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PREM 19/1190

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Part 26

4996

Confidential Filing

Public Expenditure and
Cash Limits

ECONOMIC POLICY

Part 1: May 1979

Part 26: December 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
5.12.83							
6.12.83							
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21.2.84							
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29.2.84							
29.2.84							
PART ENDS							

PREM 19/1190

Public Expenditure
White Paper

A. "THE GOVERNMENT'S EXPENDITURE PLANS
1983-84 to 1985-86" VOLUMES 1 and 2
are in ~~attached folders~~ separate box

+

B. 1984-85 to 1986-87

PART 26 ends:-

Cu/Ex to Pm 29.2.84

PART 27 begins:-

Medwood to AT 2.3.84

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(A)(83) 8 th Meeting, Minutes	01.12.83
H(84) 2	10.01.84
H(84) 1 st Meeting, Minute 2	18.01.84
C(84) 6	03.02.84
CC (84) 5 th Meeting, Minute 7	09.02.84

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 SA Wayland

Date 22 August 2013

PREM Records Team



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

PRIME MINISTER

PUBLIC EXPENDITURE AND TAXATION IN THE LONGER TERM

Following the Cabinet discussion on 9 February, Peter Rees and I have, as you know, been working on the text of a Green Paper on the longer term prospects for public expenditure and taxation. The plan is to publish it on Budget Day.

- ...
2. I attach the latest version of the text. Work on it is still proceeding, and some passages referring to particular Departmental programmes are still being cleared informally with Principal Finance Officers. But the work is, I believe, sufficiently far advanced to be worth showing to colleagues.

 3. We agreed on 9 February that those colleagues who wish to see the text should let me know; and I have had some half dozen requests. But, given the potential interest of the Green Paper, I am in fact copying this minute and the draft to all Cabinet colleagues, the Chief Whip, the Attorney General, and Sir Robert Armstrong. Given the risk of leaks, I should be grateful if all concerned would respect the CMO classification. Given the printers deadlines, I have to ask that any comments on the text should reach me by 5 March.

A handwritten signature in black ink, appearing to be 'N.L.'.

N.L.

29 February 1984

SECRET

cc BI
IR.
5



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

28 February 1984

Andrew Turnbull Esq
10 Downing Street

Dear Andrew,

As you know, we have since the 9 February Cabinet been pressing ahead with the preparation of a text of the proposed Green Paper on the prospects for public expenditure and taxation in the longer term, with a view to its publication on Budget day. The Chancellor has now asked me to send you the enclosed copy of the latest version of the text, as it has emerged from a series of meetings taken by him, and which he would like to discuss with the Prime Minister at their meeting tomorrow. You will see that it follows the form agreed by Cabinet - ie concentrating on aggregate public expenditure figures, and avoiding detailed figures for individual programmes. Nevertheless, some inter-departmental clearance clearly is required, and the process is now starting, with officials in spending Departments being shown in confidence the paragraphs dealing with their departmental programmes. The Chancellor will wish to discuss with the Prime Minister how best to handle clearance with Cabinet colleagues.

The enclosed text is still very much a working draft. The graphs are being re-done, and Michael Scholar is still working on the annexes. But the Chancellor would like to be sure at this stage that the Prime Minister is content with the way in which the text is coming out.

Yours ever,
J O Kerr
J O KERR

DRAFT GREEN PAPER

PUBLIC EXPENDITURE AND TAXATION INTO THE 1990's

Introduction

1. This Green Paper is the government's contribution to the current debate on public expenditure and taxation in the longer term.

2. Each year the government reviews and carries forward its public expenditure plans in the Public Expenditure Survey, and publishes the results in a White Paper. The latest in this series, The Government's Expenditure Plans 1984-85 to 1986-87, (Cmnd 9143), was published last month. As a decision-making process which produces detailed control totals for public spending, and later Supply Estimates for Parliamentary approval, the Public Expenditure Survey is inevitably concerned with the relatively near future - on current practice the next three years. But the government takes these decisions within a longer-term strategic framework: thus, in the latest account of the government's Medium Term Financial Strategy (MTFS) in Part 2 of the Financial Statement and Budget Report (FSBR), assumptions about public spending, borrowing and taxation are set out for the next five years. Beyond this, the government thinks it valuable from **time to time** to look to the more distant future, to form a view both of the likely pressures for public spending much further ahead and of the economic and fiscal prospect which will govern what public expenditure can be afforded.

*a promise to repeat?
update?*

3. This Green Paper is concerned with the longer-term fiscal prospect, for the years up to 1993-94. It does not record decisions by the government either on public expenditure programmes or on taxation. It attempts, rather, to set out reasonable and defensible assumptions about how the economy as a whole might develop and to derive from them a framework within which to conduct the discussion of expenditure and taxation.

4. The government believes that the public debate on this issue is of the first importance. As this Green Paper will argue, the growth of public spending has, over the past twenty years, been the motive force which has driven ever upwards the burden of taxation, on individuals and companies alike. The government believes that it is necessary to reverse this process, to decide first what can be afforded, then to set expenditure plans for individual programmes consistently with that decision.

I Public Expenditure - past trends

5. Over the last twenty years public expenditure has risen both in real terms and as a proportion of total national output. Changes in definition and coverage over the years complicate the figures. But in broad terms, public expenditure* has risen in cash from around £10 billion in 1963-64 to some £126 billion in 1984-85. In real terms the rise has been from around £64 billion** in 1963-64 to getting on for double that figure, in 1984-85.

6. The real annual average rate of growth of public expenditure over this period was 3 per cent; GDP growth averaged 2 per cent a year. Thus over these twenty years real public spending has risen by 91 per cent, while real national income has risen by 49 per cent.

7. As a proportion of GDP, general government expenditure rose from around 36 per cent in 1963 to a peak of 48 per cent in 1975-76. After the cuts imposed after the crisis of 1976 the proportion declined to an estimated 42 per cent in 1977-78. But since then the proportion rose again up to 1982-83, since when it has fallen somewhat.***

8. Charts 1 and 2 illustrates these changes.

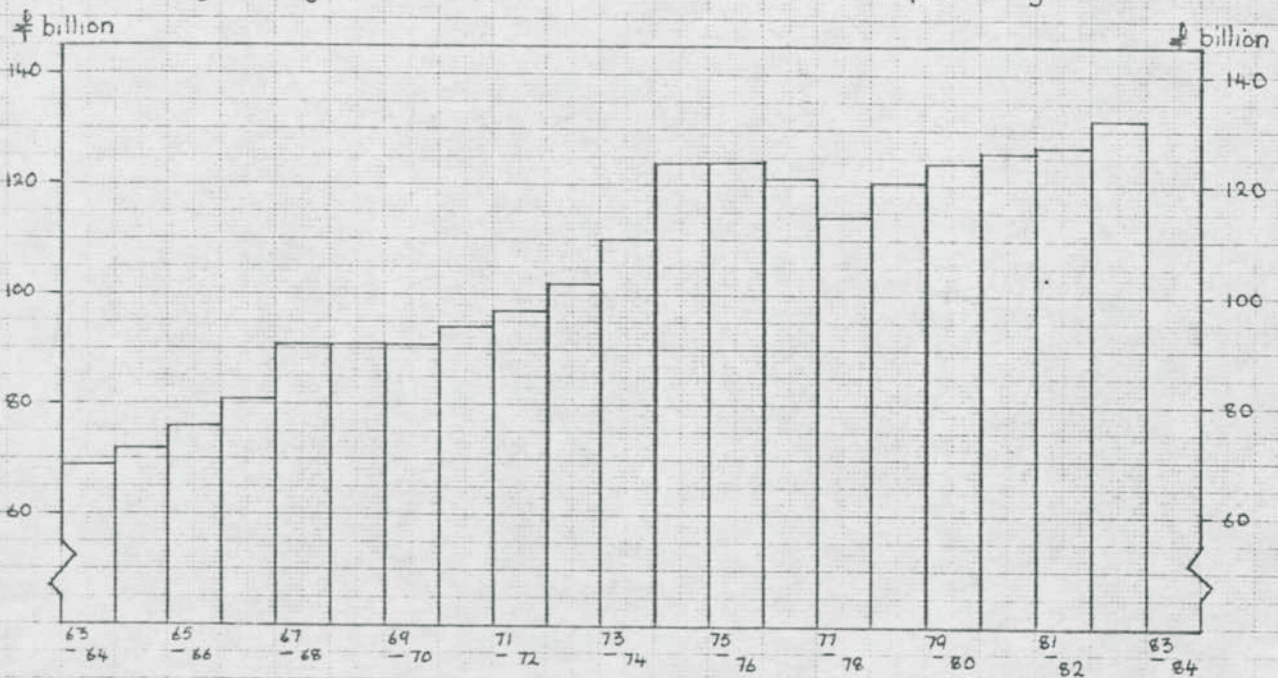
* on the general government expenditure definition. This and other definitions are explained in Annex 1.

** in 1983-84 cost terms. 'Cost terms', 'real terms', and other related concepts are explained in Annex 1.

*** Changes in definition mean that the published figures in the past have risen as high as 60 per cent in 1976 before the treatment of nationalised industries and certain other components of expenditure was changed.

Chart 1

Trends in general government expenditure¹ in real terms² over the past 20 years

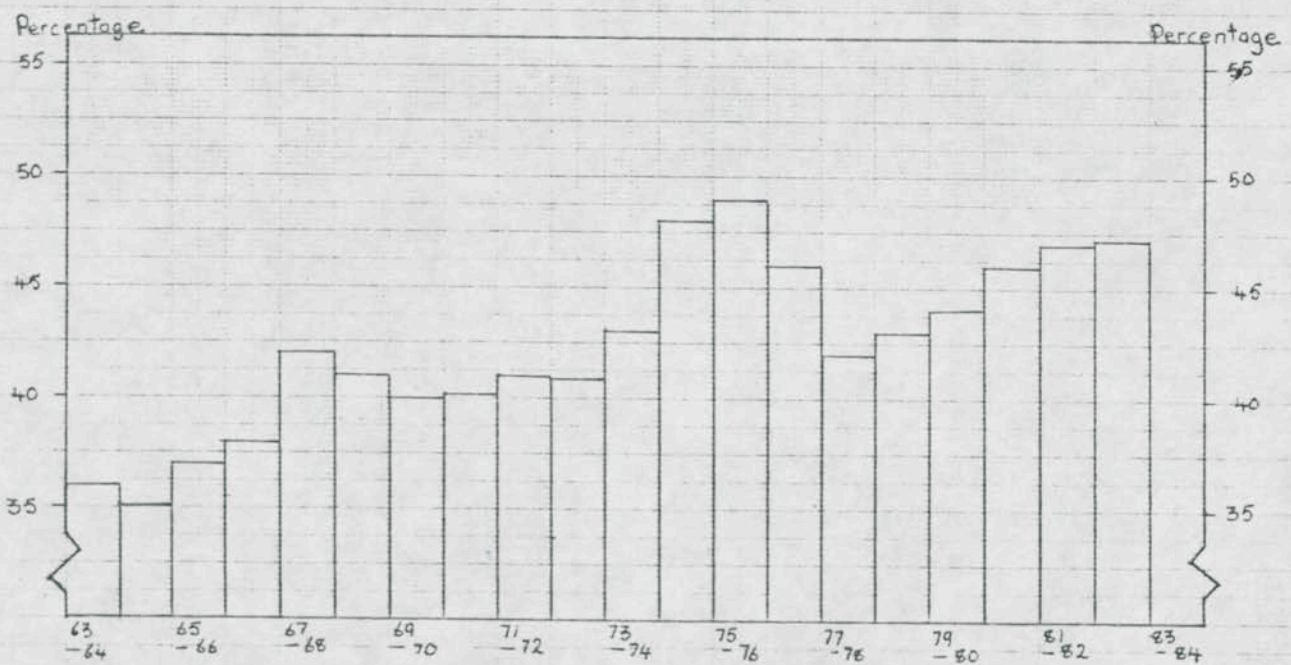


1 Defined as in the national accounts

2 Cash figures deflated using GDP deflator, base year 1982-83 = 100

Chart 2

Trends in general government expenditure¹ as a percentage of GDP over the past 20 years



1 Defined as in the national accounts

9. Public service manpower, too, grew rapidly over these years:

Table 1

Public Service Manpower, excluding the armed forces, since 1960

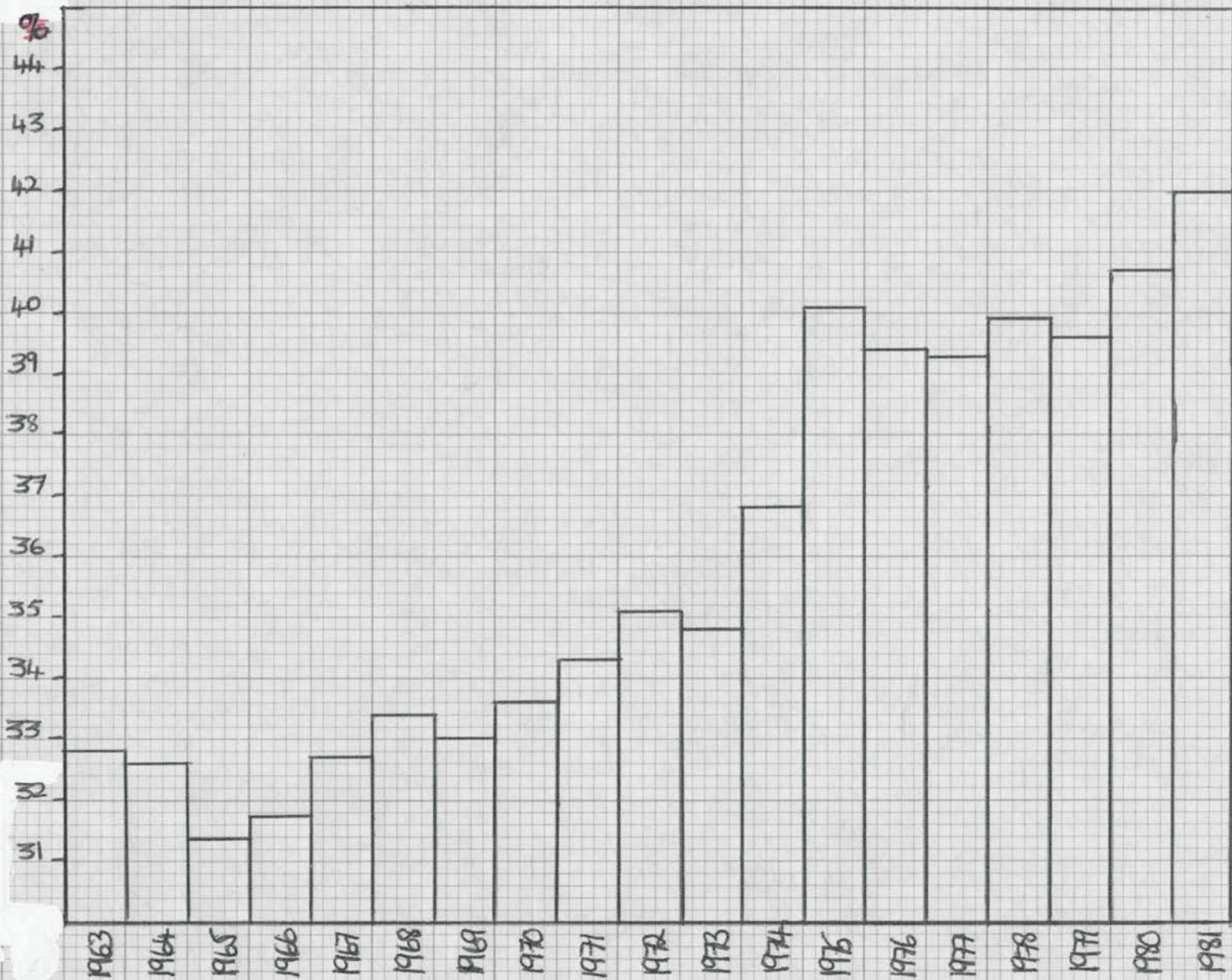
	(thousands, numbers unemployed)					
	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>	<u>1980</u>	<u>1985</u>
Civil Service	640	655	702	708	700	[649]
National health service	543	[600]	648	869	952	[997]
Local Government	1,821	2,154	2,559	2,993	3,027	[2,931]
Total	3,006	[3,411]	3,911	4,569	4,681	[4,578]

10. Powerful forces were at work driving public expenditure upwards over this period. Rising expectations about the help which the government should give to the more disadvantaged sections of the community led, in Britain as in many other countries, to a steep rise in spending on the social programmes. Public spending was also increased for economic reasons, either as a general stimulus to demand, in the hope that this would encourage economic growth and employment, or to secure more specific economic objectives - for example in regional or industrial development. At the same time, there has all too often been over-optimism about the prospective growth in total national output, so that spending plans have been set at a level unsustainable for anything but the very short-term.

11. During the 1970's there was a major deterioration in the economic background. A series of shocks to the international trading and monetary system - in particular, the oil price increases of 1973 and 1979 - created conditions of deep recession and rapid inflation, which imposed severe strains on the budgetary position of countries world-wide. Higher inflation was itself a cause of higher public expenditure. Recession-induced expenditures climbed steeply, and at the same time rising expectations of public services continued unabated, notwithstanding the greatly increased difficulty of financing higher spending.

12. Chart 3 shows how rapid the growth of public spending has been in the seven major OECD countries:-

GENERAL GOVERNMENT
EXPENDITURE AS A PERCENTAGE
OF GDP (Averages for the Seven major OECD Countries)



Source: OECD Secretariat and National Accounts.

An analysis, by member country, of these totals, together with their GDP growth rates, is set out at Annex 2.

More recent trends

13. Since 1978-79 public expenditure has grown by just over 7 per cent in real terms. Tables 1A and 2 show how different expenditure programmes have changed over the past five years, both in cash and after allowing for inflation as measured by the GDP deflator.

Table 1A Total public expenditure by programme £ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Defence	7,497	9,228	11,173	12,605	14,408	15,716
Overseas aid and other overseas services						
Overseas aid	727	798	904	978	984	1,063
Net payments to EC institutions	751	839	221	153	580	500
Other overseas services	367	439	496	554	600	731
Agriculture, fisheries, food and forestry	812	1,007	1,345	1,382	1,861	2,087
Trade and Industry	2,034	2,257	2,743	3,249	2,269	1,800
Energy	550	561	623	1,118	892	1,180
Employment	1,045	1,237	1,934	2,241	2,359	2,287
Arts and Libraries	340	404	478	524	616	624
Transport	2,672	3,278	4,000	4,277	4,395	4,560
Housing	3,571	4,520	4,461	3,128	2,640	2,760
Other environmental services	2,222	2,640	3,071	3,108	3,554	3,787
Law order and protective services	2,034	2,577	3,160	3,731	4,174	4,681
Education and Science	7,754	8,942	10,898	11,841	12,682	13,356
Health and personal social services	7,425	8,899	11,362	12,724	13,817	14,688
Social Security	16,437	19,417	23,429	28,567	32,445	35,324
Other public services	966	1,156	1,415	1,538	1,631	1,666
Common services	853	1,009	1,098	1,454	1,560	950
Scotland	3,713	4,547	5,359	5,830	6,242	6,767
Wales	1,489	1,769	2,112	2,218	2,386	2,587
Northern Ireland	2,132	2,446	2,899	3,215	3,500	3,799
<u>Other planning total items</u>						
Special sales of assets		-999	-356	79	-488	-1,200
Reserve						100
Local authority current expenditure not allocated to programmes (England)						
General allowance for shortfall						-300
Planning total	65,752	76,922	92,672	104,676	113,377	120,328
<u>Memorandum item</u>						
Debt interest (net)	2,204	3,429	4,491	5,741	5,946	7,000

* the programme figures in Tables 1 and 2 are presented consistently with those in the public expenditure White Paper Cmd 9143. They therefore include nationalised industries borrowing which is separately identified in chart 4 and provide separate figures for Scotland and Wales which is allocated to functional programmes in chart 4.

Table 2 Public expenditure in cost terms by programme (1) £ million base year 1982-83

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Defence	12,183	12,835	13,092	13,442	14,408	14,968
Overseas aid and other overseas services						
Overseas aid	1,162	1,090	1,037	1,022	965	988
Net payments to EC institutions	1,220	1,167	259	163	580	476
Other overseas services	615	631	603	611	619	721
Agriculture, fisheries, food and forestry	1,320	1,400	1,576	1,473	1,861	1,987
Trade and Industry	3,305	3,139	3,214	3,463	2,269	1,714
Energy	893	780	730	1,191	892	1,124
Employment	1,698	1,721	2,266	2,389	2,359	2,178
Arts and Libraries	553	562	560	558	616	595
Transport	4,342	4,559	4,687	4,561	4,395	4,343
Housing	5,803	6,286	5,228	3,336	2,640	2,629
Other environmental services	3,611	3,672	3,598	3,314	3,554	3,607
Law order and protective services	3,306	3,585	3,703	3,979	4,174	4,459
Education and Science	12,602	12,438	12,769	12,627	12,682	12,720
Health and personal social services	12,067	12,377	13,313	13,568	13,817	13,988
Social Security	26,713	27,006	27,453	30,463	32,445	33,642
Other public services	1,570	1,608	1,658	1,640	1,631	1,587
Common services	1,386	1,403	1,286	1,550	1,560	905
Scotland	6,034	6,324	6,279	6,217	6,242	6,445
Wales	2,419	2,460	2,475	2,366	2,386	2,464
Northern Ireland	3,464	3,402	3,397	3,429	3,500	3,618
<u>Other planning total items</u>						
Special sales of assets		-1,389	-417	84	-488	-1,143
Reserve						95
Local authority current expenditure not allocated to programmes (England)						
General allowance for shortfall						-286
Planning total (2)	106,857	106,989	108,588	111,624	113,377	114,598

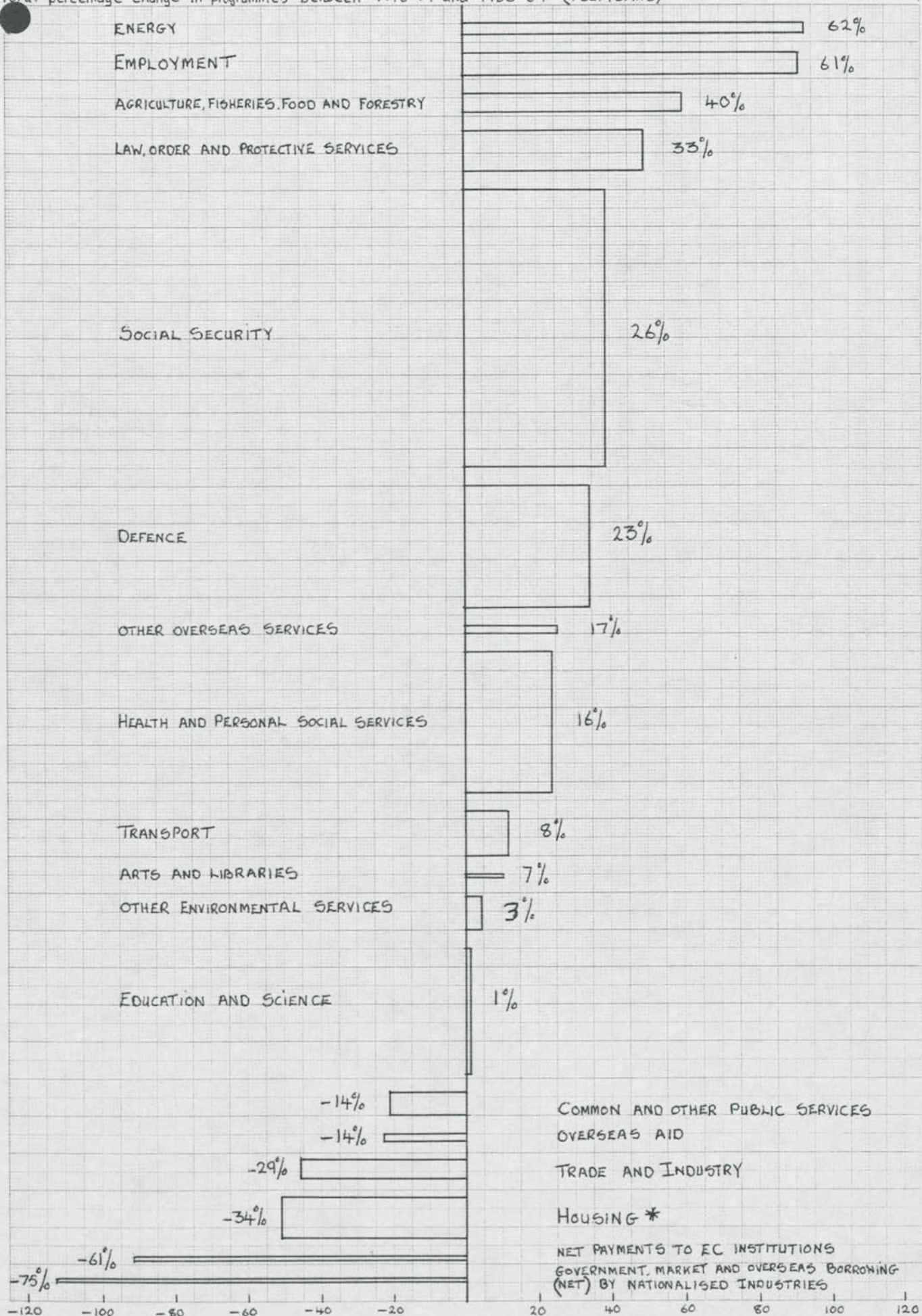
(1) Cash figures as in Table 1.3 adjusted for general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 5 per cent in 1983-84 and in 1984-85 as stated in the Autumn Statement 1983, paragraph 1.48.

(2) Totals do not always add because of rounding.

14. Chart 4 below illustrates these changes.

CHART 4

Total percentage change in programmes between 1978-79 and 1983-84 (real terms)



Notes

1. The width of each bar on the vertical axis is proportional to expenditure on the programme concerned in 1983-84
 2. Expenditure in Scotland, Wales and Northern Ireland has been allocated to individual programmes.
- * Housing figures are calculated before any deduction for council house sales.

15. The principal reasons for this increase in public expenditure are given below:-

- (i) Provision for defence expenditure has increased by £8.2 billion over the last five years, 23 per cent in real terms. This is primarily a reflection of the Government's commitment to meet the NATO aim of real increases in defence expenditure of 3 per cent per annum in full up to 1985-86. In addition, all defence Falklands costs have been met out of monies additional to the 3 per cent annual rate of real growth.
- (ii) Agriculture, fisheries, food and forestry expenditure has grown 40 per cent in real terms. This is mainly due to the high cost of market support under the Common Agricultural Policy which now accounts for more than half of this programme. Market support for products covered by the CAP involves public expenditure (mainly by the Intervention Board for Agricultural Produce) on purchases into intervention, export refunds and production and consumption subsidies. This expenditure has increased because CAP pricing policy has increased agricultural production in the UK. Most of this expenditure is prefunded or reimbursed from the Community budget: receipts from this source are taken into account in assessing our net contribution to EC institutions (recorded in programme 2.7).
- (iii) Expenditure on the law and order programme has grown by 33 per cent in real terms since 1978-79 to reach £4.7 billion in 1983-84. More than half of this is on police, and has permitted an increase in the authorised establishment from 118,663 to 121,500, a greater increase in actual strength within these limits, and substantial increases in pay. The priority the Government attaches to law and order has also led to measures to relieve the pressures on the prison service, which accounts for 12 per cent of the programme. The number of prison staff has risen by 1,300, and the programme of prison building, refurbishment and maintenance has been expanded.

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- (iv) The health and personal social services programme has grown about 16 per cent in real terms since 1978-79, continuing a pattern of sustained growth over and above that attributable to demographic pressures, which has seen expenditure on the National Health Service roughly triple in cost terms since the early 1950s. Expenditure on services mainly for elderly people (who now occupy 2 in every 5 occupied hospital beds) has increased rapidly, at over 3 per cent per year in real terms over the past eight years. There has been considerable expansion to meet rising expectations: more treatments, new treatments and higher levels of staffing. More patients have had hospital treatment: in 1982 there were nearly 8½ per cent more in-patient and day cases than in 1978. Spending on drugs was [12 per cent] higher in real terms in 1982-83 than in 1978-79. The average GP had some 7 per cent fewer patients on his list in 1982 than in 1978: this in itself should permit a higher standard of health care for the mentally ill in hospital; and the nursing staff/patient ratio has improved by 17 per cent since 1978-79. But pressures for additional expenditure continue to be intense, and there appears to have been little, if any, effect on the gap between services and expectations.
- (v) Social security spending has grown 26 per cent in real terms over the period 1978-79 to 1983-84. In 1983-84 it is estimated at £35.3 billion, 29 per cent of the public expenditure planning total*. About half of the programme represents expenditure on the elderly; over the period the retirement pension and linked long-term benefits, such as supplementary pension, have more than kept pace with the rise in prices, and the number of pensioners has increased by around 650,000. There have also been significant increases in the numbers receiving disability benefits; for instance mobility allowance recipients rose from 95,000 in 1978-79 to 315,000 in 1983-84, and the numbers in receipt of attendance

* This is defined in Annex 1.

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allowance went up by over two thirds. The programme has also been affected by the recession, leading to significant increases in spending on unemployment benefit and supplementary benefits; in total, expenditure on the unemployed has increased in real terms since 1978-79 from £2.4 billion to £6.2 billion and now represents about 18 per cent of the social security programme, or 5 per cent of the public expenditure planning total.

(vi) Interest on government borrowing, although not in the planning total, also has to be paid for. Since 1978-79 the cumulative public sector borrowing requirement has totalled around £60 billion. As a result the stock of public sector debt held outside the public sector has risen by 57 per cent and gross debt interest (now running at about £15½ billion a year) has increased by 86 per cent. In the past, high inflation progressively reduced the burden of public debt. Now, to reduce this burden, government borrowing has to be reduced.

(vii) Local authorities

Responsibility for spending on many services lies with local authorities not central government. They account for about a quarter of public expenditure. While central government grants finance over half of local authorities' current expenditure, local authorities are free to determine both levels of spending and their own priorities. Despite continuing calls from the government for restraint, and changes to the grant system to make it act as a disincentive to high spending, local authority current spending has risen since 1978-79 by 9 per cent in real terms in England, and 15 per cent in Scotland. The consequence has been a heavy and rising rate burden, despite large cash increases in Exchequer grants.

16. The Government has contained the effect of these increases on total public expenditure by reducing expenditure on other programmes:

(i) the cost of central government administration has been sharply reduced. Since May 1979 the size of the Civil

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Service has been reduced by 99,700 - from 732,300 in April 1979 to 632,600 in January 1984. It is now smaller than at any time since 1945. This reduction represents savings approaching £600 million a year.

- (ii) net payments to the European Communities institutions have been reduced by budget refunds amounting to some £2,600 million in the three years to December 1983.
- (iii) expenditure on trade and industry has fallen by 29 per cent in real terms over the last five years. Support for BL and the aviation industry has fallen sharply since 1981-82. The 1979 changes in regional policy contributed to declining regional development grant payments from 1982-83; and steel redundancy payments fell off from their 1981-82 peak. These falls were offset in part by large increases in spending on science and technology.
- (iv) the public sector housing programme has been reduced by 34 per cent in real terms over the last five years, before taking account of the effect of public sector housing sales. Such sales count as negative public expenditure, so that the net reduction in the public sector programme is larger than this. New starts in the private sector are now at their highest level for ten years.

17. The overall picture is, thus, one of a considerable shift in the composition of public expenditure since 1978-79, reflecting in large measure the government's priorities and commitments. Four years ago, for example, the net public sector housing programme was almost twice the size of the law and order programme - yet by next year it will be no more than half its size; and the trade and industry programme fell from being about one quarter of the size of the health and education programmes in 1978-79 to being about one-eighth of those programmes by 1983-84.

18. These figures do not include what are sometimes called "tax expenditures", such as relief for mortgage interest and life assurance premium relief. These two amounted to a little under £1½ billion (cash) in 1978-79 and to about £3½ billion in 1983-84 - a real terms increase of about 50 per cent.*

II Taxation - past trends

19. The rise in public expenditure over the past twenty years has necessarily led to a corresponding rise in taxation. Taxes and rates, plus national insurance contributions, were some 29 per cent of GDP in 1963-64. They rose to over 37 per cent by the end of the 1960's. The proportion fluctuated during the 1970's. By 1978-79 non-North Sea taxes plus national insurance contributions and rates represented 34.7 per cent of non-North Sea GDP.

20. Because of the upward pressures on public expenditure and the need to reduce an excessive and unsustainable level of borrowing, the non-North Sea burden has increased further since 1978-79 - from 34.7 per cent to 38.6 per cent in 1983-84. This increased burden was necessary despite the contribution made by the North Sea to total government revenue: North Sea taxes rose in cash terms from £½ billion in 1978-79 to £8½ billion in 1983-84. Chart 4A illustrates the total change in the tax burden throughout the period since 1963-64.

* Information on direct tax allowances and reliefs, and on the difficulties of quantifying their costs, is published in the annual Public Expenditure White Papers (most recently on pp 164-5 of Cmnd 9143-II)

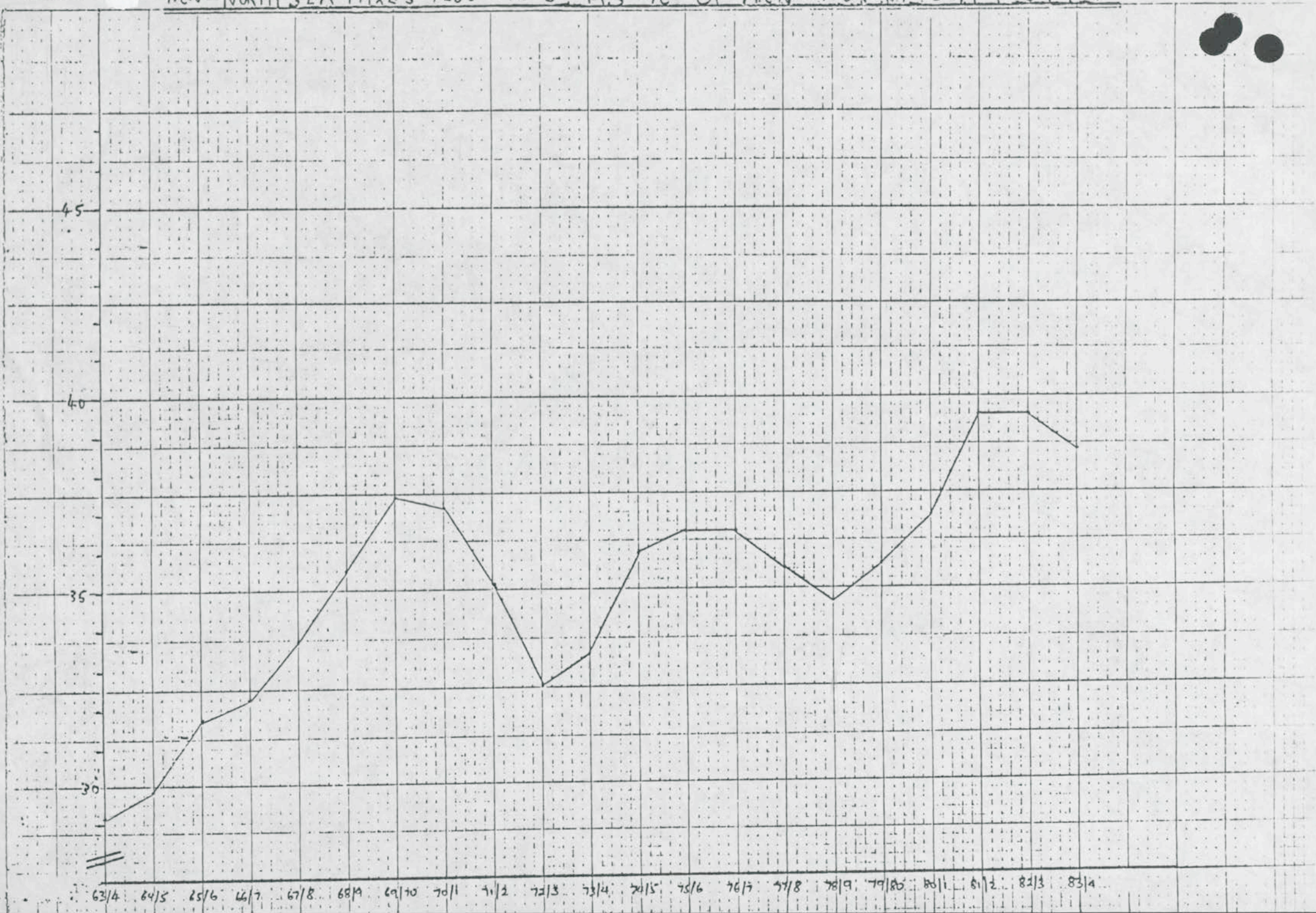
*explain why
comparison is
confined to non North
Sea taxes and GDP*

X

CHART

4A

NON-NORTH SEA TAXES PLUS NIC'S AS % OF NON-NORTH SEA GDP



21. The shares of the different taxes in the total burden have also changed over this period. The following table shows this for the period since 1963-64.

Table 3

Tax and other payments in real terms £ billion (1982-83 prices)					
	1963-64	1978-79	1983-84	%Change 1963-4 to 1983-4	%Change 1978-79 to 1983-84
Income Tax	16.7	31.1	30.0	+80	-2
Corporation Tax					
Mainstream	4.3	3.7	3.2	-26	-14
ACT	-	2.2	1.7	-	-25
North Sea Taxes	-	0.9	8.7	-	+830
Capital taxes & stamp duty	2.4	2.3	2.6	+8	+17
Taxes on expenditure	18.5	25.6	32.2	+74	+29
NIS	-	3.4	1.5	-	-53
LA rates	6.4	9.4	11.6	+81	+23
Total Central Government taxes and rates	48.3	78.7	91.4	+90	+17
NICs - employees	4.4	6.7	9.9	+125	+52
NICs - employers	3.9	10.1	10.3	+164	+6
Total, taxes, rates & NICs	56.5	95.5	11.5	+97	+19

Memorandum items:

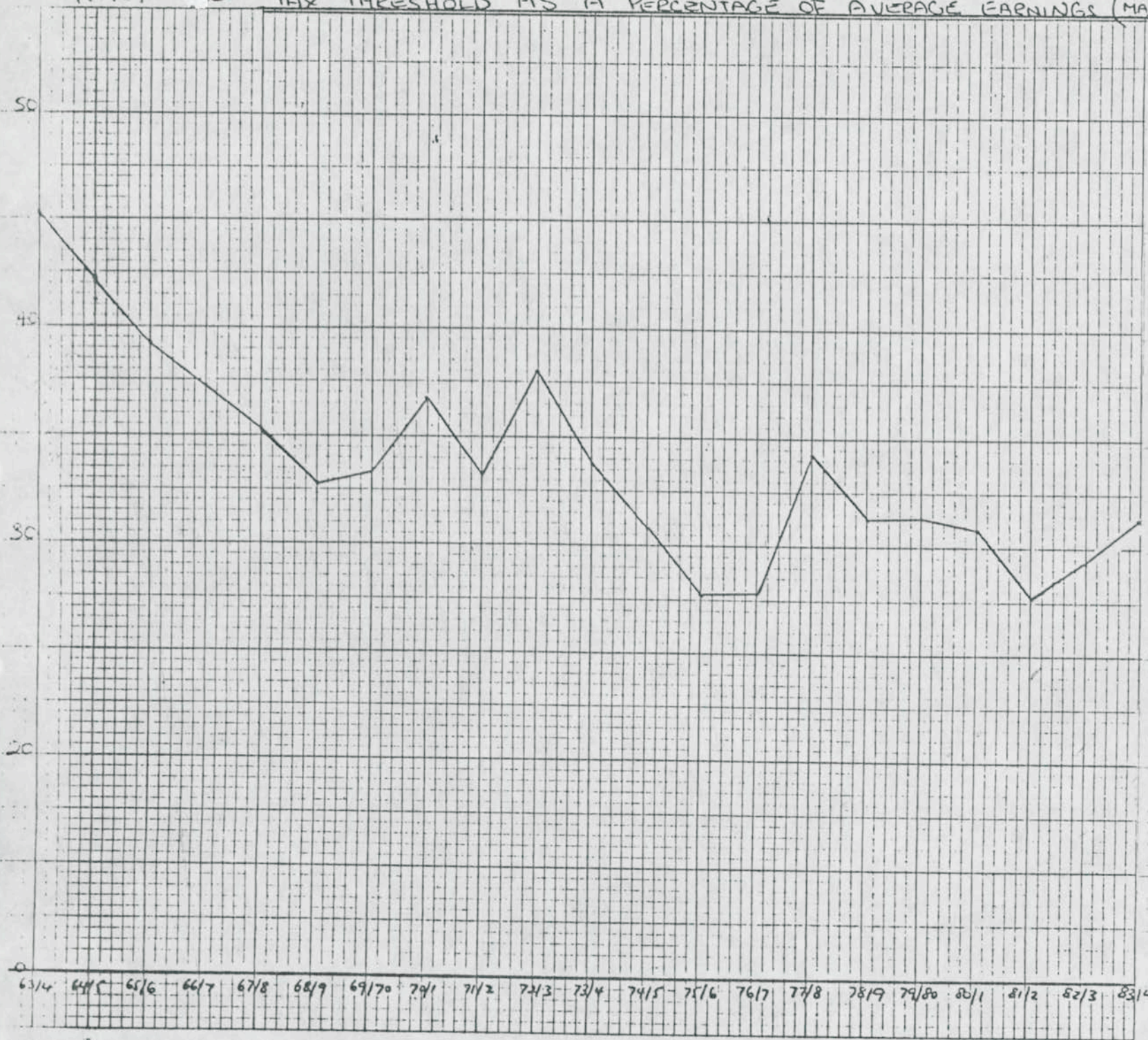
Income Tax and employees' NICs	21.1	37.8	39.9	+90	+7
NIS and employers' NICs	3.9	13.3	12.1	+210	-9
Employees' and Employers' NICs	8.3	16.8	20.2	+140	+25

Over the period as a whole, the increasing tax burden has led to a substantial increase in income tax. There has however been a small fall since 1978-79, helped by the new revenue from North Sea taxes and the policy of shifting the burden from direct to indirect taxation. There has been a big increase in national insurance contributions, as the real value of benefits generally has been maintained or even increased while their volume has grown. Rates, reflecting higher expenditure by local authorities, have grown throughout the period. The yield of Corporation Tax has risen very little, because of declining company profitability.

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22. One important result of these trends has been that many people on low incomes are now paying tax. The tax threshold for a married man fell from 45 per cent of average earnings in 1963-64 to 31 per cent in 1983-84. Chart 5 illustrates this change. The low starting-point for tax means not only that large numbers of low-paid people have been brought into tax for the first time, but also that the average rate of tax paid by those above the threshold, who may be on average earnings or less, has increased. A married man without children at average earnings paid about 13.1 per cent of his income in income tax in 1963-64. He pays over 20 per cent today. Chart 6 shows how this proportion has varied throughout the period.

CHART 5 TAX THRESHOLD AS A PERCENTAGE OF AVERAGE EARNINGS (MARRIED MAN WITHOUT CHILDREN)

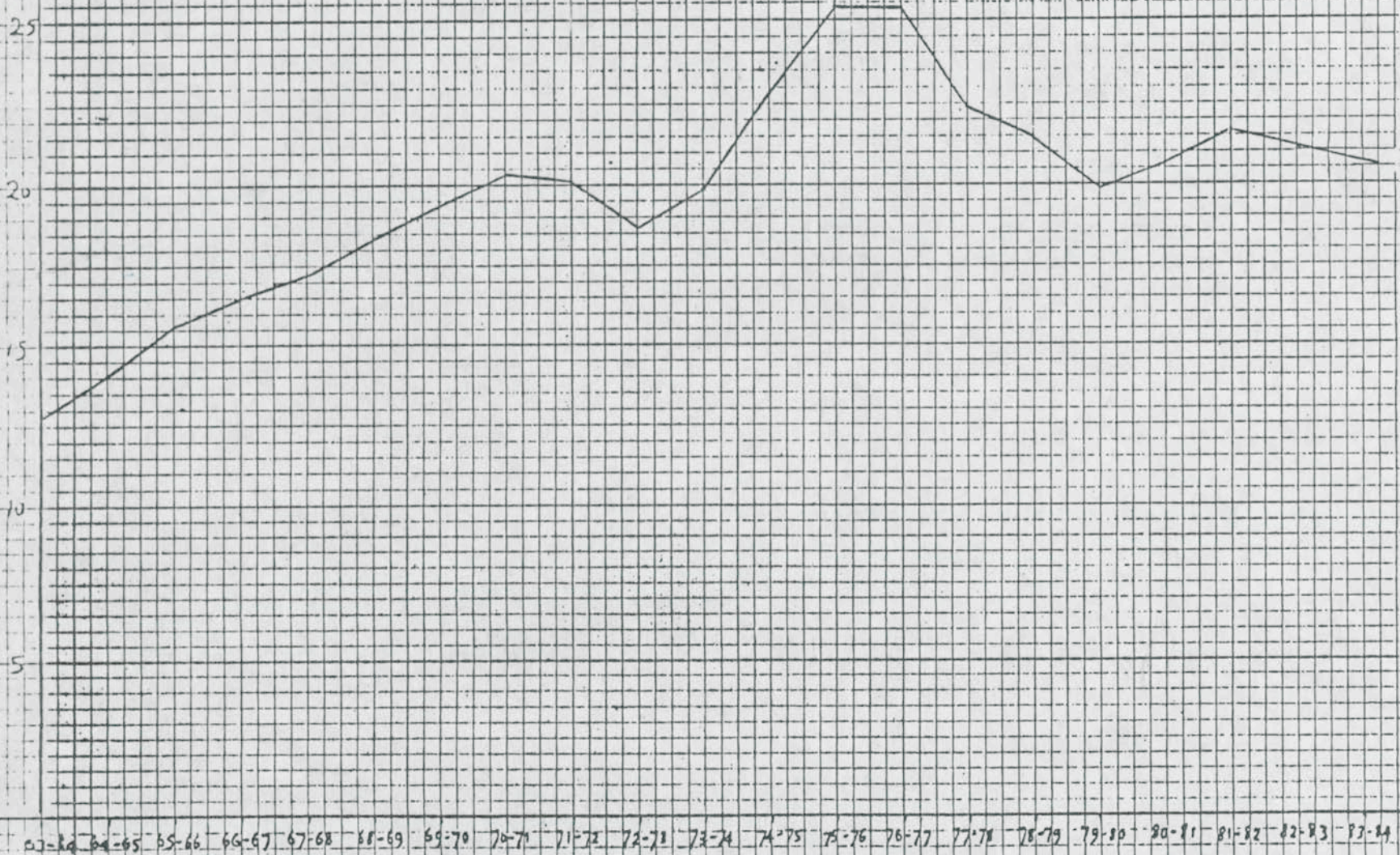


Show an estimate for 84-5 dotted line

Chart 6

INCOME TAX AS PERCENTAGE OF GROSS EARNINGS: MARRIED MAN (NO CHILDREN at average earnings)

of GROSS
EARNINGS



show an estimate
for 84/85
dotted line

23. The burden of tax on the lower paid has therefore risen substantially. At the same time, the level of social security benefits has, over the period as a whole, been raised broadly in line with earnings. The result has been that increasing numbers of people have come to be simultaneously subject to tax and entitled to means-tested benefits. If their income rises, they therefore suffer both an increase in tax and a withdrawal of benefits and the marginal rate of deduction for them, taking those two effects together, can be higher than the tax rate at the top of the income scale. This is the "poverty trap". Another effect of raising taxation on low incomes, while maintaining or increasing the value of benefits, has been to change the ratio between net pay in work and benefit income in unemployment. Income in unemployment can therefore become a high proportion of, and can even equal, net income in work: the "unemployment trap".

III Public expenditure - future prospects

(a) Medium term

24. The government's policies for public expenditure up to 1986-87 were set out in the Public Expenditure White Paper published on 16 February. Total public expenditure is planned to grow in cash in the three years 1984-85 to 1986-87 by 5 per cent, 4½ per cent and 3½ per cent respectively, from £126.4 billion to £136.7 billion. Given the likely prospect for inflation over that period, the government expects the level of public expenditure to remain broadly constant in real terms up to 1986-87. Further, the assumption in the government's Medium Term Financial Strategy, set out in Part 2 of the FSBR, is that total public expenditure will remain constant at its 1986-87 level in real terms for a further two years, up to 1988-89, although decisions have yet to be taken for these years.

(b) Longer term pressures

25. Beyond 1988-89, the prospects are necessarily a good deal less clear, both for public expenditure totals and for individual programmes. There will be some who will argue that it makes little sense to consider, still less to decide upon, public spending totals without a clear idea of the implications for individual programmes.

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✓ The government believes that such thinking has been largely responsible for the upward drift of public expenditure over many years. It is necessary to turn the argument round the other way, to decide first what can and should be afforded, then to set expenditure plans for individual programmes consistently with that decision. This Green Paper is primarily concerned with this major fiscal issue. It does not, accordingly, attempt to make detailed projections of individual expenditure programmes so far ahead in the future. But it is possible now to discern some of the pressures for still higher public spending.

26. It is in the nature of the public services that demands are literally limitless, because they are not restrained by the price mechanism which forces those making demands to balance them against costs. Where possible, the government is seeking to transfer the provision of services into the market sector. In other areas it may be possible to use charges as a more direct way of testing demand, even within the public sector. There may, too, be a case for hypothecating revenues to individual expenditure programmes, particularly in the social field, in order to bring home the costs of benefit improvements. But over a wide range of services the only means of limiting the burden on the economy is for the government to control the supply.

27. Over the next decade there are reasons to expect continuing pressures for more spending, and insistent demands for improvements. One is demography - especially, the effect of increasing numbers of the very elderly. Another is rising expectations, as incomes of the working population increase. In those services which depend on personal contact, there will be less scope for reducing costs by the use of new technology, so that the relative cost of providing these services will tend to increase over time. In other areas technological advance will yield substantial cost savings; but it can also open up new possibilities for improved levels of service, and therefore new demands.

28. The following paragraphs indicate the main pressures on individual expenditure programmes.

Social Security

29. Since there is no clear 'right' level for any particular social security benefit, there are constant demands both for real increases in the level of benefits and for extension of benefit coverage to those who do not at present qualify.

30. Because about half of present expenditure goes on the elderly, the numbers of those above pension age is the main demographic influence on the programme. Between now and 1995-6 the projection is for very little increase in this number - from about 9.9 million to 10.2 million. But, in the early years of the next century numbers will rise rapidly as the 'baby boom' of the 1950's and early 1960's comes to retirement age and by 2025-6 the latest projections suggest a total of 12.3 million.

31. Moreover, against this background the programme will also have to cope with the rapidly - growing pension entitlement under the 1975 Social Security Act. More people - particularly married women - will be entitled to a pension in their own right, and between now and 1993 steady growth in the number of pensioners is expected. By 1993 there will be 600,000 more pensioners than in 1983-84. On average each 100,000 pensioners represents about £160 million of the total provision for the basic state pension. More significantly, the earnings-related pension element of the 1975 State Earnings-Related Pension Scheme (SERPS) scheme is now beginning to increase expenditure, and the effect will be appreciable from the early 1990's. Unless there are changes to the 1975 scheme it will be reaching maturity from the turn of the century; anyone retiring after 1998 will be potentially entitled to a full earnings-related pension and this will have its full impact at the same time as demographic factors begin to exert their maximum pressure. There will be more pensioners; and they will, in general, be a lot better-off, even relative to those in work, than they are now.

32. Until then however, most pensioners will be reliant on the basic state retirement pension; and there will continue to be substantial dependence on supplementary pension. The government is committed to raising these benefits in line with inflation. But, as the recovery progresses, there is likely to be strong pressure for benefits to rise faster than this. Lastly, there is growing support for equalisation of

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pension age as between men and women - although whether this would increase or reduce public expenditure would depend upon the age at which equalisation was set.

33. Such pressures are not confined to expenditure on the elderly. As noted in paragraph 15(v), expenditure on disability benefits has been growing rapidly. To meet the calls for a comprehensive disability benefit would cost about £3 billion a year. Increases in child benefit are often advocated not only to alleviate family poverty, but also to reduce the poverty and unemployment traps. But significant increases in this universal benefit are very expensive: each £1 on child benefit costs £500 million in a full year.

34. Nevertheless, as the economic recovery progresses and the number of those unemployed falls over the next decade, the recession-induced pressures on the social security programme will abate: for each 100,000 fewer unemployed there should be a fall in the cost of benefits to the unemployed of around £185 million.

Defence

35. It is difficult to be confident of a reduction in international tension or in external threats to UK interests. Pressures for increases in defence spending may also be fuelled by the growing sophistication of defence equipment. The government will seek to offset these factors by pursuing greater value for money within the defence programme, and a more equitable division of the common defence effort among the European Allies. But there will continue to be strong arguments for more expenditure on defence.

Demography

36. The demographic projections referred to in the following paragraphs are summarised in the table below:

Table 4

		Demographic projections for the United Kingdom			
		millions			
		1981	1984	1991	2001
Under 15		11.6	11.0	11.1	12.2
(as % total)		(20.1)	(19.5)	(19.5)	(21.0)
15 to pensionable age		34.5	35.1	35.3	35.5
(as % total)		(61.4)	(62.3)	(62.0)	(61.2)
Pensionable age		10.1	10.2	10.5	10.3
(as % total)		(18.0)	(18.1)	(18.4)	(17.7)
Total		56.2	56.3	56.9	58.0
of which over 75		3.2	3.5	3.9	4.2
(as % total)		(5.7)	(6.2)	(6.8)	(7.2)

Source: Office of Population, Censuses and Surveys (OPCS).

Health and
Personal Social
Service

37. As with social security, demographic changes constitute a major influence on this programme. Health care costs are dependent on age. The costs in the 0-4 age group are about twice as much per head as for those of working age; for the 65-75 age group about four times as much, and for the 75 and over age group about nine times as much. Until the early 1990's, and again from the early years of the next century, the proportion of the elderly and very elderly in the population is forecast to rise. In particular the numbers of those over 75 are forecast to rise from 3.5 million in 1984 to 3.9 million in 1991. If current levels of gross health expenditure per head of population in different age groups were to remain constant over time, spending would need to rise about 1 per cent a year between 1983-84 and 1993-94 simply to keep pace with demographic changes.

38. Medical advances may prove a major further pressure. Where these lead to simpler or non-hospital treatments, they may in fact reduce costs. But where they involve expensive equipment, expensive surgical techniques or new drugs they can lead to powerful demands for increased funds. Even where unit costs are relatively small (eg hip replacement surgery) widespread demand for such treatment may strain the resources available.

39. Changes in social attitudes and patterns of treatment may also pose problems for expenditure control in this programme. Increasingly, on both medical and social grounds, the aim is to keep

the elderly and the mentally ill and mentally handicapped in the community. Although treatment in hospital is expensive, keeping people in the community requires heavy investment in support services - the medical professions, social workers and domiciliary support. This affects both the family practitioner services and the local authority personal social services, both of which are highly labour-intensive.

40. Finally, evidence from other countries suggests that increased affluence will lead to pressures for a greater proportion of spending on health care. Here as elsewhere, demographic pressures and increasing demands are not the whole story. The scope for cost reductions flowing from new technology has already been mentioned. Beyond this the Health Service needs to achieve continuing efficiency improvements, from higher productivity and better management, following the example of private industry in recent years. As standards of living grow it would be reasonable to expect people to make a larger direct contribution to the costs of their medical treatments, through higher charges; and many have chosen to make provision for their health needs outside the State system, whilst continuing to contribute towards Health Service costs through their taxes. As living standards continue to rise, some further increase may be expected in the numbers who so choose. These developments will moderate the pressures for an increased contribution from the taxpayer, but such pressures will still continue.

Education

41. Demographic changes affecting education over the next decade are such that, if current levels of provision per pupil and per student were broadly maintained, education's share of GDP could be expected to decline significantly. The number of pupils in maintained schools is expected to fall from over 8.9 million in 1984 to a trough of some 8.05 million in 1991, rising thereafter to around 8.2 million by 1994. If the cost per pupil were maintained at existing levels every 100,000 fewer pupils would lead on average to savings of around £90 million a year - although there are diseconomies of scale which will erode such savings. The number of students in higher education is projected to fall from 580,000 in 1984 to around 465,000 in 1994. A number of factors, however, are likely to work in the opposite direction. There will be the usual pressures for increased expenditure

per pupil. Moreover the number of primary school children is forecast to rise steadily from 1986, with under fives projected to increase from 1988. As more married women take up paid employment the pressures for increased nursery provision seem likely to grow, although these pressures could be met by employers or by private individuals rather than the public authorities. Technological advance in industry may, too, result in extra demand for relatively expensive courses in science and technology within further and higher education - although there may be scope for involving employers in the financing of such courses.

Capital expenditure

42. Table 1.13 of the latest Public Expenditure White Paper shows that total public sector capital spending has remained broadly constant in real terms since 1978-79. The government believes that there is no self-evidently correct level of capital spending in aggregate, but that each capital project should be proceeded with when justified by a searching investment appraisal. Without a rigorous case-by-case assessment of this kind scarce resources will be wasted, as has all too often happened in the past. Nevertheless, in the longer term, with sustained economic growth and more demand (in the case of roads, for example, heavier traffic) there will be pressures to spend more on maintaining and improving the stock of capital assets in the public sector.

Public Service
Pay and Pensions

43. Public service pay accounts for about one-third of public expenditure - some £38½ billion in 1983-84 - or about 13 per cent of GDP. Each extra 1 per cent on the pay bill adds around £1/3 billion to public expenditure, with particularly heavy effects on the law and order programme (of which 73 per cent is pay), education (62 per cent) health and personal social services (56 per cent) and defence (37 per cent). Increases in pay also lead to increases in public service pension costs. To the extent that real incomes in the private sector rise there are likely to be upward pressures on public service pay which would have direct implications for the level of service which could be provided within a constant level of public expenditure, unless offsetting improvements in efficiency can be made.

International Comparisons

44. Other countries face similar pressures on spending. In the United States a Report by a National Commission on Social Security Reform was published last year. The Commission estimated that the two main social security trust funds which provide Old Age and Survivors Insurance and Disability Insurance faced a shortfall of between \$150-\$200 billion between 1983-89 unless benefits were restrained and taxes increased. The Commission expected that the Health Insurance Fund would also run into financial problems at the end of the decade. In each case the difficulties were expected to grow in the first half of the next century.

45. The Japanese government has also recently produced a report on social expenditure looking ahead to the year 2000. The report, 'Japan in the Year 2000', found that:

- (i) In the year 2000 16 per cent of the Japanese population was expected to be over 65, compared to 9 per cent at present.
- (ii) Partly as a result, the proportion of the population at a productive age was expected to fall from 60 per cent today to 55 per cent by 2015.

46. [Paragraph on European experience - to follow.]

