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1.
Prime Minister.

I suggest we give decision ^{with} the Chancellor on the way to Ottawa.

John CPR paper
17 min

Qa 05635

To: MR WHITMORE

From: J R IBBS

Public Expenditure

1. I have seen the Chancellor's draft paper on tax and public expenditure, as he sent it to the Prime Minister on 15 July.

2. It seems to me that there is one central point. It will not be possible to achieve the Chancellor's aim, of getting expenditure totals below those derived from the March White Paper, unless Ministers resolve now to make a much more aggressive attack on current spending than they have achieved so far. An indirect approach, of endorsing this as an 'objective' without accepting the consequences, will not be enough. Previous experience suggests that bilaterals will not achieve the reductions needed. Cabinet in the Autumn will be no further forward. And Ministers in the meantime will be lulled into supposing that they are still on course towards a lower burden of taxation.

3. I suggest that the Prime Minister might find it helpful if the Chancellor's paper were complemented by a short CPRS paper to sharpen up the choice that Ministers face. I attach a draft which takes the Government's economic strategy as its starting point, with the firm objective of a declining PSBR, but then brings out the tax/expenditure choice and what this implies for programmes. Private sector firms have faced similar harsh choices and most have cut back sharply on their current costs. I believe this paper might help Cabinet face the decision with the main issues placed squarely before them.

4. I am sending a copy of this minute to Sir Robert Armstrong.

17 July 1981

Att

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PUBLIC EXPENDITURE

Note by the Central Policy Review Staff

1. The Chancellor's paper asks Cabinet to endorse the over-riding aim of getting public expenditure totals below those derived from the March White Paper. This is to allow reductions in the tax burden. Treasury Ministers will then discuss with colleagues bilaterally how programmes can contribute to the overall aim, and will make proposals in the Autumn.

2. Cabinet on 17 June endorsed the objective of maintaining the present economic strategy. Within that framework, Ministers may find it useful to have a brief note on the strategic public expenditure issues, even at this stage in advance of the Autumn discussions. Some of the issues cannot be resolved until then.

(I) Public expenditure and taxation. The Chancellor argues the need to reduce the burden of taxation both as a political priority, and to improve supply-side performance via incentives and company profits. The comparison of employment effects is difficult, e.g. because of market reactions (his paragraph 8). But the employment trade-off will depend heavily on the particular tax and expenditure options being considered, and on the time-scale.

Will Ministers need more information on the employment trade-off when considering particular tax and expenditure options?

(II) Public expenditure totals. The attached table gives the figures agreed for the last White Paper, in constant prices of late 1979. They will be updated, and converted into cash, for discussion in the Autumn. But the totals show that in these (volume) terms, the Government has not yet succeeded in reversing the upward trend of public spending. Furthermore, only a small increase of some $1\frac{1}{2}$ per cent would mean that the upward trend would continue in 1982/83.

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(III) Programmes. The table shows the main programme totals. These represent the outcome of past Ministerial decisions on priorities. They show once again the large proportion of programmes protected by some form of commitment - social security (28 per cent in 1982/83), defence (13 per cent on these figures, now higher), health (12 per cent), law and order (4 per cent). Beyond these (well over half the total), there are tight constraints on cutting back many other programmes - e.g. EEC, agriculture, industry, employment, education. Much of the rest is current spending by local authorities, where there is the problem of control. In deciding whether a reduction below the White Paper totals should be the over-riding aim, Ministers must in effect ask themselves:

Is it realistic to look for further cuts in most of these programmes?

(IV) Additional bids. These are over £6bn. (cash) or 5 per cent of the total. The Treasury's aim implies either rejecting these or offsetting them by extra cuts elsewhere. But the additional bids are by no means all for optional volume additions. They are of various kinds [as the Chancellor says]:

(i) Cash squeeze. Under cash planning, any cash squeeze due to higher prices or pay this year is carried forward into the base for next year. Perhaps £1 bn. (including $\frac{1}{2}$ bn. for local authorities) more cash is needed now to buy the volume planned for 1982/83 in the White Paper.

