery will gather momentum next year as growth in Europe and Japan picks up. Inflation is likely to remain moderate.

(iii) Major countries agreed (cf Williamsburg Summit, IMF Interim Committee) on need to maintain counter inflationary policies while reducing growth in public expenditure and curbing budget deficits.

(iv) European Commission's Annual Economic Report shows UK coming out of recession earlier than rest of Community. Forecasts that in 1983 and 1984 UK will be fastest growing EC economy.

Defensive

(i) Tight policies to blame for recession? No. Failure of wages to adjust to tighter policy stance prime cause of profit squeeze, and fall in output and jobs. UK problems move entreached.

(ii) Interest rates too high? Further progress against inflation and lower budget deficits best way to achieve realistic and sustainable reduction in interest rates.

(iii) Fiscal policies ignore recession? Important to reduce medium term structural deficits but should take account of recession in setting pace.

(iv) UK spends less on social security/benefits higher than elsewhere in EC? Many EC countries have greater per capita GDP than UK. Different governments, different priorities.

(v) Inflation will accelerate as activity recovers? Provided major industrialised nations remain firmly committed to prudent economic policies, no reason to expect inflation to accelerate.

(vi) US recovery slowing down? US economy has recovered very strongly this year. Natural that pace of upswing should slow over next few months but recovery expected to continue.

(vii) Rapid US recovery result of bigger budget deficit? Increase in US deficit may have temporary effect on US activity, but recovery also reflects fall in inflation and lower interest rates. Disappointed that Administration and Congress so far failed to agree on ways to reduce budget deficit. If heartening recovery to prove durable and not be dissipated in rising inflation, interest rates, deficit will need to be curbed. US Administration committed to that.

(viii) Gloomy European prospects? European growth expected to be slower than in US or Japan. European prospects best (UK and Germany) where greatest progress has been achieved against inflation and budget deficits.

(ix) Japanese reflation? Different conditions from UK. Inflation very low, savings high.

(x) Excessive exchange rate volatility/US dollar? Market determines exchange rates. Right that major countries should take account of exchange rate in setting policy.

(xi) Debt crisis? Serious problems persist and further difficulties cannot be ruled out. Renewed growth, firm adjustment and adequate finance all necessary to solve debt difficulties. Recent pick up in commodity prices and emerging recovery in OECD will help improve prospects.

(xii) IMF quota increase? UK among first to ratify quota increase. By mid-November over 70 countries representing about 4.0 per cent of quotas had ratified. Concerned that Congress not yet agreed to ratify increase in US's quota but President has pledged his support.

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(xiii) Need for international monetary reform? Welcome decision by industrial countries' finance ministers to carry out further work to identify where improvements in international monetary system might be sought. Must recognise, however, that inflationary policies led to breakdown of original Bretton Woods arrangements. Prudent policies offer best prospects for stable and durable system.

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B3 INDUSTRY ACT FORECAST - SHORT TERM ECONOMIC PROSPECTS

Factual

(i) The Industry Act Forecast shows projections of GDP, manufacturing output, prices and the current account for the whole of 1984. It thus updates the FSBR forecast and extends it by a half-year. Attached table summarises latest forecast.

(ii) Main features of forecast.

(a) Underlying inflation likely to remain on downward path: year on year increase in RPI forecast at 5 per cent at end-1983 and 4½ per cent at end-1984. (IAF suggests temporary rise in first half 1984 as in assumption given to Government Actuary for year to May 1984 of 5½ per cent.)

(b) Total output expected to grow around 3 per cent 1984 on 1983. This follows expected 3 per cent rise 1983 on 1982, which is somewhat faster than envisaged at Budget time. [FSBR said 2 per cent 1983 on 1982.]

(c) Manufacturing output also forecast to rise by nearly 3 per cent in 1984.

(d) With prices tending to rise faster than costs, profitability expected to improve.

(e) Exports forecast to increase 4 per cent 1984, compared with ½ per cent 1983. Imports projected to grow 5 per cent in each year. Current account of balance of payments to show small surplus, £½ billion, in 1983 and to be in balance in 1984.

(f) All components of expenditure rise in 1983: growth in consumers expenditure particularly strong, 3½ per cent. Balance of demand expected to change in 1984. Consumers expenditure to rise at slower rate (2½ per cent) while exports (4 per cent) and fixed investment (4 per cent) expected to rise faster, ie recovery expected to become more broadly based. Total domestic demand to rise 3 per cent in 1984.

(g) PSBR for 1983-84 now expected to be around £10 billion, 3¼ per cent of GDP (see brief C1). For 1984-85, PSBR and monetary policy consistent with indications of MTFS.

(h) GDP in major 6 OECD countries expected to grow by 2½ per cent in 1983 and 3½ per cent in 1984. This follows a ½ per cent fall in 1982.

(i) World trade in manufactures (UK weighted) estimated to have fallen 3 per cent in 1982 and 1 per cent in 1983. Forecast to increase by 5 per cent in 1984.

(j) IAF does not provide explicit forecasts of pay or unemployment but mentions general factors in text (see Defensive (i) and (iv) below).

(k) the IAF assumes effective exchange rate to vary little from the average of the first three quarters of 1983.

(iii) IAF foresees faster growth (3 per cent) in 1983 than Budget FSBR forecast (2 per cent). Inflation at end-1983 now likely to be lower (at 5 per cent) than predicted in FSBR (6 per cent).

(iv) Summary of outside forecasters' views shown in Brief B4.

Positive

(i) Total output in 1983 put at 3 per cent above 1982 level. Similar increase now foreseen for 1984.

(ii) Performance on inflation again seen to be better than previous forecast. And inflation expected to be reduced further by end-1984.

(iii) Given fall in world trade, exports did relatively well in 1982. Although export performance was less good in 1983, forecast to rise by 4 per cent in 1984.

(iv) Higher exports and increased investment (4 per cent increase forecast for 1984) will make recovery more broadly-based.

Defensive

(i) Outlook for unemployment bleak? Following practice of all previous governments no forecast of unemployment given but IAF test says "unemployment may be levelling off" and "forecast is for employment to rise". Working assumptions to 1984-85 given to Government Actuary. Assumptions for later years will be in PEWP.

Underlying rise in unemployment average of 9,000 a month in 6 months to October, compared with 28,000 a month in preceding 6 months. Fall in employment appears to be coming to an end (making allowance for self-employed, total employed labour force estimated to have risen 18,000 in Q2 1983). Together with recent monthly movements in unemployment, vacancies and hours worked, this suggests unemployment may now be levelling off.

(ii) Manufacturing sector still weak. Manufacturing output has recovered more slowly than total output though now 2½ per cent higher than at trough in early 1981. But with healthy growth in demand in prospect manufacturing production expected to rise at least at same rate as rest of the economy in 1984.

(iii) Total output still below peak levels in second quarter of 1979. Total GDP rather erratic in first two quarters of 1983. But average measure of GDP in first half of 1983 now higher than in first half of 1979. Since trough of recession (first half 1981) output has grown by 2½ per cent a year on latest CSO revised figures (see vii).

(iv) Earnings growth to rise again. IAF text suggests for next year "there should not be a reversal of the downward trend of earnings growth".

(v) Further 2½ per cent growth of consumers' expenditure in 1984 unrealistic. Is perfectly realistic. Real incomes of those in work will be rising. And saving ratio still coming down as inflationary expectations recede.

(vi) CBI business optimism deteriorating. Business optimism rose in October (if not as much as in July). Other CBI indicators also point to higher confidence about future. In October Quarterly Survey output and demand expectations rose further and investment intentions point to 5 per cent increase in manufacturing investment in 1984.

(vii) CSO downward revisions to GDP figures for first half 1983 (announced 11 November) were taken fully into account in this forecast. They affect the first half year only and 1983 as a whole expected to show growth of about 3 per cent.

(viii) Misleading to use GDP "average" measure, GDP "output" measures more reliable. No. Although output measure generally preferred as a guide to quarter by quarter movements, average measure usually more reliable for longer periods of a year or so, with which IAF is concerned.

(ix) Real interest rates too high - will choke of recovery. Worldwide, real interest rates are too high - as Chancellor said at Mansion House. But in our economy we nevertheless expect 3 per cent growth in 1984, reflecting rising exports and final home demand together with improving company sector finances and low inflation.

(x) Resumption of heavy destocking in third quarter 1983. [Provisional figures for Q3, to be published on Thursday 17 November, show destocking of £400 million (1980 prices) by manufacturers and £270 million by distributors. Manuacturers destocking was mainly of cars and of materials and fuel.] Third quarter stockbuilding figures were taken fully into account in forecast. The figures include substantial destocking of cars, a natural consequence of very high car sales in August. Quarterly movements in stocks are frequently erratic. Other indicators, notably the healthy financial surplus of Industrial and Commercial companies recorded for the first half of 1983 and recent CBI Surveys, continue to suggest little pressure on firms for further substantial reductions in stock levels.

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The Prospects: summary

Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(¹)

		Percentage changes		
		1982 to 1983	1983 to 1984	Average errors(²) from past forecasts
A	Output and expenditure at constant 1980 prices			
	Gross domestic product (at factor cost)	3	3	1
	Consumers' expenditure	3½	2½	1
	General government current expenditure	2½	1	1½
	Fixed investment	2½	4	2½
	Exports of goods and services	½	4	3
	Change in rate of stock-building as a percentage of the level of GDP	1	½	1
	Imports of goods and services	5	5	3
		1983	1984	
B	Balance of payments on current account (£ billion)	½	0	3
C	Retail prices index (4th quarter)	5	4½	3(³)

(¹) The forecast includes the effect of the fiscal adjustment in 1984–85.

(²) The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on Government forecasts, notably in the Economic Progress Report, June 1981. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast.

(³) The average error for inflation was calculated from a period of much higher inflation and probably overstates the margin of error at low rates of inflation.

B4 OUTSIDE FORECASTS (see summary table attached)

1. WORLD ECONOMY

(i) Economic recovery continues in the OECD area bolstered by strong GNP growth in USA. Real GNP growth (OECD) rises from 2-2¼ per cent this year to 3-3½ per cent in 1984 (despite uncertainties over US deficit, international debt problems).

(ii) World trade outlook for 1984 more encouraging; after little or no growth this year, is expected to show some growth in 1984. Forecasts for 1984 vary: P&D expect 2¼ per cent growth (reflecting little or no contribution from non-oil LDC's and OPEC to world trade). Others such as NIESR and LBS expect stronger growth of 4-4½ per cent in 1984, reflecting higher OECD activity rates.

(iii) World consumer price inflation rises gradually from 5-5½ per cent this year to 6½-7 per cent next year (rise in non-oil commodity prices partially offset by low increases in unit labour costs).

2. FINANCIAL CONDITIONS

(i) Monetary and fiscal policies assumed to remain in line with MTFS guidelines although some groups point to danger of upward pressure on public expenditure.

(ii) Some expect 1983-84 PSBR of £9-9½ billion though decreasing to £8-8½ billion for 1984-85 (reflecting, in part, increase in public sector asset sales).

(iii) Many forecasters expect recent more moderate growth in the main monetary aggregates - £M3, M1 and PSL2 - will continue, bringing 1983-84 outturn close to top end of 7-11 per cent target range.

(iv) Most see gradual downturn in short-term interest rates from 9½ per cent to about 8½ per cent in 1984.

(v) Effective exchange rate lies between 83 and 85 by end of year, depreciating to 79-81 end-1984 (reflecting worsening current account).

(vi) Concern about public spending affects judgements on 1984 Budget, with some groups expecting little or no scope for tax cuts, apart from indexation of income tax allowances and specific duties.

3. INFLATION AND AVERAGE EARNINGS

(i) Retail price inflation rises gradually from 5½ per cent (1983 Q4) to 6¾ per cent by 1983 Q4. Some groups (LBS, Phillips and Drew) see inflation peaking early next year and slowing slightly thereafter. However LBS forecast inflation to accelerate to 7½ per cent in 1987, reflecting forecast pick-up in world inflation. Import prices may rise slightly next year, reflecting increases in commodity prices, but expected to remain low in relation to domestic costs.

(ii) Earnings expected to rise 7-8 per cent in 1983-84 payround, a little more than in 1982-83, partly reflecting higher price inflation and improving company profitability.

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4. COMPANY SECTOR FINANCE

Further growth (about 15 per cent) in ICC's profits expected 1984, reflecting higher level of activity. Improvement in profit margins also expected to continue, reflecting low unit labour costs and modest increases in raw material and fuel prices.

5. OUTPUT

GDP growth put in range 1¾-2½ per cent for 1983 and 1984 though some groups expect recovery to weaken a little in 1984, mainly reflecting slowdown in consumption.

6. DEMAND

(i) General agreement that consumer spending will rise less strongly during 1984. Real disposable incomes unlikely to change much. Rising inflation and higher level of consumer indebtedness suggest that further significant reductions in the savings ratio, a major contribution to recent growth in consumer spending, are unlikely.

(ii) Pattern of domestic demand is expected to change as growth of consumer spending weakens. Restocking continues (though contributing less to GDP growth in 1984 than in 1983) and fixed investment, particularly private sector investment, picks up.

7. OVERSEAS TRADE

(i) Most groups expect export volumes to grow 3½-4 per cent in 1984, reflecting quicker pace of world recovery. Import volumes are seen as rising more slowly in 1984 than in 1983 (3-4 and 5½-6 per cent), partly reflecting the weaker contribution of stockbuilding and consumer spending to recovery in domestic demand.

(ii) Balance of payments current account is generally expected to show a surplus of £½-1 billion this year. Views about 1984 differ - some (S&C) see current account improving, reflecting effect of gains in competitiveness on UK exports. Others (P&D) see deterioration in current account in 1984, reflecting a worsening in terms of trade.

9. UNEMPLOYMENT

Some groups (LBS, P&D) expect unemployment to peak early next year and decline slowly thereafter. Others see a continually rising trend. In medium term LBS expect 2.8 million 1987 while Cambridge expect 4.4 million 1990.

Positive

(1) Most major groups expect inflationary pressures to remain subdued next year.

(2) Current account generally remains in surplus next year.

(3) Interest rates expected to be ½-1 per cent lower next year.

(4) More groups expect the MTFS guidelines to be ahered to. Growth of the main monetary aggregates is expected to remain within 7-11 per cent target range.

<u>Defensive</u>

(i) <u>Growth peters out next year</u>? Many forecasts have yet to take on board the effects of rebasing the National Income statistics to 1980, which shows the recovery to have been stronger than previously thought. LBS expect sustained recovery of 2-2½ per cent in 1984 and 1985. Exports and private investment provide stimulus to growth in 1984.

(ii) <u>Unemployment to increase</u>? Unemployment forecasts subject to wide margins of error and uncertainty. No government has made forecasts. Most outside assessments expect slower rate of increase in 1984 while some expect a gradual fall.

(iii) <u>Inflation set to accelerate</u>? No. Most groups expect only a gradual rise, remaining under 7 per cent in 1984.

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SUMMARY OF OUTSIDE FORECASTS OF KEY INDICATORS

GDP (output)

(percentage change on year earlier)

	Consensus	Range	
1983	2.1	1.8 (LBS, CBI) -	2.4 (Simon & Coates)
1984	1.9	1.7 (NIESR) -	2.4 (LBS)

Note: On the expenditure measure of GDP, Liverpool are at to top end of the range in both years with 3½ per cent in 1983 and 3¼ per cent in 1984.

Retail Price Inflation

(Percentage change on year earlier)

	Consensus	Range	
1983 Q4	5.5	5.4 (Phillips & Drew, Henley) -	5.8 (Simon & Coates)
1984 Q4	6.7	6.3 (Phillips & Drew) -	7.5 (NIESR)

Unemployment

(UK adults, sa, millions)

	Consensus	Range	
1983 Q4	3.05	3.0 (Phillips & Drew) -	3.1 (LBS)
1984 Q4	3.12	3.0 (Phillips & Drew) -	3.2 (NIESR, CBI)

Note: Cambridge expect 3.5 million in 1984, but this figure is a yearly average, includes school leavers, and is on the old basis. At the bottom end of the range for 1984 Liverpool expect average of 2.7 million.

PSBR (£ billion)

	Consensus	Range	
1983-84	8.8	7.0 (Liverpool) -	10.0 (Henley)
1984-85	8.7	2.5 (Liverpool) -	10.5 (Henley)

C1 PSBR 1983-84 and 1984-85

Factual

(i) PSBR for 1983-84: outturn in first half of financial year £7 billion (£4¾ billion seasonally adjusted). This is somewhat higher than PSBR for the same period last year: £4½ billion (3¼ seasonally adjusted).

(ii) October PSBR was published on 16 November giving a cumulative PSBR of £7.1 billion for the first seven months of 1983-84.

(iii) PSBR for 1983-84 as a whole now expected to be around £10 billion, 3¼ per cent of GDP, some £2 billion higher than the Budget forecast.

(iv) 1983-84 forecast takes account of measures announced by the Chancellor on 7 July as well as other developments since Budget FSBR. Estimates of both expenditure and revenue have changed. Many factors involved, working in both directions. On central government main ones are higher supply expenditure and interest on extra borrowing incurred in 1982-83 and to date in 1983-84. Higher LABR due mainly to overspending on current account and lower than expected rate income.

[NOTE ON 1983-84 PUBLIC EXPENDITURE PLANNING TOTAL FORECAST OUTTURN: The FSBR put the 1983-84 public spending plans at £120.5 billion inclusive of the contingency reserve. After a shortfall allowance of £1.2 billion the estimated outturn was published as £119.3 billion. The AS plans for 1983-84 are lower, at £119.8 billion. But, because of longfall of £0.5 billion now expected, the estimated outturn is up at £120.3 billion. This is still within the plans implicit at Budget time. - THESE PRECISE DETAILS NOT TO BE REVEALED. Chancellor may well reveal £120.3 billion in rounded terms in the House. See E1 Defensive (iii).]

(v) PSBR for 1984-85 £8 billion, 2½ per cent of GDP. This is after fiscal adjustment of -£½ billion. Fiscal position has thus deteriorated by some £1 billion since Budget.

(vi) A small upward revision to projected 1984-85 receipts (£½ billion) is more than offset by a £1½ billion upward revision to general government expenditure. This is partly due to extra debt interest payments on higher borrowing in 1982-83 and 1983-84 but mainly lower shortfall and higher spending by local authorities.

(vii) PSBR percentages:

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
PSBR as per cent of GDP	4¾	5¾	3½	3¼	3¼	2½

Positive

Government borrowing amongst lowest in industrialised world. Essential to continue progress in getting borrowing down within MTFS framework if interest rates to be reduced further.

Defensive

(i) 1983-84 PSBR out of control?

No, but wide margins of error around PSBR forecasts (average error, from past forecasts is £4-5 billion for year ahead at Budget time). So outturns can differ substantially from plans in short run. Spending and borrowing do seem to be running higher than expected in Budget but have taken steps to bring spending back closer to planned path.

(ii) Why has 1983-84 PSBR forecast increased so much since Budget?

Higher than expected receipts from North Sea taxes have been offset by lower tax receipts elsewhere. Lower than expected underspend of central government expenditure plans in 1982-83 has continued into 1983-84, so total expenditure now expected to be higher. Main increases are on supply expenditure, higher service of the national debt. Local authority budgets indicate that higher local authority borrowing due mainly to current spending above forecast and rate income less than expected.

(iii) Government massaged Budget calculations?

Certainly not. FSBR "latest estimates" for 1982-83 and forecasts for 1983-84 were based on all information available at the time. PSBR, and the public sector transactions underlying it, are notoriously difficult to forecast (average error of previous forecasts is £4-5 billion for year ahead at Budget time).

(iv) 7 July measures not enough to get PSBR back on track?

7 July measures intended to bring spending back closer to the planned path and they have done that. Given margins of error in forecasting the PSBR, it would have been most unwise to do more. The PSBR figure is not a short-run target but a forecast based on information available at the time.

(v) 1984-85 PSBR

Autumn Statement shows a PSBR for 1984-85 of £8 billion, as provided in the MTFS. PSBR for next year will be considered again in the Budget.

(vi) Why has fiscal prospect for 1984-85 deteriorated since Budget?

1984-85 expenditure now forecast to be higher than thought at the time of the Budget because of higher debt interest payments and lower estimate of aggregate shortfall on planned expenditure. Receipts generally are only slightly higher than expected despite much higher receipts from North Sea taxes.

Contact Points:

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Mr P Patterson (EA1)	233-3483	- particularly re 1984-85

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C2 MONETARY AND EXCHANGE RATE DEVELOPMENTS

Factual

(i) Target aggregates, M1, £M3 and PSL2, were within 1982-83 range. Growth accelerated at the beginning of the new target period, but in the last few months there has been a marked slowdown in most measures of money. £M3 is now back within the target range.

% change, seasonally adjusted

Monetary growth to mid October 1983 growth at an annual rate over past:	Target aggregates M1	£M3	PSL2	Mo
3 months	+9.1	+4.7	+8.2	+7.4
8 months (target period)	+12.7	+10.8	+13.1	+6.8
12 months	+11.2	+9.6	+11.9	+6.3

(ii) 1983-84 target range for M1, £M3 and PSL2 is 7-11 per cent.

(iii) UK short-term interest rates have been relatively steady over the year, continuing a gradual decline. Effective exchange rate has also been fairly steady since the election, although there have been larger movements in individual cross rates against DM and $, reflecting movements in those currencies.

	Exchange Rates			Interest Rates		
	£ Effective	£/$	£/DM	UK 3 month interbank	UK 20 year Gilts Yield	3 month Eurodollar
1982 Q4	89.1	1.65	4.13	10.0	10.8	10.0
1983 Q1	80.5	1.53	3.68	11.1	11.3	9.2
Q2	84.3	1.56	3.87	10.2	10.5	9.3
Q3	84.9	1.51	3.99	9.8	10.8	10.0
Oct	83.4	1.50	3.90	9.3	10.6	9.6
Nov 15	84.0	1.48	3.97	9.3	10.2	9.7

(iv) Clearing banks' base rates are now at their lowest level for 5½ years, back to their November 1982 level, and 7 points below October 1981 peak.

May 10 1978	9%
October 1 1981	16%
November 4 1982	9%
January 12 1983	11%
October 4 1983	9%

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(v) Since mid April PSBR has been more than matched by debt sales to non bank private sector, largely as result of exceptionally high sales of gilts.

(vi) Growth in bank lending (especially to companies) has slowed down. (Growth was 14½ per cent to mid-October 1983, compared with 31 per cent in year to mid-October 1982).

(vii) In his 20 October Mansion House speech the Chancellor summarised main points of his recent review of monetary policy:

(a) more attention may be paid to other measures of narrow money - notably Mo - besides M1.

(b) Over the medium term the aim is not to over - or underfund the borrowing requirement.

(c) The exchange rate is still taken into account in interpreting monetary conditions, but there is no target or mechanical formula for it.

Positive

(i) Prompt fiscal action and successful funding have helped to reduce growth of all the main aggregates (see 3 month growth rates); £M3 is now within its target range. Narrow monetary aggregates are growing more slowly (though still a bit faster than they were a year ago).

(ii) Other indicators - the stable exchange rate, falling inflation and inflationary expectations and lower interest rates - support the view that monetary policy is consistent with the Governments' objectives.