47. The OECD Secretariat's recent survey of the prospects for social expenditure concluded it was difficult to foresee increases in the scope or coverage of any of the main social programmes in the major OECD countries, despite the likely pressures to do so. Beyond 1990 the Secretariat expected the principal challenge facing social welfare systems might be to accommodate the demands of an ageing population which required both higher provision for pensions and heavy demands on the health system. The disappearance of the extended family meant that older people had come to rely more on the state. The Secretariat concluded that if these trends were not reversed the demands on public welfare programmes would be likely to increase.

V. Future prospects for the tax burden

48. As the economic recovery has gained pace from mid-1981 onwards, and with the benefit of the rapid fall in the rate of inflation, public spending has been held in successive Public Expenditure Surveys to the cash plans announced in the 1982 White Paper. It will be vital to maintain this firm control of public expenditure in the years ahead; without it there will be little prospect of alleviation of the excessive levels of taxation of recent years.

49. In the process of debating and determining public spending it is clearly right that decisions about the level of total spending should reflect in some degree the purposes and needs of particular programmes. But, as experience over many years and in many countries has shown, the reality of spending decisions has been that their effect has been to raise total expenditure to a level which bears no relation to what taxpayers will tolerate or to the consequences for incentives and growth. This process cannot be allowed to continue indefinitely.

50. The size of the tax burden over the next decade will depend upon a large number of factors. The two most important are the rate of economic growth and the level of public expenditure.

Economic growth

51. It is the government's policy to continue the sustained reduction in inflation of recent years so that, with appropriate micro-economic policies - the encouragement of enterprise, efficiency and flexibility - conditions are created for continuing economic growth and higher employment. The growth rate over the next decade will depend on how quickly costs and prices adjust to the Government's financial framework. More rapid adjustment, particularly in the labour market, will mean faster growth. The growth rate will also depend on how successfully public expenditure is controlled so that the burden of taxation can be reduced and incentives improved.

52. For the purposes of this Green Paper it has been assumed that the economy will grow on average 2½ per cent a year for the five years until 1988-89. For this period, the projections are in line with

those of the Medium Term Financial Strategy, as set out in the Part 2 of the FSB. Thereafter there are two factors pointing to some slow-down in the growth rate: in the North Sea sector output may by then be in gradual decline, exerting a contractionary influence, of perhaps $\frac{1}{4}$ per cent a year, to GDP; and the labour supply will hardly be increasing. Two alternative growth paths after 1988-89 are considered. In the first GDP grows by 2 per cent a year, equivalent to about $2\frac{1}{2}$ per cent a year for the non-North Sea sector. This is about average for the period since 1951 and significantly better than in the last decade. In the second case GDP grows at $1\frac{1}{2}$ per cent a year, equivalent to about $1\frac{3}{4}$ per cent for the non-North Sea economy.*

53. It is important to avoid over-optimistic growth assumptions since it is never difficult, if the economy grows faster than expected, either to increase public expenditure or to reduce taxes. It is very much more difficult, when the growth rate is disappointing, to cut expenditure; and damaging to raise taxes.

The North Sea

54. The path of North Sea tax revenues has an important bearing on the composition of the overall tax burden. The profile of production, the behaviour of real oil prices and the level of tax-deductible expenditure by oil companies are important in this context. Production is expected to be close to its peak level in 1984-85, and may fall steadily after that. In the years to 1988-89 the projections are at the centre of the ranges [announced in Parliament on 1 March.] Thereafter, production is assumed to fall by an average 5 million tonnes a year so that by 1993-94 it may be little more than half of its peak level. It is assumed here that after falling over the next two years or so in real terms, oil prices flatten off and then start to rise again as the balance of supply and demand becomes progressively tighter. From 1988-89 they may be rising by 2-3 per cent a year. In spite of this North Sea revenues fall in the projections from about 3 per cent of GDP in 1983-84 to about $1\frac{3}{4}$ per cent of GDP in 1993-94 as North Sea oil and gas production falls. The calculations are set out in Annex 4.

* The background to the growth assumptions is set out in Annex 3.

Debt interest and
public sector
borrowing

55. Another important feature of the projections is the prospect for net debt interest payments. This reflects the course of public sector borrowing and interest rates. Some fall in real interest rates from present high levels is to be expected, with the path depending on the course of the PSBR and world interest rates. Falling inflation also points to lower nominal rates. With stable prices by the end of the period real interest rates will have come down to more normal levels, and net debt interest may have fallen from about 3 per cent of GDP in 1983-84 to about 2 per cent in 1993-94. The calculations are set out in Annex 5.

56. Falling inflation and interest rates require a further reduction in the PSBR as a percentage of GDP. If the PSBR did not fall, achievement of lower inflation would require unacceptably high real interest rates. Such a situation would be unlikely to be sustainable indefinitely.

57. In the period to 1988-89, the PSBR is assumed to follow the illustrative path set out in the MTFs. Thereafter it is assumed to fall further as a share of GDP, from 1½ per cent in 1988-89 to 1 per cent in 1993-94. On this basis, the ratio of public sector debt to GDP should be broadly stable by the end of the period. There is inevitably some uncertainty about the precise PSBR path which would be consistent with the government's aims on inflation. But given the aim of stable prices, the scope for varying the PSBR as a share of GDP is relatively limited. If a higher path were followed, a good deal of the apparent scope for increased spending or lower taxes would be pre-empted in the event by higher debt interest payments.

58. The fall in the PSBR as a share of GDP after 1984-85 broadly matches the fall in net debt interest payments. Both reflect the fall in inflation in the projections, and the accompanying fall in nominal interest rates. Net of debt interest little or no underlying change in the PSBR is assumed. On this basis, the tax burden for the non-North Sea sector can be reduced to the extent that public expenditure falls more than North Sea tax revenues as a share of GDP.

Public expenditure
and the tax burden

59. In assessing the effect on the tax burden of different assumptions about the growth of public expenditure this Green Paper concentrates on changes in non-North Sea taxes. Accordingly, and for consistency, changes in the level of non-North Sea taxes are expressed in the following paragraphs as a proportion of non-North Sea GDP. This treatment reflects the natural focus of public interest in these issues - which is on the level and burden of personal and corporate taxation in the non-North Sea sector.

60. If the public expenditure planning total is held flat in real terms up to 1988-89 as in the MTFS, the non-North Sea tax burden would be lower than in 1983-84 but still slightly above its level in 1978-79. The figures are shown in Table 5 below.

Table 5: The Burden of Taxation in the MTFS period

	(per cent)			
	<u>1973-74</u>	<u>1978-79</u>	<u>1983-84</u>	<u>1988-89</u>
Non-North Sea Tax*	33	34.7	38½	35½
Total Taxes**	33	34.1	39	36

* As a proportion of non-North Sea GDP (at market prices)

** As a proportion of GDP (at market prices)

61. Thereafter, the extent of the further reduction in the tax burden will depend on the growth of public expenditure. The government intends to continue to hold public expenditure firmly in check. But part III of this Green Paper describes the pressures which are likely to build up for more spending. Therefore, rather than carry forward a single projection beyond 1988-89, this Paper explores the implications of two alternative projections - that the public expenditure planning total either stays flat or grows by 1 per cent a year in real terms over the following five years. The figures in Table 6 illustrate what the burden of taxation in 1993-94 would be on the two different projections for GDP and on the two different assumptions about public expenditure growth after 1988-89.

Table 6: The Burden of Non-North Sea Taxation in 1993-94
(per cent of non-North Sea GDP at market prices)

GDP growth (per annum after 1988-89)	<u>Public Expenditure Growth after 1988-89 (per annum)</u>	
	<u>Zero</u>	<u>1%</u>
<u>1½%</u>	33	35
<u>2%</u>	32	34

62. If the public expenditure planning total is held flat, the burden of non-North Sea tax could be brought down to well below its 1978-79 level of 34.7 per cent by 1993-94. This further reduction in tax and improvement in incentives should lead to a better economic performance and thus make it more likely that the higher growth path is achieved. But, even so, the tax burden would be only about 1 per cent lower than it was in 1973-74 and still some way above the level of the early 1960's. With 1 per cent growth of public expenditure the picture would be worse: after a decade the tax burden would be little different from what it was in 1978-79. With 2 per cent growth of expenditure - ie still below the growth rate of the last twenty years - the burden of taxation would be 36-37 per cent, well above the 1978-79 level.

63. Such a reduction in the burden of taxation will allow a reversal of the trends of the last twenty years - the bringing into tax of the lower paid and the increase in the tax paid by those on average earnings - which have been described earlier in this paper. The proportion of income taken by income tax for those on average earnings is now 20 per cent. In the worst case shown in Table 6 this percentage would fall to 18 per cent. This reduction would, to those on present average earnings, be worth £3.50 a week. In the best case, it would fall to 13½ per cent (worth an extra £11 a week to those on present average earnings), still not quite down to the levels of the early 1960's. These calculations* are made on the extreme assumption that the benefits of tax reductions are concentrated exclusively on personal allowances.

*which allow for Budget changes, including those on company taxes

VII Conclusion

64. Public expenditure, in Britain as in other countries, has risen over many years, both in real terms and as a share of national income. It is difficult to escape the conclusion that there is an inbuilt tendency for spending to rise; and an inbuilt resistance to expenditure reductions. The inevitable consequence has been that the taxes required to pay for this spending - taxes on people and on the firms they work for, - have risen in step, unless, for a limited period, governments increased their borrowing. Such borrowing, however, has to be repaid, and might more properly be described as a tax on future generations.

65. These increases in taxation have, in the government's view, had a serious impact on Britain's economic performance over many years. Since lower growth has not led to lower demands for public services, the outcome, year after year, has been still higher taxation to finance ever higher public expenditure.

66. As public spending takes a larger and larger share of GDP, so the public sector steadily encroaches on the rest of the economy. This is a process which cannot go on indefinitely. Last month's Public Expenditure White Paper documented the government's determination to hold its spending at broadly its present level in real terms for the next three years; and the revised medium term financial strategy, presented in the Budget, projects this unchanged level of public spending forward for two more years. These plans, like those in the 1982 and 1983 White Papers, represent a major change in direction for this country.

67. This Green Paper shows how difficult it will be to stick to these intentions. There will be demands on all sides - in the fields of defence, social security, health and education, to name but a few - to improve public services, and there will also be arguments that additional spending is required in some cases simply to stand still and prevent these services from deteriorating. Some of this will, no doubt, be special pleading; but in some cases programmes will need to be increased, and the increases financed by reductions in programmes

of lower priority, or by further efficiency savings across programmes as a whole.

68. Without firm control over public spending, however, there can be no prospect of bringing the burden of tax back to tolerable levels. On the illustrative framework set out in this Paper the tax burden will be reduced to the levels of the early 1970's only if public expenditure is held at its present level in real terms right up to 1993-94.

69. If, on the other hand, we assume what by historical standards is a very modest rate of public expenditure growth - 1 per cent a year in real terms after 1988-89, compared with the average 3 per cent growth of the last twenty years - the tax burden would be scarcely back to its 1978-79 level even after ten years of growth at about 2 per cent a year: still less to its level in the 1960's and early 1970's.

70. In order to underline the inescapable connection - so often overlooked in public debate on these issues - between public spending and the taxes required to finance it, the projections in this Green Paper have concentrated upon quantifying the reduction in the tax burden which different combinations of circumstances might produce. But it would, of course, always be open to the government to decide, once the virtuous circle of lower taxes and higher growth had been established, to devote some of these resources to improved public services rather than reduced taxation. There should, however, be no general presumption that higher public spending is inevitable if provision in these areas is to be improved, given the scope for switching from public to private sectors, and for improved efficiency within the public sector.

71. All these projections are of course, subject to a wide range of uncertainty. But on one issue there can be no room for doubt: Parliament and the government must reach its judgement about what public expenditure in total can be afforded, then contain individual programmes within that total. If the public discussion of these important issues leads to a wider understanding of this fact - that finance must determine expenditure, not expenditure finance - the discussion will have served a useful purpose.

72. The government looks forward to a continuing debate on the fiscal prospects in the longer term. There will, no doubt, be much discussion of the validity and realism of the broad economic assumptions made in this Green Paper; of the conclusions to be drawn for individual programmes from the consideration of future pressures on public spending; and of whether the additional resources created by continuing economic growth should go to reducing the present unacceptably high level of taxation, or to further improvements in the public services, or to both in some degree. But the government hopes that the main theme of this Green Paper will remain at the centre of the debate: that to break away - as at some stage, on any view, we must - from the pattern of the past in which public spending and taxation took an ever-larger share of our national product, we must establish a clear view of what can be afforded; set our spending plans accordingly; then stick to those plans.

DEFINITIONS

Units for measuring public expenditure

1. Three units of measurement have been used in recent and past public expenditure White Papers. These are

- (i) Cash: This is the amount of cash paid or received during the year. The Government's public expenditure plans are now made in cash terms.
- (ii) Real (or cost) terms: This is equal to cash expenditure, excluding the effects of any rise in average GDP prices. (If cash expenditure were £100m in year A and £106m in year B, and the GDP price level had risen by 5 per cent between the two years, expenditure in year B would be about £101m in "year A cost terms".) Cost terms is a useful measure of expenditure for comparisons over time, and for medium and longer term public expenditure projections.
- (iii) Input volume: This is the physical quantity of input.

2. None of these units measures the amount of service delivered by a programme. Growth in input volume over time is usually less than growth in the amount of service delivered, because of increases in the efficiency with which the inputs are used. Changes in cost terms expenditure may be more or less than changes in the amount of service delivered, depending upon both relative price changes and efficiency gains. The difference between growth in cost terms expenditure and growth in input volume, for a whole programme or part of a programme (eg pay), is usually called the relative price effect.

3. Sometimes the term level of service or level of provision is used to describe changes in the amount of service delivered adjusted for, especially, demography. Neither the amount of service delivered nor levels of service can usually be measured precisely.

4. It is important when describing the growth or contraction of public expenditure programmes to distinguish between changes in cash expenditure, real (or cost) terms expenditure, input volume and levels of service.

Glossary of other terms

Cash limits: Cash limits set a limit on the amount of cash the Government proposes to spend or authorise on certain services or blocks of services during one financial year. The nationalised industries' contribution to public expenditure is controlled by means of external financing limits, which are a form of cash limit for individual industries.

Cash plans: Planned cash expenditure for each programme over the next few years are published annually as a White Paper called The Government's Expenditure Plans.

Debt interest: "gross debt interest payments" by the public sector are as defined in the national income accounts. "Net debt interest" is broadly that part of gross debt interest that has to be financed from taxation or further government borrowing (see Cmnd 9143 for further details).

Estimates or Supply expenditure: Expenditure by central government which is financed by monies voted by Parliament in the annual Supply Estimates.

General government expenditure: General government expenditure is the principal measure of public expenditure (q.v.) in the national income accounts, published monthly in 'Financial Statistics'. Unlike the planning total, general government expenditure includes debt interest, non-trading capital consumption, stock appreciation and VAT paid by local authorities but refunded to them, and it excludes revenue from certain sales of assets. A fuller list of the differences is provided in Part 5 (paragraph 32) of the public expenditure White Paper Cmnd 9143.

Medium Term Financial Strategy: The statement of the government's objectives for monetary and fiscal policy for the medium term, published in the annual Financial Statement and Budget Report (FSBR).

Public Expenditure Planning Total The planning total includes all public expenditure programmes (including grants to and borrowing by public corporations), special sales of assets and the Reserve.

Public expenditure: There is no unique definition of public expenditure. Different definitions are required for different purposes and these change overtime. The difference between the public expenditure planning total (q.v.), the national accounts definition of general government expenditure (q.v.) and the definition used for measuring public expenditure as a percentage of GDP are described in Part 5 (paragraph 32 to 37) of the public expenditure White Paper Cmnd 9143.

Public Expenditure Survey: The government's annual review of expenditure plans covering the forthcoming three year period, published in The Government's Expenditure Plans.

PSBR (Public sector borrowing requirement): The PSBR is the difference between public sector cash receipts from and payments to the private sector and overseas. The PSBR is the sum of the central government, local authorities and public corporation borrowing Requirements less all lending transactions between the sub-sectors.

Public expenditure as a share of GDP: The relative size of public expenditure can also be measured by setting it against the gross domestic product (GDP). In doing so it must be remembered that not all public expenditure is part of GDP; the former includes transfer payments (for example social security benefits) whereas GDP does not. This measure of public expenditure is intended to indicate the proportion of nominal GDP to be financed through government taxation and borrowing.

[Taxation glossary to be added]

ANNEX 2

SOCIAL EXPENDITURE BY COUNTRY, 1960-1981

	Social expenditure as a percentage of GDP		Annual growth rate of real GDP		Annual growth rate of real social expenditure	
	1960	1981 ^a	1960-75	1975-81 ^a	1960-75	1975-81 ^a
	United States	10.9	21.0	3.4	3.2	7.7
Japan	8.0	17.5	8.6	5.1	9.7	8.9
Germany	20.5	31.5	3.8	3.0	6.7	1.9
Canada	12.1	21.7	5.1	3.3	9.5	2.9
France ^b	13.4	23.8	5.0	2.8	7.4	7.6
Italy	16.5	29.1	4.6	3.2	7.4	3.1
United Kingdom	13.9	24.9	2.6	1.0	5.6	3.3
Australia	10.2	18.6	5.2	2.4	8.6	2.4
Austria	17.9	27.9	4.5	2.9	6.0	4.6
Belgium	17.0	38.0	4.5	3.0	9.1	4.6
Denmark	10.2	29.0	3.7	2.2	9.3	4.4
Finland	13.2	n.a.	4.5	2.9	7.3	n.a.
Greece	8.7	12.8	6.8	3.5	7.8	2.3
Ireland	11.7	27.1	4.3	3.5	8.2	5.2
Norway	11.7	27.1	4.3	4.1	9.5	5.6
Netherlands	16.3	36.1	4.5	2.0	9.2	1.4
New Zealand	13.0	19.6	4.0	0.4	4.4	3.7
Sweden	14.5	33.5	4.0	1.0	8.4	4.0
Switzerland	7.7	14.9	3.4	1.8	6.9	2.5

Notes:

a) Or latest available year. b) Excluding education expenditure.

Source: OECD Secretariat and National Accounts.

n.a.: not available

GROWTH IN THE LONG TERM

This annex discusses the assumptions for GDP growth that underlie the projections of non-North Sea taxation for 1993-94. As explained in paragraph 34 two assumptions for GDP growth for the period 1988-89 to 1993-94 are made, of 2 per cent and $1\frac{1}{2}$ per cent, with corresponding figures of $[2\frac{1}{4}]$ per cent and $[1\frac{3}{4}]$ per cent for GDP less North Sea. The growth rate over the preceding five years, the period of the MTFs, is assumed to be $2\frac{1}{4}$ per cent a year.

2. Since 1951 there have been two distinct phases in output growth. From 1951 to 1973 the growth of GDP⁽¹⁾ averaged 2.9 per cent a year with little variation from cycle to cycle (Table A.1). Since 1973 growth in the UK, as in other industrialised countries, has been much slower: between 1973 and 1979 the average was 1.3 per cent and from 1979 to 1983 it was 0.3 per cent, although this is not strictly comparable because 1983 was not a cyclical peak.

3. The growth of North Sea production has contributed about $[0.7]$ per cent a year since 1973, implying an average growth of GDP less North Sea output of $[0.3]$ per cent over the period 1973 to 1983.

4. The slowdown in growth after 1973 was not accompanied by any slowdown in the rate of increase in the working population, which increased, as it had done in the period up to 1973, by about $\frac{1}{2}$ per cent a year on average (Table A.1). Numerically, most of the slowdown in output growth after 1973 is accounted for by a slower growth of output per employed person. This averaged 1 per cent over the 1973 to 1979 cycle, compared with about 2.4 per cent in the two decades to 1973. This measure may tend to understate the underlying growth of productivity since it takes no account of changes in hours worked or numbers of part-time workers.

(1) Factor cost at 1980 prices, average estimate

5. Output growth in peace-time periods before the Second World War was generally higher than in the decade after 1973, but lower than in the two decades before 1973. The growth rate between most cyclical peaks from the 1850s to the Second World War was within the range $1\frac{1}{2}$ per cent to $2\frac{1}{2}$ per cent a year (Table A.2). Productivity growth was nearly always within the range $\frac{1}{2}$ per cent to $1\frac{1}{2}$ percent a year.

6. There are three main factors which are relevant to the trend rate of growth over the period 1988-89 to 1993-94:

i. North Sea production. This is assumed to decline by about $[3\frac{1}{2}]$ per cent a year over the period 1988-89 to 1993-94 (see Annex 4), equivalent to a reduction in the GDP growth rate of about $[1\frac{1}{4}]$ per cent a year. The rate of decline is rather less rapid than that assumed for the period from 1984-85 to 1988-89. North Sea production is an integral part of the economy with complex interactive effects between the onshore and North Sea sectors, notably through the exchange rate and current account. The decline of North Sea production will tend to stimulate the growth of the rest of the traded goods sector of the economy, just as the opposite occurred when North Sea production was building up. But it is unrealistic to expect onshore GDP growth to compensate fully for declining North Sea production in the short term. The underlying growth of onshore GDP is unlikely to be raised much above what it would otherwise have been.

ii. Labour supply. The contribution of the labour supply to the growth in productive potential is determined by demographic factors, projections of which are relatively firmly based, and by activity rates. The projections recently published by the Department of Employment⁽²⁾ suggest an increase in the labour supply over the period 1988-89 to 1993-94 of $[10,000]$ a year on average, slower than the increase projected from now until 1988-89 of about $[120,000]$ a year. This suggests that the labour supply will not make a significant contribution to trend GDP growth from 1988 onwards.

(2) See Department of Employment Gazette February 1984

iii. Productivity growth. The causes of the slowdown in measured productivity growth after 1973 are not fully understood. Some of them, however, may be reversible. In particular, there is no reason to believe that oil price shocks will recur with as much disruption as in the 1970s. The harmful effects on investment and growth of high and variable inflation have been reversed. There is evidence from the last two or three years that firms have been increasing efficiency and reversing the labour hoarding that had contributed to poor productivity in the 1970s. It is difficult to assess how much of this might be a once-for-all event caused by the pressures of the recession and how much represents a trend change in productivity growth. The absolute level of productivity in the UK remains well below that in competitor countries so there is plenty of scope for making productivity gains. There is also an increasing awareness of the need for efficient working practices. For these reasons it seems likely that productivity growth will improve substantially on that of the 1970s. But it may not regain the levels of the 1950s and 1960s especially if a reduction in unemployment is associated with a shift, within and between industries, towards more labour-intensive activities and processes.

7. The assumed growth rates of $1\frac{1}{2}$ per cent and 2 per cent a year between 1988-89 and 1993-94 thus lie within the range of $1\frac{1}{2}$ per cent to $2\frac{1}{2}$ per cent that prevailed before the Second World War. They are lower than the growth rate in the two decades before 1973, and higher than that since 1973. Various factors, including North Sea oil production, labour supply and the labour-intensity of some areas of production, suggest that the pre-1973 performance will not be matched. Others, such as the reduction in inflation, the rise in productivity growth and increasing cost-consciousness, point to a better performance than in the 1970s. It is not fruitful to attempt to predict what the actual outcome will be. But there are reasons for believing that the assumed growth rates are plausible in the light of past experience and the sparse knowledge that we have about future developments.

Table A.1

Growth of Output, Working Population and Productivity since 1951
(per cent per annum)

	GDP	Working Population	Output Per Employed Person
1951-1955	2.8	0.7	1.9
1955-1960	2.5	0.5	2.1
1960-1964	3.4	0.8	2.3
1964-1968	2.6	0.1	2.8
1968-1973	2.6	0.2	2.6
1973-1979	1.3[0.5] ¹	0.6	1.0
1979-1983	0.3[] ¹	0.1	1.9

¹GDP less North Sea

Note: The growth rates are measured between years which are approximately comparable from a cyclical point of view except in the case of the last period: all years up to and including 1979 were cyclical peaks, but it is expected that 1983 will turn out to have been below the peak-to-peak trend.

Table A.2

Growth of Output and Productivity since 1856
(per cent per annum)

	GDP	Output per Employed Person
1856-1860	1.8	0.6
1860-1865	2.0	1.3
1865-1873	2.4	1.6
1873-1882	1.9	1.3
1882-1889	2.2	1.2
1889-1899	2.2	1.1
1899-1907	1.2	0.5
1907-1913	1.6	0.5
1924-1929	2.6	1.4
1929-1933	2.0	0.8
1951-1973	2.9	2.3
1973-1979	1.3	1.0

Note: The growth rates are measured between years which are approximately comparable from a cyclical point of view.

NORTH SEA OIL REVENUES TO 1993-94

This annex describes how the projections in this Green Paper of Government revenues from the North Sea over the period to 1993-94 were derived.

2. For the period to 1988-89 the projections of North Sea revenues are in line with those underlying the Medium Term Financial Strategy. Revenues in 1988-89 are projected to be about $\underline{\pounds 8\frac{1}{2}}$ billion in current prices, equivalent to about $\underline{\pounds 7\frac{1}{2}}$ billion in 1982-83 prices. Oil and natural gas liquids (NGL) production is assumed to be at about the centre of the new forecast ranges, announced by the Minister of State for Energy in Parliament on $\underline{7}$ March; and it is assumed that real world oil prices, after falling by more than 10 per cent over the next two years, then remain constant at their end-1985 level. A fuller description of the MTFs projections of North Sea revenues is given in a Press Notice published on Budget day.

3. In assessing the level of oil production after 1988-89 we have projected forward production from fields currently in production or under development and have assumed that all the likely candidates for development among existing discoveries do in fact go ahead. To the extent that some of the latter do not do so, we assume that their place is taken either by other projects among existing discoveries or by future discoveries. This produces a profile in which the centre of the range of oil production continues to fall after 1988-89 though at a slower rate than in the previous three years. By 1993-94 we are assuming that oil production is a little over 65 million tonnes, representing the centre of a range of $\underline{40-95}$ million tonnes. New fields among existing discoveries account for about a quarter of this total. In projecting gas production we have taken account of fields currently in production or under development. New developments are assumed to come forward at a rate sufficient to ensure that likely future demand is met.

4. By the end of the MTFs projections, the real sterling North Sea oil price is assumed still to be below current levels. For the purposes of the projections beyond 1988-89, we have assumed that the real oil price grows on average at about $2\frac{1}{2}$ per cent a year,

reaching £150 a tonne (in 1982-83 prices) by 1993-94. This assumption is consistent with some rise over the same period in the real world oil price. A constant real gas price after 1988-89 is assumed for new gas developments.

5. The implication of these assumptions about production and prices is that the real value of oil and NGL production is assumed to fall at about $4\frac{1}{2}$ per cent a year over the period 1988-89 to 1993-94. The projections of Government revenues from the North Sea were derived by taking the average tax rate on gross revenues from oil and gas production implicit in the MIFS projection of total royalty and tax receipts in 1988-89 and assuming it remained constant over the period after 1988-89. The 1988-89 figure is based on the results of the Inland Revenue field-by-field model of the North Sea. It could be argued that the average tax rate might rise after 1988-89, as some of the fields now or soon to come on stream exhaust their tax allowances and pay tax at the full rate. On the other hand, if the assumptions underlying these projections prove correct, existing discoveries yet to be developed will be contributing a significant proportion of production by the early 1990s. This would tend to depress the average tax rate.

6. As a result of these assumptions, total North Sea oil and gas revenues are projected to fall from about £7 $\frac{1}{2}$ billion (at 1982-83 prices) at the end of the MIFS period to about £6 billion by 1993-94, or from 2 $\frac{1}{4}$ per cent of GDP to about 1 $\frac{3}{4}$ per cent.

7. The margin of error around these estimates is very large indeed. Even the projections of revenues to 1988-89 in the MIFS are highly uncertain. The uncertainties increase as one moves further into the future. They arise at each stage of estimation: production, prices and tax deductible expenditures. Production projections are particularly uncertain at this stage because it is too early to assess the extent to which the changes made to the North Sea fiscal regime in the 1983 Budget might give rise to higher production during the next ten years.

Annex 5

Debt Interest

This annex explains the evolution of net debt interest of the public sector. The definition of net debt interest used here is on a National Accounts basis and includes only debt interest flows between the public and private and overseas sectors: it therefore differs from the concept used in Public Expenditure White Papers.⁽¹⁾

2. Debt interest flows are related to the stock of debt outstanding, the current and past rates of interest, and the characteristics, particularly the maturity structure, of the stock of debt outstanding.
3. Gross debt interest payments by the public sector, principally to holders of gilts and National Savings, reached a peak as a proportion of GDP in 1981-82, reflecting the high level of the PSBR, and increasing interest rates from about 1975 onwards. The bulk of government stock outstanding is of fixed interest securities. Because of this, total debt interest payments are slow to react to changes in interest rates. Over the next five years the stock of public sector debt is expected to decline as a proportion of GDP, because the ratio of the PSBR to GDP is low compared with the assumed growth of money GDP. The lower stock of debt outstanding, coupled with an assumed decline in both nominal and real interest rates as inflation is brought down further and pressure in financial markets eases, imply a further reduction in debt interest payments over the long-term period from 1988-89 to 1993-94, perhaps by an amount equivalent to up to 1 per cent of GDP.
4. Debt interest receipts by the public sector are flows on loans made by the public sector to the private and overseas sectors. [These include such items as public corporations' trade credit and loans by local authorities for house purchase as well as interest on the reserves.] The maturity structure of the debt instruments is on average shorter and a

(1) See Cmnd 9143-II, Explanatory and Technical Notes for a definition of the PEWP definition of net debt interest.

higher proportion is accounted for by variable interest instruments than in the case of British Government Securities and National Savings. As a result interest receipts are relatively more sensitive to changes in interest rates, and are projected to fall proportionately more than interest payments over the next ten years. Nevertheless, net debt interest payments are projected to decline as a proportion of GDP, by about [0.7] per cent of GDP, because the initial stock of liabilities of the public sector are about [three] times initial assets.

28 FEB 1984

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SECRET

CC NO

4



Prime Minister (2)
Work is now getting under way
on the three studies on the
health side agreed at the DHSS
seminar.

Treasury Chambers, Parliament Street, SW1P 3AG

AT
24/2

Rt Hon Norman Fowler MP
Secretary of State for Social Services
Department of Health & Social Security
Alexander Fleming House
Elephant & Castle
LONDON
SE1 6BY

ms

23 February 1984

Dear Secretary of State

PUBLIC EXPENDITURE REVIEWS

When we had a word a little while ago with the Prime Minister, we agreed that three aspects of health spending should be reviewed. The purpose of this letter is to say how I see the scope of these three reviews.

In each case the aim of the review would be to examine the scope for improved control and public expenditure savings both in the longer term, and in the immediate future. I would hope to see specific proposals emerge which we can then confidently put forward to our colleagues. In the process of so doing I hope that the reviews will identify possible immediate savings as well as any immediate action which could and should be taken now to secure longer term improvements. The reviews should be radical, but consistent with the wider approach we are now trying to promote to greater financial control and responsibility in the field of primary care.

It was agreed that each review could be conducted jointly by the DHSS and the Treasury. If possible I think there should be an agreed joint report to us both on each review by DHSS and Treasury officials. As far as immediate savings are concerned, recommendations should be submitted to us both in time for the findings to be taken into account in the next public expenditure survey. Work on longer term savings can no doubt continue after that, if necessary, but nevertheless I would wish it to be carried out promptly.

① The first subject area to be covered is the contractual relationship between the NHS and the contractor professions in the family practitioner services. I know that you already have in hand a fundamental

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review of the pharmacists' contract; I am grateful for Kenneth Clarke's letter of 17 January about this. The public expenditure review would not duplicate or take over this work, but rather would extend its radical approach to the other contractor professions. In the case of general practitioners, for example, the review might look at whether the arguments that led to item of service payments and direct reimbursements are still valid, as well as whether the system has become too complicated. For dentists, there is the fundamental issue of whether the item of service basis of remuneration is producing the results we would wish. We cannot expect to achieve everything at once, and in some areas we will be able to build on work already in hand. But I would certainly expect to see, for each professional group, a clear plan for how we intend to go forward.

② The second area for review is the PPRS including its impact upon prescribing practice. Again, I am aware of work already in hand here, and in the case of the PPRS of the changes which have recently been made to the scheme. We shall have to look at these again in the light of the report of the Review Board on Non-Competitive Government Contracts. The public expenditure review would however need to consider more fundamental changes than have been made so far. Action taken so far has altered some of the parameters of the scheme without affecting its basic mode of operation: the new review will need to consider that. For example, it should consider the justification for reimbursing any promotional expenditure by drug companies, an issue to which I drew attention in my letter of 29 November 1983 to Kenneth Clarke: though the timescale for making any further changes will have to take account of what has been said on this in Parliament and to the industry. But I do not think that it is sensible to look at the PPRS in isolation from our wish to see more effective and more economical prescribing practices. We need to be sure that the form of the PPRS will not frustrate attempts by doctors to prescribe economically by reference to the price of individual drugs. We agreed that it was most important to bring about changes here to promote prescribing of cheaper drugs and to discourage unnecessary prescriptions.

③ The third area for review is that of NHS charging policy generally. It goes without saying that this is a highly sensitive area, which will need to be handled with care. But the Government's policy of seeking ways of financing a higher proportion of essential public services other than from taxation requires us to look at NHS charges, although we all recognise that our Election pledges may rule out some of the major changes for this Parliament. We do need to be clear in our own minds, however, about the charging options which are worth considering for the future.

There are some charges not ruled out by our pledges, which the review should consider for possible introduction in the shorter term. I have particularly in mind cost-related charges for drugs. Quite apart from the possibility such charges offer for raising increased income, they could have a strong and beneficial influence on prescribing practice. There are links too with the review of contractual relations with the practitioners.

If you agree, I suggest that we should ask our officials to begin work on these three reviews forthwith. Given the sensitivity of the subjects we need to keep the circulation of the papers as limited as possible.

S E C R E T

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

Yours sincerely

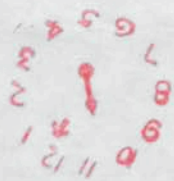
J. G. Greville

J- PETER REES

[Approved by the Chief Secretary]

S E C R E T

Even lot : Public Exp Pt 26 •



24 JAN 1984



EFFICIENCY UNIT

70 WHITEHALL, LONDON SW1A 2AS

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cc AD

NBIM

AT

21/2

21 February 1984

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment

Dear Patrick

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

Thank you for your letter dated 8 February which I have seen on my return from the Far East. I have subsequently been pleased to learn that while I have been away officials have settled a way forward that meets the essential requirements.

I think we both have the same objective in this matter. The label attached to the work is not particularly important provided the approach is rigorous and is seen to be so. However, I should not want to be associated with a cosmetic exercise nor to have my interest in the matter represented as some narrow "efficiency" view (your inverted commas!). I have emphasised to the Prime Minister the opportunity I see for Ministers to achieve better value for money through determined use of all the techniques now available to examine programmes, policy and performance. I hope the work on the urban programme will be a splendid example and I look forward to seeing the results.

Copies go to the Prime Minister, Peter Rees and Sir Robert Armstrong.

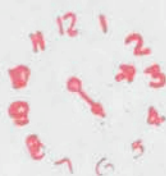
yours ever

ROBIN IBBS

Leon Pa: Public Exp.

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21 JAN 1984



PUBLIC EXPENDITURE WHITE PAPER

February 16th 1984

CORRECTION

Paragraph 42 should read:

"Applications for Home Improvement Grants at the temporary higher rate of 90 per cent will not be admitted after March 31st this year. The higher rate was clearly stated to be temporary when introduced in the 1982 Budget and was designed partly to absorb surplus capacity in the building industry at that time. Original deadline has been twice extended. Grants at 75 per cent will continue to be available at discretion of local authorities".

PUBLIC EXPENDITURE WHITE PAPER, February 16 1984.

KEY POINTS

1. Keeps to pre-election plans and commitments. PM said during campaign: "We have laid out our plans for the next 3 years on Government spending... they are all laid out to see". Cash total for next year, 1984-85, exactly as in last White Paper at £126.4 billion. Provisional total for 1985-86 of £132.1bn also very close to figure for that year in last White Paper.

2. No cut in real terms ("cost terms") in public spending between this year and next. Plans for future years also consistent with maintained spending in real terms. Planning total for new year of survey, 1986-87, £136.7bn.

3. Public spending to continue falling in proportion to our growing economy. Peak of 44 p.c. in 1981-82 during recession. Has fallen in 2 years since and is expected to fall again in coming years.

4. Within the unchanged total next year some major changes in individual programmes in relation to last PEWP are:

Increases - £0.4bn. agricultural support (mainly EC)
 £0.6bn. local authority current expenditure
 £1.3bn. social security

Decreases - £0.3bn. defence
 £0.5bn. housing
 £0.7bn. Nationalised industries' external borrowing

5. Public sector Capital spending has not been falling. Next year it will total £23.9bn. which is broadly the same in real terms as in 1978-79. White Paper contains a new table - Table 1.13 - which gives much clearer and more detailed picture of capital spending, and shows that those who criticise Government for "decimating" public investment are quite wrong. (The big cuts were, of course, under Labour in 1976-9).

6. Within the planning total for next year the reserve has been reduced since the Autumn Statement by £250m. This is mainly to accomodate a revised estimate of spending on some social security benefits, partly offset by lower uptake of the Youth Training Scheme.

7. The old contingency reserve has been redefined and is now called, simply, the Reserve. Its role from 1984-85 on is to cover all contingencies including changing forecasts for demand-determined programmes. This new discipline will help discharge election pledge to maintain firm control of public spending.

8. Commentary on individual programmes puts more emphasis on policy objectives and monitoring of progress towards them. White Paper now contains several hundred output measures.

OUTTURN 1983-84

9. Forecast outturn of £120.3bn. is slightly higher than planned level of £119.6bn. in last White Paper in spite of mid-year corrective measures. This reflects higher spending than forecast on some demand-led programmes and a smaller shortfall than expected on cash-limited programmes.

10. The excess is still very small in relation to the total at 0.6 p.c. The new style of reserve which covers both demand-led and other increases is designed to exercise greater control over such increases in future. In future, shortfall will show up as an under-spend on the reserve. Reserves for future years are purposely sizeable at £2.75bn., £3.75bn. and £4.75bn. Figures will be reviewed in the light of experience with the new system.

CAPITAL EXPENDITURE

11. New Table 1.13 shows level and trends in capital spending much more clearly than before. Contrary to much received wisdom capital spending has not been declining in the public sector. In real terms it has been running at much the same level since 1978-79. As proportion of GDP it was 8 p.c. a year to 1980-81 and 7.5 p.c. since.

12. Previous presentation tended to mislead both as a guide to levels and trends and to demands on the producing industries. The White Paper totals are designed in large measure for control purposes. Thus, in Table 1.11 receipts from council house sales are deducted from gross IA capital spending, although of course they do not reduce public sector investment. In Table 1.13, however, they are not deducted. Capital expenditure by nationalised industries which has tended to rise since 78/79 has been added in to give a full picture of investment by the public sector as a whole. Defence expenditure on equipment which in a civil context would be regarded as capital spending has also been included. By UN convention it is generally classed as current expenditure, but in this context it is perverse to regard a merchant ship as capital expenditure and a naval ship in the next berth as current expenditure.

13. Capital spending is not good of itself. It is only worthwhile if it produces a proper return.

ASSET SALES

14. Special Asset sales are estimated at £1.2bn in current year rising to about £1.9bn. next year and £2bn. in each of the following 2 years.

15. Cash raised from asset sales will help to reduce Government borrowing. But main purpose of privatisation programme is to increase competition, private ownership and to promote the efficient use of resources in the economy. Sale of equity in BT is planned for autumn and BA in early 1985.

DEBT INTEREST

16. Net debt interest, which is not included in the planning total for public expenditure, is expected to level off next year at about £7½bn. after many years of growth.

17. Stabilising the burden of debt interest is one of the benefits of lower levels of borrowing in recent years combined with a gradual reduction in the interest rates Government has to pay.

MANPOWER AND PAY

18. This year's White Paper reports both on the likely outcome of the manpower targets the Government set in 1979, and sets out its goals for the period to 1988. For the first time manpower plans have formed an integral part of the Public Expenditure Survey. By the beginning of April the civil service (ie Central Government employment) will have contracted by 14 p.c. since April 1979 to about 630,000, the smallest level since the war and a little below the Government's target. A further fall of 6 p.c. to 593,000 is planned by 1988. Armed forces' UK-based manpower is expected to rise from 320,600 in April 1983 to 329,000 in April 1985 with figures for the years beyond subject to review.

19. Between 1979 and 1982 NHS manpower rose about 7 p.c. to 1,006,700. Most of the extra staff were in areas directly concerned with patient care. To help ensure a proper balance between spending on equipment and staff and to improve manpower control, manpower targets involving a net cut in staff of $\frac{1}{2}$ p.c. have been agreed with Regional Health Authorities in 1983-84.

20. Local authority manpower fell by only 4 p.c., or 91,000, between June 1979 and June last year. Number employed on law and order rose 7 p.c., but the much larger numbers employed in education fell by $6\frac{3}{4}$ p.c. Pupils on school rolls fell 10 p.c. Since June local authority manpower has begun to rise again slightly. Government intends that the joint boards to be set up on abolition of GLC and Met. Counties will each have specific manpower targets. Manpower costs account for two thirds of Local authorities' relevant current expenditure.

21. Plans for 1984-85 allow for average increases in rates of pay and allowances of 3 p.c. from the due settlement dates. Any overrun will have to be absorbed in other ways within individual programmes. Pay accounts for about 30 p.c. of total public expenditure; on some programmes the proportion is much higher.

LOCAL AUTHORITIES

22. Local authority current spending has continued to exceed planned levels. Next year's provision has again had to be increased by £600m. on the previous White Paper total. The result will be an additional tax burden particularly on the rate payer.

23. The Government's targets for expenditure by individual authorities allow a 3 p.c. increase for authorities which have kept within target in the past and a maximum 6 p.c. cut for authorities which have previously failed to meet targets. What that means for services depends on how successfully authorities control their own costs. The Audit Commission's recent handbook shows there is plenty of scope for improving cost control.

24. Rates Bill is designed to protect ratepayers from consequences of continued local over-spending. Selective rate limitation will first operate in 1985-86.

25. Local authorities' current expenditure has risen significantly faster than that of central government since 1978-79 (Table 1.11). This is despite the policy commitments to increase spending on various central government programmes such as defence and health and the effect of the recession on social security spending. Local budgets, by contrast, should have benefited from the reduction in school rolls.

26. Local authorities' capital expenditure, has fallen in real terms since 1978-79 largely because of council house sales which reduce the net figure.

SOCIAL SECURITY

27. Plans show increase of about £1.3bn. in 1984-85 and £1.6bn. the following year over last White Paper. Reductions in coverage of housing benefit need to be seen in that context. Next year's increase includes an addition of about £360m. since the Autumn Statement.

28. Reasons for increase: 1983 benefit improvements (including 11 p.c. increase in child benefit and one-parent benefit) and changes in uprating assumptions; more up-to-date estimates of spending on supplementary benefit.

29. Changes in housing benefit made partly to offset a proportion of the increases which would otherwise have been even bigger. Housing benefit now goes to 1 in 3 households, 40 p.c. of the population. Some recipients have above average earnings. Cuts will affect those households most able to afford them. Most pensioner claimants will not be affected. No-one on supplementary benefit need be affected. Modifications to Government's proposals announced on February 6 will give families longer to adjust but do not affect existing expenditure plans. Over half claimants will face reductions of less than 50p a week.

30. Most other industrialised countries are also finding difficulty in paying for their social security programmes. The Netherlands plans to de-index social security benefits, France and Germany are delaying pension increases, Belgium has cut some unemployment benefits, and so on.

DEFENCE

31. Spending will increase by 3 p.c. a year in real terms to 1985-86 in accordance with NATO's aim. Apart from US we are the only NATO country to achieve this.

32. On top of the NATO commitment we are spending extra money to defend the Falklands. Including this expenditure, by next year we shall have increased our spending on defence by more than a quarter in real ("cost") terms since 1978-79.

33. The reduction in 1984-85 spending compared with the figure for that year in the last White Paper takes into account the March 1983 NIS reduction, the 3 p.c. public service pay assumption for 1984-85 and the 1983-84 cash limit cut.

34. The 3 p.c. growth commitment has not been extended into the final year of the survey, 1986-87. Even so defence spending will be some £700m. higher in that year than in the previous year.

HEALTH

35. Planned spending on the NHS in 1984-85 has been maintained at the level proposed for that year in the last White Paper. For the following year there is an increase of about £150m. on the figure in the last White Paper. This more than fulfills pledges made by the Prime Minister in Edinburgh during the election.

36. Since coming into office the Government has increased health spending by 17 p.c. more than inflation. This means, for instance, $\frac{1}{2}$ million more in-patient day cases, nearly $\frac{1}{2}$ million more people visited at home by Health visitors and District nurses, $2\frac{3}{4}$ million more courses of dental treatment.

37. Greater efficiency can produce more health care per £m. Hence the Government's encouragement for contracting out, the management reorganisation proposed by Griffiths report, and manpower monitoring.

EDUCATION

38. Provision for spending on education is £140m. higher than in the last White Paper in 1984-85 and £104m. higher in 1985-86. The increase is mainly in local authority spending, partly offset by a small net reduction in voted expenditure.

39. Parental contributions to student support have been increased for middle and upper income parents and the minimum grant has been halved. It is perfectly reasonable to expect the better off parents to contribute more towards maintaining their children in higher education. British system of support for students in higher education is still far more generous than that in practically any other country.

HOUSING

40. The reduction in net spending on housing compared with the last White Paper mainly reflects a higher forecast level of receipts from council house sales. Gross capital spending on housing is expected to be broadly the same in cash terms in 1984-85 as in 1983-84. Of the £490m. reduction since the last White Paper nearly £300m. relates to higher receipts, £100m to lower current expenditure and the rest to a modest reduction in former plans for capital spending plus lower interest rate assumptions in forecasting subsidies.

41. Private sector housing starts in 1983 were highest since 1973. This is good news both for house purchasers and the construction industry.

42. Home Improvement Grants will end after March 31 this year which is the deadline for applications. The grants were clearly stated to be temporary when introduced in 1982 Budget and were designed partly to absorb surplus capacity in the building industry at that time. Original deadline has been twice extended.

LAW AND ORDER

43. Increase of about £80m. in 1984-85 and £90m. in 1985-86 on plans in last White Paper. Partly to fund prison building programme which should eliminate present over-crowding by end decade.

TRADE, INDUSTRY, ENERGY AND EMPLOYMENT

44. Government has been able to reduce support for industry next year largely because no provision has been necessary for BL. In 1983-84 support for BL totalled £150m.

45. Support for industrial R and D and innovation continue to grow through the survey period reflecting Government priorities. Assistance to shipbuilding and steel tapers off as restructuring is completed

and support for Rolls Royce falls as the RB 211 development stage comes to an end.

46. White Paper figures do not reflect any launch aid which may be provided for the A320 and V2500. Nor do they reflect cuts which may stem from the proposed changes in regional policy.

47. Employment spending in 1984-85 has been reduced by about £135m. since the last White Paper. This reflects this year's cash limit reduction in July and lower forecasts of expected demand for the Job Splitting and Job Release Schemes and the Youth Training Scheme. Total provision will still be £245m. higher than in 1983-84.

TRANSPORT

48. Expenditure in 1984-85 will be similar to the level planned for that year in the last White Paper, adjusting for the transfer of functions. Spending on national roads will rise slightly while capital expenditure on local transport will fall.

AGRICULTURE

49. Forecast spending by the Intervention Board for Agricultural Produce (IBAP) has risen sharply over the level provided in the last White Paper by £408m. in 1984-85 and £240m. in 1985-86.

50. About a third of this is pre-funded by the EC and the rest is re-couped in due course by the proceeds of sales and EC reimbursement for losses. Nevertheless it increases the overall cost of the CAP, strengthening the Government's resolve to reform it.

51. MAFF expenditure has been cut slightly by £131m. in 1984-85 and £33m. the following year compared with the last White Paper figures. The cuts have mainly fallen on capital grants. An industry which is as heavily subsidised as agriculture under the CAP cannot expect to be exempt from the Government's commitment to control public expenditure overall.

EC

52. Net payment to EC institutions is forecast to fall in 1984-85 from £500m. to £375m. This figure is calculated on the stylised assumption that the UK continues to receive a refund of two thirds of the "allocated" budget. The £75m. drop below the figure given in the Autumn Statement stems largely from new exchange rate assumptions which have reduced forecast VAT payments. The contribution is expected to rise again in the 2 following years, but projections are uncertain.

NATIONALISED INDUSTRIES

54. External finance required by the nationalised industries falls from £2.5bn. in 1983-84 to £1.9bn. in 1984-85. This mainly reflects reductions in costs and improvements in performance. In 1984-85 industry tariffs are expected to rise at or slightly below the rate of inflation. The Government is not using the electricity industry or any other NI as a milch cow by forcing them to put up prices beyond their economic level.

55. Allowing for privatisation removing some enterprises from the public sector, NI investment is expected to be 12 p.c. higher in 1983-84 than in the previous year.

56. The National Coal Board and British Rail continue to require by far the largest amounts of external finance.

SECRET
SECRET



c.c. J. Redwood

ee Master

File
3

10 DOWNING STREET

From the Private Secretary

17 February, 1984.

Territorial Programmes

The Chief Secretary, accompanied by Mr. Bailey, came to see the Prime Minister today to talk about the territorial expenditure programmes. Mr. Redwood was also present. The paper attached to the Chief Secretary's minute of 30 January indicated that there was substantial over-provision in Scotland and in Northern Ireland, though not in Wales. This arose, not so much from the working of the current formula, but from the generous base line established in the 1970s. The Chief Secretary handed the Prime Minister a further note setting out a number of indicators of over-provision, for example, pupil-teacher ratios, rents, roads. He argued that, with the growth of the North Sea oil sector, and electronics, there had been a substantial narrowing of the income differential. Incomes in Scotland were now about 99% of those in England. A number of English regions, for example, Cumbria and the North East, felt a sense of grievance at the level of provision enjoyed north of the border.

The Prime Minister agreed that the figures did indeed point to over-provision. She pointed out, however, that there was an important political dimension to the Scottish case. Major changes were taking place in the structure of Scottish industry. There had been a number of major closures, for example, Invergordon, Linwood, Wiggins Teape, and now Scott Lithgow and Henry Robb. There were further major redundancies still in prospect, - Ravenscraig, Bathgate, and the Scottish pits. Despite strong growth elsewhere in the Scottish economy, all these redundancy cases would attract strong political opposition.

The Secretary of State was in a difficult position. On a number of cases in the past he had sought to find a new operator, but this had generally been unsuccessful. He had played a cooperative role in the handling of these closures. This had been enormously valuable in allowing the necessary restructuring of industry to take place, and in allowing heavy exchequer subsidies to be withdrawn. A frontal assault on public expenditure in Scotland would put him in extreme difficulties, and could create a possible opening for the SNP.

SECRET

/ The

MR

The Prime Minister said she recognised the case for reducing public expenditure provision in Scotland and Northern Ireland, but felt that this should be tackled with great care. There should be no attempt to publicise the figures. Instead, the aim should be to pare down the figures starting with the last year of the survey. The Chief Secretary should begin to sound out the Secretaries of State for Scotland and Northern Ireland.

I would be grateful if this letter were shown only to those who need to know of its content.

Andrew Turnbull

John Gieve, Esq.,
HM Treasury.

Chief Secretary

From: W J E NORTON
Date: 17 February 1984

MR BAILEY

AMW 17/2

cc: Mr Watson

TERRITORIAL STUDY

Here is some supplementary briefing for the call on No. 10, as requested.

(1) More examples of over-provision in Scotland

(a) Pupil-teacher ratios in schools: 1981-82

England	18.5
Wales	18.0
Northern Ireland	18.7
Scotland	17.1
<u>Scotland less Highlands and Islands</u>	<u>17.3</u>

(b) <u>Housing:</u>	<u>% Dwellings Unfit</u>	<u>% Dwellings lacking in basic amenities</u>	<u>Rents</u>
England	about 5.2	5.0	£14.05
Scotland	4.5	2.8	£9.84

(2) Anecdotal evidence of over-provision in Scotland

(a) Teacher training. The Scots, despite some recent closures, still have a large admitted surplus of capacity.

(b) Roads. Glasgow has the highest/mileage of urban motorway per capita in Europe. A glance at any road map will show the now extensive system of fast modern highways in the Lowlands, and even parts of the Highlands - and everybody who uses them agrees that most of them are, by English standards, extensively under-used.

(3) Decline in Scottish population, compared with England

	<u>Scotland</u>	<u>England</u>
1975	5.21m	46.70m
1978	5.18m	46.66m
1981	5.15m	46.82m

(4) Methodology - Major Objective Factors

"Lack of pupil places" (see Appendix to minute to No. 10) refers to the imbalance between supply and demand caused by population movements, especially the movement out of cities into the countryside.

(5) Cases in the pipeline

- | | | |
|-----|------------------------------------|--|
| (a) | <u>Scotland</u>
(Outside block) | Scott Lithgow
Bathgate |
| (b) | Northern Ireland
(Inside block) | Harland and Wolff
Power station investments (perhaps)
Lear Fan |

WJEN

W J E NORTON



10 DOWNING STREET

Prime Minister

The Chief Secretary (who will be accompanied by N Bailey) is coming to take you through the Treasury contention that public expenditure provision for Scotland, and to a lesser extent N. Ireland, is too generous

You will need to decide how, if you wish to proceed, to approach S/S Scotland. CST has volunteered a draft letter for you to send. Alternatively CST could write with your endorsement.

AT

16/2



Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull Esq
Private Secretary (Economic Affairs)
10 Downing Street

14 February 1984

Dear Andrew,

PUBLIC EXPENDITURE WHITE PAPER - BRIEFING

I am enclosing a copy of the main question and answer brief prepared for the Chief Secretary's Press Conference to launch the Public Expenditure White Paper at noon on Thursday 16 February. (I shall send you tomorrow morning the much longer background briefing which is still being finalised.)

2. Much of the material in the White Paper has been anticipated by the Press and it contains nothing which is newly controversial. It seems unlikely, therefore, that it will give rise to Questions to the Prime Minister on Thursday afternoon. You may however, like to look particularly at the following items in the brief, which might possibly come up:-

- i. Q3 - 1983-84 outturn: effect on the PSBR.
- ii. Q7 - Realism of the plans/risk of overspending.
- iii. Q11 and 12 - Real terms comparisons (a point which TCSC will make in their report on the Autumn Statement to be published tomorrow)
- iv. Q14 - Unemployment assumption.
- v. Q17 - Green Paper on the long-term.
- vi. Q21-26 - Capital expenditure (particularly Q22 and 24 on the "built infrastructure").
- vii. Q27 - Defence - the NATO commitment.
- viii. Q39-41 - Housing Benefit
- ix. Q42-46 - Local authority spending.

3. You may also have seen comments in the papers last Sunday that cuts in the Defence programme could put the Trident and other major defence projects in doubt (copies attached). On this we would suggest an answer as follows:-

Defence cuts?

(X) There are no "huge cuts in defence spending" as one Sunday newspaper speculated. On the contrary, by 1985-86 defence spending will have increased in cost terms for seven years in a row. Provision for equipment in 1985-86 will be over (fifty) per cent higher in cost terms than in 1978-79.

4. If there is anything further you need, perhaps you could have a word with Tony Hart in GEP1 (ext 7208).

5. I am copying this letter to David Hayhoe.

yours sincerely
JG

JG J GIEVE

CONFIDENTIAL

NSBPM
AT 13/2 CC NO



PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

13 February 1984

Dear John,

Public Expenditure and Taxation in the Longer Term

In summing up the discussion of C(84)5 at Cabinet on 9 February the Prime Minister said that members of the Cabinet who wished to be consulted about the drafting of a discussion document should inform the Chancellor of the Exchequer.

I am writing to let you know that the Lord President would like to be so consulted, and would be grateful if those consulted could be given a reasonable period of time in which to give the draft full consideration.

I am sending copies of this letter to Andrew Turnbull and Bernard Ingham.

*Yours ever,
Janet Lewis-Jones*

JANET A LEWIS-JONES
Private Secretary

John Kerr Esq
Private Secretary to the
Chancellor of the Exchequer

CONFIDENTIAL

Econ Pol. Pt 26

Public Expenditure

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①
PRIME MINISTER

PUBLICATION OF PUBLIC EXPENDITURE WHITE PAPER

The Chief Secretary proposes to publish the PEWP at 12 p.m. on Thursday, 16 February. Bernard has been anxious to bring the publication time forward from the afternoon in order to ensure that the White Paper can be given publicity on the 1 o'clock news and in the provincial evening papers. The only disadvantage is that it will appear shortly before Question Time but, given adequate briefing, I think we can cope with this. It will also mean that the Chief Secretary may have to leave the Cabinet meeting shortly before the end though there is no problem here as there are no special papers on the agenda.

Agree?

AT

Yes

9 February 1984



Ref. A084/451

PRIME MINISTER

Capital and Current Expenditure

C(84) 7

Flag A _____

BACKGROUND

On several previous occasions members of the Cabinet have expressed disquiet at a decline in the proportion of public expenditure going to capital investment. This disquiet was reflected in the discussion on the 1983 Public Expenditure Survey on 10 November 1983, when the Chief Secretary, Treasury was invited to give thought to how more satisfactory information on the split between capital and current expenditure could be made available, and to circulate proposals (CC(83) 33rd Conclusions, Minute 4). There was a further exchange in the Cabinet on 12 January (CC(84) 1st Conclusions, Minute 5).

Flag B

Flag C

2. In his memorandum C(84) 7 the Chief Secretary, Treasury provides a new presentation of the figures for capital spending. These include a number of adjustments, of which the most important appear to be as follows:

(a) Sales of assets are excluded because they have no bearing on the volume of new work.

(b) Expenditure on defence equipment and construction is counted as capital expenditure (the international statistical conventions on the preparation of national accounts count all defence spending as current).

(c) The capital expenditure of the nationalised industries is scored, rather than their external financing limits.

3. The adjusted figures, which will appear in the Public Expenditure White Paper published on 16 February, show that in cost terms public capital spending on goods and services has stayed broadly constant over the period 1978-79 to 1983-84, and should continue to do so in 1984-85. Comparisons with plans



for later years are more difficult because of the expected transfer to the private sector of major nationalised industries; but the Chief Secretary suggests that if adjustments are made for this there should be little change in 1985-86, and a small fall in 1986-87.

4. The Chief Secretary recognises that the new figures will not satisfy the Government's critics. However, he points out a number of further points that can be made in reply.

(a) Much current expenditure is as valuable economically as capital expenditure; and current expenditure may be as good as or better than capital expenditure in securing particular objectives.

(b) Some public investment, for example in housing, should be carried out by the private sector.

(c) Demographic and other factors may mean that less capital expenditure is needed.

