C(82) 32

COPY NO 83

6 September 1982

CABINET

PUBLIC EXPENDITURE IN THE LONGER TERM

Note by the Secretary of the Cabinet

I attach, as background for the Cabinet's discussion on Thursday 9 September, a report by HM Treasury Steering Group on Longer Term Trends in Public Expenditure.

Signed ROBERT ARMSTRONG

Cabinet Office

6 September 1982

PUBLIC EXPENDITURE IN THE LONGER TERM

A Report by an Interdepartmental Group of Officials

INTRODUCTION

1. This report considers the way in which the costs of the Government's public expenditure policies could develop over the rest of the decade, against the background of some assumptions about economic developments over this period.

2. The aim is not to forecast total public expenditure, or individual programmes, or the course of economic development. The public expenditure figures have been built up on the basis of the continuation of current policies at the programme level, and the economic scenarios have been constructed on specific assumptions. One should beware of any spurious sense of precision. The figures for individual programmes are not to be regarded as bids or targets, and the results cannot be other than very broad brush.

3. The report presents a snapshot of 1990. It also, in the notes on individual programmes in Annex 2, offers some comments on the path by which some of the programmes might achieve the levels shown for them in 1990. In general, however, it is not concerned with possible developments regarding public expenditure in the period between 1984-85 (the last year covered by Cmnd 8494) and 1990-91. But it is clear that if the Government intends significantly to influence the outcome as regards public expenditure in 1990-91, the necessary decisions would need to be taken a number of years in advance.

THE TWO ECONOMIC SCENARIOS

4. In considering the longer term implications of the Government's public expenditure stance, the report first adopts a set of assumptions about productivity, inflation, growth and unemployment which would represent a substantial and continuing improvement on our recent national economic performance. This is Scenario A. Its principal features are set out in Annex 1. The assumptions are that inflation will fall and remain at a modest level, that wage restraint, combined with lower tax rates and interest rates, permit rapid rebuilding of profit margins, that productivity continues to grow well, and that economic growth will as a result be sustained at a level well above what has recently been achieved. Such a performance implies an all-round improvement in our affairs, and may not be far short of the best we can expect.

5. But things may not turn out like this. The United Kingdom has long suffered from low efficiency and poor productivity, and there is still much to do to improve the flexibility and performance of the economy. We are highly dependent on what happens in the world economy. The world economic environment remains very difficult. In common with our European neighbours, but to a greater extent than some of them, we have lost competitiveness, and despite some recent improvement will not easily regain it. It is accordingly

necessary to look at public expenditure against the background of much less favourable economic assumptions than in Scenario A. In Scenario B, which is also described in Annex 1, the main differences from Scenario A relate to productivity growth ($1\frac{1}{2}$ per cent instead of 3 per cent per year in the decade of 1990), Gross Domestic Product (GDP) growth ($\frac{1}{2}$-$\frac{3}{4}$ per cent instead of $2\frac{1}{2}$ per cent) and unemployment and inflation (which stick around their present levels instead of coming down).

6. None of this is to say that events will turn out precisely according to either of these scenarios. They are hypotheses, not forecasts; it would in particular be a mistake to suppose that a prediction of the future can be obtained by splitting the difference between them. But they seem to cover an adequate range of possibilities against which to examine public expenditure trends in the light of the Government's objectives.

7. These economic scenarios interact with public expenditure trends in two ways. On the one hand assumptions on economic growth, inflation, unemployment, interest rates, productivity and earnings growth are needed to cost the programmes. On the other hand the taxation and interest rate consequences of public expenditure have implications for the supply side of the economy and for employment and productivity. The presumption underlying Scenario A is that expansion of the private sector provides the main engine for growth in the economy and that this expension would be promoted by reductions in taxation and interest rates and hence in total public expenditure as a proportion of GDP.

THE PUBLIC EXPENDITURE PROJECTIONS

8. In making the public expenditure projections it has been assumed that the Government will continue to constrain the size of the public sector by privatisation and restraint on expenditure. Firm intentions to privatise have been reflected in the expenditure figures, but no account has been taken of any substantial further privatisation. Allowance has been made for changes in expenditure as a result of demographic changes, and, for some economic services such as transport, for the likely growth in national income. But only limited allowance has been made for the likely increase, if national income grew as assumed in Scenario A, in the public's demand for some of the public services, notably health, education, and environmental services, and for increasing real social security benefits. (Social security benefits, for example, are assumed to increase by less than earnings.) International evidence suggests that this demand could increase on a significant scale. The Government is not obliged to meet it and may decide to divert it into privately provided services. But the scope for such diversion is limited over this period. And local authority expenditure, although projected to continue its relative decline, may continue to be difficult to control.

9. The projections have been combined with the two economic scenarios to show what could happen to public expenditure as a proportion of GDP. This proportion is also a measure of the ratio of taxation and Government borrowing to GDP; although to the extent that this is reduced by privatisation resources will not be released for expansion elsewhere. Privatisation of a corporation for example will move its borrowing from the public to the private sector, but this will not reduce interest rates.

10. The inflation assumptions in the two scenarios are very different, so it is not easy to interpret differences in expenditure between the scenarios when the figures are set out in current prices. The figures have therefore also been deflated by the inflation indices assumed in the two scenarios. This avoids measurement problems caused by changes in the value of money, but takes account of changes in the relative costs of different elements in the various programmes. This means that the programmes, and the totals are expressed both in what are called "cost terms" and as a proportion of GDP.

11. The projections assume that levels of services over the period to 1990 will not, taking one year with another, be squeezed on account of inflation. The levels of service at which it would be appropriate for Ministers to aim if inflation were high is a matter for future decisions.

12. Figure 1 shows how, compared with 1979-80 and 1982-83, total public expenditure could develop on the basis of the two economic scenarios.

13. In cost terms, the 1990-91 programme total (the term programme total is used here to describe total public expenditure as defined in Cmnd 8494 and previous public expenditure White Papers; also shown in figure 1 is the wider total including debt interest and some other adjustments, often used for comparisons with GDP; the figures for 1979-80 are outturn and those for 1982-83 are Cmnd 8494 adjusted for the changes in public expenditure announced in the Budget;) in Scenario A is 20 per cent higher than it was in 1979-80. In Scenario B it is 18 per cent higher. As a percentage of GDP the total in Scenario A falls, compared with 1979-80, by a little over 1 percentage point, taking it back to where it stood in 1971-72. In Scenario B it increases by nearly 6 percentage points.

