C(79) 4 COPY NO 76

14 May 1979

CABINET

# PUBLIC EXPENDITURE: SCOPE FOR CUTS

Memorandum by the Chief Secretary, Treasury

## INTRODUCTION

1. One of our most urgent tasks is to decide on immediate reductions in the spending plans we have inherited for the current financial year 1979-80. This is important to give the Chancellor maximum scope in his Budget for reducing the burden of direct taxation and meeting an appropriate monetary target. It is not possible at this stage to say precisely how much we should aim to take off the current spending plans for this year. Clearly, the more we can agree to reduce public spending, the larger the step we can take in this Budget towards our fiscal and monetary objectives. We must not prejudice this aim by adding too rapidly to those programmes, eg. defence and law and order, where we are committed to improvements.

2. This paper accordingly concentrates on the current financial year. After the Budget we shall want to review spending plans over the next four years. This can be done best in the context of the new public expenditure survey, and I shall be putting proposals to Cabinet on how that survey should be conducted.

## CASH LIMITS

3. The parallel paper on cash limits (C(79) 5) explains the current position, and makes proposals on the treatment of pay increases higher than provided for in cash limits at present. For the purposes of this paper we need to bear two points in mind:

a. Higher price increases than provided for in cash limits will squeeze the volume of public expenditure in 1979-80. The precise amount depends on the effect of the Budget on prices, but a squeeze of 4-5 per cent on this component of the cash limits should be sustainable. It is for Ministers in charge of Departments to determine how in detail to manage this in their several programmes.

b. There will be a further volume squeeze on current expenditure to the extent that action is taken to offset <u>pay</u> settlements higher than provided for, on the lines proposed in my other paper.

CUTS: GENERAL

4. But we need to go beyond the generalised volume squeeze through cash limits. Recognising that the scope for cuts in the current year is limited by the extent to which expenditure is already committed for this year or where the cuts we intend imply major reviews of policy, often requiring legislation, I invite my colleagues to consider the proposals listed in the Annex.

5. That list amounts to some £750 million (1979 Survey prices). In selecting candidates for the list, I have tried to avoid so far as possible a disproportionate cut in capital spending (the large item for local authority housebuilding is an exception, but there has been heavy underspending in the past so that much of this sum might otherwise go on council house improvements, mortgage lending, etc.). Several of the items propose increased charges, which will have an effect on the Retail Price Index (RPI). But in present conditions it seems to me right to raise charges where possible, so that the user (apart from exempt categories) pays a larger share of the cost of providing the service.

6. The figures in the Annex are generally for England and Wales; for relevant services proportionate cuts would be expected for Scotland (11 per cent) and Northern Ireland (3 per cent). This would add some £60 million to the total above.

LOCAL AUTHORITIES

7. A large proportion (about 25 per cent) of total current spending is the responsibility of local authorities. This is not directly controlled by central Government, which provides 61 per cent of the cost of relevant expenditure in England and Wales ($68\frac{1}{2}$ per cent in Scotland) through the rate support grant (RSG). The financial position of individual authorities varies, but is generally strong. They have substantial balances, and have increased rates by 19 per cent on average (England and Wales) instead of the single figures predicted by the previous Administration. They have thus insulated themselves from most of any likely squeeze resulting from higher pay and prices. There is some danger that they will spend in volume terms more than the plans in the last Public Expenditure White Paper and RSG settlement, by up to some £400 million in England and Wales and £50 million in Scotland.

8. The extent to which the RSG cash limit should be adjusted in respect of pay settlements is discussed in my other paper. Adjustments in respect of pay increases can be combined with a call for general economies in services, and the adjustments to the RSG modified accordingly. I propose that the increase in the RSG cash limit which would otherwise

have taken place to support the pay settlements should be abated by an amount of at least £200 million (England and Wales) and £25 million (Scotland). We could also make it clear that this cut is intended to make it more likely that total local authority spending in the current year stays within present planned volume. The cut should be backed by guidance to authorities, pointing out (if Cabinet agrees) that central Government manpower should be subject to a substantial squeeze, so that it is right for local authorities to seek parallel economies in manpower, both administration and directly employed labour.