(d) Investment in industrial and commercial activities is of little value if it fails to earn a proper return, as much investment by the nationalised industries and other public sector bodies has failed.

5. Finally, the Chief Secretary points out that the balance between capital and current expenditure is the result of decisions by spending Ministers on their programmes: it is not a matter that can be determined centrally by the Treasury. The case for capital expenditure will have to be considered project by project.

6. In his letter of 3 February to the Chancellor of the Exchequer, the Secretary of State for the Environment proposes the establishment of an interdepartmental group with terms of reference requiring it:

"to examine the state of the publicly owned civil capital stock of housing and roads, water and sewerage, hospitals and education buildings, the Government civil estate and the capital stock of universities; to evaluate such evidence as is readily available of its present and likely future condition and fitness for its purposes and its needs



for maintenance, repair and replacement; to consider means of assessing the position and keeping it under review as a basis for cost-effective decisions on public expenditure and investment; and to make recommendations".

The defence estate and the nationalised industries would be excluded. The group would have a Treasury chairman and would be asked for an initial report by May or June in time for it to be taken into account in the 1984 Public Expenditure Survey.

MAIN ISSUES

7. The main issues before the Cabinet are as follows:

- (i) Do the figures as now presented allay the disquiet which has been expressed by some Ministers in the past?
- (ii) If not, what should be done about it?
- (iii) In particular, do Ministers wish to establish special machinery, such as that proposed by the Secretary of State for the Environment?

The figures

8. The Cabinet may well feel that although the unadjusted figures which have previously been used exaggerate the problem, the new figures circulated with C(84) 7 still leave grounds for disquiet.

(a) Defence expenditure gives employment to the construction and equipment industries, and may help strengthen our industrial base. But it makes no direct contribution to the country's productive capacity. If the defence figures are excluded from the calculations, the figures in Annex B to C(84) 7 appear to imply a decline of about 1/7th, in cost terms, in capital spending on goods and services between 1978-79 and 1984-85.

(b) Ministers have been concerned not only at the absolute decline in capital spending but also in its decline

What contribution to productive capacity did investment in steel and power stations make?



as a proportion of public expenditure. Public expenditure has increased substantially both in real terms and as a percentage of GDP since 1978-79. Moreover, if the capital spending figures are increased by adjustments such as the exclusion of asset sales, the same adjustments must be made to public expenditure, and the totals will be correspondingly higher.

(c) The combined effect of the points at (a) and (b) above is that more than all of the published increase in public spending in real terms since 1978-79 has gone to current expenditure, defence capital expenditure, and transfer payments.

What should be done?

9. Even if the Cabinet should feel that the figures in C(84) 7 give too reassuring an impression, it is hard to quarrel with the ✓ Chief Secretary's assertion that the remedy, if one is needed, is mainly in the hands of spending Ministers. Given the overriding need to hold to the published planning totals, it is hardly reasonable to expect the Chief Secretary to reject savings offered by spending Ministers on the grounds that he thinks, in contradiction to the judgment of the Minister with operational responsibility, that to do so would produce the wrong balance between capital and current expenditure in a particular programme. If the Secretary of State for the Environment and other spending Ministers responsible for the capital stock and the public services consider that the policies which are being pursued in their areas on repair maintenance and replacement are economically unsound, they should demonstrate the case for changing those policies with specific evidence that more expenditure now will avoid the need for much greater expenditure later. Any bid for additional expenditure would have to be considered alongside other bids.

10. Spending Ministers will no doubt argue in reply that the practice of dealing with expenditure programme by programme, primarily by bilateral discussion, makes it difficult for the Cabinet collectively to ensure that deserving bids for additional expenditure are given adequate priority. If a particular



spending Minister is unable to find an offsetting saving himself, he is likely to feel constrained to abandon his bid. In an ideal world it may have been more desirable in terms of the national economy that an offsetting saving should have been made in some other programme to accommodate his bid.

11. The only way of getting round this difficulty is for the relevant spending Ministers to convince not just Treasury Ministers but their colleagues collectively that some additional expenditure is desirable. If Ministers are so persuaded collectively, and if they nevertheless wish to avoid an increase in public expenditure as a whole, they each have to be prepared to make their own contributions to the savings required to offset the additional bid. The fundamental requirement remains that evidence has to be produced which would convince Ministers collectively of the need for this adjustment in expenditure priorities.

Machinery

12. If it is agreed that this is what needs to be done, the question then arises of what new machinery, if any, is required to assist the process.

13. The Secretary of State for the Environment's proposal seems to have some considerable disadvantages:

(1) The terms of reference of the proposed committee are loaded with questions to which the answer could not fail to be "more money".

(2) If the existence of the committee became known, it could become the object of a whole variety of pressures for more expenditure.

(3) The committee could itself all too easily become a lobby for higher expenditure all round, indeed an anti-Treasury lobby, arguing the case on generalities and deflecting attention away from the need for hard evidence on specific cases.

In general I doubt the value of a general review of the adequacy of the stock of infrastructure assets; each area - roads, hospitals or whatever - needs to be looked at specifically, and decisions on priorities for expenditure brought to Ministers in the context of the regular discussions on public expenditure.

14. A possible way forward would be to invite the Chief Secretary to consider how, in the context of the next Public Expenditure Survey, special examination should be made of any proposals from Departments



for cost-effective expenditure on the repair, maintenance and replacement of the public sector capital stock: and how the results of this examination might be assembled and presented to Ministers collectively within the framework of the existing Public Expenditure Survey Committee system and the PESC report. This would avoid the creation of elaborate new machinery and ensure that new work was properly integrated into existing control systems.

HANDLING

15. You will wish to ask the Chief Secretary, Treasury to introduce his memorandum. All Ministers in charge of spending Departments are likely to wish to comment: the Secretary of State for the Environment will no doubt want to develop the suggestions in his letter of 3 February; and I understand that the Secretary of State for Education and Science is likely to support them.

CONCLUSIONS

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

- (i) Any points arising from the new presentation of the figures for public capital spending.
- (ii) Whether it is accepted that the case for capital expenditure must be considered project by project on the basis of specific evidence put forward by individual spending Ministers.
- (iii) Whether any new machinery is required for enabling Ministers collectively better to assess specific bids for additional capital expenditure against other expenditure priorities.

approved by ROBERT ARMSTRONG
and signed in his absence.

Lindsay Wickham.

8 February 1984

Ref. A084/445

PRIME MINISTERPublic Expenditure and Taxation in Longer Term(C(84)6

BACKGROUND

Flag A

The Cabinet have discussed long term prospects for public expenditure and taxation on two recent occasions: on 9 September 1982 (CC(82)41st Conclusions, Minute 4) and 21 July 1983 (CC(83)24th Conclusions, Minute 5). Although there were differing views about the extent to which it might be desirable to pursue the objective of reducing taxation at the expense of other policy objectives, there was agreement on both occasions that it was desirable to stimulate an informed public debate on the issues.

Flag B
Flag C

2. Although there has subsequently been a good deal of public debate, it has often been of a kind unhelpful to the Government. The documents prepared for the Cabinet discussion in 1982 leaked and caused serious embarrassment. It has proved difficult for Ministers to discuss hypothetical figures or measures affecting individual expenditure programmes without being misrepresented. The Government has sometimes been obliged to respond by giving assurances about policy in various areas and the effect may have been to constrain rather than increase the Government's freedom of manoeuvre.

3. In his memorandum C(84)6 the Chancellor of the Exchequer suggests that the time has come for the Government to contribute more positively to the public debate. The Treasury and Civil Service Committee (TCSC) intend to mount an enquiry into public expenditure in the longer term and the Government will have to give extensive evidence. The Chancellor proposes, in effect, that the Government should take the initiative by publishing a Green Paper or other form of discussion document at the time of the Budget.

4. The document would not give figures for individual programmes, though it would draw attention in qualitative terms to particular pressures for increased expenditure, such as demographic factors, technology, and capital infrastructure. In outline it would:

- a. give figures for the past 20 years or so;
- b. draw attention to the pressures mentioned above;
- c. set out global figures for public expenditure, taxation and borrowing for the period up to 1993-94 on the assumption that, for the period up to 1988-89, GDP would grow at 2½ per cent a year and public expenditure would be held constant in real terms (as proposed in C(84)5); and, for the period between 1988-89 and 1993-94:
 - i. public expenditure would either be held constant in real terms (described in paragraph 7 of C(84)6 as the "main case") or grow at 1 per cent a year;
 - ii. GDP would grow either at 2 per cent or at 1½ per cent a year.

A further assumption is that the public sector borrowing requirement (PSBR) at the end of the period would be equal to 1 per cent of GDP.

5. The document would be primarily designed to show (paragraphs 5 and 6 of C(84)6) that by holding public expenditure constant in real terms to 1993-94 and on the assumption of 2 per cent growth in GDP the non-North Sea tax burden could be reduced from 39 per cent now to around 32 per cent (compared with 34.7 per cent in 1978-79 and 33 per cent in 1973-74).

MAIN ISSUES

6. The main issues before the Cabinet are as follows:

Please see
Item 4
on Agenda

- i. Is the approach suggested by the Chancellor of the Exchequer satisfactory as regards its substance?
- ii. If so, should the Government take the initiative and publish it as a contribution to public debate?
- iii. Are the form and timing suggested by the Chancellor of the Exchequer satisfactory?

Substance

7. On the substance of the approach suggested by the Chancellor of the Exchequer, three points in particular may attract comment:

- a. whether it is worthwhile and defensible to talk about public expenditure for ten years ahead without talking about individual programmes;
- b. whether it is desirable to illustrate the consequences both of keeping public expenditure constant in real terms and also of 1 per cent real growth;
- c. whether the assumed level of PSBR in 1993-94 (1 per cent) can and should be justified by positive arguments.

Individual programmes

8. The Cabinet will be familiar with the pitfalls of discussing long term trends in individual expenditure programmes. But it may be argued that an illustration of the taxation consequences of a particular level of total public expenditure, given a particular assumption about the PSBR, is little more than an empty exercise in arithmetic. Although the public may be able to grasp the potential benefits in terms of lower personal taxation, little may be achieved in public education if there is no exposure of the hard choices involved in getting there. Since it is intended to

First establish that there is a problem, then go on to hard choices re proceed step by step.



refer to pressures on public expenditure from demographic changes and other factors, should there not be some illustration of how difficult it may be both to meet these pressures and keep public expenditure constant in real terms? There are undoubtedly political risks in proceeding down this track. On the other hand, is the exercise worth doing at all unless these implications are brought out?

Alternative public expenditure assumptions

9. Some may argue that the kind of document envisaged by the Chancellor already ties the Government's hands too much by its emphasis on the benefit of holding public expenditure constant in real terms to 1993-94. They may say that this will provide the Government's opponents with a too convenient Aunt Sally. It may even be seen as a covert attempt by the Treasury to preempt decisions on the overall level of public expenditure not just for the remainder of this Parliament (through the extended MTFS discussed under the previous item) but in the next Parliament as well.

10. There may be criticism from the opposite direction that, although the main case illustrated in the document will be constant public expenditure in real terms, it is also intended to illustrate 1 per cent real growth in public expenditure. It may be argued that this will present a confusing public message. The Chancellor would no doubt reply that the alternative assumption is useful in showing that, for the same level of growth in GDP, a 1 per cent real growth in public expenditure means that the burden of taxation will be nearly two percentage points higher. But it will be necessary for the Government to be clear in its own mind about the purpose of the alternative 1 per cent growth assumption for public expenditure. Is it intended to suggest that the Government has an open mind about the path of public expenditure growth in the 1990s, or is it intended to reinforce the case for holding public expenditure constant?

PSBR assumption

11. The level of PSBR in 1983-84 is obviously an important element in the calculations in the proposed document. In paragraph 6 of the Annex to C(84)6 a figure of 1 per cent of GDP by that year (compared with 2½ per cent in the current MTF5 for 1984-85) is presented as an arbitrary statistical assumption required by falling inflation and interest rates. Some Ministers may argue that this is critical to the argument. If a higher PSBR was allowed the calculations would probably show that it was possible to achieve a greater reduction in taxation or less restraint in public expenditure or some mix of the two. If so, it becomes important to establish what benefits can be derived from the assumed level of PSBR in terms of price stability. Should not the document therefore contain some positive argument on this point? If it is thought that such arguments would be difficult to deploy convincingly, may this not be a serious weakness in the document?

Should the Government volunteer its views?

12. The discussion on the substance should have clarified the Cabinet's position on public expenditure in the longer term and the nature of any message which it might want to get across. This will have an important bearing on how far the Government should take an initiative by publishing a document and how far it should merely respond to enquiries from the TCSC.

13. The arguments in favour of taking the initiative are that the Government wishes to encourage public debate and should itself contribute to that debate; and that since it will be necessary to produce a good deal of material in response to requests from the TCSC, there is much to be said for a single considered presentation rather than piecemeal and reactive material, which the TCSC will use in their own way.



14. On the other hand, some members of the Cabinet may feel that the difficulties involved both in the papers prepared for the discussion in 1982 and in the new approach suggested by the Chancellor of the Exchequer are so great as to make it undesirable to volunteer material, and that it would be better simply to respond to requests from the TCSC.

a document of some kind has been more or less promised.

Form and timing

15. The form and timing of any document will inevitably depend on its content. Some members of the Cabinet may feel that the content of the document envisaged in C(84)6 does not quite justify a Green Paper, and that something less formal would be more appropriate.

16. The proposal to publish at the time of the Budget has advantages. In particular, it could be presented as a natural extension of the rolling forward of the medium term financial strategy proposed in C(84)5. Moreover there might be less temptation to criticise the document as too thin and arithmetical if it was presented along with the mass of material at Budget time.

Further action

17. If the Cabinet agree that a document should be prepared, they will no doubt wish to invite the Chancellor of the Exchequer to circulate it in draft for clearance before publication. The strategic importance of a paper of this kind is so great that I believe that the paper should be seen, discussed and endorsed by the whole Cabinet, so that collective responsibility for it is fully engaged. It is indeed possible that the Cabinet may be unwilling to reach final decisions until they have been able to study a full text. If this is right, it will be desirable to invite the Chancellor of the Exchequer to circulate any document in sufficient time to allow Cabinet discussion and time for amendment before publication.

HANDLING

18. You will wish to invite the Chancellor of the Exchequer to introduce his memorandum. All members of the Cabinet are likely to wish to contribute to the discussion. The Lord Privy Seal may have particular comments from the standpoint of relations with the TCSC, and the Lord President of the Council from the standpoint of presentation of the Government's policies.

CONCLUSIONS

19. You will wish the Cabinet to reach conclusions on the following:

- i. Is the substance of the Government's contribution to the public debate on long term prospects for public expenditure and taxation, as proposed in C(84)6, acceptable?
- ii. Should the Government volunteer such a contribution, or await questioning from the TCSC?
- iii. What should be the form and timing of any contribution?



ROBERT ARMSTRONG

8 February 1984



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NOBEM 07/84
cc X10

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LONDON SW1P 3EB
01-212 3434

My ref: J/PSO/10956/84

Your ref:

8 February 1984

Dear Robin,

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

Thank you for your letter of 2 February.

I am quite clear that what I want is a policy and programme review, not (at this stage at least) an "efficiency" exercise. I think Peter Rees concurs with this. When we have made progress on the policy review there may be particular aspects of programme management and project control that would benefit from the scrutiny approach, although the National Audit Office are at present carrying out a full examination of this programme, with a particular emphasis on VFM, and our own Internal Audit will be examining the Urban Development Grant scheme later this year. Many other aspects of the programme have also been examined in detail and we have an active external research programme that is now concentrating on methods of appraisal. All this work, however, is subsidiary to the main policy and the programme review that is now being carried forward on the lines that I have set down. We cannot have two separate exercises running concurrently: there is a lot of work to be done and time is limited.

As you know, the Chief Secretary and the No. 10 Policy Unit have agreed to join in the review, so there will be no lack of independent appraisal, radical questioning and objective commentary. I will be glad to have one of your staff join in the review, if you can nominate someone quickly. The work is already well in hand here.

I am copying this to the Prime Minister, Peter Rees and Sir Robert Armstrong.

Patrick Jenkin

PATRICK JENKIN

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Sir Robin Ibbs

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8 February 1984
Policy Unit

PRIME MINISTER

CABINET: BUDGET BACKGROUND

The paper on capital and current expenditure is excellent. It answers the criticism that we have been spending insufficient on capital account by demonstrating that capital spending has been level in cost terms since 1978/9.

Capital spending is not a good in itself. It is only worthwhile if it improves services, or if it is a commercial investment that earns a good return. All too often in the past, far too much money has been squandered in eg steel, shipbuilding, motor cars - only to see the new plants closed down, the men made redundant, and the capital written off a few years later.

There is no point whatsoever in spending on capital account to build more buildings like schools when demand for the service is falling.

It is dangerous to assume that you can judge a suitable overall level of public capital expenditure. Stressing the argument that expenditure has not fallen could imply that the Government should be judged by the aggregate amount of capital spending. Instead, you should be judged by the return generated on public investment projects, and by success or failure in maintaining a decent infrastructure for the rest of the economy.

Those who seek more capital expenditure are often driven to speak for new sewers. Results from surveys of the sewer system are often reassuring rather than disturbing. There is no need to dig up all the streets and replace all the sewers that are currently there. The best way of knowing when a sewer's useful life is over is still to wait for it to collapse. New technology is also coming to our aid. Spray-on and plastic linings are possible, rather than complete replacement. The DoE agree that there is no major problem with sewer replacement. The current programme is running at over £200 million per annum. The Government could say that those who want to replace all the sewers do not know what they are talking about, and would inflict unnecessary costs with traffic dislocation and noise.

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Public expenditure and taxation in the longer term

As recommended, the Green Paper should have an introductory section setting out the inexorable growth of the last 20 years.

The section drawing attention to likely pressures for further spending should not make too much of the demands for new capital infrastructure (see above).

The Green Paper could be used as an opportunity to state the case in favour of making most of the commercial industrial investment in the private rather than the public sector. In this connection, the recent trend of decisions is disturbing. In the last 2 weeks alone, the Government has accepted from the DTI the expenditure of up to £220 million on A320, up to £60 million on Rolls Royce, up to £100 million on Nissan, and £80 million plus on Scott Lithgow. At this rate, taxes will have to go up. A Government which does not believe in interfering in business, and believes in letting the market take more of the strain, has to be careful lest it gets dragged back in to an enormous programme of subsidy and expenditure on industrial matters.

In setting out the general projections, there would be some merit in showing three cases. The three public expenditure cases could be: a 1 per cent per annum reduction; holding constant in real terms; and a 1 per cent per annum increase. The growth variables could also be three in number. The paper could take: 1 per cent (comparable to the experience of the last 10 years); the central case of 2 per cent, as outlined in the Treasury paper; and a more optimistic 3 per cent.

If all these variables were put together in a table of possibilities, it would provide the necessary background for an informed public debate. The danger of narrowing the options too far would be to invite the criticism that:

- (a) the Government have given up any hope of ever reducing public spending;
- (b) it was attempting to fiddle the figures by taking an unduly optimistic growth rate for the economy as a whole; and
- (c) on any reasonable balance of the figures provided by the Government, there was no chance whatsoever in getting tax down below

the 1978/79 level which the Conservative Party in Opposition so roundly condemned.

It would also be helpful if some more optimism could be injected into the general debate about the considerable opportunities there are for reducing public spending. The list beneath shows some of the avenues that could be explored more vigorously:

DHSS:

Making Child Benefit contributory (£4 billion expenditure).

Abolishing state earnings-related pension schemes (saving £10 billion per annum by 2010).

Making Griffiths work, and squeezing an extra 2 per cent efficiency out of the NHS, a modest target (£300 million).

DTI:

Reducing the budget for money wasted on unproductive industrial support and subsidy, c.£500 million.

Regional Policy:

A further £250 million.

Transport:

Reducing bus and train subsidies, c.£400 million.

Agriculture:

Reducing MAFF assistance, c.£300 million.

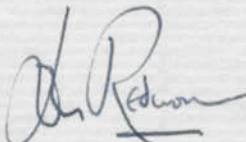
Government Procurement:

Better practices, £750 million.

Public Sector Pay:

Better control, say £300 million.

In summary, the best economic strategy for this Government remains to reduce taxation, whilst not relenting on the pressure to reduce the PSBR and money supply. In order to deliver, some of those spending programmes which do not reflect the Government's general philosophy not only have to be questioned, but have to be stopped.


JOHN REDWOOD

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AT 8/2

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

The Rt Hon Patrick Jenkin MP
Secretary of State for
the Environment
2 Marsham Street
LONDON
SW1P 3EB

7 February 1984

Dear Patrick,

copy attached
(original in
Cabinet Folder)

Thank you for copying to me your letter of 3 February to Nigel Lawson about the state of the capital stock.

I agree with what you write.

We need, it seems to me, to take a measured view of the problem against a longish time-scale and within the inevitable financial constraints if we are to avoid storing up trouble for ourselves either in this Parliament or the next.

As the issue is, as you imply, sensitive, I hope that any inter-departmental study would do its job without publicity.

I am copying this letter as you did yours.

Kevin Keoh.

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MINISTERIAL CONFERENCE ON
**THE LONGER-TERM PERFORMANCE
OF OECD ECONOMIES:
CHALLENGES FACING GOVERNMENTS**

13 th - 14 th February, 1984

NOTE
BY THE SECRETARY-GENERAL



CONFIDENTIAL

MINISTERIAL CONFERENCE ON
**THE LONGER-TERM PERFORMANCE
OF OECD ECONOMIES:
CHALLENGES FACING GOVERNMENTS**

13 th - 14 th February, 1984

NOTE
BY THE SECRETARY-GENERAL

THE LONGER-TERM PERFORMANCE OF OECD ECONOMIES

CHALLENGES FACING GOVERNMENTS

0.1 This paper takes a step back from today's settings for today's policy instruments to examine how economic policies affect the structure, and hence the longer-term performance, of OECD economies. High unemployment and rising public sector debt set the context in which economies must be able to adjust to continuing rapid but uncertain changes in technology and trade. Four features of economic structure are singled out as likely to encourage successful adaptation: a stable and non-inflationary policy environment; sufficient flexibility to maintain both efficiency and high employment in the provision of public and private goods and services; an open world system of trade and finance to increase and distribute the gains from new technologies; and a high degree of social consensus. The latter is not only good in its own right, but is necessary to maintain economic flexibility and political stability.

0.2 There are two compelling reasons why now is the right time to bring these issues to the front of the stage. First, the experience of the 1970s — the "school of hard shocks" — provides a compelling reminder that sustained improvement in living standards requires not only a continuing adaptation to continuous change, but also the flexibility to adjust to sudden shocks, nationally and internationally. Second, many government programmes and policies are already in the process of being cut back, reformed, or replaced, under the twin pressures of budgetary imperatives and structural change.

0.3 Thus, the time is ripe for trying to approach a wide range of policy issues in a consistent way, to ensure that government cutbacks are well placed, and that policies and programmes are coherent in their approach to government, to the private sector, and to the world economy. Both market and governmental processes are prone to failure in some degree because they have to deal with an uncertain future. Perhaps the most basic challenge for governments is to find ways to harness political and

economic forces to produce social and economic structures robust enough to cope satisfactorily with a rapidly changing environment.

0.4 For the public sector, the challenge is to limit and scale down the costs of public services, and to maintain a stable policy environment, while improving the ability to achieve social and economic objectives. For the private sector, which for this discussion comprises all business enterprises — including those owned or regulated by governments — the challenge is to achieve and maintain sufficient flexibility to ensure that changes are seen as opportunities rather than threats. These objectives are mutually reinforcing, since a stable and efficient public sector makes less claim on the resources of the private sector, helping to reduce costs and maintain incentives to work, to save, to invest, and to innovate. Similarly, a more flexible and innovative private sector generates jobs and investment more robustly, lessening the transfer load and financing requirements of the public sector.

0.5 A national economy that is flexible and efficient stands to gain more from the changing opportunities offered by open world markets, and is likely to have a bigger stake in improving the international framework for trade and investment. In the reverse direction, economies that are more open to world markets need to be capable of absorbing inevitable shocks. If this is well understood, then domestic political forces are more likely to embrace adaptability, and to reject rigidity. Flexibility and openness are thus mutually reinforcing. But they are also threatened in the same way when things go wrong. Political forces, policies or administrative structures that reduce flexibility, whether of domestic or world markets, reduce the benefits which the open system can bring, and conversely.

0.6 Consistent domestic policies to improve responsiveness require a high degree of consensus if they are to work. Consensus requires the costs of

change to be shared in a manner that is widely perceived to be equitable. This in turn requires, among other things, the maintenance of the basic "safety net" policies of the welfare state.

0.7 There are three main parts to the paper. All are concerned with government policies to achieve social objectives in a flexible, efficient and equitable

manner, and to provide a stable environment for sustained and non-inflationary economic growth. The first part deals with the public sector itself, the second with employment, investment and technology, and the third with the international system of trade and finance, and hence with the economic linkages between nations.

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Part 1

PRESSURES ON THE PUBLIC SECTOR

1.1 Ministers are invited first to discuss the activities of governments themselves: starting with size and effectiveness and then turning to public sector deficits and debt. The scope for policy change is, of course, limited by institutional rigidities and political pressures that, in the short term, largely determine the scale and structure of public sector activities.

Size and Effectiveness

1.2 In order to contain the size of public sectors, to reduce deficits and to respond to growing taxpayer resistance, most governments have been trying to restrain public expenditure. This has not proven easy, given protracted recession, expenditure commitments via indexation and otherwise, and interest payments on a growing public debt. Many governments are also trying to reorient public expenditures to different policy priorities; such restructuring is especially difficult under overall restraint.

1.3 Between 1960 and 1983 the share of total public expenditure in GDP for OECD economies rose by an average of more than 20 percentage points, to approach 50 per cent. While Chart 1 displays diversity in both size and growth, the public sector share in all but two countries exceeded, by the end of the period, the highest individual share in 1960.

1.4 Public expenditures have also changed in composition, away from governments' own consumption and investment towards transfers. Public transfers alone – social security transfers to households, subsidies to enterprises, and interest on the public debt – accounted on average for half of total public expenditure in 1983, compared to some 40 per cent in 1960.

1.5 The scale of these developments has raised sharp questions about feasible limits to the size of the public sector and the transfer burden, beyond which overall economic performance is seriously impaired. Worries include detrimental effects on individual and entrepreneurial initiative; disincentive effects of higher cash benefits and subsidies; distortions due to the level and pattern of taxation; and the

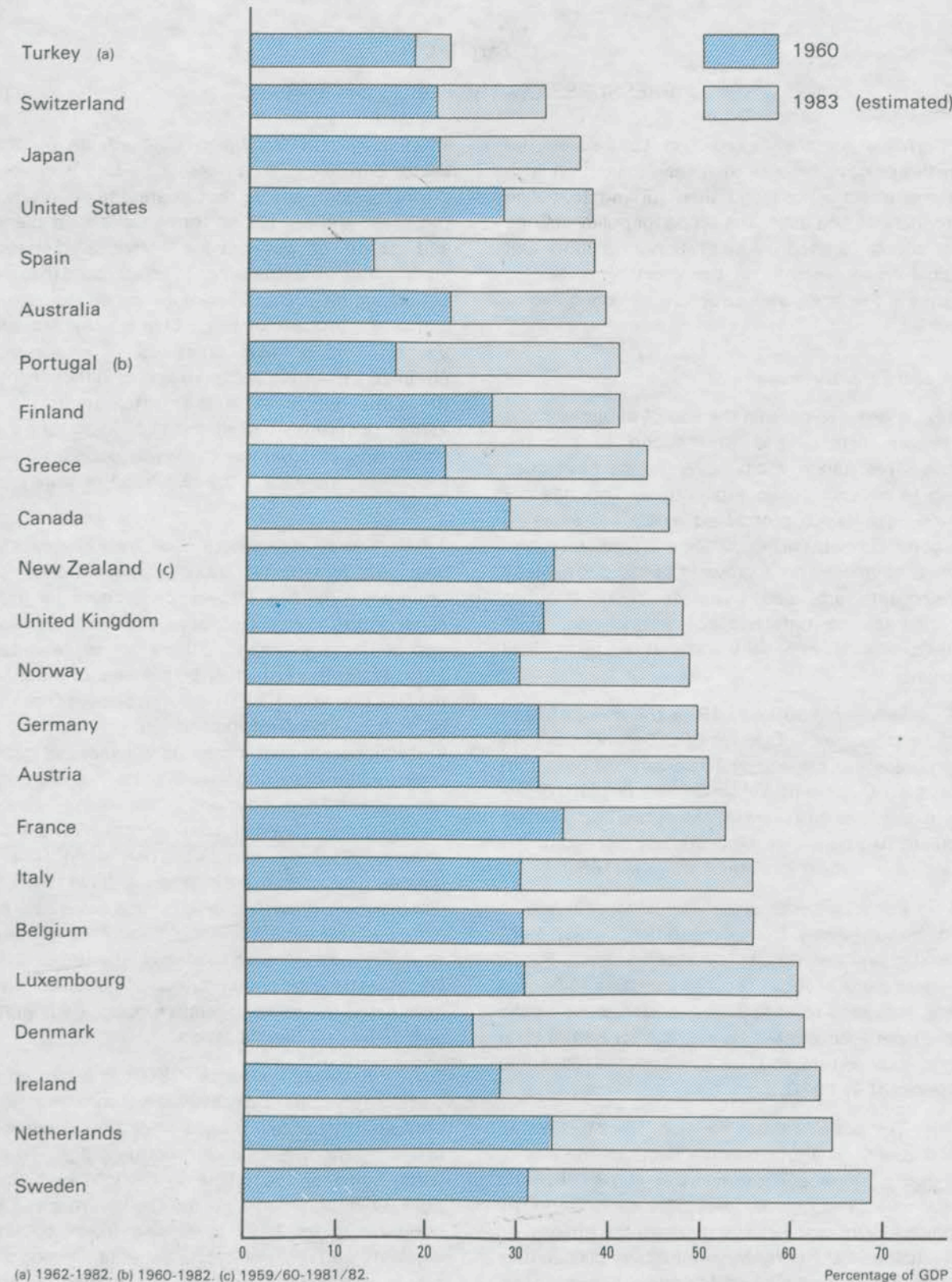
inflationary and "crowding out" effects of public sector borrowing. In a number of countries voters are increasingly saying that existing tax burdens are too great and are asking for reductions in the size and scope of government activities. Especially among the industrialising Member countries, the education, health, and social insurance systems are still in the process of being built up. All are under financial and political pressures to increase the effectiveness of the public sector, and face many of the same difficulties in their attempts to do so. Within government itself the expanding range and complexity of initiatives overloads decision-making processes, increasing the likelihood of policy mistakes.

1.6 Social expenditure – on health, education, pensions and other income maintenance programmes – is the largest component of public expenditure. It has also been the fastest growing and is the one taken up here for more detailed analysis. From a little over 50 per cent of the total in the OECD area in 1960 it grew to about 60 per cent by 1983. Growth of expenditure can be traced to four influences: cost increases in excess of general cost inflation; demographic shifts; extensions of coverage and eligibility; and increases in real benefit per recipient. Relative cost increases and demographic shifts have contributed only slightly over the period. The major determinants have been the discretionary growth in programme coverage, eligibility and real benefit levels. Although coverage and eligibility may increase modestly, the future cost of social expenditure commitments is likely to be dominated by trends in relative costs, demographic shifts and real benefit levels.

1.7 Between now and 1990 it is expected that demographic shifts will increase commitments, but only slightly so; fewer children of school age being offset by more people of retirement age. To illustrate, consider the following thought experiment: hold unemployment in the seven major OECD countries at its 1982 level, and freeze coverage, eligibility and real per capita benefits. Demographic trends would then imply a real increase in social expenditure of some ½ per cent per annum. If, in

CHART 1

TOTAL PUBLIC EXPENDITURE IN OECD COUNTRIES: 1960-1983



addition, the relative costs of health and education services were to increase by 1 per cent per annum, as in the recent past, real social expenditure would then increase by about 1 per cent per annum. This is less than the prospective growth rate of real GDP and would imply some reduction in the share of social expenditure in GDP.

1.8 The actual problem of controlling social expenditure is more difficult than the above arithmetic might suggest, since many earnings-related social insurance systems guarantee increases in real benefits for those who become eligible on the basis of past increases in real income. These systems thus entail future real benefit increases, particularly where populations are ageing. Total real social expenditures in the major seven economies would therefore rise faster than 1 per cent unless these commitments are cut or there are reductions elsewhere in the social expenditure system. In countries still developing their social expenditure systems, spending is likely to grow faster than in the major seven, and perhaps faster than their own GDP. By contrast, in some of the richer small countries with more extensive social expenditure programmes, expenditure reforms may well lead to slower relative growth.

1.9 Pensions and other income maintenance transfers broadly succeed in finding their way to those with lower incomes. Across-the-board cuts in pensions, unemployment compensation and other cash benefits create hardship, and the scope for further selectivity is limited. It may be necessary to re-examine the role of government as a supplier of high levels of security to the well-insured if there are difficulties finding resources for minimum levels of security on a broader scale. Pension benefits may need to be curtailed but, because of the long-term nature of the pension contract, this requires the mechanism for adjusting benefits to be specified well in advance.

1.10 Part of the historical growth in social expenditure has not reflected intentional expansion of benefits so much as inability to cut back in areas of declining demand (e.g. falling school enrolments) and to preclude unintended groups being the beneficiaries of support programmes. Efficient control of future social spending requires some programmes to be cut while others grow, all under continuous pressure to do more with less. This means reform within a coherent long-term framework for social policies. Efficiency is especially important in health and education, since they make up the largest and fastest growing elements of direct government spending on goods and services.

1.11 Government involvement in the socio-economic system is not always reflected in an expenditure or revenue line in a budget: there is a myriad of "off-budget" activities. These include tax exemptions, tariffs and import quotas, credit practices (loans and loan guarantees and quantitative guidance), governmental regulation – including of prices and interest rates – and expenditures by non-budget agencies. While off-budget activities and direct budget expenditures may provide alternative ways of meeting public objectives – including transfers from producers to consumers and vice-versa – there have been other reasons for an expanding use of off-budget measures. Off-budget activities may appear attractive both to recipients and public agencies in search of greater autonomy and lesser exposure to central surveillance and budget cut-backs. Governments themselves have sometimes seen cosmetic advantages in the use of off-budget measures. True costs, though less apparent, are not necessarily less. Only very few Member countries have highly developed procedures for monitoring off-budget activities, but most – including the less advanced – now appear concerned with the implications of their spread.

1.12 *In summary*, except for those countries where new welfare state initiatives are under way, the dominant reason for the growth of government has been the increasing role of the state in transferring income. On budget, this is done out of taxation revenues as payments to the old, the poor, and the unemployed, by the provision of health and education services, and by the payment of subsidies to activities ranging from agriculture to manufacturing. Off budget, the transfers take such forms as tax-reliefs, regulated prices and interest rates, protection from foreign or domestic competition and guaranteed loans. The idea of government as a mechanism for enriching some at the expense of others is older than Adam Smith; in the current century, and especially in the past twenty-five years, this has been combined with large increases in social expenditures intended to provide a broader and more equitable distribution of income and public services. The pace of increase and the resulting pervasiveness of these activities has led many to conclude that longer-term economic potential has become impaired; that a shrinking private sector has become "overloaded". Most OECD governments find that the balance of political and economic pressures has swung from favouring a steady expansion of public services to demanding a reduction in the financial claims that governments make on taxpayers. Thus there has been widespread adoption of budget limits, and a growing realisation

that the days are past when public expenditures can grow in one field without being cut back somewhere else.

Issues for Discussion

- *Setting the appropriate scale for government spending, and choosing the best path for getting there.*
- *Controlling the size and improving the responsiveness of social expenditures.*
- *Off-budget activities: measurement, effectiveness, and control.*
- *Establishing a stable fiscal framework: are policy rules or other commitments to future tax and spending policies credible and useful?*

Deficits and Debt

1.13 Virtually all OECD countries are in deficit on general government account, by amounts of up to 12 per cent of GDP and on average by more than 4 per cent of GDP. This figure is double what it was in 1979, and compares with an average deficit of less than half a percent in the first half of the 1970s. Despite efforts by most governments over the last three or four years to reduce them, budget deficits now represent as much as 20 per cent of gross private savings and more than half of savings after depreciation provisions. There has been growing acceptance that effective fiscal planning requires a conceptual separation of temporary or "cyclical" government borrowing from "structural" elements in the budget deficit (which arise expressly from government policy or need explicit government action to change). This approach does not avoid facing the difficult budget problems but can give an improved framework for fiscal planning.

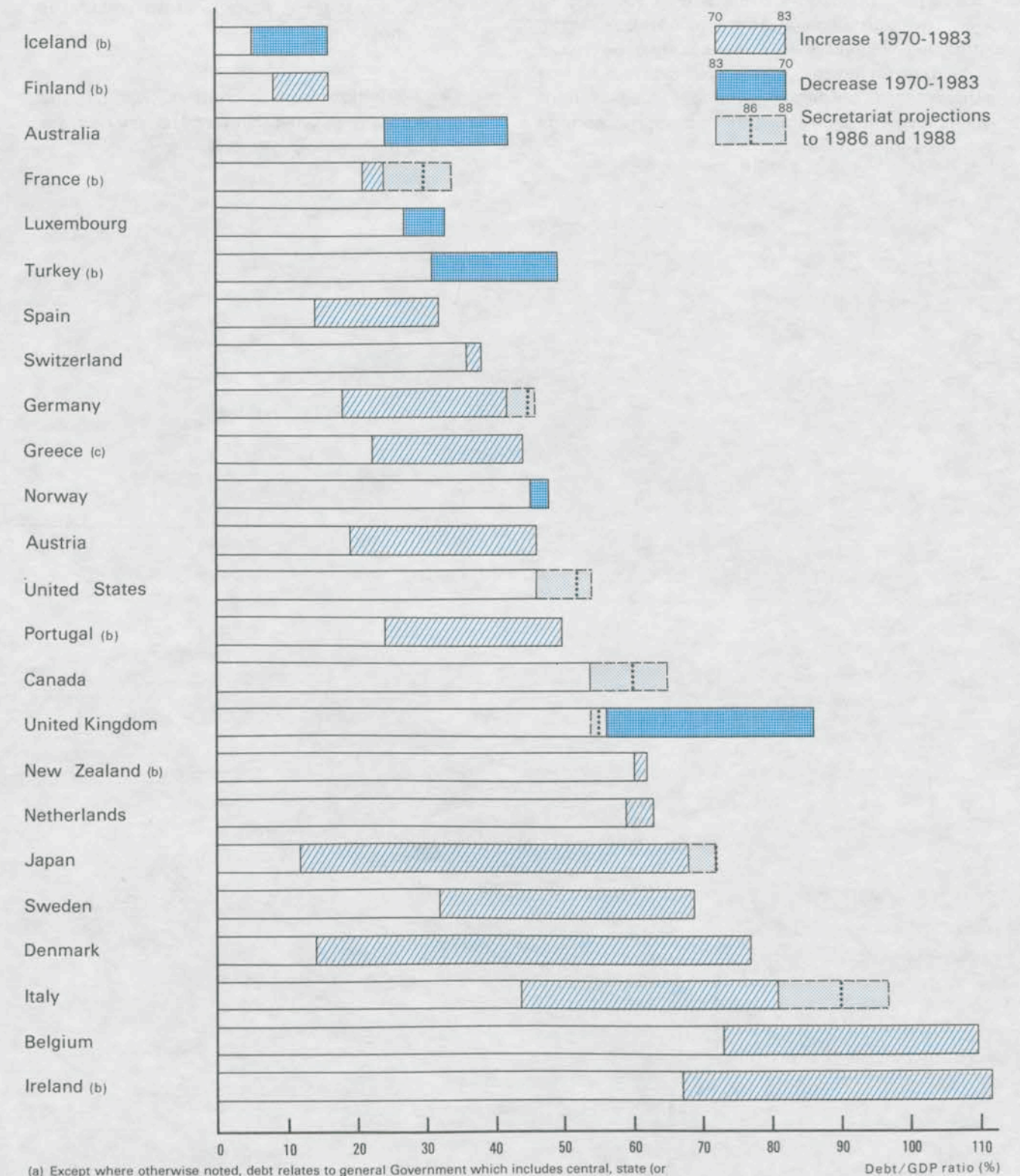
1.14 It is, however, important to note that "built-in stabilizers", though self-correcting in the recovery phase, can add to structural budget deficits nonetheless, by increasing outstanding debt and hence future interest payments. Only if bonds issued to cover cyclical deficits were redeemed — by future budget surpluses — would this be avoided. During the period 1978-84, the collective structural deficit of OECD countries will have been cut from about one-and-a-half per cent of GDP to approximately zero structural balance (despite increasing interest payments); yet the combined debt/GDP ratio will have increased by over 10 percentage points of GDP and is still increasing.

1.15 The appropriate speed of deficit reduction depends not just on the cyclical availability of "excess" private savings, but on the build-up of public debt and how this influences the private sector's willingness to hold government bonds. Persistently increasing government debt/GDP ratios may be a sign of fiscal instability if they go along with increasing amounts of public debt in private portfolios, relative to other assets, and rising interest payments.

1.16 Since country circumstances and priorities differ, there is no generally optimal ratio of debt to GDP; Chart 2 shows actual and projected debt ratios. As well as the "normal" demand for government debt on the part of private financial investors, the role of government as an investor in nationalised industries and public infrastructure must be recognised. Some forms of government expenditure — in infrastructure, research or education, etc. — may yield a rate of return sufficient to cover the interest payments and to repay the loans; or the debt service costs may be seen as a legitimate charge on future generations for the less tangible benefits they will reap from today's investments. Some governments may appropriately choose to run a long-run budget deficit, and perhaps even allow for an increasing public debt/GDP ratio over protracted periods. The phase of historical development is important: during long periods a number of OECD economies have been, appropriately, capital importers, some of the borrowing being reflected in the public sector accounts. Of course, the region as a whole is traditionally, and appropriately, a capital exporter to the developing world.

1.17 *In summary*, debt/GDP ratios have risen faster than is consistent with longer-term stability of public finances, contributing to higher real interest rates and hence to less capital formation. Most OECD governments have adopted or proposed medium-term plans that envisage reduction of structural deficits. Fulfilment of these plans will lead to eventual declines in debt/GDP ratios. All have agreed that macro-economic policies should provide a stable environment for steady non-inflationary growth. In the meantime, recession-induced deficits are large enough to keep debt/GDP ratios rising for most OECD countries. Claims on private savings remain heavy. A double policy challenge thus remains. First, OECD governments should ensure that public and private sector savings are large enough to meet their combined investment requirements and also to permit increased capital exports to the rest of the world. In some cases intent to reduce structural deficits needs to be translated into

CHART 2
GOVERNMENT DEBT-GDP RATIOS IN OECD COUNTRIES: 1970-1983 (a)
(Countries ranked by 1983 ratio)



(a) Except where otherwise noted, debt relates to general Government which includes central, state (or provincial) and local Government sectors and incorporates Social Security funds. Figures for 1983 are Secretariat estimates. The terminal year is 1981 for Iceland, Luxembourg and Switzerland and 1982 for Portugal and Turkey.
(b) Central Government debt.
(c) Public sector debt (including nationalised industries) for the years 1976 and 1982.

action, and in all cases persistence with phased reductions in deficits depends on the creation and maintenance of political will and social consensus, in turn requiring enough internal budget flexibility to meet emerging needs, and to repair new holes in the safety net. Second, since there is likely to be limited fiscal room for several years, governments must find other means of dealing with the medium-term unemployment problem. This second challenge is the main topic of Part 2.

Issues for Discussion

- *Setting medium-term targets for structural budget deficits, and for debt/GDP ratios.*
- *Transition from current budget deficits to the medium-term targets, in a context of high unemployment.*

Part 2

LIVING WITH CHANGE: FLEXIBILITY AND EFFICIENCY
IN THE PRIVATE SECTOR

Structural Change, Investment and Employment

2.1 Structural change in OECD economies is not new. Chart 3 shows how significantly civilian employment in OECD countries has shifted from agriculture and manufacturing to government and other services from 1960 to 1983, and this despite a tendency to protect rural employment. For much of the period these changes helped to produce, and were facilitated by, rapid and widespread growth of output and employment. Looking forward from 1983, the medium-term prospects are less rosy, with almost 33 million now unemployed in the OECD, and an average unemployment rate almost three times as high as a decade previously. Most forecasts show OECD unemployment rates continuing at very high levels for several years, thus making durable job-creation a vital requirement of any medium-term economic strategy.

2.2 What are the policy options? First, there is general agreement that a stable non-inflationary macro-economic framework is essential. Going beyond that, three distinct strategies can usefully be distinguished to expose the issues starkly for argument. It must be realised that actual policies will involve differing mixes of all three, with the chosen mix depending on each country's political and social structure, stage of development and on the pressure of events. The first two strategies place a high value on adaptation in response to change, while the third attaches a higher value to supporting the existing pattern of output and employment. The first, or *market*, strategy relies essentially on the ability of the market system to solve the complex problem of matching workers with jobs, and placing investment where returns are highest. The second, or *interventionist*, strategy involves greater state involvement in setting targets for investment and employment, and in supporting activity in the chosen industries. The third, or *defensive*, strategy attempts to shelter the existing structure of activity and employment from the effects of change. Usually the defensive strategy is intended to provide only temporary

assistance to smooth the path of adjustment, but when new opportunities do not appear, then temporary tends to become indefinite. Most OECD governments rely heavily on the market strategy, and adopt the other strategies when they perceive evidence of market failure, or where the market result creates excessive political or social pressure. What the various approaches mean in practice is best illustrated by contemporary issues: low investment, new technologies, and labour market rigidities.

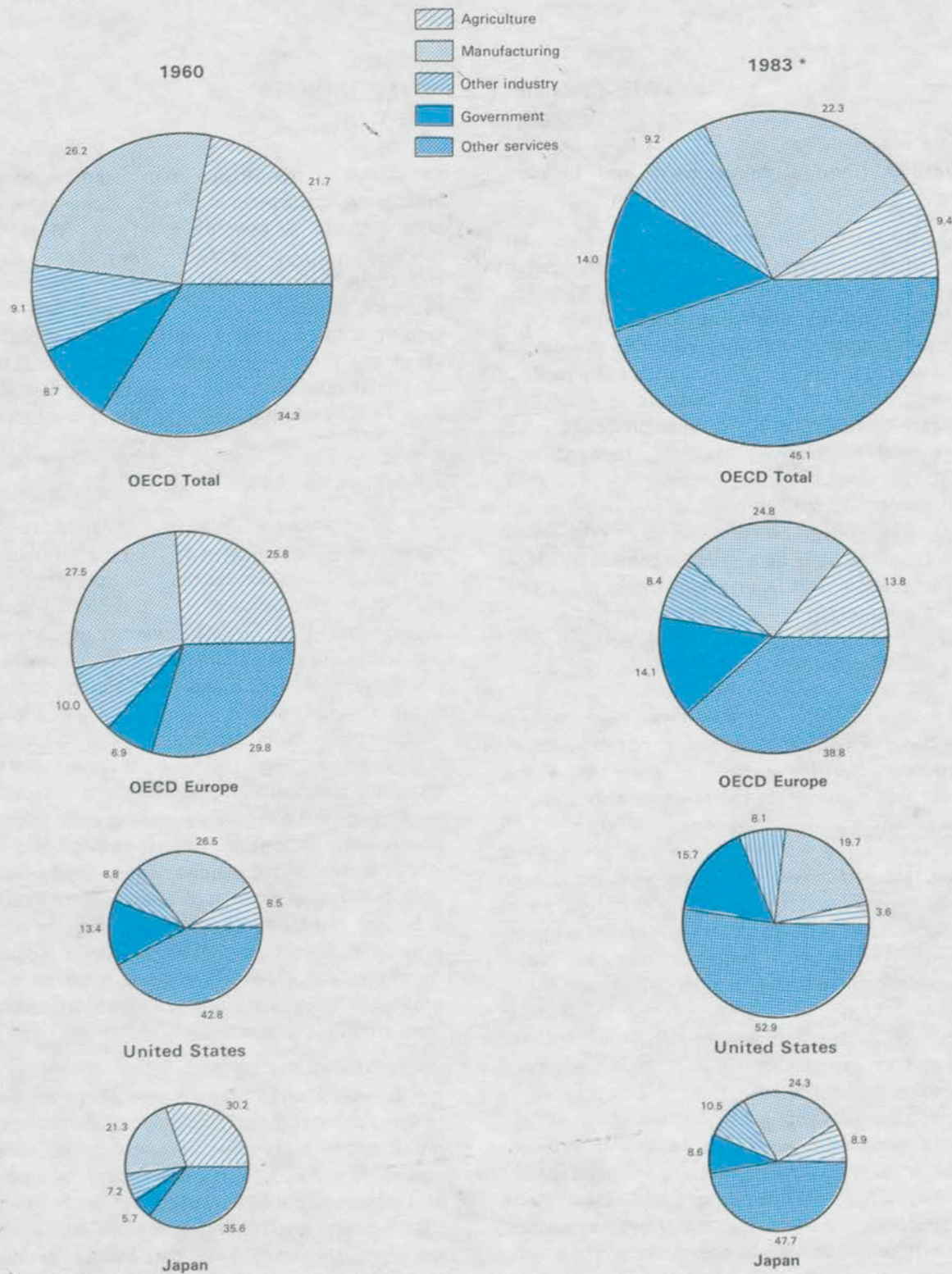
Investment for Jobs

2.3 Especially in Europe, low investment and ageing capital are seen as limiting the supply of new job opportunities. Under the first policy option, the reaction to this perception would be to ensure, as discussed in Part 1, that government current and capital spending was not creating undue pressure on domestic capital markets, and that the tax and financial systems did not artificially limit the ability of enterprises to obtain capital from domestic and foreign savers. High real interest rates would then represent competition for savings at the world level, leading domestic firms and governments to respond accordingly, adopting capital-saving and more labour-intensive techniques where applicable, and thus conserving what was scarce. If the resulting stock of capital were then not large enough to provide sufficient jobs, it would be a signal that domestic labour costs were too great to support profitable new ventures, suggesting inadequate labour market flexibility.

2.4 Under the second policy option, governments would tend to take a view about the amount of investment required to produce new job opportunities, and then provide investment grants, favoured access to markets, loan guarantees, tax incentives and increased public investment in order to achieve the desired result. Under the defensive option, governments would tend to continue or increase subsidies and protection for the existing pattern of employment and economic activity, for example by restricting lay-offs, capital flows and imports.

CHART 3

STRUCTURE OF CIVILIAN EMPLOYMENT 1960-1983 ^{*(1)}



1. Areas of the circles are proportional to total employment.

* Secretariat estimates.

New Technologies

2.5 Current and foreseeable changes in micro-electronic and communications technology have created great uncertainty about future employment. Some have even argued that thinking machines will render human workers obsolete in the same way that horses were replaced by railways and motor vehicles. Most others would argue, with more support from historical evidence, that electronic process control will upgrade the use of labour and also help to make much more efficient use of energy, raw materials and capital equipment, the other scarce factors of production, thus expanding the opportunities for output without reducing employment. Under this view, new technologies are likely to increase flexibility, since production equipment that can be reprogrammed easily to different tasks helps to cut obsolescence and to keep output in line with changing demands.

2.6 Under the first policy option, the reaction to this uncertainty would be to maintain the competitive environment and to ensure that the social framework, insofar as it is affected by government policies, was well-tuned and ready to respond to new opportunities, without policy makers having to try to select the most promising ventures. Attention to safety net policies, and to the timely and flexible provision of public services, education and other infrastructure, is especially important where changes occur quickly, and where the skills and capital required for the new products and processes are very different from those released by the declining sectors.

2.7 Under the second and third policy options, governments would respond in two additional ways. Governments following the interventionist strategy would select and subsidize certain sectors, firms, or products thought likely to provide a starting point for the development and application of promising future technologies. Governments following a defensive strategy would restrict new job-displacing technologies by limiting the entry of foreign products, financially supporting firms using older techniques, or restricting foreign investment.

Labour Market Flexibility

2.8 Unemployment is often decomposed, as are budget deficits, into structural and cyclical components. The level of structural unemployment depends on labour-market institutions, labour force growth, the skill structure of the labour force, and a host of other changing factors.

2.9 Most current estimates of structural unemployment in OECD countries are much higher than they were several years ago, and there is a premium on medium-term policies designed to increase the flexibility of labour markets. All of the policy approaches outlined above include more attention to flexibility and breadth in education, training, retraining and adjustment assistance for displaced workers, and to housing mobility, although the form of the policies differs somewhat under the three approaches.

2.10 When it comes to flexibility of wages, working conditions, job descriptions and tenure, the three policy options are more distinct. The first places a premium on institutions and arrangements for industrial relations and income distribution that provide the most scope for flexibility of wages and employment. The main role for public policy would be to encourage competitive labour markets by restricting monopoly elements. In the second option, governments would take a more active role in advertising job openings, in assuring mobility of housing and portability of pensions, facilitating local and community employment initiatives, and in tri-partite bargaining with business and labour about wages and working conditions. Under the third option, governments would take inherited wage and employment rigidity as largely given and adopt subsidies to existing employment and industry, protection from foreign competition, restrictions on lay-offs, and enforced work-sharing as alternative ways of dealing with the consequences of labour market rigidities.

2.11 Political pressures, and the desire to have specific policies that can be seen to focus directly on the provision of new jobs, have led many OECD governments to follow the third option to an extent that may be reducing the longer term flexibility of their economies. In each case, the reasons are pressing, and there is the prospect of avoiding immediate hardship. The problem is, of course, that resulting damage to the overall flexibility of the economy is not felt until it accumulates over the years.

2.12 Building or recovering flexibility and the social consensus to support it is a long-term investment, with costs that are immediate but with benefits that accrue largely to the credit of future governments. For such investment to be feasible, it is necessary for governments and the social partners to take a long view, to be convinced that the gains exceed the costs, and to agree that both the immediate costs and the longer-term gains will be fairly shared.

2.13 *In summary*, if governments do not start soon to invest more of their political capital in building or rebuilding the flexibility of the economy, the foreseeable pace of technological change will lead to ever-increasing payments for subsidies to investment and employment, transfers to the unemployed and protection for increasingly uncompetitive industries. All of these will put further upward pressure on non-wage labour costs, on government deficits and on interest rates, producing inflation or crowding out the public and private investment spending necessary to build a solid base for longer-term growth. On the other hand, successful attempts to increase flexibility will be reinforcing: For example, increased wage flexibility can lead to a more efficient industrial structure, higher average

wages and lower non-wage labour costs which in turn make it easier to generate more jobs and more flexibility. A stable macro-economic policy environment, with low inflation and predictable tax systems, can help this process by reducing overall uncertainty and thereby making the most effective use of private sector adaptability.

Issues for Discussion

- *Taking advantage of new opportunities: lessons from national experiences in living with change.*
- *Practical means for increasing employment by improving social consensus and labour market flexibility.*

Part 3

NATIONAL POLICIES AND THE INTERNATIONAL FRAMEWORK

The World System of Trade and Finance

3.1 World trade has grown faster than national economies over the past quarter century and financial linkages among countries have developed more rapidly still. The growth of world markets for goods and capital, spurred by advances in transportation and communications, and generally supported by national policies, has encouraged the production of goods where, broadly speaking, costs are least. Financial integration has facilitated the channeling of global savings to where returns are highest. These interdependent trends have permitted and encouraged faster growth of real incomes around the world. Benefits from this open system of international trade and finance occur most clearly in a context of fairly smooth and predictable growth. In these circumstances, everyone gains from trade and, even though there may be disputes and inequity in the process of sharing those gains, there is widespread support for the open system, and for the interdependence it brings.

3.2 These gains from the interdependent system have come under increasing challenge in recent years, reflecting the more turbulent economic environment and protracted recession. Can interdependence contribute to instability? An interdependent world economy, like an electric power grid, can smooth out local disturbances, but can amplify large ones. The world oil shocks of the 1970s remain a vivid reminder of this. Similarly, the accumulation of large stocks of international debt became a potentially powerful transmitter of instability when expectations were unsettled by a major disturbance.

3.3 A second concern has been that growing market integration, and the global diffusion of technologies among regions with very different wage levels, may create sustained pressures on employment and standards of living in OECD economies. A rise in structural unemployment and proliferation of non-competitive sectors may thus appear as the only alternative to continued downward pressure on real wages to preserve "competitive parity" with successive generations of emerging competitors.

3.4 There is an important sense in which these concerns are beside the point. The forces pushing towards increased integration in the world economy are very powerful; resistance will distort but not arrest the process. More importantly, if there is sufficient flexibility within economies, the gains from integration will exceed the costs. It must not be forgotten that developing countries' demand for imports has consistently matched — and indeed run ahead of — their export receipts. This is the counterpart of net capital exports from the OECD to developing countries. The implication is, of course, that the pressures faced by sectors losing competitiveness will be more than counterbalanced by opportunities in export sectors. Provided resources shift, complementarity in trade relations can be maintained in the course of integration. Living standards globally can converge *upwards*, rather than levelling down.

3.5 It is also important to recognise that economic interdependence — even among the industrial countries — falls short of full economic integration. Integration is an uneven process and interdependence is far from uniform. Larger economies continue to perceive their economic futures as primarily determined by domestic policy choices; and there is a good deal of truth to this. Even for smaller economies heavily dependent on trade, an important degree of domestic policy autonomy can exist if there is sufficient economic flexibility. These qualifications do not change the basic facts of large and growing interdependence. In this context, the central issue for the foreseeable future is how to maintain an open international trade and financial framework in an increasingly integrated, multi-polar, though asymmetric, world economy. Two topical examples — international indebtedness and structural adjustment — illustrate the dimensions of this issue.

International Indebtedness

3.6 The rapid accumulation of sovereign debt during the past decade was based in part on expectations about the future which have since

become untenable. A number of developing countries and international banks have thus found themselves in overextended positions. The required adjustments are sufficiently large and long-lasting to pose a continuing threat to the overall stability of trade and financial relations. The strategy guiding international efforts to contain this threat has been to find the right mix of financing and adjustment to preserve and eventually strengthen the open international trade and investment system.

3.7 This strategy has so far worked, but both optimistic and pessimistic scenarios can readily be imagined for the years ahead:

- An *optimistic* scenario would see growing trade between the developed and developing countries in the course of a global recovery in which the level of real interest rates recedes and the pattern of global capital flows becomes more sustainable. In such a scenario, the trading climate would permit expanding opportunities for profitable investment, promoting flows of private capital to the developing world; expanding trade and financial linkages would provide the means for a gradual resolution of existing debt problems.
- A *pessimistic* scenario would see the strains perpetuating; with more inward-looking development policies, increased protection and distorting export subsidies embraced as less painful than alternative domestic adjustments. Such actions in the current environment of high unemployment would provoke retaliation. The end result would be lower global trade in an increasingly distorted pattern, in turn discouraging private investment flows, or making them more dependent on yet further interventions by governments to provide "protected markets" to potential foreign investors. Financial strains would thus be perpetuated with official action needed to preserve the stability of the overall financial system and pressures would mount to find official substitutes for hesitant private flows.

