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CABINET

PUBLIC EXPENDITURE: MAIN ISSUES

Note by the Chief Secretary, Treasury

The attached paper by Treasury officials is circulated as background to the Cabinet's discussion of the 1980 Public Expenditure Survey. It has been prepared in accordance with the proposals in my minute of 28 February to the Prime Minister concerning the preliminary work for the 1980 Survey. It summarises the main issues which are likely to arise in the course of the Survey.

W J B

Treasury Chambers

3 July 1980

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THE PUBLIC EXPENDITURE SURVEY 1980:  
THE MAIN ISSUES

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Note by the Treasury

This paper by Treasury officials is to summarise the Government's expenditure plans as they now stand and to indicate some general issues which arise from the additional bids and options for reductions which have been put forward by Departments in this year's public expenditure survey. The detailed material has been circulated separately, for reference.

2. Last year the Government set a new strategy and direction for public expenditure, in the plans published on Budget Day in Cmd 7841. The theme was a progressive reduction in the volume of public expenditure over the period to 1983-84. The plans reflected the Government's view of priorities and their objective of improving efficiency. On the assumptions of the medium-term financial strategy published at the same time the plans would be consistent with the intended path for the public sector borrowing requirement, and thus with the overriding objective of progressive reduction in money supply growth. It was stated that public expenditure plans, tax policies and interest rates will be adjusted as necessary in order to achieve the money supply objective.

3. The present 1980 survey is the first annual review of the plans in Cmd 7841. The period covered is to be one year shorter than in previous surveys, so it deals with the years 1981-82 to 1983-84.

4. The two basic questions are:

- What changes have occurred or are in prospect in the public expenditure plans as they now stand?
- Has the general economic prospect changed in a way which calls for revision of the plans to sustain the medium-term financial strategy?

Changes agreed or inevitable

5. Some increases and decreases are already agreed or inevitable in the plans in Cmnd 7841. Table 1 shows the main components, and the further proposals for change made by Departments.
6. The outcome of the European Community negotiations, together with some other changes in the estimated UK contribution, produces savings estimated to rise from around £400 million in 1981-82 to around £750 million in 1983-84 after taking account of the extra costs of the agricultural settlement, and on stylised assumptions for the years after 1981.
7. Certain estimating increases on various programmes cannot be avoided, but can in some cases be offset by savings in other expenditure. Increases of this sort amount to some £170 million in 1981-82, but in that year are more than offset by reductions on other programmes arising from such factors as revisions in economic assumptions.
8. The result of these changes, and of the gas levy (see paragraph 13 below), is totals between  $\frac{1}{4}\%$  and  $\frac{1}{2}\%$  below those in Cmnd 7841.

Pay

9. Following the "catching up" settlements, further increases in public service pay are assumed to be overall somewhat less than those in private sector pay. If public service pay were to rise faster, further cuts in the volume of expenditure would be necessary to contain the cost of public expenditure within the figures now envisaged: see paragraph 19 below.

Pressures for increases

10. In certain programmes there is strong pressure for increases.
11. Four loss-making nationalised industries - coal, rail, steel and shipbuilders - face problems in keeping within the previous plans. Precise figures cannot be determined yet. Meanwhile it would be prudent not to assume the shortfall in the industries' financing requirements contained in the last White Paper. On this basis, and allowing for changes in the other industries' plans and for delays in the flotation of British Aerospace (but before making any option cuts), the nationalised industries' finance would be £ $\frac{1}{2}$  billion or so higher in each year. To what extent can or should this threat be averted by policies for

the loss-makers and by making the option cuts, mainly reductions in investment plans, included in the separate report to Ministers?

12. There are other threats in the industrial sector, notably Rolls Royce (perhaps an extra £100 million in 1981-82), and British Leyland. The Department of Industry has additional bids amounting to over £100 million in 1981-82: the Secretary of State is seeking offsetting savings, and it remains to be seen what can be done.

13. The gas levy agreed by Ministers earlier this year will reduce BGC's internal resources and so increase public expenditure by amounts rising from around £350 million or more in 1981-82 to possibly £700 million or more in 1983-84, depending on the rate of levy; but there will be no effect on the PSBR.

14. The prospect of industrial recession is also reflected in the Department of Employment's proposals that, in addition to meeting extra demands on the redundancy and maternity pay funds, provision should be made to continue throughout the period the temporary short-time working scheme and the job release scheme at the 1980-81 levels. These schemes have hitherto been funded year to year.

15. Local authorities' budgets for 1980-81 imply current expenditure some 2-3% over the present plans (about £ $\frac{1}{2}$  billion at 1980 survey prices). The Government have asked for revised budgets, and Ministers are considering other possibilities for corrective action. Can and should further action be taken to achieve the further reductions already planned for 1981-82 and the later years? Should further provision be made in the relevant programmes to allow for the possibility that local authorities will not adhere to the Government's plans?