(iii) Clearing bank base rates are now at their lowest level for 5½ years, at 9 per cent, 7 points below their last major peak in October 1981.

(iv) High debt sales earlier in the year put us well ahead in funding higher PSBR now expected.

Defensive

A - CHANGES IN MONETARY POLICY

(i) Did Mansion House speech mark big policy shift?

No. Chancellor said he was considering "some changes of emphasis which represent merely a continuing evolution of a well-tried strategy"; changes relate to "technical aspects of operation of monetary policy "only - notably appropriate definition of money. Reference to funding PSBR by "external flows" does not represent any change in HMG's overseas borrowing policy.

(ii) Any change in target aggregates for this year?

No.

(iii) Targets 1984-85. Will be set in Spring. Precise targets will need to take account of structural changes but adjustments will be consistent with maintaining direction of policy. Whichever indicator we choose to emphasise, it is unlikely that it would be appropriate to maintain a single range for both broad and narrow aggregates, since the trend velocity of non-interest-bearing money is quite different from that of

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broad money. But there is nothing unusual about different target ranges for different aggregates - there are a number of examples overseas [eg USA].

(iv) Are you moving towards monetary base control?

No. All that is being considered is using the base as an indicator of narrow money.

(v) What's wrong with M1?

Nature of M1 is changing with rapid growth in interest-bearing deposits (many of which are "wholesale" deposits). Now less likely to respond unambiguously to changes in level of interest rates; and less reliable as measure of transactions balances.

(vi) Why so many M's?

No single monetary indicator has ever given complete picture of monetary conditions. Policy decisions have to be taken with an eye to both the growth of liquidity in the economy - as shown by broader measures like £M3 and PSL2 - and to the amount of money immediately available for current transactions -as shown by the narrower aggregates like M1, MO and notes and coin.

(vii) A special exchange rate - monetary growth index?

No. Role of exchange rate in assessing financial conditions remains unchanged, as the Chancellor explained in his Mansion House speech.

(viii) Should be an exchange rate target?

No. As Chancellor explained in Mansion House Speech, exchange rate can move for reasons unconnected with fundamental developments; its signals as to tightness of policy can therefore be misleading. But right to take account of it as one of range of indicators alongside monetary targets.

(ix) Join EMS exchange rate mechanism?

Possibility kept under review, but no early plans to join. Joining in wrong conditions would be damaging to EMS system as well as to domestic policy. As a major international currency, like the DM, sterling especially exposed to currency market pressures: sterling and other EMS currencies continue to be differently influenced by eg events affecting oil markets, and movements in dollar. In wrong conditions, membership would mean swapping exchange rate instability for interest rate instability, and as CBI have recently recognised this would not be helpful to British industry.

B - CURRENT MONETARY SITUATION

(x) Likely outturn for monetary growth in 1983-84?

Too early to judge, but recent month's figures are encouraging. The public sector contribution, which accounted for the rapid growth around the turn of the financial year, has moderated over recent months; and private sector demand for bank credit is growing much more slowly than a year ago.

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(xi) Monetary growth out of control?

No. Deceleration of recent months has brought £M3 back within target range along with a slowdown in M1 and PSL2. Rapid growth in M1 not unexpected.

(xii) Growth in real money supply excessive?

The rise in real money is largely the consequence of our success in reducing inflation, not due to laxity in nominal monetary growth. Nothing wrong with this: indeed a faster growth in the real value of money is one of the main mechanisms whereby reducing inflation contributes to economic recovery.

(xiii) Slowdown in monetary growth and bank lending to companies suggests faltering in recovery?

No. Recovery is continuing. All that has happened has been deceleration of monetary growth from very high levels in the Spring, bringing monetary aggregates back towards target range, and, in the case of £M3, within it. Slowdown in bank lending reflects improvement in company sector's financial position.

(xiv) Interest rates still too high? Prospects for further cut in rates?

Base rates now back at their lowest level for 5½ years, and 7 points below their peak in October 1981. October fall in rates welcome, but only reliable way to achieve further falls in interest rates is to stand by strategy set out in MTFS for sound financial conditions, low inflation and low PSBR.

(xv) Real interest rates too high - scope for reduction?

Real interest rates are high whilst the economy adjusts to new low level of inflation - just as real interest rates were negative when inflation was accelerating in the 1970s. Real interest rates in the UK are not unusually high by international standards. Now witnessing some fall in real interest rates in developed countries as inflation is brought firmly under control. Best way to securing further reductions is firm control of public sector borrowing here and abroad.

(xvi) Impact of revised PSBR on interest rates?

Have been able to fund PSBR so far this year without undue pressure on rates. Important thing is to keep trend of borrowing moving down over a period of years. That matters more than outturn for any individual year.

(xvii) Exchange rate too high/uncompetitive?

(See (ix) above). No magic way of influencing exchange rate. A lower nominal exchange rate brought about by monetary and fiscal laxity would benefit no-one. Any temporary gain to cost competitiveness would soon be lost in rising inflation. Prospects for growth and jobs would be diminished not improved. Only way to improve competitiveness, as industry has been doing since 1981, is through sensible wage settlements, further gains in productivity and improvements in non-price aspects of competitiveness.

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(xviii) <u>£ should be lower against DM, higher against $</u>?

Certainly not within HMG's power to bring about lower value of $ against DM.

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D1 NATIONAL INSURANCE CONTRIBUTIONS (Detailed questions to DHSS)

Factual

(i) No change in Class 1 (employer and employee) contribution rates.

[Note: Between 1975 and 1979 - period of Labour Government - employees contributions rose 1.0 percentage points and employers by 1.5 percentage points. Between 1979 and 1984 - period of Conservative Government - employees contributions rose by 2.5 percentage points and employers by 0.45 points. When account is taken of NIS changes, employers payments will have fallen from 13.5 per cent in 1979-80 to 11.45 per cent in 1984-85 (contracted-in).]

(ii) Lower earnngs limit (LEL), which sets level at which contributions on earnings become payable, to increase from £32.50 to £34.00; in line with uprating of single person basic retirement pension. (Note once Lower Earnings Limit is reached contributions become payable from first £1 of earnings.)

(iii) Upper earnings limit (UEL), which sets ceiling up to which contributions are levied, to rise from £235 to £250 (in line with assumed increase in earnings). Those earning below £235 and contracted-in pay no more. Those earning above £250 pay maximum addition of £1.35 per week.

(iv) Treasury Supplement will be reduced from 13 per cent to 11 per cent of contributions.

(v) These changes will be implemented by Order.

(vi) Surplus of revenue over expenditure at end year expected to be £200 million; accumulated balance in Fund expected to be £4,480 million. Government Actuary has recommended a minimum balance of about $^1/_6$ (16.5 per cent) of benefit expenditure - expected balance will be around 21½ per cent.

(vii) Further background to be given by Secretary of State for Social Services on 17 November and in Government Actuary's report (also published on 17 November). Government Actuary's report will include certain economic assumptions - not forecasts - given to him by Government, namely:-

(a) Unemployed, excluding school leavers, GB, averages 2,850,000 in both 1983-84 and 1984-85, school leavers and others 180,000 in 1983-84 and 170,000 in 1984-85.

(b) Average Earnings in 1984-85 6½ per cent higher than in 1983-84.

(c) Retail prices up 5½ per cent in year to May 1984.

(viii) For further details of changes, see table attached.

Positive

(i) First time since 1979-80 no increase in Class 1 contribution rates. Increase in Upper Earnings Limit in line with assumed increase in earnings. Most employees pay little or no more - only those earning above £235 (well above average earnings) pay noticeably more - and maximum for them only £1.35.

(ii) When account is taken of National Insurance Surcharge, which is assumed to remain at 1 per cent throughout 1984-85, real burden on employers falls. This is because average NIS rate in 1983-84 was about 1¼ per cent (2½ per cent for Local

Authorities). Most (£830 million) of projected cash increase (£990 million) in employers' and employees' overall payments is attributable to increased earnings. Only very small part (£160 million) attributable to changes in earnings limits.

(iii) Contributions go to pay for benefits. Cost of this month's benefit uprating £1½ billion (not all from Fund). Most benefits worth more than when Government came into office.

Defensive

(i) Why not reduce contributions? Benefit expenditure continues to increase. Although Fund looks heathy for 1984-85, caution needed to avoid frequent unsettling small changes in contribution rates. GA's recommendation was for minimum not target balance.

(ii) So why reduce Treasury Supplement? Treasury Supplement was reduced in earlier years (from 18 per cent to 14.5 per cent in 1981 and to 13 per cent in 1982) to help restore balance of expenditure on social security benefits met by general taxpayer as against contributor. Non-contributory benefit expenditure, and, hence proportion of total benefit expenditure met outside Fund by general taxpayer, continues to rise faster than Fund expenditure. The further reduction in Treasury Supplement will help contain shift to taxpayer of overall burden of benefit expenditure.

(iii) Why increase UEL? Legislation requires UEL to be reviewed each year and to be between 6½ and 7½ times basic pension. Thus UEL could have been left unchanged at £235. But UEL relevant for calculation of state earnings related pension and guaranteed minimum pension. Necessary to increase UEL if value of those pensions not to decline. Also, not unreasonable that earnings limit should be broadly indexed as are most benefits paid from the Fund and as is generally done with specific duties and income tax personal allowances. UEL increased by 6.4 per cent to £250 this is less than 7¾ per cent increase in average earnings in year to September 1983 and in line with assumed increase in average earnings next year. For employers real burden will be lower - because average payment of NIS to 1984-85 will be lower than in 1983-84.

(iv) Cash burden on employers rises by £700 million? £700 million is the increase in payments of NICs. But only £80 million of this arises from change in UEL - rest is effect of higher earnings; emphasises need to contain pay increase. Also, when account taken of NIS, employers cash burden rises by only £330 million - less than 3 per cent - well below assumed increase in both prices and earnings.

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ANNEX

MAIN LIMITS AND RATES OF CONTRIBUTIONS 1983-84 and 1984-85

Limits	1983-84 (current year)	1984-85
Class 1 (Employer & Employee)		
Lower earnings limit	£ 32.50	£ 34.00
Upper earnings limit	£ 235.00	£ 250.00
Class 2 (Self Employed)		
Small earnings exception	£ 1,775	£ 1,850
Class 4 (Self Employed)		
Lower profits limit	£ 3,800	£ 3,950
Upper profits limit	£ 12,000	£ 13,000

Rates	1983-84 (current year)	1984-85
Class 1 standard rate		
Primary (Employee)	9.0%	9.0%
Secondary (Employer)*	10.45%	10.45%
Class 1 contracted-out rate up to lower earnings limit		
Primary (Employee)	9.00%	9.00%
Secondary (Employer)*	10.45%	10.45%
Class 1 contracted-out rate above lower earnings limit		
Primary (Employee)	6.85%	6.85%
Secondary (Employer)*	6.35%	6.35%
Class 1 reduced rate for married women and optants (employee)	3.85%	3.85%
Class 2 flat rate self-employed contribution (per week)	£ 4.40	£ 4.60
Class 3 flat rate non-employed contribution (per week)	£ 4.30	£ 4.50
Class 4 earnings-related self-employed rate	6.3%	6.3%

* excluding National Insurance Surcharge

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D2 NATIONAL INSURANCE SURCHARGE

Factual

(i) No change in rate announced in Statement. Remains 1 per cent for 1984-85.

(ii) NIS is levied and collected as a percentage charge on earnings liable to employers' NIC. Increase in NIC Upper Earnings Limits means NIS payments will be about £10 million higher than would otherwise have been the case (but see also Brief D1).

(iii) Rate already reduced by 2½ percentage points. The rates since 1979 are:

Rate up to 1981-82	3½	per cent
Effective average rate during 1982-83	2	per cent
Rate from April to July 1983	1½	per cent
Rate from August 1983	1	per cent

(iv) Local authorities pay at 2½ per cent in 1983-84 only: subsequently at 1 per cent. The reduction to 1½ per cent announced in the 1982 Autumn Statement was not extended to LAs because it was not practicable to recover the benefit through the Rate Support Grant. For the same reason the ½ per cent cut announced in 1983 Budget will not be extended to LAs until 1984.

(v) Expected yields (receipts basis):

1984-85 about £1,300 million (private sector about £850 million)

1985-86 about £1,400 million (private sector about £900 million)

Positive

(i) NIS reductions since 1982 have benefited private sector by about £2 billion per year.

(ii) Government's objective to abolish NIS over the lifetime of this Parliament. [Queen's Speech Debate, Hansard, 22 June 1983, col 56: PM said "We hope during the lifetime of this Parliament finally to abolish Labour's pernicious tax on jobs, the National Insurance Surcharge".]

(iii) Even taking account of NIC increases since 1978-79, the overall effect of NIC and NIS changes is worth about £1½ billion to private sector employers in a full year.

(iv) Overall NIC/NIS rate on contracted-in employers increased from 8½ per cent to 13½ per cent under previous Labour Government. Now down to 11.45 per cent. Contracted-out rate down from 9 per cent to 7.35 per cent.

Defensive

(i) Does NIC UEL increase inevitably mean higher NIS payments?

Yes, because NIS is collected through the NIC system, on the same range of earnings. Impossible to separate them. But this £10 million increase is almost negligible if counted against benefits of NIS cuts in recent years.

(ii) Why not abolish NIS now?

Sympathy with calls for abolition. But obvious difficulties given cost even after recovery from public sector. (1984-85 cost of abolition, if effective from April: £750 million. The revenue cost for 1984-85 differs from the expected receipts because there is a £100 million carryover from 1983-84). No intention of pre-empting overall Budget judgement.

(iii) Abolition in 1984 Budget?

Wait and see. Obvious difficulties given cost even after public sector clawback (1984-85, if effective from August: £450 million. 1985-86: £900 million).

(iv) NIS reductions purely cosmetic, as increases in employers' NIC have offset them?

Not so. Employers were shielded from increases in NIC rates for two consecutive years. 1983-84 increase for the contracted-in was restricted to ½ per cent; for the contracted-out it was restricted to 0.65 per cent. Even allowing for total increase in employers' NIC since 1979, private sector employers' combined NIC and NIS is about £1½ billion less than it would otherwise have been.

(v) Introduce selective reliefs?

Not practicable, because of links with NIC collection system.

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E1 PUBLIC EXPENDITURE 1983-84

Factual

(i) Supply expenditure outturns for first half of financial year published 17 November along with Winter Supplementary Estimates. [See separate briefing accompanying Financial Secretary's Note on Winter Supplementaries].

(ii) Local authorities budgetting for a significant overspend on current expenditure. But capital expenditure is expected to be slightly below plan. [Note: A lot of this overspend and underspend was anticipated in the Budget FSBR forecast.]

(iii) Latest public expenditure plans for 1983-84, £119.8 billion, are shown in Table 2.1 of Autumn Statement. The new plans incorporate effects of 7 July measures and other known developments since FSBR (for example, additional agricultural support and higher expenditure on the family practitioner services). Estimated outturn against these plans is provisionally put at £120.3 billion: a figure not given in the Autumn Statement itself but which the Chancellor is ready to give in rounded form in reply to questions. Current assessment of outturn on general government expenditure, £120½ billion, is shown in Table 1.7 of Autumn Statement.

[NOT FOR USE: reconciliation of public expenditure plans and estimated outturn on general government expenditure:

Public expenditure in 1983-84

	£ billion
Planning total (plans), Table 2.1	119.8
Forecast shortfall (-)/longfall (+)	+0.5
Planning total (estimated outturn)	120.3
adjustments*	+0.2
General government expenditure (estimated outturn), Table 1.7	120½]

(iv) Percentage of planned public expenditure (including net debt interest, capital consumption and local authority VAT payments) to GDP in 1983-84 is 42½ compared with outturn of 43½ in 1982-83 and 44 in 1981-82. (Even with longfall allowed for in Table 1.7 of the Autumn Statement, 1983-84 percentage is still 42½.) NB. Percentages slightly lower than those previously published, by between ½ and 1 percentage points, because of upward revisions to GDP published by CSO in September.

Defensive

(i) How does latest plan of £119.8 billion in Table 2.1 of Autumn Statement compare with planning total of £119.3 billion in Table 5.5 of FSBR?

Former relates to plans, not estimated outturn, and incorporates effect of 7 July measures as well as other developments since Budget. The latter was an estimated outturn. [IF PRESSED: FSBR estimated outturn incorporated a net allowance for shortfall of £1.2 billion. Developments since then (higher than expected spending in 1982-83 and indications that this was continuing into 1983-84) suggested this

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* Deduct capital expenditure of certain public corporations and public corporations market and overseas borrowing.

shortfall would not arise - 7 July measures therefore taken to bring spending back closer to planned path.]

(ii) What are main differences between latest plan of £119.8 billion in Table 2.1 of Autumn Statement and planning total estimated outturn that surely must underlie Table 1.7 of Autumn Statement?

Latter incorporates latest view of expected spending against plans. Planning total outturn for current year estimated to be about £½ billion above the revised planning total of £119.8 billion shown in Table 2.1. [NOT FOR USE: Main components of overspend are £1¼ billion on local authority current expenditure and around £¾ billion on central government expenditure, offset by £½ billion underspend on nationalised industries EFLs, £¼ billion on l.a. capital and underspent Contingency Reserve of about £¾ billion.]

(iii) Why not publish an estimate of shortfall and/or estimated outturn on the planning total in the current year?

To do this in Table 2.1 would be confusing. Figure for next year is expressed in terms of plans (see E2 Defensive (xiii) and (xiv)). Important to compare plan with plan in comparing this year and next.

[NOTE: Chancellor has indicated his willingness to give the House a rounded estimated outturn of £120 billion if they ask for it. This could be expressed as 'just over £120 billion and about £1 billion more than was envisaged at Budget time, but still within the White Paper plans'. NB 1983-84 outturn forecast not to be revealed until given to House.]

(iv) Reasons for 7 July measures?

1983 PEWP and Budget FSBR incorporated net allowances for shortfall against plans of £1.2 billion. As a result of the higher than expected spending in 1982-83 and strong indications that this was continuing into 1983-84 it became clear that measures were needed to bring spending back closer to the planned path.

(v) 7 July measures not enough?

Measures were taken to bring spending back closer to the planned path and this they have done. Remains to be seen how actual expenditure will compare with those plans - substantial margins of error in any forecast of estimated outturn at this stage. [See also C1 Defensive (iv)].

(vi) Cash limit breaches?

Monitoring information published 17 November in Financial Secretary's Note on Winter Supplementary Estimates suggests cash-limited expenditure overall is on course. Those cash limits in any danger of being breached being monitored carefully with relevant Departments. [See separate briefing on Winter Supplementaries.]

(vii) Local authorities' overspending?

Local authorities' budgets show more current overspending than expected at time of Budget. Overspending authorities have again lost grant. Outline of 1984-85 RSG settlement announced recently by Secretary of State for Environment explained penalties for overspending next year will be even more severe.

(viii) Local authorities' capital expenditure?

Past years have seen heavy underspending but latest returns suggest problem much less in 1983-84. First quarter returns for 1983-84 suggest that, overall, net capital expenditure is likely to be quite close to planned level.

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(ix) Latest estimated outturn for 1982-83 planning total, £113.4 billion (AS Table 2.2); earlier estimate published in Supplementary Table S21 of October Financial Statistics. (Figure of £113.4 consistent with figure of £114 billion for general government expenditure shown in Table 1.7.) The overshoot on the estimated outturn shown in Budget FSBR (£112.5 billion) was due mainly to lower than expected underspending against plans.

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E2 PUBLIC EXPENDITURE 1984-85

[NB Detailed questions on programmes should be addressed to Departments concerned.]

Factual

(i) Plans for 1984-85 (Cmnd 8789) were £126.4bn. The planning total based on the revised plans in the Autumn Statement has been maintained at this level.

(ii) The Reserve for 1984-85 stays at the level set in the White Paper (£3 billion). This compares with £1.5 billion in 1983-84.

(iii) Major increases in plans compared with the post Budget plans are:-

Intervention Board for Agricultural Produce	£422 million
Local authority current expenditure	£595 million
Social Security	£163 million

(iii) Major reductions are:-

Nationalised Industries	£666 million
Housing	£497 million
Special Sales of Assets (higher estimated receipts)	£400 million
Defence	£260 million

The 3 per cent pay factor announced on 15 September 1983 represents a saving on all programmes of £400 million.

(iv) On latest forecasts of GDP, revised plans for 1984-85 represent a fall in percentage of public expenditure to GDP, from 42½ in 1983-84 to 42 in 1984-85.

(v) In 'real' (cost) terms, planning total shows a small increase from £114,100 million in 1983-84 to £114,600 in 1984-85 (on 1982-83 base year). Since the difference is only 0.4% on present forecast of GDP deflator, the Statement describes the figures as "broadly constant".

(vi) Plans now announced are firm. Precise figures may change slightly between now and White Paper in the light of more detailed recalculation. Reserve will also be reviewed before the White Paper is finalised.

(vii) White Paper will be published in the early part of 1984. Will contain figures for 1985-86 and 1986-87.

Positive

(i) Outcome of the annual review of expenditure plans has been to hold planning total at the level announced in previous plans. Repeats the Government's similar achievement last year.

(ii) The fall of ½ percentage point in the GDP ratio continues Government's progress in reducing public expenditure as ratio to GDP. Now 1½ points below level of 1982-83.

Defensive

(i) The Reserve is unchanged but Special Sales of Assets have increased. A Treasury conjuring trick to get back to the planning total? The Special Sales of Assets total is made up of a number of components. It is not our practice to disclose details of its composition because the timing of sales is dependent on market conditions and the price information is commercially sensitive.

The increase of £400 million in the figure for asset sales in 1984-85 results from a number of changes and reassessments. Among the more important changes is the slippage of the sale of Enterprise Oil into 1984-85. We are not saying that we expect £400 million from this sale. But it is a real change which among other things has led Ministers to take a different view of the prospects for sales in 1984-85.

(ii) Why is the Contingency Reserve so big? The Reserve for 1984-85 has been set at a level (£3bn) which will, for the first time, accommodate both discretionary increases and all other contingencies, including estimating changes. At this stage the estimates of expenditure on some demand-led services are inevitably still uncertain. Other possible calls on the reserve might arise in the areas of European expenditure, agricultural and other industrial support and from the introduction of a degree of end-year flexibility, both for central government and for local authority capital expenditure.

In its comments on this year's Budget the Treasury and Civil Service Committee argued that the proposed Reserve of £1.5 billion for 1983-84 was too low. We do not accept that, but the retention of a bigger Reserve should help to avoid some of the difficulties of control which arose earlier this year.

(iii) Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in controlling inflation makes it easier to accommodate such changes without major cuts in services.

(iv) Why not major increase in public expenditure to boost economy? Way to get sustainable growth is by expanding production in private sector without adding to inflation. Higher public spending would require higher taxation and/or higher interest rates, which would hold growth back.

(v) Hasn't Government gone too far in reducing public expenditure? Government is planning for an increase (£6½ bn) between plans for 1983-84 and 1984-85.

(vi) Capital/Current split? Too early to give figures. No breakdown for the nationalised industries is yet available, and the split for some other programmes will depend upon decisions still to be taken about the allocation of the programme totals. A full analysis will be given in the White Paper.

