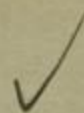


MOST CONFIDENTIAL RECORD



Inc.....

**SUBJECT**

Cc (81) 29<sup>th</sup> CONCS.

23 JULY 1981

1981. PUBLIC EXPENDITURE SURVEY.

No.	Contents	Date

MOST CONFIDENTIAL RECORD  
TO  
CC(81) 29th CONCLUSIONS

Thursday 23 July 1981

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1981 PUBLIC  
EXPENDITURE  
SURVEY

Previous  
References:  
C(81) 23rd  
Conclusions and  
CC(81) 22nd  
Conclusions,  
Minute 5

The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(81) 37) on tax and public expenditure; memoranda by the Chief Secretary, Treasury (C(81) 38) and the Secretary of State for the Environment (C(81) 40) on local authorities' current expenditure in 1982-83; and a note by the Secretary of the Cabinet (C(81) 39) covering a note by the Central Policy Review Staff (CPRS) on public expenditure.

THE CHANCELLOR OF THE EXCHEQUER said that, contrary to the Government's expectations and promises, the burdens of tax and of public expenditure had both increased since 1979. The present burden of tax was one of the main factors hindering the growth of new employment opportunities. To widen the gap between the incomes of those in and out of work, to improve incentives for the lower-paid and to ease the poverty trap, a priority should be to raise substantially the starting point for income tax; in particular, it would be essential in the next Budget to avoid again withholding "Rooker-Wise" increases in personal tax thresholds, but he was not proposing at this stage any further reductions in income tax. It was also necessary to reduce the tax burden on business, probably by a reduction in the National Insurance Surcharge. Tax reductions of this kind were a better way of stimulating real employment, and with better long-term consequences, than additional public expenditure. To bring inflation down well into single figures and to permit a fall in interest rates over the medium term, it was necessary to keep to the medium-term financial strategy, and progressively to reduce the Public Sector Borrowing Requirement (PSBR) as a proportion of Gross Domestic Product (GDP). If, however, the financial markets were to take the view that the Government's determination was weakening, the economic strategy, and the reduction of inflation, would be increasingly vulnerable to the effects of high interest rates in the United States of America. The key to tax reductions lay in reducing the prospective totals of public expenditure. There were, however, serious problems in reducing the totals even to those in the 1981 Public Expenditure White Paper (Cmnd 8175). The present returns showed additional bids in 1982-83 of £6½ billion in cash, of which about £2½ billion was for additions to the nationalised industries' External Financing Limits (EFLs) and nearly £1½ billion for measures to reduce unemployment. Against this background, he

SECRET

invited the Cabinet to endorse the general approach to the 1981 Public Expenditure Survey indicated in C(81) 37, and in particular the overriding aim of getting the overall expenditure totals below those derived from Cmnd 8175 so as to make possible, within the overall economic strategy, the tax reductions necessary for fulfilling the Government's economic and employment objectives.

In discussion the following were the main points made -

- a. The Chancellor of the Exchequer's paper was inadequate, because it did not provide the Cabinet with the figures which would be the only sensible basis for discussion: such figures as (for example) the expected outturn for 1981-82, and the Chancellor of the Exchequer's forecasts and assumptions on the proportion of public expenditure to GDP.
- b. The approach recommended by the Chancellor of the Exchequer did not offer a sufficiently imaginative and practicable response to the acute social and political problems now confronting the Government. A strategy centred on reductions of taxation and public expenditure would be irrelevant to the problems of Northern Ireland, or to those of Merseyside and other areas of urban dereliction and deprivation. Merseyside in particular was a community which was visibly falling apart, its hopelessness and despair compounded by the lack of commitment to the area of any of the wealth-creating institutions in the country. With unemployment totals rising to 3 million later in the year, and following the recent rioting in a number of cities, the tolerance of society was now stretched near to its limit. To give people renewed hope and confidence for the future, it was essential to take new and constructive action urgently.
- c. Such action could build on the many substantial improvements which the Government had achieved in the last two years and which provided a sound base from which to respond to a revival in growth, as the present world-wide recession came to an end: for example, improvements in management methods, in productivity, in competitiveness, and in the structure of business taxes, particularly those affecting small firms. To consolidate these achievements and reap the benefits of them required the continuance in office of the Government through the next Parliament; without that the achievements would be thrown away. If action were delayed for too long, it would then be seen as a panic reaction to mounting problems; if it came too late, it would risk wasting the improvements which the Government had made.