3.8 Which of these outcomes occurs is primarily determined by the cumulated policy choices of national governments. These include the basic macroeconomic policies required to avoid renewed inflation, crowding out of private investment and exchange rate instability. The question is whether there is sufficient political will to promote increasing interdependence and openness on the trade and

investment side, thereby validating financial interdependence, and whether the overall gains of such an approach are perceived as sufficiently great to outweigh short-term costs.

3.9 In any event, developing countries seem bound to experience a period of scarcity of international capital, reflected in relatively high real interest rates, greater creditor selectivity and sharper risk assessment. Commercial capital will remain available even to countries with large debts, provided the borrowers are able, through adjustment policies and efficient resource allocation to meet the interest cost of the debts, and to assure adequate social and political stability. Official resource flows are subject to growing resource constraints and distortions arising from attempts to gain commercial advantage over competitors; officially supported capital flows should meet the difficult test of efficiency of resource use and should respect the multilateral character of the trade and finance system.

Issues for Discussion

Ensuring that the pattern of external finance for indebted countries

- ***promotes positive adjustment, and hence improves resource allocation within both developed and developing countries;***
- ***helps to increase the efficiency of the open world system of trade and finance.***

International Implications of Structural Adjustment Policies

3.10. Structural adjustment provides a second important concrete example of pressures bearing on the open international trade and finance system. Over the last decade, the demands on governments to counter the perceived adverse impacts on domestic firms of adjustment policies implemented in other countries have intensified. The underlying factors which have been at work in this process are the severity of the recession, the pace of technological change and intense international competition.

3.11 At the same time, the inherently greater sensitivity of an integrated world economy to differentials between countries in costs, competitive conditions and market opportunities has altered the international dynamics of structural policies. Government support measures which alter relative cost positions are fast translated into changes in world market share — leading other producing countries to seek to match them. Protectionist measures tend to

spread more rapidly than in the past, as trade diversion quickly shifts the pressure of competitive imports from markets which close towards markets which remain open.

3.12 Indeed, protection is more pervasive than generally assumed. After full implementation of the Tokyo Round, tariff protection will be at its lowest level since the First World War but the number of known restrictive trade agreements on manufactured imports introduced by US, EEC, Japan and Canada has quadrupled since 1975. The product categories currently subject to discriminatory and non-conventional forms of protection comprise at least 15 per cent of world trade in manufactures and a quarter of OECD manufactured consumption.

3.13 The proliferation of offsetting border and non-border measures can undermine world economic growth, increase international frictions and damage the framework for international trade:

- Since over one-third of OECD area investment is geared to serving foreign markets, increased uncertainty regarding the potential introduction of new trade barriers, of duties and subsidies, and of administrative obstacles to the flow of payments, technology and enterprise, dissuades firms from innovating and expanding.
- Such uncertainties also discourage export-oriented investment and generally outward-looking strategies in developing countries, with adverse implications for world-wide economic development.
- Defensive and protectionist policies may result in shifts of adjustment burdens, in particular employment problems, from one country to another. Efforts by governments to counter such shifts can easily lead to a vicious circle of retaliation.
- It is particularly difficult for small economies and for developing countries successfully to offset subsidies and other trade-distorting measures implemented by others, especially those measures that influence competition for third-country markets.

These risks are unlikely to diminish over the present decade.

3.14 The extent to which defensive measures impede world economic development, shift the burden of adjustment, or lead to international

friction depends both on the measures themselves and on the economic environment:

- Measures that are taken unilaterally, outside the framework of internationally agreed rules and consensus, are particularly corrosive.
- The potential for international friction may be greatest when the assisted sectors are those characterised by slow growth in demand and excess capacity at the global level.
- Measures that are credibly temporary in scope impose less threat to the overall system than measures that do not limit the time period over which assistance is provided.

3.15 Given the dangers inherent in competitive subsidisation and retaliation, the central task is to identify more clearly those structural policies which may give rise to harmful international repercussions and to explore options for international co-operation in dealing with them.

Issues for Discussion

Ground rules to avoid policies and practices that distort international trade in the course of providing

- ***support for declining activities;***
- ***protection and subsidies for the high-technology sector.***

Policy Responses

3.16 *In summary*, it can thus be seen in both of the examples treated here — international indebtedness and structural adjustment — that there are two broad policy responses. One is to resist the fundamental trends toward increasing world integration, by aiming for greater domestic or regional self-sufficiency, in the hope that short-term employment benefits or longer-term insulation from foreign disturbances, might compensate for a lower global efficiency of resource use. This may appear feasible from a single-country perspective, but if many countries attempted to implement it, none would find the results acceptable. The other response is to accept a collective responsibility to increase the flexibility and stability of the open system. This approach is not easy politically. If it is to succeed, it requires commitment to maintain a stable macroeconomic environment and action to halt and reverse the current drift towards market-distorting and trade-restricting measures.

NOTES AND REFERENCES

Documents referred to in the notes are listed below

Part 1

Size and Effectiveness

paras. 1.2 to 1.5:

For detailed information on public sector size and composition see "The Role of the Public Sector". For a review of the overall effects of public sector growth, see "Consequences of Public Sector Size and Growth".

paras. 1.6 to 1.10:

Past trends in social expenditure growth and projections until 1990 are outlined in "The Growth of Social Expenditure: Recent Trends and Implications for the 1980s" and its supporting documents.

para. 1.11:

Off-budget activities are discussed in "Off-Budget Expenditure: An Economic and Political Framework" and "Budgeting for Loans and Loan Guarantees"; implications for the budget process and public management are discussed in "The Capacity to Budget - Adaptation of the Budget Process in OECD Countries: A Framework for an Intergovernmental Study".

Chart 1:

Public expenditure includes all general government expenditure, according to the standardised System of National Accounts (SNA). It comprises all capital and current expenditure, including social security, by central, regional, and local governments, but excludes public enterprises. The data are published regularly by the OECD in *National Accounts, Volume II, Detailed Tables*. The 1983 figures are estimates.

Deficits and Debt

paras. 1.13 to 1.14:

"Structural Budget Deficits and Fiscal Policy Responses to the Recession" provides concepts and estimates for structural budget deficits. The latest Economic Policy Committee (EPC) General Assessment [pp. 46-58] provides an analysis of possible structural budget deficit trends up to 1986. OECD Economic Outlook, No. 31, July 1982, pp. 40-43 describes the use of "cyclically adjusted" budget deficits in short-term economic analysis.

paras. 1.15 to 1.16:

For general government debt/GDP ratios in the major seven economies see the latest "Economic Prospects, General Assessment", Table 2.8, p. 56. "Medium-term Financial Strategy: The Co-ordination of Fiscal and Monetary Policies" contains tables, for most OECD central government sectors over the period 1970-82, showing interest payments, internally and externally

held public debt and its relation to private sector financial assets.

For a discussion of the impact of inflation on public sector deficits and government debt/GDP ratios, see pp. 20-23 of "Public Sector Deficits, Problems and Policy Implications" and pp. 52-55 of the latest "Economic Prospects, General Assessment".

Chart 2:

For the United States, Japan, Germany, the United Kingdom, Italy, Canada, Belgium, the Netherlands, Norway, Spain and Sweden, public debt figures refer to end-of-year general government debt held by private and overseas sectors, the central bank and public corporations. They are thus net financial liabilities, exclusive of intra-sectoral borrowings. The sum of central government and local authorities gross debt is used for Australia, Austria, Denmark, Luxembourg, New Zealand and Switzerland. Total public sector debt (i.e. including public corporations) is given for Greece. Central government (state) debt is given for France, Finland, Iceland, Ireland, Portugal and Turkey. Details about the data sources may be obtained upon request from the OECD Secretariat (Economics and Statistics Department).

Part 2

Structural Change, Investment and Employment

para. 2.1:

See *OECD Employment Outlook*, pp. 7-11 and *Economic Outlook*, No. 34.

para. 2.3:

Capital shortage unemployment problems are discussed in "The Present Unemployment Problem" pp. 20 and 35-44.

Economic Outlook, No. 33, pp. 47-49

paras. 2.5 to 2.7:

The analogy with horses is from Leontief, W. "Technological Advance, Economic Growth and the Distribution of Income", *Population and Development Review* 9, No. 3 (September 1983).

OECD work on the links between technological change and employment is in *Micro-Electronics, Robotics and Jobs* and *Assessing the Impacts of Technology on Society*.

Labour Market Flexibility

paras. 2.8 to 2.9:

"Intergovernmental Conference on Employment Growth in the Context of Structural Change - Issues for Discussion".

For a discussion of the cyclical/structural unemployment split, see *OECD Employment Outlook*, pp. 7-8, and *Economic Outlook*, No. 33, pp. 47-49.

paras. 2.10 to 2.13:

For further discussion of the possible effects of labour market rigidity, see *The Challenge of Unemployment*, pp. 45-66. See also pp. 98-108, which discuss how efficiency and equity in the labour market can be reconciled.

para. 2.13:

This is elaborated in *Positive Adjustment Policies - Managing Structural Change*, in particular Part II Chapter B: Industry Policies and Chapter E: Manpower and Social Policies.

Chart 3:

Civilian employment includes all those persons with a job, excluding members of the armed forces. The government sector closely approximates the SNA definition of general government. These figures are published regularly by the OECD in *Labour Force Statistics* and summarised in *Historical Statistics*, which accompanies the July issue of the *OECD Economic Outlook*.

Part 3

The World System of Trade and Finance

paras. 3.1 to 3.5:

See *World Economic Interdependence and the Evolving North-South Relationship and Development Co-operation*, Chapter 2.

paras. 3.4 to 3.5:

See "The International Flow of Technologies"
Short-term macro-economic interdependence is analysed in "International Economic Linkages"

paras. 3.6 to 3.9:

See *External Debt Surveys*, 1982 and 1983, and *Development Co-operation*, Chapter 3

International Implications of Structural Adjustment Policies

para. 3.10:

On the international implications of domestic policies, see Part III of *Positive Adjustment Policies - Managing Structural Change*

paras. 3.10 to 3.15:

See *Government Assistance to Industry: The Positive Adjustment Perspective*

para. 3.15:

On the methods available for assessing the impact of subsidisation, see *Transparency for Positive Adjustment - Identifying and Evaluating Government Intervention*

OECD SOURCE DOCUMENTS

Part 1

1. "The Role of the Public Sector" [CPE/WP1(82)4].
2. "Consequences of Public Sector Size and Growth" [CPE/WP1(83)8].
3. "The Capacity to Budget - Adaptation of the Budget Process in OECD Countries: A Framework for an Intergovernmental Study" [CT/PUMA/514].
4. *The Welfare State in Crisis* (OECD, 1981).
5. "The Growth of Social Expenditure: Overview and Main Issues" [SME/SAIR/SE/83.09].
6. "The Growth of Social Expenditure: Recent Trends and Implications for the 1980s" [SME/SAIR/SE/83.01] and accompanying documents.
7. "Off-Budget Expenditure: An Economic and Political Framework" [CT/PUMA/506].
8. "Budgeting for Loans and Loan Guarantees" [CT/PUMA/523].
9. *Measuring Local Government Needs: The Copenhagen Workshop* (OECD, 1981).
10. "Structural Budget Deficits and Fiscal Policy Responses to the Recession" [CPE/WP1(83)1 and 2].
11. "Economic Prospects, General Assessment" [CPE(83)6].
12. "Public Sector Deficits, Problems and Policy Implications", *OECD Economic Outlook, Occasional Studies*, June 1983.
13. "Medium Term Financial Strategy: the Co-ordination of Fiscal and Monetary Policies", *OECD Economics and Statistics Department, Working Papers*, No. 9, July 1983.

Part 2

1. *Technical Change and Economic Policy* (OECD, 1980).
2. "Intergovernmental Conference on Employment Growth in the Context of Structural Change - Issues for discussion" [SME/SC/83.17].
3. "Industrial Adjustment and Government Support: Report for the Economic Policy Committee" [IND(83)5].
4. *Micro-electronics, Robotics and Jobs* (OECD, 1982).
5. *Industry in Transition* (OECD, 1983).
6. *Assessing the Impacts of Technology on Society* (OECD, 1983).
7. *OECD Employment Outlook* (September 1983).
8. "The United States and Europe: Coping with Change" *The OECD Observer* (May 1982).
9. *The Challenge of Unemployment: A Report to Labour Ministers* (OECD, 1982).
10. "The Present Unemployment Problem" [CPE/WP1(83)6].

Part 3

1. *External Debt of Developing Countries - 1982 Survey* (OECD, 1982).
2. *External Debt of Developing Countries - 1983 Survey* (OECD, 1984).
3. *World Economic Interdependence and the Evolving North-South Relationship* (OECD, 1983).
4. "International Economic Linkages" *OECD Economic Studies No. 1* (OECD, 1983).
5. "The International Flow of Technologies" [SPT(83)22].
6. *Development Co-operation - 1983 Review* (OECD, 1983).
7. *The Internationalisation of Banking: The Policy Issues* (OECD, 1983).

8. "Government Assistance to Industry: The Positive Adjustment Perspective" [CPE(83)11].
9. *Transparency for Positive Adjustment - Identifying and Evaluating Government Intervention* (OECD, 1983).

General

1. *Facing the Future: Mastering the Probable and Managing the Unpredictable* (OECD, 1979).
2. *Statement on Positive Adjustment Policies: Communiqué by the OECD Council at Ministerial Level of 18th May, 1982* [C(82)57(Final)Annex].
3. *Positive Adjustment Policies - Managing Structural Change* (OECD, 1983).
4. "Positive Adjustment Policies: Review of On-Going Work in the Organisation" [CPE(83)12].



CSJR



10 DOWNING STREET

X/17 Redwood

please note

MR. TURNBULL

ck

6/2

The Chief Secretary is in Paris until Wednesday of next week so I have arranged for him to come and talk to the Prime Minister about the attached at 11 a.m. on Friday 17 February.

CR

6 February 1984

1. ~~CR~~ (a) Fine (he can also tell her about his trip to Paris)

X/ (b) Please add JR

2. CF

In addition to these papers pl include the attached OECD report. No other briefing required

AF

BF



Prime Minister ②

Advance warning of Mr
Jenkins' intervention at
Cabinet on capital / current.

AT
6/2

→ CC A10
2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

3 February 1984

Dear Nigel

mf

We are to discuss trends in capital and current public expenditure in Cabinet next week and I would like to put a proposal to you which might be considered at that meeting.

My proposal concerns the need for a longer term examination of the extent and need for capital, maintenance and repair expenditure running across all the major programmes. (I first put this forward during my bilaterals with Peter Rees last autumn, and mentioned it again in my letter of 18 January about the Public Expenditure White Paper which I copied to colleagues.)

The case for such a study is that unless we begin to consider now what action is needed for the cost-effective modernisation, maintenance and replacement of the public services capital stock on a regular and systematic basis, the process of squeezing expenditure on such work is bound to lead to public dissatisfaction and eventually to rushed and wasteful expenditure of a "catching-up" nature.

There is growing evidence of concern on this subject. The House of Lords debate on 18 January showed this. The PSA Advisory Board under Nigel Mobbs has expressed anxiety about the maintenance of the civil estate. There is widespread criticism in the construction industry that we are simply letting public buildings decay.

The NEDO Council meeting last July authorised the Director General to discuss the form of future work on the criteria for public sector investment, in the context of maintaining and improving the quality of the built infrastructure. The NEDO study is now under way, aiming at a report in August, and, with Treasury agreement, an inter-departmental group of officials has been nominated to shadow its work.

The NEDC study is to concentrate on the criteria used to justify and authorise expenditure, and seems unlikely to come up with the answer to what I see as the main question: just what is the state of our built infrastructure? I think we need a study to draw together details of the age and condition of the public stock; to set out current policies and levels of expenditure on repair and maintenance; to attempt

some assessments of future life and needs; and to set out the options in terms of action or inaction (including options for drawing in more private investment where this is feasible), with the emphasis on their cost-effectiveness and value-for-money. If there prove to be implications for the way options are presented each year in PESC, I think we should ask for them to be drawn out.

My proposal is that the inter-departmental group mentioned above, in addition to keeping an eye on the NEDO study, should be given terms of reference which require it to "examine the state of the publicly owned civil capital stock of housing and roads, water and sewerage, hospitals and education buildings, the Government civil estate and the capital stock of universities, to evaluate such evidence as is readily available of its present and likely future condition and fitness for its purposes and its needs for maintenance, repair and replacement; to consider means of assessing the position and keeping it under review as a basis for cost-effective decisions on public expenditure and investment; and to make recommendations". These terms would exclude the Defence estate and the nationalised industries, mainly in order to keep the study manageable.

I see cost-effectiveness, and better financial management and planning of spending and of assets as the key concepts. In applying them, I hope we can get behind the economists' concepts of capital and current spending, and the rather stale arguments they generate, to the real state of affairs. This focus should prevent us from treating the study just as potential cover for a variety of PESC bids, or simply as an exercise in promoting the construction industry. I see it as giving us a firm basis for a considered, realistic judgement about what stock of assets we wish to see five or ten years hence; and for selecting a pattern of spending that will get us there. We may well find areas in which provision for replacement, repair and maintenance is adequate, or even more than adequate; as well as areas in which it appears to be falling short. I would be very surprised if we did not find areas in which spending could be better directed.

I am convinced that such a study is now urgently needed, and I hope you and colleagues will agree to it. I very much agree with the comment Peter Rees makes in his letter of 30 January to Arthur Cockfield that the need for the study is a practical one, and that it can only be done by assembling the evidence programme by programme. I think we do also however need to draw the evidence together in order to give ourselves a collective overview of the condition of the capital stock and the need for repair, maintenance and modernisation. The inter-departmental group mentioned above could take this study on board, but in view of the importance of the subject and the PESC implications I would propose that Treasury should take over the chair and that the group should be asked for an initial report by May or June in time for it to be taken into account in the next PESC round.

/ I am sending a copy of this letter to the Prime Minister
and Cabinet colleagues.

You are
Pat

PATRICK JENKIN

- MR. BUTLER
- MR. COLES
- MR. TURNBULL ✓
- MR. FLESHER
- MR. BARCLAY
- MR. ALISON
- MR. SHERBOURNE

I have arranged the following meeting with the Prime Minister:-

Subject *P.E.R. Territorial Programmes*
 Date *Friday 17 February*
 Time *11.00*
 Venue *Nobis*
 Person/people invited *Choy Lee*

Added Ministerial attendance

Briefing

- a) I have commissioned briefing from
- ✓ b) Could you arrange briefing if necessary

Caroline Ryder

AT o/r

MR STIBBARD

- cc Miss O'Mara)
- Mr Folger)
- Mr Hart) HMT
- Mr Duff)
- Mrs Todd)
- Mr Morrison
- Mr Tansley
- Mr Turnbull No 10 ✓

RATIOS OF EXPENDITURE TO GDP

In pt 25.

The reconciliation which Howard Morrison provided to Andrew Turnbull in November was based on last year's return to OECD. We decided that it would be most helpful if the new reconciliation you requested could be based on this year's return, just completed, updated to be consistent with January Financial Statistics.

This new reconciliation between the Public Expenditure and OECD total outlays as percentages of GDP is attached. We have reconciled the whole period 1973 - 1982 so that we can be confident that the divergent movements over the whole period can be explained.

The most noticeable difference, as you pointed out, is that the 1975 peak for public expenditure is higher than the 1981 peak but for OECD total outlays the reverse is true. This, as you can see, is mainly due to the exclusion of net lending from the OECD figures and the inclusion of debt write-offs.

The use of a slightly different definition of GDP by OECD is not a significant factor in the comparisons: it increases the OECD percentage by roughly 0.1% in each year. Much more important is the treatment of sick pay and unfunded pension schemes. These are effectively double counted in OECD statistics: OECD include sick pay and unfunded pensions in wages and salaries; they then impute a payment from employees to a notional fund and finally score the sick pay and pensions again as payments from this "fund".

The next OECD publication will contain estimates consistent with Blue Book rather than January Financial Statistics: we cannot avoid this if the UK contribution is to be internally consistent. This means that the total outlays will be a marginally greater percentage of GDP for the period 1980 - 1982 than shown on the attached sheet.

Howard Morrison

Pr R G WARD

2 February 1984

RECONCILIATION: PUBLIC EXPENDITURE v OECD TOTAL OUTLAY AS % GDP

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Public expenditure as % of GDP (Fin year) (November 1983 Economic Trends)	40.9	45.8	45.8	43.9	39.8	40.7	40.3	42.6	44.2	43.4
Revisions to GDP								- 0.1	- 0.1	- 0.2
Adjustment to gross debt interest	+ 3.3	+ 3.5	+ 3.2	+ 3.3	+ 3.1	+ 3.1	+ 3.0	+ 3.1	+ 3.2	+ 3.0
Change from Fin Year to Cal Year	- 1.5	- 1.3	+ 0.6	+ 0.6	+ 0.4	- 0.3	- 0.1	- 0.4	- 0.4	- 0.3
Other adjustments and revisions	- 1.1	- 1.1	- 1.0	- 1.3	- 0.6	- 0.3	+ 0.6	+ 0.5	- 0.6	+ 0.7
General Government current, capital expenditure and net lending as % of GDP (Cal Year) (January 1984 Financial Stats)	41.6	46.9	48.6	46.5	42.7	43.2	43.8	45.7	46.3	46.6
- net lending	- 2.1	- 2.7	- 3.6	- 1.9	- 0.2	- 1.0	- 1.7	- 1.5	- 1.0	- 1.0
+ OECD pensions/sick pay adjustments	+ 1.1	+ 1.1	+ 1.3	+ 1.3	+ 1.3	+ 1.2	+ 1.2	+ 1.2	+ 1.4	+ 1.4
+ debt write off	+ 0.9	-	+ 0.2	-	+ 0.2	-	-	-	+ 1.4	+ 0.4
+ other	- 0.5	- 0.3	+ 0.1	- 0.1	- 0.2	- 0.1	- 0.1	-	- 0.2	- 0.1
OECD total outlays of general government as % of GDP (consistent with January 1984 Fin Statistics)	41.0	45.0	46.6	45.8	43.8	43.3	43.2	45.4	47.9	47.3

Econ Pol: Public Expend. pt. 26

3 FEB 1984



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70 WHITEHALL, LONDON SW1A 2AS

Enquiries : 01-233 8412

Direct line : 01-233

2 February 1984

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment

Dear Secretary of State,

*DR
2/2*

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

I have followed with interest the exchange of letters culminating in Peter Rees's response to your letter of 25 January and I have been genuinely impressed by your call for, "a thorough, comprehensive and constructive review of the programme".

I have also read what has been said about methods of review. A genuine willingness to tackle the difficult questions among those who have a good knowledge of the programme is clearly wholly to be welcomed. But I am bound to say that my experience with Group working is that it rarely produces the kind of radical questioning that is needed to make substantial progress in a short time. For one thing, such exercises are often "top down" and paper based. They can seek consensus at the price of fudging hard choices and ruling out imaginative alternatives.

I doubt if you want a paper-based cosy exercise. I hope, therefore, that you will agree to do the work as a scrutiny with one man clearly responsible for the report - though he would need to stay in close touch with, and listen to, David Edmonds and his Group. And he may well need the support of a team. I understand Peter Rees is prepared to offer someone good for this key job. For my own part, I would naturally be available to advise you and would be keen to talk to the team during their work. I would also propose to ask Ian Beesley, the executive head of the Efficiency Unit, to give "staff officer" support suitable to a major scrutiny of this scope.

I hope you will find this helpful. I am copying it to the Prime Minister, Peter Rees and Sir Robert Armstrong.

*Yours sincerely
Ian Beesley*

ib.

ROBIN IBBS

(Approved by Sir Robin Ibbs and signed in his absence.)

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Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 LONDON
 SW1P 3EB

1 February 1984

Rees Secretary of State,

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

Thank you for your letter of 25th January. I welcome the large measure of agreement between us on the need for a radical review of the Urban Programme in time for it to inform the discussions on PES '84.

Given that you have already put work in hand under David Edmonds, I would not wish to press my original proposal for a Treasury-chaired steering committee. I am very content to fall in with your suggestion that representatives from the Treasury the Efficiency Unit and the No 10 Policy Unit should join the working group.

I am glad that you agree that the Treasury should provide a good man to work full-time on the review. It will be important that he should be able to get about, ask whatever questions he judges to be necessary and put forward his frank appraisal and conclusions. As you put it, the subject requires concentrated and informed effort - this is just what such a man, backed by the authority of the Edmonds group, should be able to achieve. This is, in my view, the essence of the successful scrutiny technique.

I think we now have a good basis on which officials can get to work. I am asking mine to get in touch with yours.

Copies of this letter go to the Prime Minister, Sir Robert Armstrong, Sir Robin Ibbs and John Redwood.

yours sincerely

PR

for PETER REES
 (approved by the Chief Secretary
 & signed in his absence).

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10 DOWNING STREET

From the Private Secretary

1 February 1984

Publication of 1984 Public Expenditure White Paper

You wrote to David Barclay on 20 January suggesting publication on Thursday 16 February with the announcement taking the form of a Written Answer. Since then it has been agreed that there should be a debate on the White Paper, with the Chief Secretary leading for the Government. The Prime Minister is content with these proposals.

I am copying this letter to David Heyhoe (Lord Privy Seal's Office).

Andrew Turnbull

John Gieve, Esq.,
Chief Secretary's Office.

CONFIDENTIAL

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Prime Minister 2
 In addition to seeking your approval of these papers, the Chancellor would like to settle timing of distribution.

AT 31/1

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

31 January 1984

Andrew Turnbull Esq
 10 Downing Street
 LONDON SW1

Bubble Chamber
 Pt 26

Dear Andrew,

CABINET: 9 FEBRUARY

The Prime Minister and the Chancellor have agreed that it would make sense to consider in Cabinet on 9 February not only the overall economic position in the run up to the Budget, but also the issues of Capital and Current Expenditure, and Public Expenditure in the Longer Term. That means that we have three papers to circulate, and the Chancellor has had it very much in mind that the Prime Minister would wish to see, before her departure for Budapest, the three drafts. All three will therefore reach you today, so that the Prime Minister is in a position to discuss them, if she should so wish, at her meeting with the Chancellor tomorrow.

- I enclose with this letter copies of the main Economic Strategy paper, and of the Long Term Public Expenditure paper.

The former is on similar lines to Sir Geoffrey Howe's paper of exactly a year ago, which was the basis of a satisfactory discussion in the comparable Cabinet. You will however note one significant innovation (at paras 12 and 13). Because it seems appropriate in the first MTFS of the new Parliament to set out a path for (the monetary aggregates and) the PSBR which covers a full five years, it is necessary to show public expenditure figures going beyond the ambit of the recent Survey and the forthcoming Public Expenditure White Paper. Although the figures for the extra two years can only be assumptions, the Chancellor thinks it right to seek collective approval for them.

The Long Term Public Expenditure paper is, as you will see, prepared on a very different basis from the 1982 exercise, and should not carry the same risks as that exercise did. There could indeed be criticism of the absence of Departmental programme figures in a Green Paper along the lines proposed, but the Chancellor believes that it is necessary to publish a discussion document, and that it would be better to face such criticism than to provide a detailed breakdown of expenditure forecasts, along 1982 lines. He would be happy to discuss this with the Prime Minister tomorrow.

The Capital/Current paper is being forwarded separately to you from the Chief Secretary's office this afternoon.

The Prime Minister may wish to discuss tomorrow the timing for the circulation of papers to Cabinet. There seems no reason why the Capital/Current paper should not go round on Thursday, with the Long Term Public Expenditure paper following on Friday. But it would be in line with the recent precedents if the Economic Strategy paper was not circulated until next week.

Yours ever,
 J O KERR
 Principal Private Secretary

RAFT CABINET PAPER

ECONOMIC STRATEGY

Memorandum by the Chancellor of the Exchequer

The background to the Budget, which will set the tone for the remainder of this Parliament, is one of steady growth in output and continuing success on inflation. My aim will be to build on this, and on the progress made in my predecessor's Budgets.

Economic prospects

2. The recovery began in early 1981, ahead of the rest of the industrialised world, mainly as the result of falling inflation and lower interest rates. A year ago the Treasury forecast was of growth in output of some 2 per cent in 1983. Most outside forecasters saw this as optimistic. In fact growth has been around 3 per cent; while inflation has fallen more than expected, averaging 4½ per cent in 1983, the best performance since 1967. Numbers in work have been growing again for the first time since the recession began, with total employment, job vacancies, and overtime all up, and short time working at its lowest level for 4 years.
3. The prospects for the year ahead are also encouraging. The latest forecast suggests that output will grow by a further 3 per cent this year, and that inflation - after rising to about 5½ per cent in the early summer - will be down again to around 4½ per cent by the end of the year. CBI surveys and the CSO leading indicators confirm expectations of a continuing increase in activity, reinforcing the better prospect for jobs.
4. There remains 2 major external worries. First, the size of the US budget deficit continues to exert upward pressure on world interest rates, thus exacerbating the international debt problem, and it seems clear that adequate remedial action has been postponed until after the Presidential Election. Secondly, although the risk of a sharp fall in oil prices has receded a little, it has not disappeared: and such a fall, though in the long term helpful to world economic activity, would be distinctly unhelpful to our balance of payments and tax revenues in the coming year.
5. There is also a domestic risk. With company profits and job prospects improved, wage settlements could begin to creep up again, damaging competitiveness in foreign and domestic markets. We need to do all we can to ensure that this does not happen.

Something needed here on unemployment which will be in Minister's minds after Thursday's figures
AT

6. Provided it does not, the change already apparent in the pattern of our recovery should continue. Initially the recovery arose principally from an end to de-stocking, and rising domestic consumption. This year we expect continuing growth in consumer spending, higher industrial investment, especially in manufacturing, and a further increase in housing investment. But a greater contribution to recovery should come from overseas demand. Export growth of some 5 per cent this year should help to ensure a continuing surplus on the balance of payments, and the export recovery is already showing in recent trade figures.

7. Annex 1 sets out some of the key figures. Those for this year are based on early forecasts; a further and firmer forecast will be published as usual at Budget time.

Economic Strategy: The MTFs

8. We have shown that it is possible to achieve falling inflation and steady growth, without resort to the fiscal boost which simply fuelled inflation in the past. Getting inflation down was indeed an essential precondition for durable recovery. In the world at large our current performance is seen as demonstrating the success of firm financial policies, and the importance of cutting back on borrowing. I am convinced that we must hold to the strategy. It is now bringing results, and to change it would risk throwing away all that has been achieved.

9. The present Medium Term Financial Strategy, set out in last year's Red Book, extends only to 1985-86. I believe that we should this year publish projections covering the remainder of this Parliament. The benefits, for expectations and market confidence, of setting out a clear medium term path, providing an assurance of a stable monetary and financial framework, need no repetition.

10. Lower inflation, both as a desirable end in itself, and as a source of higher growth and more jobs, must remain our objective. I do not underestimate what has already been achieved, but even 5 per cent inflation would have seemed worryingly high in the 1950s and 1960s, and is still well above the rates prevailing among our main competitors, the Americans, Germans and Japanese. So fiscal and monetary policy must be designed to achieve a continuing gradual decline in inflation through this Parliament, with price stability as our ultimate objective.

11. This means that monetary growth has to be brought down, and preferably without the enforced recourse to higher interest rates which has been a distinct and growing possibility in recent months. So we must aim for lower Government borrowing. The PSBR as a share of GDP came down from 5½ per cent in 1978-79 to 3½ per cent in 1981-82, but we have since registered no further downward progress. I believe that the MTFs path must show a significant further fall. to what?

12. In successive MTFs we have shown a path for the PSBR deriving from assumptions about future revenue and expenditure. The expenditure figures have been in line with those in the most recent Public Expenditure White Paper. For a 5 year MTF, we would this year have to show expenditure figures going 2 years beyond those covered in the 1983 survey and hence in the forthcoming White Paper. I believe that the assumption at this stage should be that expenditure is held constant in real terms at the level for 1986-87 which resulted from this year's Survey: the different status of the additional 2 years' figures would of course be signalled in the text; and final decisions on the 1987-88 and 1988-89 figures will of course remain to be taken in subsequent surveys.

13. On this basis, I seek colleagues agreement to the principle of rolling-forward the MTF for 5 years, and to using for the final 2 years the assumption of rolling-forward the 1986-87 public expenditure figure constant in real terms.

Borrowing: 1983-84 and 1984-85

14. The published autumn forecast of the outturn 1983-84 PSBR was £10 billion: £1.8 billion above the target set by my predecessor. But for the measures we took in July to rein back spending, the increase would have been larger.

15. As the difference between two very substantial figures (revenue and expenditure totals) the outturn PSBR is of course particularly hard to forecast accurately. With more help from Departments, I hope our performance this year will be better than last year's. But I can at present say no more than that the latest expectation is still of an outturn of around £10 billion.

16. It will be important for market confidence, and the credibility of our policy generally, that this year's overshoot should be seen not to carry forward into next year. We need, as a minimum, to be seen to be getting back to the path for borrowing set out in last year's MTF, where a PSBR of £8 billion was envisaged for 1984-85.

17. There are in fact powerful arguments for aiming for a lower figure. We are at the stage of the cycle when output rises above the long term trend. We also face the possibility of a gradual decline in North Sea oil revenues after next year. And, in judging the appropriate 1984-85 PSBR, we have to take into account sizeable privatisation plans of some £2 billion a year. While asset sales are rightly treated as diminishing public expenditure, and

hence the PSBR, they produce less downward impact on interest rates; and the pressures on the financial markets need to be taken into account in judging the appropriate level for the PSBR.

18. For all these reasons, I am clear that it would be wrong to provide for a PSBR next year higher than the £8 billion envisaged for 1984-85 at the time of last year's Budget; and it may well be prudent, in terms of market confidence and hence interest rates, to aim for a slightly lower figure.

Fiscal options

19. I warned in the autumn that I foresaw no room this year for tax reductions over and above broad indexation, and the autumn forecast in fact implied a small tax increase, on conventional assumptions.

20. There has since been a welcome improvement in the fiscal prospect for 1984-85. Increases in oil production, and a higher forecast sterling oil price, now lead to an expectation of higher oil revenues. The risk of my having to put taxes up in March now seems slight, and, unless circumstances change significantly in the next 6 weeks, my intention will be to keep taxes overall broadly unchanged in real terms next year, after providing for indexation (the effects of which are illustrated in Annex 2).

21. The prospect is for real tax reductions in 1985-86, but it would be rash to bring them forward to the coming year on any significant scale, given the obvious uncertainties, and the importance of being seen to get borrowing back under firm control. It may nevertheless be right to consider this year measures with costs falling in 1985-86.

22. A broadly neutral Budget does not of course necessarily preclude changes in particular taxes, or some shift in the balance between those paid by individuals and by companies. (Annex 3 shows how taxes have moved over recent years.) Striking the right balance is never easy, though in economic terms the importance of the choice can be exaggerated, since over a period of years the consequences for output, inflation, and employment are very similar.

Summary and Conclusion

23. The recovery has been faster than we expected; and is set to continue. It shows the value of sound financial policies consistently applied. We need to keep strictly to our public spending plans, and keep borrowing moving down in support of firm monetary targets. That is the right way to keep inflation low, and sustain growth, thus further improving the prospects for jobs. It is also the only way to the tax reductions in later years which we all wish to see, and which are necessary to improve the performance of the economy in the longer term.

24. I accordingly:

- a. seek colleagues' agreement to the rolling-forward of the MTFs up to 1988-89 (with an assumption of public expenditure remaining constant in real terms after 1986-87 (paragraph 13);
- b. seek colleagues' views on the appropriate level of the PSBR for 1984-85 (paragraph 18), and the appropriate balance between the different taxes in a broadly neutral 1984 Budget (paragraph 22).

Selected Economic Indicators

	1979	1980	1981	1982	1983	1984 ⁽¹⁾
World GDP, volume (per cent change)	3	1	2	0	2½	4
UK GDP, volume (per cent change)	2½	-2½	-1½	2	3	3
Domestic demand, volume (including stockbuilding) (per cent change)	3½	-3½	-1½	3	4½	3-4
Retail prices Q4 (per cent change)	17½	15½	12	6	5	4-5
Interest rates (average 3-month interbank)	13½	16½	14	12½	10	9½ ⁽²⁾
Current balance (£ billion)	-½	3	6½	5½	2	1-2
Unemployment (UK per cent narrow definition)	5	6½	10	11½	12½	12½ ⁽³⁾

Tax and Public Expenditure as % of GDP

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Tax and NIC	34	35½	37	39½	39½	39	-(4)
Public Expenditure ⁽⁵⁾	40½	40½	42½	44	43½	(43) ⁽⁶⁾	(42) ⁽⁶⁾
PSBR	5½	5	5½	3½	3½	3½	-(4)

(1) Provisional pre-Budget figures.

(2) End-January.

(3) Not a forecast. Figures based on assumptions in PEWP.

(4) Depending on decisions to be made.

(5) Including debt interest. PEWP figures.

(6) Confidential until publication of the Public Expenditure White Paper.

TAXATION: Effects of Indexation**DIRECT TAXES**

The Retail Price Index increased in the year to December 1983 by 5.3 per cent. With indexation by this amount and statutory rounding, the figures for the main allowances and other thresholds would be:-

<u>Personal Allowances</u>	<u>1983-84</u> £	<u>1984-85</u> £
Single and wife's earned income allowance	1785	1885
Married allowance	2795	2945
<u>Bands eg</u>		
30% rate	0-14600	0-15400
60% rate	over 36000	over 38100
Investment Income Surcharge threshold	7100	7500

The total revenue costs of indexation of income tax (reflected in the forecast) are £875m in 1984-85, £1130m in a full year at forecast 1984-85 prices and incomes

INDIRECT TAXES

Excise duties: increases based on 5.3 per cent revalorisation with rounded price changes including VAT effects:

	<u>Typical price change</u>	<u>Revenue (a)</u> <u>(84-85 prices)</u> £m	<u>RPI impact</u> <u>effect</u> %
Beer	1 pence/pint	95	0.1
Wine	5 pence/75 cl light wine	25	neg
Spirits	28 pence/bottle	28	0.05
Tobacco	3½ pence/20KS	115	0.15
Petrol	4½ pence/gallon	225	0.1
Derv	4 pence/gallon	50	nil
VED	£5/car	90	0.05
Increased revenue (reflected in forecast)		<u>628</u>	<u>0.4 (b)</u>

(a) First and full year revenue effects are largely identical.

(b) RPI effects do not sum because of rounding.

ADY RECKONER: Illustrative Tax Changes

£ million at forecast 1984-85
income levels

Direct Revenue Effect

	<u>1984-85</u>	<u>Full Year</u>	
INCOME TAX			
<u>Allowances and Thresholds</u>			
1% above or below indexation on allowances and thresholds	162	201	
1% above or below indexation on allowances only	145	177	
<u>Rates</u>			
Change basic rate by 1p	950	1025	
<u>Investment Income Surcharge</u>			
Change threshold by £500	1	18	
CORPORATION TAX			
Change main rate by 1 percentage point	100	170	
Change small companies' rate by 1 percentage point	10	18	
OTHER TAXES			
	<u>First year</u>	<u>Full Year</u>	<u>RPI</u>
	<u>cost/yield</u>		
VAT: 1 per cent change	550	740	0.5
NIS: 1 per cent change from August	450	850	

(Assuming recovery from public sector)

EXCISE DUTIES

The costs and effects of specimen changes in alcohol, tobacco and petrol etc are on the previous page.

BACKGROUND FACTSTax burden

1. Since the Government came to power total taxation as a proportion of GDP at market prices has risen by over 5 percentage points reaching a peak in 1981-82, since when it has declined slightly. The figures are as follows:

Table 1

		Total taxation* as a % of GDP (market prices)
		1978-79
		34.1
		1979-80
		35.4
		1980-81
		36.8
		1981-82
		39.7
		1982-83
		39.6
		1983-84 (estimate)
		38.8
Confidential		1984-85 (forecast**)
		38.9

ie. no progress after an improvement - 1982-84.

* Including National Insurance Contributions and local authority rates

** Makes the usual conventional assumptions that the income tax thresholds and allowances and the specific duties are indexed and that the PSBR is as indicated in the 1983 MTFs.

Personal taxation

2. Despite reductions in income tax, total personal taxes (direct and indirect) are some £10bn higher than they would be under the 1978-79 tax regime (suitably indexed). For income tax and national insurance the following table gives an idea of how the proportion of gross pay they represent has risen, particularly for the low paid:-

Table 2

Income tax and National Insurance Contributions (NICs)
as a percentage of gross earnings

	<u>Married*</u>		
	$\frac{1}{2}$ average earnings	Average earnings	2 average earnings
1978-79	16.4	28.0	31.6
1981-82	21.1	29.4	32.4
1982-83	21.1	29.9	32.4
1983-84 (forecast)	20.2	29.6	31.7
1984-85 (assuming indexation)	20.4	29.7	31.8

(* Wife not working: the couple are assumed to have no children, to avoid distortion of the figures from abolition of child tax allowances.)

2. These figures reflect the rise in the employees' NIC rate from 6½ per cent to 9 per cent. So far as income tax is concerned, personal allowances have increased 6 per cent in real terms since 1978-79 and just about kept pace with earnings. The basic rate is down from 33p to 30p, but the 25p reduced rate band has been abolished.

4. As the table shows, indexation of allowances in the Budget would lead to a very slight rise in the proportion of incomes taken in tax and NIC. This is because earnings are forecast to rise by 6½ per cent, slightly more than the indexation percentage (5.3 per cent).

Company sector

5. Real rates of return have been falling since the early 1960s:

Table 4

Net pre-tax real rates of return

	Industrial and commercial companies excluding North Sea	Manufacturing companies
1960	13.5	13.5
1965	11.0	9.8
1970	8.6	7.6
1975	4.5	3.0
1979	5.7	4.1
1980	4.4	3.8
1981	4.0	3.5
1982	4.3	3.6
1983 (estimate)	6.4	na

Last year saw a strong recovery in company profits (reflected in the figures above) though the rate of return remains below the level seen in 1978 (7.5 per cent). (Figures for manufacturing alone are not yet available.)

During the last Parliament total taxes paid by businesses (outside the North Sea) fell slightly as a percentage of GDP. But within this total NIS and corporation tax fell while business rates rose, as the following table shows:

Table 4

Taxes paid by businesses £bn (excl North Sea)
(figures in brackets are % of GDP)

	CT	Self-employed income tax	NIS	NIC	Rates	Others ⁽¹⁾	Total
1978-79	3.9 (2.3)	1.2 (0.7)	1.3 (0.8)	4.0 (2.3)	2.5 (1.5)	2.3 (1.3)	15.2 (8.9)
1983-84	5.1 (1.7)	2.3 (0.7)	0.9 (0.3)	6.9 (2.3)	5.5 (1.8)	4.4 (1.4)	25.1 (8.3)

(1) Petrol and derv duty, VED, capital taxes, etc.



Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

31 January 1984

Dear Andrew

I attach a draft approved by the Chief Secretary of the Paper he is to put to Cabinet on 9 February on the balance between capital and current expenditure. Subject to any comments the Prime Minister may have, he proposes to circulate this to Cabinet on Thursday.

Yours sincerely

J. Gieve

JOHN GIEVE
Private Secretary

DRAFT CABINET PAPER

CAPITAL AND CURRENT EXPENDITURE

Paper by the Chief Secretary to the Treasury

Background

On 10 November 1983 I was invited by the Cabinet "to give thought to how more satisfactory information on the split between capital and current expenditure could be made available, and to circulate proposals at an early stage of the 1984 survey". It was subsequently agreed on 12 January that Cabinet should have a paper "about the trend over time in the distribution of public expenditure between current and capital expenditure" for its early February discussion of the economic situation and prospect.

2. It has been alleged that public sector capital spending has declined, so producing an imbalance between capital and current expenditure.
3. This paper considers in turn;
 - (i) the presentation of the facts on public sector capital spending.
 - (ii) the case for any particular level of public sector capital spending or relative proportions of capital and current expenditure.

Presentation

4. Successive Public Expenditure White Papers have shown a decline in the proportion of capital within the public expenditure planning total. A detailed table 1.9 on this same basis will again be included in next week's 1984 White Paper. It is shown at annex A. The aggregate figures show:

RESTRICTED

	1978-79	1979-80	1980-81	1981-82	1982-83	<u>£ billion</u>	
						1983-84 Estimated outturn	1984-85 Plans
Cash	9.1	10.2	11.1	10.8	10.0	10.4	10.0
1982-83 cost terms	14.9	14.2	13.0	11.6	10.0	9.9	9.4

5. Over the period 1978-79 to 1984-85 this aggregate suggests a fall of nearly 40% in cost terms.

6. The public expenditure planning total, of which these figures are a part, is an aggregate of individual control totals. But it does not measure the economic and social significance of public sector activity, and is a poor guide to public sector spending on capital goods and the construction industries. The Chancellor told the House on 24 November that it was hoped to improve the clarity of the presentation of this aspect in the forthcoming White Paper.

7. The better indicator for this purpose is gross spending by the whole of the public sector on new capital goods.

8. The planning total figures understate this in three ways:

- a. figures of capital formation are shown net of asset sales; this does not measure new work.
- b. by international convention, virtually all defence expenditure is classified as current not capital. This obscures the real nature of much defence spending,
and its impact on the equipment and construction industries.
- c. external financing limits rather than capital expenditure are scored for the nationalised industries and some other public corporations.

9. Colleagues will now have seen that the new White Paper will also include a new table 1.13 on a more comprehensive basis. The full table is shown in annex B; annex C shows the adjustments and details the reasons for them.

10. The summary statistics on the new basis show:

	<u>£ billion</u>						
	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84 Estimated outturn	1984-85 Plans
<u>Capital Public spending on goods and services</u>							
Cash	11.8	14.2	16.5	17.3	18.7	20.3	21.1
1982-83 cost terms	19.3	19.8	19.3	18.5	18.7	19.4	19.1
<u>Public capital spending on goods and services plus capital grants to private sector:</u>							
Cash	13.4	15.8	18.4	19.4	21.4	23.4	23.9
1982-83 cost terms	21.8	22.0	21.6	20.7	21.4	22.2	21.7

11. The contrast with the planning total presentation is striking. Whether looking at spending on goods and services alone, or including capital grants to the private sector, the picture is of virtually no change in cost terms over the 1978-79 to 1984-85 period. In presenting the White Paper we shall be able to demonstrate that much of the criticism of the trend of the capital spending figures has been misplaced.

Position in Later Years

12. Figures on the new basis after 1984-85 will not be given in the White Paper because of data problems. Particular difficulties relate to the "capital" proportion of defence spending and the treatment of the planned privatisation of British Telecom, British Airways and

Enterprise Oil. The programme of privatisation will undoubtedly mean that "nationalised industry investment" - and hence public sector investment - will be treated as falling significantly from 1984-85 onwards. (Indeed, privatisation has already had some effect in the earlier years; investment by companies already privatised was some £300 million in 1978-79). This is a deliberate act of policy and one we can readily present. But colleagues may like to note that if we assume that:

- (i) the capital proportion of total defence spending remains as is planned for 1984-85 (one-third);
- (ii) the three privatised corporations continue to invest at the same rate in cost terms as in 1984-85

then the cost terms figures for public sector capital spending on goods and services on the new presentation show:

	£ billion 1982-83 cost terms		
	1984-85	1985-86	1986-87
Excluding BT, BA and EO after 1984-85	19.1	17.0	16.6
Adding back assumed investment by BT, BA, and EO	19.1	19.0	18.6

13. On a broadly comparable basis this suggests little change in 1985-86 and a small fall in 1986-87.

What Level of Capital Spending?

14. The new presentation shows that the level of public sector capital spending has been broadly maintained. We cannot expect that to silence our critics; they will continue to argue that we should spend more still. This plea is always seductive and strikes a chord with our supporters. Certainly no-one can deny that certain types of capital project should be a high priority for any Government. However I am sure that we should continue to examine projects one by one and that it would be a great mistake to start looking for a correct - or even a minimum - level of capital expenditure in aggregate.

15. In reaching a balanced assessment of this question we must bear in mind first that some types of current expenditure can be as important as capital.

For example, industrial training is as much an investment as bricks and mortar. Most R&D is current, but designed to improve long term productive capacity. Much current expenditure provides valuable orders and work for private industry, such as NHS purchases of drugs. More work for the private sector can in turn lead on to increases in productive capacity and demands on the capital goods industries.

15a. That is not to say all current expenditure should be viewed equally favourably. To the extent that we fail to hold back areas such as local authority current spending the capital/current balance is bound to be affected. Similarly, the growth of large current programmes like social security holds down the capital proportion within total public spending.

16. Second, there are areas in which we would wish to see investment by the public sector held back because it is more properly a matter for the private sector. Some investment, such as defence, can effectively be carried out only by the public sector. But elsewhere, as in housing, we have as a matter of policy cut back public sector investment to encourage a shift towards private sector provision. Similarly, transferring nationalised industries to the private sector is intended to free their investment from Government constraints and to ensure that fully commercial considerations will apply to future investment decisions. We need to look, therefore, at investment in the economy as a whole; and aggregate private sector investment is much greater than that in the public sector. Precise comparisons on the new presentation are difficult. But on a broadly equivalent basis, after deducting private sector purchases of Council houses, private sector investment in 1982-83 was some £29 billion compared with public sector capital spending on goods and services of £18.7 billion. (The conventional national accounts presentation gives figures of £31 billion and £12 billion respectively).

17. Third, appropriate levels of public sector investment are affected both by demographic factors and the rate of economic growth. There are examples of the "need" for capital spending falling; such as the impact of the birth rate on the need for educational buildings, the shift of emphasis in the health service from expansion of facilities to more efficient use of the existing capital stock, and the effect of lower economic growth in recent years on demand for energy and other infrastructure projects.

18. Fourth, capital investment is not an end in itself, but a means to an end. In some policy areas, consideration must be given to whether the end is best served by capital or current spending. For example, is the aim of better education best served by improved teacher training or new school buildings? Is the aim of maintaining a desired standard of infrastructure best served by maintenance of the existing capital stock or by new capital works? In the public as in the private sector, it is essential to consider the costs of investment proposals and compare them with expected returns; and in relevant cases to compare the returns with what could be achieved by non capital spending.

19. In the nationalised industries the test should nearly always be whether the project will earn a commercial return. In the public services, where it is often not possible to put a market value on the output, the costs have to be set against an evaluation of the benefits of maintaining or improving the service to meet demonstrated need. The 1960s and 1970s produced many projects where the costs, timescales or commercial risks were seriously underestimated and the actual returns achieved were inadequate. In general, the nationalised industries' returns on capital since the early 1970s have been very poor; particular examples include the Isle of Grain, BSC modernisation and rail electrification. Similarly, Concorde is by no means the only example of uneconomic investment by central and local government.

20. The starting point for assessing future capital spending plans must be through project appraisals in accordance with the normal guidelines. Consideration of the correct level turns on the return which particular projects can be expected to achieve. The initiative for altering the balance within programme totals between capital and current expenditure must rest with spending Ministers and their departments. Under the present arrangements for controlling public expenditure it is not possible for Treasury Ministers to alter the overall balance significantly, nor is it likely that satisfactory alternative arrangements could be devised which would enable them to do so.

Conclusions

21. The new table of public capital spending to be included in this year's White Paper will demonstrate that this type of expenditure has been broadly constant in cost terms over recent years.

22. There is no way of determining in aggregate what are the right proportions of current and capital expenditure within a given total of public spending. The case for capital expenditure can only be considered project by project

23. At the end of the day the balance between current and capital spending must depend primarily on colleagues' judgement of the priorities within their own programmes. But it will be evident that the scope for accommodating cost-effective projects within the planning totals we have agreed will depend on our ability to withstand pressure for increased current expenditure.

TOTAL PUBLIC EXPENDITURE BY ECONOMIC CATEGORY

Table 1.9

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Current expenditure									
Wages and salaries	20,948	24,840	30,841	34,245	36,290	38,423	39,097	40,620	41,840
Other current expenditure on goods and services	11,501	14,012	16,652	19,357	22,361	24,633	26,034	27,510	28,700
Subsidies	4,004	4,939	6,102	6,027	6,060	6,128	5,423	5,060	4,700
Current grants to the private sector	18,542	22,115	27,053	32,846	37,316	40,286	42,395	44,880	47,100
Current grants abroad	1,618	1,819	1,306	1,289	1,784	1,812	1,779	2,050	2,140
Local authority current expenditure not allocated to programmes							735	510	350
Total	56,614	67,725	81,955	93,764	103,811	111,281	115,463	120,620	124,830
Capital expenditure									
Gross domestic fixed capital formation	5,244	6,019	6,238	5,166	5,445	5,927	5,308	6,140	6,430
Increase in value of stocks	57	-14	84	7	318	381	447	270	270
capital grants	1,810	1,869	2,204	2,338	2,954	3,300	3,032	3,100	3,130
Net lending to private sector	240	658	921	1,356	732	-62	980	500	410
Net lending to nationalised industries and some other public corporations	1,075	2,464	2,770	1,943	1,593	901	892	150	-370
Net lending and investment abroad	267	-319	-521	-270	-97	47	192	150	140
Cash expenditure on company securities (net)	4		-1		371	151	3		
Market and overseas borrowing by nationalised industries and some other public corporations	442	-481	-623	294	-1,281	-239	-819	-590	-910
Total	9,138	10,196	11,073	10,833	10,035	10,407	10,036	9,730	9,100
Adjustments									
Special sales of assets		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
Reserve						250	2,750	3,750	4,750
General allowance for shortfall						-400			
Planning total	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680

Table 1.13

£ million

PUBLIC SECTOR CAPITAL SPENDING	1978-79 outturn	1979-80 outturn	1980-81 outturn	1981-82 outturn	1982-83 outturn	1983-84 estimated outturn	1984-85 plans
Goods and services (1)							
General government and List III public corporations							
Expenditure on dwellings	2104	2395	2302	1943	2204	2199	2290
New constructions other than dwellings	2556	3165	3766	3912	4259	4395	4571
Purchases (net) of vehicles, plant and machinery	67	734	877	902	1104	1144	1155
Defence expenditure (2)							
Construction	46	205	283	271	395	456	526
Equipment	1779	2211	2905	3445	3800	4554	5200
Nationalised industries and other List I and II public corporations (1)(3)(4)(7)							
Expenditure on dwellings	0	2	3	2	3	5	8
New construction other than dwellings	4704	1766	2175	2284	2691	2907	2895
Purchases (net) of vehicles, plant and machinery	0	3720	4134	4550	4253	4743	4639
					181		
Total, goods and services	11815	14200	16445	17309	18709	20392	21281
Cost terms (Base year 1982-83)	19201	19750	19270	18458	18709	19421	19302
Capital grants to private sector							
General government and List III public corporations (1)	1462	1566	1890	1974	2501	2921	2601
Nationalised industries and other List I and II public corporations (1)(3)(4)	9	12	12	14	14	24	25
Total, capital grants to private sector	1471	1578	1902	1988	2595	2945	2626
Total, goods and services plus capital grants to the private sector (5)	13286	15778	18347	19297	21304	23337	23907
Cost terms (Base year 1982-83)	21592	21945	21498	20578	21304	22226	21684
Net lending							
General government and List III public corporations (1)							
Net lending to private sector (6)	244	658	920	1356	1094	87	975
Net lending and investment abroad	267	-319	-521	-770	-97	47	203

1) See definition of List I, II and III public corporations in part V of Volume 2 (PW)P1
 2) NATO definition of defence capital expenditure. Table 14.4J reconciles this definition with that used elsewhere in this White Paper
 3) Not included in the planning total
 4) The 1978-79 figure includes net expenditure on land and existing buildings by nationalised industries
 5) See Table 4.2 for reconciliation of this total with non-current expenditure in table 3.8
 6) Includes cash expenditure on company securities
 7) "Nationalised industries" includes British Telecom's and British Airways' 1984-85 planned capital spending. No figures are available for Enterprise Oil
 8) British Telecom's accounts treatment of certain fixed assets changed in 1981-82

million

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
1978-79 outturn	9138	10196	11073	10833	10035	10407	10036
Capital expenditure in Table 1.8							
ADJUSTMENTS							
Goods and services							
deduct							
deduct	-143	-402	-821	-1720	-2334	-1899	-2837
deduct	57	-14	84	7	318	381	447
Defence expenditure							
add							
deduct	1825	2416	3188	3716	4195	5010	5728
deduct	101	125	114	129	159	180	239
Nationalised industries and other List I and II public corporations expenditure (1)							
add							
deduct	4743	5506	6328	6892	6951	7702	7570
deduct	341	294	304	355	372	363	325
Net lending to nationalised industries and some other public corporations							
deduct	1075	2464	2770	1943	1593	901	892
deduct	442	-481	-623	293	-1281	-239	-819
Market and overseas borrowing							
Net lending							
deduct	244	658	920	1356	1103	89	983
deduct	267	-319	-521	-270	-97	47	192
Public sector capital spending in Table 1.13	13322	15793	18362	19348	21348	23296	23912

(1) See definition of List I, II and III public corporations in Part 5 of Volume 2
 (2) Several points on the nationalised industries figures need to be noted:- (a) they are not included in the planning total, (b) they include the planned capital spending in 1984-85 of British Telecom and British Airways but no figures are available for Enterprise Oil, (c) British Telecom changed the accounting treatment of certain fixed assets in 1983-84, (d) the 1978-79 figure includes net expenditure on land and existing buildings
 (3) Includes cash expenditure on company securities

ANNEX C CONTINUED

The table sets out the adjustment in moving from the old to the new presentation of capital expenditure. These are:

- a. figures of gross domestic fixed capital formation are shown in the national accounts net of assets sales. But in measuring new work placed with industry it is not appropriate to deduct (or add) sums which merely transfer the ownership of assets between the public and private sectors. Hence, the adjustment excludes the purchase and sale of land and existing buildings. Council house sales is by far the largest component, which has risen from under £500 million in 1978-79 to over £2000 million a year now.
- b. by international convention, virtually all defence expenditure is classified as current not capital. The adjustment includes the NATO definition of defence capital expenditure rather than the conventional definition. The NATO definition of capital covers equipment (excluding ammunition) and construction, but excludes spares and repair and maintenance. It gives a broad indication of expenditure of a capital nature rather than operating costs, although the method of compilation is necessarily approximate.
- c. external financing limits rather than capital expenditure are scored within the planning total for nationalised industries and some other public corporations. The adjustment substitutes their aggregate capital expenditure, which is currently around £7 billion a year and has shown little change in real terms since 1978-79.
- d. the adjustment omits net lending from the total.

MR TURNBULL

PUBLIC EXPENDITURE REVIEWS: TERRITORIAL PROGRAMMES

The Treasury have undertaken an impressive piece of work which gives Ministers all the information they need.

The next phase is to move on to decisions. As the Chief Secretary's letter points out, the main problems lie in the assessment of needs in Scotland and Northern Ireland, and unfortunately the over-provision is most marked in the sensitive areas of health and housing.