14. Comparison of 1990-91 with 1982-83 shows the programme total in cost terms at nearly 14 per cent higher in Scenario A and 13 per cent higher in Scenario B; as a percentage of GDP the total is nearly 4 points lower in Scenario A and 3 points higher in Scenario B. But this is in part because public expenditure in 1982-83 as a percentage of GDP has been increased by economic recession; this has reduced GDP and increased social security expenditure. It may therefore be a less satisfactory basis for comparison.

15. Figures 2 and 3 show how the various major programmes could contribute to these changes, expressed both as a proportion of GDP and in cost terms. In both scenarios the share of GDP devoted to defence would be higher in 1990-91 than in 1979-80; although with no non-pay relative price effect there would in Scenario A be no increase over 1982-83. Health and social security are shown as a broadly constant proportion in Scenario A, and a rising proportion in Scenario B. Education is shown as a declining proportion in both cases. The share of economic services (agriculture, industry, transport, nationalised industry borrowing), tends to fall, as does that of environmental services (housing, water and sewage, etc).

16. In cost terms, increases in major programmes from 1979-80 to 1990-91 on the basis of the assumptions in this report would be -

a. 35 to 50 per cent in defence expenditure, depending in part on the assumed non-pay relative price effect;

b. 30 to 35 per cent in the law and order programmes;

c. 25 to 35 per cent in expenditure on health due largely to demographic pressures;

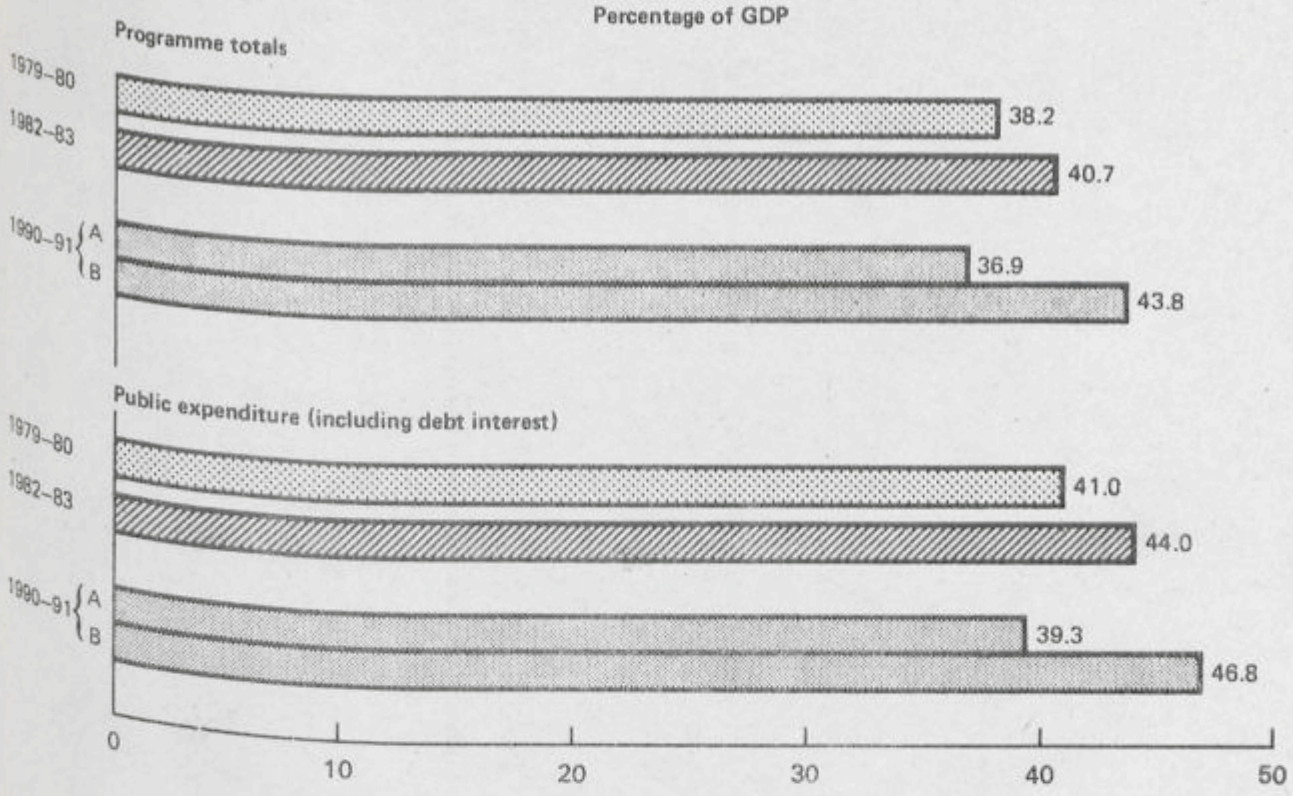
d. 20 to 25 per cent in the social security programme, even though demographic changes are relatively favourable for this programme in the 1980s, compared with the 1970s or the 1990s.

The cost of education would be slightly higher in Scenario A than Scenario B if economic growth increased the real earnings of teachers. Different economic situation could affect infrastructure and industry programmes; higher growth is taken, for example, to involve more road buildings; a sluggish economy could involve more assistance to industry and employment and housing expenditure.

