

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

C(80) 72

COPY NO 56

17 November 1980

CABINET

PUBLIC EXPENDITURE

Memorandum by the Chancellor of the Exchequer

1. I undertook at Cabinet on 13 November (CC(80) 40th Conclusions, Minute 7) to circulate a paper drawing together the results of the decisions reached so far and their wider implications for the Government's economic strategy.

THE ARITHMETIC

2. I attach tables showing the results for public expenditure (Table 1) and, for 1981-82 only, for the Public Sector Borrowing Requirement (PSBR) (Table 2).

3. Two cases are shown for each of the future years: Case A with no further cuts beyond those already agreed or offered; Case B with the outstanding proposals accepted in full, namely:

Defence is reduced by £500 million rather than the £152 million offered by the Secretary of State.

Social Security is cut by £200 million in 1981-82 (including the agreed £60 million resulting from the switch to monthly payment of Child Benefit) and by about £350 million in subsequent years.

Scottish Programmes are subject to a specific cut of £20 million in 1981-82, and £30 million a year thereafter, rather than the £10 million a year offered by the Secretary of State.

Health cash limited Central Government expenditure is cut by 1 per cent rather than nothing as previously agreed.

NATIONALISED INDUSTRIES

4. Together with the Chief Secretary, Treasury, I have re-examined the decisions on nationalised industries' External Financing Limits taken in E Committee on 5 November. I am reluctantly persuaded that further reductions there could only be achieved by larger price increases or by even more severe investment cuts - the reductions we have already agreed are relatively more severe than those which we are making in other programmes. Indeed, there would be a real risk that, even with the best will, the managements of some nationalised industries could not produce further reductions in practice.

THE RESULTS FOR PUBLIC EXPENDITURE

5. As Table 1 makes clear our expenditure plans for 1981-82 are going to be substantially higher than the target we set in July - by £2 billion in Case A, by £1½ billion in Case B (these figures are at "1980 Survey" prices, ie the prices of late 1979). Instead of the total being below the March White Paper level, because of the £0.7 billion European Community refund, it would be £1.3 billion above it in Case A, and £0.7 billion in Case B. The comparison in 1982-83 is even worse.

6. In Case A expenditure plans for next year would be much the same as the outturn now expected for this year - itself about £½ billion (at late 1979 prices) above the planned level - and higher than the outturn in any year since 1976-77, and nearly £4 billion higher than the post-International Monetary Fund low in 1977-78.

7. At the same time Gross Domestic Product (GDP) will be declining as our economy is confronted by the general recession in the world economy, the major difficulties of adjusting to higher oil prices and their effect on the exchange rate, and the need to reduce further the rate of inflation. Public expenditure as a proportion of GDP will rise: 41 per cent in 1977-78, 41½ per cent in 1979-80 and about 43 per cent in 1981-82.

8. While the plans will still show expenditure falling in the subsequent years, the commentators would justifiably point out that as so often in the past a promised downturn in public expenditure has been once again postponed. Once again a White Paper showing dramatic "cuts" in public expenditure will be followed by one in which the totals are significantly increased.

9. The Government's commitment to the reduction of public expenditure only has a chance of remaining credible if we are at least seen to be taking some action to curb the still substantially growing programmes - Defence, Social Security and Health - and being ready to take the politically difficult decisions required. Even on my proposals expenditure on these programmes (which between them account for about two-thirds of all Central Government expenditure) will be respectively 11 per cent, 10 per cent and 5 per cent higher in 1983-84 than in 1978-79.

THE RESULTS FOR THE ECONOMY

10. As Table 2 shows, if no further cuts were agreed, the PSBR next year would be about £12 $\frac{3}{4}$ billion, before taking account of measures to increase revenue. If my remaining proposals were agreed in full it would still be £12 billion. Both are far above the level likely to be consistent with success in the medium term in our fight against inflation and the achievement of substantial reductions in interest rates.