The next step must be to invite in the Chief Secretary to discuss handling. It might be best to tackle the problem of Scotland first, whilst reassuring Wales that they are not overspending, and hinting that Northern Ireland is a special case. The Chief Secretary and Prime Minister could discuss how to broach the subject of the £900 million overspend with the Secretary of State for Scotland, with a view to opening negotiations which could result in £0.5 billion savings in due course.

JOHN REDWOOD

Prime Minister ②

Overprovision in the territorial programmes was one of the main areas suggested by the Treasury. You asked to see a summary of the Treasury work before agreeing that an approach be made to the Secretaries of State.

Agree a start meeting with CST?

Yes no

AT

2/2

We have seen similar figures some 3 years ago. I do not think they will get us very far. But we can have a start meeting.

3/4
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File with
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u/s



NAPM
AT
30/1

Treasury Chambers, Parliament Street, SW1P 3AG

Lord Cockfield
Cabinet Office
Whitehall
London SW1A 2AS

30 January 1984

Dear Lord Cockfield,

PUBLIC EXPENDITURE WHITE PAPER - PART 1, TABLE 1.13

Thank you for your letter of 13 January about points arising from the new Table 1.13 in this year's White Paper. I have also received comments on this from Patrick Jenkin.

On your first point, I think it is important that we should hold firmly to the main aim of Table 1.13. This is to show far more clearly than hitherto what the public sector has spent on all new construction and capital goods in each year since 1978-79. We are no longer confining the table to construction, because information on public sector capital spending is of interest to a much wider range of industries. I accept, as Patrick says, that the table will not satisfy the construction interests; but it will present a much more balanced picture of total capital outlays. It would be inconsistent with that objective to reduce the total by the amount of receipts from asset sales, since they bear no direct relationship to the value of work placed with these industries.

We have made this clear at three points in the White Paper - in the last "main point" at the beginning, in paragraph 29 (where there is a fairly full explanation) and again in the text accompanying the Table itself, in particular sub-paragraph (b) which deals with the point about asset sales. (I could not, incidentally, accept that the commentary is "meagre": it already runs to 1/8th of the text of Part 1!). On the whole, I would rather not add to this by trying to pre-empt the point

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made by Jack Diamond, which seems to me rather a different one related to the accounting treatment of the capital stock. To do so might appear unduly defensive and it would, I think, detract from the main message of the table.

Rather, I should like to say in my Press Conference presenting the White Paper that our object is the simple one of showing gross what the public sector is putting into all capital expenditure. There is no reason why we should set against that figure the receipts from the sale of assets (including council houses) since the capital purchases in question are, self-evidently, not so reduced.

On your second point, I agree that there is an argument to be had about whether or not our gross capital expenditure is sufficient overall to maintain our capital stock. (The Director General of the CBI has recently made the same point.) As you suggest, the factual information is limited (the CSO produce some figures but I understand they are not very reliable). There are also a number of conceptual problems about whether there is a "right" level of capital expenditure. Even if there is, I believe we shall not establish it by looking at these overall statistical totals. The need is a practical one - as Patrick suggests - to consider individual proposals for improvement and establish as clearly as we can whether such an investment will earn an adequate return. If I may put it another way, the case for more spending on the sewers lies under the ground, not in the CSO's figures for capital consumption.

I am copying this letter to Cabinet colleagues.

yours sincerely

PR

PETER REES

*(signed by the chief Secretary
in his absence)*

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a/No



FROM: CHIEF SECRETARY

DATE: 30 January 1984

PRIME MINISTER

PUBLIC EXPENDITURE REVIEWS : TERRITORIAL PROGRAMMES

Before deciding how best to approach the Secretaries of State, you asked to see a summary of the work the Treasury had undertaken, pointing to substantial over-provision of public expenditure in the block budgets for Scotland and Northern Ireland, though not Wales (your Private Secretary's letter of 3 January).

2. This summary is attached; a copy of the full report is being given to the Policy Unit. The three Secretaries of State so far know nothing of the work we have done.

3. I am of course ready to discuss this if you wish. If you decided to send a note on the basis of the attached to the Secretaries of State, calling for a review, I should be happy to provide a draft.

PK

SCOTLAND, WALES, AND NORTHERN IRELAND:
PUBLIC EXPENDITURE BLOCK BUDGETS

The three territories receive a large part of their funds in the form of block budgets, together accounting for one-tenth of public expenditure, within which the Secretaries of State have wide discretion in relating resource allocation to local needs:

Block budgets (£m cash)

	1982-83	1983-84	1984-85
Scotland	5,937	6,058	6,240
Northern Ireland	3,568	3,806	4,020
Wales	2,228	2,370	2,440
Total	<u>11,733</u>	<u>12,234</u>	<u>12,700</u>

Public expenditure

planning total	<u>113,007</u>	<u>119,568</u>	<u>126,370</u>
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2. Per Capita spending in the territories, on the latest available (1981-82) figures, is high in relation to England. The picture is broadly similar whether one takes all programmes for which expenditure can be attributed to the territories (as below), or the blocks alone:

	Population (million)	Per capita expenditure (£)	Percentage above England
Northern Ireland	1.5	2,161	45%
Scotland	5.1	1,937	30%
Wales	2.8	1,756	18%
England	46.8	1,493	-

3. The relative generosity of the provision for the territories is of long standing and was reflected in the baselines for the budgets when they were introduced in the period of 1978-80. Baseline provision for the blocks as a whole is rolled forward each year under normal PES ground-rules - a flat percentage increase on the previous year's provision. The block system also entails the use of population-based formulae which, on principle of rough justice, allocate marginal changes (up and down) as a direct consequence of changes made in comparable English programmes during the annual Survey negotiations (see Annex A for details). Thus the system runs on from year to year, hitherto unchecked and largely automatic in operation.
4. What has happened is that the generous starting baselines, inherited from the 1970s and rolled over each year as described, have broadly maintained (even slightly improved) the territories' position relative to England; while the formulae for their part have had a more or less neutral effect over time (see Annex A). Under present arrangements, the territories' advantageous position seems set to continue.
5. The justification for the generosity of provision of course has been the special needs of the territories. But the study indicates that for many programmes, territorial expenditure

today is substantially above the UK average when assessed against objective measures of need. Examples are in Scotland health and personal social services, housing, and schools and in Northern Ireland health and housing.

6. These conclusions are reached by updating, in a broad-brush way, the results of an earlier needs assessment study, started in ^{the} devolution context and published in late 1979. The methodology used in this study is explained at Annex B.
7. For Scotland a literal reading of the results would point to excess expenditure currently of around £900m per annum in a block budget of £6b. In the imperfect nature of the methodology, this figure must be treated with caution. But it does show conclusively that substantial over-provision exists. The excess appears to have grown by around £275m since 1978-79, after inflation is allowed for; over half of this increase is due to a rise in Scottish expenditure provision relative to England much of which was implicit in the forward plans already in existence when the block was established (which looked forward to 1982-83); the remainder of the increase is due to reduced relative need in Scotland. Over-provision is thus likely to rise less rapidly in future. But it is there, and general economic circumstances do not provide much justification for it. Helped by oil as well as by high past levels of public spending, Scotland is rapidly closing the wealth gap with England: on both personal disposable income per capita and GDP per capita, it now scores 97-99% of the national average.
8. Wales, on the other hand, has expenditure not significantly above need overall, a situation expected to continue.

But with Northern Ireland we are back to a current excess approaching £200m per annum, a figure which leaves out of account the law and order programme where special considerations obviously arise. This excess has also grown since 1978-79; the growth is here almost entirely due to a rise in expenditure relative to England, for reasons similar to those applying to Scotland. Again, this figure must be treated with caution, and there are of course some strong arguments for special treatment (economic as well as political) in Northern Ireland's case; eg on the economic indicators cited for Scotland above, Northern Ireland scores only 72-81% of the national average. But here, too, over-provision undoubtedly exists.

9. The results just described find some support in anecdotal evidence. It must also be borne in mind that Scotland and Wales, at least, have up to now been quite generously treated in some programmes falling outside their blocks such as agriculture, coal, rail, and shipbuilding. For example:
 - a. some 25% of the PSO grant to British Rail is for lines in Scotland and Wales - equivalent to about £200m a year;
 - b. the subsidy to Scottish mines is three times and to Welsh mines five times the UK average and equivalent to some £180m a year;
 - c. Scottish electricity prices are some 5% lower than in England and Wales on average, a larger differential than can be easily justified in economic terms.
10. Northern Ireland, too, has done well on agriculture. Further, our recent White Paper, embodying the results of the Review of Regional Economic Policy, implicitly recognises

that some shift is taking place in the relative economic fortunes of England and the territories, in favour of the latter; we are here addressing another manifestation of that same shift.

11. If a full review confirms the disparity, it could be put right by setting the baseline provision for the new final year in each annual Survey, not on the normal basis for public expenditure programmes - a flat percentage increase on the previous year's provision - but at a level related to need. There are various ways this might be achieved, as discussed in the report; and it is only realistic to assume that any adjustment will need to be phased over a good run of years. But a start could be made in the 1984 Survey, and it may be possible to secure some savings in the early years of that Survey too.

THE TERRITORIAL FORMULAE

The formulae apply only to marginal changes to the baselines made in the course of the annual Survey rounds. Any decision made in an annual Survey to increase, or reduce, a "comparable English programme" (as defined in the Treasury study) leads to an automatic adjustment, in the same direction, to the three territorial blocks, on the basis that Scotland gets 10:85 and Wales 5:85 of the change in the English programme, while Northern Ireland gets 2.75% of the consequential adjustment in GB public expenditure. These formulae are intended to reflect the relative population ratios : in fact Scotland's, due to its falling population, is now significantly too high (10:85 = 11.765% against an "entitlement" of 11.067%), Wales' is slightly too low (5:85 = 5.882% against an "entitlement" of 6.022%), while Northern Ireland's is about right (2.75% against an "entitlement" of 2.776%). The actual population figures on which these ratios are based are (1981 census): England 46.8m; Scotland 5.1m; Wales 2.8m; Northern Ireland 1.5m.

2. These formula discrepancies from "entitlement" matter little in practice, however, since the impact of the formulae is not only complex in itself in any given situation but - inasmuch as net increases to baseline public expenditure in one year tend to be offset by net decreases in another - is self-cancelling over time. That is to say: a net addition to public expenditure by way of a decision on a PES bid, being for the territories population-based, always erodes their baseline advantage over England, though does so differentially depending on the relationship between each territory's formula on the one hand, and, on the other, the proportion between block expenditure and comparable expenditure elsewhere. The formula discrepancies from "entitlement" have a much smaller impact - a partial offset where the formula is itself generous in relation to "entitlement" (Scotland), or an extra penalty where the formula is ungenerous (Wales). But a net reduction in public expenditure by way of a PES decision has precisely the opposite effect, in all respects.

3. The Treasury study shows that the formulae do in fact have a more or less neutral effect over time. The net formula cuts of 1979 and 1980 have been partially offset by the net formula additions of later years, and any residual effect has impacted only marginally on the ratio of territorial to English expenditure.

THE NEEDS ASSESSMENT STUDY

The present internal Treasury study has involved a broad-brush update of work completed earlier under the title of the Needs Assessment Study.

2. The original Needs Assessment Study was an inter-departmental study, begun in 1976 and completed in 1979, of the relative needs of the four countries of the UK for public expenditure on the services that were to have been devolved under the Labour Government's devolution proposals. The study was actually completed after the collapse of those proposals, and was published by the Conservative Government in December 1979. A limited update was undertaken in 1980.

3. Here we describe the methodology used in the original interdepartmental studies, and repeated, with necessary limitations, in the present internal Treasury study.

Scope of the Needs Assessment Study

4. The purpose of the study was to provide information on relative public expenditure needs. It did not investigate absolute needs. It set out to answer the question: given £100 of public expenditure in England on providing the services studied, how many £'s of public expenditure would be required in the other three countries of the UK to achieve similar levels of provision?

5. The Needs Assessment Study only took account of "objective" factors affecting expenditure need. Broadly, these were factors outside the direct control of the authority providing the service. It did not take account of what were termed "subjective" factors. These were factors flowing primarily from differences in policy in

the four countries and included, for example, bilingualism in Wales and denominational schooling in Northern Ireland. Nor did it take into account broad political considerations, for example, differences in overall economic positions which might be felt to justify differences in standards of public services.

Methodology

6. The approach adopted in the Needs Assessment Study was a pragmatic one. The assessments of need that were made were based heavily on Departments' experience and expert judgement, rather than on more formal statistical techniques.

7. Indicators of expenditure need were constructed in a number of stages.

8. First, the six main programmes that were covered by the study - Health and Personal Social Services; Education (excluding Universities); Housing; Other Environmental Services; Roads and Transport (excluding railways); and Law, Order and Protective Services (excluding the police) - were divided into expenditure blocks on the basis of the policy aims to which the expenditure was directed. For example, the Education programme was split into schools, further education, and libraries and museums.

9. Second, previous studies and Departments' knowledge and experience were drawn upon to identify the objective factors for each block, which would give rise to variations in the amount of expenditure needed in each of the territories to provide the same level of service as in England. These were mainly the number and characteristics of the individuals for which the service was provided, for example, the number and age of pupils for the schools block, plus factors influencing the cost of supplying the service,

for example, the sparsity of the population. A list of the factors that were most important for each block is provided as an Appendix.

10. Third, statistical indicators were derived to measure the relative incidence of the objective factors. Suitable statistics were readily available for many of the factors, for example, those based on population size and structure. In other cases, for example homelessness and road congestion, broad estimates or proxy measures had to be used.

11. Fourth, the statistical indicators were combined - weighted - together to give an index of expenditure need for each of the three territories relative to England. The weights used to combine the indicators were chosen to reflect the relative importance of the objective factors in causing variations in expenditure need. In some cases, this would be done on the basis of objective information. For example, the weight given to pupil age in determining expenditure need for schools was based on evidence of actual unit cost variations between different levels of schooling in the UK. In other cases, for example in deciding the relative weights to attach to homelessness and substandard dwellings in the need for housing investment, the assessment had to be based on judgement.

12. Finally, the indices of relative need for each of the blocks were aggregated together to provide an overall assessment of need. This was done on the assumption, basic to the study, that the overall assessment should be sufficient to provide in Scotland, Wales and Northern Ireland for the same range and level of service as in England, taking the objective factors into account. Accordingly, the indices for each expenditure block were combined in proportion to their share in English expenditure.

MAJOR OBJECTIVE FACTORS

(i) Health and Personal Social ServicesHospitals and Community Health

Current:

Size of population

Structure of population

Morbidity

Social deprivation

Teaching responsibilities

Capital:

As on current plus shortfall in volume or quality,
locational unsuitability, design unsuitability of
existing capital stock.

Replacement of capital stock

Family Practitioner Services

Size of population

Structure of population

Morbidity

Deprivation

Personal Social Services

Size of population

65 and over: numbers living alone
poverty

Under 18: density

18-64: poverty

(ii) Education

Schools

Current:

School population

Age distribution

Capital:

Lack of pupil places

Overcrowding

Substandard places

Deprivation

Further education

Current:

Number of students

Capital:

Lack of student places

Libraries and other

Total population

(iii) Housing

Capital:

Household/dwelling balance

Substandard dwellings

Overcrowding

Generalised Subsidies

Number of public sector dwellings

Loan Charges

Housing Assistance

Public and private tenants having low income

(iv) Other Environmental Services

Water services

Population growth and shift

Industrial growth and shift

Rate of deterioration of existing assets

Local Environmental Services

Size of population

Relative density of population

Relative sparsity of population

(v) Roads and Transport

Roads

Capital:

Congestion

Substandard roads

Current:

Road mileages and type

Heavy vehicle usage

Public Transport

Capital:

Replacement needs of existing stock

Current:

Fleet size and type

Elderly

(vi) Law, Order and Protective Services

Administration of Justice and Treatment of Offenders

Population

Number and types of crime

General Protective Services (other than Police)

Number of buildings and other installations
in the various categories of high fire risk

(vii) Industrial and Economic Activities

Derelict Land Clearance

Areas of derelict land by type

Factory building

Areas of high unemployment

Industrial Development Activities

Areas of high unemployment

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Mr MacTavish

PS
PS/Plus

PS/Lady Young

Chief Clerk

Mr Briant (Finance Dept)

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Geoffrey Howe QC MP
Foreign and Commonwealth Secretary
Foreign and Commonwealth Office
Downing Street
London SW1A 2AL

30 January 1984

Dear Foreign Secretary

FCO EXPENDITURE PROBLEMS

Thank you for your minute of 24 January. I am glad that we have found the basis for a reasonable settlement. May I, however, clarify two points?

I infer from the form of words that you use that, since you have opted to run down your unallocated reserves as part of the deal on the FCO Vote 1 estimate for 1984-85, you will absorb small claims that might otherwise have been met from them.

I take it too that there can be no question of the Board of the British Council trying to reopen or avoid your instruction to plan on the level of the present PES provision for 1984-85.

As for the future, I admire the precision of your analysis. There is only an agreement to agree, but there is I am sure goodwill and understanding on both sides! While accepting your analogy between the FCO's exchange position and the state of a man's digestion (was it really Brown LJ?), I have to point out - not too acidulously I hope - that in any year the overriding consideration must be the Government's capacity to swallow and digest increased public expenditure even in such a meritorious area as the FCO. Subject to that I am sure our officials can work out a suitable formula which can determine the starting point for the annual PES ritual.

Yours sincerely

J. G. Rees

J. PETER REES

[Approved by the Chief Secretary]



10 DOWNING STREET

Prime Minister ②

Bob Young has been
nominated to represent
the Policy Unit. Part of
his brief will be to ensure
that Mr Jenkins's working
group, though admirably
thorough, does not lose
sight of the wood.

AT

26/11

Manleyson

mb

CFO



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

25 January 1984

Dear Chief Secretary

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

Thank you for your letter of 20 January about the Urban Programme (UP).

Your proposals for reviewing this programme are very much in line with my own thinking. Over the past 3 years or so there have been more than 20 external reviews of UP or aspects of it - including two by the Select Committee on the Environment last session (one incomplete); the current examination by the National Audit Office (still in progress); its relationship to regional policy was considered by the Quinlan/Anson inter-departmental committee; there is a substantial research programme (now overseen by an interdepartmental steering group); and there are various other enquiries in progress including the Archbishop's Committee on inner cities and a very large research project sponsored by SSRC.

None of these external studies, however, has really addressed the objectives and management of the programme in a thoroughgoing way or with sufficient knowledge of the programme or the problems of economic and social deprivation that are its concern. I want to see a thorough, comprehensive and constructive review of the programme, and I have therefore encouraged my officials (as one of the ingredients of the DOE work on FMI!) to undertake their own review of the programme, its scope, methods, priorities and effectiveness. They have already done a good deal of work on this and I have asked them to report to me with their initial assessment and options for changes within the next three or four months, certainly in time for consideration within PES '84.

I would like to see this work carried through quickly on this kind of timescale. I have seen the suggestions in Alan Bailey's letter as to the mechanics. I think that at this stage the subject requires more concentrated and informed effort than can be applied by a scrutiny-type approach steered by an interdepartmental committee meeting once or twice a fortnight and comprising chiefly people who, inevitably, are not going to be able to give more than a very small part of their time to the work. I suggest that it calls for a Working Group approach, with members able to devote a substantial amount of time to the job. We already have our own group working on this, led by David Edmonds the Under Secretary in charge of the Inner Cities Directorate. I would welcome the addition of representatives from the Treasury, the Efficiency Unit and No 10 Policy Unit. In particular, I would be glad if the Treasury were able to assign a young Principal to

join the Group full time. The new members of the Group will need fairly intensive briefing on the content and character of the programme, and the Group should certainly visit some of the priority areas covered by the programme and meet the local authority officers responsible for its execution on the ground. I think this dimension of the exercise in particular will certainly be more fruitful under DOE sponsorship.

The terms of reference that you suggest are well within the scope of the work that I have set in train but I do not want it to be restricted to those aspects. I have encouraged my officials to go wide in their review - for example, I am particularly interested in the relationship between UP and other programmes, whether there is any duplication and whether we could not apply UP more effectively to reinforce, supplement or redirect those programmes according to our sense of priorities. I suggest therefore that the review should cover the aspects that you mention but should not be restricted to those if the Group find that there are other important aspects that should be dealt with and brought to our attention.

As you know, the Urban Programme is an exceptionally diverse and complex programme. The review requires concentrated attention and needs to be carried forward vigorously and at a faster pace than an interdepartmental committee affords. We can arrange that interested departments are kept in touch with the work and, of course, the Group's report will need to be considered ultimately by other colleagues as well as by ourselves.

I want to see greater concentration on the areas where the problems are worst and I want to be satisfied that the programme is well managed and that the resources allocated to it are applied effectively. I note what you say about sending "the wrong signals". I would say that one of the marked advantages of the way the UP is structured is that it affords Ministers ample scope to ensure that it is addressed to the problems and priorities that we consider important. The meeting with the AMA (which they have asked for and which I can hardly refuse) offers one such opportunity. I would not, however, propose to announce that we have this review of UP in hand: we need to get our own ideas clear about its future before we invite the local authorities and others to comment.

I hope that you will agree to the review being conducted in this way. If you have thoughts on the subject which could help the Working Group focus on the main issues, I would be glad to have them.

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

Yours sincerely
A.H. Davis

for
PATRICK JENKIN

Approved by the S.F.'s
and signed in his absence

25 ... 1984

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a No
LPC

23/1/84
Mr MacInnes
R/P
R/Lady
Chief Clerk
Mr Bryant
(in)



FCS/84/19

CHIEF SECRETARY, H M TREASURY

FCO Expenditure Problems

Since we met on 18 January, I have been considering how we might make progress on the issues outstanding between us. I would now like to propose the following settlement:

- (a) I would accept the £1.2 m. reduction this year in the FCO Vote 1 cash limit.

- (b) The £7.2 m. cost to FCO Vote 1 for 1984/85 resulting from depreciation of sterling between 1 October 1982 and 1 October 1983 would be dealt with as follows: An addition of £3.6 m. would be made to the Estimate for 1984-85. I would adjust my expenditure plans as necessary in order to save a further £3.6 m. (I propose to do this by reducing my present unallocated reserves of £4.2 m. You said that you would not entertain small claims which would appropriately score against those reserves if those claims could not be accommodated within the reduced reserve figure. But of course if there is a further deterioration in sterling or overseas inflation during the course of the year, it will be open to the FCO to make a claim under the existing Rawlinson/Palliser understanding.)

/(c)

RESTRICTED AND ADMINISTRATION
IN CONFIDENCE



- (c) Officials should work out a clear procedure for the future for taking account of the effect on FCO expenditure of movements in exchange rates and overseas inflation, both in advance of the financial year and during the course of it.
- (d) The Estimate for the British Council in 1984/85 should be at the level of the present PES provision and I would instruct the Council to plan on this basis. However, I will wish to discuss with you in due course the case for an addition.

I would be grateful to have your confirmation that you accept a settlement on this basis.

I recognise, as you will of course, that (c) above is no more than an agreement to agree, which would risk rendering the whole deal void for uncertainty if it ever came to be construed in the courts! It is precisely that kind of uncertainty that we need to avoid, at least at the stage of determining the base line. It is not as though we are concerned with something as amorphous as MOD's RPE, where the amount of cash available can influence the behaviour of the spending department and its suppliers. The exercise is, and should be, as precise and mathematical as it is for corporate accountants or auditors in determining the impact of exchange rate gains (or losses) on the company accounts.

The scale of a man's exchange rate losses/or gains, is as much a question of fact, as Lord Justice Brown would have said, as the state of his digestion. Of course, that fact -

/once



once determined - may (but should not normally) have an impact on subsequent policy decisions. The important thing is to secure an agreed starting point for the annual PESC ritual. This would be in line with practice in Canada and the USA; and with the Treasury's assessment of revenue from North Sea oil, which equally depends upon exchange rate changes.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

23 October 1984

January



CC 450
Prime Minister ②
 CST has now launched
 the review of the Urban Programme.
 AT 23/1

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 LONDON
 SW1P 3EB

20 January 1984

PUBLIC EXPENDITURE REVIEWS: URBAN PROGRAMME

You will know that each year after the Public Expenditure Survey the Treasury considers, in the light of that Survey, questions which ought to be pursued before Ministers come to take decisions on the next Survey. I have consulted the Prime Minister on a number of key areas to be looked at this year in order to identify options for savings. She has agreed that, as one potential area for savings, we should seek to clarify the objectives of the Urban Programme and to develop ways of measuring its cost-effectiveness.

Last year's review of regional policy looked at the economic aspects of the Urban Programme and concluded that further research should be done over the next two years. However it left untouched the social and environmental aspects. I am sure that we must now get a clearer view of the objectives of the whole programme and its parts, and consider the cost-effectiveness of the very large expenditure involved. I do not think that work along those lines would duplicate or overlap with the regional policy review's conclusions. I am aware also of the National Audit Office's interest in the Urban Programme.

I suggest that the terms of reference for this review should be as follows:

- (a) to clarify the objectives of the Urban Programme;
- (b) to consider the resources devoted to its various parts;
- (c) to assess its cost-effectiveness and ways of improving the measurement of that;
- (d) to identify options for change.

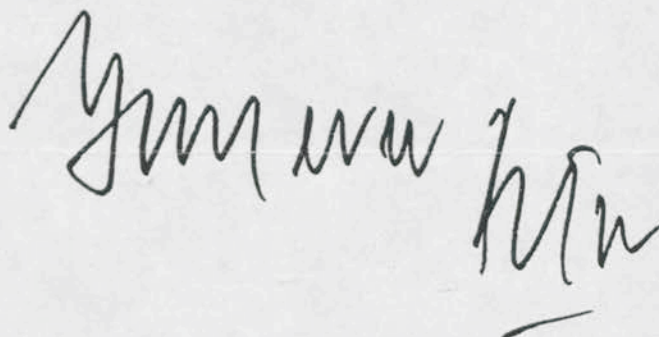
CONFIDENTIAL

We shall have to involve other colleagues with an interest in the Urban Programme, but I think it would be helpful if you and I could agree on the general approach first.

We have some ideas about how this review might be conducted. Clearly our two departments will need to be closely involved. The Prime Minister would like the No 10 Policy Unit to be kept in touch; the Efficiency Unit may also be able to contribute. I am asking Mr Bailey to get in touch with Sir George Moseley to sort out the mechanics.

I hope that you will agree that this is the best way to proceed. If you see any difficulties I should of course be pleased to have an early word. Meanwhile I think that it is important that we do not run the risk of giving the wrong signals about the Urban Programme. I have seen your letter of 10 January to Keith Joseph, but I must confess that I have considerable doubts about the involvement of colleagues with the next AMA meeting as you propose. Certainly before there were any such involvement we should all need to be clear about the implications of this review for what could be said then.

Copies of this letter go to the Prime Minister, Sir Robert Armstrong and Sir Robin Ibbs.

A handwritten signature in dark ink, appearing to read 'Peter Rees', written in a cursive style.

PETER REES

CONFIDENTIAL

11/11/1984



010 CCNO.

Prime Minister



This will be on the morning of a Questions day, but it was last year without difficulty. I do not think there is much new which will cause controversy, except perhaps defence. We will obtain the briefing referred to at X.

AT 20/1

Treasury Chambers, Parliament Street, SW1P 3AG

D M Barclay Esq
PS/Prime Minister
10 Downing Street
LONDON
SW1

20 January 1984

Dear David

ms

PUBLICATION OF 1984 PUBLIC EXPENDITURE WHITE PAPER

The preparation of the 1984 White Paper is on schedule for publication in mid-February as planned. If the Prime Minister is content, the Chief Secretary proposes that publication should be on Thursday 16 February. Publication earlier in that week is not possible as the Chief Secretary is attending OECD Ministerial meetings in Paris from 12 to 15 February. Our consultations show that publication of the White Paper on 16 February would not clash with any other major publication or announcement.

There was no oral statement last year on publication of the White Paper and a statement does not seem necessary on this occasion. It should be sufficient to announce the date and time of publication in a Written Answer shortly before and then place copies in the Vote Office.

As in the past, we expect the Chief Secretary will take an on-the-record press conference on the White Paper at 3.30 pm. on 16 February.

As the White Paper is a long and complex document, we propose to issue Confidential Final Revises (CFRs) on the afternoon of Wednesday 15 February, embargoed until 3.30 pm. on the following day. The Treasury's Press Office, in making their arrangements for publication, will consult and agree these in the usual way with your Press Office at No. 10.

X) I am copying this letter to David Heyhoe (Lord Privy Seal's Office). We shall of course provide Mr Biffen with briefing on the White Paper for his meeting with the Lobby on the same day.

Yours sincerely
J. Gieve

JOHN GIEVE
Private Secretary

CONFIDENTIAL

DRAFT CABINET PAPERPUBLIC EXPENDITURE AND TAXATION IN THE LONGER TERM
MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

A public debate on the longer-term prospects for public expenditure has been under way for some time. It should prove useful, for our declared aim is to reduce the burden of public spending and taxation, and it will help if we can, by emphasising the fiscal rewards, widen support for reining back the growth in public expenditure and so taxation. I believe that the time has now come for us to contribute to the debate. In any event, the Treasury and Civil Service Committee are about to call for a paper on the issue; and we shall have to comply. The right course is, I believe, to publish a Green Paper, or some other form of discussion document.

2. But obviously this is not without difficulties:-

- i. Different expenditure programmes have enormously varying timescales - for example, the full burden of the State earnings-related pension scheme does not arise until well into the next century.
- ii. There are major uncertainties - for example about the rate of growth of output. This can be handled by giving alternative projections, but the risk is that these will blur the message.
- iii. Some key economic assumptions - for example the rates of decline in unemployment, and of growth of real earnings - may be misrepresented as forecasts or even objectives.

More significantly, the 1982 work on long-term public expenditure, which was leaked to the press, shows the difficulties of projecting individual Departmental programme totals, forecasts of which are at once misrepresented as Government commitments or Treasury aims.

3. To meet these problems the Chief Secretary and I now propose a different approach, which would avoid the need to display any individual programme figures. As explained in

C(84)[], I shall need to publish a new medium term financial strategy (MTFS) with the Budget, and I believe that it should extend to 1988-89, thus including expenditure totals for two further years beyond the 1986-87 horizon of this month's Public Expenditure White Paper. I propose the simultaneous publication of a Green Paper projecting overall public expenditure totals forward, on alternative assumptions, for a further 5 years to 1993-94, and showing what this would mean for the burden of taxation.

4. The Green Paper would start with two introductory sections:

- i. A section on past public expenditure trends, showing the seemingly inexorable rise over the past 20 years, at an annual average rate of 1½ per cent, taking the total to over 40 per cent of GDP: and, in parallel, the growth in the burden of taxation, now up to 39 per cent of GDP compared with the 1978-79 level of 34 per cent. This section would also show how, notwithstanding the considerable contribution North Sea taxation has made to the public finances, the burden of non-North Sea taxation has grown since 1978-79, from 35 per cent to 39 per cent of non-North Sea GDP.
- ii. A section drawing attention to likely pressures for further spending increases over the next decade - eg demography (health and social services), technology (notably defence and health), and capital infrastructure.

5. The central part of the paper would recall our 1979 commitment to reduce public expenditure as a proportion of GDP, and the actual course of events, which saw a sharp rise in this proportion, to a peak of 44 per cent of GDP in 1981-82. It would explain the reasons, which are in no way disreputable, and owe much to the recession. But it would go on to show how the tax burden could be reduced and economic prospects improved if, with recovery well under way, these pressures were held in check, and the public expenditure totals held constant in real terms through to 1993-94.

6. The annex sets out some projections, (which would require reworking before publication). The main case assumes 2% GDP growth, and shows that with expenditure held constant in real terms throughout, the non-North-Sea tax burden would still be above the 1978-79 level (which we denounced at the time as too high) by 1988-89, and around 32% by 1993-94, ie just below the 1973-74 level (33%), but still some way above the level of the early 1960s. This would produce a sharp improvement in incentives. If other taxes

were held constant as a proportion of GDP, the rate of income tax could be reduced to 25p and allowances raised substantially, bringing the married man's allowance to nearly 60% of average male earnings as against 31% now. In practice, of course, some of the revenue would certainly be used to reduce the burden on the corporate sector.

7. It would of course be possible to illustrate other cases - for example an annual growth in expenditure of $\frac{1}{2}\%$ or 1% after 1988-89. But if we do not leave ourselves room for substantial tax reductions, the rate of GDP growth would be unlikely to maintain the 2% average: the average over the past decade was only 0.9%. The annex takes 1 $\frac{1}{2}\%$ GDP growth as a lower variant, and shows that with 1% growth in expenditure we could expect to get the non-North-Sea tax burden back to the 1978-79 level only at the very end of the 10 year period.

8. If Cabinet agrees to the principle of publishing a Green Paper at Budget time, I would welcome views on the appropriate spending assumption for the period after 1988-89, and would circulate a full text for clearance within the next fortnight.

ANNEX: PROJECTIONS OF PUBLIC FINANCES TO 1993-94

1. The projections discussed here illustrate various paths of public expenditure over the next decade, and their implications for the burden of taxation.
2. A key factor in the projections is the assumed rate of economic growth. This affects not only the amount of tax which is collected for given rates and allowances, but also the burden of taxation associated with given paths of public expenditure and borrowing. For the first five years of the projections, to 1988-89, GDP is assumed to grow by an average 2½% per annum. Thereafter, there are two factors pointing to some slow down in the growth rate: the North Sea sector will by then be contributing minus ½% per annum to total GDP growth; and the growth of the labour supply will be somewhat less than in the first half of the decade.
3. The growth rate after 1988-89 will depend in part on the success of policy in bringing down the share of public expenditure and the burden of taxation. Accordingly we consider two cases. In the first, total GDP grows by 2% per annum, equivalent to about 2½% per annum for the non-North Sea sector. This is about the average for the post-war period, and significantly better than the last decade. In the second case total GDP grows at 1½% annum, equivalent to about 2% for the non-North Sea sector. Higher growth is more likely, the greater the reduction in the tax burden.
4. The path of North Sea tax revenues has an important bearing on the burden of non-North Sea taxation. Apart from the profile of production, the behaviour of real oil prices is of key importance. It is assumed here that after falling over the next two years or so in real terms, they flatten off and then start to rise again as the balance of supply and demand becomes progressively tighter. From 1988-89 they may be rising by 2-3% per annum, but even so North Sea revenues fall from about 3% of GDP in 1984-85 to about 1½% in 1993-94 as output falls.
5. Another important feature of the projections is the path of net debt interest payments. This reflects the paths of public sector borrowing and interest rates. On the latter, some fall in real interest rates from present high levels is to be expected, with the path depending on the course of the PSBR and world interest rates. Falling inflation also points to lower nominal rates. If stable prices are achieved by the end of the period and real interest rates have come down to more normal levels, then net debt interest may fall from about 3% in 1983-84 to a bit under 1½% in 1993-94. This more than offsets the fall in North Sea taxes.

6. Falling inflation and interest rates require a reduction in the PSBR as a percentage of GDP. It is not possible at this stage to anticipate the path in the MTFs, but for the purposes of this exercise we assume that it falls gradually to 1% by the end of the period.

7. It follows from these assumptions that the non-North Sea tax burden can be lightened to the extent that the fall in public expenditure relative to GDP exceeds the required reduction in the PSBR. By 1988-89, even if the public expenditure planning total is held flat in real terms - in line with the MTFs, but 2 years longer than in the Public Expenditure White Paper - the non-North Sea tax burden would still be above its level in 1978-79*. The figures are shown below.

I assume this is the 2 1/4 growth case.

The Burden of Taxation in the MTFs period

	<u>1978-79</u>	<u>1983-84</u>	<u>1988-89</u>
Non-North Sea Tax	34.7	38.6	35 1/2
Total Taxes	34.1	38.8	36

8. By 1993-94, some further reduction in the tax burden should be possible if the growth of public expenditure is held in check. Figures are presented here, for the two GDP paths discussed earlier, on two different assumptions about public expenditure. The assumptions are for growth in the planning total of zero and 1% per annum in real terms after 1988-89. The tax implications are summarised in the table below.

The Burden of Non-North Sea Taxation in 1993-94

<u>GDP growth (pa)</u>	<u>Public Expenditure Growth (pa)</u>	
	<u>zero</u>	<u>1%</u>
<u>1 1/2%</u>	32 1/2	34 1/2 ← ie about starting point - 1978-79
<u>2%</u>	31 1/2	33 1/2

*The burden of non-North Sea taxes is defined as non-North Sea tax revenues as a share of non-North Sea GDP. It falls more than the share of non-North Sea taxes in total GDP because of the declining contribution of North Sea output total GDP. Recent data for the tax burden are as follows:

<u>1975-76</u>	<u>1976-77</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
36.5	36.4	35.4	34.7	35.7	36.9	39.6	39.5	38.6

9. If the public expenditure planning total were to be held flat, the burden of non-North Sea tax could be brought down to well below its 1978-79 level of 34.7% by 1993-94. The higher growth assumption is more likely to be the appropriate one in this case. But even so, the tax burden would be only fractionally lower than it was in 1973-74, the end of the previous Conservative administration, and still some way above the level of the early 1960s.** With 1% growth of public expenditure the picture would be worse. After a decade, the tax burden would be only marginally lower than the 1978-79 figure, which was widely held to be excessively high.

** Figures for the (non-North Sea) tax burden in selected earlier years are:

<u>1963-64</u>	<u>1973-74</u>	<u>1978-79</u>
30%	33%	34.7%



mt

10 DOWNING STREET

Prime Minister

To note conclusions of discussions on chemists' remuneration. I had not realised that the principle raised by the post 1980 chemists (why should we have any overpayment deducted in respect of a period when we were not in business) is also applicable to other NHS contractors.

This strengthens the case for legislation, which is designed to put the law back to where all parties thought it to be

AT
20/11

BF. 2/2/84

From: P J Stibbard
19 January 1984

MISS M O'MARA


cc Mr Folger
Mr Hart
Mr Duff
Mrs Todd
Mr Ward - CSO (with incoming
note)

RATIOS OF EXPENDITURE TO GDP

Your note of today to Philippa Todd.

2. The CSO wrote to Andrew Turnbull on 30 November reconciling the PEWP and OECD definitions for 1981-82/1981 (copy attached). I would be grateful if the CSO could do the same again (with the ET article figure as a starting point this time) for both the years in question. It will also be useful to know the rationale of the OECD treatment of "certain pension schemes" and details of any other major reason why the OECD figures show a different trend to the PEWP figures.

3. I note that the difference between the mid-1970s peak and the level in recent years is about the same on the current PEWP definition and on the UK version of general government expenditure - although they diverged last year (respectively the black unbroken line and the blue broken line in Chart 2 of the ET article - offprint attached to top copy). So it appears that OECD adjustments are the main cause of the difference. Perhaps the CSO could let us know whether the OECD use the same GDP ^{definition} as ourselves and whether they have yet incorporated the GDP revisions made last Autumn by the CSO.


P J STIBBARD

Geom Pot - Public Exp Pt 26



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ec 170

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

Prime Minister ②

To note. I do not think
Government is required to underwrite
any particular section of the capital
goods / investment sector. I suspect
much of the decline in construction
is due to completion of the motorway
network

My ref:

Your ref:

11 JAN 84

ms

Dear Peter,

AT 12/11

Your Private Secretary circulated draft texts of the public expenditure White Paper on 10 January. I have made a few detailed drafting comments which have been conveyed to your Department at official level, which I hope can be taken on board.

You drew attention to the new Table 1.13. I welcome this new presentation of the total picture on capital expenditure including construction expenditure and expenditure on capital equipment. But I think you should be cautious about the interpretation of it. It may be true that total capital expenditure has remained level in cost terms over the past five years. But within this, construction expenditure has declined by some 25% to 30%. Although expenditure on equipment eg in the Defence field has grown substantially over the period this will not be regarded as an adequate offset either by the construction industry or by those concerned about the state of the public infrastructure.

I was also interested to see Arthur Cockfield's letter about Table 1.13. I was myself happy to see this Table presenting the gross capital expenditure figures since this is what is most directly relevant to meeting needs in the various programmes, and to the level of public sector work for the construction industry. The convention which Treasury are often obliged to follow elsewhere in the White Paper of presenting net figures (ie gross capital expenditure net of receipts) often gives a very misleading impression of the scale of programmes that are supported by a large volume of receipts, particularly the housing programme. We would therefore be glad to see more rather than less use made of gross figures in future, where these are relevant. Meanwhile, however, I would not of course object to including some explanation in the text about Table 1.13 on the lines Arthur Cockfield suggests.

Finally I very much support the point Arthur Cockfield makes about the need to establish better information about the state of the capital stock in the public sector, and whether we are doing enough to keep it in good condition. This will of course be a central theme of the current NEDC study of the built infrastructure and of the interdepartmental group which we have recently agreed to establish to liaise with that study. So far as the present White Paper is concerned we need to underline the importance

CONFIDENTIAL

of repair and maintenance expenditure maintaining the capital stock and one of my drafting suggestions has been to include a reference to the level of expenditure on repair and maintenance in the commentary on Table 4.5.

I am copying this letter to Cabinet colleagues.

Your ever
Pat

PATRICK JENKIN

Elon Pol:

Public Exp Pt 26

19 JAN 1984

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NBPM

AT 17/1

cc FOREIGN Policy
Review of British Council
Aug. 79

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State
Foreign and Commonwealth Office
Downing Street
London SW1A 2AL

16 January 1984

Re: Secretary of State,

FCO EXPENDITURE PROBLEMS

will request if required

We are meeting on Wednesday to discuss your minutes of 12 December and 9 January about the effect of sterling depreciation on FCO expenditure. Meanwhile it might be helpful if I reply on the two other issues outstanding between us - the case limit breach in 1982-83 and your proposal for extra provision for the British Council.

Cash Limit Breach 1982-83

You minuted me about this on 12 December. I accept that the Exchequer did not lose as a result of the breach, because the extra receipts which could not be appropriated in aid of your Vote came in as Consolidated Fund Extra Receipts. However, I understand that the fact that the excess expenditure was matched by extra receipts was only established for certain when the final accounts were being put together well after the end of the financial year. If sterling had moved differently, there could have been a real loss to the Exchequer. It is the failure to control your expenditure flow towards the end of the financial year to ensure that the cash limit was observed which disturbs me, and my officials will be discussing with yours how your financial management system can be improved. I do not feel therefore that there are sufficient extenuating circumstances to justify an exception to the rule requiring a corresponding adjustment in the year following a cash limit breach. The FCO have already been favourably treated in this respect by my agreement that there should be no offsetting deduction for the 1982-83 Vote 2 cash limit breach. I would be grateful if you would arrange for an early announcement to Parliament of the breach and the reduction of £1.2 million this year.

You also referred in your minute to the prospective outturn for 1983-84. I understand that you now expect to be able to stay within your cash limit without using receipts which would normally come to the Exchequer. I am very glad to hear this, as it would have been very difficult for me to provide you with extra money in this way. I appreciate that the £1.2 million deduction will make things a little tighter, but I do not think it is too much to ask you to make any marginal adjustments to your expenditure which are necessary.

British Council

In your minute of 30 December you asked for additional provision for the British Council in 1983-84 and 1984-85 and responded to my comments about the Council's lobbying activities.

I am prepared to accept an increase in the British Council cash limit in 1983-84, in accordance with the Blaker commitment, to cover the risen costs experienced by the Council. I think however that ODA should contribute their appropriate share of this from within the Aid Programme which under the 65:35 formula would come to about £1 million. Officials are still checking the figures, but subject to that I agree that the British Council cash limit should be increased by up to £1.9 million.

We then need to consider how this £1.9 million increase should be financed. Although I appreciate that you are fairly tight up against your cash limit on your main Vote this year, I would normally have to ask you, even at this late stage in the year, to make the fairly small savings necessary to accommodate this. Since however I am having to maintain my position on the £1.2 million deduction for the cash limit breach, I am prepared to offer a package settlement whereby I will find the £1.9 million for the British Council from the central Contingency Reserve if you accept the £1.2 million cash limit cut in Vote 1.

I am most surprised that you should propose a further increase in the British Council's PES provision for 1984-85. We considered this proposal in our bilateral discussions in the autumn and you agreed to withdraw it. It was only on this basis that I was able to accept the overall settlement we reached and it is simply not acceptable for you to reopen this now. The Council has been aware for some time that the Blaker commitment lapses at the end of 1983-84 and that their budget will be subject to the normal rules of cash planning from 1984-85. We have already treated them

favourably by adding £4.3 million to their PES provision for 1984-85, in order to help them maintain their level of activity and minimise the difficulties of moving into the cash planning era, albeit some time after the rest of the public sector. Though no new money can be made available for the Council I would be prepared to consider a proposal to transfer some of your existing cash-limited provision to their grant-in-aid, if that is your order of priority.

On the question of the Council's lobbying activities, the independence to which you refer does not in my view justify the use of Government-financed resources to campaign against the Government (this morning's Times leader is another example). I feel strongly that you should make this clear to the Council - and you may wish to add that it is counter-productive as far as the Government is concerned.

I am copying this letter to the Prime Minister.

yours sincerely

PR

per PETER REES

*(Approved by the Chief Secretary
& signed in his absence).*

~~1) For Pot Aug 79 Brit Council~~

~~2) Econ Pot Public Exp.~~

recommendations which have a wider application are being followed up as part of the Department's management priority of improving service to the public.

A number of steps already taken—for example, the introduction of a postal claim form for the unemployed claiming supplementary benefit—assist in meeting objectives mentioned by the report; and its ideas will also be taken into account in the current study of problems in inner-city DHSS offices.

Turning Point (Grant)

Mr. Stevens asked the Secretary of State for Social Services if he will now give a decision on the application from Turning Point for a grant in respect of renovations to the property which is the basis of the ROMA project for drug users.

Mr. Geoffrey Finsberg: No. It is not possible to make a decision on the information supplied so far by the organisation. We are in contact with Turning Point about this, and a decision will be made as soon as possible.

ROMA Project

Mr. Stevens asked the Secretary of State for Social Services when he will announce the 1982-83 revenue grant to the ROMA project for drug users.

Mr. Geoffrey Finsberg: A letter has been sent to the project's chief executive today advising him of the award of grant-aid for ROMA.

Communication Aids (Resource Centres)

Mr. Waller asked the Secretary of State for Social Services when and where resource centres will be set up to act as focal points for the development and sharing of expertise in the application of communication aids for speech-impaired people.

Mr. Rossi: The Department, in conjunction with the Royal Association for Disability and Rehabilitation, has decided to provide funds for the development of communication aids centres in Hammersmith and Fulham health authority, at the Charing Cross hospital; in Sandwell health authority; in Newcastle health authority; and in the Institute of Child Health, at the Wolson centre. My right hon. Friend the Secretary of State for Wales is taking similar action to create a centre at the Rookwood hospital, Cardiff. These, together with the existing centre at the Frenchay hospital, Bristol, will form a national network of centres specialising in the use and development of communication aids.

NATIONAL FINANCE

Tax Payments (Interest Charges)

Mr. Iain Mills asked the Chancellor of the Exchequer if he will introduce legislation to give discretionary powers to Her Majesty's Inland Revenue on the application of interest generated by late payment of tax where the late payment was due to delays caused by prolonged assessment by the district valuer.

Mr. Ridley: Where a substantial delay on the part of the Inland Revenue gives rise to an interest charge, the

Revenue has discretion to mitigate or remit the interest charge otherwise due. Such consideration is also given to cases involving the valuation office.

Capital Outflow

Mr. Austin Mitchell asked the Chancellor of the Exchequer what effect the outflow of capital in recent months has had on the money supply.

Mr. Bruce-Gardyne: It is misleading to consider the monetary impact of either the capital or the current account in isolation. The inevitable counterpart to a large current account surplus is a net capital outflow. But to the extent that the private sector runs an overall balance of payments deficit there will be a net contractionary effect on the domestic money supply.

The most recent estimates for the external counterparts to changes in £M3 appear in table 11.4 of the January edition of "Financial Statistics".

Mr. Austin Mitchell asked the Chancellor of the Exchequer whether he will take steps to counter the contractionary effects of the outflow of capital in recent months on the level of economic activity.

Mr. Bruce-Gardyne: The net capital outflows of recent years are the inevitable counterpart to a large current account surplus. Capital outflows in the form of direct and portfolio investment by United Kingdom residents overseas represent an increase in the nation's net financial wealth. As such they provide a useful source of future net revenue from overseas.

There is no reason to believe that recent capital outflows have exerted a contractionary effect on the United Kingdom economy. There is little evidence to suggest that the capital spending of United Kingdom firms has been constrained by a shortage of external finance. Moreover, United Kingdom direct investment overseas often increases the United Kingdom's access to overseas markets, thereby encouraging output and investment in the domestic economy.

Government Expenditure

Mr. Wigley asked the Chancellor of the Exchequer what is his latest estimate of the effects on central Government spending to date during the current financial year arising from the interest rates being lower than those projected at the time of the Budget.

Mr. Brittan: Estimates of the effects of interest rates differed from those previously projected are not available. Estimates of expenditure on public expenditure programmes and of debt interest payments for 1982-83 as a whole are published today in the public expenditure White Paper. Estimates of central Government payments of debt interest will appear as usual in the Financial Statement and Budget Report on Budget day.

Independent Television Companies (Corporation Tax)

Mr. Watson asked the Chancellor of the Exchequer what is the Government's anticipated revenue from corporation tax levied upon independent television companies for 1982-83.

Mr. Wakeham: I regret that this information is not available.



10 DOWNING STREET

From the Private Secretary

13 January, 1983

FILE

B/C: MLOWEN

RW

cc: HO	MJD
LCO	MAFF
HMT	DOE
FCO	SO
DES	WO
NIO	DTI

LPO
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D/Am.
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CDLO
CO

PUBLIC EXPENDITURE WHITE PAPER

The Prime Minister has seen your two letters to me of 10 January. She has noted the points made on the text of Part 1. She is content that the text of all three parts should now be sent to the printers, for publication on Thursday, 16 February.

I am sending a copy of this letter to the Private Secretaries to all Cabinet Ministers.

(A. Turnbull)

J. Gieve, Esq.,
Chief Secretary's Office

SH

✓ CC NO

CONFIDENTIAL



Chancellor of the Duchy of Lancaster

NORM AT 17/1
CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

13 January 1984

Dear Peter,

In your Private Secretary's letter of 10 January to the Private Secretary at No 10 you draw specific attention to the new presentation of capital expenditure in Table 1.13. You comment that;

"It can be demonstrated from this table that in real terms the level of this expenditure has been broadly the same since 1978-79."

There is one aspect of this which continues to be troublesome namely the argument commonly put forward that the privatization programme constitutes sales of capital assets by Central Government and should be set off against capital expenditure. On the basis of this argument the level of capital expenditure would be falling, not broadly constant. We are under constant attack by Jack Diamond on this point and he is drawing of course on his previous knowledge as Chief Secretary. The point is particularly sensitive in relation to the new White Paper presentation as one of the major factors in producing the broadly constant level of expenditure is that receipts from Council Houses have been added back. I know what the answer to the Diamond argument is: but I wonder whether there might be some merit in pre-empting the argument in the White Paper rather than leave the field wide open to the Diamonds. The White Paper already contains a "Commentary" on the new Table but it is a pretty meagre commentary.

There is another strand in the Diamond argument, namely that what we are looking at is gross capital expenditure without any indication whether or not that is sufficient to maintain our capital stock or whether, as Diamond would argue, our capital stock is deteriorating. This is much more difficult to answer as the factual information needed is presumably not available.

I am sending copies of this letter to all other members of Cabinet.


COCKFIELD

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
H M Treasury
Parliament Street
London SW1

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Econ for Public Exp.

CONFIDENTIAL

CC NO



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

NBPM

AT 17/1

John Gieve Esq
Private Secretary to the
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

13 January 1983

Dear John,

PUBLIC EXPENDITURE WHITE PAPER 1984

I refer to your letters of 10 January to Andrew Turnbull covering the texts of Parts 1, 2 and 3 of the White Paper.

My Secretary of State's only comments concern the chapter on local authority expenditure at the end of Part 2. On paragraph 2 of that chapter, Mr Younger was sorry to see that the Chief Secretary felt it necessary to make cost terms comparisons between England, Scotland and Wales using a base year before the Government came into office. The use of the past tense in the fourth sentence of that paragraph is not accurate since it refers to budgets and in Scotland the actual expenditure will not be as high once selective action and general abatement are taken into account. This sentence should therefore be reworded as follows:

"In 1983-84 local authorities budgeted to spend, in cost terms, 9% more in England, 15% more in Scotland and 2% more in Wales than they actually spent in 1978-79."

I am copying this letter to Andrew Turnbull and to the Private Secretaries of all Cabinet Ministers.

Yours sincerely,
John Graham

J S GRAHAM
Private Secretary

Econ Pol. Public Exp

Pt 26



17 JAN 1991

See: H(84)2 10/184

pa
Dms
16/1



10 DOWNING STREET

MS

Prime Minister⁽²⁾

This is the paper on
chemists remuneration
referred to at your
seminar on the health
service yesterday.

The meeting then was strongly
in favour of legislation as
proposed by Mr Fowler. His
paper will be considered by
H Committee next Wednesday
(18 January).

Dms
13/1



10 DOWNING STREET

Prime Minister ⁽¹⁾

Attached is Part I of the Public Expenditure White Paper. The Chief Secretary's letter highlights the main points - in particular the new section on public sector capital spending.

I have not sent you the draft of Part II on the individual programmes. It is 2 inches thick and in poor condition. But if you want to see the text of any particular programme, I can send it.

Content with publication?

Yes

MVI

AT

12/1

DRAFT

MAIN POINTS FROM THE WHITE PAPER

- The Government's revised plans for expenditure in 1984-85 total £126.4 billion. This is the same as the provisional total for that year published in the last White Paper (Cmnd 8789) and confirmed in the Autumn Statement.
- On the assumption of an increase in the general price level of 5 per cent between 1983-84 and 1984-85, the level of public expenditure is expected to be broadly stable in cost terms between the two years.
- A provisional planning total of £132.1 billion has been set for 1985-86 - broadly the same as the figure in Cmnd 8789. *on increase of 4.5 per cent.*
- For 1986-87, the provisional planning total is £136.7 billion, a cash increase of around 3½ per cent on the preceding year.
- The main changes in the expenditure plans for 1984-85 compared with Cmnd 8789 are increases for agricultural support (£0.4 billion), local authority current expenditure (£0.6 billion) and social security (£1.3 billion); and decreases in provision for defence (£0.3 billion), housing (£0.5 billion) and nationalised industries' external finance (£0.7 billion). Receipts from special sales of assets are expected to increase by £0.4 billion.

- Since the Autumn Statement, within the unchanged planning total, the reserve for 1984-85 has been reduced by £250 million. This results mainly from an increase in the estimated take-up of some social security benefits, partially offset by a reduced requirement for the Youth Training Scheme. As announced in the Autumn Statement, to improve control the reserve will in future cover all contingencies, including estimating changes as well as policy changes.

- A new Table 1.13 indicates more fully the expenditure of the public sector on capital goods and the value of work commissioned from the construction industry. Total capital expenditure in the public sector as presently constituted is planned to be about £23.9 billion in 1984-85; in cost terms it has been at broadly the same level since 1978-79.

DRAFT

PART ONE

THE EXPENDITURE PLANS

INTRODUCTION

1. This White Paper sets out the Government's plans for expenditure in the years 1984-85 to 1986-87. The plans are summarised in Table 1.2, which shows the composition of the planning total.

2. The planning total for 1984-85 emerging from this White Paper is £126.4 billion, the same figure as in the last White Paper (Cmnd 8789 of February 1983). This is some £6.1 billion higher than the latest estimated outturn for 1983-84, which is now expected to be some £0.7 billion above the Cmnd 8789 plan: thus, on the assumption of an increase in the general price level between 1983-84 and 1984-85 of 5 per cent, the public expenditure planning total is expected to be broadly stable in cost terms between the two years. The planning totals for 1985-86 and 1986-87, £132.1 billion and £136.7 billion respectively, are provisional and will be reviewed in the 1984 Survey. The total for 1985-86 is broadly the same as in the last White Paper.

CHANGES SINCE CMND 8789

3. Table 1.12 shows the changes since Cmnd 8789. Further detail is in the programme chapters and Table 4.2 in Volume 2.

4. The main changes in the expenditure plans for 1984-85 compared with Cmnd 8789 are increases in provision for agricultural support (£0.4 billion), local authority current expenditure (£0.6 billion) and social security (£1.3 billion); and decreases in provision for defence (£0.3 billion), housing (£0.5 billion) and external finance for the nationalised industries (£0.7 billion). Receipts from special sales of assets, which go to reduce the planning total, are expected to increase by £0.4 billion, reflecting among other changes the fact that the sale of Enterprise Oil is now expected in 1984-85.

MAIN FEATURES OF PROGRAMMES

5. Table 1.3 and Chart 1.4 show the main programmes as now planned.

Social Security

6. By far the largest single programme is social security. It accounts for over one-quarter of the total, and is nearly all on benefits, about half on benefits payable to those over retirement age.

7. Since Cmnd 8789 there has been a return to the "historic" method of uprating benefits used before 1976. The programme provides for upratings in November based on the rise in prices in the twelve months ending in the previous May. (Decisions on the level and details of the uprating will normally be announced by the Secretary of State for Social Services in June of each year.) The projections assume that the retail prices index will rise by $5\frac{1}{2}$ per cent between May 1983 and May 1984, and by $4\frac{1}{2}$ per cent and 4 per cent respectively in the next two years, and that unemployment (Great Britain, excluding school leavers etc) will average 2.85 million in 1983-84 and thereafter. These assumptions are not forecasts or predictions. The assumption that unemployment for the later years will remain at the same level as for 1984-85 follows the usual convention; the actual level of unemployment in later years will depend on developments in the world economy and at home.

8. The plans show an increase of about £1300 million in 1984-85 and £1600 million in 1985-86 compared with Cmnd 8789. The reasons for this include the effect of the 1983 benefit improvements and uprating, (including the 11 per cent increase in child benefit and one parent benefit), and the effect of changes in the uprating assumptions for 1984 and 1985, slightly offset by lower unemployment assumptions. Together these factors added about £600 million in 1984-85 and £840 million in 1985-86. Another factor is revised estimates of expenditure on supplementary benefit, associated with a higher number of beneficiaries than previously estimated, and on housing benefit. These are partly offset by lower estimates of expenditure on unemployment benefit. Reductions in the coverage of help with housing costs were announced in the Autumn Statement. Final and detailed decisions affecting the composition of expenditure in 1984-85 will be taken in the context of decisions on the next uprating of social security benefits.

Defence

9. The provision meets the Government's commitment to plan to implement the NATO aim of 3 per cent real growth per annum up to 1985-86; the 3 per cent growth commitment has not been extended into 1986-87. Additional provision has been made in each year in respect of Falklands costs.