FIGURE 1

Public expenditure

Percentage of GDP



£billion, 1980-81 cost terms

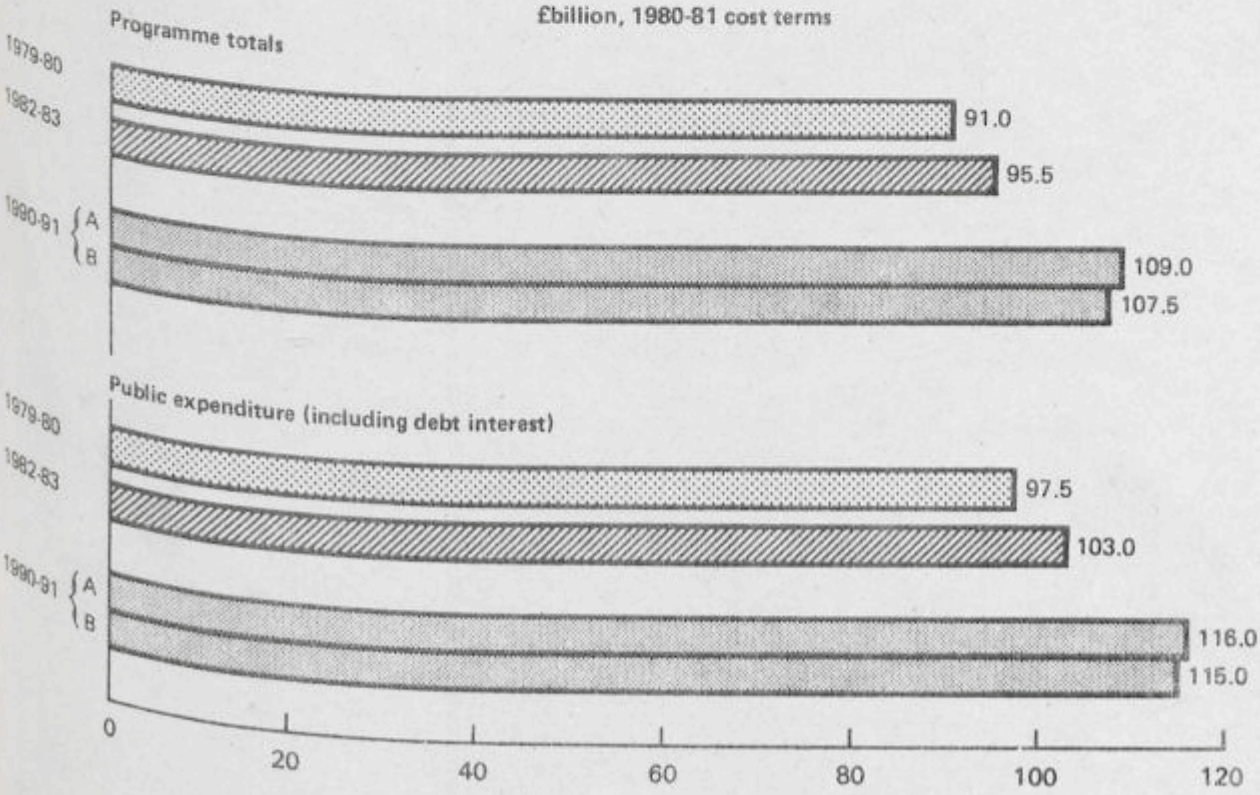
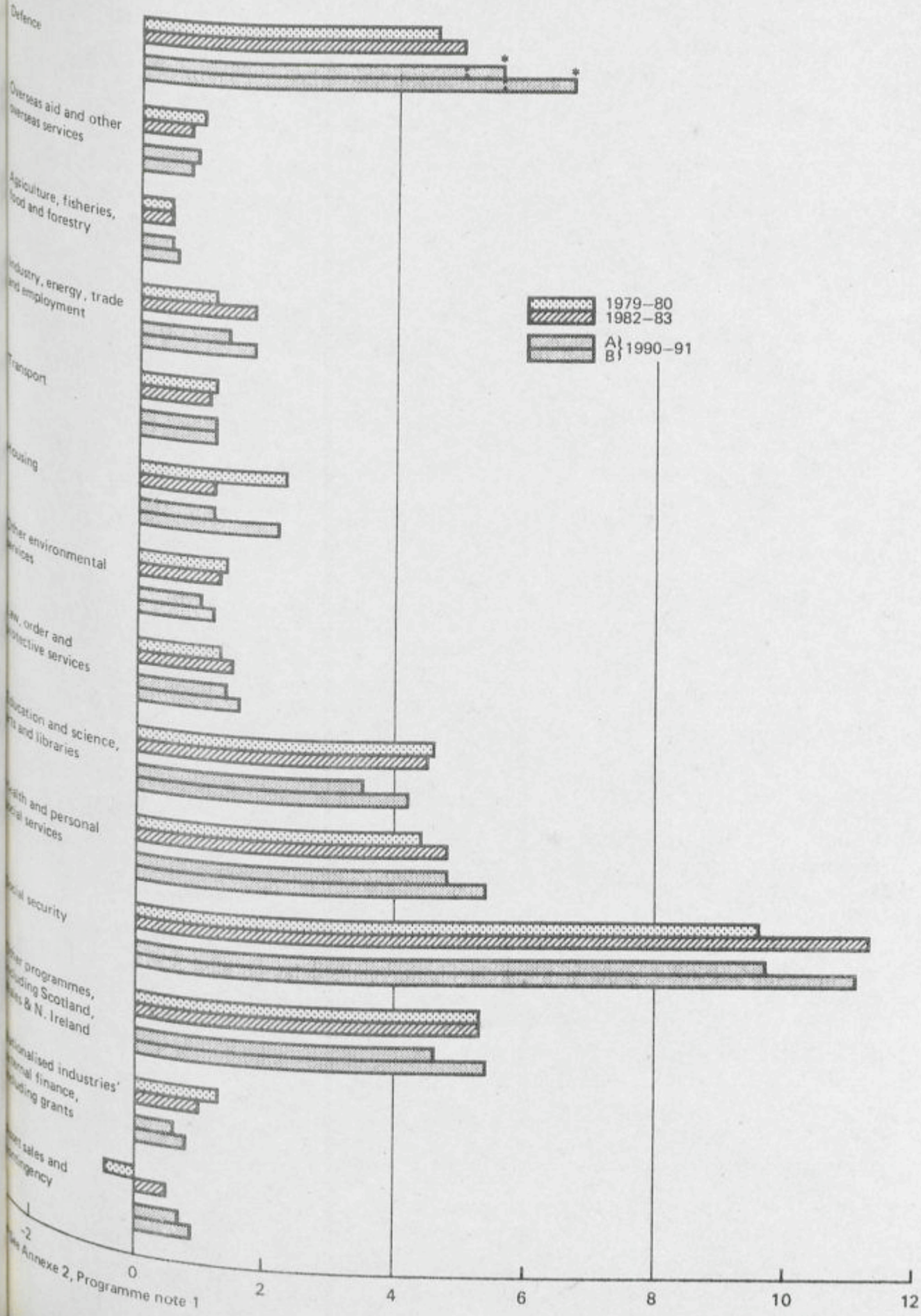