11. Reductions in the PSBR on the scale now required will mean significant increases in the tax burden. We are taking steps to raise further revenue from the North Sea. Even so, given the pressing need to shift the balance in favour of the (non-oil) company sector, substantial additional revenues will have to be taken from individuals. Given our failure to contain public expenditure within our previous plans, the prospect is now that, in addition to the employee national insurance contribution which we discussed, I shall have to increase the real burden of personal taxation in the Budget.

12. The increases in public expenditure for the later years put seriously at risk the chances of making any significant reduction in that tax burden then.

CONCLUSION

13. I consider it essential to the maintenance of our economic strategy and the credibility of our commitment to reduce public expenditure in the medium term that we should make the greater part of the additional cuts now proposed, so that the totals are close to those shown for Case B.

G H

Treasury Chambers

17 November 1980

SECRET

TABLE 1

COMPARISON WITH WHITE PAPERS

	£ billion/late 1979 prices					
	78-9	79-80	80-81	81-82	82-3	83-4
Labour White Paper			82.1	83.5	85.1	-
March 1980 White Paper			77.8	76.9	75.4	75.2
March White Paper less EC refund			77.3	76.2	74.7	74.6
Outturn/forecast outturn	77.9	77.7	78.1			
Plan:						
A - including agreed cuts and offers				78.2	77.0	76.1
B - including full proposed cuts				77.6	76.2	75.2

Note: A - assumes cuts of £152 million a year on defence, £10 million a year (beyond the formula) on Scotland, the savings on child benefit (retiming of payments), and no cut on health;

B - assumes cuts of £500 million a year on defence, £20-30 million a year (beyond the formula) on Scotland, £200 million in 1981-82 rising to £400 million in the later years on social security, and 1% on health (£60 million a year in England plus the formula cuts of £12 million).

SECRET

TABLE 2

	1981-82				£bn	
	State of play 30 October 1980		CASE A		CASE B	
	Public exp. late 1979 prices	PSBR Cash (rounded)	Public exp. late 1979 prices	PSBR Cash (rounded)	Public exp. late 1979 prices	PSBR Cash (rounded)
Public expenditure target/ PSBR in forecast	76.2	11	76.2	11	76.2	11
Public expenditure proposals						
(a) Increases	2.8)		3.0)		3.0)	
(b) Agreed reductions	-0.6)	2½	-0.8)	2½	-0.8)	2½
Total	78.3*	13½	78.4	13½	78.4	13½
Public expenditure reductions not yet agreed:						
Defence	-0.5)		-0.15)		-0.5)	
Social security	-0.2)		-0.05)		-0.2)	
Scotland (non-formula)	-0.1)	-1¼	-0.01)	-¼	-0.02)	-1
Health (% cut - GB)	-0.15)		-)		-0.07)	
Other	-0.1)		-)		-)	
Total	77.2*	12¼	78.2	13¼	77.6	12½
Effect of holding all new public service pay increases to 6%		-½		-½		-½
Effect of 1% increase in employees' National Insurance				-½ ⁰		-½ ⁰
PSBR after all spending adjustments		<u>11½</u>		<u>12¼</u>		<u>11½</u>

Figures do not add up to totals because of rounding

The PSBR effect is less than the direct revenue effect (of about £1 billion) because (i) the original forecast already included some increase in contributions in order to balance the current income and expenditure from the National Insurance Fund and (ii) there is some offsetting indirect effect through lower economic activity.