Housing

10. The net public expenditure provision for housing covers current spending on subsidies and administration plus capital expenditure on new public sector building, refurbishment of public sector stock, support for owner-occupation through low-cost home ownership initiatives, and improvement grants to the private sector less receipts, mainly from sales of public sector dwellings.

11. The revised net provision of £2500 million for 1984-85 is a reduction of £490 million compared with Cmnd 8789. This stems mainly from an increase of £295 million in the forecast level of receipts and some reduction in the provision for capital expenditure. It is assumed that rents will rise in line with prices. The new level of gross capital provision is broadly the same in cash terms as that for 1983-84.

12. The net provision for 1985-86 and 1986-87 is £2610 million and £2680 million respectively. That for 1985-86 is a net reduction of £500 million compared with Cmnd 8789 mainly in the provision for capital expenditure, although it still represents a cash increase of £110 million on the revised plans for 1984-85. This is consistent with the Government's policy of shifting the balance in the provision of new housing towards the private sector.

Agricultural Support

13. The increases for the Intervention Board for Agricultural Produce of some £420 million in 1984 - 85 and £240 million in 1985-86 represent revised forecasts of the costs of implementing the Common Agricultural Policy (CAP) in the United Kingdom. This largely reflects additional spending on intervention purchases, an element of CAP support which falls initially to be financed by Member States rather than pre-funded from the European Community Budget. These costs are largely recouped as and

when intervention stocks are sold. The projections depend critically on developments in agricultural markets.

Health

14. Compared with Cmnd 8789, expenditure on the National Health Service (NHS) in England is maintained at the planned level in 1984-85 and increased by £148 million above plan in 1985-86 - ie. by £728 million over the 1984-85 level. The new plans provide for a further increase in 1986-87 of £698 million (5 per cent) over the new 1985-86 level. The plans provide for growth in the hospital and community health services in recognition of demographic pressures; and for increased demand mainly in the Family Practitioner Services.

Education and Science

15. The plans allow for an increase of £140 million in 1984-85 over Cmnd 8789 and of £104 million in 1985-86. The increases in the first two years are mainly in local authority expenditure (see paragraph 21 below), offset by a small net reduction in voted expenditure. The new plans provide for a further increase of £302 million in 1986-87 compared with the new level for 1985-86. The plans for higher education allow for more students than were provided for in Cmnd 8789. The parental contribution to the student award will be higher for those in the upper part of the income scale.

ANALYSIS BY SPENDING AUTHORITY

Central Government

16. Central government expenditure in aggregate accounts for nearly three-quarters of total programmes. Of this:

- slightly less than half is on goods and services, mainly for defence and the National Health Service; the pay and related costs of the civil service amount to just under one tenth of central government expenditure;
- just under 40 per cent is social security benefits;
- the remainder is other transfer payments, such as housing subsidies, industrial support and lending to the nationalised industries.

The figures are summarised in Table 1.5

Nationalised industries

17. The nationalised industries' external finance is shown in Table 1.6. Part 3 sets out changes of coverage and shows the external financing limits for individual industries in 1984-85. As in previous White Papers, no comparable financing breakdown is shown for subsequent years. The finances of trading bodies such as nationalised industries depend on trading conditions and results and there may be large swings in either direction for individual industries.

Table 1.6 Nationalised industries' external finance: £ million cash⁽¹⁾

	1983-84 estimated outturn	1984-85 plans	1985-86 ⁽²⁾ plans	1986-87 ⁽²⁾ plans
Borrowing from Government (net)	983	856	112	-404
Market and overseas borrowing (net)	-260	-827	-587	-895
Grants	1891	1852	1620	1390
Total External Finance	2614	1881	1145	91

(1) This table includes the water authorities which this year appear in Part 3 for the first time.

(2) Figures for these years reflect current assumptions about privatisation and exclude certain industries. See Part 3.

18. By comparison with Cmnd 8789, total net external finance for the nationalised industries and water authorities decreases by £734 million in 1984-85 and by a further £1000 million in 1985-86. The Government have encouraged the industries to fulfil their investment plans and make full and proper use of their investment allocations. Investment in 1983-84 is expected to show an increase of 8 per cent over 1982-83 levels. The industries as a whole are planning to finance progressively more of their investment from internally generated funds in future years. Overall, industries' tariffs are expected to rise at or slightly below the rate of increase of the retail prices index in 1984-85.

19. The industries' aggregate needs for external finance are forecast to decline sharply between 1984-85 and 1986-87. By far the largest amounts of external finance continue to be for British Rail and the National Coal Board.

Local authorities

20. Public expenditure by local authorities is shown in Table 1.7. Current spending has continued to exceed planned levels, imposing an added burden particularly on the ratepayer. Accordingly, the Government is seeking to supplement the existing restraints with additional powers.

21. In 1983-84 local authorities budgetted to exceed the provision set in Cmnd 8789 by £1 billion. Once more this has had a knock-on effect into the next year and so, for realism, the government has been obliged to increase provision for relevant current expenditure by £600 million over that underlying Cmnd 8789. As in 1983-84 some of the increase in England and Scotland has not been allocated to services. Further information is contained in Chapter 2.17 of Volume 2.

SPECIAL SALES OF ASSETS

22. Because future receipts from special sales of assets are dependent on content, timing and market conditions, no attempt is made to break down present and future year figures. Details for 1982-83 are included in Part 4.

23. Net sale proceeds from special sales of assets in 1983-84 are expected to total around £1200 million compared with the original target of £740 million and the revised target of £1250 million. Major items in 1983-84 have included the sale of further shares in Cable and Wireless and BP, and a second instalment from the sale of Britoil shares.

24. Target proceeds from special sales of assets have been set at £1.9 billion in 1984-85 (an increase of £400 million since Cmnd 8789), £2.0 billion in 1985-86 and £2.0 billion in 1986-87.

RESERVES

25. The plans for 1984-85 contain a reserve of £2.75 billion over and above the total of programmes. Reserves have also been provided of £3.75 billion for 1985-86 and £4.75 billion for 1986-87. The reduction since the

Autumn Statement of £0.25 billion in the reserve for 1984-85 results from a number of changes, including an increase in the estimated take-up of some social security benefits, partially offset by some reduced requirements e.g. for the Youth Training Scheme. Full details of changes since the Autumn Statement are set out in Table 4.2 of Volume 2.

26. The reserve is now intended to cover all contingencies, including any estimating changes in demand-led and other programmes as well as policy changes and new initiatives during the course of the year. The widening of the reserve to cover all changes in expenditure, for whatever reason they arise, underlines the Government's intention to treat the planning total itself as a control total.

DEBT INTEREST

27. Table 1.2 shows two figures of debt interest. The net definition of debt interest represents, broadly, interest payments financed from taxation or further government borrowing. Gross debt interest represents total payments of debt interest by the public sector as defined in the National Accounts: it thus includes (unlike the net definition) interest payments matched by interest receipts or by provision for interest in the accounts of public trading activities. Table 4.9 of Volume 2 reconciles the two definitions.

CAPITAL EXPENDITURE

28. Tables 1.9 to 1.11 provide an analysis of the planning total by economic category and spending authority. Table 1.13, which appears in a new form in this White Paper, shows expenditure by the public sector on capital goods and the value of work given to the construction industry in each year to 1984-85. The Government have not taken decisions about the allocation of expenditure in the later years in sufficient detail for these analyses to be extended beyond 1984-85.

29. Capital expenditure as defined in most of the tables in this White Paper excludes the capital spending of the nationalised industries and certain other public corporations but includes all their borrowing. It includes the negative effect of council house sales and excludes defence expenditure which, under international conventions for national accounting, is mostly classified as current expenditure even though much defence

expenditure on works and equipment is of a capital nature. Table 1.13 shows that, after taking account of these factors, capital spending in the public sector as at present constituted is planned to be about £23.9 billion in 1984-85. This is about £600 million higher than the estimated outturn for 1983-84. In cost terms, the level of this expenditure has been broadly the same since 1978-79, £21.7 billion compared with £21.6 billion.

30. Within the total of public sector capital spending for 1984-85 shown in Table 1.13, planned expenditure on goods and services accounts for £21.3 billion (89 per cent of the total), an increase of £900 million over the estimated outturn in 1983-84. Of this expenditure, £2.3 billion is on dwellings, £8 billion is on new construction other than dwellings and £11 billion on plant, machinery and other capital equipment. The planned expenditure in 1984-85 on plant and new construction other than dwellings represents an increase of £800 million over the estimated outturn for 1983-84.

PUBLIC EXPENDITURE AND GDP

31. As shown by Chart 1.8, the percentage of public expenditure (including net debt interest and certain other adjustments) to gross domestic product (GDP) peaked at 44 per cent in 1981-82. Using the expected outturn of expenditure and forecasts of GDP as shown in the Autumn Statement, the 1983-84 percentage is expected to be 42½ per cent, falling further to 42 per cent in 1984-85.

CASH LIMITS

32. The White Paper plans for 1984-85 will be translated directly into cash limits, which are the control figures for the coming year. The great majority of limits are on voted expenditure and are published in the Supply Estimates. Others, mostly covering capital expenditure by local authorities and expenditure by Northern Ireland Departments, will be published at the same time. Individual cash limits will not normally be changed during the year. Any increases in cash limits will be charged to the reserve. New arrangements for end-year flexibility on capital programmes will, however, allow some carry-forward of unspent resources to the following year.

33. 40 per cent of public expenditure is directly cash-limited. This includes the external financing limits of the nationalised industries. Another 40 per cent consists of "demand-led" services where, once policy and rates of payments have been determined, expenditure in the short term is substantially dependent on the number of qualified applicants: eg social security benefits. The remaining 20 per cent is local authority current expenditure: the Rate Support Grant, the Government's main contribution to the financing of such expenditure, is subject to a cash limit, but not the expenditure itself. Table 4.3 in Volume 2 gives more detailed information by main programme, distinguishing current and capital expenditure in 1984-85.

MANPOWER

34. The Civil Service is now the smallest since the Second World War. It has been reduced from 732,300 in April 1979 to 636,300 in October 1983; it is intended that a further reduction to 630,000 should be achieved by the end of 1983-84 - a total reduction of 14 per cent. The Government's post-1984 plans - which recognise the important contribution to the control of public expenditure from continued efficiency in the use of resources - are set out in Table 1.15. These propose a continuing steady reduction in the size of the Civil Service to about 593,000 by 1988, a further fall of 6 per cent.

35. For the armed forces, UK based manpower is expected to rise from 320,600 in April 1983 to 332,400 in April 1985. These figures are based on the manpower objectives set out in Cmnd 8288, as increased by subsequent commitments in the South Atlantic and other adjustments. Figures beyond 1985 are subject to review. The figures for 1984 and 1985 include provision for young unemployed engaged for one year's service under the Armed Forces Youth Training Scheme for which some 5,000 places are available.

36. Between 1979 and 1982 total NHS manpower in Great Britain increased by 66,910 (about 7 per cent) to 1,006,700. The increase was predominantly among those directly involved in patient care. The Government are concerned to ensure that NHS manpower is used to the best effect. To this end, manpower targets have been settled with regional health authorities in England. These targets provide for a reduction of 4800 between March 1983 and March 1984 - that is a reduction of $\frac{1}{2}$ per cent. Comparable measures are in hand in Scotland and Wales.

37. Local authorities in Great Britain have reduced their manpower by 91,000 (4 per cent) from 2,361,000 in June 1979 to 2,269,000 in June 1983. Since then, however, this slight downward trend has been reversed. Since manpower accounts for about two-thirds of local authorities' relevant current expenditure, this development is of considerable concern. If local authorities' manpower does not resume its downward path authorities will be faced with difficult choices if they are to remain within the Government's expenditure plans for future years. Within the overall changes in manpower, the service which has seen the largest reduction is education, which employs about half of local government workers: numbers fell by over 75,000 or 6½ per cent between 1979 and 1983. Over the same period, school rolls fell by 10 per cent. The staff employed on law and order services increased by over 13,000 (7 per cent) during this period, consistently with the Government's priorities.

PAY

38. Pay accounts for about 30 per cent of total public expenditure; on some programmes the proportion is much higher. Labour costs are also an important component in the cost structure of the nationalised industries. For the civil service, the health service, the armed forces and other central government groups the present plans are based on the Government's decision, announced on 15 September 1983, to provide in 1984-85 for average increases in pay and allowances of 3 per cent from due settlement dates, after taking account of planned manpower changes.

PUBLIC EXPENDITURE IN 1982-83 AND 1983-84

39. The outturn of expenditure in 1982-83 is now put at £113.3 billion about £0.3 billion more than the preliminary estimated outturn published in Cmnd 8789, after adjusting for classification changes since then.

40. Compared with the planning total for 1983-84 of £119.6 billion in Cmnd 8789, the 1983-84 outturn is tentatively estimated at about £120.3 billion, after taking account of the reductions in cash limits and other changes announced by the Chancellor on 7 July. A smaller than expected underspend on Central Government cash limits is forecast, and there have been increases in some non-cash limited programmes, notably social security and agricultural support. Local authorities are estimated to overspend by £1½ billion on current account. There have been additional

receipts for asset sales (nearly £½ billion) and lower nationalised industries' external financing (£½ billion).

PRICE CHANGES

41. The plans for future years are in cash. Save for the projections for social security and superannuation, they do not depend on specific assumptions about future price changes but are generally consistent with the Government's intention to continue to exercise downward pressure on the rate of inflation.

PUBLIC EXPENDITURE IN COST TERMS

42. Table 1.14 shows public expenditure in "cost terms" for the years up to and including 1984-85. Cost terms figures are the cash outturn or plans adjusted to the 1982-83 price base so as to exclude the effect of general inflation as measured by the GDP deflator. For this purpose the GDP deflator is assumed to increase by 5 per cent in both 1983-84 and 1984-85, as forecast in the Autumn Statement.

Commentary to accompany the new capital spending table (to replace Table 1.13) in PEWP

Table 1.13 is a new table designed to give an indication of expenditure on capital goods and the value of work given to the construction industry by the public sector. It expands a previous table which confined itself to capital expenditure in the public sector on new construction. That table is now included in Part 4 (Table 4.5)

The public expenditure planning total is designed primarily for financial control; it does not provide comprehensive information about public sector capital spending. In particular the figures need to be adjusted to take account of:

- (a) Capital spending of the nationalised industries and some other public corporations. The planning total includes the capital grants to and net borrowing by the corporations (see Table 1.9) but this is only a fraction of their capital expenditure.

(b) Asset sales. Public sector capital expenditure is usually measured net of asset sales, and in particular council house sales. Thus the Government's policy of selling council houses and the privatisation programme decrease public sector capital spending in the conventional presentation (eg in Table 1.9). (Private sector capital spending is correspondingly increased). While receipts from the sale of assets reduce public expenditure as defined in the planning total, they do not in themselves reduce the public sector's demand for capital goods and services or its call on the construction industry. They are not therefore deducted from the figures in Table 1.13.

(c) Virtually all expenditure on defence is classified as current expenditure in accordance with United Nations national accounting conventions. This includes purchases of major items of equipment such as ships, vehicles and aircraft as well as expenditure on barracks and other military installations. Much of this expenditure is of a capital nature and provides work for the capital goods industries.

The figures in the new table take account of these adjustments as far as the available data allow.

The figures cover the following types of expenditure:

(1) Direct expenditure on the purchase of new assets. This excludes purchases (and therefore sales) of land and existing buildings. It should also exclude purchases (and sales) of other existing assets, such as used vehicles or equipment, but it is not possible to separate out these figures and, in any case, the impact would be relatively small.

(2) Capital grants to the private sector, of which the largest components are financial support for the industrial sector and the housing sector. Much of the investment in housing will go to finance construction work, except that the figures for housing associations will also include finance for their expenditure on the acquisition of land and existing buildings.

(3) Net lending to the private sector and investment abroad has not been included in the total but is shown for information.

The figures do not include repairs and maintenance which provides a large amount of work for the construction industry. Similarly the provision of spares is excluded from the figures but provides work for the capital goods industries.

TABLE 1.1. PLANNING TOTALS (1)

	£billion cash					
	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
January 1979 White Paper (Cmnd 7439) ⁽²⁾	109.7	120.1				
March 1980 White Paper (Cmnd 7841) ⁽²⁾	101.0	106.4	112.4			
March 1981 White Paper (Cmnd 8175) ⁽³⁾⁽⁴⁾	104.4	109.9	113.6			
March 1982 White Paper (Cmnd 8494) ⁽⁵⁾	105.7	114.7	120.7	127.6		
February 1983 White Paper (Cmnd 8789)	104.7	113.0	119.6	126.4	132.3	
[This White Paper	104.7	113.3	120.3	126.4	132.1	136.7]

(1) As defined in this White Paper.

(2) Converted into cash using the same inflation assumptions as used for converting the plans in Cmnd 8175. See footnote (3)

(3) Converted into cash as explained in page 103 of Cmnd 8494 Vol 2.

(4) Including changes announced in the Budget Statement on 10 March 1981.

(5) Including changes announced in the Budget Statement on 9 March 1982.

PLANNING TOTAL

Table 1.2

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Public expenditure programmes									
1. Central government (1)	43,606	51,055	62,134	72,293	80,852	85,311	90,350	95,120	99,070
2. Local authorities (1)	17,710	21,199	24,554	26,160	28,683	32,110	31,691	32,590	33,310
3. Certain public corporations capital expenditure	455	581	753	682	679	405	458	390	340
4. Nationalised industries external finance	2,349	2,999	3,221	3,553	2,143	2,500	1,881	1,140	90
5. Other public corporations external financing	1,633	2,086	2,366	1,909	1,490	1,362	1,118	1,100	1,120
6. Planned expenditure on programmes	65,752	77,921	93,028	104,597	113,846	121,688	125,499	130,350	133,930
7. Special sales of assets (net)		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
8. Reserve (2)						250	2,750	3,750	4,750
9. Planned expenditure on programmes, sales of assets and the Reserve	65,752	76,922	92,672	104,676	113,358	120,738	126,349	132,100	136,680
11. General allowance for shortfall (5)						-400			
12. Planning total (outturn / estimated outturn)	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680
13. Percentage change on previous year									
Memorandum items									
Debt interest									
- net (6)	2,204	3,429	4,491	5,741	5,946	7,000	7,500	7,500	7,500
- gross (6)	8,351	10,602	12,638	14,709	15,580	15,600	16,000	16,000	16,000
(not included above)									

TOTAL EXPENDITURE BY PROGRAMME

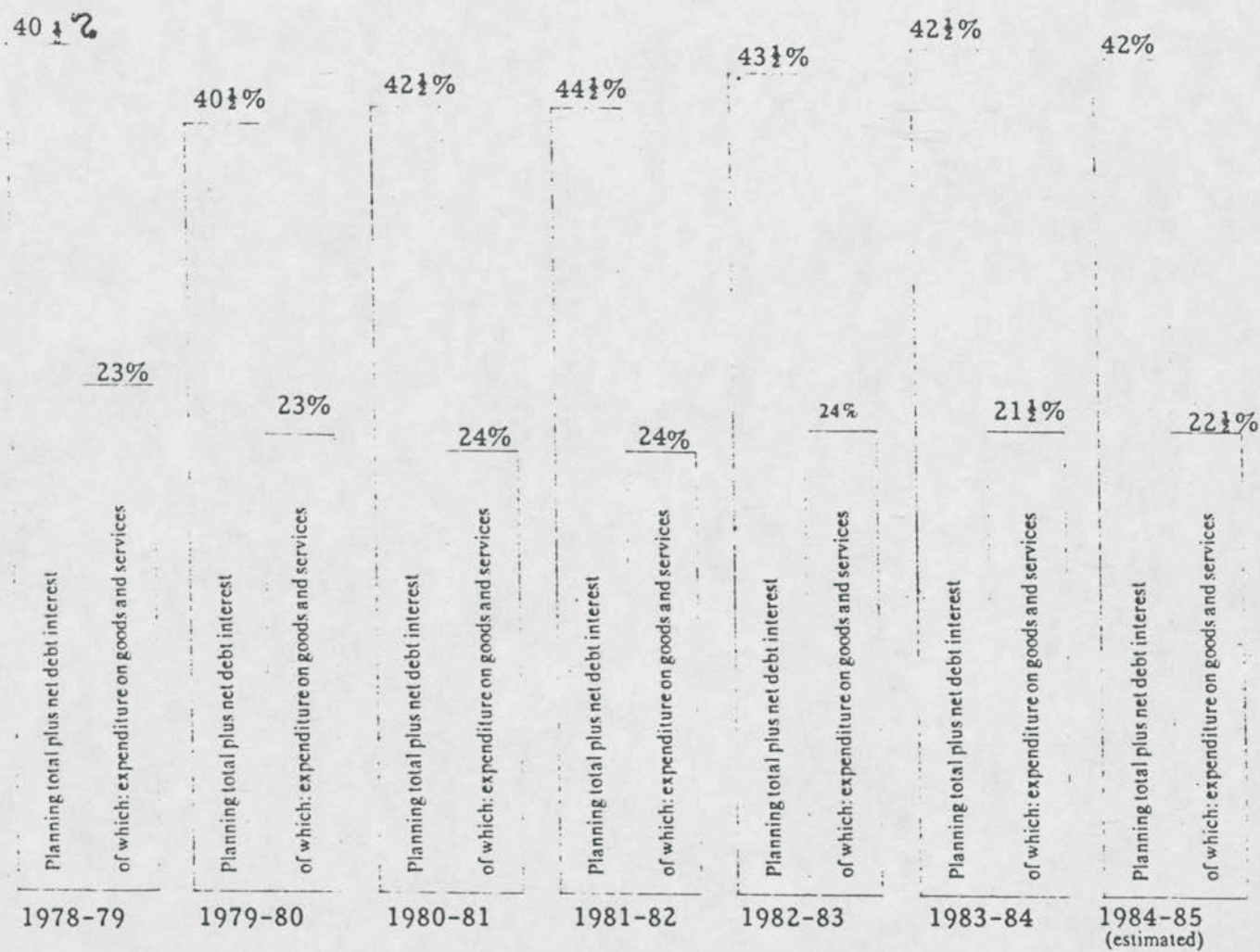
Table 1.3

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Defence	7,497	9,228	11,173	12,605	14,408	15,716	17,031	18,060	18,660
Overseas aid and other overseas services									
<i>Overseas aid</i>	727	798	904	978	984	1,063	1,125	1,160	1,200
<i>Net payments to EC institutions</i>	751	839	221	153	580	500	375	550	600
<i>Other overseas services</i>	367	439	496	554	600	731	783	810	830
Agriculture, fisheries, food and forestry	812	1,007	1,345	1,382	1,861	2,087	2,048	1,920	1,930
Industry, energy, trade and employment	3,991	4,007	5,149	6,771	5,716	6,080	5,599	4,700	3,660
Arts and libraries	340	404	478	524	616	624	599	620	640
Transport	2,672	3,278	4,000	4,277	4,395	4,560	4,376	4,700	4,690
Housing	3,571	4,520	4,461	3,128	2,640	2,760	2,496	2,610	2,680
Other environmental services	2,222	2,640	3,071	3,108	3,554	3,787	3,451	3,540	3,600
Law order and protective services	2,034	2,577	3,160	3,731	4,191	4,681	4,904	5,130	5,280
Education and science	7,754	8,942	10,898	11,841	12,683	13,356	13,052	13,450	13,750
Health and personal social services	7,425	8,899	11,362	12,724	13,817	14,659	15,421	16,250	17,060
Social security	16,437	19,417	23,429	28,567	32,485	35,324	37,207	39,520	41,630
Other public services	966	1,156	1,415	1,538	1,631	1,666	1,789	1,870	1,900
Common services	853	1,009	1,098	1,454	1,560	950	1,105	1,180	1,280
Scotland	3,713	4,547	5,359	5,830	6,243	6,761	6,859	6,970	7,140
Wales	1,489	1,769	2,112	2,218	2,384	2,581	2,588	2,700	2,800
Northern Ireland	2,132	2,446	2,899	3,215	3,500	3,799	4,032	4,220	4,380
Local authority current expenditure not allocated to programmes (England)							660	400	200
Adjustment									
Special sales of assets		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
Reserve						250	2,750	3,750	4,750
General allowance for shortfall						-400			
Planning total	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680

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CHART 1.8 PUBLIC EXPENDITURE AS PERCENTAGE OF GDP AT MARKET PRICES.
[not drawn to scale]



(1) Includes payments of VAT by local authorities and non-trading government capital consumption to make the total comparable with GDP at market prices.

TOTAL PUBLIC EXPENDITURE BY ECONOMIC CATEGORY

Table 1.9

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Current expenditure									
Wages and salaries	20,948	24,840	30,841	34,245	36,290	38,423	39,097	40,620	41,840
Other current expenditure on goods and services	11,501	14,012	16,652	19,357	22,361	24,633	26,034	27,510	28,700
Subsidies	4,004	4,939	6,102	6,027	6,060	6,128	5,423	5,060	4,700
Current grants to the private sector	18,542	22,115	27,053	32,846	37,316	40,286	42,395	44,880	47,100
Current grants abroad	1,618	1,819	1,306	1,289	1,784	1,812	1,779	2,050	2,140
Local authority current expenditure not allocated to programmes							735	510	350
Total	56,614	67,725	81,955	93,764	103,811	111,281	115,463	120,620	124,830
Capital expenditure									
Gross domestic fixed capital formation	5,244	6,019	6,238	5,166	5,445	5,927	5,308	6,140	6,430
Increase in value of stocks	57	-14	84	7	318	381	447	270	270
capital grants	1,810	1,869	2,204	2,338	2,954	3,300	3,032	3,100	3,130
Net lending to private sector	240	658	921	1,356	732	-62	980	500	410
Net lending to nationalised industries and some other public corporations	1,075	2,464	2,770	1,943	1,593	901	892	150	-370
Net lending and investment abroad	267	-319	-521	-270	-97	47	192	150	140
Cash expenditure on company securities (net)	4		-1		371	151	3		
Market and overseas borrowing by nationalised industries and some other public corporations	442	-481	-623	294	-1,281	-239	-819	-590	-910
Total	9,138	10,196	11,073	10,833	10,035	10,407	10,036	9,730	9,100
Adjustments									
Special sales of assets		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
Reserve						250	2,750	3,750	4,750
General allowance for shortfall						-400			
Planning total	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680

TOTAL PUBLIC EXPENDITURE BY SPENDING AUTHORITY AND PROGRAMME

Table 1.10

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Central government									
Defence	7,506	9,232	11,177	12,610	14,406	15,714	17,028	18,050	18,670
Overseas services	1,830	2,052	1,609	1,658	2,183	2,262	2,240	2,480	2,590
Agriculture fisheries food and forestry	642	748	1,094	1,096	1,561	1,837	1,846	1,730	1,740
Trade, industry, energy and employment	2,609	2,328	3,421	4,592	4,661	4,928	5,000	4,960	4,790
Arts and libraries	126	154	175	195	230	235	253	270	280
Transport	489	590	745	881	1,063	1,064	1,170	1,210	1,260
Housing	559	523	536	460	591	781	737	820	870
Other environmental services	144	166	196	207	230	279	311	310	320
Law, order and protective services	485	602	790	901	1,008	1,216	1,372	1,440	1,490
Education and science	1,152	1,384	1,704	1,814	2,070	2,182	2,270	2,360	2,420
Health and personal social services	6,315	7,534	9,670	10,858	11,784	12,437	13,148	13,870	14,570
Social security	16,175	19,117	23,038	27,987	31,439	32,821	34,729	36,900	38,900
Other public services	962	1,153	1,372	1,519	1,613	1,648	1,770	1,850	1,880
Common services	856	1,000	1,101	1,460	1,560	950	1,105	1,180	1,280
Scotland	1,502	1,840	2,268	2,468	2,585	2,737	2,885	3,010	3,120
Wales	586	709	901	959	1,039	1,131	1,214	1,260	1,320
Northern Ireland	1,667	1,922	2,337	2,628	2,830	3,089	3,271	3,420	3,560
Total central government	43,606	51,055	62,134	72,293	80,852	85,311	90,350	95,120	99,070
Local authorities									
Agriculture fisheries food and forestry	114	175	168	195	206	166	135	130	130
Trade, industry, energy employment	75	94	116	132	146	160	157	160	170
Arts and libraries	214	250	302	328	386	389	346	360	370
Transport	1,334	1,592	1,924	2,085	2,368	2,513	2,248	2,350	2,420
Housing	1,617	2,098	1,591	869	675	1,038	999	1,140	1,200
Other environmental services	1,755	2,116	2,534	2,570	3,005	3,084	2,777	2,880	2,950
Law, order and protective services	1,549	1,975	2,370	2,830	3,179	3,462	3,530	3,690	3,790
Education and science	6,603	7,558	9,194	10,027	10,613	11,175	10,782	11,090	11,330
Health and personal social services	1,110	1,365	1,692	1,866	2,033	2,222	2,273	2,380	2,500
Social security	262	300	391	580	1,046	2,503	2,478	2,610	2,720
Scotland	1,977	2,376	2,773	3,089	3,285	3,500	3,452	3,480	3,560
Wales	805	951	1,092	1,120	1,238	1,354	1,293	1,340	1,380
Northern Ireland	294	349	408	469	503	541	562	590	610
Local authority current expenditure not allocated to programmes (England)							660	400	200
Total local authorities	17,710	21,199	24,554	26,160	28,683	32,110	31,691	32,590	33,310
Certain public corporations Capital expenditure(1) (excluding adjustments)	455	581	753	682	679	405	458	390	340
Nationalised industries external financing limits	2,349	2,999	3,221	3,553	2,143	2,500	1,881	1,140	90
Other public corporations external financing limits	1,633	2,086	2,366	1,909	1,490	1,362	1,118	1,100	1,120
Adjustments									
Special sales of assets		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
Reserve						250	2,750	3,750	4,750
General allowance for shortfall						-400			
Planning total	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680

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TOTAL PUBLIC EXPENDITURE BY SPENDING AUTHORITY AND ECONOMIC CATEGORY

Table 1.11

£ million cash

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Central government									
<i>Current:</i>									
Goods and services	19,596	23,626	29,161	33,077	36,321	39,089	41,787	44,030	45,850
Subsidies and grants	20,819	24,637	29,523	35,034	39,480	41,118	43,073	45,570	47,590
<i>Capital:</i>									
Goods and services	1,418	1,580	1,934	2,172	2,704	2,890	3,296	3,280	3,360
Grants	1,330	1,386	1,685	1,681	1,994	1,965	1,953	2,060	2,090
Other net lending and capital transactions	443	-175	-170	330	353	248	241	190	180
Total	43,606	51,055	62,134	72,293	80,852	85,311	90,350	95,120	99,070
Local authorities									
<i>Current</i>									
Goods and services	12,854	15,226	18,332	20,526	22,330	23,966	23,344	24,100	24,690
Subsidies and grants	1,222	1,429	1,801	2,257	2,733	4,270	3,924	4,070	4,200
Local authority current expenditure not allocated to programmes							735	510	350
<i>Capital</i>									
Goods and services	3,465	3,980	3,951	2,671	2,736	3,071	2,129	2,790	3,000
grants	123	165	187	274	556	937	708	650	650
net lending and other capital transactions	46	399	283	433	328	-135	851	460	420
Total	17,710	21,199	24,554	26,160	28,683	32,110	31,691	32,590	33,310
Certain public corporations									
<i>Capital:</i>									
Goods and services	418	445	437	330	323	347	330	340	340
Grants	15	23	29	29	32	34	45	50	50
Net lending and other capital transactions	22	113	287	323	324	23	83		-50
Total	455	581	753	682	679	405	458	390	340
Nationalised industries external financing limits									
<i>Current</i>									
Subsidies	811	1,085	1,109	1,363	1,799	1,835	1,829	1,620	1,390
<i>Capital</i>									
Grants	122	90	83	71	64	52	32	30	30
Net lending	974	2,305	2,652	1,827	1,518	861	856	110	-400
Market and overseas borrowing	442	-481	-623	293	-1,239	-248	-836	-610	-920
Total	2,349	2,999	3,221	3,553	2,143	2,500	1,881	1,140	90
<i>of which: local authority lending</i>	73	88	118	109	131	155	163	180	190
Other public corporations external financing limits									
<i>Current</i>									

Subsidies	1,312	1,722	2,028	1,507	1,148	1,002	771	740	760
Capital									
Grants	219	204	220	285	308	311	294	310	320
Net lending	101	159	118	117	75	40	36	40	30
Market and overseas borrowing				1	-41	9	17	20	10
Total	1,633	2,086	2,366	1,909	1,490	1,362	1,118	1,100	1,120
<i>of which: local authority lending</i>	213	325	431	421	433	512	265	270	280
adjustments									
Special sales of assets		-999	-356	79	-488	-1,200	-1,900	-2,000	-2,000
Reserve						250	2,750	3,750	4,750
General allowance for shortfall						-400			
Planning total	65,752	76,922	92,672	104,676	113,358	120,338	126,349	132,100	136,680

Table 1.13

£ million

PUBLIC SECTOR CAPITAL SPENDING	1978-79 outturn	1979-80 outturn	1980-81 outturn	1981-82 outturn	1982-83 outturn	1983-84 estimated outturn	1984-85 plans
Goods and services							
(1)							
General government and List III public corporations							
Expenditure on dwellings	2104	2395	2302	1943	2204	2199	2290
New constructions other than dwellings	2556	3165	3766	3912	4259	4395	4571
Purchases (net) of vehicles, plant and machinery	0	736	877	902	1104	1133	1155
(2)							
Defence expenditure							
Construction	46	205	283	271	395	456	528
Equipment	1779	2211	2905	3445	3800	4554	5200
Nationalised industries and other List I and II public corporations (III(3)(4)(7))							
Expenditure on dwellings	0	2	3	2	3	5	9
New construction other than dwellings	4704	1766	2175	2284	2691	2907	2895
Purchases (net) of vehicles, plant and machinery	0	3720	4134	4550	4253	4743	4639
					181		
Total, goods and services	11815	14200	16445	17309	18709	20392	21281
Cost terms (Base year 1982-83)	19201	19750	19270	18458	18709	19421	19302
Capital grants to private sector							
General government and List III public corporations (1)	1462	1566	1890	1974	2581	2921	2601
Nationalised industries and other List I and II public corporations (III(3)(4))	9	12	12	14	14	24	25
Total, capital grants to private sector	1471	1578	1902	1988	2595	2945	2626
(5)							
Total, goods and services plus capital grants to the private sector	13286	15778	18347	19297	21304	23337	23907
Cost terms (Base year 1982-83)	21592	21945	21498	20578	21304	22226	21684
Net lending							
General government and List III public corporations (1)							
(6)							
Net lending to private sector	244	658	920	1356	1094	87	995
Net lending and investment abroad	207	-319	-521	-270	-97	47	203

1) See definition of List I, II and III public corporations in part V of Volume 2 (PEWP)

2) NATO definition of defence capital expenditure. Table 14.4 reconciles this definition with that used elsewhere in this White Paper

3) Not included in the planning total

4) The 1978-79 figure includes net expenditure on land and existing buildings by nationalised industries

5) See Table 4.2 for reconciliation of this total with non-current expenditure in Table 1.8

6) Includes cash expenditure on company securities

7) "Nationalised industries" includes British Telecom's and British Airway's 1984-85 planned capital spending. No figures are available for Enterprise Oil

8) British Telecom's accounts treatment of certain fixed assets changed in 1981-82

Table 1.15

Annex A

	1.4.84	1.4.85	1.4.86	1.4.87	1.4.88
AGRICULTURE FISHERIES AND FOOD					
Ministry of Agriculture Fisheries & Food	11,193	11,150	11,106	11,310	11,260
Intervention Board for Agricultural Produce	623	610	590	566	560
CHIEF TELLOR OF THE EXCHEQUER					
Int. Revenue	69,850	70,200	69,300	66,300	62,900
Customs and Excise	25,150	25,350	25,100	24,900	24,700
Department for National Savings	8,050	8,025	7,900	7,875	7,590
HMSO	1,000	1,700	1,500	1,460	1,440
Treasury	3,820	3,570	3,535	3,500	3,455
Royal Mint	977	965	981	970	960
Central Office of Information	949	952	955	945	935
Registry of Friendly Societies	129	129	129	127	120
Government Actuary	643	643	643	643	643
National Investment & Loans Office	52	52	52	52	52
EDUCATION AND SCIENCE					
Department of Education and Science	2,402	2,472	2,437	2,417	2,392
EMPLOYMENT					
Department of Employment	31,048	30,238	29,995	29,211	28,505
Health & Safety Commission/Executive	3,742	3,662	3,652	3,644	3,644
Manpower Services Commission	22,229	21,677	21,297	21,297	21,297
Advisory, Conciliation & Arbitration Service	645	639	632	629	629
ENERGY					
Department of Energy	1,110	1,106	1,085	1,062	1,033
ENVIRONMENT					
Department of the Environment	6,681	6,601	6,501	6,471	6,356
Property Services Agency	6,695	6,645	6,515	6,435	6,370
Ordnance Survey	27,502	26,986	26,347	25,693	25,296
	2,815	2,948	2,934	2,920	2,906
FOREIGN AND COMMONWEALTH OFFICE					
Foreign and Commonwealth Office	9,437	9,373	9,214	9,109	9,026
Overseas Development Administration	1,793	1,565	1,545	1,525	1,500
HOME OFFICE					
Home Office	35,755	36,633	38,193	40,123	41,132
LORD CHANCELLOR					
Lord Chancellor's Department (including Public Trustee Office)	10,125	10,195	10,195	10,170	10,000
Land Registry	6,725	6,845	6,910	6,910	6,950
Public Record Office	406	406	413	419	425
NORTHERN IRELAND					
Northern Ireland Office	200	196	191	188	186
SCOTLAND					
Scottish Office	9,800	9,909	9,791	9,622	9,542
Scottish Courts Administration	879	879	879	879	879
General Register Office Scotland	283	266	268	278	274
Registers of Scotland	754	800	832	854	889
Scottish Record Office	132	128	125	122	118
SOCIAL SERVICES					
Department of Health and Social Security	90,709	90,000	89,500	88,850	87,850
Office of Population Censuses and Surveys	2,162	2,152	2,132	2,102	2,155
TRADE AND INDUSTRY					
Department of Trade and Industry	12,759	12,754	12,754	12,754	12,754
Export Credits Guarantee Department	1,840	1,840	1,835	1,835	1,830
Office of Fair Trading	320	313	313	313	313
TRANSPORT					
Department of Transport	14,120	14,528	14,713	14,511	14,174
	14,206	14,514	14,699	14,497	14,160
WELSH OFFICE					
Welsh Office	2,195	2,206	2,206	2,206	2,206
SMALL DEPARTMENTS					
Cabinet Office	518	518	518	518	518
Charity Commission	329	329	320	320	320
Crown Estate Office	114	116	117	118	119
Director of Public Prosecutions	237	242	241	240	240
Law Officers' Department	22	22	22	22	22
Lord Advocate's Department	22	22	22	22	22
Management and Personnel Office	1,104	1,198	1,174	1,168	1,158
Office of Arts and Libraries	49	45	45	45	45
Paymaster General's Office	870	873	912	938	967
Privy Council Office	33	33	33	33	33
Crown Office & Procurator Fiscal Service	966	980	1,000	1,020	1,040
Treasury Solicitor's Department	460	456	452	447	442
DEFENCE					
Ministry of Defence	200,000	179,000	176,000	173,000	170,000
CONTINGENCY MARGIN	1,360	2,000	1,000	6,500	7,500
TOTAL	630,000	608,208	605,255	600,554	592,723



10 DOWNING STREET

Prime Minister

This provides the run of public expenditure / GDP figures.

It shows

(i) the ratio has begun to decline from peak in 1981-82 (the trough of the recession)

(ii) The peak under the Conservatives was lower than the peak under Labour in 1974-75.

AT

4/11

Pharley on no

12/02

From: Mrs Todd
11 January 1984

MISS M O'MARA ←

cc Mr Scholar
Mr Hart
Mr Stibbard

RATIOS OF PUBLIC EXPENDITURE TO GDP

Mr Stibbard asked me to reply to your minute to him of 10 January on the above.

2. May I draw your attention to the article entitled "Public Expenditure: Definitions and Trends" in the November issue of Economic Trends. This includes the series that No 10 require. I attach a copy of a table from the article with the appropriate column marked.

3. This series will alter marginally as the planning total and net debt interest will alter in outturn years in the White Paper. We do not yet have final figures for the revised series. But the ratios should not alter when rounded to the nearest half.

Phyllis Todd

P TODD

APPENDIX

Public expenditure 1963-64 to 1982-83

TABLE 1a

	£ billion			February 1983 (Cmnd 8789) Definition excluding PCMOB ⁴			February 1983 (Cmnd 8789) Definition		
	Definition prior to February 1977 (Cmnd 6721)			Definition excluding PCMOB ⁴			Definition		
	Cash	1981-82 cost terms ¹	Percentage of GDP ²	Cash	1981-82 cost terms ¹	Percentage of GDP ²	Cash	1981-82 cost terms ¹	Percentage of GDP ²
1963-64	11.9	68.5	38.5	9.9	57.1	34.0			
1964-65	12.8	70.7	38.1	10.8	59.6	33.9			
1965-66	14.2	74.9	39.5	12.0	63.4	35.1			
1966-67	15.7	79.3	41.0	13.3	67.3	36.3			
1967-68	17.9	87.7	44.0	15.5	76.3	39.9			
1968-69	18.8	88.2	42.9	16.1	75.6	38.2			
1969-70	19.8	88.1	42.1	17.0	75.8	37.5			
1970-71	22.2	91.5	42.8	19.1	78.4	37.7			
1971-72	24.6	92.7	42.2	21.4	80.7	37.6			
1972-73	28.3	98.4	43.0	24.8	86.4	38.5	29.3	95.0	40.9
1973-74	33.8	109.8	46.2	28.6	92.7	39.9	39.3	107.0	45.8
1974-75	45.6	124.1	52.0	38.6	105.1	45.0	48.9	106.0	45.8
1975-76	57.1	123.7	52.1	48.5	105.1	45.4	54.4	104.1	43.9
1976-77	63.7	122.0	49.9	53.2	101.9	43.0	56.8	95.6	39.8
1977-78	67.7	114.0	45.8	56.0	94.2	39.3	65.8	100.2	40.7
1978-79	78.2	119.2	46.5	65.3	99.6	40.4	76.9	100.4	40.3
1979-80	93.0	121.3	46.3	77.4	101.0	40.6	92.8	102.0	42.6
1980-81	112.7	123.9	49.0	93.4	102.6	42.9	104.7	104.7	44.2
1981-82	124.1	124.1	49.4	104.4	104.4	44.1	113.4	106.4	43.4
1982-83	137.4	128.9	49.5	114.7	107.5	43.8			

¹ Cash deflated using GDP deflator, base year 1981-82 = 100.
² Defined as total public expenditure plus general government consumption of non-trading capital divided by GDP (expenditure estimate) at market prices. The definition of total public expenditure prior to Cmnd 6721 included payments of VAT by local authorities and gross debt interest.
³ Defined as the planning total plus general government consumption of non-trading capital plus payments of VAT by local authorities plus net debt interest divided by GDP (expenditure estimate) at market prices.
⁴ Public corporations market and overseas borrowing.

42.5
42.0

1983-84
1984-85
Cas in Autumn
Statement and
PEWP to be
published shortly

JAN 1994

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Treasury Chambers, Parliament Street, SW1P 3AG

A Turnbull Esq
10 Downing Street
LONDON
SW1

10 January 1984

Dear Andrew

PUBLIC EXPENDITURE WHITE PAPER 1984

I am sending you separately the text of Part 1 of the White Paper. I attach herewith the text of Parts 2 and 3. We have aimed this year to introduce a more consistent pattern for each of the main programme chapters, to help comparisons between programmes; to put a greater emphasis on the statement of policy objectives; and to relate policy objectives to progress and performance indicators wherever possible.

The Chief Secretary is grateful for the cooperation of his colleagues and their officials in this endeavour. Progress has been made, particularly in making the presentation more consistent and in including a clear statement of the policy objectives for programmes. Less progress perhaps has been made in the more difficult area of relating policy objectives to progress and performance indicators and further work will be required on this before next year's White Paper.

For the first time manpower planning has been integrated into the Public Expenditure Survey, and so each chapter includes departments' manpower plans to 1987. To help Select Committees and others reconcile the Survey and Estimates, chapters also indicate explicitly where to look in Estimates to find the relevant supply expenditure for the year ahead. The external financing limits of the nationalised industries have now been included in the relevant programmes and the separate programme for Government lending to them abolished.

The only other point I should make is that, as last year, the main tables are not included in the texts attached since they are still being processed. They are summarised in the Part 1 tables.

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Copies of this letter go to the Private Secretaries of all Cabinet
... Ministers. A further copy is enclosed with each letter for the
Department's PFO.

Yours sincerely

John Gieve

JOHN GIEVE

CONFIDENTIAL

Econ 101. Public Exp. 1526



CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

M

A Turnbull Esq
 Private Secretary
 10 Downing Street
 LONDON
 SW1

10 January 1984

Dear Andrew

PUBLIC EXPENDITURE WHITE PAPER - PART 1

I attach two copies of a near-final draft of Part 1 of the 1984 Public Expenditure White Paper. Publication is planned for Thursday 16 February, roughly one month before the Budget. To meet this, final copy has to be with the printer by early next week.

2. The figures and text are close to finality, but further minor changes, particularly to correct the figures, will continue to be incorporated until copy is sent to the printer.

3. The Chief Secretary, who has approved the draft, has asked me to draw attention to four points in particular:-

- 1) The reserve for 1984-85 has been reduced from £3 billion to £2.75 billion since the Autumn Statement within an unchanged planning total. This results from a number of changes, including an increase in the estimated take-up of some social security benefits (£357 million) - on which the Prime Minister has seen earlier correspondence - partially offset by some reduced requirements eg for the Youth Training Scheme (£170 million). This latter figure has still to be finally agreed with the Secretary of State for Employment.
- 2) The reserves for 1985-86 and 1986-87 are £3.75 billion and £4.75 billion, an increase in each case of £1 billion on the preceding year. The figure for 1985-86 is thus £¼ billion higher and that for 1986-87 £¼ billion lower than the illustrative figures which Cabinet had before it in November. The Chancellor and the Chief Secretary consider that these reserves represent an adequate provision for contingencies as redefined in paragraph 2.32 of the Autumn Statement (see also paragraph 25 of the attached draft)
- 3) Target receipts from the special sale of assets in 1984-85 are unchanged at £1.9 billion. In each of the two later years the targets are £2 billion.
- 4) The planned provision for programmes, reserves and receipts from the sale of assets leads to a planning total of £126.4 billion in 1984-85. This is the same as the total for that year published in the last White Paper (Cmnd 8789). The provisional total for 1985-86 (£132.1 billion) is slightly less than the figure in

Cmnd 8789 (£132.3 billion). The provisional total for 1986-87 is £136.7 billion, £0.6 billion below the baseline adopted for the 1983 Survey. These more favourable figures for the later years result from the improved prospect for receipts from the sale of assets, partially offset by the adjustments to the reserve and increases in expenditure on some demand-led programmes referred to above.

4. You may wish to draw the Prime Minister's attention particularly to paragraphs 28-30 and Table 1.13, which are a new and improved presentation of capital expenditure by the public sector. The table shows more clearly the public sector's expenditure on capital goods and the value of work given to the construction industry in each year to 1984-85. It can be demonstrated from this table that in real terms the level of this expenditure has been broadly the same since 1978-79.

5. Copies of this letter, with copies of the draft, go to the Private Secretaries to all Cabinet Ministers. A further copy is enclosed with each letter for the Department's PFO. Any comments should be received in the Treasury not later than lunchtime on Tuesday 17 January.

Yours sincerely

J. Gieve

JOHN GIEVE
(Private Secretary)

Econ. Pub. Exp. 1526

GP's could save £60m by stricter prescribing

By Nicholas Timmins
Social Services Correspondent

The National Health Service drug bill could be cut by more than £60m a year if family doctors had detailed information about their own prescribing habits and were encouraged to discuss them, according to a study carried out by the Royal College of General Practitioners.

With the computerization of the Prescription Pricing Authority, such an approach could easily be adopted, the study argues, with savings rising by about another £17m once the costs of dispensing drugs by pharmacists is added.

The study, of more than 40 GPs, assistants, and trainees in inner London, involved providing the doctors with detailed information about what drugs they prescribed, their costs, and how their prescribing habits compared with other doctors in the study, and with national prescribing habits.

At the end of the two-year study, the doctors were prescribing 5.7 per cent fewer prescriptions for each 1,000 patients than doctors in a control group.

The results of the study come as the Government has ruled out Greenfield committee proposals to allow pharmacists to substitute unbranded generic drugs for brand name products when dispensing prescriptions. But Mr Kenneth Clarke, Minister for Health, has announced that there will be a new campaign to encourage more generic prescriptions.

Big savings could come from generic prescribing of just six drugs, which the report describes as "the big six". If a family doctor with an average sized list of patients prescribed unbranded versions of Mogadon, Valium, Indocid, Aldomet, Lasix and Inderal more than £1,000 a year could be saved, the report says.

Doctors gain ground over deputies rule

Proposed restrictions on the use of deputizing services by family doctors to cover night and weekend calls will be reconsidered if GPs can produce effective arguments against them, Mr Kenneth Clarke, said yesterday.

But he made clear that he will not allow them to use the services every night and weekend as some now do, and that he considers his own proposals flexible, despite doctors' condemnation of them as unacceptable and impracticable.

*Prescribing A Suitable Case For
Treatment Occasional Paper 24
Royal College of General
Practitioners 1 Queen Anne's Lane
London WC1A 4AE*

The Times

10.1.1984

②
PRIME MINISTER

NHS DRUGS BILL

In the exercise to reduce drug costs DHSS considered two approaches:

i) More generic prescribing. This might have saved £40m depending on how successful they were in changing doctors' practices.

ii) Negotiating lower prices for all drugs. DHSS followed this course as they believed it would save more, £100m, and there would be more assurance of the savings that would be produced. This is to be backed up with a campaign, falling short of any compulsion, to promote generic prescribing. DHSS believe that this might produce another £5m of savings.

The Royal College of General Practitioners has produced a report - see attached press cutting - which claims that savings of £60m could be made from generic prescribing. DHSS rather dismiss this report since the saving is greater than they thought could be achieved by this route. Furthermore, they believe the savings would be very much less now that the price of branded drugs is being reduced.

Thus, DHSS thinking seems to be that there is not much further to be gained from generic prescribing. This is, of course, a proposition that we will need to challenge.

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10 January 1984

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10 DOWNING STREET

From the Private Secretary

9 January 1983

Public Expenditure Reviews

When I wrote to you on 3 January about further studies on public expenditure, I said that the Prime Minister was still considering how best to proceed with work on promoting greater competition in the UK defence industry.

As you will see from the attached letters, MOD have been asked to prepare a paper on this subject. It was felt better to allow the Secretary of State for Defence, who was already working in this area, to produce the paper in the first instance.

BF

(Andrew Turnbull)

John Gieve, Esq.,
Chief Secretary's Office,
HM Treasury

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10 DOWNING STREET

From the Private Secretary

3 January 1984

Dear John.

PUBLIC EXPENDITURE REVIEWS

The Prime Minister has seen the Chief Secretary's minute of 22 December and welcomes the effort to focus on key areas of public expenditure in order to identify options for savings to be followed up in the next Public Expenditure Survey.

The Prime Minister agrees that the objectives of the urban programme need to be clarified and ways of measuring its cost-effectiveness need to be developed. She would be grateful if the Chief Secretary would approach the Secretary of State for the Environment and other colleagues to set such a review in hand.

On defence equipment expenditure, the Prime Minister is still considering how best to handle further work in this area.

The Prime Minister is very concerned about the growth of expenditure on the Family Practitioner Services and she would therefore welcome the proposed review of the contractual relationship between the NHS and the contractor professions. She is also concerned about the current growth of social security expenditure, as recorded in the Chief Secretary's letter to the Secretary of State for Social Services of 22 December. She is particularly concerned about the growth of housing benefit and in addition to work on forecasting and control she is anxious to establish why housing benefit has become so widespread, extending a long way up the income scale. In particular, she would like to know how current expenditure on housing benefit compares with the forecasts which were made at the time this new benefit was established. In both these areas, she would be grateful if the Chief Secretary would approach the Secretary of State for Social Services to set in hand the work required. A preliminary discussion of these issues is likely to take place in the meeting arranged for 12 January.

On territorial programmes, the Prime Minister has noted the argument that overall spending, in relation to "needs", in Scotland and Northern Ireland is substantially higher than in England and Wales. Before deciding how best to approach the other Secretaries of State, the Prime Minister would be interested to see a summary of the work which the Treasury has undertaken.

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In all of these areas, the Prime Minister would be grateful if the No.10 Policy Unit could be kept closely involved.

Yours sincerely

Andrew Turnbull

Andrew Turnbull

John Gieve, Esq.,
Chief Secretary's Office.

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The Autumn Statement: A Summary



The Chancellor of the Exchequer presented his *Autumn Statement* to Parliament on 17 November 1983. This Supplement summarises the *Statement*, which is published in full as House of Commons Paper 112 (HMSO £4).

THE FORECAST IN OUTLINE

Output, demand and employment

In the UK output has been rising since 1981, as real domestic demand has recovered, helped by falls in inflation and interest rates. Output in 1983 is expected to be about 3 per cent higher than in 1982. The growth in domestic demand is likely to slow down perhaps from 4 per cent in 1983 to 3 per cent in 1984, but a continued rise in investment and a recovery in exports should sustain the growth in activity. With world demand recovering, and the profitability of home supply increasing, the forecast is for UK output to grow by 3 per cent in 1984 and for employment to rise.

Balance of payments

The main factor in the sharper growth of imports relative to exports since 1981 has been the recovery in domestic demand in the UK, ahead of most other industrial countries. This has been reflected in the current account of the balance of payments, where a surplus of over £5 billion in 1982 has given way to a small surplus in the first nine months of 1983. With a recovery forecast for exports, the current account may remain near balance in 1984. The forecast assumes that the exchange rate will not change much from recent levels.

Inflation

This year has again seen a lower than expected rate of inflation in the UK. Costs are rising more slowly than prices, leaving room for a sizeable recovery in profitability from an historically

low base. At the same time the real income of those in work has risen. Current inflationary pressures continue weak and by the end of next year inflation should be below the current rate of about 5 per cent.

Borrowing

The public sector borrowing requirement in this financial year, 1983-84, looks like turning out higher than expected at Budget time. This is despite the 7 July measures and partly reflects the same factors that caused higher than expected spending at the end of 1982-83. For 1984-85, this forecast continues to assume, as in the medium-term financial strategy, a public sector borrowing requirement of 2½ per cent of gross domestic product, or £8 billion. The present forecast, subject to a wide margin of error, assumes an increase of taxation in order to achieve this, after allowance for indexation of personal taxes and specific duties.

Monetary policy

Monetary policy in 1984-85 is assumed, like fiscal policy, to be consistent with the indications given in the medium-term financial strategy. These included a range for monetary growth of 6-10 per cent.

World economy

A vigorous rise in activity in the US is not being matched elsewhere. In parts of Europe, in OPEC, and in many of the developing countries, activity and imports have fallen, in the process of adjustment to international or national debt problems. World trade is only now beginning to recover after the fall of the last two years.

ECONOMIC PROSPECTS FOR 1984

The world economy

Recent developments

Output rose in all the major countries in the first half of 1983. Rapid growth in the US continued into the third quarter, but the recovery in Europe has been weak and erratic. Underlying inflation in the major six economies has fallen to about 5 per cent. Interest rates in most countries remain high in real terms. The upward trend to unemployment has slowed substantially in many countries, and is being reversed in the US.

After falling substantially during 1982 world trade in manufactures appears to be growing again in the course of this year, largely as a result of the growth of imports into the US. Many developing countries, including some members of OPEC, have had to reduce imports sharply because of falls in their earnings from primary products and because of difficulties in meeting debt obligations or obtaining fresh bank credit. Oil prices fell earlier this year in the face of a substantial fall in demand but other commodity prices have been rising from very low levels in 1982.

Prospects

Recovery in the US is expected to moderate after the rapid

growth in mid-1983. In Europe recovery should resume in 1984 after some faltering in the second half of this year. Inflation, overall, may not change much, with a slight rise in the US matched by further falls in Europe. Outside the OECD area, the timing and extent of recovery in imports, as the need lessens for further downward adjustment, is very uncertain. On the assumption of improved export earnings and financial flows, developing countries should be able to sustain renewed growth in imports in 1984. The recovery in world trade should be faster than that in output; this is the normal pattern in an

Table 1 World economy

	Percentage changes on a year earlier				
	Average 1975-82	1981	1982	1983	1984
GNP ⁽¹⁾	3	2	-½	2½	3½
Prices ⁽¹⁾ (consumers' expenditure deflator)	8½	9	7	5	5
World trade in manufactures (weighted by UK markets)	4	3½	-3	-1	5

⁽¹⁾ Major six countries (US, Japan, Germany, France, Italy, Canada).

upswing of the cycle, but seems not to have occurred in 1983 because of sizeable falls in imports in many countries outside the major six. The outlook for the world economy is summarised in table 1.

Exchange rate, relative costs and trade

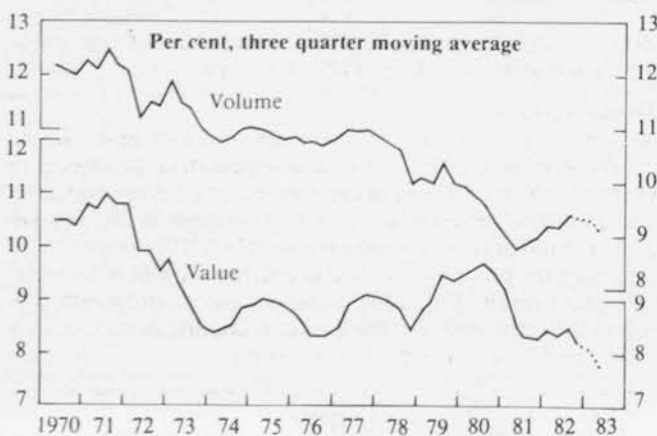
Relative costs

Over the course of the last two and a half years there has been a partial reversal of the sharp deterioration in relative costs in the 1978-81 period. Between the first halves of 1981 and 1983 the level of domestic unit labour costs in manufacturing relative to those of our competitors is estimated to have fallen 20 per cent. This was rather more than the fall in the effective exchange rate: above-average productivity gains, and reductions in the national insurance surcharge, partly offset by slightly higher earnings growth in the UK, resulted in domestic costs in manufacturing rising slightly less than those of our competitors. For the purposes of this forecast it is assumed that the effective exchange rate will not change much from the average level for the first three quarters of 1983. Further gains in relative costs are likely to depend on improvements in UK unit labour costs relative to those overseas.

