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10 DOWNING STREET

THE PRIME MINISTER

Personal Minute

No. m 3/81

CHANCELLOR OF THE EXCHEQUER

Public Expenditure White Paper

Thank you for your minute of 23 January about some of the difficulties involved in the public expenditure figures to appear in the White Paper. As you say, there are problems of both substance and presentation. Both are very serious and I feel, as I believe you do, that we cannot simply let matters take their course on the basis of the rather compressed statement of the position in your minute. I realise that the time between now and the Budget is short, and that it would be difficult to re-open the whole range of programme decisions at this stage, but we are agreed, I hope, that the Treasury should nevertheless consider what proposals you can frame and how we can enlist the help of colleagues in order to head off the adverse reaction which the White Paper is otherwise likely to produce.

There are longer term issues here concerning the planning and control of expenditure, and there are immediate issues concerning these particular figures and their presentation. I will set out some thoughts on each aspect in turn, as an input into the work which is going on. Some of these comments confirm points of which the Treasury are already aware.

Planning and Control

I remain convinced that the present system of programming in volume terms plays a substantial part in the continued escalation of the expenditure figures. It is true that, for the year immediately ahead, by superimposing cash limits on many though not all programmes, we restrict our commitment to finance cost increases,

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and this may have the effect of producing a volume cut in programmes if cost increases exceed the allowance made for inflation in the cash limits.

However, as I understand it, this volume squeeze is not carried through into subsequent years, but the cut is in practice restored when the volume programme is rolled forward and revalued in the annual public expenditure exercise. If this is an accurate account of the position, in my view the least that we should now do is to change the procedures to stop this happening.

We should at the same time discontinue the degree of discretion which spending Departments have in putting forward their revaluations, and move on to a system of centrally determined figures for use in this operation. I believe that this would have a healthy effect on cost control. I realise that this change could not be put into effect until the 1981 public expenditure exercise, but it could have an important effect on opinion if we decided on the change now and announced it in the coming White Paper. I understand that the Treasury are already working on a proposal of this kind, and also on a slightly different one - though the effect would be similar - whereby the PESC figures would be revalued by the cash limit factors for the year in which the PESC review was being conducted.

This approach accepts that, if we are to have any forward programming, we cannot get away altogether from a constant price basis, and that adjustments for inflation will have to be made to the figures when the time comes; but it does not concede that the adjustment will always be sufficient to cover cost increases irrespective of their size. I should be grateful if you would consider urgently whether we could make even more radical moves in that direction.

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To me some of the merits of a cash approach for all years ahead are:-

- (i) It is the only sound basis for conducting a Survey on the principle of "this is what we expect to be able to afford". A forward view of the economy for each of the years can provide an estimate of the amount of cash likely to be available for Public Expenditure. Provisional allocation of the total can take account of priorities as well as the historic pattern.
- (ii) Of course, the estimates of cash available will not be spot on. But it is part of real life that the future is uncertain and planning should recognise this. It is not possible to guarantee that a given amount of cash will be available in the event, nor because of variable inflation how much it will purchase. Even if centred on a single figure, plans should cover a range of possible outcomes so that people work out priorities for deleting or adding items if the need or opportunities arises. Volume planning encourages a sense of spurious precision and the likelihood that people become dedicated to unrealistic expectations.
- (iii) Planning in cash terms gives people a positive interest in achieving efficiency and low inflation. A reward for increased efficiency is automatic since something extra can be fitted into the cash total.

I recognise that an entirely cash approach may not be practicable at this juncture. But this need not prevent us now from endorsing the principle that the volume programmes for the later years will be subject, when the time comes, to the constraint of cash limits which would not necessarily compensate in full for

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price increases. I believe that this could deter spending Departments from committing their volume programme in advance up to the hilt, and that a statement of intent on these lines could, like the proposal set out in my previous paragraph, help to get a better reception for the White Paper.

We should have to consider carefully how to express this principle. On one formulation it would simply amount to extending into the future the approach which we have been adopting in practice so far. Taken a stage further, it could entail a continuing policy of price restraint for the public services irrespective of the rate of inflation in the economy. I can see that this would have important implications, but I am not at all sure that we need shrink from them.

#### Presentation of the Figures

If we cannot reduce the figures for individual programmes at this stage, the only apparent means of reducing the planning total is by adjusting the figures for the contingency reserve - though I should have preferred it if we were in a position to make a further adjustment by changing the treatment of borrowing by the nationalised industries. As regards the contingency reserve, I support the principle of setting it at a credible level. Nevertheless there seems to me a case for taking the line that the additions to programmes which have already taken place will make it necessary to adopt a more stringent view to further additions in the next financial year, and that Cabinet should accept now that they will have to find new savings when the time comes if they want to approve more than a limited number of new items. I should be grateful therefore if you would take a further look at the contingency reserve from this point of view.

Margaret Thatcher

30 January 1981

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