(vii) Did Ministers take decisions without proper capital/current assessment? True that final figures not yet available. But decisions were qualitative as well as quantative. The need to consider the level of capital spending was in Ministers' minds throughout the public expenditure discussions. n.b. the cut in Housing is much less than it appears. About £300 million of the apparent reduction is additional receipts from the sale of council houses, which are scored as negative public expenditure.

(v ii) Effects on industry? Main effect will be through staying within expenditure plans. Public sector will not be pre-empting resources, raising interest rates or rekindling inflation.

(ix) Local authority current expenditure Government obliged to recognise excessive levels of past and present spending in formulating plans for future which are realistic. But cannot condone failure to meet targets and abide by guidelines which has become a persistent feature of local government current spending. Plans for relevant current expenditure in 1984-85 make provision which is realistic in relation to levels of overspending in 1983-84. But also indicate lower level of expenditure which Government considers desirable and which could have been achieved had authorities complied with previous plans.

(x) Local Authority Capital. Total net provision for LA capital in 1984-85 likely to be about £3¾ billion or roughly the same in cash terms as the expected outturn in 1983-84. (The figure would be considerably higher but for sales of Council houses which are netted off). Authorities' capital spending in 1983-84 is closer to plan than usual and there is not likely to be the huge underspending of earlier years. The Government hopes that this trend will continue in 1984-85.

Total capital spending for 1984-85 depends on decisions Ministers still have to take about allocation of their programmes. A measure of end-year flexibility is being introduced on the overall cash limits which will permit some carry forward of underspending. The Secretary of State for the Environment is announcing details.

(xi) Nationalised Industry planned expenditure for 1984-85 is about £666 million lower than previous plans. A tight financial framework concentrates the industries' minds on increasing efficiency and minimising costs. Individual EFLs are the responsibility of the appropriate sponsor Minister. They are set after careful consideration of an industry's likely performance in 1984-85 and take account of a wide range of factors. Overall, we expect changes in nationalised industry prices in 1984-85 to be at or below the rate of inflation. (These are the only changes in the review which are likely to have any effect on prices.)

(xii) Government's commitment to the NHS? The Government's plans for 1984-85 are to increase spending on health in Great Britian by £800 million over the level this year, just as promised by the Prime Minister in her election speech in Edinburgh. The further real growth planned in NHS services will be in addition to the growth of about 7½ per cent already planned for since the Government came into office. This is a further demonstration of the Government's commitment to the NHS. It is also taking a number of measures designed to increase efficiency in order to make the available cash go even further towards providing better services for patients.

(xiii) Why no net shortfall allowance? It is too early to give a precise figure. Wait for the White Paper.

(xiv) What are the main differences between the plan of £126.4 billion in Table 2.1 of the Autumn Statement and the estimated outturn for the planning total which must surely underlie Table 1.7? On present estimates the net shortfall this year is close to zero; the position needs to be monitored further before deciding on a figure for next year. [NOT FOR USE: AS estimate is a long-fall of about £¼ billion; consists of £1½ billion on central government expenditure and £1¾ billion on local authority current, offset by availability of the £3 billion Contingency Reserve.]

(xv) Long-term public expenditure? This review has been concerned with the period 1984-85 to 1986-87 and the detailed information in the AS relates to 1984-85 only. The Government has said it would welcome a wider public debate and the factors affecting the level of public expenditure in the longer term are under continuous review. But do not expect specific early announcements.

(xvi) Realism of 3% public service pay factor if earnings in economy to rise 6½% (GAD assumption)? These figures are not forecasts, and they cover different things. 6½ per cent refers to increase in total average earnings (including overtime etc) in whole economy between 1983-84 and 1984-85. 3 per cent factor is provision made for increase in pay rates for central government employees from due settlement dates in 1984-85. The 6½ per cent assumption takes account of the 3 per cent factor. Gap between them is not unusual - was 3 points last year and 3½ points in year before.

(xvii) You claim to have kept to the White paper plans. But has there not been an increase in what you expect those plans to buy because of changed expectations about inflation? True. But we plan in cash. The fact that the same cash plans will now buy more is one of the benefits of reducing inflation. Control of public expenditure has played an important part in this.

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F1 DEFENCE (Detailed questions to MOD)

	£m cash
Defence programme	17,008
ROFs net financing	(-2)
Defence Budget	17,010
of which Falklands	684

Factual

(i) Cash provision is nearly £1,300 million (8.2 per cent) higher than the current year.

(ii) In real terms there is provision for growth of some 3 per cent over 1983-84, with an addition for Falklands costs. 1984-85 Falklands provision is £684 million.

(iii) The provision is £280 million (1.6 per cent) lower than envisaged in Cmnd 8789. It is £260 million (1.5 per cent) lower than the survey baseline (the Budget National Insurance Surcharge reduction accounts for the £20 million difference).

(iv) The civilian manpower target for 1 April 1988 is 170,000.

Positive

(i) Defence continues to be the second largest programme.

(ii) Defence expenditure has increased in real terms every year since 1978-79. The 1984-85 provision is the sixth successive year of increased defence spending.

(iii) In absolute terms, the level of UK defence spending is the highest in Western Europe. As a proportion of GDP and per capita, UK defence budget is second only to the US amongst our major allies.

Defensive

(i) In fixing 1984-85 provision, account was taken of the 1983-84 cash limit cut, along with the NATO aim and all other relevant factors. The 1983-84 non-Falklands defence budget (even after the July cut) provides for more than 3 per cent real growth over 1982-83 expenditure.

(ii) Provision for later years will be announced in the PEWP.

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F2 AGRICULTURE AND IBAP (Detailed questions to MAFF)

Factual

(i) The "Agriculture" totals include agriculture, fisheries and food expenditure in the UK. A territorial allocation will be given in the White Paper. The 1984-85 provision is £1009 million, compared with £994 million provided in Cmnd 8789 as amended by the Budget. The increase of £15 million amounts to about 1.5 per cent. Details of adjustments within the total will be announced by Minister of Agriculture in an arranged PQ on 17 November.

(ii) The "IBAP" programme represents expenditure by the Intervention Board for Agricultural Produce on agricultural support under the CAP. 1984-85 provision is increased by £422 million (51 per cent) to £1247 million. About one third of increase reflects expenditure pre-funded from Community Budget. Two-thirds reflects assumed extra intervention purchases particularly for milk products; these costs fall initially on the Exchequer but are re-couped from the market and by Community reimbursement for losses when intervention stocks are sold.

Defensive

(i) Overall net increase in "Agriculture" mainly accounted for by 100 per cent EC funded expenditure. Remaining small increase in domestic expenditure more than covered by savings on arterial drainage and flood protection, within the MAFF programme but shown as part of nationalised industry (water authorities) EFLs.

(ii) Increase for IBAP reflects latest estimates of costs of implementing CAP. Forecasts are highly uncertain and dependent on weather, harvests, market conditions etc.

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F3 **ENERGY INDUSTRIES EFLs AND PRICES** (Detailed questions to DEn)

Factual

(i) The increase in expected external financing requirement for the National Coal Board is some £180 million. There are reductions for the Electricity Supply Industry, British Gas Corporation and BNOC which go towards an overall £670 million decrease for the nationalised industries overall.

(ii) NCB's projected trading position has deteriorated due mainly to weak markets. Coal price increases this Autumn have averaged about 3 per cent - well below the RPI.

(iii) Gas and electricity tariffs are a matter for the industries. Discussions are taking place within the industries on increases for 1984-85.

(iv) Expect the increases now under discussion to be below the rate of inflation.

Positive

(i) Decrease for Electricity partly reflects expected achievement of the efficiency aim set by Government that unit costs should be 4.25 per cent lower in real terms by 1984-85 than in 1982-83.

(ii) It is right to charge energy prices which reflect the cost of meeting additional demand ("economic pricing"). This is a well established principle endorsed by successive Governments. It is no more than what happens with private sector companies competing with each other. It involves no subsidisation and no taxation.

(iii) Charging prices below these levels leads to wasteful investment. For example it would result in building power stations which made losses in the same way that subsidising, say, TV sales would result in factories being built and equipped to produce loss making TV sets.

(iv) The electricity industry was investigated by Coopers and Lybrand in 1982. In the light of these findings electricity prices are now close to the economic level, but certainly not above them.

(v) BGC was investigated by Deloittes in 1983. This showed most gas prices to be well below economic levels. The freeze on gas prices in 1983-84 has increased that gap and a 5 per cent increase in 1984-85 will not prevent the gap getting wider still.

(vi) Gas and electricity profits large in terms of £ million (see Annex). But these are huge industries. Capital invested is some £32 billion in electricity and £12 billion in gas. The return on these assets is not high. Few private sector businessmen would be satisfied with these returns.

(vii) A policy of holding down energy prices was tried in the mid 1970s and was generally regarded as unsatisfactory - including by the last Labour Government who set about reversing this policy.

Defensive

(i) Price increases for gas and electricity have yet to be settled by the Industries but are expected to be below the rate of inflation.

(ii) Using prices to cut public expenditure - the EFLs for 1984-85 will reflect efficiency savings the Government considers the industries should make. It is for the industries to determine detailed tariffs but the Government does not want prices to rise above economic levels.

(iii) Price increases will cause electricity to exceeds its financial target - there is no prospect of price increases in excess of those envisaged when the financial target (which covers both 1983-84 and 1984-85) was set - ie a standstill in 1983-84 and an increase below the rate of inflation in 1984-85.

(iv) Effect on industry - gas and electricity prices for industrial consumers are generally in line with continental competitors, except for electricity in France. Special measures were taken in the 1981 and 1982 budgets to help large consumers of electricity - costing £100 million. The right approach is not to sell energy at a loss to industry, but to get down the cost of the gas and electricity industries.

(v) Effect on poor consumers - action has been taken to relieve standing charges for small consumers of gas and electricity. Some £350 million a year of assistance with fuel costs is provided by social security.

(vi) It is backdoor taxation - No. Prices are not above economic levels - so there is no taxation.

(vii) When will increases be announced - that is for the industries.

(viii) Investment by NCB next year should be about the same as the £800 million this year. The level for later years has yet to be determined.

(ix) Sizewell PWR station is still included in the ESI programme but extension of the public enquiry has resulted in reduced provision being needed in 1984-85.

(x) Special Sales of Assets/Privatisation Apart from Enterprise Oil, the energy industries will not be a significant contributor next year.

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A. USEFUL QUOTES

(a) On gas, Deloittes Report (1983)

"In 1982-83 sales of gas in all markets, apart from the interruptible market, were taking place at prices which were insufficient to meet marginal costs and then the costs of maintaining supply".

(b) On electricity, Coopers Report (1982) was not published but on 12 November 1982 the then Energy Secretary said prices would be frozen in 1983-84 as :

"the cost to the industry of meeting marginal increases in demand is likely to be lower than expected."

(c) On last Labour Government's policy. Green Paper on Energy (1978) said :

"The principle that prices should reflect the costs of supply on a continuing basis while providing an adequate return on capital is now firmly established"

"Prices are important above all because they are all pervasive, affecting millions of decisions over which the Government can have no direct control"

"Since the object is to guide investment and other decisions that will affect future events, the relevant cost is the cost incurred or saved in expanding or contracting supplies at present or in the future, rather than an average of past costs. Energy prices should therefore at least cover the cost at which supplies can be provided on a continuing basis, while yielding an adequate return on investment.".

B. PROFITS AND PRICES

(a) Electricity (England and Wales)

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Turnover (£m)	6,171	7,511	8,471	9,187	8,971*	9,300*
Price increase (%)						
- Domestic	13	30	11	9	0	(3)
- Industrial	14	24	12	11	0	(3)
- RPI	16	17	11	7	5	
Pre-tax profit/loss after interest (CCA) (£m)	-499	-272	470 -85	868 332	663 200* 186	469 100-200* 25
Return on assets (CCA) (%)	0.5	1.7	2.0	3.2	1.9*	~~1.7-1.9*~~ 1.3-1.4

*estimated

(b) British Gas Corporation

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Turnover (£m)	3,513	4,295	5,235	5,958	6,495*	7,265*
Pre-tax profit (CCA) (£m)	466	381	311 144	663 188	600 564* 380	592*
Return on assets (CCA) (%)	5.0	4.0	3.0	5.7	4.3* 4-4½	4.0*

*estimated

3/12.7

4.0%

Price Increases for gas :

Domestic

April 1980	17%
October 1980	10%
April 1981	15%
October 1981	10%
April 1982	12%
October 1982	10%
January 1984	5% (proposed)

Industrial

		Percentage increase on previous quarter of average firm/interruptible industrial contract price
1979	Q1	0.7
	Q2	2.6
	Q3	19.0
	Q4	13.3
1980	Q1	3.2
	Q2	8.2
	Q3	12.6
	Q4	1.9
1981	Q1	-
	Q2	0.2
	Q3	-
	Q4	-
1982	Q1	-
	Q2	3.4
1982	Q3 -1984 Q1	-
1984	Q2	about 3

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F4 HOUSING (Detailed questions to DOE)

Factual

(i) The existing net provision for housing in 1984-85 is some £3 billion comprising some £4.3 billion gross spending less £1.3 billion receipts.

(ii) The revised net provision involves a reduction of £0.5 billion (ie - 17 per cent). This comprises an increase of £0.3 billion in assumed receipts, which come mainly from sales of public sector dwellings, and a reduction of £0.2 billion in the gross provision.

(iii) The reduction in the gross capital provision is about £170 million of which some £124 million is a reduction in the provision for local authorities.

(iv) The local authority capital provision covers expenditure on new dwellings, improvements to existing dwellings and home improvement grants. It is for each local authority to determine its priorities within the capital allocation made by the DOE.

(v) The temporary arrangements under which local authorities receive additional allocations to cover expenditure on home improvement grants during 1983-84 in excess of an agreed figure will not be repeated in 1984-85. The temporary higher rates of home improvement grant will not continue beyond the announced closing date of 31 March 1984.

Defensive

(i) Effect on construction industry. The revised provision for gross capital expenditure in 1984-85 is the same in cash terms as the provision for 1983-84. Effect of measures on the construction industry, if any, is therefore likely to be minimal.

(ii) No figures for individual authorities' planning of capital expenditure. The 1984-85 capital allocations for individual local authorities will be announced shortly, taking account of the government's decision on gross spending and each authorities' expected receipts from sales of public housing. Authorities have been promised that no authority's allocation will be less than 80 per cent of that for 1983-84. Government considering whether arrangements can be made to give local authorities greater certainty about future capital allocations. [See also brief E2.]

(iii) Ending of temporary Home Improvement Grant measures. These measures, introduced in the 1982 Budget, were temporary measures designed to take up immediate capacity and not to add to longer terms demands on the industry. The deadline for expiry, originally 31 December 1982, was twice extended, ultimately to 31 March 1984. That date has now been confirmed.

(iv) 1983-84 capital underspending by local authorities. The outturn for gross capital expenditure, which determines the level of output, is expected to be slightly above plan. However excess receipts expected to lead to modest net underspend overall.

Positive

The Government's housing policy is focussed on encouraging provision by the private sector. The small reduction in gross public expenditure on housing is consistent with that policy. MTFS fosters economic conditions in which the private sector can flourish. The fruits of this are now becoming evident. For example, private sector housing starts in 1983 likely to be highest for 10 years.

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F5 HEALTH (Detailed questions to DHSS)

Factual

(i) The agreed provision for health in England in 1984-85 is £13,130 million, which is the same figure as in the 1983 Public Expenditure White Paper.

(ii) The new plan represents an increase of more than 5 per cent over spending this year.

(iii) Discussions are in progress with the industry on the scope for further savings in the drugs bill next year.

Positive Points:

(i) The outcome honours the Election and other pledges on the NHS: total health spending in Great Britain is planned to increase by £800 million over this year's level, just as the Prime Minister said in her Election speech in Edinburgh.

(ii) Provision is being made in full for costs of demographic change - a bit under 1 per cent more resources in real terms.

(iii) Full provision is being made for the Family Practitioner Services to avoid the risks of an over-run as happened this year.

(iv) The NHS is being expected to bring forward major efficiency savings to provide for improvements in services and to reduce waiting lists. The Griffiths report recommends ways of transforming the management of the NHS and will make it much easier to secure such savings.

Defensive Points:

(i) Exemptions from charges will remain but no responsible Government could rule out increases in charges to patients. IF PRESSED: The level of charges is a matter for my right hon Friend the Social Services Secretary. [SENSITIVE];

(ii) The Government announced on 15 September that it was making provision of 3 per cent (in its cash plans) for pay increases within central government, but that this did not predetermine any individual settlement. Fruitless to speculate on what action might be taken if NHS settlements next year turn out at a different figure.

(iii) Reasonable to look to improved efficiency and cost reductions to offset the costs which can arise from advances in medical science. Many medical advances actually reduce costs (eg drugs which allow the mentally ill to be treated at home rather than in long-stay institutions).

(iv) Nonsense to suggest that this year's manpower cuts of about ½ per cent will damage an organisation as big as the NHS.

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F6 SOCIAL SECURITY (Detailed questions to DHSS)

Factual

(i) Social Security programme rises by £163 million (+0.4 per cent) in 1984-85 in comparison with the last White Paper after Budget changes: Budget changes themselves added £748 million to the White Paper totals.

(ii) Benefits will be uprated later this month (21 November), mostly by 3.7 per cent but Supplementary Benefit rises by 4.3 per cent and Child and One Parent Benefits by 11 per cent.

(iii) This month's benefit increases based on new method for calculating uprated announced in the Budget; relevant RPI change is historic movement in prices between May 1982 and May 1983 ie 3.7 per cent. November 1984 increase will be based on movement in prices between May 1983 and May 1984 - currently assumed to be 5½ per cent.

(iv) Main policy change in Budget was 11 per cent real increase implemented November 1983 in level of Child Benefit.

(v) £163 million increase since Budget is net effect of substantial demand determined increases, partly offset by policy changes.

Main demand determined increases arise on Supplementary Benefit and Housing Benefit. Main policy changes are also on Housing Benefit. Further detail to be given by Secretary of State for Social Services on 17 November.

Positive

(i) When benefits are uprated later this month - at a cost of around £1½ billion - nearly all will have more than maintained their value since Government took office - some such as Mobility Allowance have risen substantially in real terms.

(ii) New uprating method ensures greater accuracy in maintaining value of benefits. Old forecast method was inaccurate 5 times out of 7.

(iii) Manifesto renews undertaking, given for period of last Parliament to "continue to protect retirement pension and other linked long-term benefits against rising prices". That pledge more than fulfilled. [Note: pledge does not cover other benefits such as supplementary allowance, unemployment benefit, housing benefit etc.]

Defensive

(i) Housing benefit changes hit at poor?

Housing benefit now goes to around 7 million (about 1 in 3) households of which some will have incomes above average earnings. Changes designed primarily to reduce benefit to this better off group.

(ii) Unemployment benefit as percentage of earnings lowest in Western world?

[Study in Economic Bulletin for Europe, published by UN, says that UK proportion of benefits for unemployed to earnings ('replacement ratio') lowest in West; have fallen between 1972 and 1982 from 75 to 47 per cent; but 'cost of unemployment', as percentage of Government spending, higher than elsewhere - 11-17 per cent.]

Valid international comparisons extremely difficult. Study claims all benefits included, but rent and rate rebate payments have not been taken into account. Including these, for 'average workers' as used in study, gives ratio of around 70 per cent in 1982. Similar problems in making comparisons over time. Calculations of overall costs to Government meaningless because included hypothetical figures for lost tax revenue.

(iii) Long term supplementary benefit for unemployed?

[Social Security Advisory Committee recommended long term rate to be payable to unemployed after 12 months 'as matter of necessary justice and highest priority'.]

Proposed extension of eligibility for long term rate of supplementary benefit would add about £0.4 billion to cost of social security - now standing at £35 billion. Many unemployed will also be receiving help with housing costs through housing benefit. Extension would mean giving long-term scale rate to people still in the labour market, which would have wider economic repercussions, for instance on work incentives. Cannot afford to do more.

(iv) Government plans for pensions?

[Government Actuary's Quinquennial Review of NI Fund published last July analysed possible future cost of contributory benefits and levels of contributions required. Most important factor expenditure on earnings-related pensions. Social Services Secretary told interviewer 27 October (New Society) 'we will be announcing a major inquiry into pensions soon'.]

Government Actuary's conclusions last July not firm predictions but illustrative of possible burden on future generations. Social Services Secretary will shortly announce comprehensive review of provision for retirement, covering adequacy of pensions in both State and private sectors, emerging costs, role of occupationsl pension schemes and other issues, including pension age, flexible retirement etc. Government Actuary's Report and recent ideas on 'portable pensions' will be included in the review.

Contact point: A J White (ST1) 233-3169

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F7 CIVIL SERVICE MANPOWER

Factual

(i) Government plans to reduce the Civil Service from 732,000 in 1979 to 630,000 by 1 April 1984 (14 per cent) should be achieved.

(ii) Manpower requirements up to 1988 have been reviewed and are set out in a written PQ reply to be given on 17 November. The plans provide for a reduction to about 593,000 by 1 April 1988, a fall of 6 per cent from 1 April 1984 target of 630,000: a written reply to be given on 17 November.

	1984	1985	1986	1987	1988
1 April targets (thou)	630	608	605	601	593

(iii) Aim has been to improve efficiency and match staff numbers more closely to departmental functions.

(iv) Proposed change in status of the Royal Ordnance Factories (to a Companies Act company) accounts for some 18,500 of the overall reduction of 37,000 by 1 April 1988.

Positive

(i) The figures make allowance for improved productivity during the period, including the introduction of new technology, where appropriate. They also reflect plans for privatisation and contracting-out where this offers better value for money and is consistent with sound management.

(ii) A contingency margin has been included in the figures to provide a reasonable amount of flexibility in our forward planning to cope with unexpected but essential new tasks or increases in workload.

(iii) The figures will be reviewed annually to take account of changing workload and other developments. Subject to that the presumption will be that they will be adhered to, or reduced further where possible.

Defensive

(i) Why are figures so very different for various departments?

Aim has been to match staff numbers as closely as possible to the essential work each department has to carry out. Not an arbitrary exercise to cut across the board by a fixed percentage. Sensible reductions are planned on account of increased efficiency and privatisation. But increases have also been allowed (eg Home Office) where the needs of the work dictate.

(ii) Contingency margin now only 7,500, previously 15,000. Realistic?

When 630,000 target was set, unemployment was rising substantially and contingency had to be allowed for Department of Employment. Problem should not arise this time [NB no forecasts or expectations on unemployment to be given].

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F7 Cont.

(iii) Criteria for drawing on the contingency margin?

Inescapable new commitment or an increase in workload arising from an existing commitment. Treasury to be satisfied that they could not find compensating reductions from elsewhere within their existing manpower allocation. Each case would be considered on its merits.

(iv) What if a contracting-out proposal not feasible?

If particular plans turn out to be not feasible, then it will be a matter for consideration whether alternative savings should be found from within the departmental target, or whether an adjustment to target should be made from the contingency margin.

(v) How can you fix manpower figures up to 1988, when no plans have been published for so far ahead on public expenditure?

The manpower figures for later years reflect the broad spending plans to 1986-87, which are to be published in the PEWP once details are finalised. The manpower figures are, of course, subject to review in forthcoming public expenditure surveys when manpower and expenditure plans will, again, be considered together.