SECRET

TABLE 3

AGREED REDUCTIONS

DEPARTMENTS (excluding nationalised industries)	£m late 1979 prices					1982-83	1983-84
	-----1981-82-----	Specific cuts	1% reduction in LA current expenditure	2% vol. cut in cash-controlled programmes	Total		
DO (Total)	-	-	-	-21	-21	-21	-21
DAFF/DAFS/WOAD	-26	-	-	-9	-35	-35	-35
Employment	-	-	- $\frac{1}{2}$	-18	-18 $\frac{1}{2}$	-18 $\frac{1}{2}$	-18 $\frac{1}{2}$
Transport	-15	-	-10	-21	-46	-46	-46
DOE (Housing)	-34	-	-1	-29	-64	-90	-85
DOE (PSA)	-12	-	-	-7	-19	-15	-15
DOE (Other)	-62	-	-15	-13	-90	-84	-79
Home Office	-10	-	-21	-9	-40	-40	-40
Lord Chancellor's Department	-1	-	-	-1 $\frac{1}{2}$	-2 $\frac{1}{2}$	-2	-2
DES	-85	-	-61	-30	-176	-211	-191
DAL	-6	-	-2	-3	-11	-11	-11
DESS (Health) lost charges (UK)	+121	-	-	-	+121	+121	+121
DESS (PSS)	-	-	-12	-	-12	-12	-12
DESS (social security)	-	-	-	-17	-17	-17	-17
Scotland (formula only)	-	-	-	-45	-45	-50	-50
Wales (formula only)	-	-	-	-20	-20	-25	-25
N. Ireland (formula only)	-	-	-	-7	-7	-6	-2
Other Departments (2%)	-	-	-	-47	-47	-47	-47
Other changes	-209	-	-	-	-209	-106	-571
TOTAL AGREED	-339	-123	-297	-297	-759	-715	-1146

SECRET

TABLE 3 (continued)

II UNRESOLVED REDUCTIONS		-----1981-82-----		1982-83		1983-84	
DEPARTMENTS (excluding nationalised industries)	Specific cuts	1% reduction in LA current exp.	2% vol. cut in cash-controlled programmes	Total			
Defence							
A	-	-	-152	-152	-152	-152	
B	-312	-	-188	-500	-500	-500	
DHSS (social security)							
A - child benefit timing	-61	-	-	-61	-1	-13	
- bids	+9	-	-	+9	+12	+14	
- N. Ireland	-1	-	-	-1	-	-	
	-53	-	-	-53	+11	+1	
B - child benefit timing	-61	-	-	-61	-1	-13	
- bids	+9	-	-	+9	+12	+14	
- other	-148	-	-	-148	-363	-364	
- N. Ireland	-6	-	-	-6	-9	-10	
	-206	-	-	-206	-361	-373	
Scotland							
A	-10	-	-	-10	-10	-10	
B	-20	-	-	-20	-30	-30	
DHSS (health)							
A	-	-	-	-	-	-	
B - England	-	-	-60	-60	-60	-60	
- S, W, NI	-	-	-12	-12	-12	-12	
	-	-	-72	-72	-72	-72	
Total unresolved							
A	-63	-	-152	-215	-151	-161	
B	-538	-	-260	-798	-963	-975	

TABLE 4

PUBLIC EXPENDITURE 1980-81 TO 1983-84 BY DEPARTMENTS

Estimated including provisional Treasury estimates of effect of revised economic prospects)

DEPARTMENTS	£ million late 1979 prices			
	1980-81 (Cmd 7841)	1981-82	1982-83	1983-84
Total	1,211	1,137	1,079	1,077
HEALTH/DAFS/WOAD	768	661	612	546
Employment	1,268	1,415	1,331	1,271
Transport	2,867	2,707	2,631	2,631
HE (Housing)	4,065	3,220	2,700	2,380
HE (PSA)	348	322	303	304
HE (Other)	2,855	2,666	2,584	2,574
Home Office	2,572	2,585	2,637	2,667
Lord Chancellor's Department	246	272	290	303
RES	8,513	8,174	7,993	7,826
LOCAL	381	358	353	353
Grants (excluding WOAD) - A	1,698	1,634	1,584	1,550
- B*		1,631	1,581	1,547
Grants to Ireland - A	2,404	2,405	2,370	2,366
- B*		2,396	2,359	2,355
Defence - A	9,510 ⁴	9,790	10,089	10,391
- B		9,442	9,741	10,043
HESS (Social Security) - A	19,731	20,800	20,900	20,950
- B		20,650	20,550	20,600
Scotland (excl DAFS) - A	4,285	4,155	4,070	4,008
- B		4,138	4,043	3,981
HESS (HPSS) - A	9,116	9,232	9,401	9,486
- B		9,172	9,341	9,426

Including extra savings on social security and health resulting from case B.
Volume consistent with August cash limit.