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C(80) 58

COPY NO

54

22 October 1980

CABINET

PUBLIC EXPENDITURE PROGRAMMES

Memorandum by the Chief Secretary, Treasury

1. Cabinet decided on 10 July to keep public expenditure plans for 1981-82 and later years within the totals announced in the March White Paper (Cmnd 7841) less the benefit from refunds of European Community contributions (CC(80) 28th Conclusions, Minute 2). The separate paper C(80) 59 shows the importance of sustaining that decision. Indeed, if it were practicable, it would be helpful to reduce public expenditure further in 1981-82.
2. But the prospects have deteriorated since July. We foresaw then that cuts in other programmes would be needed to offset increased provision for nationalised industries, then put £470 million (this, and all other figures in this paper, are at late 1979 prices) over what was provided in the March White Paper. Subsequent developments show very large prospective excesses over the March totals, of the order of £2.7 billion in 1981-82, and more in later years. To offset these increases and get back to the March White Paper will now require larger and more difficult cuts in programmes, with serious difficulties, both practical and political.
3. The main reasons for the increases, set out in table 1 are:
 - i. £600 million more must be provided for the nationalised industries. The July increase would have allowed specifically £1,220 million for the industries in 1981-82. They have now sought external financing limits totalling over £2,500 million. I have proposed in the Ministerial Committee on Economic Strategy (E) that their bids be scaled down to £1,520 million, which is £300 million more than we allowed for in July. In addition increased provision of £300 million is needed in the Reserve for next year, partly for the end-year flexibility scheme for nationalised industries.

ii. The changed prospects for unemployment, inflation and interest rates indicate increased provision of perhaps £700 million in 1981-82, and more in later years, for benefits, housing subsidies and export credit subsidies.

iii. In view of the recent discussion in E Committee, we need to allow something for the proposals, originally amounting to £400 million, put forward by the Secretaries of State for Industry and Employment for "seed-corn" measures for industry and measures concerning unemployment, particularly for young people. The Annex to this paper provides for a net increase limited to £150 million.

iv. An additional £550 million is needed in 1981-82 for a necessary increase in the Reserve, together with a reduced estimate for shortfall.

v. Certain other smaller items require a further £250 million.

4. To cover these increases we need both the specific cuts, as so far discussed in bilaterals with the Ministers concerned, and certain general cuts which I now propose, affecting a large number of programmes. The proposals in this paper need to be considered in conjunction with those in C(80) 60 concerning cash limits. They concentrate on 1981-82. Figures are also shown illustratively for 1982-83 and 1983-84 but the economic assumptions may need revision before the Budget and we can look at these years again when we have settled 1981-82.

SPECIFIC CUTS

5. Proposals for specific cuts are in the first column of Table 2: additional notes on some of the main ones are in the Annex. In a few cases the amounts have been reduced from what was suggested earlier in order to allow for the interaction with the general cuts described below. Bilateral discussions have led to agreement so far on only £0.2 billion of the £1 billion proposed.

6. The difficulties, political, industrial, practical, of many of the cuts are evident. Equally evident, to sustain our economic strategy and our specific commitment on public expenditure, we must make significant savings in the very large as well as in smaller programmes. This means moving away from certain previous commitments, notably as to health, defence, education and social security.

7. One key issue is social security, which accounts for a quarter of total public expenditure. This is being considered separately.

8. Defence is an area of special difficulty. I respect the concern of the Secretary of State for Defence and others as to both national security and relations with our North Atlantic Treaty Organisation allies. But this is a very large programme, some 18 per cent of presently planned programmes other than social security for 1980-81. My proposal would mean that we had at least stopped the decline in defence spending which occurred under our predecessors, and that when most programmes are having to fall. Significant increases for defence now need to be deferred until later in our period of office.

GENERAL CUTS

9. For the cash limit factor for expenditure other than pay the proposal in C(80) 60 is 11 per cent. This will imply some degree of cash limits squeeze if inflation turns out higher. Eleven per cent is clearly within the realistic range of expectation, but requires the recent good performance on prices to be continued. Some moderate cash limits squeeze may yet still be implied.

