

1) MR WHITMORE

2) PRIME MINISTER

1.  
Generally I think the draft minute to the Chancellor is good and I am in favour of sending it. On a minor point, I am rather doubtful about including the last two paragraphs of all and I think they could be dropped without doing any damage to the impact of the minute.

Public Expenditure

file  
29.

The attached draft minute, which you might possibly send to the Chancellor, has been drafted mainly by Leo Pliatzky. Basically, it makes four points:-

- i. Any cash limit squeezed on volume should be carried forward into later years.
- ii. Volume figures should in future be revalued by a single, centrally imposed factor - rather than by the price and pay increases experienced by spending departments. (An alternative idea, which the Treasury are also considering, is to revalue the figures by the cash limit figures for year one of the PESC period: it would have much the same effect in terms of encouraging cost consciousness; and this is also referred to in the draft).
- iii. Establishing the principle that in future years cash limit factors will not necessarily compensate in full for price increases.
- iv. In order to get the public expenditure figures down in the forthcoming White Paper, the Contingency Reserve and the provision for shortfall should be reduced.

The draft also outlines the advantages of a total cash system (these have been provided by Robin Ibbs).

/You will

79 x 60

7.

6 x 11

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72.

~~87-82~~

87-82

82-3

83-4,



You will wish to consider whether, in the light of the fact that we now know that the Treasury are considering some of these ideas, you should still send a minute. An argument against is that it might divert attention away from the work that is already in hand. On the other hand, a substantive minute would serve to indicate how concerned you are, and there are one or two points in it - namely iii. and iv. above and also the thought that something needs to be said in the Budget statement - that the Treasury may not be considering. You may wish to have a word with me and Clive about this tomorrow morning before deciding.

I warned Sir Leo that you might not want to send it. He was still very keen that you should see his interpretation - with some elaboration - of your thinking.

DL

29 January 1981

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MR. LANKESTER

Public Expenditure White Paper

The draft minute to the Chancellor which I am letting you have will for the most part speak for itself. But as regards paragraphs 5 and 6, does attempt to formulate the ideas which the Prime Minister put to us, and she will have to judge whether the formulation corresponds to what she has in mind. If it does, I should point out that, on one interpretation, it comes close to a permanent incomes policy for the public services. I am myself not against that but I do not think that you can have indefinite pay restraint in the public services irrespective of what is happening in the economy as a whole. Certainly that is a point which the Treasury would make. So sooner or later you could be driven to something approaching an incomes policy for the private sector. I should not be against that either, but the Prime Minister may not care for these implications of the idea.

I understand that the proposal for a minute on these lines may now be overtaken by events, but I am letting you have the draft anyway.

Leo Pliatzky

28 January 1981

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Draft Minute to the Chancellor of the Exchequer

PUBLIC EXPENDITURE WHITE PAPER

Thank you for your minute of 23 January about some of the difficulties involved in the public expenditure figures to appear in the White Paper. As you say, there are problems of both substance and presentation. Both are very serious and I feel, as I believe you do, that we cannot simply let matters take their course on the basis of the rather compressed statement of the position in your minute. I realise that the time between now and the Budget is short, and that it would be difficult to reopen the whole range of programme decisions at this stage, but we are agreed, I hope, that the Treasury should nevertheless consider what proposals you can frame and how we can enlist the help of colleagues in order to head off the adverse reaction which the White Paper is otherwise likely to produce.

There are longer term issues here concerning the planning and control of expenditure, and there are immediate issues concerning these particular figures and their presentation. I will set out some thoughts on each aspect in turn, as an input into the work which is going on. Some of these comments confirm points of which the Treasury are already aware.

Planning and Control

I remain convinced that the present system of programming in volume terms plays a substantial part in the continued escalation of the expenditure figures. It is true that, for the year immediately ahead, by superimposing cash limits on many though not all programmes, we restrict our commitment to finance cost increases, and this may have the effect of producing a volume cut in programmes if cost increases exceed the allowance made for inflation in the cash limits.

However, as I understand it, this volume squeeze is not carried through into subsequent years, but the cut is in practice restored when the volume programme is rolled forward and revalued

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Depth assessment has come to  
conclude that whether this is  
& cost - they are not the only certain

in the annual public expenditure exercise. If this is an accurate  
account of the position - and I am open to correction if it is not  
in my view the least that we should now do is to change the  
procedures so as to stop this happening, to discontinue the degree of  
discretion which spending Departments have in putting forward  
these revaluations, and to move on to a system of centrally  
determined figures for use in this operation. I believe that this  
would have a healthy effect on cost control, I realise that this  
change could not be put into effect until the 1981 public expenditure  
exercise, but it could have an important effect on opinion if we  
decided on the change now and announced it in the coming White Paper.

where  
- of  
spending

I understand that the Treasury is <sup>the</sup> looking already working on a proposal <sup>of this kind</sup>

This approach accepts that, if we are to have any forward  
programming, we cannot get away altogether from a constant price  
basis, and that adjustments for inflation will have to be made to  
the figures when the time comes, but it does not concede that the  
adjustment will always be sufficient to cover cost increases  
irrespective of their size. I should be grateful if you would  
consider urgently whether we could make even more radical moves in  
that direction. I ~~recognise that some methods of doing this -~~  
<sup>it may be best</sup> for instance by expressing programmes for the medium term as well  
as for the year ahead in at least provisional cash figures reflecting  
the scale of price increases which we envisage are not practicable  
at this juncture. <sup>But if a fully cash system is not practicable</sup> But this need not prevent us now from endorsing  
the principle that the volume programmes for the later years will  
be subject, when the time comes, to the constraint of cash limits  
which would not necessarily compensate in full for price increases.  
I believe that this could deter spending Departments from committing  
their volume programme in advance up to the hilt, and that a statement  
of intent on these lines could, like the proposal set out in my  
previous paragraph, help to get a better reception for the White  
Paper.

But I  
should  
just  
like to  
point  
out that  
a fully  
cash  
approach  
has  
some  
substantial  
advantages  
then on:

We should have to consider carefully how to express this  
principle. On one formulation it would simply amount to  
extrapolating into the future the approach which we have been  
adopting in practice so far. Taken a stage further, it could  
entail a continuing policy of price restraint for the public  
services irrespective of the rate of inflation in the economy.  
I can see that this would have important implications, but I am  
not at all sure that we need shrink from them.



resentation of the Figures

If we cannot reduce the figures for individual programmes at this stage, the only apparent means of reducing the planning total is by adjusting the figures for the contingency reserve and for shortfall, though I should have preferred it if we were in a position to make a further adjustment by changing the treatment of borrowing by the nationalised industries. As regards the contingency reserve, I support the principle of setting it at a credible level. Nevertheless there seems to me a case for taking the line that the additions to programmes which have already taken place will make it necessary to adopt a more stringent view to further additions in the next financial year, and that Cabinet should accept now that they will have to find new savings when the time comes if they want to approve more than a limited number of new items. I should be grateful therefore if you would take a further look at the contingency reserve from this point of view.

As regards the low shortfall figure, I wonder if this is designed, among other things, to cater for a continued over-run on defence spending. If so, would not the right response be to initiate measures to forestall the over-run rather than to resign ourselves to it in the low provision for overall shortfall.

I agree that the text of the White Paper will be important in securing acceptance for its contents. For instance, I feel that we should take credit for the turn-round in the relative price effect which we will secure next year rather than be unduly self-critical about the residual cost effects in future years of this year's exceptional pay increases arising from inherited commitments, or about the larger take-up of the special employment measures. However, these are purely drafting points. I await the advice which has been promised on the more substantial matters.