Trends in trade

Over the course of the 1970s and early 1980s a number of structural changes have been taking place in the UK economy. These have been reflected in the diverse movements of the components of the visible trade balance. The surplus on non-manufactured goods has been on a rising trend, and the balance of trade in oil has moved from a deficit of 3 per cent of nominal GDP in 1976 to a surplus of 1½ per cent last year. But the balance of trade in manufactures, as a percentage of nominal GDP, has shown a falling trend over this period. Trends in shares of UK exports in world trade manufacturing are shown in chart 1.

Chart 1 Shares of UK exports in world trade in manufacturing



Due to an error in rebasing the volume series to 1980 prices, this chart as published in the *Autumn Statement* (no. 1.4) contained incorrect figures for the volume share of UK exports of manufactures in world trade between 1974 and 1977.

Trends in import penetration have varied by sector. Outside manufacturing there has been no general upward trend, with falls in some sectors. Within manufacturing, import penetration has risen strongly.

For 1983 as a whole, the volume of total exports is expected to be slightly higher than in 1982. While the level of exports of manufactures has been a little weaker than expected at Budget time, reflecting the lower level of world trade in 1983, oil exports have been rather higher. The rise in imports of manufactures, perhaps 10 per cent or more in 1983, results in roughly equal measure from both the rapid growth in the domestic demand for manufactures and a further loss by UK manufacturers of share in the domestic market. Imports of basic materials have also risen this year with the recovery in domestic activity, although imports of fuel and services have tended to fall. Imports of goods and services in volume terms could be 5 per cent higher than in 1982.

Trade prospects

Recovery in the world economy and recent improvements in UK competitiveness should lead to a period of growth in export volumes. This would be consistent with recent evidence from the CBI survey, where there is a positive balance of respondents optimistic about export prospects. With North Sea oil production approaching its peak, exports of fuels are expected to be broadly unchanged from recent levels. Exports of manufactures, non-manufactured goods and services are all projected to increase. Further growth in import volumes of manufactures is likely in 1984, as the economy continues to expand, although import volumes for non-manufactures, including fuel, may change little from current levels.

Terms of trade

So far there has been only a small deterioration in the non-oil terms of trade since the peak in 1981. Some slight further fall is expected, as importers raise prices to cover higher costs, including higher commodity prices. Exporters' profit margins should continue to recover.

Current balance

Between 1981 and the first nine months of 1983, the current account of the balance of payments moved from a surplus of £6½ billion to a position of small surplus. Much of this change reflected the earlier recovery in UK demand compared with the rest of the world. But the recovery of world trade now expected for 1984 should lead to growth in exports much more in line with growth in imports. With an increase in the invisibles balance, on services and interest, profits and dividends, the prospect is for broad balance in the current account over the forecast period.

Inflation

As expected, the 12-monthly increase in the retail prices index has turned up in recent months, from a low of 3¾ per cent in May and June to 5 per cent in October. This upturn mainly reflects the particularly favourable profile of retail prices in the second half of last year and early 1983 and it is expected to be only temporary. Underlying inflationary pressures remain downward with producer prices for home sales of manufacturing output increasing by 5½ per cent in the year to October compared with 7 per cent a year ago.

The market price GDP deflator rose by 5 per cent in the year to the second quarter of 1983 (6½ per cent in the financial year 1982-83) compared with 15 per cent at the beginning of 1981. This reflected much smaller rates of increase in the main elements of domestic costs as financial and competitive pressures on industry encouraged lower pay settlements and historically exceptional gains in manufacturing productivity. In the first half of 1983, unit labour costs in the whole economy were only 2 per cent higher than a year earlier, with the reductions in the national insurance surcharge helping to limit the growth in industrial costs. Profit margins, squeezed severely in many sectors during the downturn, have been recovering since 1981.

Costs

World inflation rates have also declined appreciably over the last two years, with commodity prices falling through most of 1982. Although some commodities have recovered strongly this year, the effect on the UK economy has been fairly muted. While the spot market rates which enter into some of the most widely-quoted indices of commodity prices have risen rapidly, there has been less impact on the prices at which most trading has actually taken place. Oil prices have also been fairly steady since the fall early in 1983. Import prices, though rising faster than domestic costs, have not provided strong upward pressure on prices charged by domestic producers.

Pay

Pay settlements in the year ending in August were fairly tightly bunched around an average level of about 5½ per cent. Little variation was observable in settlements as the round progressed. Because of productivity bargaining, grading drift and other factors, earnings growth is usually above settlements and was about 7½ per cent during the last pay round. This was about 1½ per cent less than in the previous year but the

slowdown in earnings growth did not match that of prices. In August 1982, retail prices had been 8 per cent above the level of a year earlier. By the end of the pay round retail prices were rising at only 4-5 per cent. With wage-earners also benefiting from the increases in tax allowances in the 1983 Budget, after-tax real earnings for an average employee rose about 4 per cent during the year to August 1983.

At the same time, employers' labour costs per unit of output – held down by substantial gains in productivity and the reductions in national insurance surcharge – were rising more slowly than prices being charged by producers. The past year has therefore seen both rising real earnings and falling real unit labour costs.

Prospects

The current pay round is starting against an improved background for both employees and employers with real take-home pay higher and unit labour costs rising more slowly than prices. Competitive pressures are still strong, both on employers in world and domestic markets and on employees in a weak labour market. So, despite the continued recovery in domestic output and a rise in employment over the next year, there should not be a reversal of the downward trend of earnings growth.

Lower rates of inflation now being achieved in other industrial countries are reinforcing the pressures on domestic industry to keep down prices and costs. Over the next year, allowing for some further recovery in margins, the market-price GDP deflator is expected to rise by about 5 per cent. Taking account of movements in import prices and the recent bumpy path, annual changes in the retail prices index may be a little more volatile. Some further increase – perhaps to about 5½ per cent – is expected for the 12-monthly rate in the first half of next year as past favourable factors drop out of the comparison. These effects should, however, be short-lived and the 12-monthly increase is expected to fall back, perhaps to around 4½ per cent by the end of 1984.

Domestic recovery and a rise in external demand, with prices tending to rise faster than costs in most markets, will all contribute to a continuing rise in profits. While profitability for most industrial and commercial companies, outside the North Sea, is not yet back to 1979 levels, there has already been a sizeable recovery since 1981, reflected in a larger financial surplus as the rise in company expenditure has not fully kept pace with the rise in income.

Demand and activity

The base year for constant-price estimates of output and expenditure was changed this summer from 1975 to 1980. The direct effect of rebasing on year-to-year GDP changes was probably fairly small, but it combined with the usual process of revision as a result of new information to produce a different pattern of GDP growth over the past five years. The fall in GDP in 1981 was smaller than had been thought and the recovery since the trough of the recession has been faster as shown by the average of the expenditure, income and output measures.

Output growth

Latest estimates put the growth of the average measure of GDP between the first halves of 1982 and 1983 at nearly 3 per cent. Within this average the expenditure measure showed a growth of over 3½ per cent while the output measure (conceptually identical, but compiled largely from independent data sources) showed a rise of nearly 2 per cent. Although the output measure is generally preferred as a guide to shorter-term, particularly within-year, movements, the average measure is usually more reliable for longer periods and provides the main basis for the assessment of activity movements in this forecast.

The buoyancy of GDP over the past year has reflected recovery in domestic demand. Consumers' expenditure, which had been virtually flat over the previous three years, rose by 3 per cent in the second half of 1982 and a further 1½ per cent in the first half of 1983. Fixed investment, particularly in dwellings, is recovering.

Personal consumption

Since the first half of 1982 real personal disposable income, in total, has been little changed. The rise in consumers' ex-

penditure (and the fall in the saving ratio from over 12 per cent in the first half of 1982 to over 8½ per cent in the first half of 1983) has been mainly financed by a rise in borrowing. Lower inflation and lower interest rates have been major factors in the fall in saving: lower inflation has meant that consumers have needed to save less to maintain the real value of their financial wealth. In the 1960s, when inflation averaged 4 per cent, the saving ratio averaged 8 per cent.

Total real personal disposable income is now beginning to rise again as real take-home pay rises and employment stops falling. But other factors bringing about a lower saving ratio – primarily lower inflation and nominal interest rates – should continue to have an impact. The fast growth recently experienced in consumer durables expenditure (20 per cent over the last year) is not expected to continue, but the saving ratio is expected to stay below last year's level as expenditure on non-durables recovers further. The rise forecast for consumers' expenditure in 1984 reflects both a small further fall in saving and a rise in real after-tax incomes.

Investment

Total fixed investment, which fell in 1980 and 1981, rose in 1982, and in the first half of 1983 was nearly 3 per cent up (at constant prices) on a year earlier. Two areas of private fixed investment – house-building and investment by manufacturing industry – fell sharply in the recession. Outside manufacturing, business investment now seems to be growing at an annual rate of some 6 per cent.

Surveys point to a steady growth in industrial investment, including manufacturing investment, in 1984, reflecting recent and prospective rises in output and profits. Total fixed investment is forecast to rise by 4 per cent in 1984.

The improvement in prospects for industrial investment reflects in part the better financial position of the company sector as margins as well as output recover. This is also expected to relieve some of the pressure on stock levels. Much of the destocking in 1980 and 1981 reflected companies' need to improve their cash flow at a time of high interest rates and poor output expectations. Recent surveys suggest that, with expectations of output growth fairly stable, stock-output ratios may not depart radically from current levels.

Demand and activity

As the UK and world recoveries become more firmly established the composition of final expenditure is expected to begin to shift away from personal consumption towards exports and industrial investment. The improvement in the relative cost position of domestic industry over the last two years should also limit the proportion of additional demand met by imports, though, overall, the rising trend in import propensities is forecast to continue. But the growth in imports should be more nearly matched by the growth in exports.

Table 2 Expenditure and GDP

	Percentage increases on a year earlier		
	1982	1983	1984
Domestic demand ⁽¹⁾	3	4	3
Exports of goods and services ⁽¹⁾	1½	½	4
Imports of goods and services ⁽¹⁾	3	5	5
Domestic production – GDP at factor cost (average measure)	2	3	3

⁽¹⁾ Expenditure measures at market prices.

Table 3 Output

	1980=100			
	1983		1984	
	I	II	I	II
GDP (average measure)	102½	103½	105	106½
Manufacturing output	94½	95½	97	98

Manufacturing output resumed its slow recovery at the beginning of 1983 and latest data suggest that the level of output in mid-year was about 3 per cent above the trough of the first quarter of 1981. In the same period, the average measure of GDP rose by about 5 per cent. With the expected recovery in exports and fixed investment, the growth in manufacturing production in 1984 may not be very different from that of the economy as a whole.

Productivity and the labour market

Most productivity gains made over the last three years have been in the manufacturing sector. Since the end of 1980, employment in manufacturing has fallen by one million or 15 per cent while output has not changed very much. The rise of over 18 per cent in output per person employed in the manufacturing sector has been the major factor in the 10 per cent increase in output per head in the whole economy. As output growth is being consolidated, so the fall in employment seems to be ending; manufacturing employment (which now accounts for about one quarter of total employment) has been declining more slowly in the last six months while outside manufacturing, employment is now rising. Unemployment may now be levelling off. Other labour market indicators, notably unfilled vacancies and hours worked, are pointing to some recovery in the pressure of demand for labour.

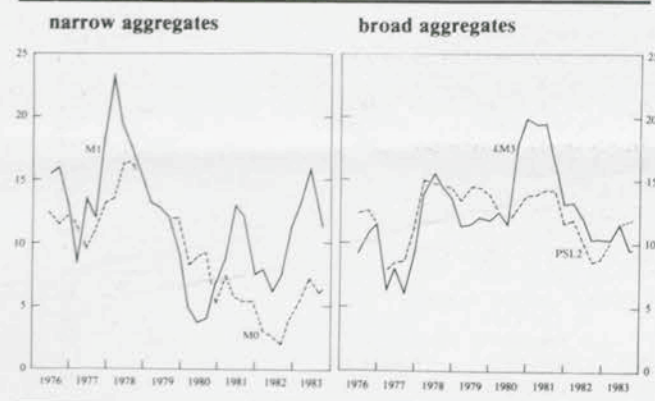
Monetary growth and fiscal projections

Money supply and interest rates

US interest rates, which had fallen rapidly during 1982, rose a little in 1983, in response to the rapid recovery in activity and to the faster rise in monetary aggregates. In the other major OECD economies, there was no significant change in interest rates.

In the current target period, February 1983 to April 1984, the growth of £M3 to mid-October was just within the target range of 7-11 per cent. PSL2 and M1 were rather above the top of the range. Since the summer, monetary growth on all three measures has slowed significantly compared with earlier in the target period. Narrower non-interest-bearing forms of money continue to grow more slowly than the broader aggregates. The forecast makes the same assumption about 1984-85 as the medium-term financial strategy: that there will be a range for M1, £M3 and PSL2 of 6-10 per cent. (See *Economic Progress Report*, December 1983, for article on monetary aggregates.)

Chart 2 Monetary growth, percentage changes on a year earlier for banking months March, June, September and December



Fiscal projections

The public sector borrowing requirement in 1982-83 was £1½ billion higher than forecast in the *Financial Statement and Budget Report*. There was less underspending on central government voted expenditure and higher borrowing by local authorities. The higher level of central government expenditure and higher local authority borrowing seems to have continued into the current financial year. This explains a substantial part of the upward revisions to the anticipated level of public expenditure and the public sector borrowing requirement in 1983-84, despite the cash limit reductions and additional asset sales announced on 7 July. In the first seven months of 1983-84, the public sector borrowing requirement

was just over £7 billion. The total for the year as a whole is now projected at £10 billion, some £2 billion higher than forecast at Budget time. There is inevitably still a substantial margin of error surrounding this forecast (average errors in public sector borrowing requirement forecasts at this time of year exceed £2 billion) but there are several factors which give grounds for expecting increased public borrowing this year. On the expenditure side the outturn for 1982-83 and information on likely spending this year suggest less shortfall than allowed for in the *Financial Statement and Budget Report*. In addition, debt interest payments are higher, partly because of higher borrowing. On revenues, extra receipts from North Sea oil seem likely to be broadly offset by lower receipts elsewhere.

Adopting the conventional assumptions of indexed tax rates, allowances and specific duties and taking a public sector borrowing requirement in 1984-85 of 2½ per cent of GDP, equivalent to £8 billion (as in the medium-term financial strategy), this points to a negative fiscal adjustment, perhaps of the order of £½ billion. The forecast assumes, conventionally, that the fiscal adjustment takes the form of an increase in income tax. The size of the fiscal adjustment is, of course, extremely uncertain and depends on revenue and expenditure estimates subject to a number of major uncertainties, in either direction. For the public sector as a whole, the flows on either side of the account approach £200 billion.

General government expenditure in national accounts terms is forecast to rise, in cash, nearly 5½ per cent in both 1983-84 and 1984-1985. Table 4 shows the basis of these figures.

Table 4 General government expenditure⁽¹⁾

	£ billion		
	1982-83	1983-84	1984-85
General government expenditure ⁽²⁾	114	120½	126½
National accounts adjustments ⁽³⁾	3½	4	5
Interest payments	14	14½	15
Total expenditure in national account terms	132	139	146½

⁽¹⁾ Totals may not add due to rounding.

⁽²⁾ Expenditure on programmes by central government and local authorities plus the contingency reserve and special sales of assets, after making allowance for expected outturn.

⁽³⁾ Adjustments to line 1 to the definitions used in national accounts statistics.

Revenue

Revenue estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue in 1984-85 is projected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of excise duties, using a figure of 5 per cent. Estimates for oil revenues assume that North Sea oil prices do not change very much from present levels.

The revenue projections are shown in table 5. Real GDP (average measure) is forecast to grow by nearly 3 per cent in 1983-84 and 1984-85. The general rate of inflation, as measured by the GDP deflator, is put at about 5 per cent in 1983-84 and 1984-85.

PUBLIC EXPENDITURE IN 1984-85: THE GOVERNMENT'S PLAN IN OUTLINE

Plans for public expenditure in 1984-85, as set out in the last public expenditure white paper (PEWP)*, have been revised and new outline plans set out in the *Autumn Statement*. Full figures will appear in the next PEWP shortly before the Budget. All figures are in cash unless otherwise stated.

The planning total for 1984-85 has been held to £126.4 billion in line with figures given in the 1983 PEWP.

Planning total figures for each year since 1978-79 in cash and in 'cost terms' are shown in table 8 (cost terms - this is at 1982-83 costs as measured by the GDP deflator, a wider annual index of changes in total home costs than the RPI). The table also shows how public expenditure has fallen as a percentage of

*The Government's Expenditure Plans 1983-84 to 1985-86 Cmd 8789.

gross domestic product (GDP) from 44 per cent in 1981-82 to a planned 42 per cent for 1984-85.

Revised spending plans for 1984-85 are compared with the last white paper figures after Budget and other modifications in table 10.

Although the planning total remains unchanged there have been alterations to individual programmes. Increases, mainly in demand-led programmes, e.g. pension payments, have been offset by savings elsewhere and there has been an increase of £0.4 million in estimated receipts from special sales of assets reflecting the expected sale of Enterprise Oil (see *Special sales of assets* below) and other factors.

Table 5 General government receipts⁽¹⁾

	£ billion		
	1982-83	1983-84	1984-85
Taxes on income, expenditure and capital	92	96	104
National insurance and other contributions	18½	21	22½
Interest and other receipts	11	11	11
Accruals adjustments	—	—	—
Total receipts	122	128	137½
of which North Sea tax revenues	8	9	9½

⁽¹⁾ Totals may not add due to rounding.

Table 6 Public sector borrowing

	£ billion		
	1982-83	1983-84	1984-85
General government expenditure	132	139	146½
General government receipts	-122	-128	-137½
Implied fiscal adjustment ⁽¹⁾	—	—	-½
General government borrowing requirement	10½	11	8½
Public sector borrowing requirement as percentage of GDP	9	10	8
Money GDP at market prices	282	305	329

⁽¹⁾ On the same assumption as in the 1983 MTFS about the PSBR as a proportion of GDP.

Table 7 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.

Table 8 Public expenditure planning totals 1978-79 to 1984-85

	Planning total £ million		
	Cash ⁽¹⁾	Cost terms ^(1,2) base year 1982-83	Public ⁽³⁾ expenditure as % of GDP
1978-79 ⁽⁴⁾	65 800	106 800	40½
1979-80 ⁽⁴⁾	76 900	107 800	40½
1980-81 ⁽⁴⁾	92 700	108 600	42½
1981-82 ⁽⁴⁾	104 600	111 600	44
1982-83 ⁽⁴⁾	113 400	113 400	43½
1983-84 ⁽⁵⁾	119 800	114 100	42½
1984-85 ⁽⁵⁾	126 400	114 600	42

⁽¹⁾ Figures are rounded to the nearest £100 million.

⁽²⁾ Cash plans adjusted for general inflation as measured by the GDP deflator at market prices. The GDP deflator is forecast to increase by some 5 per cent in 1983-84 and some 5 per cent in 1984-85.

⁽³⁾ Includes planning total plus net debt interest, payments of VAT by local authorities and non-trading government capital consumption.

⁽⁴⁾ Outturn/estimated outturn.

⁽⁵⁾ Plans.

Special sales of assets

Net proceeds from special sales of assets are shown as increasing by £400 million, reflecting a number of changes, including the postponement of the sale of Enterprise Oil (the company has been set up to take over the oil assets of British Gas) from 1983-84 to 1984-85. There are considerable uncertainties attached to this figure, which is dependent on market conditions at the time of sales.

Nationalised industries

External financing limits (EFLs) - made up of grants by government plus nationalised industries' net borrowing in a financial year - for nationalised industries in 1984-85 are set out in table 9. Overall, there is a decrease of £666 million in expected external financing requirements. Requirements have decreased for all industries, other than the National Coal Board, the British Steel Corporation, British Shipbuilders and the Civil Aviation Authority.

Table 9 External financing limits for the nationalised industries (1984-85)

	£ million ⁽¹⁾
National Coal Board	1 103
Electricity (England and Wales)	-740
North of Scotland Hydro-Electric Board	-2
South of Scotland Electricity Board	261
British Gas Corporation	-100
British Steel Corporation	275
British Telecom	-250
Post Office	-52
National Girobank	-1
British Airways Board	-160
British Airways Authority	10
British Railways Board	936
British Waterways Board	43
National Bus Company	66
Scottish Transport Group	16
British National Oil Corporation ⁽²⁾	-4
British Shipbuilders ⁽³⁾	175
Civil Aviation Authority	20
Water (England and Wales)	286
Total	1882

⁽¹⁾ Figures are shown rounded to the nearest £1 million.

⁽²⁾ The figure for BNOOC is not a limit. BNOOC's trading results are likely to fluctuate from year to year given the uncertainties of oil trading.

⁽³⁾ The British Shipbuilders EFL is provisional pending decisions on the industry's corporate plan.

Reserve

The white paper included for 1984-85 a provisional reserve of £3 billion. In the 1983 review of plans no call has been made on

this reserve, which will be available to meet all contingencies including estimating changes.

Education and Science

Provision is increased by £175 million overall. Four-fifths of the programme is local authority current expenditure. Within other expenditure there is increased provision for the costs of subscriptions to international science; an increase, after higher parental contributions and other savings, in provision for awards for more students in higher education; and savings in certain voluntary and direct grant institutions.

Home Office

The net increase of £92 million includes additions of £32 million for prisons and £19 million for police. There is also provision for additional expenditure by the Criminal Injuries Compensation Board and for a start-up loan to the Cable Authority, which is to supervise cable TV.

Defence

The provision allows for annual growth of some 3 per cent in real terms, with an addition for Falklands costs.

Social Security and Health

The programme provides for an uprating in November 1984 based on the rise in prices in the 12 months to May 1984, although the precise uprating for individual benefits will not be announced until June when the May index of retail prices (RPI) becomes available. Main policy changes are reductions in the coverage of help with housing costs, particularly housing benefits. The net effect is an increase on previous plans of £163 million.

Provision for the hospital and community health services should provide growth of nearly 1 per cent for the increasing number of very old people. Cost improvement programmes should release further resources to meet medical advances, reduce treatment shortages and waiting times, and allow other improvements. The provision for capital spending is being increased over this year's level by rather more than the forecast of general inflation. The provision planned for the family practitioner services allows for estimated demand. The provision for personal social services has been increased.

Local authorities

In the face of continued overspending the Government have been obliged to increase provision for current expenditure relevant for rate support grant (RSG) for 1984-85 by just under £600 million from the plans underlying the last PEWP. Provision will be £24.3 billion. This should enable the Government's policies for individual services to be broadly maintained.

Local authorities have been given provisional targets for total expenditure based on the revised provision for current expenditure.

Authorities which exceed their targets or guidelines will lose grant. (In 1983-84, some £292 million of grant has been 'held back' from authorities in England and Wales in the face of planned overspending; £45 million has been abated from grant in Scotland and four authorities have been required to make rate reductions equivalent to £19 million.)

Early returns from the local authorities for 1983-84 suggest no repetition of the massive capital underspending in 1981-82 and 1982-83. Overall, expenditure is expected to be within

about £¼ billion of the planned level of just under £4 billion.

Environment - housing

It is proposed that local authority, housing corporation and other gross capital expenditure in the housing field should be set at £3,245 million, almost exactly the same in cash terms as this year's provision. The Secretary of State for the Environment has announced separately measures to ensure that better use is made of the available provision and particularly of the growing volume of capital receipts from the sale of council houses. These increased receipts, together with other changes, will produce a reduction in the net programme total of £497 million.

NATIONAL INSURANCE CONTRIBUTIONS

National insurance contribution rates for employers and employees are to remain unchanged but there will, as usual, be an adjustment in the earnings limit, and the Treasury supplement will be reduced.

Contributions are currently payable on all earnings, once the lower earnings limit of £32.50 a week is reached, up to the upper earnings limit of £235 a week. The lower earnings limit will now increase to £34 a week, in line with the single rate retirement pension, and the upper earnings limit to £250. There will be similar increases to the limit for self-employed contributions.

The current full rate of class one contributions will continue at 9 per cent for employees and 10.45 per cent for employers. The Treasury supplement, equal to 13 per cent of contributions (before taking account of the rebate for contracted-out contributions), will be reduced to 11 per cent.

ASSUMPTIONS USED BY GOVERNMENT ACTUARY

Each year the Government Actuary reports on what changes in contributions he thinks necessary to maintain the balance in the national insurance fund. Contributions are not a tax and are paid into the national insurance fund and the redundancy and maternity pay funds, as well as being used to help pay for the National Health Service.

The Government Actuary uses certain assumptions to assess what both the income of the national insurance fund and the payment from it are likely to be in the coming year. These working assumptions, which are not forecasts or predictions, are currently that:

- the number unemployed, excluding school-leavers, averages 2,850,000 in both 1983-84 and 1984-85 and that, in addition, the number of unemployed school-leavers and students or persons whose employment has temporarily stopped averages 180,000 in 1983-84 and 170,000 in 1984-85;
- average earnings in the tax year 1983-84 are 7 per cent higher than in 1982-83 and the average in the tax year 1984-85 6½ per cent higher than in 1983-84. These are increases in average earnings over the economy as a whole and the latter figure 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;
- the movement in prices between May 1983 and May 1984 (the relevant period for the November 1984 benefit uprating) will be 5½ per cent.

TAX READY RECKONERS

The tables below show illustrative changes to the major taxes and estimates of their direct revenue effects at forecast 1984-85 price and income levels.

The tables are published to inform discussion and help commentators or those making budget representations by providing 'building blocks'. Care should be exercised in fitting them together (pages 28-29 of the *Autumn Statement* give detailed guidance on use). It is, of course, not yet known what the increase in the index of retail prices will be between

December 1982 and December 1983, the figure which governs statutory indexation. The figure of 5 per cent is an illustrative assumption.

First-year and full-year effects

The figures given are for full-year effects and also for the effect in the first year (1984-85); that is, the part of the full-year effect which would be expected to come through in tax receipts in that financial year. The two figures are different as some revenues affected by changes are received by the Exchequer after the end of the first financial year. Nor are the first-year revenue effects the same as the effects on the public sector borrowing requirement for that year. These differences occur because of the second-round effects of tax changes on the economy.

Basis of the calculations

Estimates of the size of the direct effects of tax changes depend on economic variables, such as prices, earnings, consumers' expenditure, etc., and so may alter as the prospects change. The illustrative tax changes shown are based on a view of the economy that is consistent with the prospects described in the *Autumn Statement*. There are in principle a number of ways of measuring the direct effect on revenue of a tax change, depending on whether assumptions are made about changes in the tax base and whether revenue from other taxes is included. The definitions used here are explained in more detail in *Economic Progress Report*, March 1981 (page 15), and in the 1981-82 *Financial Statement and Budget Report*.

Table 11 Income tax

	1983-84	1984-85
Allowances	£	£
Single and wife's earned income allowance	1 785	1 875
Married allowance	2 795	2 935
Additional personal and widow's bereavement allowance	1 010	1 060
Single age allowance	2 360	2 480
Married age allowance	3 755	3 945
Aged income limit	7 600	8 000
Income tax rates	Bands of taxable income	
	1983-84	1984-85
per cent	£	£
30	0-14 600	0-15 400
40	14 601-17 200	15 401-18 200
45	17 201-21 800	18 201-23 100
50	21 801-28 900	23 101-30 600
55	28 901-36 000	30 601-38 100
60	over 36 000	over 38 100

	1983-84	1984-85
	£	£
Investment income surcharge threshold	7 100	7 500

Table 12 Costs of indexation

£ million at forecast 1984-85 prices, incomes and capital values

	First year cost	Full year cost
Indexation of income tax allowances and thresholds of which:	800	1 045
Increases in main personal allowances	730	900
Increases in the basic rate limit ⁽¹⁾	40	70
Increases in further higher rate thresholds ⁽¹⁾	30	60
Increases in investment income surcharge threshold	Negligible	15
Indexation of capital transfer tax thresholds and bands	15	35
Indexation of capital gains tax exempt amounts	Nil	10

⁽¹⁾ Additional costs after previous changes have been introduced.

Indexation of direct taxes

If income tax allowances, thresholds and bands were adjusted to reflect indexation by an illustrative 5 per cent the 1984-85 levels would be as shown in table 11. The rules for rounding-up set out in the 1980 Finance Act (for income tax) have been followed. The figures for 1983-84 are shown for comparison. The costs of this indexation are given in table 12.

Table 10 Public expenditure plans

	1983-84			£ million
	White paper (Cmnd 8789) with Budget and other pre-survey changes ⁽¹⁾	White paper (Cmnd 8789)	White paper (Cmnd 8789) with Budget and other pre-survey changes	Revised plans ⁽²⁾
Departments (excluding nationalised industries' external finance)⁽³⁾				
Ministry of Defence	15 716	17 288	17 270	17 010
Foreign and Commonwealth Office (including Overseas Development Administration)	1 719	1 801	1 806	1 807
European Community	380	450	450	450
Intervention Board for Agricultural Produce	1 274	835	825	1 247
Agriculture	992	998	994	1 009
Forestry Commission	59	60	60	56
Department of Trade and Industry	1 488	1 370	1 411	1 351
Department of Energy	470	457	457	543
Export Credits Guarantee Department	55	164	164	166
Department of Employment	2 981	3 317	3 376	3 308
Department of Transport	3 366	3 466	3 546	3 537
DOE - Housing	2 709	2 988	2 993	2 496
DOE - Property Services Agency	-145	-115	-116	-92
DOE - Other Environmental Services	3 186	3 227	3 210	3 209
Home Office	4 041	4 253	4 241	4 333
Lord Chancellor's Department	449	509	509	501
Department of Education and Science	12 583	12 912	12 877	13 052
Office of Arts and Libraries	560	584	585	595
DHSS - Health and Personal Social Services	14 478	15 382	15 328	15 414
DHSS - Social Security	34 783	35 939	36 687	36 850
Civil Superannuation	937	1 017	1 036	1 053
Scotland ⁽⁴⁾	6 160	6 339	6 339	6 318
Wales ⁽⁴⁾	2 397	2 486	2 480	2 459
Northern Ireland	3 796	4 019	4 031	4 020
Other Departments	1 967	2 058	2 069	2 116
Adjustment for refund of VAT on certain services contracted out by Government departments	-	-	-	-30
Nationalised industries	2 748	2 615	2 548	1 882
Local authority current expenditure not allocated to departments	904	455	455	625
Special sales of assets	-1 250	-1 500	-1 500	-1 900
Reserve	1 040	3 000	3 000	3 000
PLANNING TOTAL	119 843	126 374	127 131	126 385

⁽¹⁾ Including measures announced on 7 July 1983 and changes of classification.

⁽²⁾ Some figures may be subject to detailed technical amendment before publication of the 1984 PEWP.

⁽³⁾ Provision for pay in these programmes reflects the pay factor of 3 per cent announced on 15 September 1983.

⁽⁴⁾ Excluding agricultural expenditure, which is included in the agricultural line.

Table 13 Revenue effects of indirect tax changes

	5% Revalorisation ⁽¹⁾			£ million 1984-85 prices and income levels Unit changes from present levels of duty		
	Current level of duty on typical item ⁽²⁾	Price change inc. VAT (pence)	Full year yield ⁽³⁾ £m	Price change inc. VAT	Actual percentage change in duty %	Full year yield/cost ⁽³⁾ £m
Indirect taxes						
Beer (pint)	15.1p	0.9	80	1p	5.7	95
Wine (bottle of table wine 75 cl)	84.75p	4.9	25	1p	1.0	5
Spirits (bottle)	£4.56	26.2	25	1p	0.2	1
Tobacco (20 king size cigarettes) ⁽⁴⁾	66.2p	3.3	110	1p	1.5	35
Petrol (gallon)	74.1p	4.3	210	1p	1.2	50
Derv (gallon)	62.83p	3.6	50	1p	1.4	12½
VED (cars and light vans)	£85	£4.25	77	£1	1.2	18
VED (goods vehicles)	£150-£2 940	£7.50-£147	19	£1.50-£29.40	1.0	3.8

⁽¹⁾ An 'across the board' revalorisation by 5 per cent (including the minor duties not shown above) would yield about £600 million in a full year, and the impact on the RPI would be to raise it by less than ½ per cent.

⁽²⁾ VAT is payable in addition to the duty except in the case of VED.

⁽³⁾ Assuming for illustrative purposes implementation on 1 April, the first and full-year yield of changes in excise duties would be identical for petrol, derv and VED; for beer and tobacco the first-year yield would be approximately eleven-twelfths of the full-year yield; and for wine and spirits it would be approximately twenty-three twenty-fourths.

⁽⁴⁾ The duty on cigarettes has *ad valorem* and specific elements; the percentage change relates only to the specific element, but the price change includes the subsequent increase in *ad valorem* duty and VAT.

Table 14 Direct effects of specimen changes in income tax and corporation tax

	£ million at forecast 1984-85 income levels	
	First year cost/yield	Full year cost/yield
Income tax⁽¹⁾		
Rates		
Change basic rate by 1p ⁽²⁾	950	1 025
Change all higher rates by 1p	35	70
Personal allowances		
Change single and wife's earned income allowance by £20	63	76
Change married allowance by £20	52	64
Change single age allowance by £20	5	7
Change married age allowance by £20	4	5
Change aged income limit by £100	2	3
Change all main personal allowances by 1%	145	177
Change (raise-/lower+) all main personal allowances by 10%	-1 415/+1 470	-1 735/+1 805
Higher rate bands		
Change (raise-/lower+) all higher rate thresholds by 1%	-12/+12	-21/+22
Change (raise-/lower+) all higher rate thresholds by 10%	-110/+140	-190/+245
Investment income surcharge		
Change (raise-/lower+) threshold by £500	-1/+1	-17/+19
Change rate by 1p	1	19
Allowances and thresholds		
Change all main personal allowances and higher rate and investment income surcharge thresholds by 1%	162	201
Change (raise-/lower+) all main personal allowances and higher rate and investment income surcharge thresholds by 10%	-1 575/+1 690	-1 945/+2 090
Corporation tax⁽³⁾		
	First year	£ million Full year
Change rate by 1 percentage point ⁽⁴⁾	100	170
Change small companies' rate by 1 percentage point	10	18

⁽¹⁾ Changes are from the indexed levels of allowances and thresholds shown in table 11. Percentage changes are, however, of 1983-84 levels.

⁽²⁾ Including the effect of the change on receipts of advance corporation tax and on consequent liability to mainstream corporation tax.

⁽³⁾ Assessment to corporation tax normally relates to the preceding year. These are, therefore, the changes to revenue that would occur if the changed rates were applied to forecast 1983-84 income levels.

⁽⁴⁾ Assuming small companies' rate unchanged.

Direct revenue effects

Table 14 gives estimates of the direct effects (at forecast levels of 1984-85 prices and incomes) of changes in the main personal allowances, thresholds and rates of income tax from the indexed level of allowances and thresholds set out in table 11. For corporation tax the table shows the effect of a 1 percentage point change in the rate of tax and in the small companies' rate. It shows the costs or yields resulting from individual allowances changes of £20 and of changes in all allowances by 1 and 10 per cent of their 1983-84 values. It also shows the effect of a package which changes all main personal allowances and higher-rate and investment income surcharge thresholds by 1 per cent and 10 per cent. These changes have been calculated as percentages of the 1983-84 levels and the effects estimated on top of the 5 per cent illustrative indexation.

Indirect taxes

Figures for changes in excise duties are shown in table 13. The first section shows the extra revenue from the individual duties if they were to be increased by exactly 5 per cent, together with the price increase that would result (after allowing for consequential VAT).

The second section shows for most duties the revenue yield from changing current level of duty so that (after VAT) the price of a typical item is changed by exactly one penny. For vehicle excise duty a £1 change for cars and light vans and a 1 per cent change for goods vehicles is shown.

Table 15 shows the revenue effects of 1 percentage point change in the rates of VAT and the national insurance surcharge.

Table 15 VAT and NIS

	First year ⁽¹⁾ yield/cost	Full year yield/cost
1% point change in rate of VAT	550	740
1% point change in NIS assuming recovery from the public sector	1 180	1 330
	750	850

⁽¹⁾ Assuming implementation on 1 April.

PRIME MINISTER

PUBLIC EXPENDITURE REVIEW

The Policy Unit suggested to you recently that it would be useful, before the start of the PES round, to identify areas where public expenditure might be saved. The Policy Unit have had talks with the Treasury which have generated the proposals in the Chief Secretary's minute. In addition to these five subjects, a review of agriculture has already been put in hand and work is continuing on control of Community expenditure (attribution and non-additionality). One area not covered by the Chief Secretary, but which the Policy Unit wish to pursue, is industrial support from INMOS through to British Leyland. They will be preparing a further note on this.

I am most concerned about this. It looks out of control. We need a meeting with all Ministers + P.U.'s Treasury. We can't go on like this.

The way forward on each of the Treasury's suggestions appears to be:

- (i) Urban Programme: you should minute the Secretary of State for the Environment, using Treasury-provided draft. Treasury can spread P.J. verbally.
- (ii) Defence Equipment: paper to be commissioned at next meeting of OD. Yes no
- (iii) Family Practitioner Service and Social Security & Benefits: Chief Secretary to approach Mr. Fowler,
- (iv) to set up joint work by their officials.
- (v) Territorial Programmes: I believe that Michael Scholar mentioned to you recently. The Treasury have done a great deal of work which points to the conclusion that spending, in relation to "needs", in Scotland and Northern Ireland is substantially higher than in England and Wales. Before approaching the Ministers responsible, you may want to look at a note by the Treasury setting out the prosecution case. Yes no

cf CST's letter to Fowler

Agree to proceed in this way?

Treasury shelves work on public spending study

BY MAX WILKINSON, ECONOMICS CORRESPONDENT

THE TREASURY has shelved plans to publish a strategy document on public spending early this year because of anxieties expressed by senior ministers. Mr Nigel Lawson, Chancellor of the Exchequer, said last summer that he wanted to provoke a debate about public spending programmes over the next 10 years.

One of his aims was to convince the nation that public spending could not be allowed to rise nearly as fast as it had done in most of the post-war period if the Government were to stick to its anti-inflation strategy and reduce taxes.

He set the Treasury, in consultation with spending departments, to work out detailed projections for public spending, particularly in the sectors of health, education, defence and social security.

By late autumn, the work was running into difficulties about the future shape of the welfare state and Britain's defence commitments for the next 10 years.

Treasury officials found they could not make sensible projections without some decisions in principle from the highest political level.

An important issue, for example, is whether it should be assumed that the National Health Service will provide at least the present standard of care for the whole population, or whether private health schemes will be encouraged to take an increased share of the burden.

Another hot political question is whether pensioners and the unemployed can expect their benefits to be fully protected against inflation beyond the life of this parliament.

A recent study by the Paris-based Organisation for Economic Co-operation and Development has suggested that social benefits will need to be cut in most countries if public spending is to stay under control.

However, in discussions towards the end of last year Cabinet ministers showed reluctance to take controversial or unpalatable decisions on such questions for periods which seem remote in political terms.

The Prime Minister is known to be anxious that the Government should avoid the political controversy which surrounded the Treasury's last long-term public spending exercise, extensively leaked at the time of the last election.

This study suggested that radical decisions would be needed to curb the growth of many spending programmes.

The Treasury also suggested in a commentary on the study that former pledges, like the present commitment to protect pensions against inflation, "should be allowed to expire."

It has since been suggested that the Treasury's assumptions about possible rates of economic growth and Government revenues may have been unduly pessimistic.

The Institute for Fiscal

Studies (the independent "think tank" for tax matters) has calculated, for example, that if the economy grows at an average rate of 1½ per cent a year, public spending will remain at about the present proportion of national output without any radical surgery being needed.

In formulating its new study on spending, the Treasury has run up against a problem of presentation. It believes the consequences of very low growth, perhaps ½ per cent to ¾ per cent a year, need to be examined.

But it fears projections based on such "pessimistic" assumptions might be viewed as undermining confidence in the Government's strategy for promoting a "sustainable economic recovery."

Ministers will not be anxious to put their names to hypothetical spending cuts which might not be necessary.

There are, in addition, differences in the Cabinet between ministers like Mr John Biffen, Leader of the House, who does not want to see a radical attack on the welfare state, and other ministers who would like to see a much more "self help" society with lower public spending and lower taxes.

The Treasury has put its work on long-term public spending on the shelf and the idea of a Green Paper on the subject, mooted in the early autumn, appears to have been firmly ruled out for now.

FROM: CHIEF SECRETARY
 DATE: 22 December 1983



cc JR
 W. J. P.

PRIME MINISTER

PUBLIC EXPENDITURE REVIEWS

To maintain our firm grip on public expenditure it is important that we should use the time between the annual Surveys to tackle in depth the difficult areas where there are potentially large savings. The regional policy review is a good recent example. With your agreement I should now like to open up some more reviews, which we can consider before the next Survey, either in Cabinet Committee or, if you prefer, in a smaller group under your chairmanship.

The aim should be to look at the objectives of a spending programme afresh to see whether we should - or whether, politically, we can - devote substantially less resources to it. Radical reviews on these lines will need the agreement of colleagues concerned, and we should set firm guidelines for officials. In some cases you may want to hold a meeting of Ministers first, or to send a minute setting out the scope of the review.

We have already agreed, at your meeting on 21 December to a review of spending on agriculture. My other candidates are:

1. Urban programme. This has grown to a large total (£325m this year) with no clear definition of objectives or tests of success. The regional policy review failed to get to grips with it, and it may be giving the wrong signals to high-spending local authorities in urban areas.

The objectives and cost-effectiveness need to be set out in detail, with options for substantial savings, for us to consider before the next Survey. You may want a meeting with Patrick Jenkin and other colleagues to launch this. Alternatively, I would be glad to provide a draft minute for you to send him.

2. Defence equipment. Following the HARM/ALARM decision Cabinet commissioned an exercise to establish what technology it is militarily essential to have in this country. In my view it would help with future equipment procurement decisions to follow up this exercise now with a broader examination of the UK defence industrial and technological base so as to promote greater competitiveness in this area and maximise value for money in defence procurement. If you agree, the broader examination might be commissioned by OD when the Committee discusses the initial paper which I understand is with Michael Heseltine. It would be useful for the No. 10 Policy Unit and Cabinet Office Scientific staff to continue to take part in the work.

3. Family Practitioner Service. This expenditure is 'demand-led' and hard to forecast or control. Implementation of the Binder Hamlyn recommendations, and the current review of the drug purchasing scheme (PPRS), should help. But Binder Hamlyn's terms of reference did not cover the cost-plus contractual relationship between the NHS and family practitioners. This badly needs review: it tends to build up arrears of payments; it offers GPs no incentive to prescribe economically; and following legal action by some disgruntled pharmacists it now seems that its legal basis is unsound. If you agree - I do not think that Norman Fowler is likely to dissent - further work should be done in this area and a report made to Ministers for decisions by the middle of next year. It may also be necessary to look again at further options (eg. cost-related charges for drugs) before the next Survey.

4. Social Security benefits. Norman Fowler has already agreed in principle, during the Survey discussions, that all benefits should be reviewed to see if they are relevant to the 1980s. Pension issues are being considered by his Enquiry. Other priority areas are housing benefit and unemployment and supplementary benefits. I am concerned more widely about the inadequacies of forecasting, monitoring and control of benefits expenditure (where there has just been another large "demand-led" increase), and I shall insist in that context that officials do more work on this so that we can find ways of improving matters before the next Survey.

5. Territorial programmes. There is good prima facie evidence that the overall level of spending, in relation to "needs", in Scotland and Northern Ireland is substantially higher than in England and Wales. Our regional policy decisions have made only a very limited impact on this problem. This is a politically sensitive issue, and I would certainly not suggest that we could make any dramatic cuts in the short term. But I think we should ask officials to establish the facts as clearly as possible so that we can consider some adjustment at the margin, starting in the final year of the next Survey. If I may, I will let you have after Christmas a draft of the kind of minute you might send to colleagues concerned initiating this work.

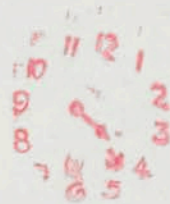
If you agree with these proposals, I hope that my officials and the No. 10 Policy Unit ^{can} keep in close touch as the work proceeds.

Jst. Giers

for PETER REES

[Approved by the Chief Secretary]

22 DEC 1983



LBS

file

CENTRE FOR ECONOMIC FORECASTING
262 - 5050
EX. 385-

EMBARGO: 00.30 HOURS MONDAY, 12 DEC. 1983

Volume 8 numbers 2/3

November/December 1983

THE AUTUMN STATEMENT

The Autumn Statement is notable for the optimistic tone of its economic forecasts. The fiscal projections are however disappointing since they confirm that the PSBR in 1983-4 could be some £2bn higher than originally planned. In this *Forecast Release* we examine the reasons for the Treasury's optimism about short-term prospects; analyse the causes of the PSBR overshoot; and discuss the implications of using asset sales rather than public expenditure cuts as a means of keeping public borrowing under control.

Our main conclusions are:

(1) If the authorities are correct in assuming stable oil prices and a stable exchange rate, then inflation could fall to 4½ per cent by the end of next year as they project.

(2) We believe it more likely that the exchange rate will drift downwards and hence inflation will be higher than officially forecast.

(3) A re-run of our October forecast on Treasury assumptions suggests that growth will be closer to 2½ per cent than 3 per cent next year, with exports, stockbuilding and consumption all lower than officially forecast.

(4) The PSBR overshoot in 1983-4 suggests that the cash limit system for controlling spending systematically leads to above-target borrowing whenever (as at present) inflation and thus tax revenues turn out lower than expected.

(5) Asset sales up to a reasonable amount are an acceptable substitute for spending cuts or tax increases if the purpose of the PSBR target is to control the size of the public sector; they are not a good substitute if the purpose of controlling public borrowing is to reduce inflationary pressure by limiting the public sector's claims on real incomes.

I The Forecast

Inflation

Many commentators, including ourselves, have forecast that (leaving aside short term movements in the RPI due to special factors) inflation will rise in the later stages of the cyclical upswing, and will be higher next year than this. The Treasury forecast challenges that view, and asserts that by the second half of next

year inflation will once again be falling. Which of us is more likely to be correct? Is it realistic to forecast falling inflation next year, which will be the fourth year of the present recovery?

It should be stated at the outset that forecasting uncertainty is such that the difference between the Treasury and LBS inflation forecast is well within the margin of error attached to either. The average error for past Treasury forecasts made at this time of year for one-year-ahead inflation is 3 per cent. This figure, calculated for a period of much higher and more variable inflation, may overstate the uncertainty, but even if the likely error is only half as big, it still spans the difference between Treasury and LBS forecasts.

It is nevertheless instructive to examine the reasons why the two forecasts differ, since it serves to highlight some interesting differences in economic assumptions underlying the two forecasts.

Short-term forecasts of inflation in general strike a balance between two approaches: domestic prices can be determined either by domestic costs adjusting to world prices with little change in the exchange rate; or by world prices expressed in sterling terms adjusting to domestic costs via a change in the exchange rate. Monetary policy is an important factor in determining which of these effects dominates. Policy is especially important at present because there is a substantial gap between the prospective rates of increases of domestic costs and world prices, as Table 1 shows.

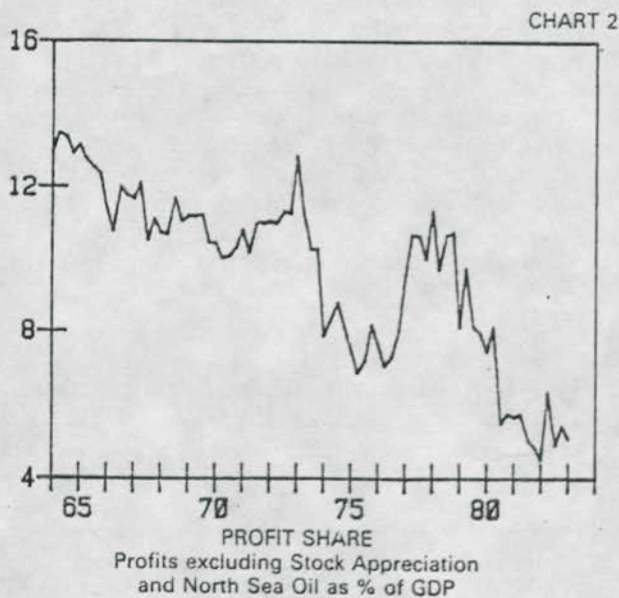
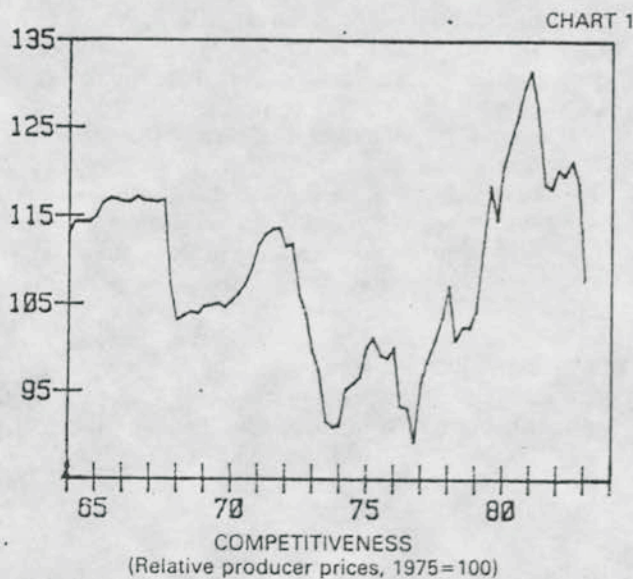
The gap between domestic costs and world prices

Table 1
Key Elements in LBS forecast of Inflation

	% changes, 1983Q4 to 1984Q4
World producer prices	6.8
Exchange rate	-6.2
World producer prices in sterling	13.1
Earnings per head (manufacturing)	6.3
Productivity (manufacturing)	4.1
Unit labour costs (manufacturing)	2.1
Producer prices	6.4

provides an opportunity to improve both competitiveness and profits. The opportunity is welcome because, as Chart 1 shows, we start from a position in which competitiveness, despite its improvement since 1981, is still weak, while Chart 2 shows that profits, though rising rapidly, are still low by historical standards. The problem is that improving competitiveness requires lower prices, while improving profits requires higher prices. One way of reconciling these conflicting claims is via a lower exchange rate. In our October forecast we forecast a modest fall in the exchange rate, but the Autumn Statement reveals that that is not what the Treasury is currently assuming.

The authorities do not have an explicit policy for the exchange rate. They attempt to balance their long-term aim of stable prices (which is helped by a high exchange rate) against the short-term need to encourage export-led growth (which is helped by a lower exchange rate). The exchange rate was high in the summer months (following the Conservative election victory) and exports have been weak. The authorities seemed at that time content to see the exchange rate edge downwards.



However, the Autumn Statement assumes little further slippage from now on. If that implies that the authorities will be prepared to defend the exchange rate at its present level (if necessary by raising interest rates), then clearly the exchange rate projection underlying our October forecast was wrong.

What then would our forecast have looked like if we had assumed a broadly constant exchange rate, as the Treasury does? We have carried out some simulations to quantify this, and these are reported in detail on p3. The broad answer is that incorporating the Treasury assumption of a constant exchange rate into the LBS forecast would by itself bring our RPI forecast (1983Q4 to 1984Q4) down from 5.5 to 4.8 per cent. Further adjustments to bring our public spending and oil price assumptions into line with latest official plans and projections result in higher output and lower unit costs, which bring the LBS forecast for the RPI very close to the Treasury view.

The moral of the exercise is clear: inflation prospects depend crucially on the exchange rate. We remain of the view that unless there is official action to prevent it, the exchange rate will tend to weaken over the next year. The underlying reason for this is the large monetary overhang and weak competitive position, which could lead to persistent balance of payments weakness on capital and current account. However, if the exchange rate does hold up (and if the Treasury is right in its oil price assumptions), inflation next year could be lower than this year.

Output

If the difference between Treasury and LBS inflation forecasts turns out, on close inspection, to reflect mainly differing assumptions, the same cannot be said of the output forecasts. The official growth forecast for 1984 is 3 per cent on the average measure of GDP. In October we forecast 2.2 per cent on this measure. The difference between these growth rates, though within the average error of 1 per cent for the official GDP forecast, does imply a genuine difference of view which is worth exploring.

A key difference between the two sets of numbers is the forecast for personal consumption. Insufficient information is given in the Autumn Statement to pin down exactly why the Treasury and LBS forecasts differ. Qualitatively it appears that the two forecasts are similar – both forecasts expect the “saving ratio to stay below last year’s level” and both predict a “rise in real after-tax incomes” (A.S. para 1.31). Each is “consistent with a rise in employment over the next year” (A.S. para 1.41). Even on earnings, where the Government Actuary’s working assumption is a rise of 6½ per cent between 1983-4 and 1984-5 (A.S. para 3.04), there is little difference, once the LBS October forecast is adjusted for lower oil prices and higher exchange rates. However it is probable that real incomes are higher in the Treasury forecast at the end of 1983, reflecting recent information which suggests lower inflation and higher consumption in the current quarter. This, plus a slightly lower savings ratio throughout is probably sufficient to explain the

difference in consumption.

Another reason why the official forecasts are higher than ours is that public consumption is projected to grow by 1 per cent next year, compared with the 0.3 per cent which we forecast in October. This stems from the lower inflation forecast which permits greater volume growth within an unchanged public expenditure Planning Total.

HMT's view of personal consumption has two important corollaries. Higher consumption reflects higher real income which is partly a consequence of a stronger exchange rate. The counterpart of the extra consumption, in the Treasury forecast, is a higher level of imports than in the LBS projection. But this is offset by higher exports which, given the exchange rate assumption, looks optimistic even against the background of expected world recovery. It seems unlikely that exports will be 4 per cent higher next year without any significant fall in the exchange rate.

The other corollary of higher real personal incomes (brought about by lower prices) is that profits rise by less. In the official projections, mainly because of the stronger exchange rate, persons are better off and companies are worse off than in the LBS forecast. But despite this the official forecast of stockbuilding is distinctly higher than ours which seems questionable.

Table 2 shows the main elements of the Treasury and LBS forecasts. Our overall assessment of the official projections is that, given their own assumptions about the exchange rate and oil prices, the price forecast looks reasonable, but the output forecast looks high. If the exchange rate remains close to present levels over the next year, then we would expect exports and stockbuilding to be distinctly lower than officially forecast, and output to be nearer 2½ per cent than 3 per cent.

Table 2
Comparison of Treasury and LBS Forecasts for 1984

Percentage changes	Treasury (Autumn Statement)	LBS (October forecast)	LBS (on Treasury assump- tions)
GDP (average)	3	2.2	2.4
Consumers' expenditure	2½	2.0	2.0
Government consumption	1	0.3	1.1
Fixed investment	4	4.4	4.7
Stockbuilding (as % of GDP)	½	0.3	0.3
Exports	4	3.1	2.7
Imports	5	3.8	3.9
Current balance of payments (£bn)	0	0.3	0.5
RPI (4th quarter)	4½	5.5	4.4
PSBR (£bn fin. yr)	8	7.6	8.0

Re-running the October forecast on Treasury assumptions

In this section we examine in detail how the latest Treasury forecast differs from our most recent forecast. One reason why forecasts differ is that they are made on different exogenous assumptions. We have therefore re-run the LBS forecast using, as far as possible, the same assumptions as those underlying the Treasury forecast.

Assumptions

Table 3 sets out the principal assumptions/forecasts made by HMT and LBS on world prices and output, the exchange rate, taxes and public spending.

Table 3
Key Assumptions for 1984

	HMT	LBS
North Sea Oil price (\$)	30*	31.5
World GNP (% change)	3½	3.3
Exchange rate (1975=100)	83*	81
Rooker-Wise indexation	5	5.1
National insurance surcharge (rate, %)	1	abolished
Government consumption (% change)	1	0.3
Fiscal adjustment (£bn, minus sign means increase in taxes)	-½	0.5

*HMT numbers are "interpreted" from the Autumn Statement

For 1983 the differences are unimportant. For 1984, the assumptions on world activity and the indexation of taxes and allowances in next year's Budget are very close. But on other items, there are important differences:-

1) Oil prices

The Treasury assumes that "North Sea Oil prices do not change very much from present levels" (A.S. para 1.47) whereas we forecast that, with the recovery in the world economy, there would be some upwards pressure on oil prices during 1984.

2) The Exchange Rate

The Treasury assumption is that "the effective exchange rate will not change very much from the average level for the first three quarters of 1983" (A.S. para 1.11). Our forecast was that, with UK interest rates following-US rates down and little or no surplus on the current account, the exchange rate would fall throughout 1984 to bring competitiveness back closer to its long-run average levels. Thus next year it would be 3½ per cent lower than in 1983 on average.

3) Taxes and Public Spending

Although the Planning Total in 1984-5 has been held at £126.4bn, the projection for total public expenditure in National Accounts terms has increased (since the Budget Statement) from £145bn to £146½ bn, reflecting among other things higher debt interest payments. The forecast of public revenue increased by only £½ bn, with a significant underlying fall in the forecast of non-North Sea revenue. This decline probably reflects the effect of lower inflation only partly offset by higher activity. The fall in inflation also means that the Planning Total, although unchanged in cash terms, is consistent with a higher volume of public spending. On the other hand, the 1983-4 overshoot of the PSBR means that the tax cuts assumed for 1984-5 no longer appear likely.

The Forecasts compared

If we re-run the October forecast on the Treasury's assumptions, then we obtain the results set out in Table 4. Each line in Table 4 shows the effect of changing just one assumption while the last line shows the effect of

bringing all the assumptions into line with the Treasury's.

The *first* simulation, holding the oil price constant, results in lower inflation in 1984 but at the cost of a higher PSBR as North Sea Oil tax revenues are reduced; output is slightly higher. The *second* simulation, with a constant exchange rate (and oil prices rising as in our October forecast) again results in lower inflation. But, because of the effects on UK competitiveness, output is lower and this in turn has an adverse effect on the PSBR. The *third* simulation, with higher public spending has a beneficial effect in the short run, on output and, because unit costs are lower, inflation, but raises the PSBR. The *fourth* simulation, with an unchanged national insurance surcharge, lowers the PSBR but at a small cost to inflation and output.

The growth rate in 1984 is 2.3 per cent at 1975 prices compared with the official forecast of 3 per cent at 1980 prices. As we showed in the October Focus (Table 20 p 17), the growth rate in 1984 will be only very slightly affected by the move to 1980 prices. On the Treasury assumptions, therefore, we would expect GDP growth of up to 2½ per cent in 1984.