FIGURE 2

Public expenditure programmes

Percentage of GDP

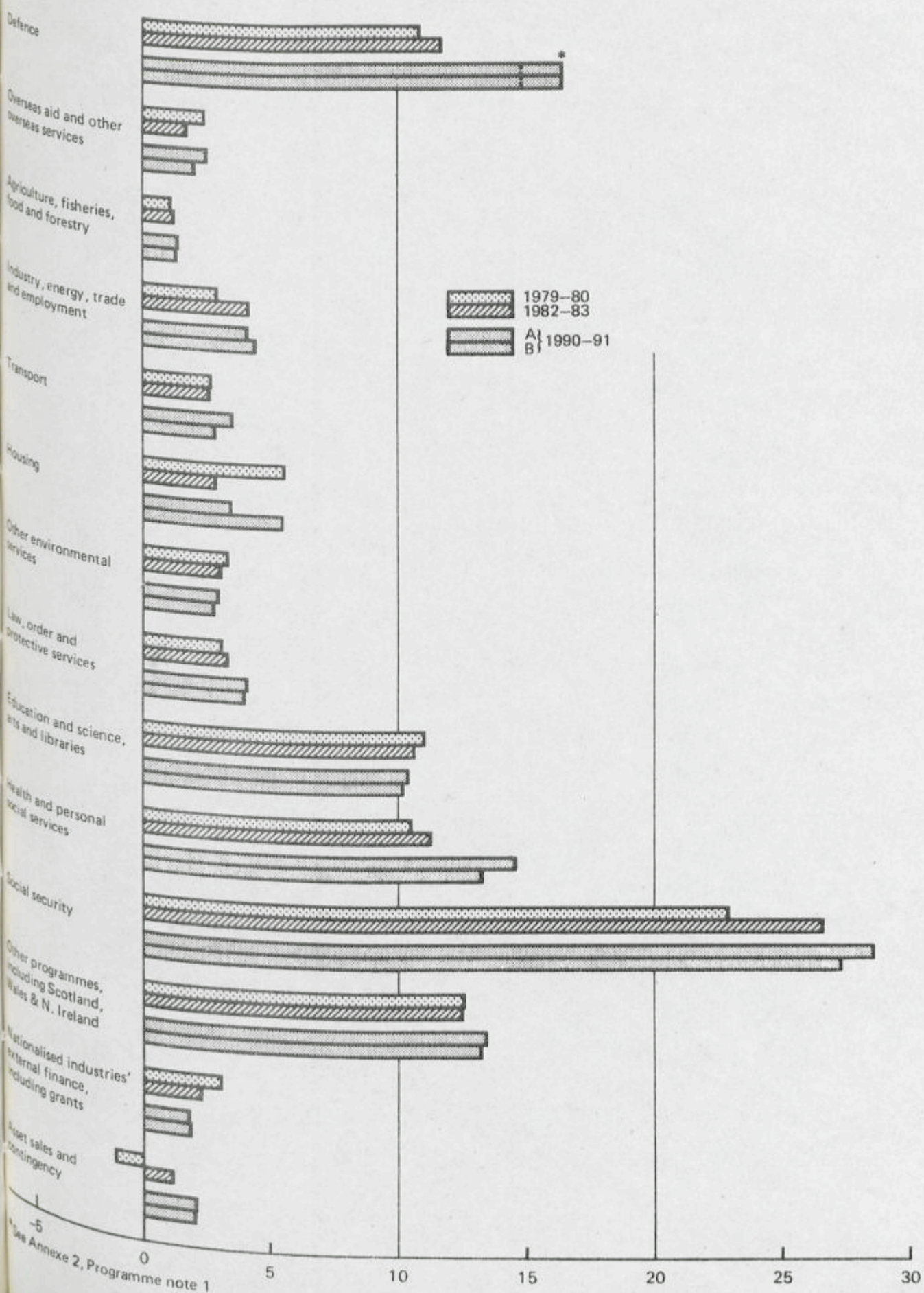


See Annexe 2, Programme note 1

FIGURE 3

Public expenditure programmes

£billion, 1980-81 cost terms



* See Annexe 2, Programme note 1

ANNEX 1

ECONOMIC SCENARIOS

The main assumptions of Scenarios A and B are summarised in Table 1. In Scenario A, economic growth in the 8 years to 1990-91 is similar to that of the 1950s and 1960s. In Scenario B growth is similar to that of the last 8 years. These growth rates are combined with the productivity assumptions and a small growth in the labour supply, to give consistent figures for unemployment.

2. Inflation is assumed to settle at 5% per year in Scenario A and 10% per year in Scenario B, although this has little direct effect on the public expenditure projections.

3. Scenario A assumes high productivity growth but, in the early years, much lower real wage growth. In Scenario B, real wages grow more rapidly than in Scenario A in the early years and more slowly in the later years. Public service wage growth is assumed in both scenarios to fall behind that in the marketed sector to 1982-83; thereafter wages in both sectors are assumed to grow at the same rate.

4. The change in public service wages relative to average GDP prices is a "relative price effect". This "pay-RPE" has been taken into account in projecting the public service expenditure programmes.

CONFIDENTIAL

BLE 1: ECONOMIC SCENARIOS - MAIN ASSUMPTIONS

	SCENARIO A	SCENARIO B
P (average annual growth rate rom 1980-81)	2¼%	¾% to 1985-86 then ½% to 1990-91
oductivity in the marketed ector (average annual rowth rate from 1980-81)	3%	1½%
employment (narrow definition, xcluding school leavers)	2 million in 1990-91	3 million in 1990-91
flation (GDP deflator)	5% per year in mid and late 1980s	10% per year in mid and late 1980s
al interest rate	2% in 1990-91	2% in 1990-91
al trade-weighted xchange rate (1980-81 = 100)	83 in 1990-91	83 in 1990-91
al marketed sector wages verage annual increase rom 1980-81)	1½%	1½%
al public service wages verage annual increase rom 1980-81)	½%	¼%

ANNEX 2

EXPENDITURE PROGRAMMES

1. DEFENCE

1.1. The likely path of defence expenditure over the next decade is determined by the Government's commitment to the NATO target of 3 per cent annual real growth. At present this commitment does not extend beyond 1985-86. The UK supported the 1981 NATO Ministerial Guidance extending the Alliance's commitment to 1988.