(vi) Why are proposed reductions so much smaller than between 1979 and 1984; falling-off in the Government determination?

(a) The 1984 target of 630,000, which should be achieved, represented a very large reduction of 102,000 or 14 per cent over the period 1979-84. That has been done, and credit is due to the Civil Service for its major contribution to bringing it about.

(b) The Government is not aiming to do the same thing again. Staffing is now more closely aligned to the essential work that has to be done.

(c) What the Government is aiming to do is to maintain a steady pressure on numbers in order to take maximum advantage of all opportunities to improve efficiency, by the further streamlining of functions, the application of new technology and privatisation or contracting out where these make good sense. The figures are what the Government thinks it sensible to aim for over the next period in the light of this objective.

Contact point: B Brader (GEP4) 233-8260

F8 EDUCATION (Detailed questions to DES)

Factual

(i) Main element in overall programme increase of £175 million (1.4 per cent) is for local authority current expenditure. Most important changes in Vote-borne spending relate to Student Grants. Any queries on relatively small adjustments to other elements of education programme entirely for DES.

(ii) Higher than expected numbers of students have necessitated increased provision for grants.

(iii) Changes in terms and conditions of awards will produce some offsetting savings. These include:

- halving minimum awards from £410 to £205 a year;

- steepening income-related scale of parental contributions;

Those on higher incomes will thus be expected to pay rather more towards maintenance of their student children than now.

(iv) Value of grants increased by 4 per cent as part of the package.

(v) Fees of all students on mandatory grants will still be met in full.

Positive

(i) Access on demand of suitably qualified young people to higher education is being maintained.

(ii) New parental contribution scale will better reflect ability to pay.

Defensive

(i) Unfair to cut real value of award again? Only a modest reduction. Bulk of savings will come from other changes.

(ii) Halving minimum award unfair to parents? Students on minimum grant will continue to get tuition free of charge, with all fees paid. Reasonable to ask better off parents to pay more towards maintenance.

Contact point: M J C Faulkner (HE2) 233-8481

F9 NATIONALISED INDUSTRIES EXTERNAL FINANCING LIMITS (SEE F3 FOR MORE ON ENERGY INDUSTRIES)

Factual

(i) Nationalised industry expected external finance is decreased from £2548 million to £1882 million (reduction of £666 million or 26 per cent). Increases for National Coal Board, British Steel Corporation, British Shipbuilders, and Civil Aviation Authority. All other industries have decreased requirements.

Positive

(i) Decrease shows that Government attempts to encourage industries to reduce current costs and increase efficiency are proving successful.

(ii) The decrease for Electricity partly reflects expected achievement of the efficiency aim set by Government that unit costs should be 4.25 per cent lower in real terms by 1984-85 than they were in 1982-83.

Defensive

(i) Nationalised industry price rises in 1984-85 are still to be settled by the industries but are expected to be at or below the rate of inflation.

(ii) Too soon to say exact effect decreased financial requirements will have on industries' investment programmes. Investment increased in real terms in 1982-83 and is expected to do so again this year. Hope is that investment will be maintained in 1984-85 but this requires industries to restrain current costs in the way that private sector companies have to do.

Contact points:		
	Individual industries	Relevant Sponsor Departments
	Overall programme	G E Grimstone (PE2) 233-3980

229/12

F10 SPECIAL SALES OF ASSETS

Factual

(i) The target for special sales of assets is increased from £1500 million to £1900 million (eg by 27 per cent).

Positive

(i) Momentum of privatisation programme being maintained.

Defensive

(i) Although the sale receipts are clearly beneficial, the main objective of the privatisation programme is to promote competition and improve efficency.

(ii) Are receipts being used to fudge the figures?

Special sales of assets have customarily been treated as negative expenditure within the Planning Total. Labour Government did so in 1977-78 with sale of BP shares and we have followed this practice since 1979-80. Forecast represents our present best estimate of likely receipts.

(iii) Forecast too low?

Always genuine uncertainty about level of likely receipts. Dependent on market conditions at time of sale and on decisions yet to be taken, for example, about phasing of receipts. Right that Government should take a cautious view when setting targets.

(iv) How is £400 million increase made up?

Asset sales programme always has a number of components (ie nine sales 1982-83, thirteen sales 1981-82). Because details and timing of sales are commercially sensitive, not our practice to breakdown target figures into detailed components. The Government has however made clear that it plans to sell British Telecom in Autumn 1984. The revised 1984-85 target also takes account of the fact that the disposal of Enterprise Oil has regrettably slipped from 1983-84.

(v) 1983-84 target?

The 1983-84 asset sales target is £1250 million. Despite the slippage of Enterprise Oil to 1984-85, the asset sales programme is still broadly on course.

Contact points:	Individual privatisations	Relevant Sponsor Departments
	Overall programme	G E Grimstone (PE2) 233-3980

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G TAX READY RECKONER

Factual:

(i) Part 4 of the Autumn Statement contains a 'ready reckoner' for changes in income-tax, corporation tax and indirect taxes at 1984-85 price and income levels.

(ii) It also gives the 1984-85 levels of allowances, thresholds and bands following indexation by an illustrative 5%, the 'cost' of this indexation and the revalorisation of the excise duties.

Limitations and Pitfalls

(i) Changes to income tax are over and above the indexed levels of allowances etc; those for excise duties are from the current (unrevalorised) level of duties.

(ii) The income tax changes are costed in isolation, and this should be recognised in estimating the costs on yields of intereacting changes and packages. For example, revenue effects of a change in an income tax rate depends on the level of allowances, thresholds etc assumed.

(iii) Revenue effects of income tax changes are generally linear over a range and can be pro-rated.

(iv) Within limits, revenue effects of changes to indrect taxes can also be scaled up or down, and unit changes can be combined with revalorisation changes. Large increases, though, may result in last unit of duty raising less than previous ones.

Positive

(i) This ready-reckoner gives estimates for the direct effect on revenue in the next financial year, (prior to Autumn Statements estimates were given for current year only).

(ii) Helpful to those making budget representations, or who wish to cost tax packages.

(iii) More information than last year - cost and RPI impact of revalorisation package for indirect taxes given.

Defensive

(i) Why no PSBR costs? The total effect of a tax change on the PSBR will depend on how the economy responds - which is highly uncertain and on what is assumed about monetary policy. Direct revenue effects do not require such assumptions. [If pressed: PSBR costs in 1984-85 are generally close to first year costs (usually a bit lower).]

(ii) Why are some increases in allowances etc more than 5%? Because the rules for rounding up in 1980 and 1982 Finance Acts (which have been applied here) mean that some increases are rounded up by quite large amounts.

(iii) Why are first-year revenues less than full-year revenue for some taxes? This happens when duties are deferred (beer, tobacco). It also applies to VAT and NIS because these taxes are collected in arrears. There are also lags in collecting income taxes, especially higher rate tax.

(iv) Indexation percentage likely to be wrong (as last year)? 5% is a round number broadly consistent with the annual rise in the RPI towards the end of the year.

Contact point: Ms B Holman (DEU4) 233-4188

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* Last published ready-reckoner was in Treasury Supplement to Economic Progress Report, July 1983

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H

H THE AUTUMN STATEMENT AND TCSC REACTIONS TO THE 1982 PUBLICATION

Factual

(i) In June last year the Treasury and Civil Service Committee published a report on Budgetary Reform. It made a number of recommendations designed to help towards greater public and Parliamentary discussion of budget options and generally to improve the presentation of information. The Government in its reply said that it would each year publish an Autumn Statement (AS). Last year's was the first such Statement.

(ii) The Statement brings together the announcements usually made in the Autumn: outline public expenditure plans for 1984-85 and proposed changes in national insurance contributions from April 1984. It has in addition an economic forecast giving the information required in the 1975 Industry Act and a more complete statement of the fiscal position: expenditure, revenue and borrowing figures for both the current year and next year.

(iii) There is also a section giving ready reckoners of the direct revenue effects of illustrative changes in major taxes, based on assumed income levels of the coming year.

(iv) The TCSC sought improvements in the AS after last year's publication: -

(a) more detail on the forecast and extension to the medium term;

(b) on public expenditure estimates of net debt interest payments; information on proportion indexed-linked and more information at programme level;

(c) on taxation, more information on provisional plans.

Positive

(i) This is the second Autumn Statement. Have sought to improve clarity of presentation this year.

(ii) With figures now given for public finances this year and next, and with the revenue ready reckoners, AS now goes some way towards indicating kinds of choices Chancellor may face in preparing his next Budget.

(iii) Have this year included for first time statistical table showing effect of NIC and NIS changes on total payments by employees and employers, previously published, rather inconveniently, as a separate press notice.

Defensive

(i) Why no draft Budget proposals? Government explained in its original reply to TCSC that detailed tax proposals would not be given: November is too early for this. But AS sets out economic background now available to Government itself and should help people in putting together their Budget representations.

(ii) Why no figures for later years? This is partly a matter of practicalities: wish to make information about 1984-85 available as quickly as possible means that something has to give. But in any case, as Government's reply said, right time to consider prospects for later years is after Budget. Extending forecast to medium term, not desirable, given increasing uncertainty.

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H (Contd.)

(iii) Why no ready reckoners for economic effects of tax changes? We do publish model simulations from time to time, including effects of tax changes.

(iv) Were tax and expenditure decisions in fact taken together to a greater degree than previously? To take public spending decisions at precisely the same time as tax decisions is not practically possible. But public spending decisions are taken in the context of the MTFS and against the background of a full assessment of the economic prospects, including those for revenue, borrowing, money and interest rates. That is a real sense in which expenditure and finance are taken together. Detailed tax decisions are best taken at time of Budget; and detailed expenditure plans will be published in PEWP.

Contact Point: D Norgrove (CU) 233-8737

MR

CHIEF SECRETARY TO THE TREASURY

15th November

My Dear Prime Minister,

It was extremely kind of you, with your many other pre-occupations to write to me about the outcome of the Public Expenditure round. I will, if I may, pass on the gist of your

thanks to those who
helped me in the Treasury.
Their support to a novice
Chief Secretary was magnificent.
But I should add
that I am very conscious that
without your unstinted
moral support and interest
and without the support

CHIEF SECRETARY TO THE TREASURY

of Willie and other colleagues in Misc 99 the outcome and atmosphere might have been rather different.

With gratitude.

Yours sincerely

Peter Rees

CONFIDENTIAL

cc NO

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

15 November 1983

Michael Reidy Esq
Private Secretary to the
Secretary of State for Energy

Dear Reidy,

AUTUMN STATEMENT: ENERGY PRICES

The Autumn Statement which the Chancellor will publish on 17 November will contain no reference to gas and electricity price increases. Nor will he refer to them in his statement in the House on the same day.

We must however assume that the Chancellor will be questioned in the House on the subject. Subject to your Secretary of State's views, he proposes to answer along the following lines:-

> "Gas and electricity tariffs are a matter for the industries. Discussions are now taking place within the industries. I expect these discussions will result in price increases below the rate of inflation."

Conceivably he may also be questioned on press speculation that an instruction is to be issued to the Electricity Council. I understand that the Council will be meeting on 17 November. It would be useful if you could let me know the timing, and the likely outcome. I hope that the risk of an announcement by them that they oppose a 3 per cent price increase is low. But if there were to be such an announcement, and before the Chancellor's statement, and he were questioned about an instruction, he would, subject to your Secretary of State's views, propose to reply simply that:-

> "The Council has not yet reported its views to my Rt Hon Friend."

I am copying this letter to Andrew Turnbull in No 10 and to Bob Whalley in the Lord President's office.

Yours ever,
John Kerr.

J O KERR
Principal Private Secretary

FILE

da

10 DOWNING STREET

THE PRIME MINISTER

14 November 1983

Dear Peter,

I know what a burden the public expenditure survey puts on the Chief Secretary, and I felt that I should write to say to you that the outcome of this year's survey has been very satisfactory. For the Government to be able to show that it is holding public expenditure within its published plans is very important for the credibility of its financial strategy.

That this has been achieved owes a great deal to your work as Chief Secretary. Your remit was a difficult one but you pursued it with skill, determination and good humour.

I am very grateful to you and to all those in the Treasury who have supported you.

Yours ever

Margaret

The Rt. Hon. Peter Rees, Q.C., M.P.

da

010 cc FM 14

④

Prime Minister

Good advice

AT 10/11

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

10 November 1983

Dear Peter

Now that the Cabinet has completed its deliberations about the Public Expenditure Survey 1983, I should like to draw your attention to a point which was of considerable concern to my non-Treasury colleagues on the Ministerial Group on Public Expenditure (MISC 99).

The note by Treasury officials circulated under cover of MISC 99(83)8 explained that, before this year's Survey began, there had already been agreed increases over the totals set out in the last Public Expenditure White Paper (Cmnd 8789) amounting to £778 million in 1984-85 and £1,272 million in 1985-86. Part of the increases in both years arose as a result of revised economic assumptions but the bulk of the increases resulted from policy changes agreed at the time of the 1983 Budget (notably the increase in child benefit, restoration of the 5 per cent abatement of unemployment benefit, and the changeover to the historic method of uprating instead of "clawback").

Since the Cabinet agreed in July that we should keep within the published planning totals, and maintain adequate planning reserves, it was inevitable that savings would have to be found from Departmental programmes agreed at the time of the last Survey to offset these increases agreed at Budget time, as well as to offset any additional bids which had to be accepted.

It occurred to us to wonder how far colleagues, when considering the proposed expenditure increases at Budget time, including the increases in child benefit, fully took on board that, unless the published planning totals were to be breached, substantial offsetting savings would have to be found from Departmental programmes. The inevitable moral must surely

The Rt Hon Peter Rees QC MP
Chief Secretary

be that substantial increases in agreed expenditure between Surveys are highly undesirable and that, if and when they are proposed, we must be sure that colleagues, in agreeing to them, are fully aware of the likely consequences for Departmental programmes generally.

I am sending copies of this letter to the Prime Minister, the Chancellor of the Exchequer, to other members of MISC 99 and to Sir Robert Armstrong.

Yours ever

Willie

10 NOV 1983

CONFIDENTIAL Top Copy in Econ Pol, mtgs with the Ch/Ex, Oct '83

6

PRIME MINISTER

Bilateral with the Chancellor

The Chancellor will want to concentrate on public expenditure. The main issues are:-

i) Outstanding questions on individual programmes.

ii) Bridging the gap on the totals.

iii) Announcing the outcome.

These issues are covered in full in the Cabinet Office brief.

Since the brief was prepared the Chancellor has had a meeting with Mr. Buchanan-Smith. The latter reported that the Electricity and Gas Boards were resisting the price proposals in the MISC 99 package. Sir Denis Rooke will only accept 5 per cent if he is given a financial target for the next two years. He is hoping to close off options on increases in gas prices. The Electricity Boards argue that the 3 per cent increases would cause them to exceed their financial targets.

The Chancellor is still considering what approach to take at the meeting and a minute will come over later tonight. He may advise that Energy Ministers should make a further effort to persuade the industries or he may take up an offer from Department of Energy to deliver the public expenditure savings by other means.

Other issues are:-

i) NIC. The Chancellor is likely to recommend no change in rates, a maximum rise in the upper earnings limit and a cut in the Treasury contribut of 2 per cent.

/ii)

ii) After his presentation to the Cabinet on bridging the gap the Chancellor will go on to discuss the Industry Act forecast and the negative fiscal adjustment. You will want to go over with him in advance.

iii) EC net contribution. You said you were not happy with the Chancellor's proposal to use the conventional assumptions. You suggested using the uncorrected figures. The Chancellor is likely to say that this would show the EC contribution £700m. higher. This would raise the programme total. This could only be prevented from raising the programme total if the contingency reserve were reduced by a corresponding amount.

iv) RSG. I minuted you earlier on Patrick Jenkin's wish to reopen the hold-back positions in the RSG settlement. The Chancellor will argue that the tough hold-back provision was a quid pro quo for a high rate of grant and that it is wrong to modify one element of the package. The Chancellor has considered your suggestion that hold-back should not apply where spending is below GRE. He feels this is tantamount to an increase in targets for many authorities and will cause expenditure to rise.

AT

9 November 1983

cc OP

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

PRIME MINISTER

PUBLIC EXPENDITURE: ENERGY INDUSTRIES

As you know, MISC 99 agreed substantial savings on these industries. Two of their recommendations are that domestic gas prices should be increased by 5 per cent in January 1984 and that electricity prices should rise 3 per cent in April 1984. Alick Buchanan-Smith has however told me, and I believe Willie Whitelaw, that his soundings suggest that there will be serious difficulty in securing the agreement of the two industries to these increases.

2. On gas, Denis Rooke's attitude apparently is that he will only increase prices by 5 per cent if we set a financial target covering the years 1983-84 to 1986-87. As you know, I have not been in favour of setting such a target until we had an agreed pricing policy for gas: Andrew Turnbull's letter of 19 October recorded that you shared this view. But Alick accepts that any financial target set now would have to be provisional and subject to revision in the light of whatever we finally agree on gas prices. He undertakes to ensure that our options are left open. On that basis, I have told him that I would be content for him to offer Rooke a provisional target covering the years in question, if this should indeed prove necessary to secure the 5 per cent price increase in January. Rooke's agreement apparently has to be secured by 17 November if we are not to forego January implementation.

3. On electricity, the problem is rather greater, for the Electricity Council apparently now oppose any price increases in 1984-85. They maintain that they can meet this financial target without an increase, and Alick believes that this is correct, and that it will be very difficult indeed to get them to swallow one.

4. This is highly unsatisfactory, for we cannot afford to lose the £210 million 1984-85 public expenditure saving from the higher price. Alick is however confident that he could produce efficiency savings which would enable him to deliver the MISC 99 savings without an electricity price increase in 1984, particularly if he could have flexibility to fill part of the gap from other energy industries.

5. I am not happy about this, and would prefer the MISC 99 package. I told Alick that I was sure that he must push for the 3 per cent price increase. But I did indicate that I thought compensating efficiency savings (provided that the bulk of them came from electricity) would be a less unsatisfactory fall-back than losing the MISC 99 saving as well as MISC 99's proposals for securing them. The savings would of course have to be real and deliverable, not just vague hopes.

6. I wanted you to know of these developments in advance of tomorrow's Cabinet. We could talk about them when we meet at 10 tomorrow morning.

N.L.

N.L.
9 November 1983

CONFIDENTIAL

Prime Minister

To be aware that there is still a disagreement about whether the inflation compensation formula should be published. The MISC 99 Secretaries have confirmed it was not discussed at MISC. Surely better that MoD does not parade its distinction from other programmes? But agree leave to parties for time being.

AT 9/11

ECNO

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

9 November 1983

Dear Secretary of State

I have seen your letter of 4 November to Willie Whitelaw.

I have accepted the formulation you propose, subject to the amendments we agreed with the Prime Minister on Friday evening.

At that meeting, we also discussed how the formulation should be interpreted. The letter of 7 November from the Prime Minister's private secretary to the Lord President's Office records the different views expressed and that you would consider whether you wished to pursue this.

Your letter also asks that the formulation be published with the Survey provision - presumably in the 1984 Public Expenditure White Paper. We did not discuss the possibility of publication in MISC 99 or on Friday, but I cannot agree that such a course is either necessary or desirable. My concern is that publication of the defence guarantee could not only detract from cash planning generally but also rebound adversely on other public expenditure plans or embarrass other colleagues. In view of this, I hope you can reconsider the matter; but if publication remains your preference, we might look at it again once we have agreed on how the formulation should be interpreted.

I am copying this letter to the Prime Minister, the Lord President, the Chancellor of the Exchequer and Sir Robert Armstrong.

Yours sincerely

J.G. Gieve

for PETER REES

[Approved by the Chief Secretary]

CONFIDENTIAL

Public exp pt 25

13

Ref.A083/3185

PRIME MINISTER

Public Expenditure Survey 1983
(C(83) 34)

BACKGROUND

It has been the Cabinet's objective during the current Public Expenditure Survey to hold to the published planning totals for 1984-85 and 1985-86 and to hold total spending in 1986-87 at the same real level. The relevant figures are as follows.

£ billion

1984-85	1985-86	1986-87
126.3	132.1	137.2

The Cabinet have agreed that these figures should include adequate planning reserves.

2. In his minute of 18 October the Chief Secretary, Treasury reported good progress towards those objectives. But there were still gaps of £1.1 billion in 1984-85, £1.7 billion in 1985-86, and £2.5 billion in 1986-87. There were outstanding issues on defence, agriculture, foreign affairs, education, arts and libraries, and the nationalised energy industries; and agreement had not been reached on local authority current expenditure in 1985-86 and 1986-87.

3. You set up the Ministerial Group on Public Expenditure (MISC 99) under the chairmanship of the Lord President of the Council to try to resolve outstanding issues. The Lord President's Memorandum (C(83) 34) reports the results of the Group's work. Agreement has been reached on all the programmes except education and science, either within the Group or bilaterally between the spending Ministers concerned and the Chief Secretary. (The figures agreed for Arts and Libraries do not include anything in respect of the Priestley recommendations; but you have been discussing that separately with the Chancellor of the Exchequer

and Lord Gowrie, and I do not suppose that you will want to bring it up in Cabinet. The amount concerned - £5 million - is insignificant in the context of the totals, and should be capable of being accommodated without difficulty, if agreement is reached, and without prejudice to other programmes.)

4. There are still small excesses over the agreed planning totals (£129 million in 1984-85, £392 million in 1985-86, and £290 million in 1986-87). The figures include reserves of £3 billion in 1984-85, £3.5 billion in 1985-86, and £5 billion in 1986-87, as previously recommended by the Chief Secretary. C(83) 34 draws the Cabinet's attention to the outstanding issues on the education and science programme, and to the agreements that have been reached on the defence programme.

MAIN ISSUES

5. The main issues for the Cabinet are as follows:

(i) Do the Cabinet endorse the agreements reached on programmes other than defence and education and science?

(ii) Do they also endorse the agreements reached on the defence programme?

(iii) What view do they take of the issues raised on the education and science programme?

(iv) In the light of the answers to the questions at (i) to (iii) above, is the overall result satisfactory? In other words, can any over-shoot of the published planning totals be dealt with in a way which is realistic and will command public confidence?

(v) How should the Government's decisions be announced?

Electricity and Gas Prices

6. Of the agreed programmes the one most likely to provoke discussion is that for the nationalised energy industries, and in particular the savings assumed from price increases.

It has been assumed that domestic gas prices will increase by 5 per cent on 1 January 1984, instead of the 4 per cent preferred by the industry and the 6 per cent sought by the Treasury; and that electricity prices will increase by 3 per cent in both 1984-85 and 1985-86, although the industry is understood to be planning for a price freeze in 1984-85. The electricity price increase is particularly important since it produces savings of £210 million in 1984-85, £90 million in 1985-86, and £30 million in 1986-87.

7. Before he left for China the Secretary of State for Energy instructed his Minister of State, Mr Buchanan-Smith, to put these proposals confidentially to the industries. (The Lord President has written to say that this should not have been done in advance of the Cabinet discussion, but it is common ground that at some stage there would have to be an effort to talk the industries round to the Government's view.) Mr Buchanan-Smith will probably wish to report on the industries' reactions so far. We understand that on gas Sir Denis Rooke is reluctant to impose a domestic price increase higher than 4 per cent unless the industry is given a financial target (it does not at present have one). On electricity the industry is said to see great difficulty in justifying to their customers any price increase next year.

