

CONFIDENTIAL

PRIME MINISTER

Public Expenditure Survey 1981: Guidelines
(C(81) 20)

BACKGROUND

Page 4

In C(81) 20, the Chancellor of the Exchequer invites the Cabinet to approve the broad guidelines for the preparation by Departments of the 1981 Public Expenditure Survey report, covering 1982-83 to 1984-85. The approval of such guidelines at this stage in the year is a standard feature of the public expenditure planning cycle, but the present proposals have the added importance of incorporating in the guidelines for the first time arrangements for translating the figures from volume to cash terms and, therefore, requiring the endorsement of provisional inflation assumptions much longer in advance than in previous years. This follows Cabinet's agreement in principle on 24th February that the discussion of the plans for 1982-83 should be in cash terms subject to their later approval of the detailed arrangements, including the inflation assumptions (CC(81) 8th Conclusions, Minute 6). At that meeting, the Chancellor said that he did not then wish to propose cash planning for the years beyond 1982-83, since that would raise problems which would need further consideration.

Timetable

9

2. The Chancellor of the Exchequer envisages that Cabinet would take stock in July of public expenditure plans in general terms (but not of the details of individual programmes) with the possibility of making a provisional proposal for an overall cut, and of giving a steer to the local authorities. Treasury Ministers might then have bilateral discussions in September with spending Ministers on how the overall cut might be implemented. The Chancellor would report on the outcome in early October, leading to decisions by Cabinet at the end of October and in early November.

CONFIDENTIAL

CONFIDENTIAL

3. Building on the experience of last year, this timetable recognises that decisions taken in July for 1982-83 on the local authority programmes, or more generally, would probably have to be re-opened in the autumn as the forecasts for the borrowing requirement, and the implications for taxation, clarify. Deferring substantive decisions to the autumn is, therefore, realistic but it will mean that the Cabinet will be faced in September-November with a concentrated programme of complex and difficult decisions. In practice this will be no different from what in the event happened last year, but I shall wish to put further advice to you later on how the timetable might best be handled. In particular, it will be necessary to take account of the Chancellor's absence from about 21st September to 2nd October at the Commonwealth Finance Ministers' meeting in New Zealand followed by the IMF meeting in Washington; your visit to Melbourne from 30th September to 7th October for the Commonwealth Heads of Government Meeting; the Party Conference in the week beginning 12th October; and the Mexico Conference from 21st-24th October.

4. It is likely that Members of the Cabinet will be anxious for the public expenditure discussions to be set in the context of more general discussion of the economic situation. You indicated some weeks ago that opportunity would be found for such a discussion; it will be helpful if you confirm this now, and say that you expect this discussion to be on 4th June. You may want for the present not to give any hint that this might be the first of a regular series of economic discussions three times a year, on the lines suggested by the Chancellor.

Options

5. As is the usual practice, the Chancellor of the Exchequer asks the Cabinet to agree that the Survey report should include costed options for reductions in expenditure, showing the political, social, economic and other implications of each, as well as the separate identification of any bids for additional expenditure for whatever reason. This year he proposes that such options should be presented for all programmes and that they should display the possibilities for cuts of:-

- (i) 3 and 5 per cent in 1982-83
- (ii) 5 and 7 per cent in 1983-84 and in 1984-85.

CONFIDENTIAL

The cuts identified would apply to programmes as converted to whatever cash base the Cabinet approves (see below), with the consequence that, if the figures are converted to cash, as proposed by the Chancellor, the option cuts could be additional to any volume squeeze resulting from the inflation assumptions chosen. The options are lower for 1982-83 in recognition of the fact that by the time decisions are finally taken in the autumn a good deal of expenditure will have already been committed. These proposals do not involve any separate exercise on manpower numbers; it would, however, be open to any Department to offer staff cuts, additional to those already in the pipeline, in order to find its option cuts.

6. Although the Cabinet is likely to agree that there should be some identification of the options for cuts, some Ministers will wish to question the levels proposed and whether they should apply to all programmes. It will be argued that it is wholly unrealistic, and an exercise in self-deception, to think of cuts as high as 5 to 7 per cent; and that, apart from any political difficulties (e.g. Social Security and NATO commitments), it is simply impracticable to look for cuts of this order from all programmes when some are demand-led and others (such as the industrial programmes) represent the cash provision for commitments already largely given.

7. In reply to these points, the Chancellor of the Exchequer will be at pains to point out that he is not making substantive proposals for cuts of this order in each and every programme, nor does he expect such across the board cuts to emerge later in the year. What he is looking for is the systematic and orderly identification of all the options - and their attendant difficulties - so that later in the year Ministers have available a basis for taking informed and practicable decisions on cuts in some programmes if this proves to be necessary. The need for cuts, and their extent, will turn on discussion later in the year of the Chancellor's assessment of the economic situation as it is developing, and in particular of the balance which the Government wishes to strike for the next two years or so between its expenditure and taxation objectives. To leave out some programmes from the preliminary stage of identification of options would itself present difficulties of deciding on the exemptions and run the risk that some fundamental possibilities would escape scrutiny.