(ii) Prices. Nearly £1 bn. of bids is for expected pay and price increases higher than the average (provisionally 7 per cent).

(iii) Nationalised Industries. Bids for increased EFLs amount to $\frac{1}{2}$ bn. - mainly to offset the impact of recession. If investment is not to be cut, nor prices increased, reducing the bids requires cuts in current costs (i.e. greater efficiency). In some industries, redundancy payments may make it impossible to do this at least in the first year.

(iv) Local authorities. If the Government cuts back on RSG, differentially or across the board, the main result will be higher rates.

(v) Current vs. capital. Ministers will want to hold back current spending where possible to make room for productive capital investment

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and other forms of "spend to save". The Chancellor's paper discusses a pay/capital trade-off. Otherwise, central Government manpower is already being squeezed. Are there other forms of current spending (e.g. some social security payments) which could be held back?

(vi) Employment. Ministers have asked for further work on the £1.4 bn. bid and other options. A medium-term package which meets the Government's objectives will not be easy to find without adding substantially to present expenditure totals (even net).

The question for Ministers is:

Can the case for these additional bids be over-ridden in the interests of achieving the tax objective?

Conclusion

3. In summary, the question before Ministers is whether they are prepared to mount now a much more aggressive attack on current spending than they have found possible so far. Otherwise the Government's taxation and public expenditure objective will not be achieved. In the private sector, firms have had to find ways of meeting cash crises by drastic action to cut back, often by doing things they had previously regarded as unthinkable.

Can the public sector be made to yield dramatic further cuts in current spending?

Table 1.7
Total public expenditure by programme

	1981-82	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81 estimated	1981-82	1982-83	1983-84
	£ billion projected cash spend(1)	9,436	9,287	9,082	9,026	9,294	9,746	9,750	10,050	10,350
		707	680	720	805	788	803	741	680	680
Overseas aid and other overseas services:		16	281	632	774	826	380	392	390	390
EEC contributions		453	445	552	442	455	465	459	460	460
Other overseas services		2,369	1,433	1,133	971	1,010	1,150	1,005	980	920
Agriculture, fisheries, food and forestry		4,850	4,328	2,854	3,530	2,929	3,899	4,023	3,080	2,460
Industry, energy, trade and employment		3,953	3,531	2,983	2,915	2,967	2,824	2,736	2,670	2,670
Transport		6,072	5,880	5,093	4,728	4,928	4,256	3,143	2,720	2,230
Housing		3,729	3,425	3,308	3,351	3,210	3,064	2,976	2,880	2,860
Other environmental services		9,421	9,393	9,011	9,171	9,236	8,909	8,544	8,360	8,190
Law, order and protective services		8,618	8,700	8,746	8,973	9,003	9,067	9,234	9,400	9,480
Education and science, arts and libraries		15,737	16,246	17,093	18,644	19,106	19,775	21,161	21,600	21,400
Health and personal social services		1,023	954	919	914	931	941	973	930	920
Social security		1,088	1,108	1,079	1,068	1,103	1,106	1,183	1,180	1,230
Other public services		4,589	4,518	4,368	4,462	4,530	4,399	4,271	4,170	4,100
Common services		1,795	1,803	1,744	1,766	1,788	1,737	1,676	1,630	1,600
Scotland		2,300	2,294	2,278	2,466	2,437	2,472	2,436	2,410	2,410
Wales		1,694	415	-281	812	1,857	2,050	1,400	350	-150
Northern Ireland										
Government lending to nationalised industries										
Adjustments										
Nationalised industries' net overseas and market borrowing(2)		861	1,853	1,187	537	-322	-500	-585	-400	-550
Special sales of assets		-	-	-697	-	-999	-325	-175	-125	-125
Contingency reserve		-	-	-	-	-	193	1,500	2,000	2,000
General allowance for shortfall		-	-	-	-	-	-	-500	-500	-500
Planning total		81,283	79,202	74,375	77,951	77,776	79,245	79,225	77,900	76,000

(1) See paragraph 9.

(2) Including Civil Aviation Authority.