8. The Cabinet will wish to consider:

(i) whether the proposed price increases are reasonable;

(ii) what should be done if the industries are unwilling to go along with the Government's proposals.

9. There ought to be no dispute about the reasonableness of the proposed increases. On domestic gas the Treasury's original proposal was 6 per cent on the grounds that this was necessary to keep the price steady in real terms since the last increase 15 months previously. MISC 99 accepted the Secretary of State for Energy's proposal of 5 per cent purely on the grounds that this would give rise to less difficulty with the British Gas Corporation, and without prejudice to future gas pricing policy.

It ought to be difficult for Sir Denis Rooke to reject this proposal since his own estimate of inflation since the last price increase is 5.1 per cent. On electricity it seems very likely that a price freeze in 1984-85 would have to be followed by a price increase of around 6 per cent in 1985-86. MISC 99 considered that, quite apart from the public expenditure savings, it would be much more acceptable to have a price increase of 3 per cent, well below the inflation rate, in each of the two years 1984-85 and 1985-86.

10. The first step must obviously be to persuade the industries to fall in with the Government's views. Even if the initial reaction reported by Mr Buchanan-Smith is adverse, the Cabinet may feel that it is too soon to give up the effort. Should the effort eventually fail the options would be to impose the increases (which would probably require legislation and would raise obvious political difficulties) or insist that the industries find equivalent offsetting savings.

Wales

11. The letter of 8 November from the Secretary of State for Wales to the Chief Secretary raises a number of points on his programme. He asks the Chief Secretary to accept that the Cabinet's decisions will not be taken to rule out separate agreement on a solution. Presumably this means that an increase in the Welsh programme would not be precluded. Clearly the Cabinet cannot go into details. If the Secretary of State for Wales raises the matter, it should suffice to agree that the Cabinet's decisions are without prejudice either to the Secretary of State's right to claim on the contingency reserve or the Chief Secretary's right to resist.

Defence

12. You will wish to treat defence as an agreed programme for endorsement by the Cabinet and to avoid encouraging more discussion than is necessary. We understand that exchanges are still going on between the Secretary of State for Defence and the Chief Secretary, Treasury about the interpretation of the form of words relating to the two earlier years but the Cabinet should not become involved in that. In relation to the third year, 1986-87,

the important point is that the figure of £18,650 million is a straightforward cash provision, unqualified by any words about commitments to real growth. It is true, as a matter of arithmetic, that the figure was arrived at by adding 1 per cent on top of the 3 per cent cash factor for 1986-87, but there is no implied commitment to 1 per cent real growth in 1986-87.

Education and Science

13. There are two issues, discussed in detail in Annex C of C(83) 34:

(i) Do the Cabinet endorse the recommendations of MISC 99 on student grants and university current expenditure?

(ii) If not, how should any resulting changes in the figures be dealt with?

In addition the Secretary of State for Education and Science may be tempted to re-open some of his rejected bids for additional expenditure, notably that for science. Since the education and science programme, unlike all the others, has not been agreed, he is entitled to do so, but you will not wish to encourage him to widen the area of debate beyond the two issues which have been identified.

14. On student grants, as you know, the Cabinet will wish to weigh the need for savings of £25 million, £45 million and £50 million over the three years, against the political difficulty of further reducing the value of grants; and also, if savings are to be made in this area, to consider whether the balance of the proposed package is acceptable in its impact at vaious income levels.

15. On university current expenditure the main issue is whether an efficiency saving of £50 million in 1986-87 would be inconsistent with your assurance of 7 June about holding higher education expenditure steady in real terms after 1984-85.

16. If the Cabinet should reject all or part of the MISC 99 recommendations, the excess over the planning totals will be increased. There would be three possible ways of dealing with the situation:

(i) The Secretary of State for Education and Science could be asked to find alternative savings. But he and MISC 99 are agreed that the recommended savings are the most that could be found within his programme. And it could be regarded as unfair for the Cabinet to insist that the Secretary of State should find savings in a form which he regards as undesirable, having rejected his own proposals for savings.

(ii) Other Ministers could be asked to find savings. That would mean re-opening all other programmes. It hardly seems practicable.

(iii) Treasury Ministers will have to deal with the addition to the excess in some way or another.

Overall Situation

17. The net result of the changes made before the Survey, bilateral agreements between the Chief Secretary and spending Ministers, and the recommendations of MISC 99 is an excess of £129 million in 1984-85, £392 million in 1985-86, and £290 million in 1986-87, compared with the objectives agreed in July. These figures might, of course, be marginally changed as a result of any discussion of individual programmes on 10 November.

18. The gaps could be bridged in one or more of the following ways:

(i) Proceeds from the disposal of Enterprise Oil will not be available until 1984-85, instead of 1983-84 as previously assumed. This will increase resources in 1984-85 by £400 to £500 million. About £300 million of this will be needed to cover prospective overruns on social security expenditure; but we understand that unless the agreements on individual programmes come seriously unstuck on 10 November, there will still be enough to cover the gap without touching the reserve of £3 billion for 1984-85.

(ii) It would be possible to show higher, but still credible, figures for asset sales in 1985-86 and 1986-87.

(iii) The proposed reserve of £5 billion for 1986-87 is high; it might be possible to reduce it by, say, £½ billion without undue risk, but Treasury Ministers will probably be reluctant to do so at this stage.

19. Treasury Ministers will not wish to show their hands too clearly; and you will probably not wish to press them to go into detail. Even so, there will be great advantage in being able to say - and say in public - on 10 November that the 1983 Survey is now concluded, within the previously agreed totals; and Treasury Ministers will need to provide sufficient information for that to be said with reasonable conviction.

Announcements

20. It is usual to announce the figures for individual programmes for 1984-85 in the Autumn Statement which is due to be made on 17 November. (Details for later years eventually appear in the Public Expenditure White Paper.) But you will probably wish the Cabinet to approve a form of words for immediate use, to the effect that the Survey has been "satisfactorily concluded and totals held." I understand that the Chancellor of the Exchequer intends to discuss a draft with you before the Cabinet meeting.

Manpower

21. At the Cabinet meeting on 20 October it was reported that there was an outstanding disagreement about the manpower target for the Ministry of Defence. The Secretary of State for Defence had withheld his agreement on the grounds that the targets generally were not sufficiently demanding. He has however now accepted the Chief Secretary's proposed target on the understanding, approved by the Cabinet on 20 October, that every attempt would be made to improve on the targets set for Departments.

Capital/Current Expenditure

22. The Cabinet asked on 20 October for information about the breakdown between capital and current expenditure. A note by Treasury officials has therefore been attached to C(83) 34 at Annex E. Some Ministers may express disappointment that the note is not more informative. The Treasury has however had genuine difficulty since some Departments have not yet decided their own capital/current split. There are also problems about how the two categories should be defined. You will wish to discourage further discussion at this stage. If need be, the Chief Secretary might be asked to circulate a fuller paper in good time before the next Public Expenditure Survey round.

HANDLING

23. The Chancellor of the Exchequer is most anxious that individual programmes should be settled before he describes how any remaining gap can be bridged: he fears that if he shows his hand too soon, any outstanding issues will be settled over-generously; and it is even possible that agreed programmes may be re-opened. You may therefore wish to divide the discussion into three parts:

(i) individual programmes, especially defence and education and science;

(ii) the overall situation;

(iii) announcements.

Individual Programmes

24. You might introduce this part of the discussion by inviting the Lord President of the Council to introduce his memorandum. The Chief Secretary, Treasury could then be invited to make any general points. The Secretary of State for Defence and the Secretary of State for Education and Science will wish to discuss the points arising on their programmes. Mr Buchanan-Smith (in the absence of the Secretary of State for Energy) may wish to speak about the savings to be found from the gas and electricity supply industries. Any of your other colleagues may wish to contribute. But you will naturally wish to discourage any attempt

to re-open agreements; if there are points of detail still to be settled, they should be discussed between the spending Minister and the Chief Secretary.

Overall Situation

25. In the light of the first part of the discussion you might invite the Chancellor of the Exchequer to speak, in particular on how any remaining gap between agreed expenditure programmes and the planning totals is to be covered. The Chancellor might also give such indication as he considers right regarding revenue prospects and other matters to be covered in the Autumn Statement on 17 November. (This would do something to meet the wish expressed by some members of the Cabinet on 20 October to have information about the likely revenue outturn when reports are made on prospects for expenditure.)

Announcements

26. Again, you might invite the Chancellor of the Exchequer to propose a form of words for use in response to enquiries about the progress of public expenditure discussions.

CONCLUSIONS

27. You will wish the Cabinet:

(i) to agree the figures for individual expenditure programmes in 1984-85, 1985-86 and 1986-87;

(ii) in particular to decide such matters as arise on

- defence
- education and science;

(iii) to note the Chancellor of the Exchequer's account of the general situation and how he proposes to bridge any remaining gap between the agreed expenditure programmes (plus reserves) and previously agreed planning totals;

(iv) to agree on the terms of an announcement.

RA

Approved by
ROBERT ARMSTRONG
and signed in his absence

9 November 1983

Public Exp Pt 25

Public expenditure totals

NOTE OF A DISCUSSION ON ENERGY INDUSTRY ISSUES AT NO 11 DOWNING STREET AT 4.30 PM ON 9 NOVEMBER 1983

Present:-

Chancellor	Mr Buchanan-Smith, Minister of State Department of Energy
Mr Middleton	Sir Kenneth Couzens
Mr Bailey	Mr Wilson
Mr Kerr	
Mr Robson	

The Chancellor said that he had been very concerned at reports that the Department of Energy were not confident of delivering the MISC 99 agreement in respect of the gas and electricity supply industry. The deal struck in MISC 99 was not precisely as Treasury Ministers would have wished, but they had accepted it, and so - they had understood - had the Secretary of State for Energy. The savings which MISC 99 had agreed would be crucial to the Government's success in achieving the aim, agreed in July, of holding to the public expenditure totals. He had therefore thought it appropriate, in the light of the reports he had heard, to ask for an urgent meeting with Mr Buchanan-Smith (in the Secretary of State's absence in China): it was important to know the precise position before Cabinet on 10 November.

2. Mr Buchanan-Smith said that his Secretary of State had agreed in MISC 99 to do his best to secure the price increases sought from the gas and electricity industries: he had however given no guarantee of success. Subsequent soundings had confirmed the difficulties he had foreseen.

3. In relation to gas, Sir Dennis Rooke would probably be prepared to accept a 5 per cent increase in domestic prices on 1 January 1984, but only on two conditions. First, he would accept no increase in the standing charge, though he would find the cash foregone by savings elsewhere. Secondly, he would insist on prior agreement with the Government on

a 4-year financial target.

4. On electricity, the situation was still more difficult. The Electricity Council were adamantly opposed to any price increase in 1984-85, and maintained - correctly, in the Department of Energy's view - that they could meet their financial target for the year without an increase. It might be possible to recoup the bulk of the £210 million expected in 1984-85 from a price increase through efficiency savings, but agreement on a price increase seemed highly unlikely: the only option other than accepting the alternative of efficiency savings might therefore be the imposition of a price increase via legislation, which would be unpopular.

5. The Chancellor said that the situation was profoundly disturbing. The suggestion appeared to be that the Government might in effect be abdicating control of nationalised industry pricing policy. And his understanding had not been that the MISC 99 package was ad referendum to Sir Dennis Rooke and Mr Jones of the Electricity Council. He and the Chief Secretary believed that the MISC 99 package should be delivered.

6. As to gas, it made little sense to set a 4-year financial target in advance of agreement within Government on the correct gas pricing policy; and he recalled that this was also the Prime Minister's view. Pricing was in any case a Board matter, not the exclusive prerogative of Sir D Rooke. But if it were really thought essential to concede a financial target in order to secure the MISC 99 agreement, he would be prepared to consider a Department of Energy proposal, provided that it were made clear to all parties that it was inevitably of a provisional nature. As for the standing charge, not increasing it would be odd, but need not perhaps be excluded, provided that a compensating saving were made.

7. On electricity, a price freeze, followed by a sharp increase in April 1985, would in his view be very unsatisfactory to Government. It was essential that the total savings agreed in MISC 99 should be found, and the very modest 3 per cent price increase agreed at MISC 99 was economically desirable in itself. If necessary, therefore, it would have to be imposed on the industry. As to the proposed contingency fall-back of seeking compensating efficiency savings, it was not even clear whether compensation in full would be in prospect.

8. Mr Buchanan-Smith said that, given the Lord President's views, he did not envisage any further exploration before Cabinet on 10 November. But his view was that the bulk of the required £210 million could be found from the electricity industry, and if there were any shortfall it would have to be found from other energy industries. It might, for example, be possible to effect on gas in 1984-85 a further £40 million saving envisaged for 1986-87.

9. It was agreed that, on gas, officials would compare notes very urgently on an appropriate provisional financial target. On electricity, Department of Energy officials would explore with Treasury officials the details of the contingency fall-back of efficiency savings instead of a price increase. Such savings would have to be real, deliverable, and verifiable; and they must not entail any transfer of expenditure into the current year. The Chancellor pointed out that, if the worst came to the worst and the 3 per cent price increase in 1984-85 were in the end foregone, the 1985-86 increase would have to remain 6 per cent, instead of coming down to 3 per cent.

10. The Chancellor repeated that he stood by the MISC 99 package. He was however grateful for Mr Buchanan-Smith's description of Department of Energy thinking; and he noted that the threat which Mr Buchanan-Smith foresaw was not to the total savings agreed in MISC 99 but to their composition.

This was important, because the 1984-85 public expenditure figures for the Autumn Statement would, if Cabinet reached agreement on 10 November, have to go to press on 11 November. An agreed 1984 EFL for the electricity supply industries would be required on the same time-scale.

MOM

for J O KERR

DISTRIBUTION:

Chief Secretary	PS/Secretary of State, Dept of Energy
Mr Middleton	PS/Minister of State, Dept of Energy
Mr Bailey	Sir Kenneth Couzens, Dept of Energy
Mr Burgner	
Mr Scholar	
Mr Robson	

10 NOV 1983

11 12 1 2 3 4 5 6 7 8 9 10

xCNO

Treasury Chambers, Parliament Street, SWIP 3AG

Miss Judy Roberts
Secretary of State's Office
Welsh Office
Gwydyr House
Whitehall
LONDON
SW1A 2ER

9 November 1983

Dear Judy

PUBLIC EXPENDITURE SURVEY

will request if required

with AT

We spoke this morning about your Secretary of State's letter of yesterday. The Chief Secretary certainly accepts that he needs to respond to the letters of 5 October and 19 October and that discussion of the issues on their merits cannot be ruled out/on simply the grounds of what Cabinet decides tomorrow. However, as you will recognise, his position on the merits is entirely reserved and he cannot lightly contemplate an addition to the Welsh block for 1984-85 (or an increase in cash limits this year).

I am sending copies of this letter to the Private Secretaries of the Prime Minister, other members of Cabinet, and Sir Robert Armstrong.

Yours sincerely

J.R. Gieve

JOHN GIEVE
Private Secretary

Public Exp Pt 2 S

12

RECORD OF A DISCUSSION ON THE NATIONAL INSURANCE CONTRIBUTIONS REVIEW AT 9AM ON 8 NOVEMBER IN NO 11 DOWNING STREET

Present:

Chancellor	Secretary of State
Mr Middleton	Mr Newton
Mr Kerr	Mr Hepple
Ms Seammen	

The Secretary of State said that, with the Fund in surplus, and the GAD forecasting a continued surplus next year, it would be feasible and appropriate not to raise National Insurance Contribution rates. An announcement this month that the rates would not rise next year would be particularly helpful in the context of the public expenditure savings on social security programmes which would also have to be announced; and the package might indeed have to be re-considered if there were any serious question of rates going up. An increase in the upper earnings limit would not, however, cause similar difficulties. As for the Treasury Supplement, it had come down from 18 per cent to 13 per cent since 1979, and a further reduction would be unnecessary and unwelcome.

2. The Chancellor said that he agreed that UEL should rise. He also saw a strong case for a reduction in the Treasury Supplement: the balance of the Fund would rise, on the GAD's calculations, unless the Supplement were reduced. As for the rate, the budgetary prospect now was for tax increases next year; and there were strong political arguments for reducing these increases by action on NIC now. It would also be appropriate, given that social security expenditure next year, and in the later PESC years, seemed likely to come out some £300 million higher than had been assumed during the MISC 99 discussions, that this increase should be offset by an increase of a ¼ per cent on the NIC rates for employer and employee. He had envisaged discussing these

issues with the Secretary of State after Thursday's Cabinet; but he had no objection to pursuing them now.

3. Mr Fowler said that he saw overwhelming political and social arguments against an increase in NIC rates. British industry, and he guessed the Secretary of State for Industry, would also be very hostile. The Chancellor said that he recognised that. Of course an increase in rates would be unpopular: all tax increases always were. Given the strength of the Secretary of State's objections, and the fact that the fiscal forecast could change before Budget time, he would however be prepared to forego an increase in NIC rates, provided that the Secretary of State agreed that the upper earnings limit should be indexed in line with earnings and should therefore rise to £250, that there should be a 2 per cent reduction in the Treasury Supplement, and on the understanding that he could look for support from the Secretary of State in the New Year if and when he had in fact to report to Cabinet ~~in the New Year~~ that the Budget would have to entail tax increases.

4. The Secretary of State said that, while he would have preferred raising UEL only to £245, he was prepared to accept an increase to £250. He would however wish to reflect further on the proposed 2 per cent reduction in the Treasury Supplement. Given that the Government's commitment was to tax reductions, any move which increased the chances that NIC rates would have to rise in future years was plainly undesirable.

5. It was noted that agreement would have to be reached on or before 11 November, in order to allow time for the Government Actuary's further calculations, and for the publication of the Autumn Statement on 17 November. In view of the Chancellor's absence in Bonn before Cabinet, and the fact that a proposed increase in NIC rates would have to be discussed in Cabinet on 10 November, the Secretary of State's considered reaction to the Chancellor's proposed deal (ie the dropping of the proposed increase in rates in exchange for agreement on a 2 per cent reduction in the Treasury Supplement) would be conveyed urgently via officials.

JOK.

J O KERR

Distribution:

Chief Secretary	PS/S of S, DHSS
Mr Middleton	Sir K Stowe, DHSS
Mr Bailey	Mr Newton, Parliamentary Under Secretary DHSS
Mr Watson	
Mr Battishill	Mr Hepple DHSS
Ms Seammen	

Undisclosed copy to: Andrew Turnbull, No 10 do

CONFIDENTIAL

② c/NO

Prime Minister
This is the exchange referred to in the Cabinet brief on public expenditure.
AT 9/11

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
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01-233 6106 (Direct Line)

From The Secretary of State for Wales

THE RT HON NICHOLAS EDWARDS MP

8 November 1983

Dear Chief Secretary,

PUBLIC EXPENDITURE SURVEY

On Thursday, we are to discuss the Public Expenditure Survey in Cabinet; and I understand that it is hoped that we will settle the major outstanding issues, though as in previous years there may be some matters that remain for resolution and I am writing to put on record those that very much concern me.

In accordance with normal practice, I have agreed to accept the formula based consequentials for my block of the changes you have agreed with our Ministerial colleagues in respect of programmes of comparable expenditure in England though I cannot at this stage know what the results will be as they are dependent on allocations by colleagues within their programmes, the details of which have not yet been made available. The consequence of the formula system is that I make my full contribution to the savings you are seeking. However, there are especial difficulties applying only to my situation which threaten to knock a hole in my provision for next year.

First of all, as I told you in my letter of 19 October, in proportionate terms there has been a much greater response to the 90 per cent housing improvement grant scheme in Wales than in England, no doubt reflecting our higher proportion of pre-1919 and unfit houses. There is therefore a disproportionately large overhang of Housing Improvement Grants which will have been approved by the end of this financial year when the Budget measures expire, but will fall for payment in 1984/85. We do not yet know how much this overhang will be, but it could be in the range £84m to £140m. This compares with my local authority

/Housing

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury

CONFIDENTIAL

Housing baseline (after taking the consequential to the cut agreed for England) of about £44.5m; we estimate that about another £50m may be available from Housing sales receipts, making a total of about £95m for allocation. Besides the grants overhang this has to accommodate other Housing commitments entered into by local authorities this year as well, quite apart from anything new in 1984/85 itself.

The position is made even worse because we look like having an overspend on the local authority capital cash limit this year. I wrote to you about this on 4 October and our officials have discussed the figures since then. It looks as though the overspend may be as large as £60m. There is thus no possibility of using the carry-forward facility you have agreed for local authority capital underspends to boost my local authority capital provision for next year. We therefore have no cushion for the grants overhang. Not only that, but if this year's overspend turns out to be as large as we fear and the whole of it is deducted from my 1984/85 local authority capital provision, I shall not be able to honour even the 80 per cent forward commitment for planning purposes which I gave to local authorities (as did the Secretary of State for the Environment in England) with your predecessor's consent. We suspect that local authorities may have already entered into legally binding commitments up to that level.

There is also no possibility of diverting resources from other services within my block on the scale necessary to counter these adverse factors. My 1983/84 provision for roads looks like being overspent by something approaching £20m, largely because of contractors taking advantage of the fine summer to press ahead with road construction (my officials have been in touch with yours about this and I shall be writing to you shortly). If anything like this sum has to be deducted from my 1984/85 provision I shall be in an extremely difficult position on the block as a whole before taking account of the local authority problems I have described above.

I shall want to discuss these matters with you before my 1984/85 provision is finalised, and I take it (in the absence of replies to my letters of 4 October and 19 October) that you accept that Cabinet's broad decisions on Thursday will not be taken to rule out whatever solution we can devise between us.

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

Yours sincerely

J H Roberts

Approved by the
Secretary of State and
signed in his absence

POSSIBLE REPHASING OF MISC 99 OFFER

The MISC 99 offer is:

	£m cash		
	1984-85	1985-86	1986-87
	17010	18040	[18464]*
Change on Treasury offer	+100	+106	[+111]*

* MISC 99 made no recommendation on 1986-87. This figure is a simple revaluation of 1985-86 by the 3% cash factor

2. The total extra across the three years is £317m but we do not believe that the MISC 99 phasing achieves the optimum effect either presentationally or managerially. If Mr Heseltine could be brought to accept that £317m extra is a final offer he might opt for rephasing. The Chancellor would not object to sensible rephasing.

3. At one extreme the whole £317m could be added to the final year giving:

16910	17934	18670

This phasing would still give 3% real increases in 1984-85 and 1985-86 in fulfilment of the Government's commitment, and a non-Falklands cash increase in 1986-87 of 4.8%, well above the cash factor of 3%. (The Treasury would much prefer to talk solely in cash about 1986-87. My translation into "real terms" would derogate from cash planning and act as a ratchet in future years.)

4. A minimal rephasing would simply round down the earlier years in favour of the final year eg

17000	18000	18514

There is a whole range of intermediate distributions.

5. The Treasury does not believe that Mr Heseltine will argue that pressure on the defence budget requires extra funds in the first two years. There are no signs of such pressure and the recently agreed flexibility arrangements will give further help. Any defence works and procurement underspend in 1983-84 can be carried forward into 1984-85 up to a maximum of £375m. No allowance is made for carry forward in any of the above figures.