1.2 In both scenarios, 3 per cent per year real growth is assumed, starting from the 1982-83 cost terms figure. It is assumed that the Government's commitment will be extended to the end of the NATO target period (1988-89) and there will be 1 per cent annual growth thereafter.

1.3. For the relative price effect (RPE) of non-pay expenditure alternative assumptions have been adopted of zero and 2 per cent positive from 1982-83. The effect of these assumptions on the projections for 1990-91 is shown in the table below.

TABLE 1.1. DEFENCE EXPENDITURE

	1979-80	1982-83	1990-91			
			A		B	
Non-pay RPE (increase per year) 1982-83 to 1990-91	-	-	0	2%	0	2%
£m (1980-81 cost terms)	10880	11732	14800	16400	14800	16400
% GDP	4.6	5.0	5.0	5.6	5.6	6.7

2. OVERSEAS AID AND OTHER OVERSEAS SERVICES

2.1 Like most developed countries we are committed to achieving a level of overseas aid of 0.7 per cent of GDP, but in general there is no commitment to a date. At present, the UK aid programme is fluctuating about 0.4 per cent of GDP, slightly above the OECD average. It is likely that cash expenditure on the aid programme will increase less rapidly than nominal GDP up to the mid-1980s.

2.2 The projections assume that in Scenario 'B', the aid programme will return to a level of 0.4 per cent of GDP by 1990-91. In Scenario 'A', some modest progress towards the 0.7 per cent target is assumed, reaching 0.5 per cent of GDP by 1990-91.

2.3 The other programmes for which the ODA is responsible (the aid administration vote; supplements etc to certain overseas pensions plus, from 1982-83 to 1984-85, foreign currency borrowing of £15m a year by the CDC) are de minimis in the context of this exercise, and are assumed to stay at roughly their present level in cost terms.

2.4 Other FCO expenditure will be affected to some degree by planned reductions in civil service expenditure and the general desire to achieve economies, although some of the expenditure (such as international subscriptions) cannot be unilaterally reduced. It has been assumed that this block of expenditure, and the small item covering the Commonwealth War Graves Commission, will remain broadly constant after allowing for inflation worldwide and exchange rate fluctuations.

2.6

TABLE 2.1 EXPENDITURE ON OVERSEAS AID AND OTHER OVERSEAS SERVICES, EXCLUDING NET PAYMENTS TO EC INSTITUTIONS

	1979-80	1982-83	1990-91 A	1990-91 B
£m (1980-81 Cost terms)	1470	1363	2020	1510
% GDP	0.6	0.6	0.7	0.6

2.5 Net contributions to the European Community Budget are currently much lower than they would have been but for the refunds negotiated under the 30 May Agreement. That Agreement also commits the Community to avoid the recurrence of unacceptable budget situations for any member state. There will be strong pressure operating during the 1980's which will tend to increase the UK's net contributions before refunds: the growing costs of supporting farm incomes and disposing of surpluses this may produce, the extension of the Common Agricultural Policy to cover Mediterranean products and the accession of Spain and Portugal to the Communities. Maintenance of the ceiling on the Communities "own resources", under which they are entitled to the yield of a value-added tax not exceeding the 1 per cent of the value of transactions incorporated in the harmonised spending base, may help to contain EC expenditure on these policies. But a satisfactory outcome for the UK net contributions will depend on our success in persuading the Community to provide budget refunds on an acceptable scale.

TABLE 2.2 NET PAYMENTS TO EUROPEAN COMMUNITY INSTITUTIONS

	1979-80	1982-83	1990-91 A	1990-91 B
£m (1980-81 Cost terms)	1010	415	500	500
% GDP	0.4	0.2	0.2	0.2

2.6 Aggregate expenditure on Programme 2 is summarised in Table 2.3

TABLE 2.3 TOTAL EXPENDITURE ON OVERSEAS AID AND OTHER OVERSEAS SERVICES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 Cost terms)	2480	1778	2520	2010
% GDP	1.0	0.8	0.9	0.8

3. AGRICULTURAL, FISHERIES, FOOD AND FORESTRY

3.1 A large part of the expenditure covered by this programme is affected by the rules of the Common Agricultural Policy, for which both the future direction of policy and the basis for funding are very uncertain over the longer term.

3.2 The projections are based on the assumption that, apart from the completion of the Thames tidal defences, expenditure by MAFF increases at 1 per cent per year in cost terms from the level of the mid 1980's, as does Forestry Commission expenditure, while expenditure by the Intervention Board for Agricultural Produce increases at about 2 per cent per year throughout the decade. The projections exclude an allowance for capital expenditure by RWA's, as explained in para 8.2 (Other Environmental Services).

3.3 Main programme 3 includes some expenditure outside England, but teritorial programmes also include expenditures on agriculture. These are assumed to amount to £200m (1980-81 cost terms) in 1990-91 for both scenarious, ie similar to their relative size in 1980-81.

TABLE 3.1 EXPENDITURE ON AGRICULTURE, FISHERIES, FOOD AND FORESTRY

	1979-80	1982-83	1990-91	
			A	B
MAFF				
£ (1980-81 Cost terms)	650	577	520	510
% GDP	0.3	0.2	0.2	0.2
IBAP				
£ (1980-81 Cost terms)	435	570	840	820
%GDP	0.2	0.2	0.3	0.4
Forestry				
£ (1980-81 Cost terms)	55	53	50	50
% GDP	-	-	-	-
TOTAL				
£ (1980-81 Cost terms)	1140	1200	1410	1380
% GDP	0.5	0.5	0.5	0.6

4. INDUSTRY, ENERGY, TRADE AND EMPLOYMENT (excluding grants to nationalised industries)

4.1. Industry

Expenditure by the Department of Industry on Regional and General Industrial Support should fall in real terms by about one third between the early 1980's and 1990-91. This fall is the effect of the assumption that support for "problem companies" would only be about £200m a year as compared with the peak of about £800m for BL and Rolls Royce in 1981-82. It is assumed that regional and other industrial support will continue at roughly the level of the early 1980's while Scientific and Technological Assistance is on a rising trend and some provision is also made for future "launch aid" projects.

