CONFIDENTIAL

Prime Minister

TL 7/11

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

7th November, 1979

Dear Tim,

PUBLIC EXPENDITURE: LATER YEARS

..... The Chancellor thought the Prime Minister might find the attached memorandum by Treasury officials useful as background to item 4 of tomorrow's Cabinet discussion.

Yours ever,

MH

(M.A. HALL)
Private Secretary

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

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PUBLIC EXPENDITURE: LATER YEARS

1. Treasury Ministers may wish to have a note on the overall picture for public expenditure in the light of recent decisions about later years.

2. The annexed table shows that, if the changes still under discussion (nationalised industries, agriculture, civil service) yield the savings hoped for, the total for 1981-82 will be slightly below the White Paper total for 1980-81, and the two later years rather lower than that. Hence the Government will have achieved its objective of a stable public expenditure programme starting from the 1978-79 level, with a small amount of leeway in 1982-83 and 1983-84.

3. But there are two important qualifications - will the programme be achieved in practice, and is it low enough?

A. Threats to Achievement

4. In the first place, there are the "changes still under discussion" already mentioned:

(i) On the nationalised industries the figures in line 5(ii) are £450 million worse than proposed earlier for 1981-82, but better in 1983-84. They assume that the phasing of gas pricing is resolved favourably (worth about £100 million in 1982-83 and £400 million in 1983-84); and that Mr. Nott's criticism of over-pricing for telecommunications does not prevail.

(ii) There is approaching £100 million a year at stake in the review of agriculture (line 5(i)), not now to be decided before December.

(iii) The assumed extra civil service staff savings (line 5(iii)) seemed optimistic to us even before last week's Cabinet, and in the light of Cabinet discussion it now seems probable that they are over-estimated by at least £100 million a year. These savings too will probably not be settled until around the end of the month.

5. In addition, there are several variations in the figures which are already foreseeable:

(i) As C(79)56 points out, the nationalised industry figures are likely to be revised downwards in next year's Investment and Financing Review. They assume success on pricing and on the loss-making industries (e.g. nil borrowing by BSC from 1982-83 onwards), and are optimistic about economic growth.

(ii) Social security spending rests on the June assumptions for prices and unemployment which may need revision in either direction; in the economists' view the unemployment figure is more likely to be too low, and an extra 100,000 would add £100 million.

(iii) Local authorities may be unable or unwilling to make the full savings in current expenditure which have been counted into the totals, e.g. on school meals and transport. Instead they may choose a further increase in the rates, adding to public expenditure overall.

(iv) On the other hand, the figures included for EEC contributions take no credit for success in renegotiating the basis for contributions, so that there could be some gain on that front.

(v) In the industry programme, extra provision may be needed for Rolls Royce and British Leyland.

(vi) The employment programme makes no provision for continuing temporary employment measures, nor for any increase in redundancy rebates (which could add £100 million a year).

6. To meet these claims, and others not yet foreseeable, there is provision in the contingency reserve of £1,500 million, £2,000 million and £2,500 million in the three years. This is certianly not more than adequate, given that child benefit uprating, which is not provided for in the social security programme, will be virtually inescapable and could cost £500 million in 1981-82 rising to nearly £1,000 million in 1983-84.

B. Adequacy of Cuts

7. The annexed table shows that the cuts in Departments' programmes so far secured fall short of the original Treasury proposals by:

1981-82	1982-83	1983-84
888	1213	1304

As a result, even counting in the extra savings not yet agreed (paragraph 4 above), the totals achieve stability but make no significant progress towards the 1977-78 level which Treasury Ministers had earlier taken as a target - and which the Chancellor's paper C(79)30 said would still (according to current projections) leave no room for real tax cuts in the 1980 and 1981 Budgets.

APPENDIX

		£m at 1979 survey prices		
		81-82	82-83	83-84
1.	Total (projected outturn) before changes	75977	77220	77200
2.	Changes proposed or assumed in C(79)35:			
	(i) major spending Departments	-5658	-7269	-7117
	(ii) nationalised industries	-750	-950	-1250
	(iii) staff savings additional to (i)	-175	-250	-300
	(iv) contingency reserve	-697	-750	-250
	(v) sales of assets	-50	+50	+50
3.	Resulting total (1 + 2)	68647	68051	68333
4.	Changes agreed so far:			
	(i) major spending Departments	-4770	-6056	-5813
	(iv) contingency reserve	-697	-750	-250
	(v) sales of assets	-200	-100	-100
5.	Changes still under discussion			
	(i) agriculture (UK)	-72	-96	-92
	(ii) nationalised industries	-300	-1000	-1650
	(iii) staff savings additional to 4(i) and 5(i) suggested by CSD	-175	-250	-275
6.	Total (1 + 4 + 5)	69763	68968	69020

	Earlier years	77-78	78-79	79-80	80-81
7.	Total (outturn) as in Cmnd 7746	65848	69767	69797	69829
8.	Total for 1980-81 proposed in C(79)26				68000