10. Rather than reduce the cash limits factor further so as to produce a deliberate major cash limits squeeze, I propose a general volume cut in all expenditures subject to cash limits (excluding local authority current expenditure) of 2 per cent in 1981-82, carried forward into the later years. The effect will be similar to that produced this year and last by the large cash limits squeeze. It is preferable to doing it all again by such a squeeze: it enables programme managers to plan for it now, and the volume figures published in the White Paper to represent more nearly the Government's intentions.

11. In addition, I propose that we seek a further 1 per cent cut in local authority current expenditure, in 1981-82, and in subsequent years, to be shared out proportionately among the relevant programmes. This involves changing the earlier decision, announced in August to local authorities, to stick to the 2 per cent reduction between 1980-81 and 1981-82 shown in the March White Paper. The extra reduction is required by the economic climate and would be so explained. It may not be implemented in full, especially in 1981-82, but we cannot exempt the local authorities from this further effort.

TOTAL EFFECT

12. Table 2 shows the effects of these proposed reductions on the main programmes, other than social security. The figures for later years carry forward the policy measures in the specific cuts, and the absolute amounts of the general cuts.

ANNOUNCEMENT

13. We have first to reach decisions on the substance, but need to keep in mind what will need to be said publicly and when.

14. Specific announcements will be needed in the next month or so of:

- i. The additional cut intended in local authority current expenditure, which is relevant to the Rate Support Grant settlement next month.
- ii. Cash limits factors.
- iii. The public expenditure policy assumed in the Industry Act forecast to be published in November.
- iv. Changes in some other programmes where operationally necessary.

15. It will be for consideration whether some announcement in general terms about our overall plans will be useful in the near future. Subject to that, the occasion for comprehensive and detailed announcement will be the next public expenditure White Paper, which I propose we publish again on Budget Day next spring.

CONCLUSION

16. I invite the Cabinet's approval of the proposals set out in this paper.

W J B

Treasury Chambers

22 October 1980

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TABLE 1

INCREASES COMPARED WITH MARCH PUBLIC EXPENDITURE WHITE PAPER (Cmd 7841)

£ million late 1979 prices

	1981-82	1982-83	1983-84
<u>Specialised industries</u>			
Anticipated in July	+470	+470	+470
Further increase for individual industries	+300	-	-
Increase in reserve (partly for end-year flexibility)	+300	+50	+50
	<hr/>	<hr/>	<hr/>
	+1,070	+520	+520
<u>Other programmes</u>			
Revised economic prospects (unemployment benefits, export credit, housing subsidies) (1)	+700	+1,100	+850
Industrial support	+150	+185	+185
Employment measures			
Reserve (not including provision for end-year flexibility for public services)	+350	+500	+250
Reduction in shortfall	+200	+340	+340
May CAP price-fixing	+40	+55	+60
Civil service manpower: extra redundancies	+64	+39	+47
Child benefit uprating by prices (proposed in July)	+75	+250	+360
Changes agreed before July (incorporated in survey baseline)	+75	+67	+55
	<hr/>	<hr/>	<hr/>
	+1,654	+2,535	+2,447
<u>Total increases</u>	<hr/>	<hr/>	<hr/>
	+2,724	+3,056	+2,967

(1) Provisional Treasury estimates. Additions will be made to specific programmes in consultation with Departments.