16. Other programmes where major additions have been proposed are:

- (1) Education The school transport defeat will cost £40-50 million a year. Additional bids "to maintain and improve the quality of education" in schools, based

on a Queen's Speech commitment, rise from £30 million in 1981-82 to over £100 million in 1983-84. A report by Treasury and DES officials on schools expenditure is being submitted separately to Ministers and it is for consideration exactly what is implied by the Government's commitment.

(ii) Health. The delayed introduction of the Road Traffic Act charging proposals, caused by H Committee's reservations, and the lower income now expected from overseas visitors will cost some £30 million in 1981-82 and £15 million in later years. Withdrawal of the sight test charge will cost £10 million a year. Against this has to be set a Manifesto commitment to maintain the planned growth of health spending, and a list of options for reductions which were rejected by Cabinet in the last survey.

(iii) Social security. Bids rise to £700 million in 1983-84. About half represent including in the social security programme provision for uprating child benefits in line with prices from its value in November 1980. (Provision for future uprating has so far been contained in the contingency reserve.) The bulk of the remaining bids are for higher increases in child benefit, and for restoring this year's cuts in the real value of certain short-term and other benefits, which cannot all be settled immediately. If Ministers have to plan for earnings to rise by less than prices in the immediate future, it is reasonable to consider less than full price indexation of at least some benefits.

#### Scope for reductions

17. Local authority current expenditure, nationalised industry finance, the health service, social security and defence together amount to three-quarters of total expenditure. Increases in any of these programmes, or a reduction in the total, must largely be met by reductions elsewhere in these areas, for the scope for finding offsetting savings in the rest of the public expenditure is limited.

18. To the extent that further net reductions are needed, either to produce a satisfactory prospect for the PSBR or to offset unavoidable additions, it will be necessary to draw on the options for reductions in the survey report. Different types

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of expenditure (eg procurement, transfers, or receipts from charges) have different effects on the PSBR and money supply. In present circumstances the effect on industrial activity will also be particularly relevant, and this has a bearing on the choice between capital and current expenditure referred to in paragraph 23.

OTHER ISSUES

Cost movements

19. The plans published in the last White Paper have been updated for a year's movements in costs, ie. broadly from 1978-79 to 1979-80 price levels. The cash needed in 1981-82 to fulfil these plans would be higher still, because of the further effects of pay awards in the last round (eg. staged payments), known new pay settlements in the current round, and forecast further pay and price movements up to 1981-82. Table 2 compares the expected increase since the White Paper in the cost of planned public expenditure on goods and services in 1981-82, with the expected price movements in the economy generally. For some Departments - notably Defence, Environment (other environmental services), Home Office, DES, DHSS (health and personal social services) and Scotland - the increase in costs is noticeably higher than general inflation. This upward "creep" is largely due to the working through of the Clegg awards and other staged comparability pay settlements. Should the volume of the programmes which show significant increases in relative cost be trimmed back to contain the eventual cash expenditure?

Manpower

20. Ministers have decided to reduce civil service manpower by a further 8% by 1984, but it is not yet settled where these savings will be made or how far by contracting out services. These decisions will determine the net expenditure savings.

21. Continued pressure on local authorities to reduce manpower will be necessary to achieve the planned expenditure cuts.

Criticisms of the last White Paper: detail of plans, and capital versus current

22. The last White Paper showed less detail than its predecessors for the later years. This attracted some criticism in Parliament, particularly as to the housing programme. It was also criticised as to the nationalised industries, though for these as much detail

was published as in previous White Papers. More detail must now be decided for 1981-82, and it must be considered whether to give more detail than in the last White Paper for the later years.

23. There has also been criticism of cuts falling more on capital than on current expenditure. Capital expenditure has been declining over the last five years at about 9% a year on average; public sector construction has been declining at about 3½% a year and this has evoked strong protests from the construction lobby. A decision to increase public investment - an analysis in the survey report shows effects on the construction industry of additional bids and options for reductions - would imply looking for offsetting reductions in current expenditure.

#### Cash limits squeeze 1980-81

24. Price, and some pay, increases will be greater in 1980-81 than provided for in the cash limits. The cash limits will consequently entail reductions in the volume of most cash-limited services in 1980-81, of which <sup>some</sup> £400 million has so far been identified by Departments. The 2½% reduction in civil service manpower in 1980-81 is being carried forward into the later years, but the Ministry of Defence propose to apply the savings to other defence expenditure, keeping the total defence budget unchanged.