SECRET

SECRET

d. Many people were now far more worried by the problems of unemployment than by levels of tax. Priority should now be given to measures to reduce unemployment, on the lines of those proposed by the Secretary of State for Employment and others; further jobs should be generated, and useful assets created, by increasing capital investment in the public sector and by expenditure to stimulate investment in the private sector. If people were convinced that the Government was taking a major and constructive initiative to tackle these problems, they might well be prepared to accept some sacrifices to ensure that the objectives were achieved.

e. It was suggested that people might be prepared to accept a severe limitation, or even a freeze, on pay increases, if it could be shown to provide resources for increased investment and special employment measures. If there were any question of limiting the uprating of social benefits, that would surely need to be accompanied by some such limitations on incomes. On the other hand, while it was clearly desirable to aim for and encourage low pay increases, it was unrealistic to think in terms of a wage freeze or of increases limited to 1 or 2 percentage points. Indeed, such limitations could be positively damaging if they were to depress demand for goods and services or to lead to any sharp escalation of bids for pay increases either immediately before or after the period of pay limitation. It was very doubtful whether the approach, discussed in the Annex to C(81) 37, whereby some particular groups might accept a trade-off between pay and capital investment in their sector, was realistic. There was no reason, for example, why doctors or nurses should accept relatively low pay awards in order to finance the construction of hospitals.

f. In addition to implementing in full in the next Budget Rooker-Wise increases in personal tax thresholds, there was also a case for restoring the benefits lost from the abatement of such increases in previous Budgets. On the other hand, it was for question whether priority should be given to tax reductions to the extent proposed by the Chancellor of the Exchequer. The assertion that tax reductions were a better way of stimulating employment than additional public expenditure was open to question. As the CPRS had suggested, the Cabinet needed more information on the employment implications of particular tax and expenditure options, if they were to select the approach which offered the best prospects of dealing with unemployment.

g. Given the present estimate of additional bids of £6½ billion in 1982-83, it would be a herculean task to contain public expenditure totals to the levels in Cmnd 8175, let alone to reduce

SECRET

SECRET

them further. It was unrealistic to look for yet further cuts on those programmes which had already borne the brunt of the succession of previous exercises to cut expenditure; the defence budget had already been decided in volume terms; there would be major political difficulties in any attempt to limit upratings in social security and unemployment benefits; and there were strong pressures for further expenditure on the law and order programmes, particularly the prison service, and to deal with the aftermath of the recent riots. It would be important to reduce the major overrun of £2½ billion on the nationalised industries' EFLs, but at a time of recession some overrun was to be expected. It had generally to be recognised that further cuts in public expenditure would be damaging to employment prospects and to private sector industry. It seemed unrealistic to look for a declining PSBR, as a proportion of GDP, at a time of economic recession.

THE PRIME MINISTER, summing up the discussion, said that, before reaching a view on the balance between taxation and public expenditure objectives, the Cabinet wished the Chancellor of the Exchequer to present them with a fuller evaluation of the options than in C(81) 37. In particular, they wanted more information on the employment implications of particular tax and expenditure options; a fuller assessment of the realism of looking for reductions in public expenditure to the levels assumed in Cmnd 8175, or below; more information on the make-up of the present additional bids in 1982-83 of £6½ billion; and an indication of the Chancellor of the Exchequer's present assumptions on the level of the PSBR in relation to GDP this year and next. In further discussion, it would be necessary to weigh the possible benefits of further expenditure on capital investment, and the consequences of not reducing public expenditure totals to at least Cmnd 8175 levels, against the risks and consequences, not only to the Government's broad objectives but also to confidence in the currency, of any departure from the medium-term financial strategy; in particular, it was essential to recognise the impact of any further increase in inflation on those whose savings and income were not protected by index-linking.

The Cabinet -

1. Invited the Chancellor of the Exchequer to circulate a further memorandum on the factors relevant to decisions about public expenditure in 1982-83 and later years.
2. Agreed to resume their discussion of the 1981 Public Expenditure Survey when that memorandum was available.

SECRET

SECRET

3. Agreed to resume consideration of the memoranda by the Chief Secretary, Treasury, and the Secretary of State for the Environment at a later meeting.

Cabinet Office

27 July 1981

SECRET