6. At the bilaterals with the Chief Secretary, Mr Heseltine argued rather that it would be presentationally difficult for him to accept the Treasury proposals for the first two years, since the figures were below the 1983 White Paper published totals. The Treasury does not see

/ this

this as a major problem since the lower figures still provide for 3% pa real growth. The real issue is whether Mr Heseltine wants more than 3% real growth in 1984-85 coupled with a base 3% cash factor uplift in 1986-87, or whether he would prefer something closer to 3% in 1984-85 coupled with a cash increase in 1986-87 higher than the straight 3% revaluation.

8. Our conclusion is that an offer of some rephasing of the MISC 99 offer could well prove attractive to Mr Heseltine. But he would first have to accept that it is redistribution not additional cash that is on offer.

Public Expenditure file

11A

SECRET

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Alick Buchanan-Smith MP
Minister of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

7 November 1983

Dear Minister

MINISTERIAL GROUP ON PUBLIC EXPENDITURE (MISC 99):
ENERGY INDUSTRIES

I have seen your letter of 3 November to Willie Whitelaw and his reply of 4 November.

2. I understand you are encountering some difficulty in getting the industries to accept the increases in gas and electricity prices. I hope you will leave them in no doubt about the need to secure the reductions in public expenditure set out in Willie's letter of 2 November to Peter Walker (assuming these are endorsed by Cabinet).

3. In the end we may have to set their external financing limits (EFLs) for 1984-85 on the basis of the figures in Willie's letter and tell the industries that they are expected to live within them. As far as electricity is concerned, we could back this up by revising their financial target for 1984-85 in the light of the MISC 99 figures.

4. I fully recognise that this could lead to a public row with the industries. I think we must be ready to face that. Our price increases are utterly reasonable and the expenditure savings involved are crucial.

5. I am copying this letter to the Lord President, the Lord Privy Seal, the Secretaries of State for Scotland and for Trade and Industry, the Chancellor of the Duchy and to Sir Robert Armstrong.

Yours sincerely

J.L. Grier

PETER REES

SECRET [Approved by the Chief Secretary]

SECRET

Mr. Turnbull

11

I agree with Mr. Gregson that you have done an excellent job. I have suggested another couple of amendments, aimed at avoiding any dissent from Mr. Heseltine.

FERB
7.11

P.01152

MR TURNBULL

cc Mr Buckley
Mr Potter

PUBLIC EXPENDITURE: DEFENCE

Thank you for letting me see the note of the defence meeting on 4 November, which is excellent. I have only two points.

2. First, I would be inclined to tighten up the passages relating to the ambiguity of the inflation formula on the following lines:

> Amend the words at the bottom of page 1 and the top of page 2 as follows:
>
> "The Prime Minister said that in her view the natural interpretation of the words "year by year" was that cash limits would not be reopened during the year to which they applied. If the Secretary of State for Defence wished to pursue the matter further, he should do so bilaterally with the Chief Secretary. It was however agreed that the .... reference
>
> Amend the last sentence in the summing up paragraph to read:
>
> "If the Secretary of State for Defence wished to pursue further the question of the timing and frequency of the review of the cash limits under the inflation formula he should do so bilaterally with the Chief Secretary.

3. These changes are designed:

- to remove the implication that there is a large measure of ambiguity about the formula (I am sure that there is but we do not want to give official endorsement to this idea)

- to put the Secretary of State for Defence more clearly in the position of demandeur, working against the grain of the actual words

- to make it clearer that any subsequent resolution of this matter is to be bilateral.

4. Secondly it would be courteous to the other members of MISC 99, and help to keep them in the picture, if you could add them to the copy list (ie the Secretaries of State for Scotland and Trade and Industry, the Lord Privy Seal and the Chancellor of the Duchy).

4. On the question of publication I can confirm that this possibility was not raised in relation to the inflation formula either at the MISC 99 meeting or at the Lord President's meeting at 10.00. By contrast, it was always clear that the other form of words relating to the 1986-87 figure was specifically designed for external consumption and was intended to be used in the White Paper.

5. The letter of 4 November from the Secretary of State for Defence to the Lord President, which was written immediately after the Lord President's meeting, did however confirm his agreement to the form of words on the basis that they would be published. I agree with you that the question of publication of this form of words was not raised at the Prime Minister's meeting. It is a matter for your judgement as to whether you say so specifically in your note of the meeting.

PG

P L GREGSON

7 November 1983

ECON POL. Public Exp

SECRET

cc. SO MOD
DTI CS-HMT
WPS HMT
CDL
CO-Gregson
CO-PH
bc NO + D.P.

HL

10

10 DOWNING STREET

From the Private Secretary

7 November 1983

Dear Janet,

Public Expenditure Survey 1983: Defence

The Prime Minister held a meeting on Friday 4 November with the Chancellor of the Exchequer, the Secretary of State for Defence and the Chief Secretary. Also present was Mr. Gregson. The meeting discussed public expenditure on the defence programme following the MISC 99 deliberations and the Lord President's meeting on Friday morning with the Secretary of State for Defence and the Chief Secretary.

The meeting first discussed the provision in 1984/85 and 1985/86. The Secretary of State for Defence said that he had dropped his additional bid to cover the extra cost of the 1983 Pay Review. He was also prepared to drop his bid for inflation compensation provided that a form of words was agreed which would cover the defence programme against the risk that inflation was different from that projected. Finally he had agreed to a reduction below base line. This produced figures of £17,010 million in 1984/85 and £18,040 million in 1985/86 (both including provision for the Falklands). These were the figures agreed with the Lord President earlier in the day. The meeting endorsed these figures.

The meeting then considered the formula which is recorded in the Secretary of State for Defence's letter to you of 4 November. This read

> "Alone of its public expenditure programmes, the Government's defence policy is currently expressed in both volume and cash terms. In order to fulfil the Government's commitments up to and including 1985/86, the cash provision will be reconciled year by year in the light of the volume requirement and of the most up-to-date forecasts of inflation and appropriate adjustments made."

The Secretary of State for Defence explained that in his view the formula would permit a review of the allocation to defence to preserve the intended volume if actual inflation diverged from the forecast path in either of the next two years.

/ The Chief Secretary

NTC

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The Chief Secretary said that he had not envisaged that the words would embrace an adjustment to cash limits for any year, once they had been set. The Prime Minister said that in her view the natural interpretation of the words "year by year" was that cash limits would not be reopened during the year to which they applied. If the Secretary of State for Defence wished to pursue the matter further, he should do so bilaterally with the Chief Secretary. It was however agreed that the reference in the text to "volume" should be replaced by "real".

The meeting then considered the provision for 1986/87. The Secretary of State for Defence suggested that this could be dealt with in a number of ways. A figure could be entered which uprated the agreed 1985/86 figure by the 3% cash factor applicable to all other programmes. Adjusting for expenditure on the Falklands, this would produce a figure of £18,464 million. This could be accompanied by a statement that

> "The Government has not yet determined the provision for defence after 1985/86 which will be considered in the light of international developments and economic circumstances nearer the time."

Alternatively the meeting could agree on a substantive figure. This could lie within a range starting with the zero real increase, going up to a 3% real increase. He recognised however that it would not be realistic to propose an increase at the top of this range. He suggested that there was merit in a figure of £18,710 million which would allow him to substantiate the claim that defence had increased by 21% in real terms (being achieved only a year later than originally envisaged).

In discussion it was argued that the first formulation was unacceptable. The Government ought to be in a position to say what its policy was. Furthermore, defence planners needed to know what basis they would be working on. It was argued that with the use of different deflators the claim of 21% real growth could already be substantiated.

After some discussion it was agreed that the figure for 1986/87 would be £18,650 million. This was on the understanding that it was a cash figure, with no implied volume commitment, and that it would not be qualified in any way.

Summing up, the Prime Minister said there was now agreement on figures for all three years which could be incorporated into the MISC 99 report. If the Secretary of State for Defence wished to pursue further the question of the timing and frequency of the review of the cash limits under the inflation formula he should do so bilaterally with the Chief Secretary.

/ I am copying

I am copying this letter to John Kerr (H.M. Treasury), John Gieve (Chief Secretary's Office), Richard Mottram (Ministry of Defence), Richard Hatfield (Cabinet Office) and Peter Gregson (Cabinet Office). I am also copying this to the Private Secretaries to the other members of MISC 99.

Yours sincerely

Andrew Turnbull

Andrew Turnbull

Miss Janet Lewis-Jones,
Lord President's Office.

SECRET

FERB

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10 DOWNING STREET

From the Private Secretary

MR. GREGSON
CABINET OFFICE

I would like to ensure that my record and the MISC 99 report are consistent. Any comments?

The Treasury are still disputing whether the wording on the inflation compensation will be published. They say this was not discussed at MISC 99, and have asked for the sentence in the second paragraph on page 2 to be included. Any views?

Andrew Turnbull

6 November 1983

SECRET

✓cc. blue

8

P.01149

PRIME MINISTER

Public Expenditure Survey 1983: Defence

BACKGROUND

The basic figures are summarised in the note by officials circulated as MISC 99(83)3 (copy attached for ease of reference).

2. An agreed settlement was reached this morning at a bilateral meeting under the chairmanship of the Lord President for the years 1984-85 and 1985-86. The outcome is as follows:

		£m cash
	1984-85	1985-86
MoD proposed provision	17,330	18,551
Treasury proposed provision	16,910	17,933
Provision now agreed	17,010	18,040
of which, Falklands	684	552

As you will see, the Treasury has conceded only £100 million out of the original gap of £420 million for 1984-85, and £106 million out of the original gap of £618 million for 1985-86.

3. To achieve this result the Secretary of State for Defence has withdrawn his bids for compensation for the 1983 pay review body awards and for inflation compensation. In the latter case the Treasury has conceded in return the following formula:

> "Alone of its public expenditure programmes, the Government's defence policy is currently expressed both in volume and cash terms. In order to fulfil the Government's commitments up to and including 1985-86, the cash provision will be reconciled year by year in the light of the volume requirement and of the most up to date forecasts of inflation and appropriate adjustments made."

The Treasury has also reduced the cuts it was seeking below baseline in 1984-85 (£167 million rather than £267 million) and in 1985-86 (£174 million rather than £280 million).

MAIN ISSUES

4. The purpose of your meeting is to settle the provision for 1986-87. The outstanding issue is whether there should be any increase on the 1985-86 figure over and above the increase resulting from the cash factor of 3 per cent which applies to all programmes.

5. The Secretary of State for Defence originally made a bid for an additional volume increase of 3 per cent. He is however now prepared merely to uprate by the 3 per cent cash factor, provided that this can be accompanied by a suitable form of words. The figures would run as follows:

	£m cash
Figure agreed for 1985-86	18,040
Less Falklands provision	552
	17,488
Plus 3 per cent cash factor	18,014
Plus Falklands provision already agreed for 1986-87	450
Figure proposed for 1986-87	18,464

6. Looked at purely in terms of the figures this would be a substantial victory for the Treasury. It is only about £100 million above the Treasury's original proposal for 1986-87 and, because of the other bids already withdrawn, it is around £1.35 billion less than the MoD's original proposal for 1986-87.

7. The Secretary of State for Defence proposes however that the figure should be accompanied by the following form of words:

> "The Government has not yet determined the provision for defence after 1985-86 which will be considered in the light of international developments and economic circumstances nearer to the time. The figure for 1986-87 is therefore that for 1985-86 (excluding Falklands provision) increased by the appropriate cash factor, together with £450 million to meet the costs of the Falklands commitment in 1986-87."

8. The Treasury do not like this approach because it leaves them vulnerable to claims for a volume increase at some time in the future. Their preference would be to concede a higher figure for 1986-87 in the hope that this could be made to stick in cash and that the Government's future policy on NATO commitments would be constrained like other policies by cash disciplines.

9. The Secretary of State for Defence is likely to argue that for the Government to commit itself now to a precise figure which is inconsistent with continuation of a 3 per cent volume commitment in 1986-87 would be damaging politically and would give the wrong signal to our NATO allies.

10. You will wish to keep in mind the danger (to which the Lord President gives considerable weight) that the Treasury's approach might lead to the worst of both worlds, ie a firm commitment now to <u>some</u> volume increase in 1986-87, adverse reactions from abroad and from the defence lobby, and the need for reassurances eventually which had the effect of maintaining the full 3 per cent volume commitment to NATO.

HANDLING

11. You will wish to begin by saying that the purpose of the discussion is not to re-open the decisions already taken about 1984-85 and 1985-86 but to see whether the position for 1986-87 can be settled before Cabinet. You might invite the Secretary of State for Defence to put forward his proposals and then seek reactions from the Chancellor of the Exchequer and/or the Chief Secretary, Treasury.

CONCLUSIONS

12. You will wish to reach conclusions, if possible, on:

i. the figure for 1986-87;

ii. if necessary, any accompanying form of words.

PG

P L GREGSON

4 November 1983

PES 1983: DEFENCE

	1983-84	1984-85	1985-86	1986-87
	£ million cash			
Baseline	15719.6	17178.0	18214.4	18192.2
(of which Falklands)	(624.0)	(684.0)	(552.0)	-
Agreed bid: Falklands				+ 450.0
Disagreed proposals for increases/reductions				
MOD bids:				
inflation compensation		+ 59.3	+ 240.0	+ 508.8
Service pay awards	+ 90.4	+ 93.1	+ 96.8	+ 99.7
1986-87 3% "real" growth				+ 564.1
Total MOD bids	+ 90.4	+ 152.4	+ 336.8	+1172.6
Treasury proposals:				
limit growth to 3% in 1984-85 and 1985-86	-	- 267.6	- 280.7	- 289.1
MOD proposed provision	15810.0	17330.4	18551.2	19814.8
Treasury proposed provision	15719.6	16910.4	17933.7	18353.1

Inflation bid

The MOD bid for inflation compensation is based on the March FSBR forecasts of inflation with an extrapolation for 1986-87 (5½%, 5% and 4½% respectively for 1984-85, 1985-86 and 1986-87). It is designed to maintain the real value of the Cmnd 8789 plans.

2. The Treasury view is that provision should continue to be based-as for other programmes - on the Cabinet agreed cash factors (5%, 4% and 3% respectively for 1984-85, 1985-86 and 1986-87). The autumn forecast for 1984-85 is likely to confirm that the cash factor of 5% is adequate. The cash provision for later years (1985-86 and 1986-87) can be reviewed in subsequent Surveys in the light of inflation and other economic factors.

Service Pay Awards

3. The MOD claim is that the defence budget should receive additional provision, in accordance with past practice, to meet the extra cost in all years of the 1983 AFPRB, TSRB and DDRB awards. In their view this is necessary in order to maintain the real growth in defence expenditure of the Cmnd 8789 plans.

4. The Treasury reject this bid, since in their view the 3% growth commitment can be honoured without accepting it and the extra costs can be accommodated by improved efficiency.

/ 5.

Limitation to 3% growth 1984-85 and 1985-86

5. The Treasury proposal is to limit growth to 3% per annum and no more in 1984-85 and 1985-86, in accordance with the statement in the Defence White Paper 1983 that "We remain committed to plan to implement in full the NATO target of 3% real growth in defence spending each year until 1985-86". In effect this means calculating 3% growth from the current 1983-84 provision (ie, after the July cash limit cut and excluding Falklands provision) rather than reverting to a higher baseline. If the cash limit reduction is not carried through the result will be real growth of more than 5% in 1984-85.

6. The MOD consider the Treasury proposal to be inconsistent with Government policy as stated in the 1981 White Paper Cmnd 8288, that "the intention will be provision for 1985-86 21% higher, in real terms, than actual expenditure in 1978-79". MOD calculate that, Falklands provision exclusive, the Treasury proposal would limit real growth in 1985-86 to 18½% over 1978-79. An increase of 5.2% in 1984-85 over the reduced 1983-84 provision is necessary to catch up on the path to 21%.

1986-87 growth

7. MOD point out that the agreement by NATO Heads of State and Government - reaffirmed in June 1983 - is to aim for real increases in defence spending of 3% a year up to 1990. MOD therefore bid for a full 3% real growth in non-Falklands provision in 1986-87.

8. The Treasury view is that the NATO guidance is not binding. After 1985-86 defence must take greater account of public expenditure and economic objectives. There should be no real growth after 1985-86 following increases of 3% in both of the preceding years. Defence provision should be planned in cash like other programmes.

Manpower

9. The Chief Secretary has proposed an MOD manpower target of 170,000 for 1 April 1988. This would represent a reduction (ROF privatisation exclusive) of 6.3% on the 1984 MOD target, which would be consistent with contributions from other major departments. The MOD see the reduction as effectively 8.8% because of the need to provide for unavoidable growth.

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P.01149

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Public Expenditure Survey 1983: Defence

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3. To achieve this result the Secretary of State for Defence has withdrawn his bids for compensation for the 1983 pay review body awards and for inflation compensation. In the latter case the Treasury has conceded in return the following formula:

4

"Alone of its public expenditure programmes, the Government's defence policy is currently expressed both in ~~volume~~ and cash terms. In order to fulfil the Government's commitments up to and including 1985-86, the cash provision will be reconciled year by year in the light of the ~~volume~~ requirement and of the most up to date forecasts of inflation and appropriate adjustments made."

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240 18714 19004 + words,

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18,464

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18,714

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18,464

18,650

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18,927

HANDLING

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PQ

P L GREGSON

4 November 1983

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H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000
Direct Dialling 01-233 8481

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4 November 1983

A Turnbull Esq
10 Downing Street

Dear Andrew

PUBLIC EXPENDITURE - EDUCATION: UNIVERSITIES

We spoke. You asked for some arguments to rebut the case that the Prime Minister's letter to the AUT precluded any cut in the universities in 1986-87.

2. First, the letter is about higher education as a whole, not just the universities. Cutting the universities would not be incompatible with the pledge - if it was one. Unit costs in the universities are higher than in local authority institutions, even after allowing for their much higher research expenditure. (But careful - we have the polytechnics in our sights too!)

3. Second (this too can cut both ways), with or without the £50 million cut in 1986-87, universities will claim their grant has not been preserved in real terms, because of various alleged relative price effects. (We are cutting student awards too, as you remarked, but this only offsets additions needed because of increased student numbers.)

letter removed for AT to PM 4/11/83

4. Third, Sir Keith has floated publicly in a letter to the UGC (copy attached) the possibility of substantial real cuts in expenditure per student. Clearly he did not consider the AUT letter a serious embarrassment: see the third sentence of his paragraph 3! (He will of course argue in reply that floating a possibility is one thing; deciding to cut is quite another, and pre-empts his consultation exercise).

5. Fourth, the AUT letter had weasel words in it: 'the intention is' and so on. 'Intentions' have already been overtaken by events - ie the 1983-84 cash limit cuts (though these were achieved painlessly for the universities - provision for restructuring was found to be more generous than required).

6. Fifth, it will be hard for anyone to tell from the next White Paper - if the tables follow the traditional layout, which in this respect is not yet certain by any means - whether or not any cuts have been

SECRET

A Turnbull Esq
10 Downing Street

4 November 1983

been inflicted on higher education in the final year. There will on past form be one single figure for higher and further education - including non-advanced (which is getting on for £1 billion).

7. Let me know if you think we can help further.

Yours ever
Michael

M J C Faulkner

cc: Principal Private Secretary
Chief Secretary
Mr Bailey
Mr Scholar
Mr Hart
Miss Kelley
Mrs Imber
Mr Ridley

MF

sc AT
FERB

Internals:
PS/PUS
DUS(FB)
Head of DS1

6

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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

MO 9

4th November 1983

Dear Willie

MINISTERIAL GROUP ON PUBLIC EXPENDITURE (MISC 99): DEFENCE PROGRAMME

Thank you for your letter of 3rd November setting out MISC 99's thinking about the Defence Programme.

I confirm that I have accepted the proposed manpower target of 170,000 at 1 April 1988 on the understanding set out in your letter.

The question of 3% real growth in 1986/87 is, as you know, to be dealt with separately.

As to the remaining issues, I am prepared to forgo my bid for increases to cover the extra cost of the 1983 Pay Review Body awards. We have dealt with the remaining questions of my bid for inflation compensation and the proposed figures for 1984/85 and 1985/86 as a linked package. I confirm that I am prepared to accept the figures of £17010M for 1984/85 and £18040M for 1985/86 (both including provision for the costs of our Falklands commitment) on the understanding that the publication of these figures will be accompanied by the following formulation which was agreed by myself and Peter Rees at your meeting this morning:

The Rt Hon Viscount Whitelaw CH MC

"Alone of its public expenditure programmes, the Government's defence policy is currently expressed in both volume and cash terms. In order to fulfil the Government's commitments up to and including 1985/86, the cash provision will be reconciled year by year in the light of the volume requirement and of the most up to date forecasts of inflation and appropriate adjustments made."

I am sending copies of this letter to the Secretary of State for Scotland, the Lord Privy Seal, the Secretary of State for Trade and Industry, the Chancellor of the Duchy of Lancaster, the Chief Secretary, Treasury and to Sir Robert Armstrong.

Yours ever

Michael

Michael Heseltine

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

4 November 1983

Economic Assumptions

The Prime Minister has seen your letter to me of 3 November. She is content with the assumptions you propose to use for the Industry Act forecast and with the figures which will be published.

ANDREW TURNBULL

John Kerr Esq
HM Treasury

CONFIDENTIAL

10 DOWNING STREET

(2)

Prime Minister

This has been sent to you to give you an idea of the shape of the MISC 99 report.

It will need to incorporate the outcome of this evenings meeting on Defence.

You will want to reflect on two points on Education

(i) whether to support KJ's attempt to protect university current by reference to your AUT letter

(ii) whether to accept the grants package.

I am preparing notes on both.

PTO

The Treasury Annex, P referred to in Para 10 will simply record the pluses and minuses on each programme. Thus no details of ~~prog~~ measures taken on programmes not going to MISC 99 will be reported to Cabinet.

Ferdy is considering whether there is a risk that colleagues will want to see Norman Fowler's Social Security measures and if so how this should be handled.

AT
4/11

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COVERING SECRET

P.01151

MR TURNBULL

MISC 99: DRAFT REPORT

The Lord President has authorised me to send you the attached draft of his report to the Cabinet as chairman of MISC 99. He has not yet seen it himself and will be looking at it over the weekend. The Prime Minister may nevertheless find it useful to see the draft in its present unfinished state because of her heavy commitments early next week.

2. The draft will need to be brought up to date to reflect the outcome of the Prime Minister's meeting this evening on defence. There are also a few gaps* where material has still to be provided and some passages in square brackets. In particular the words used to describe the overall position and how the small gap is to be bridged are being considered by Treasury Ministers over the weekend.

* eg. Annex D not yet available

3. The text will be finalised on Monday afternoon so that the report can be circulated to the Cabinet on Tuesday morning with a CMO marking.

PLG

P L GREGSON

4 November 1983

COVERING SECRET

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Fourth Draft
4 November 1983

DRAFT MEMORANDUM BY THE LORD PRESIDENT OF THE COUNCIL

PUBLIC EXPENDITURE SURVEY 1983

The Cabinet agreed on 21 July that the objective for the 1983 Public Expenditure Survey should be to hold to the published totals for 1984-85 and 1985-86; and that total spending should be held at the same real level in 1986-87. The figures were to include adequate planning reserves. The Chief Secretary, Treasury was invited to hold bilateral discussions accordingly with spending Ministers (CC(83) 24th Conclusions, Minute 5).