PROPOSED REDUCTIONS COMPARED WITH MARCH PUBLIC EXPENDITURE WHITE PAPER

DEPARTMENTS (excluding nationalised industries)	-----1981-2----- @late 1979 prices				82-3	83-4
	Cuts already proposed (inc some agreed)	1% reduction in LA current expenditure	2% volume cuts in cash -controlled programmes ^o	Total		
Defence	-312	-	-188	-500	-500	-500
HESS (health & PSS)	-	-12	-126	-138	-138	-138
(social security)	x	x	x	x	x	x
HE (housing)	-34	-1	-27	-62	-88	-83
(FSA)	-12	-	-8	-19	-15	-15
(other)	-62	-15	-18	-95	-89	-84
HESS (gross)	-85	-61	-30	-176	-236	-241
Scotland (excl DAFS)	-90	-	-60*	-150	-150	-150
Wales (excl WOAD)	-	-	-28*	-28	-32	-32
N. Ireland	-	-	-11*	-11	-10	-6
DAFS/DAFS/WOAD	-26	-	-9	-35	-35	-35
RAIL	-10	-2	-3	-15	-15	-15
Post Office	-10	-21	-9	-40	-40	-40
Transport	-15	-10	-21	-46	-46	-46
AGD: shift to TSBs, and small bid	-48	-	-	-48	+4	+4
All other Depts. (general cuts)	-	-1	-85	-86	-86	-86
Other changes to departments in 1980/40 and agreed bilateral	+39	-	-	+39	+140	-75
Other changes to unadjusted contribution: revised forecast	-100	-	-	-100	-250	-500
Sales of assets (slippage from 1980-81)	-100	-	-	-100	-	-
TOTAL	-865	-123	-622	-1610	-1586	-2042

2% volume cuts include savings resulting from reductions in civil service manpower proposed by Lord President (inc. 2½% manpower squeeze carried forward from 1980-81). Larger reductions may arise in some Departments, particularly in the later years, following decisions on the Lord President's proposals.

"Formula" cuts for Scotland, Wales and Northern Ireland; those for Scotland and Wales are likely to fall in part on local authority current expenditure.

Social security (and public service pensions) is being considered separately.

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ANNEX

IMPLICATIONS OF MAIN CUTS PROPOSED IN THIS PAPER

1. Defence

As part of the specific cuts proposed in September, defence were asked for a contribution "of the order of £400 million a year". The additional 2% volume cut now proposed would mean for defence a further reduction of £188 million. Since a total cut of nearly £600 million is clearly not feasible, this has been scaled down in the table to £500 million. The Secretary of State for Defence will be concerned that cuts of that order, on top of previous cuts built into the baseline, would damage operational capability and defence industrial capacity.

2. Education

Cabinet in July decided on cuts of £85 million next year, mainly in local authority current expenditure (on schools and further education) to achieve education's share of the 2% target reduction for local authorities. Since education is nearly half of local authority current spending, a further £61 million is needed towards the further 1% reduction; and a 2% reduction in other programmes (universities, science) would yield a further £30 million. These cuts carried forward, with some further reductions, total (gross) £240 million a year for later years. The Secretary of State will be concerned about trebling the cut in his programme, when he regards what has already been agreed as putting at risk the Queen's Speech commitment to "maintain and improve" the quality of education.

3. Health

Following decisions not to pursue fully a number of proposals for additional charges which had been made (notably charging for accident treatment) the programme is already £100 million below current spending plans. A further £126 million (2 per cent) cut in volume would mean a total reduction of £226 million below present plans. Unless Ministers are prepared to reconsider charging on the necessary scale, gross NHS spending would have to be cut, not only below the planned level arguably implied in the Manifesto commitment but in fact below volume spending in the current year. Because of upward demographic pressures, this means an absolute reduction in level of service.

4. Scotland

The figures in the table show £90 million for specific cuts, plus £60 million as the estimated "formula" cut to match the proposals for other programmes, giving a total of £150 million. The Secretary of State was originally asked for £150 million plus "formula" cuts and regarded anything on this scale as politically unacceptable. What is now proposed would still leave expenditure per capita in Scotland on comparable programmes almost one-third higher than in England.

5. Home Office

In the last round of bilaterals, the Home Secretary reluctantly accepted a cut of £10 million. He has said that he is ready to accept a further cut of £30 million as his share of the percentage cuts now proposed.

6. Environment

The proposal is for specific cuts of a further £43 million above the £65 million agreed earlier; this would include in total £12 million for PSA. The percentage cuts would add another £69 million. The PSA contribution is likely to entail a reduction in departments' accommodation programmes and standards of service provided to them.