

✓ Mr. Hodgson



This is all rather obscurely presented. But I am sure the higher figures for spending and the Contingency reserve are (unfortunately) correct.

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PRIME MINISTER

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PUBLIC EXPENDITURE AND THE BUDGET

I need to let you and David Howell know how I propose to handle the various energy related public expenditure proposals in relation to the Budget, and to the public expenditure planning totals.

2. As you know, the Contingency Reserve for 1981-82 in the White Paper is deliberately tightly drawn. It is £1,500 million in Survey prices, which is equivalent to £2,000 million cash. We are now faced with two large additional requirements for expenditure which were not foreseen at the time of that decision, namely:

You already agreed this PL

(i) the various proposals for increases in the National Coal Board's EFL, on which I commented to you in my minute of 2 March; and,

Play A
see Nat Ind Coal

(ii) the increases of some £120 million in the EFLs for Electricity and British Gas to allow some adjustment in fuel prices for bulk supplies to industry.

3. It would not be realistic to charge both these additions to the Contingency Reserve, and then expect to hold that Reserve for the rest of the year. I therefore propose to increase the size of the Reserve by £200 million (cash).

4. I will say in the Budget Speech that this is to allow for developments since the White Paper went to press, including the decision to suspend the accelerated programme



of pit closures. This would avoid giving a specific figure for the National Coal Board, and be in line with the approach which David Howell is proposing in his paper E(81)25 which we are to discuss today. Whatever figure is eventually proposed for the increase in the NCB's EFL will then be a bid on the enlarged Reserve.

5. The changes in the EFLs in respect of fuel prices will be treated as a straight addition to programmes. Together these two changes add £320 million cash to public expenditure.

6. There are one or two other minor expenditure changes which I or Patrick Jenkin will be announcing, including a boiler conversion scheme and certain minor changes in social security. These are relatively small and can be treated as bids on the Contingency Reserve. As such they do not affect the planning total or the Budget arithmetic.

7. The total change in public expenditure will therefore be some £320 million cash. This will mean that there will now be a slight increase of expenditure between this year and next in volume terms as well as in cash. This is unfortunate. We should be deluding ourselves if we tried to avoid this by saying that the large items would be absorbed within the existing Contingency Reserve.

8. I should also mention that there will be a change in the nominal amount of the Contingency Reserve to reflect the switch onto a cash control basis, which Cabinet agreed last week. We have to allow for the fact that there will now be a wider range of bids for the Reserve. The most obvious, and probably the largest, will be the adjustment in the Defence cash limit to take account of whatever we may decide on armed forces pay, when the Review Board reports.

In the past, cash
limit increases to
pay for higher pay
(or index prices) ~~to~~ did
not count against
the Contingency Reserve.



9. I am proposing to allow £300m for this widening in the basis of control. This brings the total of the Reserve to £2,500 million cash. This will not add to the public expenditure totals. The tighter control should reduce them.

10. I attach for your information the relevant paragraphs from the most recent draft of the Budget Speech.

11. I am sending a copy of this minute only to David Howell.

Amey

for (G.H.)

5 March 1981

(Approved by the Chancellor & signed in his absence)

34. This Government has not been alone in cutting planned and actual public expenditure. Our predecessors had repeatedly to do the same. Such reductions are necessary if the burdens on the rest of the economy are not to become intolerable. They are essential to the fight against inflation. This has been the recent experience of almost every other industrial democracy. In the United States, President Reagan has been obliged to propose cuts in almost every area of the budget. The Swedish, Dutch, Belgian and Danish authorities are all seeking substantial reductions in planned public spending. Japan too, has announced the lowest increase in public spending in cash terms for twenty-two years. A number of governments have already gone some way towards breaking the automatic indexation of much public expenditure. The economic conditions which call for lower public spending are a world-wide phenomenon.

35. Our own White Paper shows a volume of public expenditure next year which would be much the same as this. Developments since the White Paper went to print, including the shelving of the plans for accelerated pit closures, mean it is prudent to increase the size of the Contingency Reserve. I shall also be announcing later in my speech additional expenditure of about £120 million to help

with the fuel costs of some particularly hard pressed parts of industry. Together, these will add about one-third of a percent to the volume of expenditure next year. The resultant planning total is higher than we had intended. It will still be [nearly 5 per cent] less than our predecessors had planned - despite the much larger claims of employment support and of social security for the unemployed.

36. Moreover our decisions for the future are firmly designed to ensure that the volume of spending falls after 1981-82. The Public Expenditure White Paper shows a planned fall of 4 per cent by 1983-84.

37. Even so I must stress that the figures for later years - both for totals and individual programmes - must be regarded as provisional. They are upper limits rather than targets. Whether we shall be able to spend on that scale depends on whether we can afford to do so. During the annual review later this year we shall be looking hard at the possibility of further reductions in those spending plans. Any further economies that can be achieved will reduce the risk of further tax increases or upward pressure of public sector financing on interest rates - to the benefit of

J17. We have decided to make a major shift in the planning and control of spending from volume to cash. The introduction of cash limits by the last Government paved the way for this change. We now need to go a great deal further down that road.

J18. In the first instance we shall, from the coming year onwards, change the way in which we operate the contingency reserve. This will now be a cash control. Previously only decisions which increased the volume of spending during the year were charged to the Reserve. Next year the control will be extended so that decisions to increase cash limits - in respect of pay or prices as well as in respect of volume - will be treated as a charge on the Reserve. The Reserve will be set at £2½ billion cash, about 2½ per cent of the total of programmes. This allows both for the wider coverage resulting from the switch to a cash basis, and for the increased provision, mentioned earlier, to allow for developments since the White Paper.

J19. Even more fundamental is the change we shall be making in the way we go about future annual reviews of public spending. In planning public spending for 1982-83 we shall from the outset conduct our examination and discussions in terms of the cash which will be available for that year. This will change the whole framework and spirit