2. The Chief Secretary's minute of 18 October to the Prime Minister reported progress in those bilateral discussions. Compared with the position in July, bids for additional expenditure had been substantially reduced. But significant bids were still outstanding. In order to achieve the Cabinet's objective they would have to be offset or withdrawn, and additional savings found. The gap to be bridged was some £1.1 billion in 1984-85, £1.7 billion in 1985-86, and £2.5 billion in 1986-87; the figure for 1984-85 assumed a reserve of £3.0 billion, that for 1985-86 a reserve of £3.5 billion, and that for 1986-87 a reserve of £5 billion. There were outstanding issues on defence, agriculture, foreign affairs, education, arts and libraries, and the nationalied energy industries; and agreement had not been reached on local authority current expenditure in 1985-86 and 1986-87.

3. In accordance with the Cabinet's conclusions on 20 October (CC(83)30th Conclusions, Minute 4) the Prime Minister established the Ministerial Group on Public Expenditure (MISC 99) under my chairmanship to try to resolve outstanding issues. This note sets out the Group's recommendations.

Agreed Programmes

4. After MISC 99 was set up, the Chief Secretary reached agreement bilaterally with the Ministers concerned on overseas aid and foreign affairs; arts and libraries; and local authority current expenditure in 1985-86 and 1986-87. The Group reached agreement with the Secretary of State for Energy on the nationalised energy industries; and with the Minister of Agriculture, Fisheries and Food on the agriculture and fisheries programme. The basis on which agreement was reached is summarised in Annex A.

5. There are two programmes on which either agreement has not been reached, or which raise issues which we feel should be drawn to the attention of the Cabinet: defence; and education and science.

Defence

6. The Group reached agreement with the Secretary of State for Defence on figures for 1984-85 and 1985-86; the Secretary of State is satisfied that

these can be defended as consistent with the Government's public commitment to increase the defence budget by 3 per cent a year in real terms. They are based on the same cash factors as for other programmes. Because, alone among public expenditure programmes, the Government's defence policy is currently expressed both in volume and cash terms, the Secretary of State for Defence asked for assurances in case inflation should differ from the cash factors. He and the Chief Secretary have reached agreement on this point.

Difference of interpretation will ~~be~~ needs to be brought out here

7.

1986 - 87

to be drafted

8. Further details are set out in Annex B.

Education and Science

9. On education and science the issues are as follows. Details are in Annex C.

i. Student grants. The Cabinet will wish to consider whether the changes proposed by the Secretary of State for Education and Science are politically acceptable. Some of our supporters will object to the proposed increases in parental contributions and to the reduction in the minimum award. Students will criticise the reduction in the real value of awards that will ensue unless inflation is lower than now assumed. But MISC 99 believe that savings are essential; and that the Secretary of State's proposals are the best that can be devised. We commend them accordingly to the Cabinet.

ii. University current expenditure. MISC 99 believe that reductions in university current expenditure of £50 million in 1986-87 are feasible. Baseline provision for this item is nearly £1,450 million. The Secretary of State himself agrees that reductions are feasible, though not on this scale; and he considers that any savings that may be achievable should be used to offset unavoidable cost increases and to fund improved provision elsewhere in the education programme. He also believes that the reductions we propose will be regarded as inconsistent with an assurance given by the

Prime Minister during the Election campaign. However, MISC 99 recommend that the reductions should be made and the programme reduced accordingly.

Overall position

[10. The figures for all the programmes so far agreed, including those on which the Chief Secretary reported agreement in his minute of 18 October are set out in Annex D. If our recommendations on education and science are accepted, then the total of programmes and reserve will be [£ million] in 1984-85; [£ million] in 1985-86; and [£ million] in 1986-87. These differ from the existing planning totals for 1984-85 and 1985-86 by [£ ~~125~~ 130 million] and [£ 400 million] respectively; and from the Survey baseline in 1986-87 by [£ ~~200~~ 380 million]. Treasury Ministers consider that these gaps can be bridged, though admittedly with some difficulty. They will report in more detail orally to the Cabinet.]

latest HMT figures

Breakdown between capital and current expenditure

11. The Chief Secretary was invited by the Cabinet on 20 October to ensure that information was available on the distribution of current and capital expenditure. A note provided by Treasury officials is attached as Annex E.

Issues for the Cabinet

12. The Cabinet are invited:

(i) To endorse the totals for agreed programmes, listed in Annex D.

(ii) To consider the issues arising on the defence and education and science programmes in the light of the Group's recommendations.

ANNEX A

SECRET

AGREED PROGRAMMES

This annex describes the agreements reached on the five programmes listed in paragraph 4. The figures show the agreed changes from the baseline in Cmnd 8789.

Arts and Libraries

1984-85	1985-86	1986-87
	£m	
+ 6	+ 10	+ 13

It was agreed that provision should be increased by half the amounts sought by the Minister for the Arts. This would allow the work on the new British Library building to go ahead.

Local Authority Current Expenditure (England) 1985-86 and 1986-87

1985-86	1986-87
£m	
+ 500	+ 500

Additional provision has been made on grounds of realism. In 1985-86, £350 million of the £500 million is to be allocated to services, in proportion to shares in the baseline. For 1986-87, £300 million of the £500 million would be allocated to services, again distributed in proportion to shares in a revised baseline for 1986-87, except for an agreed transfer of £50 million from the DES programme to DHSS personal social services provision.

Department of Energy: Nationalised Industries

1984-85	1985-86	1986-87
	£m	
- 352	- 940	- 1704

The agreed savings are based on improved efficiency in the gas and electricity industries; 3 per cent increases in electricity prices in 1984-85 and in 1985-86; and a reduction in National Coal Board investment. A figure of £800 million for NCB investment will be published for 1984-85; figures of £784 million in 1985-86 and £748 million in 1986-87 will be reflected in the published aggregate External Financing Limits for all nationalised industries. It was also agreed that domestic gas prices should rise by 5 per cent in January 1984; and that the industrial gas price freeze would end in April 1984.

FCO (including ODA)

1984-85	1985-86 £m	1986-87
+ 5.8	+ 8.5	+ 21.3

The agreed additional amounts will be devoted to the British Council and the BBC's External Services. The bids for additional provision for the aid programme have been withdrawn.

Agriculture, Fisheries and Food

1984-85	1985-86 £m	1986-87
- 4.2	- 24.1	- 38.4

It was agreed that there should be additional expenditure on grants for marginal land, glasshouse restructuring and fish marketing. Capital grants under the Agriculture and Horticultural Grant Scheme will be reduced, saving some £30 million a year: with the exception of the grants in less-favoured areas for field drainage, hedges and walls, no grant will be at a rate of more than 50 per cent. Grants for arterial drainage will be reduced: and savings will also be found from the R and D programme.

ANNEX B

THE DEFENCE PROGRAMME

THE INITIAL POSITION

The Survey baseline is as follows.

	1983-84	1984-85	1985-86	1986-87
				£ million
	15719.6	17178.0	18214.4	18192.2
(of which Falklands)	(624.0)	(684.0)	(552.0)	-

During bilateral discussions the Chief Secretary, Treasury accepted a bid of £450 million for expenditure in 1986-87 in respect of the Falklands.

2. The Secretary of State for Defence advanced bids for additional provision to meet the extra cost in all years of the 1983 Pay Review Bodies' awards; and to compensate for forecast inflation higher than the agreed cash factors.

Inflation compensation	-	+ 59.3	+ 240.0	+ 508.8
Pay awards	+ 90.4	+ 93.1	+ 96.8	+ 99.7

3. The Chief Secretary rejected these bids. He also proposed that the real rate of growth in 1984-85 and 1985-86 should be limited to 3 per cent from the provision in 1983-84 after the reduction in cash limits imposed in July this year (but excluding Falklands provision).

-	- 267.6	- 280.7	- 289.1

THE GROUP'S RECOMMENDATIONS

a. 1984-85 and 1985-86

4. In discussion with the Group, the Secretary of State for Defence agreed to withdraw the bid relating to the excess cost of pay awards. He also agreed to withdraw the bid in respect of inflation compensation if he and the Chief Secretary were able to reach agreement on a form of words dealing with the possibility that inflation might turn out to be different from the agreed cash factor. The two Ministers subsequently agreed on the following.

> "Alone of its public expenditure programmes, the Government's defence policy is currently expressed both in real ~~volum~~e and cash terms. In order to fulfil the Government's commitments up to and including 1985-86, the cash provision will be reconciled year by year in the light of the real ~~volum~~e requirement and of the most up-to-date forecasts of inflation, and appropriate adjustments made."

5. In view of the general public expenditure position, the Group considered that some reduction in the defence budget, consistent with the Government's public commitments, was desirable. They accordingly proposed to

the Secretary of State for Defence that the starting point for provision in 1984-85 should be the baseline figure for 1983-84; from this would be subtracted the expenditure on the Falklands Islands; the result would then be enhanced by 5 per cent (the cash factor) and then 3 per cent (the growth factor); and planned expenditure on the Falklands Islands in 1984-85 would be added to give a revised figure for that year of £17,010 million. The same procedure, using the relevant cash factor, would be adopted for 1985-86, giving a revised figure of £18,040 million. The Secretary of State accepted this proposal.

b. <u>1986-87</u>

6. The NATO target of 3 per cent a year real growth, to which the Government is committed, expires in 1985-86.

-

Overall effect

7. The overall effect of the above is as follows.

	1984-85	1985-86	1986-87
Change from baseline	- 168	- 174	
New total	17010	18040	

The figures do not involve any change in agreed provision for the Falklands.

ANNEX C

THE EDUCATION AND SCIENCE PROGRAMME

THE INITIAL POSITION

The Survey baseline, excluding local authority current expenditure other than student awards, is as follows.

	£ million		
	1984-85	1985-86	1986-87
	3258	3388	3489

2. During their bilateral discussions, the Secretary of State for Education and Science and the Chief Secretary, Treasury reached agreement on the following changes.

	1984-85	1985-86	1986-87
Additions			
Student grants (increased numbers)	+ 40	+ 50	+ 45
Science (International subscriptions)	+ 6	+ 8	+ 7
Reductions			
Grant-aided institutions	- 5	- 7	- 10
Student grants	- 20	- 40	- 50
Net effect	+ 21	+ 11	- 8

3. The Chief Secretary considered that the net cost of these changes in 1984-85 and 1985-86 should be met by further savings: the Secretary of State for Education and Science believed that this was not feasible. He also made the following bids for additional expenditure.

	1984-85	1985-86	1986-87
Local authority capital expenditure	+ 50	+ 50	+ 50

mainly for buildings to facilitate school closures and mergers; and computers, other equipment and building for colleges.

	1984-85	1985-86	1986-87
Science	+ 29	+ 47	+ 68

to maintain and strengthen the base of science research.

	1984-85	1985-86	1986-87
Universities - capital	+ 12	+ 12	+ 12

for medical and dental school projects, rationalisation, and laboratory equipment.

Universities - current	+ 18	+ 16	+ 18

to accommodate inescapable cost increases, after allowing for efficiency savings.

4. The Chief Secretary rejected these bids. He also proposed that the baseline for university current expenditure in 1986-87 should be reduced by £75 million to encourage rationalisation as student demand declined.

THE GROUP'S RECOMMENDATIONS

5. The Group held two meetings with the Secretary of State for Education and Science and are greatly indebted to him for his help and co-operation. Our recommendations are as follows.

Local Authority Capital Expenditure

6. In view of the many other pressures on public expenditure in general, and the need to reduce local authority expenditure in particular, the Group do not feel able to support any increase in the provision for capital expenditure on schools and colleges of further education.

Science

7. Despite the arguments which the Secretary of State put forward for additional expenditure on science, and having regard to the conclusions of the Prime Minister's informal meeting on 19 October, recorded in her Private Secretary's letter of the same date, the Group do not feel able to recommend any increase.

Universities - capital

8. The Group do not feel able to recommend any increase. They consider that priority expenditure should be accommodated within the existing programme.

Universities - current

9. The Group do not feel able to recommend any increase in provision. They agree with the Chief Secretary's view that it should be possible to find efficiency savings by 1986-87, and recommend a reduction of £50 million in that year.

10. The Secretary of State for Education and Science dissents from this recommendation. He does not deny that some efficiency savings are achievable; and his own proposals (paragraph 3 above) assume savings of £22 million (1½ per cent). But he does not consider that the further £50 million, making about 5 per cent in all, is realistic. Moreover, he believes that any savings that can be achieved will be needed to offset the unavoidable and externally-imposed cost increases which the universities face, and to fund desirable improvements elsewhere in the education programme. He also believes that reductions on the scale we recommend would be widely regarded as inconsistent with the Prime Minister's letter of 7 June to the Association of University Teachers. This said that "the period of contraction [in higher education] is now nearing the end"; and that "the intention is to hold the level [of expenditure] steady in real terms after 1984-85".

Student grants

11. The proposals originally put forward by the Secretary of State for Education and Science for savings in this area included the abolition of the minimum award. We thought that this was unlikely to be acceptable to our colleagues, and invited the Secretary of State to advance alternative proposals. In reply, he indicated that he would be willing to accept the following, in preference to any alternative savings in the programme.

(a) Halving the minimum award from £410 a year to £205 a year.

(b) Steepening the scale of parental contributions. At present no contribution is payable if residual income (i.e. income after deduction of allowances such as mortgage interest) is less than £7,100; £1 in every £7 is payable between £7,100 and £9,000; £1 in £8 between £9,000 and £14,300; and £1 in £13 thereafter. The Secretary of State proposes that the parental contribution in future at points beyond £9,000 should be £1 in every £6. The effect of this change would be, for example, that those with residual incomes of £12,000 would be expected to make a contribution of £770 instead of about £650; and those with residual incomes of £18,000 would be asked to pay about £1,770 instead of £1,220.

(c) The current value of grants should be increased by only 4 per cent for 1984-85, 3 per cent for 1985-86, and 2 per cent for 1986-87, instead of 5 per cent, 4 per cent and 3 per cent respectively.

12. These proposals would produce savings of £25 million, £45 million and £50 million in the three years under discussion. We believe that they are politically and otherwise defensible and commend them to our colleagues.

Overall recommendations

13. In view of the difficulties which the Secretary of State for Education and Science faces in his programme, the Group do not think that he should be required to find further savings to offset the agreed changes outlined in paragraph 2 of this Annex. They also consider that an adjustment should be made to reflect the fact that the changes in student grants now proposed by the Secretary of State provide rather higher savings in the first two years than his original proposals. To that extent, the Secretary of State should have discretion to apportion these changes as he thinks appropriate. The net effect of our recommendations, as compared with baseline, is therefore:

1984-85	1985-86	1986-87
+ 21	+ 6	- 58

ANNEX E

CAPITAL AND CURRENT EXPENDITURE

At its meeting on 20 October the Cabinet asked the Chief Secretary to bring before the Cabinet information on the distribution of public expenditure as between capital and current expenditure, and the effect on this distribution of the reductions agreed in the 1983 Public Expenditure Survey.

2. Before the 1983 Survey planned capital expenditure represented some 10½ per cent of total public expenditure in each of the three years 1984-85, 1985-86 and 1986-87. The Treasury has carried out an analysis, with the help of spending Departments, of the changes to these percentages which result from decisions so far taken in the Survey. Most Departments are not yet able to say how the changes agreed for their programmes will affect their capital/current ratio. It is not yet possible, therefore, to calculate how the aggregate percentages above will be changed by the Survey.

3. In the areas in which the distribution of agreed changes between capital and current has already been decided the changes go in both directions: for example, the additions agreed for the Prison Building programme will increase the Home Office capital spending programme, and the reductions agreed for the Departments of Employment and Health and Social Security will reduce their current spending and add to capital. The Housing reductions, however, will show wholly as large capital cuts, although some £300 million of the total represents council house sales which count as negative capital expenditure. There are, too, large increases in current local authority spending. Against this, almost all of any lower provision which is agreed for defence expenditure will go towards reducing the proportion of total expenditure classified as current.

✓ cc D/UR

Treasury Chambers, Parliament Street, SW1P 3AG

CHIEF SECRETARY TO THE TREASURY

4/11/83

Dear Andrew

At this morning's meeting Ivan Wilson undertook to provide a slightly revised version of the Treasury note sent you by Jn. Kerr yesterday which could be handed to Mr Heseltine if the PM thought it appropriate. This is attached.

One additional point to note - re para 10 - is that nearly half the defence budget is spent on equipment. A constant real level of spending of £8-9 billion a year will lead to the continuing enhancement of defence capability.

Jn. Gieve.

DEFENCE

(Note by Treasury Officials)

	£ million cash			
	1983-84	1984-85	1985-86	1986-87
Baseline	15,720	17,178	18,214	18,192
(of which Falklands agreed)	624	684	552	450
Mr Heseltine's opening position	15,810	17,330	18,551	19,815
Treasury opening position	15,720	16,910	17,934	18,353
MISC 99 proposal	15,720	17,010	18,040	-

1. MISC 99's proposals - which will be accepted by the Treasury if they are accepted by Mr Heseltine - would mean giving defence £100m in 1984-85 and £106m in 1985-86 above the Treasury's starting position. These figures would leave the defence budget below 1983 Public Expenditure White Paper provision.

2. MISC 99 has made no proposal for 1986-87, on the ground that this is a matter for the Cabinet and not for a small group of Ministers to resolve. The Treasury's preferred position for 1986-87 would be to uplift an agreed non-Falklands 1985-86 figure by the 3 per cent cash factor applicable to all expenditure programmes and to build in no real growth above that; so as to arrive at a cash total (with 1986-87 Falklands costs on top), getting MOD away from their 'real' growth aspirations. On the MISC 99 basis this would give a Falklands-inclusive figure of £18,464m. 3 per cent real growth in 1986-87 would require an additional £530m, giving a total of £18,994m.

3. The Treasury believes that its 1986-87 figure would provide a wholly reasonable profile of defence expenditure over the next three years, with annual increases of £1.3 billion, £1 billion and £½ billion respectively in the successive years. These increases will be difficult enough to accommodate within public expenditure plans, given that the outcome of the bilaterals and of MISC 99 - defence apart - leave us short of our target by £87m in 1984-85, £408m in 1985-86 and £242m in 1986-87.

4. Defence is now the second largest programme - higher than health or education - and consumes 5.5 per cent of GDP. In absolute terms our defence spend is the highest in Europe. We have increased the defence budget every year since coming to office; five successive increases is

/ unprecedented

precedented since World War II. Since 1978-79, defence spending has increased in real* terms by over 20 per cent.

5. This has imposed a heavy burden. Over the same period, GDP has increased by only about 1 per cent. The increases in defence expenditure have been paid for not by economic growth, but by higher taxes and interest rates, and by cuts in other programmes. This cannot continue for ever. For the future, defence must take greater account of our wider public expenditure and economic objectives.

6. Further growth in military capability should come from improving efficiency and output, and obtaining better value for money. There is plenty of scope for making defence resources more effective: the civilian manpower proposals alone - now accepted by Mr Heseltine - will free an extra £120m a year.

7. Besides, MOD have had great difficulty in recent years in spending all the money provided. MOD have swallowed without difficulty the 7 July cut of £240m, plus £100m for the armed forces' and civil service pay; and still look likely to underspend this year.

8. The NATO 3 per cent aim is only an aim, like the UN aim that 0.7 per cent of GDP be devoted to overseas aid. It is not binding. Mr Heseltine has himself made this clear: he wrote to the Prime Minister in May "But the 3 per cent formula is, of course, a target not a binding commitment".

9. NATO, in any event, is unlikely to cause us difficulty. Other nations will be poorly placed to criticise the UK. The real problem is that other Allies do not follow the UK example. If they did, each European Ally would spend 5.5 per cent of GDP on defence (the current average is 3.8 per cent), and meaningless growth measures could be discarded.

10. We do not believe that, with a 1986-87 budget of over £18 billion, absence of real growth would have dire operational and industrial consequences.

a. MOD's internal plans last year assumed no growth at all after 1985-86. Mr Heseltine ought to revert to the force projections that satisfied his predecessor.

/ b.

* GDP deflator basis

b. Real growth in military effectiveness can be achieved without an equivalent increase in input cost. MOD must exploit the substantial scope for increasing defence output by greater efficiency and value-for-money.

c. MOD have cried wolf before (notably in the 1981 Survey: even after making over £1000m of cuts in his 1982-83 programme, Mr Nott foresaw a "programme gap" of £200m - but the real problem in 1982-83 was to avoid a massive underspend). MOD costings are notoriously inaccurate. The margin of error for 1986-87 is too great to attach much reliance to claims of gloom and doom at this stage.

d. Substantial scope exists for economies that do not damage the front line: for example over £1200m a year is spent on Service training; over £700m on social and welfare expenditure; and the value of defence stocks at major depots is £7 billion.

FORMULA FOR 1986-87

11. We will need, of course, to agree a figure for 1986-87 in order to complete the expenditure review for the White Paper. But we will need, also, to agree a form of words to describe this figure.

12. The Treasury's aim will be to ensure that the defence planners will work to the agreed figure, so that our commitments do not grow out of step with the available resources, forcing us in future years into highly visible cutbacks or unplanned increases in expenditure at short notice. There will be no Treasury objection to describing in public the figure as provisional and subject to review like other PES figures, provided that firm instructions on the above lines are given to the defence planners.

13. So far as the NATO target is concerned we should point to our achievement since 1978-79, and our further plans up to 1985-86 and emphasise that thereafter real growth will come from increasing efficiency and outputs, not from expenditure input.

HM TREASURY
4 November 1983

4

SECRET

MR. TURNBULL

Public Expenditure: Defence

1984/5 and 1985/6

MISC 99 has invited Michael Heseltine to accept the following figures for 1984/5 and 1985/6.

	Total	Savings below Baseline
84/85	£17.01 billion	ca £170 million
85/86	£18.04 billion	ca £180 million

The 84/5 figure is based on the reduced 83/4 baseline (following the July reductions of £240 million) uplifted by a 5% cash factor across the board and 3% real growth in line with the NATO commitment. The 85/6 figure uplifts the 84/5 baseline by a cash factor of 4% and by 3% real growth.

These proposals require a concession by the Treasury that the above cash factors should also apply to pay, i.e., 5% instead of 3% for pay in 84/5. This concession is worth about £100 million per year. If this compromise were accepted by MOD it would also be accepted by the Treasury, and the indications are that Michael Heseltine might well accept.

1986/7

Real growth in 1986/7 remains the major problem. If no real growth is included the defence budget would be £18.464 billion. If 3% real growth were conceded this would cost an extra £530 million and raise the total budget to £18.994 billion. Michael Heseltine is likely to argue for some real growth in 1986/7 but may not press for the full 3%.