TABLE 4.1
EXPENDITURE BY THE DEPARTMENT OF INDUSTRY,
(excluding assistance to steel and shipbuilding)

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	1135	1085	1170	1170
% GDP	0.5	0.5	0.2	0.3

4.2. Energy

The main items of expenditure by the Department is 1990-91 are likely to be nuclear research and development, non-nuclear research and development including that on alternative sources of energy, and payments to redundant coalmine workers (which do not count towards the NCB's EFL). These programmes are unlikely to be very sensitive to differences in economic growth in the next few years. The level of research and development expenditure on nuclear and other sources of energy, for example, will depend on forecasts of requirements and returns in the much longer term. However, £30m more has been provided for payments to redundant mineworkers in Scenario 'B' to allow for

further improvements in the terms of the scheme in order to give greater encouragement to men to leave the mines. The forecast assumes a substantial decline in expenditure on development of the Fast Reactor. If the UK enters a collaborative agreement to develop this technology expenditure could be rather higher, if a decision was taken to construct a Commercial Demonstration Fast Reactor it would be significantly higher. No allowance has been made for substantial Government expenditure on a Severn Barrage or on large-scale demonstration of wind or wave power or of combined heat and power schemes.

TABLE 4.2

EXPENDITURE BY THE DEPARTMENT OF ENERGY
(excluding grants to nationalised industries)

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	300	325	250	280
% GDP	0.1	0.1	0.1	0.1

4.3. Trade

Expenditure in 1979-80 was higher than in previous years but is expected to decline as grant in aid to the Civil Aviation Authority ends with the move to full cost pricing. Thereafter, expenditure can be expected to remain roughly constant in real terms at a level similar to that in 1980-81.

TABLE 4.3.
EXPENDITURE BY THE DEPARTMENT OF TRADE

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	230	220	220	220
% GDP	0.1	0.1	0.1	0.1

4.4. ECGD

With the phasing out of loans to banks to refinance a proportion of their fixed rate sterling export lending, the main expenditure by ECGD will in future be on interest support costs. Future expenditure on this item depends heavily on market interest rates, but the total ECGD expenditure will depend on the rate of repayment of outstanding refinance.

TABLE 4.4.

EXPENDITURE BY ECGD

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	- 55	305	150	150
% GDP	-	0.1	0.1	0.1

4.5. Employment

Much of the Department of Employment's expenditure is related to the state of the labour market. But this does not imply that, in all cases, expenditure can simply be projected on that basis.

Likely policy reactions to continued high levels of unemployment are difficult to judge. But past experience indicates that expenditure on special job creation measures should most realistically be projected on the basis that it is broadly proportional to the level of unemployment (ie negatively correlated with GDP growth). Some allowance should also be made for pressures over time to contain the unit costs of schemes which take on a permanent status.

Expenditure on redundancy payments is also related to unemployment, though to its assumed rate of change rather than its level.

However, it is doubtful whether there is any straightforward correlation between expenditure on training and the growth of GDP. Following the introduction of the Youth Training Scheme, such expenditure is planned to reach £1.5 billion in cash terms in 1984-85. It may be that faster growth could provide both the incentive and the means for employers to conduct and pay for more of their own training. Alternatively, there could be pressure for more public expenditure to accelerate the process of economic adaptation. These conflicting possibilities cannot be satisfactorily reconciled, and it would be entirely speculative to assume any shift in policy to require employers to increase their contribution to training costs. The projections are therefore based on the maintenance in real terms of planned training expenditure in 1984-85.

TABLE 4.5.

EXPENDITURE BY THE DEPARTMENT OF EMPLOYMENT

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	1455	2216	2320	2660
% GDP	0.6	0.9	0.8	1.1

4.6. Total expenditure on Programme 4, excluding assistance to nationalised industries is shown in Table 4.6.

TABLE 4.6

EXPENDITURE: INDUSTRY, ENERGY, TRADE AND EMPLOYMENT
(excluding grants to nationalised industries)

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	3065	4151	4110	4480
% GDP	1.3	1.8	1.2	1.6

5. GOVERNMENT LENDING TO NATIONALISED INDUSTRIES

5.1. Grants to and borrowing by nationalised industries are incorporated in Section 16. Grants are subtracted from Programmes 3, 4 and 6 to avoid double counting. It is more appropriate in the context of the study to consider Nationalised Industries' demands for external financing as a whole than to separate grants and borrowing as is done in Cmnd 8494.

6. TRANSPORT (excluding grants to nationalised industries)

Roads and Local Transport

6.1 Transport is not mentioned in the 1979 Manifesto, and there is some flexibility about levels of expenditure. Successive Roads White Papers have however identified infrastructure projects which assist industry and improve the environment as a priority.

6.2 In general, demand for expenditure on roads reflects the need to increase road space as traffic grows and to prevent uneconomic deterioration in existing roads with later increased costs of repair. Demand for local expenditure on public transport reflects in part objective difficulties of adapting traditional services to increasing competition from the private car and in part subjective judgements of the need to provide services at less than cost to various classes of traveller or to all.

6.3 Road traffic - both private car and lorry - is forecast by Department of Transport to grow despite increasing fuel prices throughout the period and for some decades beyond. If GDP grows at the upper end of the range considered traffic is likely to increase faster than Department of Transport plans at present assume.

6.4 Even though much of the motorway construction programme begun in the 1960s has been completed pressures for expenditure on road construction are likely to continue during the period. The emphasis may begin to shift away from inter-urban road building towards faster improvement of urban roads which will otherwise become increasingly congested. The need for road maintenance is likely to increase particularly in Scenario A. Although levels of expenditure on roads will remain therefore to some extent discretionary substantial reductions might add to costs in the longer term.

6.5 Demand for expenditure on local public transport is unlikely to decrease and there is a contingent threat, unless current policy conflicts with the GLC and Metropolitan Counties are satisfactorily resolved, of increases amounting to £½ to £1 billion by the end of the period.