#### The sharing of expenditure between Scotland, Wales and Northern Ireland

25. The Ministers principally concerned met earlier this year to consider whether any action on relative shares of public expenditure between the four UK countries should be taken in the light of the Needs Assessment Study. They agreed that, while there could be no question of a redistribution of existing expenditure allocations for Scottish, Welsh, Northern Irish and English programmes based simply on the findings of the Needs Assessment Study, it would be legitimate to take the results of the Needs Assessment Study into account as a relevant factor in decisions on the distribution of increases or reductions in the public expenditure plans.

Contingency reserve

26. Decisions on the size of the contingency reserve are for later, in the autumn. An ample reserve will be needed to cater for the uncertainties in the economic and industrial prospects and for other possible bids, eg British Nuclear Fuels Ltd (if Ministers should decide that it should no longer raise all its finance from the market); and to provide for some limited flexibility in the use of funds between one year and the next, and also to cover pay and price increases not allowed for in the Budget.

TABLE 1

	£ million 1980 survey prices					
	<u>78-79</u>	<u>79-80</u>	<u>80-81</u>	<u>81-82</u>	<u>82-83</u>	<u>83-84</u>
<u>baseline</u>						
Total Departments (incl. total NIs' borrowing)	77944	78826	78325	76434	74584	73877
Contingency reserve	-	-	1084	1264	1619	2118
Special sales of assets <sup>(1)</sup>	-	-998	-500	-45	-9	-101
Shortfall	-	-	-1120	-840	-840	-840
Planning total after shortfall	77944	77828	77789	76813	75355	75055
Percentage annual change)	(+4.9)	(-0.1)	(-0.1)	(-1.3)	(-1.9)	(-0.4)
Net changes from Cmd 7841 (revalued)			(-23)	(-64)	(-32)	(-78)
<u>Changes to baseline</u>						
Reductions in EEC contribution from settlement + other factors			-625	-495	-650	-850
Increase in IBAP expenditure including effects of EEC agricultural settlement			+187	+101	+94	+94
Net effect of revised economic assumptions			(-252)*	-86	+69	-73
Manpower squeeze in 1980-81:-						
2½% manpower squeeze with carry-forward in later years			(-90)*	-57	-56	-56
Other			(-335)*	-	-	-
Other reduced requirements				-188	-143	-113
Unavoidable estimating increases <sup>(2)</sup>				+185	+96	+25
Levy				+350	+450	+700
Resulting planning total after shortfall			77350	76625	75215	74780
<u>Options for decision</u>						
Nationalised industries' bids				+474	+430	+647
Additional bids other than lines 10 and 13, net of offsetting savings				+762	+1144	+1532
Total options for reductions <sup>(3)</sup> other than offsetting savings in line 14.				-1379	-2062	-2110
<u>Interest</u>						
Cmd 7841 revalued	2941	3300	3500	3500	3300	3000
Net effect of revised economic assumptions	-	+272	+200	+200	+200	+200

Already allowed for in shortfall in line 4.

asset  
The figure of £500m for 1980-81 is the target for net/sales to which Ministers are committed. The figures for the later years represent the balance of receipts from British Airways Board, British Aerospace and Cable & Wireless sales, and the unwinding of BNOC forward oil sales: they are current best estimates but the prospects are very uncertain.

- (2) Thames barrier and some minor agricultural estimating changes; refinance of home shipbuilding and interest support costs; shipbuilding redundancy payments and cost escalation; steel redundancy payments; export credit refinance and cost escalation; redundancy and maternity pay funds; civil superannuation; regional selective assistance in Scotland, Wales and Northern Ireland.
- (3) These options, particularly for the "smaller", staff-intensive Departments, may overlap with the further civil service manpower cuts now planned.

	1980 survey revaluation (from Cmnd 7841) to 1979-80 prices	Column (1) plus effect of known pay settlements	Column (2) plus effect of fore- cast pay and price increases up to 1981-82	Implied change in relative cost in 1981-82 (relative to GDP deflator)
	Index 1978-79 = 100	Index 1978-79 = 100	Index 1978-79 = 100	£m, 1980 survey prices
Defence	120	131	160	+280
FCO (admin)	113	127	154	-
MAFF	121	130	165	+20
Industry	118	125	158	-
Energy	125	144	173	+20
Trade	113	127	155	-
Employment	115	132	159	+10
Transport	118	122	157	+10
DOE (housing, gross)	121	122	158	+20
(house sales)	134	134	187	-230
DOE (PSA)	119	126	159	+10
DOE (other)	119	131	163	+110
Home Office	123	133	159	+50
Lord Chancellor's Dept	111	125	152	-10
DES	112	126	161	+190
Arts & Libraries	114	125	155	-
DHSS (HPSS)	120	131	167	+630
DHSS (social security admin.)	116	133	159	+20
Scotland	119	130	163	+160
Wales	116	127	161	+40
Northern Ireland	119	134	163	+60
Other Departments	115	129	156	+10
TOTAL	118	129	161	+1400