SECRET

/ Comment

Comment

We consider that a decision not to extend the 3% NATO commitment beyond 1985/6 should not cause significant defence policy difficulties nor be difficult to present either to NATO or to the public. The following points are relevant with particular emphasis on presentation:

- it is unlikely that such a decision would necessitate a major review of our defence roles as set out in John Nott's 1981 White Paper Cmd. 8288

- there was no Manifesto commitment after 1985/6

- continued growth in defence spending is incompatible with the Government's wider public expenditure and economic objectives. Since 1978/79 defence growth has far outstripped economic growth - 21% against 1%. Nor is the economy likely to achieve 3% annual growth in the next two years.

- the effect on NATO of UK plans should be seen in proper context. Other European countries do not follow the UK example. If they did, each would devote more than 5% GDP to defence whereas the European NATO average is less than 4% GDP.

- of the major Allies, the UK contribution to NATO is already second only to the US in absolute terms, per capita and as a proportion of GDP. MOD ought to be striving to reduce the unfairness of the UK defence burden, not to increase it.

	Expenditure $ million	per capita	%GDP
US	198500	856	6.6
UK	24200	432	5.1
Germany	22500	364	3.4
France	22000	407	4.1
Italy	8900	155	2.6
Netherlands	4500	313	3.2
Belgium	2800	283	3.3

- the Europeans are poorly placed to criticise us. The UK's performance on defence has been and will continue to be impressive. Between 1979 and 1982 annual average real expenditure increases compared with GDP growth were:

	Defence	GDP
UK inc Falklands	2.9	-0.4
exc Falklands	1.9	
Germany	1.7	1.6
Italy	2.4	2.4
Netherlands	1.9	0.2
Belgium	-0.4	0.7

UK figures are based on MOD's deflators which relate to defence-specific items. Expenditure based on GDP deflators would be higher at 4.0 (inc Falklands) and 2.7 (exc Falklands) respectively. There is no standard approach to deflators in NATO which has recognised that "various uncontrolled and unchecked deflators is a major weakness in defence planning and makes comparisons or real increases in defence expenditure uncertain and questionable".

/ - the US

- the US does have concerns about burden sharing between the US and Europe. Nevertheless any decision on 3% does not alter our commitment to NATO. Our aim will be to increase resources in the future when economic conditions allow. However, future economic prosperity depends upon the UK Government controlling expenditure. Reductions in the growth of defence expenditure are necessary at a time when most programmes are being cut.

- increasing growth in defence could swing public opinion against defence in general and Trident and Cruise in particular.

- MOD may argue that 3% to 1990 is the NATO aim and that this was confirmed in June. However, at the time Michael Heseltine accepted that a firm commitment to the end of the NATO planning period would cause us and most of our Allies difficulties and explicitly emphasised that the 3% formula is a target and not a binding commitment.

- defence capability will increase from 1986/87 as the benefits of earlier expenditure are realised.

- the 3% principle does not necessarily link with operational capability. It concerns only inputs and covers non-operational and support expenditure. It does not allow for increased efficiency nor for a shift of resources fron non-operational to operational objectives.

- there are potential savings in the equipment budget through greater specialisation and standardisation in NATO and through a more open and competitive procurement process (our recent work on procurement and cost growth inflation is relevant here). Profit rates on non-competitive contracts will certainly be revised downwards when the Review Body reports later this year.

- substantial scope exists for economies that do not damage the front line - civilian manpower, training, social and welfare expenditure, stocks, R & D establishments etc., not to mention the expected savings from MINIS.

Conclusions

We consider that the proposed compromise for 1984/5 and 1985/6 is acceptable. We do not consider that any real growth should be included in the budget for 1986/7.

DLP.

David Pascall

3 November, 1983.

cc Sir A Walters
B.I.

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

3 November 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

ECONOMIC ASSUMPTIONS

I told you that I planned to send you a note of the economic assumptions for the Autumn Statement, the Government Actuary's report on the National Insurance Fund and the next Public Expenditure White Paper.

The attached table sets out the figures for unemployment, the RPI, average earnings and interest rates: they are of course consistent with the figures that will appear in the Industry Act Forecast. Only the figures underlined will be published; and among them only those for 1983-84 and 1984-85 will be published this autumn (those for unemployment and prices for all years will be published subsequently in the Public Expenditure White Paper).

In settling on these figures the Chancellor has, as in past years, been concerned to strike a balance between the need to maintain our forecasting credibility and the need to exert the maximum helpful influence on expectations generally and pay negotiations in particular.

The prices and earnings assumptions are the important ones on the pay front. The RPI increase to May 1984 of 5½ per cent is ½ per cent higher than the latest (September) published figure (the October figure will be released on Friday, 11 November). But it is ½ per cent lower than the forecast for the same period published at Budget time in the Financial Statement and Budget Report, and it will be presented as a temporary increase in an otherwise declining trend.

On earnings, the Chancellor had regard in particular to the difference between the average earnings figure we are showing for the economy as a whole and the cash provision of 3 per cent for public sector pay in 1984-85. This is not, of course, a new problem. The differential of 3½ percentage points between the increase for financial year 1984-85 and the pay provision for the year compares with differentials of 4½, 3½ and 3 over the last three years respectively. We shall, as last year, stress in the Government Actuary's report that the 6½ per cent increase for the economy as a whole "takes account of the cash provision of 3 per cent made by the Government, in planning public expenditure for 1984-85, for average increases in wage and salary bills for the public services from due settlement dates."

As far as unemployment is concerned, successive Governments have been at pains to point out that the assumptions needed for planning purposes are not forecasts. We shall hold to that, and the Chancellor thought it right to stick with precedent and follow a strictly conventional approach.

Yours ever,

J O Kerr

J O KERR

CONFIDENTIAL

KEY ECONOMIC ASSUMPTIONS

	1983-84	1984-85	1985-86	1986-87
Unemployment (thousands)				
- GB narrow	2850	2850	2850	2850
- School leavers etc.	180	170	170	170
Prices*	[3.7]**	5½	4½	4
Earnings+	7	6½	6	5
Interest rates++	9½	8	7	6

* Percentage increase to May of year concerned

** Outturn - already published

\+ Annual percentage rise

++ Short-term

3

SUMMARY OF SCORECARD

	Change in relation to WP(£m)		
	1984-85	1985-86	1986-87
Agreed as at 20 October	+575	+929	+1083
Effect of MISC 99 provisional decisions	-226	-838	-1662
Effect of other decisions (LA current; OAL)	+6	+598	+660
Outstanding difference from White Paper	+355	+689*	+81*
Defence (unsettled): Treasury position	-268	-281	+161
Net change from WP if Defence carried	+87	+408*	+242*
if MISC 99's proposals on defence accepted	+187	+508	[+342]

*Assumes addition to reserve of £0.5bn in 1985-86 and £2bn in 1986-87.

MISC 99 provisional decisions so far compared with CST proposals

1984-85	1985-86	1986-87
+86	+75	-76

Note: Defence not included.

+21+6 = 4

10 DOWNING STREET

1

Prime Minister

Agree these assumptions strike right balance between ambition and credibility?

Yes no

The assumption of constant unemployment looks more plausible than it has done for some time.

AT
3/11

CONFIDENTIAL

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

3 November 1983

Andrew Turnbull Esq
No 10

Dear Andrew,

.. As agreed, I enclose a note on the outstanding issues on Defence, in preparation for the Prime Minister's meeting with Michael Scholar and Ivan Wilson at 9am tomorrow.

Yours ever,
John Kerr.

J O KERR
Principal Private Secretary

£300

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32

DEFENCE

(Note by Treasury Officials)

	£million cash			
	1983-84	1984-85	1985-86	1986-87
Baseline	15,720	17,178	18,214	18,192
(of which Falklands agreed)	624	684	552	450
Mr Heseltine's opening position	15,810	17,330	18,551	19,815
Treasury opening position	15,720	16,910	17,934	18,353
MISC 99 proposal	15,720	17,010	18,040	-

100 100 £500

£1.3b £1bn £½bn 18464

1. MISC 99's proposals - which will be accepted by the Treasury if they are accepted by Mr Heseltine - would mean giving defence £100m in 1984-85 and £106 m in 1985-86 above the Treasury's starting position. Mr Heseltine will, no doubt, argue that these figures would leave him below the baseline and the Public Expenditure White Paper.

2. MISC 99 has made no proposal for 1986-87, on the ground that this is a matter for the Cabinet and not for a small group of Ministers to resolve. The Treasury's preferred position for 1986-87 would be to uplift an agreed 1985-86 figure by the 3 per cent cash factor applicable to all expenditure programmes and to build in no real growth above that; so as to arrive at a cash total, weaning the MOD away from their 'real' growth aspirations. On the MISC 99 basis this would give a figure of £18,464m. If Mr Heseltine argues for 3 per cent real growth in 1986-87 this would require an additional £530m, giving a total of £18,994m.

3. The Treasury believes that its 1986-87 figure would provide a wholly reasonable profile of defence expenditure over the next three years, with increases above the 1983-84 figure of £1.3 billion,

£1 billion and £½ billion in the successive years. These increases will be difficult enough to accommodate within total public expenditure plans, given that the outcome of the bilaterals and of MISC 99 - defence apart - leave us short of our target by £87m in 1984-85, £408m in 1985-86 and £242m in 1986-87.

4. Defence is now the second largest programme - higher than health or education - and consumes 5.5 per cent of GDP. In absolute terms our defence spend is the highest in Europe. We have increased the defence budget every year since coming to office; five successive increases is unprecedented since World War II. Since 1978-79, defence spending has increased in real terms by over 20 per cent.

5. This has imposed a heavy burden. Over the same period, GDP has increased by only about 1 per cent. The increases in defence expenditure have been paid for not by economic growth, but by higher taxes and interest rates, and by cuts in other programmes. This cannot continue for ever. For the future, defence must take greater account of our wider public expenditure and economic objectives.

6. Further growth in military capability should come from improving efficiency and output, and obtaining better value for money. There is plenty of scope for making defence resources more effective: the civilian manpower proposals alone - now accepted by Mr Heseltine - will free an extra £120m a year.

7. Besides, MOD have had great difficulty in recent years in spending all the money provided. MOD have swallowed without difficulty the July 7 cut of £240m, plus £100m for the armed forces' and civil service pay; and still look likely to underspend this year.

8. The NATO 3 per cent aim is only an aim, like the UN aim that 0.7 per cent of GDP be devoted to overseas aid. It is not binding. Mr Heseltine has himself made this clear: he wrote to the Prime Minister in May "But the 3% formula is, of course, a target not a binding commitment".

9. NATO, in any event, is unlikely to cause us difficulty. Other nations will be poorly placed to criticise the UK. The real problem is that other Allies do not follow the UK example. If they did, each European Ally would spend 5.5 per cent of GDP on defence (the current average is 3.8 per cent), and meaningless growth measures could be discarded.

10. We may expect Mr Heseltine to argue that nil growth in 1986-87 will have dire operational and industrial consequences. We do not believe that any weight should be given to these arguments:

a. MOD's internal plans last year assumed no growth at all after 1985-86. Mr Heseltine ought to revert to the force projections that satisfied his predecessor.

b. Real growth in military effectiveness can be achieved without an equivalent increase in input cost. MOD must exploit the substantial scope for increasing defence output by greater efficiency and value-for-money.

c. MOD have cried wolf before (notably in the 1981 Survey: even after making over £1000m of cuts in his 1982-83 programme, Mr Nott foresaw a "programme gap" of £200m - but the real problem in 1982-83 was to avoid a massive underspend). MOD costings are notoriously inaccurate. The margin of error for 1986-87 is too great to attach much reliance to cries of gloom and doom at this stage.

d. Substantial scope exists for economies that do not damage the front line: for example over £1200m a year is spent on Service training; over £700m on social and welfare expenditure; and the value of defence stocks at major depots is £7 billion.

FORMULA FOR 1986-87

11. We will need, of course, to agree a figure for 1986-87 in order to complete the expenditure review for the White Paper. But we will need, also, to agree a form of words to describe this figure.

12. Mr Heseltine will argue that any figure which gives less than 3 per cent growth should be described as wholly provisional, square bracketed, and subject to review in subsequent years with the aim of meeting the 3 per cent target.

13. The Treasury's aim will be to ensure that the defence planners will work to this figure, so that our commitments do not grow out of step with the available resources, forcing us in future years into damaging cutbacks or unplanned increases in expenditure at short notice. There will be no Treasury objection to describing in public the figure as provisional and subject to review, provided that firm instructions on the above lines are given to the defence planners.

14. So far as the NATO target is concerned we should point to our achievement since 1978-79 (20 per cent real growth) and our plans up to 1985-86 (which would bring us up to more than 25 per cent real growth - Falklands inclusive - by then).

HM TREASURY
3 November 1983

CONFIDENTIAL

APPENDIX A
TO ANNEX E

MO 25/2/28/2

PRIME MINISTER

NATO MINISTERIAL GUIDANCE

The NATO Defence Planning Committee will be meeting in Ministerial session on 1st/2nd June. On present plans I shall not be present during the plenary discussion of the Ministerial Guidance, when we shall be represented by our Ambassador Sir John Graham - we need to decide the line he is to take.

2. As you know, the Ministerial Guidance is the document produced every other year to set the framework for national and NATO planning for the next five year period - in this case 1985-1990. The draft has been under discussion at working level in Brussels for some weeks and is to be considered by Permanent Representatives on 24th May prior to submission to Ministers. The resource guidance section draft is attached. You will see that, in respect of the 3% target for annual real increases in expenditure, it reads as follows:

> "notwithstanding economic and financial constraints, the standing Alliance commitment to the 3% formula guidance is confirmed."

This is a repeat of the 1981 formula which John Nott endorsed on behalf of the Government.

3. A firm commitment on defence expenditure to the end of the NATO planning period would cause us difficulties (as it would most of our allies). But the 3% formula is, of course, a target not a binding

commitment. In view of this, the UK's good record on 3% and our public commitment to meet it to 1985/86 (when the Ministerial Guidance will come up again for review), I believe it would be wrong and unnecessary to mount any opposition to a repeat of the formula to which we subscribed in 1981. Internationally, this would provoke an unhelpful transatlantic row in a crucial year for the Alliance. Domestically, the likelihood of the row becoming public could be politically very damaging in present circumstances. On the other hand there may be US pressures to toughen up the 3% formula to stress it as the minimum required (the US are, of course, planning annual average increases in defence spending of 7% over most of the NATO planning period). But the FRG have already made clear that they would not support any substantive strengthening of the 1981 formula and I believe the UK should lend them support in resisting any such US pressures.

4. I therefore propose that the UK should go along with a repeat of the 1981 3% formula but should support the FRG in resisting any US pressures to go beyond this. Additionally, if the opportunity arises, I am content that we should - as suggested by Treasury officials - support any move by others in seeking deletion from the 1981 formula of the phrase 'notwithstanding economic and financial constraints'.

5. Subject to any views of my colleagues, I propose that Sir John Graham should be instructed to proceed accordingly at the meeting of Permanent Representatives on 24th May and subsequently at the Ministerial session.

6. I am copying this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, the Chief Secretary to the Treasury, and Sir Robert Armstrong.

Ministry of Defence
20th May 1983

Approved by the Defence Secretary & signed in his absence

YdS

SECRET

Prime Minister ②

To note the components of Mr Fowler's social security savings.

AT 3/11

2

DEPARTMENT OF HEALTH & SOCIAL SECURITY

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

Telephone 01-407 5522

From the Secretary of State for Social Services

John Gieve Esq
H M Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

3 November 1983

Dear John

SOCIAL SECURITY PROGRAMME

You wrote to me on 26 October about the measures by which my Secretary of State proposes to achieve the overall public expenditure savings agreed with the Chief Secretary.

I attach an up-to-date scorecard setting out the position. This includes a brief description of the new measures that need to be taken to meet the higher figure that was agreed. You will notice that, in view of the further measures that have been brought forward, the proposal to withdraw the non-householder housing addition applies only to those aged 18-20. Secondly, the footnote to the scorecard points out that there are interactions between the housing benefit and supplementary benefit proposals. The broad effect of these is to reduce the housing benefit figures and increase the supplementary benefit figures. The figures for total PE savings take account of these interactions. We are going through all the figures again to make as sure as we can the estimates of savings are reasonable. If any of the component elements in the package is found to vary, we shall adjust the overall package to ensure that we still deliver the promised savings.

My Secretary of State has asked me to enter one caveat. He understands that the Chancellor had not intended to discuss this year's review of National Insurance contributions until after Cabinet on 10 November. My Secretary of State would want to look again at the savings proposals, particularly those on housing benefit and family income supplement, since they also affect take home pay and the poverty trap, if the review were not settled before then. It is clearly important that the Government's decisions and the public expenditure round and the NIC review should be seen to be consistent with each other. With this in mind, he has now written to the Chancellor suggesting they meet to settle this issue before Cabinet on 10 November.

I am copying this to Robin Butler.

Yours
Steve

S A GODBER
Private Secretary

SECRET

E.R.

ANNEX

SCORECARD REVISED TO REFLECT AGREEMENT WITH CHIEF SECRETARY

		1984-85	1985-86	1986-87
AGREED TARGET (26.10.83)		299	424	459
of which approx. rate rebate savings		48	50	52
leaving as PE savings		251	374	407
SAVINGS PROPOSALS	Start date			
Supplementary Benefit				
1. Withdraw non house-holder housing additions from 18-20 year olds	April 84	43	45	48
2. Restructure heating additions (ie. withdraw central heating additions with some off-setting improvements)	Nov 84 Regs	29	50	53
National Insurance Benefits				
3. Defer for 1 year abolition of retirement pensioners earnings rule	-	30	100	115
4. Introduction of spouse's earnings limit for child dependency additions	Nov 84 Bill	5	15	18
Family Income Supplement				
5. Limit uprating to new/renewal claims	Nov 84 Regs	5	15	16
6. Increase rent tapers from 21% to 31% and rate tapers from 7% to 9%		115	122	125
7. Increase minimum awards for rents from 20p to £1 and for rates from 10p to 50p	April 84 Regs	5	5	6

Contd/-

		Start date	1984-85	1985-86	1986-87
8.	Increase deductions for non-dependants	April 84 Regs	56	62	65
9.	Increase thresholds for the High Rent scheme from 120% of average rent (115% for private tenants) to 130%	April 84 Regs	6	6	7
10.	(PE) savings in administration following substantial reduction in caseload as a result of the above changes	April 84	5	5	6
	Grand Totals		299	424	459
	of which public expenditure is		251	374	407
	rates rebates are		48	50	52

(this breakdown is only provisional)

NOTE: There will be some adjustment to these figures to reflect interaction of supplementary benefit and housing benefit. But the overall PE figures will not be affected.

NOT QUESTIONS

FILE

RW7

10 DOWNING STREET

From the Private Secretary 2 November, 1983

PUBLICATION OF MONTHLY PSBR FIGURES

The Prime Minister has seen your letter of 27 October to David Heyhoe and she has noted the proposal to focus more attention on the PSBR and to introduce monthly publication.

I am copying this letter to David Heyhoe (Lord Privy Seal's Office).

(A. Turnbull)

J. Kerr, Esq.,
HM Treasury

CONFIDENTIAL

PRIME MINISTER

To report that there are the makings of a deal with Mr. Walker. He had already offered about £100 million a year from efficiency savings. Cuts in NCB investment of £40 million rising to £100 million look like being agreed (though they might not be identified in published figures). MISC 99 has offered 5 per cent on domestic gas which Mr. Walker naturally accepts. On electricity, MISC 99 have offered increases in prices of 3 per cent in each of the next two years rather than Mr. Walker's proposal of a freeze next year and an increase of 6 per cent the year after. He has agreed to take this to the electricity industry. The difficulty is that they may prove difficult as these increases could cause their financial target to be exceeded and a new target may have to be imposed.

The Treasury are disappointed about gas prices but in aggregate over the three years have got more than they were bidding for.

Mr. Walker departs for China in the morning, leaving Alick Buchanan-Smith to sell the gas price increase to Sir Denis Rooke, which should not be too difficult, and to persuade the electricity industry to accept the higher price path. Only if they prove troublesome would the deal fall apart. Alick Buchanan-Smith is in charge while Mr. Walker is away and will have to answer at Cabinet on 10 November if he cannot deliver the MISC 99 package.

AT

ANDREW TURNBULL

1 November, 1983

PART 24 ends:-

AT to PM 16A 28.10.83

PART 25 begins:-

AT to PM 1.11.83

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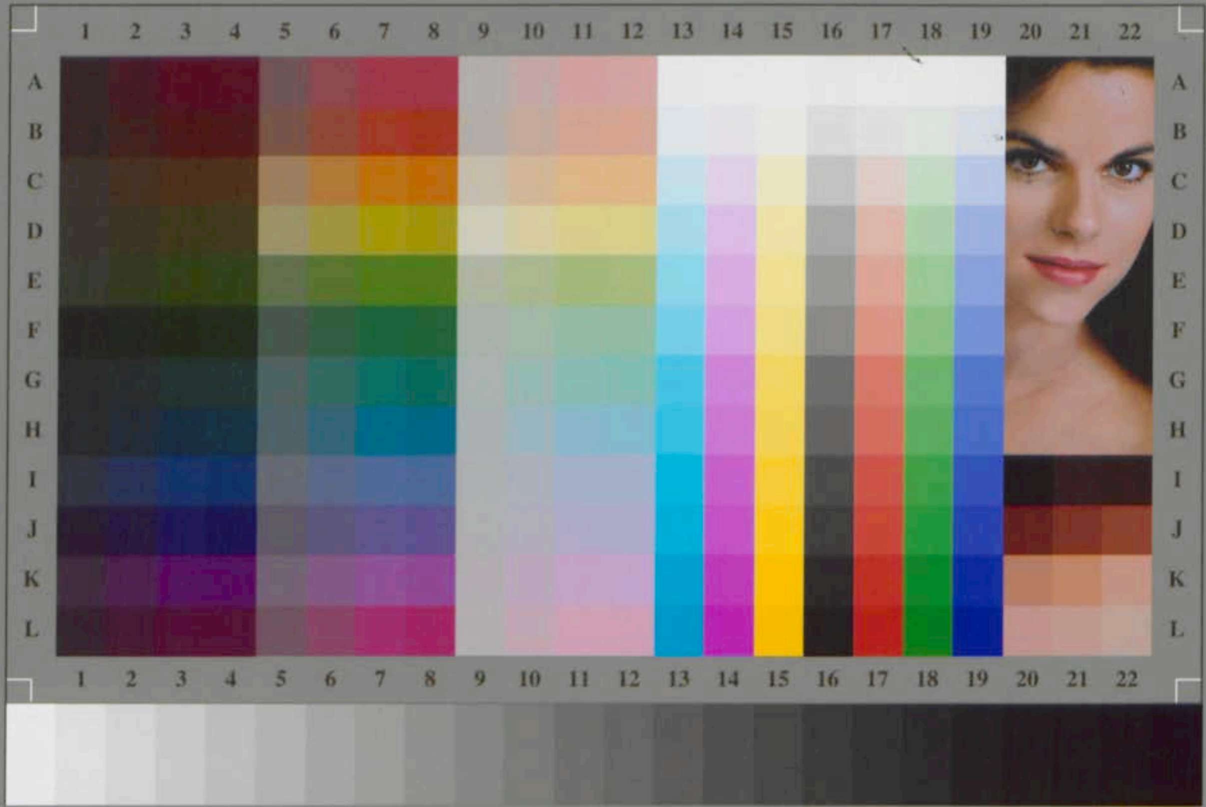

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