6.6 The projections in Table 6.1 therefore assume that cost terms expenditure will continue to absorb about 1.1 per cent of GDP in both scenarious.

TABLE 6.1 EXPENDITURE ON ROADS AND LOCAL TRANSPORT*

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 Cost terms)	2410	2390	3250	2640
% GDP	1.1	1.1	1.1	1.1

*Grants to nationalised industries are covered in a separate note

6.7 Transport (excluding Roads and local transport and grants to nationalised industries): The items of expenditure covered in the part of the Department's programme are related to its administration, research and licensing. To be broadly consistent with assumptions for the rest of the programme, they are assumed to change in line with the assumed change in GDP (Table 6.2)

TABLE 6.2 EXPENDITURE ON TRANSPORT (EXCLUDING ROADS AND LOCAL TRANSPORT AND GRANTS TO NATIONALISED INDUSTRIES)

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 Cost terms)	290	288	280	240
% GDP	0.1	0.1	0.1	0.1

Note: Includes expenditure by DOE on other transport services

6.8 Total expenditure covered in this part of the Transport programme is summarised in Table 6.3.

TABLE 6.3

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	2700	2678	3530	2880
% GDP	1.2	1.2	1.2	1.2

7. HOUSING

7.1 Public expenditure on housing has fallen sharply over the last few years. This has resulted from substantial rent increases (which have reduced subsidies from central government and from rate funds by more than 50 per cent), combined with less capital expenditure on new dwellings by local authorities, and an increase in receipts from sales under the 'Right to Buy' legislation in the 1980 Housing Act.

7.2 These trends are unlikely to continue beyond the present financial year. Further increases in the real level of rents would be largely offset by higher rent rebates (now part of Unified Housing Benefit, covered by programme 12), so that there would be little net gain to public expenditure. Some increase in gross capital expenditure is needed simply to maintain the habitability of much of the existing stock and to replace significant numbers of post-war dwellings built by industrial methods that are now becoming structurally unsound and in many cases are completely uneconomic to repair. The peak in sales will be this year; capital receipts thereafter are expected to decline.

7.3 Housing expenditure is likely to be greater in Scenario B than in Scenario A. Private sector housebuilding would probably be lower, so that more public sector expenditure would be needed if the demand from newly-formed households was to be met and the condition of the stock maintained at a level necessary to avoid a reverse in the steady post-war rise in housing standards. Sales might be lower if tenants were deterred from buying by higher mortgage rates; while the effect of these two trends on net capital expenditure, and the higher level of nominal interest rates, would increase the costs charged to Housing Revenue Accounts and thus the need for subsidy.

7.4 In constructing projections of housing expenditure in 1990-91, it has therefore been assumed that in Scenario A the same share of GDP is devoted to housing at the end of the decade as in 1982-83 while in Scenario B it has been assumed that the share will rather less than double, with the level of provision being about the same as in 1979-80.

HOUSING (England)	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	5541	2895	3500	5500
% GDP	2.3	1.2	1.2	2.2

8. OTHER ENVIRONMENT SERVICES

8.1 Expenditure covered by this programme has fallen in cost terms since the mid-70s. This mainly reflects reduced levels of capital expenditure by the Regional Water Authorities (RWAs) and of capital expenditure on local environmental services (refuse collection and disposal, recreation, administration offices and services, environmental health etc). Partially offsetting these reductions has been an expansion in expenditure on urban areas, both under the Urban Programme and by the newly-created Urban Development Corporations. The reductions themselves do not however reflect a continuing decline in requirements and are not sustainable indefinitely.

8.2 In previous years, capital expenditure by RWAs has counted in PES, but it is now proposed that only finance provided by central government (grants and loans) should be included in the main programme, with net market and overseas borrowing and leasing included in the planning total. The figures in the table below are adjusted to reflect this change in treatment; for convenience and consistency with the treatment in this exercise of nationalised industries, the total External Financing Requirement is included. There has been a corresponding change to programme 3 to exclude land drainage capital expenditure by RWAs.

8.3 About three-quarters of the expenditure in programme 8 is carried out by local authorities. Under block grant, local authority priority on current expenditure on particular services (and hence the amount falling under different programmes) is largely a matter for each authority's discretion. The same applies to capital expenditure, under the new capital control scheme. Partly because of this local discretion and partly because of uncertainty surrounding expenditure in urban areas and the financing requirement of RWAs, it is difficult to establish an objective basis for determining likely expenditure trends for this programme. Nor is it clear what effects different economic scenarios might have, since higher rates of growth while possibly reducing the net cost of urban expenditure are likely to place additional strain on water and other infrastructure. It is therefore assumed that the level of provision will be the same in both scenarios, and will in 1990-91 be 10% below the 1980-81 level.

Because of the reductions already achieved since 1980-81, and assuming the EFR of the RWAs continues to decline in cost terms, this allows for some necessary recovery in expenditure on capital programmes from the present level, assuming always that current expenditure is successfully restrained.

TABLE 8.1 EXPENDITURE ON OTHER ENVIRONMENTAL SERVICES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	3389	3117	3000	2840
% GDP	1.4	1.3	1.0	1.2

NB Figures for 1990-91 include RWAs' total external finance, and exclude their capital expenditure

8. OTHER ENVIRONMENT SERVICES

8.1 Expenditure covered by this programme has fallen in cost terms since the mid-70s. This mainly reflects reduced levels of capital expenditure by the Regional Water Authorities (RWAs) and of capital expenditure on local environmental services (refuse collection and disposal, recreation, administration offices and services, environmental health etc). Partially offsetting these reductions has been an expansion in expenditure on urban areas, both under the Urban Programme and by the newly-created Urban Development Corporations. The reductions themselves do not however reflect a continuing decline in requirements and are not sustainable indefinitely.

8.2 In previous years, capital expenditure by RWAs has counted in PES, but it is now proposed that only finance provided by central government (grants and loans) should be included in the main programme, with net market and overseas borrowing and leasing included in the planning total. The figures in the table below are adjusted to reflect this change in treatment; for convenience and consistency with the treatment in this exercise of nationalised industries, the total External Financing Requirement is included. There has been a corresponding change to programme 3 to exclude land drainage capital expenditure by RWAs.