9. We have to recognise that the £200 million cut in RSG does not represent a reduction in total public spending, but only in spending by central Government. Its effect on total public expenditure is uncertain, and likely to be much smaller, since many local authorities will be able to run down balances rather than cut back their own spending, and any cuts that do result may only contribute to bringing the total back to its planned level. The running down of local authority balances again has a complex and unpredictable effect on the Public Sector Borrowing Requirement (PSBR). But a cut in the RSG would match the squeeze we are proposing to apply to other central Government spending, and would in my view be the best way of ensuring that local authorities begin this year to cut out waste and rein back their expenditure - a process which can be carried further in the survey and RSG negotiations later in the year.

DISPOSALS

10. Because the scope for reductions this year is limited, we need to look also at the possibility of selling off assets to reduce the borrowing requirement. This needs to be looked at in detail with the Departments concerned, to take account of the particular circumstances in each of the nationalised industries which are the main candidates. Legislation would be necessary in most cases, but not for the sale of British Petroleum (BP) shares or British National Oil Corporation (BNOC) assets. Precise proposals on amounts and timing can only be made after detailed reviews, which I propose the Departments concerned should undertake, in consultation with the Treasury, and with the nationalised industries themselves, to make the maximum feasible contribution in the current year. But on present information we should be able to raise some £750-£1,000 million (in PSBR terms) from disposals this year without overloading the market. It needs to be noted that although this would produce a once-for-all reduction in the PSBR, it would not reduce public sector demands on real resources; and in so far as private sector funds were diverted from buying gilts etc., the PSBR effect would not be carried through into a reduction of Domestic Credit Expansion (DCE) and money supply.

CONTINGENCY RESERVE

11. A further contribution could be made by cutting the 1979-80 Contingency Reserve, which is the amount available within the current planning total to meet new decisions to add to the volume of spending in the course of the year. It stands at £835 million (1979 Survey prices). There are already risks of overspending on local authority current expenditure (paragraph 7 above) and nationalised industries (unless early decisions are taken to increase prices in line with cash limit assumptions); and the need could arise to offset higher expenditure on demand-determined services, eg. social security if unemployment is higher than assumed. We are committed to paying a Christmas bonus to pensioners, which at £10 would cost £108 million. Departments have reported that about £120 million of expenditure was deferred from 1978-79 to 1979-80 by the Civil Service industrial action, and I propose that we should make provision for this. Other foreseeable claims (eg. Common Agricultural Policy (CAP) and European Economic Community (EEC) budget) could amount to a further £150 million or so. We need to keep something in reserve for genuine unforeseeable contingencies. But if Cabinet is prepared to take a very firm line against any further deliberate additions - in particular, any social security uprating beyond our minimum commitment - then it would be possible to cut the Reserve by say £300 million. I shall invite Cabinet to take a decision on this when we have reached a view on the social security proposals.

12. Whatever decision we take on the size of the Reserve, it will be essential to keep expenditure within the planned total by ensuring that no volume addition is made without being met from the Reserve. The cost of new measures, or estimated additions to the cost of existing measures, should be met as far as possible within the existing total for the relevant programme, by finding offsetting savings. When this is not possible, a claim on the Contingency Reserve can be considered. But unless the Cabinet take an explicit decision to increase the total, the Contingency Reserve should represent a limit on decisions to add to the volume of public expenditure programmes during the year. The use of the Contingency Reserve in this way entails that acceptance of a claim on the reserve for one purpose pre-empts to that extent the scope for other extra expenditure. Decisions to commit a significant part of the Reserve to one area of expenditure rather than another should therefore be made by the Cabinet as a whole. It follows that major claims on the Reserve, or other claims which Treasury Ministers are not themselves prepared to accept, should be referred by the appropriate Ministerial Committee to the Cabinet for a decision.

PROCEDURE

13. Subject to the views of Cabinet on the proposals in this paper, I propose to hold bilateral discussions in the next week or so with the Ministers concerned on the proposals for specific cuts listed in the Annex, in time to report to Cabinet with my recommendations in the light of these talks, for approval before the Budget.

FURTHER SAVINGS

14. The proposals in the Annex total nearly £750 million at 1979 Survey prices. This will be in addition to the squeeze through cash limits but against it must be offset any increase we make in eg. the defence programme. But more will be needed to enable us to make the impact through direct tax cuts in this Budget which we all want to see.