Table 4
Treasury and LBS Forecasts: Key Variables

	GDP 1984	RPI		PSBR	
		84Q2	84Q4	1983-4	1984-5
HMT (Autumn Statement)	3	5½	4½	10	8
LBS (October forecast)	2.2	6.5	5.5	9.4	7.6
LBS simulations based on October forecast, with Treasury assumptions					
1. Constant oil price	2.3	6.4	5.2	9.5	8.2
2. Constant exchange rates	2.1	6.5	4.8	9.4	7.9
3. Higher government spending	2.4	6.4	5.3	10.0	8.4
4. National insurance surcharge retained	2.2	6.7	5.7	9.4	6.9
5. All of the above	2.4	6.2	4.4	10.0	8.5
6. All of the above with higher taxes (‘fiscal adjustment’)	2.3	6.2	4.4	10.0	8.0

II Fiscal Policy

The major disappointment in the Autumn Statement is what it reveals about public borrowing. The PSBR forecast for 1983-4 has been revised upwards from just over £8bn to £10 bn. As Table 5 shows £1½ bn of this change is accounted for by increased spending and the remaining £½ bn by a fall in tax revenue. However, considering that North Sea tax revenue is £1bn higher than was expected at Budget time, there is clearly a rather larger shortfall in non-North Sea tax revenue.

Table 5
Fiscal Policy in 1983-4

	Budget Statement	Autumn Statement
General Government:		
expenditure	137½	139
receipts,	128½	128
of which North Sea oil	8	9
Public Sector Borrowing Requirement	8	10

The overshoot on public spending is especially disquieting since it has occurred against a background of inflationary undershooting. In the Budget Statement retail prices were forecast to rise by 6 per cent between the fourth quarter of 1982 and the fourth quarter of 1983. The estimate in the Autumn Statement is 5 per cent. All other things being equal the unanticipated fall in the rate of inflation should have helped to keep public spending within the cash limits, since it should have lowered the cost of public procurement. However, any tendency for public procurement to undershoot will have been more than offset by the overspending on wages and salaries. The public sector wage and salary bill in the first quarter of this year was nearly 12 per cent higher than a year earlier. This is already some 3¼ per cent higher than the average for 1982-3, and the cash limit for 1983-4 is only 3½ per cent. Even allowing for the incidence of back pay in the first quarter, these statistics imply that extremely tight control will have to be exerted over the public sector wage bill during the present financial year. When allowance is made for grade drift and other slippage, the control totals imply a virtual standstill in public sector wages this year.

The tendency for public spending to overshoot is also evident in the plans for 1984-5. Table 6 shows that the Planning Total has been adhered to, despite Departmental overspending, only by increasing asset sales and by reducing the external financing limits of the Nationalised Industries. This in turn has been achieved by allowing greater increases in Nationalised Industries' prices. Financing extra spending by putting up prices is little different from financing it by an increase in indirect taxation. It is not exactly in the spirit of the Medium Term Financial Strategy.

Controlling public spending is always difficult; a more disturbing feature of the upward revision to the PSBR is the shortfall in taxes. For it underlines what could be a persistent problem with the present system of controlling public finance during a period of falling

Table 6
Public spending plans, 1984-5 (£bn)

	Planned at Budget time (Cmd 8789)	Revised planning
Departmental spending	125.2	126.4
Nationalised industries	2.6	1.9
Asset sales	-1.5	-1.9
Total	126.4	126.4

inflation. The problem can be briefly stated; public expenditure is subject to cash limits, but there are no cash limits for revenue.

What this means in practice is that if inflation turns out lower than expected, the cash limit system on the expenditure side will generate some extra expenditure volumes to offset the shortfall in prices. This is an entirely desirable result; at the micro level it provides a strong incentive to control costs, since those who are successful in doing so can spend more in real terms. At the macro level it has the result that when inflation is lower than expected, output is boosted by extra public spending. Again this is desirable: for a given level of nominal GDP (broadly determined by the monetary targets) lower inflation leaves room for more output. The cash limit system of public spending control is one mechanism whereby lower inflation can by itself generate extra output.

However there is a risk under the present system that below-target inflation will result not just in higher spending, but in higher borrowing as well. This is because variations in inflation, which are offset by volume changes on the expenditure side, leaving the cash limits intact, are not similarly offset on the income side. Hence if inflation turns out lower than expected, expenditure stays on target, but revenue is below target. This happens because lower prices will immediately reduce VAT revenue; if subsequently wages turn out lower than expected there will be some shortfall in income tax as well.

The consequence of this tax shortfall is that borrowing overshoots, which in turn means either higher monetary growth (which will eventually reverse the inflationary gains) or higher interest rates. Given the strong commitment of the present administration to its monetary targets, it seems likely that if lower-than-expected inflation leads to higher-than-planned borrowing the result will be higher interest rates. This suggests that the present system of public expenditure control may be partly responsible for the persistently high level of real interest rates.

III Should Asset Sales be in the PSBR?

Asset sales next year are planned to comprise some £2bn of equities, mainly in BT and Enterprise Oil, plus council house sales and sundry other disposals.

The current programme of equity sales is not a complete departure from previous practice. Government equity sales as a percentage of GDP have been significant on several occasions in the past, notably under the Healey Chancellorship.

In accounting terms, asset sales reduce the PSBR – they are treated as negative public expenditure. Similarly asset purchases – i.e. Nationalisation – count as positive spending and boost the PSBR. Some commentators have argued strongly that this is inappropriate, claiming that a better measure of Government borrowing needs and fiscal stance would be obtained by treating asset sales as items that help to *finance* the PSBR rather than as items that actually *reduce* it.

The issues are extremely complex. But the right place to start the discussion is surely to ask the purpose of having a fiscal target. If we can answer that question, then we should be in a better position to decide what should and what should not enter into the definition of that target. The problem is that those who advocate steering the economy by a set of fiscal guidelines do so from a mixture of motives which are not always very carefully distinguished. It is worth spelling them out in detail and then trying to decide how asset sales should be in the light of each of these arguments.

(1) Lower interest rates

The argument most often advanced in favour of fiscal stringency is that it leads to (or permits) lower interest rates. If the PSBR is reduced then, for a given rate of monetary growth, the government will have to sell less debt, which in practice usually means fewer gilt-edged securities. Fewer gilts sales usually mean higher gilts prices, i.e. lower long-term interest rates.

But if the reduction in the PSBR has been achieved through asset sales, then the boost to gilts prices from the fall in gilts sales may be rather limited. This is because the people and financial institutions who buy the assets will pay for them partly by reducing the money that they would otherwise have spent on gilts. Some commentators take an extreme view, arguing that all of the finance for asset sales comes from money diverted from the gilts market – so the asset sales have no effect at all on gilt prices. This extreme view is not supported by our econometric model, which suggests that only some of the fund spent on asset sales will be diverted from the gilts market. Thus we believe that asset sales do raise gilts prices and so reduce long-term interest rates, but the effect is not as large as if the government raised the money through taxes instead of asset sales.

(2) Crowding out

The reason why it is desirable to lower interest rates is, among other things, to encourage job-creating investment in the private sector. Public borrowing tends to 'crowd out' private investment by bidding away funds

that might otherwise be available to finance it. The normal crowding out mechanism is via high long-term interest rates, which drag up short rates and inhibit corporate borrowing. To this extent any policy that lowers long-term interest rates reduces 'crowding out'. Against this, sales of equities by the government will tend to depress equity prices, making it less attractive for private companies to raise new equity finance. Thus there will be some 'crowding out' via this route to be set against the 'crowding in' (i.e. increased private investment) caused by lower long-term interest rates. There is a possibility that the net effect of these two effects on private investment will be beneficial, because the adverse impact on equity prices of the asset sales will be mitigated by overseas purchases, to the extent that they are permitted.

If the aim is merely to lower long-term interest rates, then it is appropriate to count asset sales as a reduction in public borrowing. If the aim is to reduce total crowding out, then it looks as though asset sales are, at best, only a little better than gilt sales.

(3) Efficiency and control

Let us now push the argument back a stage further. Why is 'crowding out' believed to be a bad thing? Isn't the state just as capable of carrying out job-creating investment as the private sector? Those who condemn crowding out usually have two lines of argument. The first is that public investment is more wasteful than private investment, so that crowding out leads to inefficient allocation of resources. The second is to assert that even if the public investment were efficient, it would constitute an undesirable concentration of economic power in the hands of the state.

This is not the place to discuss the merits of either argument. The point to note is that the debate has shifted ground. The issue is no longer the level of interest rates and of private investment. Instead it is the relative size of the public sector. If the purpose of PSBR targets is to hold down the size of the public sector, then it is perfectly valid to score asset sales as a reduction in the PSBR (and nationalisation as an increase in the PSBR).

Suppose for example that public spending is fixed and the choice is to hit the PSBR target either by asset sales or by tax increases. It seems as though asset sales are preferable to tax increases since they will shift control of resources from public to private hands. Suppose on the other hand the level of taxation is fixed, so the choice lies between cutting public spending or selling assets to meet a given PSBR target. Once again if the aim is to transfer resources from public to private sector, asset sales seem at least as good as spending cuts. For the problem with spending cuts is that the resources may simply remain idle.

(4) The 'once-for-all' nature of asset sales

Another seemingly powerful argument against including asset sales in the PSBR is that they do not have a continuing impact – their effect occurs only once, in the year of sale. On top of this, some commentators argue,

the future revenues from profitable assets sold off will be lost. This argument ignores two vital points:-

a) Future borrowing needs

One is that profitable businesses have capital needs for expansion and modernisation. In many years those capital needs may exceed distributed profits plus internal funds. If the company is part of the public sector, then all of its net borrowing is counted as raising the PSBR (in the absence of 'Buzby bonds'). Thus British Telecom had a net borrowing need of some £¼ billion in 1981-2, made net repayments of the same order in 1982-3, and is scheduled to borrow around £100m this year. The government has suggested that BT would have preferred to borrow rather more to finance a bigger capital programme but was not allowed to do so because of the impact on the PSBR. Sale of assets in BT will thus have a continuing negative impact on the PSBR in most years, although of course the effect will only be a small fraction of the initial sales.

b) Capital accumulation

The public sector is in surplus on its current account and has been every year since the Second World War except 1946. Substantial spending on capital account - net of small capital tax receipts - turn this current surplus into a large borrowing requirement. This provides a counterargument to the suggestion that asset sales are a 'soft option' compared to spending cuts or tax increases, because they bring about no permanent change in the balance of income and expenditure. The asset sales are a disposal of some of the large public sector capital stock that the government adds to each year and that previous governments have built up as the counterpart to current debt liabilities. Of course, because of its nature and wastefulness and depreciation, the potential market value of that investment is way below its cost. Nevertheless public investment, even at its current low level, will ensure that next year's fall in the government's stock of saleable assets will be very much smaller than the figure of well over £3 billion raised from equity and house sales. There is an analogy with a private sector company selling off one part of its business in order to provide finance for other activities. To the extent that those sales are used to finance investment in the remaining part of the business, this is a reasonable practice employed by many companies. To the extent that asset sales go beyond this - as they will do next year - they have to be justified as a short-term measure, to tide the company over a difficult period that is partly caused by the excessive past borrowing to pay for the assets now being sold. Thus sale of assets equal to the rate of accumulation, valued at market prices, of saleable assets, is acceptable and can be sustained indefinitely. Sales above that are not sustainable and can be justified only as a short-term unwinding of earlier rates of rapid investment.

(5) Counter-inflationary policy

a) Pressure of Demand

Any argument in favour of keeping asset sales in the PSBR could be rather dangerous if it was used to justify public spending at a time when the overall pressure of demand was high. One purpose of having PSBR targets is to regulate public sector demands on resources. If public borrowing is above target this suggests that public sector claims are running ahead of available resources, and indicates a risk of inflationary pressure. The traditional response to excess pressure of demand is to cut public spending or to raise taxes. Are asset sales an equally good way of siphoning off demand from the private sector? The answer is probably that they are not because asset sales may have little effect on current spending. The total real wealth of the nation is unaffected by them (except to the extent they increase net capital inflows from abroad). The private sector's asset portfolio is redistributed but its net wealth is unchanged. There is no change in incomes. Under these circumstances it is probable that claims on resources by the private sector will be little changed.

b) Monetary policy

The above reasoning is underpinned by an essentially Keynesian view of the inflationary process, in which it is excess demand for real resources which puts upward pressure on prices. An alternative view is that inflation depends in the long term on monetary growth and nothing else. On this view asset sales are just as effective a method of controlling monetary inflation as tax increases or expenditure cuts since they reduce the money supply equally effectively. However, to the extent that inflation is a function not just of money but of the total stock of financial assets, it seems likely that asset sales are more effective as a device for hitting monetary targets than for reducing the underlying inflationary pressure due to excess stock of financial assets.

Conclusions

The one certain conclusion that can be drawn from these theological arguments is that there is no simple solution to the problem of how to treat asset sales. However it does seem fairly clear that if the PSBR target is intended as a guide to short-term demand management and a measure of public sector claims on current flows of real resources, then it is *not* appropriate to count asset sales as negative public spending. When the PSBR is used as a measure of public sector demands on the monetary system, then there is no clear case for taking asset sales out of the PSBR, although the arguments for leaving them within it are by no means conclusive. If on the other hand the PSBR target is intended to measure the authorities' success in limiting the size of the public sector, then it is appropriate to put asset sales inside the PSBR.

The risk that the government faces under present arrangements is that a successful privatisation program

could lead to inflationary overheating, since the resulting asset sales will enable the authorities to increase the direct claims of the public sector on resources while remaining within their PSBR guidelines.

National Health Service (Pharmaceutical)

4.57 pm

The Minister for Health (Mr. Kenneth Clarke): With permission, Mr. Speaker, I should like to make a statement on the discussion that I and the Secretary of State have been having on behalf of all the United Kingdom health Ministers with representatives of the pharmaceutical industry on the scope for savings in the NHS drugs bill and other matters of mutual concern.

Prescription medicines cost the NHS in England about £1,250 million in 1982-83. Drugs account for about 40 per cent. of the total cost of the family practitioner service and about 10 per cent. of the cost of the NHS as a whole. The pharmaceutical industry's profits from NHS sales are governed by the non-statutory pharmaceutical price regulation scheme which was introduced in its present form in 1978. In the words of the published scheme, it is a key objective that

"safe and effective medicines should be available on reasonable terms to the NHS, but also that a strong, efficient and profitable pharmaceutical industry"

should exist in the United Kingdom. The industry's present target profit level was set by the Labour Government in 1978. Like our predecessors, we recognise that there is a major and successful industry providing 67,000 jobs and a net balance of exports over imports of around £600 million a year.

However, the present scheme has run unaltered for over five years. A review of the PPRS and its role in relation to the industry and the NHS was announced earlier this year. After extensive discussion with the industry's representatives and having taken account of the 10th report of the Public Accounts Committee published in April, we have decided to reduce the level of profit from NHS business and the level of sales promotion allowed as an expense under the scheme.

First, under the scheme each pharmaceutical company participating in it is assigned a target rate of profit, taking account of

"the circumstances of the individual company, the contribution which it makes or is likely to make to the economy, including foreign earnings, investment, employment or research".

We have decided that these targets should be reduced by an average of four percentage points, which will represent a saving to the NHS in the United Kingdom of about £40 million a year. We have also decided that the discretion, which our Department allows in certain circumstances when companies exceed their target profit rates, should be tightened and related more closely to a company's circumstances. Companies will be told what their new targets are soon.

Secondly, the industry will spend about £180 million this year on sales promotion. Some, but not all, of this amount is an allowable expense under the PPRS. Such promotion is funded largely from NHS sales, and we have concluded that the allowable level should be reduced. We propose that companies should be asked to repay to the Department a sum equivalent to a sales promotion expenditure, which exceeds the level allowed under the scheme; and that the industry limit should be reduced from the present level of 10 per cent. of turnover to 9 per cent. in 1985-86. We estimate that when fully implemented

these measures should reduce actual expenditure on sales promotion by 25 per cent., but we will review this area again to see whether a further reduction can be made.

All the measures that I have announced will take effect from 1 April next year. In a full year they will produce savings on the NHS drug bill rising on present estimates from £65 million in 1984-85 to well over £100 million in later years. This compares with the industry's total profit from sales in the United Kingdom in 1983 of an estimated £200 million. The changes will mean that the price freeze on drugs—introduced in August as part of the £25 million savings agreed then—will continue, with few exceptions, through 1984-85 and beyond. Furthermore, the price freeze will be at the level established by the 2.5 per cent. cut that we settled in August.

We have also discussed with the industry the problem of parallel importing of medicines. This occurs when an importer takes advantage of exchange rates and low regulated prices of particular drugs in other countries to import or re-import those drugs into this country in competition with the identical or near-identical products already marketed here. At present, an exemption order under the Medicines Act 1968 is being used by parallel importers, in a way not envisaged when the order was made, to bring into Britain substantial quantities of medicines without a licence. Clearly, there are potential health hazards if a drug has not been properly manufactured or stored, if labels are in a foreign language, or if there is difficulty in tracing a batch of drugs found to be faulty. We are not aware of any injury to patients so far, but we propose to guard against that possibility.

We are statutorily required to consult on these matters, and we will therefore shortly issue a consultative document on proposals which will ensure that medicines parallel imported for general dispensing must be licensed under the Medicines Act, either in the ordinary way, or in the case of medicines also licensed in the European Community, through a modified licence to cover such safety matters as storage, labelling and tracing.

There remains the question of generic substitution, which we have been considering in the context of the PPRS review, as announced earlier this year. The Greenfield committee proposed that a pharmacist should substitute an equivalent generic preparation for proprietary medicine unless the prescribing doctor had specifically said that this should not be done. The committee acknowledged that it had not taken account of the wider implications, for example, on the pharmaceutical industry, of its recommendation. Consultation of the Greenfield report earlier this year showed professional opinion to be divided on this recommendation, which was only one of 14 recommendations.

It became clear that many general practitioners were concerned that their patients would be supplied with formulations of drugs that their doctors had not prescribed. General practitioners and pharmacists foresaw problems of divided responsibilities for the treatment of patients. The various procedures considered raise serious practical problems. We have therefore decided not to proceed with generic substitution. We do, however, intend to start a new campaign to encourage generic prescribing by doctors. As to the other recommendations of the Greenfield committee, we have already announced our acceptance of these or referred them to the appropriate educational bodies.

The motion draws attention to the disgraceful delay in the Government's implementation of the recommendations of the Home Affairs Select Committee regarding nationality fees. Related to that, can we have a debate upon the way in which visitors to this country are treated, because many visitors from the Asian Sub-Continent are treated with a lack of dignity and courtesy?

Mr. Biffen: I appreciate the hon. and learned Gentleman's point. It is likely that we could meet it by reference to the private Members' motions on Monday, the third one of which could easily cover the point. The best advice that I can offer is that he uses his well-established and recognised skills on the opportunities provided by the Consolidated Fund Bill.

Mr. Andrew MacKay (Berkshire, East): Bearing in mind last night's events in Brent, will my right hon. Friend find time for the House to debate a motion on free speech and local democracy which would give the Leader of the Opposition the opportunity to condemn wholeheartedly the Labour leaders in Brent who brought that council to a halt by mob rule last night?

Mr. Biffen: My hon. Friend resists the cloying spirit of Christmas and remains combatant on these matters, in which case I tell him that he has plenty of opportunities to exercise his initiatives as a private Member to ensure that the matter remains before Parliament.

Mr. Mark Fisher (Stoke-on-Trent, Central): Is there likely to be a statement on the British film industry before Christmas? If there is, can the right hon. Gentleman give the House an assurance similar to the one that he gave about regional policy, that it will not be smuggled in before Christmas without the House having a chance to consider it fully?

Mr. Biffen: The most helpful thing that I can do is to refer the hon. Gentleman's point to my right hon. Friend the Secretary of State for Trade and Industry.

Mr. Harry Greenway (Ealing, North): Bearing in mind the country's interest in the film "The Day After",

will my right hon. Friend consider the facilities for showing such films and others in the House? This film pulls at all our emotions and looks at the possible post-holocaust position. I believe that it points to the need to increase efforts to achieve multilateral disarmament. The country is very interested in the film but only a limited number of hon. Members would have been able to see it in the House today if all had turned up.

Mr. Biffen: I do not believe that I have any responsibility for organising film shows in the House. If I had, I would try to shrug them off as quickly as I could. I take note of what my hon. Friend says. I believe that there will be plenty of other people in the House who would be able to organise such a showing.

Mr. Speaker: Does the hon. Member for Coventry, South-East (Mr. Nellist) wish to raise the point of order that I stopped him raising earlier or has it been overtaken?

Mr. Dave Nellist (Coventry, South-East): It has been overtaken, Mr. Speaker.

Consolidated Fund Bill

Mr. Speaker: I wish to make a short statement about the arrangements for the debate on the motion for the Adjournment which will follow the passing of the Consolidated Fund Bill on Monday 19 December.

Members should submit their subject to my office not later than 9 am on Wednesday 14 December. A list showing the subjects and the times will be published later that day. Normally the time allocated to each subject will not exceed one and a half hours, but I propose to exercise a discretion to allow one or two debates to continue for rather longer to a maximum of three hours. Where identical or similar subjects have been entered by different Members whose names are drawn in a ballot, only the first name will be shown on the list. As some debates may not last the full time allotted to them, it is the responsibility of Members to keep in touch with developments if they are not to miss their turn.

A number of other matters arising from the review of the PPRS must still be resolved in discussion with the industry. In particular, a study of transfer prices, which are the prices charged by a foreign-based company to its United Kingdom subsidiary, is being conducted by independent consultants, and our Department is undertaking a study of pharmaceutical wholesalers' profit margins.

In framing the proposals the Government have sought to achieve a balance between the interests of the NHS as customer and the interests of the industry. We recognise the research achievements of the industry and the contribution that it makes to the United Kingdom economy, and we want it to continue to flourish. However, there is an urgent need to contain the drugs bill for the Health Service, which we are also determined to achieve. I hope that the industry will accept this position, as we wish to continue with the price regulation scheme on a non-statutory basis.

Mr. Michael Meacher (Oldham, West): Is the Minister aware that the measures, far from achieving a balance, are a completely inadequate response to a public scandal of enormous proportions—I use those words advisedly. Against a background of deepening cuts in the National Health Service, leading to accelerating hospital closures, redundancies of doctors and nurses, and worsening patient care, is it not outrageous that the drug companies have been permitted by the Government to make profits at the expense of the National Health Service of more than £300 million this year—my figure, rather than the Minister's, is correct—at a rate of return on capital of 25 per cent., thus making it the most profitable industry after oil and advertising?

Is the Minister further aware that 54 of the 65 companies that supply the NHS are foreign-based, and that the Public Accounts Committee estimated that their profits from the NHS were understated through transfer prices and creative accounting—the Committee's words, not mine—by up to a further £200 million this year? Is he aware that the Public Accounts Committee report of last April stated that nine companies had made £33 million in excess profits—the Committee's phrase, not mine—from the National Health Service in two years; that three or four of the largest companies had been allowed profits of up to a 35 per cent. return on capital employed; and that the smaller companies, which do not manufacture in Britain, were allowed profits of no less than 200 per cent?

Is the Minister further aware that the Comptroller and Auditor General, in a highly critical report issued earlier this year, complained that the DHSS had inadequate evidence to assess the industry's efficiency, and that the Department had failed in the administration of the profit control aspect of the price regulation scheme for drugs? In view of that scathing indictment by the official authorities, will the Minister tell the House how he intends to rectify those gross administrative deficiencies? Will he confirm that the new target rate of return, which he was careful not to mention, is still about 20 per cent., which is well above the maximum level recommended by the Public Accounts Committee of 17 per cent? Does he acknowledge that the £40 million that he proposes to save is less than the profit that one company might expect to make from only one successful drug?

In view of the Minister's frank acknowledgement of the excessive profits made by drug companies, will he

consider reducing the consequential higher prescription charges, which have increased seven times under the Government?

Is the Minister aware that the *Daily Telegraph*, which is not a Socialist magazine, recorded a survey which found that £25 million could be saved by substituting unbranded versions of the branded drugs that cost the NHS £60 million a year? Does he agree that an enormous saving could be made in this area? Does not his rejection of generic substitution owe much more to the arm-twisting of the drug companies than it does to the real concerns of general practitioners, behind which he tries to hide?

Is not the Minister's statement still a licence to print money for the drug companies, while the Government are trying to drive down the appallingly low wages of some of the lowest paid workers in the National Health Service?

Mr. Clarke: I am sorry that the hon. Gentleman is following the practice of his predecessor the hon. Member for Crewe and Nantwich (Mrs. Dunwoody) by reacting with hysterical and exaggerated language to an announcement which is extremely good news for the National Health Service and which represents a substantial saving on the drugs bill.

What we have negotiated in the proposals that I outlined to the House is part of the Government's policy towards the Health Service. We are seeking to improve its cost-effectiveness in order to maximise the value for money that we obtain from the increasing resources that the Government devote to it, for the benefit of the patients, who will receive better care. Independent consultants have examined transfer prices, because the Government wish to ensure that the figures that we use in our dealings with the pharmaceutical industry are accurate, and that no amount of ingenuity in accounting has obscured the position from which we are negotiating. As is usual with his practice on social security matters as well as on health matters, some of the hon. Gentleman's figures come completely off the top of his head. I am afraid the hon. Gentleman's figures are far less reliable than Treasury figures, DHSS figures or those from the industry.

In considering the actual rates of return, those for individual companies have to be a matter of commercial confidence. It is known that the overall target rate of return under the system we inherited from the Labour Government was 25 per cent. and above that a so-called grey area with the discretion of a further 10 per cent. What I have just announced reduces the overall target to 21 per cent. and the grey area to one third of whatever is the company's target. The figures he quotes—and some he disapproves of are for the more successful companies—were set under rules laid down by the Government of which he was a member. What I have announced is a significant reduction.

What I have announced represents a saving in a full year of over £100 million on the drugs bill of the National Health Service. The actual profits made by the pharmaceutical industry this year appear to us to be about £200 million. We disallow various costs for the purposes of the scheme. If account were taken of those, the profits might be up to £250 million. Nevertheless, we are making substantial savings in the drugs bill. We expect that pharmaceutical companies will react by cutting costs to some extent, thereby protecting their profits, which is good—for investment and employment in this country.

[Mr. Clarke]

Against this, the savings we are making are a substantial and significant response to genuine fears. I think that this is a fair balance between on the one hand the interests of drug users, that is, the National Health Service, and on the other the interests of those who work and earn a great deal of money for the country in the pharmaceutical industry.

Dr. Brian Mawhinney (Peterborough): Does my hon. and learned Friend accept that the first part of his statement on price freezing and the reduction of profits is welcome and will be seen as a positive contribution to savings in the Health Service? Will he also accept, however, that what he has said on drug substitution is a great disappointment and regrettably will be seen as a triumph for vested interests in the medical and pharmaceutical professions over the needs of patients? Does he agree that there is no reason clinically why substitution should not take place, bearing in mind that hospital doctors already use it, and that until generic prescribing are firmly in place the real savings to the Health Service on the drugs bill cannot be fully manifested?

Mr. Clarke: I have great respect for my hon. Friend's views on these matters, but I would answer him with a rhetorical question; what is he seeking to achieve in what he advocates? If he is seeking further reductions in the drugs bill, he should bear in mind that the announcement I have made is estimated to save over £100 million per annum on the National Health Service drugs bill. The House must realise that to go beyond that at the expense of the pharmaceutical industry would jeopardise much research-based manufacture in this country.

On generic substitution, I would accept as the best estimate of what might be saved the figure given by the hon. Member for Oldham, West (Mr. Meacher), that is about £25 million, but we could not achieve that and also make the other savings I have described without causing damage to the industry. If, however, the intention is to improve the prescribing practice of doctors, the best way of doing that is, as we propose, to strengthen our guidance and give further assistance to enable doctors to make their own choices about generic prescribing when they deem it suitable for their patients. Again, I respect my hon. Friend's view on this, but many doctors, though not all, were seriously concerned about a suggestion that they should prescribe one formulation of a drug which they judged suitable and then a pharmacist unknown to them who might dispense the drug anywhere throughout the country would use his judgment to substitute what he thought to be an effective alternative formulation. In hospitals doctors know their pharmacists and can have a hospital policy; I do not think it the analogy with general practitioners is altogether accurate.

Mr. Jack Ashley (Stoke-on-trent, South): Is the Minister aware that he has adopted a cowardly approach in running away from generic substitution? He cuts a very sorry figure, giving way to vested interests. He has heard neither hysterical language from my hon. Friend nor rhetorical questions. He has heard reasoned requests to change his mind. Will he recognise that the drug industry's demand for protection is a demand for excessive profits which are still far too high? Will he please think again on this important issue?

Mr. Clarke: If the right hon. Gentleman wishes to save money, then he should realise that by our announcement we are saving the maximum that can be saved. If he wishes to improve prescribing practices, we propose to campaign to do that. We will not be drawn into a vendetta against drug companies and their profits solely for what appear to be totally abstract reasons which some hon. Members feel are worth pursuing.

Mr. Robert McCrindle (Brentwood and Ongar): I welcome the Minister's statement indicating considerable savings in expenditure on the National Health Service, but will he disregard to a fair degree the continuing reference to the percentage of profits made by pharmaceutical companies? Will he confirm that a great deal of the so-called profits are reinvested in research and development and that sometimes the development of an effective drug takes many years, so that the percentages which are being bandied about are somewhat illusory?

Mr. Clarke: I am obliged to my hon. Friend. It is worth bearing in mind that the percentage profit we use for the purposes of the scheme is slightly notional. It is a long-standing convention that historic costs are taken as the basis for it and that is the basis of the figures I have given. When judging the profitability of the industry as a whole, he is right to draw attention to the fact that a great deal of it is necessary to provide an incentive for research and development. Moreover, much of the profits earned by the drugs industry are profits on exports which produce a substantial benefit to the economy of the country.

Mr. Willie W. Hamilton (Fife, Central): Is the Minister aware that there will be widespread condemnation of what will be regarded as an inadequate response to the recommendations of the all-party Public Accounts Committee with the guidance of the Comptroller and Auditor General? That, together with the complete ignoring of the main recommendations of the Greenfield report, will be seen clearly for what it is—a complete and utter sell-out to the drug companies which will still be laughing all the way to their respective banks.

Mr. Clarke: Before I rose to make the statement I knew perfectly well that whatever I said would be greeted with anger and disappointment by the hon. Gentleman, just as I know perfectly well that there will be a lot of resistance and anger in some parts of the pharmaceutical industry about what I have proposed. That is an inevitable part of the process. The fact is that the savings to the National Health Service drugs bill which I have announced go beyond some of the savings that were recently being urged upon us by some of our critics. They do not fall far short of even the wildest figures that were urged upon me by the hon. Member for Crewe and Nantwich (Mrs. Dunwoody) when she spoke for the Opposition.

Mrs. Jill Knight (Birmingham, Edgbaston): Can my hon. and learned Friend say anything about the position of pharmacists in chemists' shops as a result of his statement? Many people will be most anxious that there should not be the closure of chemists' shops which are badly needed in many areas. Does he recognise that, while he has much support for stopping the rate of increase in the drugs bill in the Health Service, he is perhaps shooting the wrong fox because many doctors prescribe drugs over and over again for patients without even bothering to examine them? The waste of drugs in that way is severe.

Mr. Clarke: The payments we make to pharmacists are on the basis of reimbursements for the cost of the drugs that they supply to patients. Our action on parallel importing will help to meet one of the complaints of the Public Accounts Committee that we sometimes reimburse chemists for more than the amount they have paid for the drugs they have dispensed. Nevertheless, there are problems between ourselves and the pharmacists, most of which were not intended by either side of that negotiating table. I look forward to more negotiations with the pharmaceutical services negotiating committee in the new year both about our present difficulties and about a better form of contract for them for the future. This should help to guard against the closure of rural pharmacies which my hon. Friend is right to be concerned about.

As to the prescribing practices of doctors, I endorse what my hon. Friend said. It is important that we should act on the other 13 recommendations of Greenfield, as we are already doing, and give further guidance and assistance to doctors in following proper and economical prescribing practices.

Several Hon. Members rose—

Mr. Speaker: Order. In fairness to the Northern Ireland debates, I intend to allow questions on this important subject to continue until half past four.

Mr. Clement Freud (Cambridgeshire, North-East): While we welcome the advertising cutback on allowable revenue, and the principle of the system, the alliance is bitterly disappointed about the Minister's failure to do anything about generic substitution, as he could have done without alienating the family practitioners, who would probably prefer some generic substitution to the cash limits being imposed. Does he accept that the pharmaceutical industry must remain independent because not one therapeutic substance has come out of the nationalised pharmaceutical industry in the Soviet Union?

Mr. Clarke: I note what the hon. Gentleman says about generic substitution, but we have reduced the target rate of return on capital by an average of 4 percentage points to bring it down to about 20 per cent. We have also made significant changes on promotional activity, about which there is strong feeling in the medical profession and among the general public. Given the savings that we can make from the package of measures that I have proposed, generic substitution would not have been a significant or worthwhile addition.

A number of GPs and pharmacists have raised problems about generic substitution. One is that of the responsibility to patients if anything goes wrong when neither the doctor, the pharmacist, nor the people who pay the pharmacist are clear about what drug has been dispensed to the patient, regardless of what it said on the doctor's prescription.

I endorse the hon. Gentleman's final comment. Those who attack the pharmaceutical industry simply because it is profit making ignore the fact that it is a highly successful industry, making valuable medical innovations and earning substantial profits overseas. The state-owned industries of the Eastern bloc have never produced any significant innovation, and if the Labour party came back into power a state-owned industry in this country would not make progress either.

Mr. David Crouch (Canterbury): It is not a convention of the House that I have to declare an interest when a

Minister makes a statement, but I do so. As I think the House knows, I am a director of a pharmaceutical company. I am also involved in the Health Service, being a member of a regional health authority. I therefore have a double interest.

I was one in the pharmaceutical industry who had recommended to it that it should look again at its figures on sales promotion and profit to see whether they could be tempered down in a way similar to the Minister's proposals. I take that view from within the industry, however, I warn my hon. and learned Friend not to go too far. It is possible to go just over the limit in reducing not so much promotion costs but profits, with the result that the industry will find it not worthwhile to continue production of the valuable drugs in this country. [Interruption.] Those who know nothing about the industry can make sneering, jeering remarks, but we are talking about one of the most successful industries, not in making money but in innovating and breaking new ground. My hon. and learned Friend must not go too far in this direction because, although the earnings and profits may seem high at 21 per cent., in its first 10 years a drug does not earn a penny. It takes all of that time to pass the approved list.

Mr. Clarke: My hon. Friend was interrupted by hon. Members who have no knowledge of the pharmaceutical industry to set against his own. I agree that the companies will find the reduction in profit levels and the changes that we have announced on promotional costs significant. We have not only reduced the profit figures but are proposing to change the method by which we control the level of expenditure on sales promotions above the prescribed limit. That will produce a significant reduction in the level of sales promotion on drugs to the benefit of the best companies and the patients. We shall heed my hon. Friend's warnings, but I think that we have struck the right balance between preserving a successful industry and making sure that we use our bargaining influence as a customer to make savings for the NHS.

Mr. Laurie Pavitt (Brent, South): On the hon. and learned Gentleman's choice of exhortation and campaigning rather than action on generic prescribing, I remind him that every Minister since Iain Macleod has tried the same campaign. There have been three separate issues under both Labour and Conservative Governments on special ways in which prescribers' notes and bulletins can be used. Each year, 80 per cent. of the drugs prescribed in the NHS are brand names and the Pharmaceutical Society of Great Britain, formed of qualified dispensing chemists, reckoned that on 10 drugs alone there would be a saving of £25 million.

In his discussions on promotions, will the Minister pursue three things? First, is it necessary to have one commercial traveller for every nine GPs? Secondly, is it necessary to have 6,600,000 free journals issued every three months to promote drugs? Thirdly, will the hon. and learned Gentleman attempt to stop the racket whereby a commercial traveller pays a doctor £10 for every person he is prepared to have on a new drug, calling it clinical investigation, when it is really sales promotion?

Mr. Clarke: I realise that I follow an honourable succession of Ministers of Governments of both parties in continuing to campaign on generic substitution. When it comes to professional opinion on generic substitution, I

[Mr. Clarke]

have not claimed that it is in our favour—it is divided. The hon. Gentleman will know that the Pharmaceutical Society of Great Britain had a highly contentious debate on the subject and passed a resolution which it would admit was distinctly inconclusive about what is good professional practice.

As to the number of travellers or representatives, and the amount of advertising and journals, the hon. Gentleman will find on examination that we have made significant changes in the level of sales promotion allowed and, compared with the actual level of sales promotion, we shall start imposing penalties on future levels at 25 per cent. below that. That could lead to important changes and improvements.

Sir Kenneth Lewis (Stamford and Spalding): Is my hon. and learned Friend aware that there are tens of thousands of households in which the bathroom and bedroom cupboards are overloaded with NHS drugs that have never been used, and that this is caused by widespread over-subscribing by doctors? If he can convince the medical profession that it needs to do something about that, he will save the NHS a great deal of money.

Does my hon. and learned Friend accept that if he can stop doctors having loads of material through their posts, and callers from foreign drug companies trying to sell them all kinds of pills and what-have-you, he will also help the medical profession?

Mr. Clarke: I agree with all of my hon. Friend's points. For the reasons that I have given, I think that the measures that we have announced will have a beneficial effect on the profession. To put things in perspective, the prescribing of drugs in this country per head of population is lower than that of most Western European countries. One has to persuade the doctors and the patients that a sensible level of prescribing is required, but our doctors and patients are less inclined to look for a pill on every occasion and for every purpose than is the case in other countries of Western Europe.

Rev. Martin Smyth (Belfast, South): Does the Minister accept that not all who may be critical of his statement are just out to get at the industry, because we recognise its strength? However, will his attempts to control the promotion of drugs and costs include stricter supervision of the amount of money spent in catering both for doctors and pharmacists who may purchase the drugs? How soon will limits be set on the importing of medicine?

Mr. Clarke: The costs of so-called hospitality and gifts are not allowed under the scheme at present and have never been accepted as an allowable expense. That kind of activity will continue to be disallowed under the new arrangements that I have announced today.

Regarding the new proposals on the importation of drugs, we hope to issue the consultation document shortly. Indeed, I hope that the technical details will go out from the Department tomorrow.

Mr. Meacher: The Minister has not answered two key questions. The Comptroller and Auditor General said that the DHSS machinery for assessing the industry's efficiency was inadequate. What new supervisory mechanisms is the Minister proposing to prevent the profit

control mechanism going out of control? Secondly, why has he rejected the Greenfield report on generic substitution when a compromise agreement had been reached informally, I understand, with the BMA whereby general practitioners who did not wish for generic substitution by a pharmacist would be able to show that on the prescription?

Mr. Clarke: On the first point, I do not think that the hon. Gentleman is correct to say that the assessment machinery that was introduced by his Government has got absolutely out of control. The only judgment of efficiency that has to be made in the scheme is that of assessing the target rate of return set for each company. It is a difficult task to assess each company in relation to its capital investment and its research base activity in this country, its export earnings and its efficiency. But I think that the job is done effectively and well within the limitations of what is practical. What the Government have announced is a sharp reduction in the resulting cost to the National Health Service.

On generic substitution the best estimate I have of the savings likely to come from the so-called halfway house that some of the BMA found acceptable is £5 million in a full year. In fact, it did not amount to much more than a re-jigging of the present form upon which the doctor prescribed. It still gave rise to all the problems about responsibility for patients if anything went wrong, as I have already indicated. Given that we are reducing our costs substantially, and that we can proceed to encourage better generic prescribing, I see no point in going in for that kind of compromise proposal worth little money but opening up a considerable amount of professional controversy.

Mr. Dennis Skinner (Bolsover): On a point of order, Mr. Speaker. As the Minister has given some very long answers and as several Conservative Members and several Opposition Members want to ask questions, I wonder whether you would take, say one question or a couple of questions from Conservative and Opposition Members bearing in mind that I am not anxious to be called but other hon. Members are ahead of me in the queue? In any case, I think it is a sell-out by the Tory party to the Government to finance the Tory party and the Tory Members of Parliament who are directors to line their pockets—

Mr Speaker: Order. I am sorry; I should like to be able to accede to the hon. Gentleman's request, but in fairness to the House I have to protect the Northern Ireland business. The House has had a good run on the statement. No doubt we shall return to the subject on other occasions.

Mr. D. N. Campbell-Savours (Workington): On a point of order, Mr. Speaker. You referred in your comments to protection of hon. Members. Would it not be proper of hon. Members to request that we be protected against Ministers who make their replies in a very elongated form, thereby denying the right not only of opposition Back Benchers but of Conservative Back Benchers to ask their questions? Should it not go on the record that many of us were precluded from asking questions by the Minister's long answers?

Mr. Speaker: Let us not get into a great argument about this. If the hon. Gentleman had been watching me, he would have seen that I was getting equally exasperated by the length of some questions from Back-Bench Members.

Mr. Harry Greenway (Ealing, North): A number of us represent several hundred people who work in this industry and we ought to be representing them in this matter. When you said at twenty minutes past four, Mr. Speaker, that you would allow the questions to run until half past four, according to my count about five questions were fitted in.

Mr. Speaker: I think that it would be totally unfair to the House if on every occasion I allowed the questions to run to the end; it would be impossible. I have to protect the subsequent business of the House.

Mr. Freud: On a point of order, Mr. Speaker. The hon. Member for Hertford and Stortford (Mr. Wells) asked you to give a ruling on the House Buyers Bill in respect of the eligibility of solicitors who are Members of the House and you said that you would give a ruling. Will you at the same time—and I ask this for the sake of convenience—give a ruling in respect of people intending to purchase houses who are Members of the House because they are equally affected by the Bill and, like solicitors, have a vested interest in it?

Mr. Andrew MacKay: On a point of order, Mr. Speaker. I would not wish ever to question a decision of yours, Mr. Speaker, but I believe that only four Members of the House still wish to ask questions of the Minister on the statement. I suspect that all of them have constituency interests. As you said earlier that Christmas is getting near, would you give us the benefit of the doubt on this occasion?

Mr. Speaker: I am afraid that Christmas is not as near as all that. In fairness to the hon. Gentleman, I fully understand his frustration, but this might be said on any day on any statement.

Mr. Derek Fatchett (Leeds, Central): On a point of order, Mr. Speaker. The statement on the drugs industry has taken so long because of the lengthy replies. Are you aware that thousands of people outside the House believe that the behaviour of the drugs industry has been a major contributor to the cuts in the Health Service and that they would think the less of—

Mr. Speaker: Order. I am not certain that that is a matter for me.

SCOTTISH AFFAIRS

Ordered,

That the matter of Electricity in Scotland—Generation and Capacity being a matter relating exclusively to Scotland be referred to the Scottish Grand Committee for its consideration—[*Mr. Biffen.*]

Northern Ireland (Appropriation)

The Minister of State, Northern Ireland Office (Mr. Adam Butler): I beg to move,

That the draft Appropriation (No. 3) (Northern Ireland) Order 1983, which was laid before this House on 23rd November, be approved.

Mr. Speaker: The hon. Member for Antrim, North (Rev. Ian Paisley) wishes to raise a point of order.

Rev. Ian Paisley (Antrim, North): Thank you, Mr. Speaker, for defending the rights of the Northern Ireland Members to have their say. We appreciate that.

On a point of order, Mr. Speaker. Could you confirm for our guidance that if the first order is debated, say, until eight or nine o'clock the remainder of the time until half past eleven will be available for debating the second order, but that another hour and a half will not be added?

Mr. Speaker: I confirm what the hon. Member has said, that the debate on the first order may go until half past eleven. If it goes until half past eleven, the second order will have an hour and a half. If the first order finishes earlier than that, the second order may go until half past eleven.

Mr. William Ross (Londonderry, East): On a point of order, Mr. Speaker. You kindly indicated to me that certain matters in the first order are substantial and justify wide debate. By inference, the remainder must be considered not to justify wide debate. One of the items that apparently do not justify wide debate is the question of control. That has caused considerable concern and debate not only in the House but in Northern Ireland. I seek your guidance as to what can be debated on the first order and at what length.

Mr. J. Enoch Powell (Down, South): Further to that point of order; I wish to make a submission, Mr. Speaker. You were good enough to write to my hon. Friend the Member for Londonderry, East (Mr. Ross) and you may have written to other hon. Members likely to take part in the debate, intimating what might or might not be regarded by the Chair as in order in the debate upon the Appropriation Order. This has been the subject of observations from the Chair at the commencement of similar debates in the past.

Might it be helpful both to the Chair and to hon. Members, since these orders are available a considerable time before the debates—I believe, that this order was laid on 23 November—if an indication of the view of the Chair could be given at an earlier date? An indication is often given by hon. Members to the Government of subjects which they would hope to raise. If it was within their knowledge what would and would not be regarded as in order, it would be possible to give that indication to the Government with more accuracy and certainty. I hope, therefore, that it might become a practice, if only an informal practice, in future where the minor Appropriation orders—I am referring not to the annual Appropriation order, but to the other Appropriation orders—are for debate for an indication to be given by the Chair generally of its views upon order in the compass of that Appropriation Order.

Mr. Speaker: I am obliged to the right hon. Member for Down, South (Mr. Powell) and I will answer his point of order first. He will understand that it is my wish to be as helpful as possible to Back Benchers, and therefore I

[Mr. Speaker]

readily accede to his request to send the information earlier than it was sent today. In sending it today, I was seeking to be helpful to hon. Members in drawing their attention to what would be in order and what might be out of order, so saving time in the debate; if the Chair must constantly be interrupting hon. Members while they are speaking, that wastes time.

To clarify the matter, I will read from the letter:

"The scope of this order is relatively narrow and policy questions should be raised only in connection with three matters; agricultural support measures, assistance to the shipbuilding industry and the housing benefits scheme. Four of the seven Supplementary Estimates are for relatively modest sums and only the reasons for the increases sought should be raised." Is that clear?

Mr. J. Enoch Powell: Further to that point of order. I am grateful to you, Mr. Speaker, for the announcement that you have made, and I listened to it with great care, as, indeed, I read with great care what you said in your letter to my hon. Friend the Member for Londonderry, East (Mr. Ross). I wonder whether in future consideration might be given to the distinction implied in the use of the words "issues of policy", as issues of policy may be involved in increases sought for a particular purpose under a particular sub-head. There is, therefore, still a difficulty that hon. Members might confront in deciding whether the increase under a particular sub-head did or did not open up the whole of that service or open up no more than a particular decision of policy taken within that service by the Government.

Mr. Speaker: To save the time of the debate today, the simplest answer would be for me to give further consideration to what the right hon. Gentleman has said. It is my wish to be as helpful as possible in all these matters, and I shall certainly consider what he said so as to make the situation clearer in future.

Mr. William Ross: Further to the point of order that I raised earlier, Mr. Speaker. You said in your reply to me that some of the sums concerned were modest. May I draw your attention to the fact that, although an individual sum may be modest, it may nevertheless have a considerable impact on a matter of policy?

Mr. Speaker: I used the word "relatively"; and that is a relative word.

4.43 pm

Mr. Butler: The order is being made under paragraph 1 of schedule 1 to the Northern Ireland Act 1974. In view of some of the points that have just been made, it might be helpful if I said that I shall be taking the House through the order and will be referring to some of the smaller issues. Whether that will encourage hon. Members to comment on those points when they make their contributions remains to be seen.

The purpose of the draft order is to authorise the issue of £107 million out of the Consolidated Fund of Northern Ireland Departments and to appropriate this sum for the purposes shown in the schedule. Hon. Members will recall that sums on account were approved on 10 March and in respect of the autumn Supplementary Estimates of Northern Ireland that the balance of the 1983-84 main Estimates was approved by the House on 7 July; together these amounted to £2,622 million.

The present draft order will bring the total Estimates provision for the year to £2,729 million. Detailed information about the provision sought can be found in the autumn Supplementary Estimates volume, copies of which have been placed in the Vote Office.

The draft order covers only seven out of the 42 Votes of Northern Ireland Departments. Major provision is sought in respect of the housing benefits scheme, which is already in operation in Great Britain, and I hasten to say that this is not new money, since assistance with housing costs was formerly provided through supplementary benefit and rent and rate rebates. There are also significant additions to existing services, notably the special aid for agriculture announced to the House earlier in the year, and assistance for Harland and Wolff Ltd., for which only a token amount had been provided in the main Estimates. I shall revert to those matters shortly.

As I have said before on these occasions, we are endeavouring to keep Northern Ireland in the most favourable position to benefit, along with the rest of the United Kingdom, from the increase in world economic activity that is expected during the remainder of 1983 and 1984. When the United Kingdom experiences economic revival, there are spin-off benefits for Northern Ireland. The steady 3 per cent. growth rate in United Kingdom GDP and the expectations for controlled or declining inflation next year augur well for Northern Ireland industry. At the moment, some reports indicate that Northern Ireland manufacturing industry is now holding up in employment terms, and generally output and other trends are reported to have improved. However, it is absolutely essential that we continue to do as much as possible to encourage industrial investment in Northern Ireland and to reinforce the effects of the economic trend. The economic initiative announced earlier this year, with its additional support measures and incentives, such as corporation tax relief grants and 100 per cent. industrial derating, is promising to be of great help in our efforts.

The combination of economic recovery, particularly in America, and the efforts of the Industrial Development Board and many others, such as the all-party and partnership missions, have brought about a greatly heightened intensity of industrial development inquiries and activity, and a measurement of that is in the number of visits being entertained in Northern Ireland at present, running at a rate five times that of last year.

In the social field, with the introduction of housing benefits, we are maintaining the common system of social benefits that applies throughout the United Kingdom. The special aid for agriculture, the assistance to Harland and Wolff and other provisions for industrial support are evidence of our willingness to take account of the special needs and circumstances of Northern Ireland, even at a time when public expenditure as a whole is under constraint. Taken together, they demonstrate yet again the Government's continuing commitment to Northern Ireland.

When I introduced the order for the main Estimates on 7 July, I reminded the House of the extent of the additional special aid to the Northern Ireland agriculture industry that would be made available in the 1983-84 financial year. I also made it clear that the necessary provision for these special measures would be taken in Supplementary Estimates. The additional provision required is now sought

B.R.
Mr Tomball

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PRIME MINISTER

You may be interested to see the attached question answered by Peter Rees about public expenditure since 1975/76. As you will see, the programmes which have shown a significant increase since 1978/79 are defence, law and order, health and personal social services and social security. Significant reductions include Government lending to nationalised industries (although this peaked in 1979/80 and 1980/81), housing (this is not of receipts from council house sales) and overseas aid and other services (which presumably reflect EEC refunds). The health figure reveals the real increase which has taken place in every year that this Government has been in office and bears out the fact that Labour actually cut NHS expenditure in real terms in 1977/78.

TR

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6 December 1983

Social Workers

Mr. Kilfedder asked the Secretary of State for Northern Ireland whether he is satisfied with the liaison arrangements of the Northern Ireland Eastern health and social services board to ensure that the officer in charge of a residential home for the elderly is being properly supported by senior social workers.

Mr. Chris Patten: Social work staff at a senior level are available in all the districts and units of management of the Eastern health and social services board to provide support and advice for the officers in charge of residential homes for the elderly.

Croft House Residential Home

Mr. Kilfedder asked the Secretary of State for Northern Ireland when was the last occasion when a resident of the Croft House residential home, Holywood, asked for a transfer to another home; and what was the result of the request.

Mr. Chris Patten: On 9 September 1983 the officer in charge of Croft House, Holywood, made a written request on behalf of a resident for a transfer to Loch Cuan House, Newtownards. This was acknowledged by the principal social worker—residential and day care—of the unit of management on 23 September 1983 and the resident's name was placed on the waiting list at Loch Cuan House.

Strip Searches

Mr. McNamara asked the Secretary of State for Northern Ireland (1) how many strip searches were made of female prisoners in Her Majesty's prison, Armagh, in the months of October and November, respectively; if he

will give the number of prisoners involved and the number of times each prisoner was searched; whether any prison contraband, smuggled items or illegal correspondence was discovered in any of the searches, indicating which items; and whether any of these items were hidden in the orifices of the body;

(2) whether, following his reply to the hon. Member for Kingston upon Hull, North on 24 October, *Official Report*, c. 41, he will indicate the nature of the unauthorised items being smuggled into Her Majesty's prison, Armagh, by persons subject to strip searches, indicating the number of prisoners involved, whether the items were hidden in the orifices of the body, and whether the persons concerned were engaged on the pre-release working out scheme.

Mr. Scott: I shall reply to the hon. Member as soon as possible.

NATIONAL FINANCE

Public Expenditure

Mr. Deakins asked the Chancellor of the Exchequer if he will publish a table showing public expenditure by main programme in real terms for each year from 1975 onwards, taking 1975 as the base year at 100.

Mr. Peter Rees: The figures in cost terms—that is, cash adjusted for the effects of general inflation as measured by the gross domestic product deflator—1975-76=100, are shown in the following table.

For 1983-84 and 1984-85, public expenditure planning totals in cost terms were given in table 2.2 of the autumn statement. Main programme breakdowns for these years are not yet available.

Public Expenditure in Cost Terms (1975-76 = 100)

	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83
1. Defence	100	102.3	99.3	98.8	104.1	106.2	109.0	116.8
2. Overseas aid and other services	100	124.4	-164.9	175.8	169.3	111.4	105.3	129.3
3. Agriculture, Fisheries, Food and Forestry	100	66.0	50.9	43.2	45.9	51.7	48.3	61.0
4. Industry, energy, trade and employment	100	90.6	57.5	71.9	57.5	67.4	81.1	82.5
5. Government lending to nationalised industries	100	23.1	-14.7	45.6	107.5	105.5	61.7	39.1
6. Transport	100	88.8	76.0	74.3	77.1	75.5	77.7	82.2
7. Housing	100	99.9	81.8	77.4	83.9	69.8	44.3	35.4
8. Other environmental services	100	85.9	77.2	80.8	82.7	83.0	76.1	80.3
9. Law, order and protective services	100	101.7	95.4	98.2	106.5	110.2	119.4	125.9
10. Education, science, arts and libraries	100	99.8	92.2	92.1	91.0	93.3	92.3	93.4
11. Health and personal social services	100	100.8	97.6	100.3	102.9	110.7	112.8	115.8
12. Social Security	100	103.3	108.9	116.5	117.8	119.7	132.8	141.5
13. Other public services	100	100.7	92.7	88.8	91.2	95.5	93.1	92.2
14. Common services	100	97.3	92.6	93.3	94.5	86.7	104.4	105.1
15. Scotland	100	97.7	90.8	93.4	96.7	97.3	96.2	96.1
16. Wales	100	100.5	91.1	95.7	99.3	99.0	95.2	96.1
17. Northern Ireland	100	99.2	97.4	103.5	101.6	101.5	102.4	106.4
Adjustments (public corporations net overseas and market borrowing, and special sales of assets)	100	241.9	49.1	73.2	-209.1	-115.9	36.8	-174.7
Planning Total	100	98.2	90.1	94.5	94.6	96.1	98.7	100.4

Excise Duty

Mrs Renée Short asked the Chancellor of the Exchequer how much was raised in excise duty from cigarette sales in 1982; and how this compares in real terms with 1973.

Mr. Hayhoe: In 1982 net receipts of excise duty on cigarettes were £3,150 million.

It is not possible to compare this in real terms with 1973 because duty was then charged on the tobacco leaf used in the manufacture of hand-rolling tobacco, pipe tobacco



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Dubs
7/12

10 DOWNING STREET

Prime Minister (2)

To note. Treasury are content with these proposals, as they should be since the saving of over £100 million in later years compares with the £60 million expected last July.

On generic substitution, DHSS propose some concession to the views of GP's, but will still campaign to encourage it.

AT

6/12

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Note Told DHSS that PM is content.

AT 7/12

SECRET



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10 DOWNING STREET

From the Private Secretary

5 December, 1983

Public Expenditure Survey

The Prime Minister has noted the exchange of correspondence between the Lord President and the Chief Secretary. She agrees that while increases in expenditure programmes between surveys cannot be avoided altogether, they should be kept to a minimum, and where they do take place, colleagues should be kept fully aware of any possible consequences for departmental programmes generally.

I am copying this letter to John Kerr (HM Treasury), to the Private Secretaries of other members of MISC 99 and to Richard Hatfield (Cabinet Office).

Andrew Turnbull

Miss Janet Lewis-Jones,
Lord President's Office.

SECRET

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● PART 25 ends:-

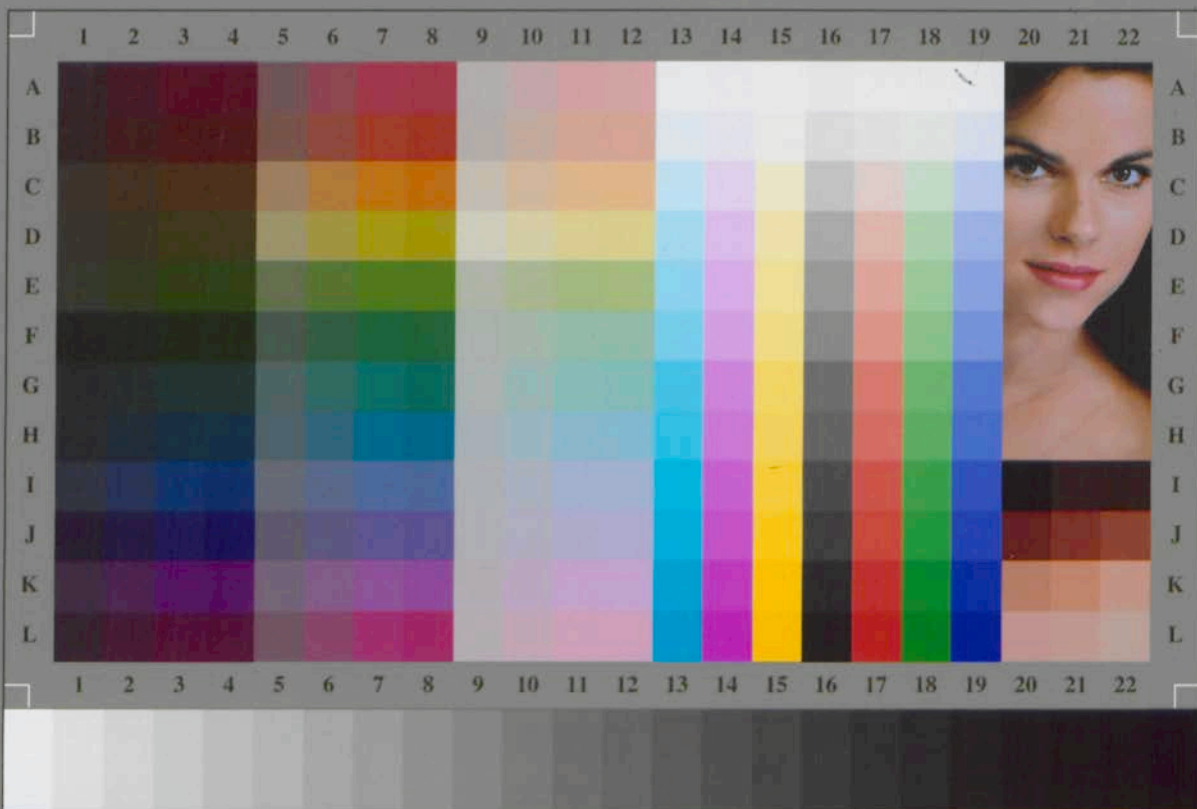
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PART 26 begins:-

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