CONFIDENTIAL

The timing of the switch to cash figures

8. Had previous practice continued, the programmes in the Public Expenditure White Paper would have been converted now from 1980 prices (i. e. late autumn 1979) to 1981 prices (i. e. late autumn 1980 prices) with the revaluation factors generally tailored to a judgment of the particular circumstances of individual programmes. The Chancellor of the Exchequer proposes - in his paragraphs 8-10 - that the Public Expenditure White Paper figures should be converted to cash now, on the understanding that there will be an amendment in October - if developments show that to be justified - of the general inflation factors assumed.

← 9. The Minister of Agriculture, Fisheries and Food, and other Ministers are likely to argue that the conversion to cash should not take place until the autumn and that, in the meantime, either the programmes should be converted to 1981 prices (continuing previous practice) or that they should be converted as a first step to estimated 1981-82 outturn prices using the factors already incorporated in the cash limits for that year. They are likely to argue that this would lose nothing since the Cabinet does not propose to take substantive decisions until the autumn, and would avoid the confusion, and the wasted effort by Departments, which could arise from making a provisional conversion to cash now and then a further adjustment in October. They will also point out that, irrespective of the conversion to a cash basis, they and outside commentators including Select Committees have to remain concerned with volume planning too.

← 10. The Chancellor will argue strongly against this on the grounds that, if there is to be a switch to cash planning, it should be made at this point in the year so that everyone - Ministers and officials alike - start to think in cash terms. He will accept that an adjustment in the autumn will require further work, but he will point out that any such adjustment would be much smaller, and therefore easier to cope with, than the fundamental and much larger adjustments which would have to be made on either of the alternatives likely to be suggested.

CONFIDENTIAL

Factors for 1982-83

11. The Chancellor proposes that the conversion from 1981-82 to 1982-83 cash figures should be based on an assumption that all costs, including pay, rise by 7 per cent between the two years. He had earlier considered proposing separate factors of $7\frac{1}{2}$ per cent for costs other than pay - in line with the Government's own published forecasts when run on for the full financial year 1982-83 - and 5 per cent for pay. This, however, risked the difficulties, discussed in his paragraphs 13 - 15, of it being leaked, while the present Civil Service dispute is still going on, that the Government had adopted a working assumption of 5 per cent. The provisional use of 7 per cent across the board avoids this problem, although it is probably marginally too low for non-pay programmes and too high for programmes dominated by pay. Further adjustments will therefore be necessary in the autumn, and account will then need to be taken of the increased flexibility in setting the pay cash limits which were proposed by the Chancellor in C(81) 15 and approved by the Cabinet on 14th April (CC(81) 16th Conclusions, Minute 2).

12. Some Ministers might argue that where, in their view, their programmes have an established track record of year to year price increases different from average revaluation factors, this should be recognised from the outset by a special adjustment for their programmes. The Chancellor will strongly resist this and argue - as in his paragraph 5 - that where a Department believes that the standard provision for cost increases is inadequate for its programme it should make a bid for additional expenditure accordingly and put forward detailed arguments in support. It will then be for Ministers collectively to consider such additional bids later in the year when they are looking at the total of the net additions, or reductions, in expenditure which they are prepared to authorise. If exceptions are made at this stage, however, the whole new system of cash limit planning could break apart.

CONFIDENTIAL

Inflation assumptions for the later years

13. At the discussion on 24th February the Chancellor did not press the question whether the later years of the Survey should be converted to cash figures. He now recommends that they should, using as simple working assumptions factors of 6 per cent for the change from 1982-83 to 1983-84 and 5 per cent for 1983-84 to 1984-85. These factors are consistent with the successful implementation of the Government's economic policy. They would be open to revision in later years if necessary. They avoid the problems of the alternative of a 'broken backed' series with 1982-83 in cash terms and of the later years at 1982-83 prices as estimated in the spring of 1981.

14. Several Ministers are likely to argue strongly against this course on the grounds that the margin of error in forecasting inflation rates increases sharply, the further out one attempts to look, that the inflation factors proposed will almost certainly have to be revised, that their adoption will cause considerable confusion (particularly when Departments must still keep sight of their volume figures), and that there will be enough difficulty in dealing with the problems which they foresee for 1982-83.

15. If the Chancellor is pressed hard on these points, he may concede that, for the 1981 Survey at least, each year should be on a 1982-83 cash basis until the autumn, when the two later years would be converted fully to cash prior to publication of the Public Expenditure White Paper.

HANDLING

16. After the Chancellor of the Exchequer has introduced his paper, you might propose that it would be easier to break the discussion into two broad halves: first, points on the timetable and the costed options; second, the question of the inflation factors for 1982-83 and for the later years. It is likely that all Members of Cabinet will wish to comment, but the Secretaries of State for Defence, Social Services and Education and Science (as the big spenders) and the Secretary of State for the Environment (qua local authorities) might be called early in the discussion.

see
Mr Heseltine's
work in his
former
form.

Th.

CONFIDENTIAL

17. The main points are those identified in the Chancellor's paper and in this brief. More detailed points, and questions of interest to particular Departments, will be picked up in the detailed guidelines which the Treasury will circulate to Departments in the light of the Cabinet's decisions.

CONCLUSIONS

18. You will wish to sum up with reference to the five proposals listed in paragraph 19 of C(81) 20.



Robert Armstrong

6th May 1981

CONFIDENTIAL