15. I therefore urge my colleagues to consider personally whether they can offer any further savings from their programmes in 1979-80, for example by bringing forward some of the savings they will be proposing for later years.

CONCLUSION

16. I invite Cabinet to agree that:

i. the proposals listed in the Annex should be discussed with Ministers concerned, after which I should report back to Cabinet with my recommendations.

ii. A reduction in the rate support grant to local authorities of £200 million should be made on the lines proposed in paragraphs 7-9.

iii. There should be detailed reviews of the scope for selling assets (paragraph 10), with the intention of raising some £750-£1,000 million in the current year.

iv. We should take a decision on a cut in the Contingency Reserve in the light of what we decide on the relevant social security proposals.

v. The Contingency Reserve should be used as an operational instrument to ensure that any decisions to add to expenditure are contained within the planned total, as proposed in paragraph 12.

vi. Ministers in charge of spending Departments should consider urgently whether they can offer any further savings in 1979-80.

W J B

Treasury Chambers

14 May 1979

ANNEX

| | Saving in 1979/80 (£m., 1979 Survey prices) |
|---|---|
| **Housing** | |
| On local authority housing capital, a reduction of £320 million cash (£280 million at 1979 Survey prices) could be made in cash limits. Substantial shortfall can be expected, particularly on new house building, in addition to the £140 million taken up by higher prices than assumed in setting the cash limit. But to ensure the full saving and to prevent local authorities from switching the cash to other activities, such as council house improvements and mortgage lending, the cash limits should be cut. | 280 |
| Local authorities should be pressed to raise rents. This could be done either by a further increase in the 1979-80 rent guideline to 70p. a week (about 12 per cent) - 20p. above present average); or by cutting the percentage subsidy payable on the "new capital costs element" of expenditure from 66 per cent to 60 per cent by affirmative Order. Neither would enforce a rent increase on local authorities this year (they could ignore guidance or make up reduced subsidy out of rate funds); but there should be some effect. | 25 |
| **Health Service** | |
| Prescription charges could be increased from 20p. to 60p. from 1 August, by negative Order (worth £65 million in a full year). When last increased in 1971, the charge of 20p. was equivalent to 56p. now. | 40 |
| Other miscellaneous charges - eg dental charges and certain family planning services (but not ophthalmic charges) - might also be increased. | 15 |
| **Education** | |
| The school meal charge could be increased from 25p. to 35p. at the beginning of the autumn term (ie by 10p., instead of the 5p. already announced, on which in any case an early negative Order will be needed). | 24 |
| The pilot scheme for awards to 16-18 year olds in full-time education has lapsed with the previous Government's Education Bill. | 10 |

er current expenditure could yield savings in the ral squeeze on local authority spending - paragraph 9 he main paper.)

Saving in 1979/80
(£m., 1979 Survey pr

4. Employment and Training

(a) Early decisions should be taken to end or cut back the Department of Employment's 1979-80 special employment measures (eg small firms employment subsidy, temporary short-time working scheme, job release scheme, special temporary employment programme). — 100

(b) The MSC programmes (Youth opportunities, training opportunities) should be held to 1978-79 planned levels. — 35

5. Industrial Support

(a) If NEB's activities are restricted, and only very limited use needs to be made of the provision for future industrial support, there should be a saving of £50 million this year (and more later). — 50

(b) By adjusting the rules for regional support (prior to a full review) a small saving could be made this year. — 15

(c) A reduction in industrial investment by the Scottish Development Agency (£7 million) and Welsh Development Agency (£3 million) should be practicable. — 10

6. Other Environmental Services

An early decision should be taken to halt further land purchases by local authorities under the Community Land Scheme. — 50

7. Aid

Though most of the aid provision for the current year has been committed, and there are sizeable potential or actual new contingencies in sight, it should still be possible to find savings of the order of £20 million, or possibly more. — 20

8. Transport

A 10 per cent average increase in British Rail fares, beyond what is needed this autumn to keep within the cash limit, could yield a further £20 million this year. — 20

| | Saving in 1979/80 (£m., 1979 Survey prices) |
|---|---|
| Energy | |
| BNOC should be restrained from buying into existing fields. | 40 |
| A halt on new energy research contracts could save £2 million. | 2 |
| About | 750 |