8.3 About three-quarters of the expenditure in programme 8 is carried out by local authorities. Under block grant, local authority priority on current expenditure on particular services (and hence the amount falling under different programmes) is largely a matter for each authority's discretion. The same applies to capital expenditure, under the new capital control scheme. Partly because of this local discretion and partly because of uncertainty surrounding expenditure in urban areas and the financing requirement of RWAs, it is difficult to establish an objective basis for determining likely expenditure trends for this programme. Nor is it clear what effects different economic scenarios might have, since higher rates of growth while possibly reducing the net cost of urban expenditure are likely to place additional strain on water and other infrastructure. It is therefore assumed that the level of provision will be the same in both scenarios, and will in 1990-91 be 10% below the 1980-81 level.

Because of the reductions already achieved since 1980-81, and assuming the EFR of the RWAs continues to decline in cost terms, this allows for some necessary recovery in expenditure on capital programmes from the present level, assuming always that current expenditure is successfully restrained.

TABLE 8.1 EXPENDITURE ON OTHER ENVIRONMENTAL SERVICES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	3389	3117	3000	2840
% GDP	1.4	1.3	1.0	1.2

NB Figures for 1990-91 include RWAs' total external finance, and exclude their capital expenditure

10. EDUCATION, SCIENCE, ARTS AND LIBRARIES

10.1 The projections for education have been calculated from a disaggregated analysis of the programme. Each major heading has been projected on the basis of underlying demographic determinants where these exist: for example, on the number of children of primary school age, and on a judgement of the levels of provision broadly consistent with the policies underlying the Government's present expenditure plans. These policies are aimed at 'maintaining and improving the quality of education' (Cmnd 8175) to the extent that overall expenditure constraints permit, and are thus largely determined by those constraints; the projections therefore are illustrative only. In the case of capital and some other expenditure there is no simple relationship available for converting demographic and other determinants into a demand for a stock of buildings.

10.2 The demographic basis for the projections is summarised in Table 10.1 for England and Wales.

TABLE 10.1: INDEX OF POPULATION

Age Group	mid 1980	mid 1990
3-4	100	130
5-10	100	96
11-15	100	74
16-18	100	85
19-22	100	104

Source: OPCS population projections 1979-2019

These figures disguise the reduction in the primary school age group in the early 1980s which is followed by an upturn between the mid 1980s and 1991. This upturn is not reflected in the 11-18 age group in the period up to 1991. The 19-22 age group peaks in the early/mid 1980s and declines thereafter. The demographic determinant is most important in the area of compulsory schooling (5-16). Outside this area, that is provision for under fives, for those over school leaving age in school, and for higher and further education (including

adult education and the youth service), there is some discretion over the numbers of pupils or students admitted - although present policy, which reflects the relevant statutory provisions, is to meet demand from 16-18 year olds for full-time courses in school or college.

10.3 The projections of current expenditure for the compulsory age groups are based on broadly constant levels of provision per pupil taking 1980-81 as a base, but with some allowance for diseconomies of scale as pupil numbers fall.

10.4 The main assumptions about the other areas of expenditure are the following:

a. funding of nursery education based on half the change in the numbers of 3 and 4 year olds implying a decline in participation rates from 40% in 1980-81 to a little over 30% by 1990-91;

b. funding for 16-18 year olds in schools and for all students on non-advanced courses in colleges according to projections of demand;

c. provision for higher education (including universities) is assumed to fall by about 10% up to the mid 1980s and then decline further in line with the size of the 19-22 age group. It is assumed that this will lead to a reduction in participation rates from nearly 13% in 1980-81 to just over 11% by 1990-91;

d. capital expenditure programmes set to stabilise after 1984-85 at some two-thirds of the level in 1980-81.

10.5 The residual components of the programme (mainly science, arts and libraries) are assumed to remain broadly constant throughout the period.

10.6 Constraints on reducing (in cost terms) the level of expenditure on the programme are imposed by:

a. the constitutional difficulties in securing changes in local authority expenditure (75% of the programme);

b. the contractual position of staff and the extent to which employers are willing to accept redundancies. The closure of educational buildings and staffing cuts are also constrained by national and local pressures from parents of pupils and other interest groups;

c. the high proportion (65%) of the programme which is spending on staff salaries.

10.7 In practical terms, pressures to maintain expenditure levels above those implied in the projections, for example to expand above those implied in the projections, for example to expand the curriculum and to increase participation rates outside the compulsory school age group, may be very great, especially if national income is increasing relatively rapidly.

TABLE 10.2: EXPENDITURE ON EDUCATION, SCIENCE, ARTS AND LIBRARIES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	11027	10610	10400	10200
% GDP	4.6	4.5	3.5	4.2

11. HEALTH AND PERSONAL SOCIAL SERVICES

11.1 Expenditure on the NHS and PSS needed to provide a given standard of service is determined mainly by demographic change (that is, changes in the total size and age structure of the population), by progress in medical science (including the development of new and better surgical procedures, methods of diagnosis and pharmaceutical products), and social trends affecting eg the number of children in care.

11.2 As regards demography, total current expenditure on the Hospital and Community Health Services in England would rise by about 0.7 per cent a year during the 1980s, if current provision per head in each of the main age groups remained constant. An equivalent figure for expenditure on personal social services is 0.6 per cent in the number of men and women aged 75 and over between 1980 and 1990, compared with 2 per cent for the population as a whole.

11.3 As for the cost of medical progress, DHSS had estimated that an increase in real current expenditure of about half a per cent a year is required as a contribution to the costs of medical advance to finance inescapable innovations without enforcing offsetting reductions in standards elsewhere.

11.4 For the hospital and community health services, the Government's financial provision for 1982-83 will provide for a 1.7 per cent growth in provision if savings of £39m are realised from increased efficiency (Cmnd 8494, paragraph 2.11.12 and announcement of special pay offers on 8 March). This was the last year of the commitment in the 1979 Election manifesto. Such an increase would be sufficient to provide for demographic change and inescapable medical developments, with a margin for small improvements or in mental handicap services. It would also permit some "levelling up" in those parts of the country which have had least spent on them. For 1983-84 and 1984-85 Cmnd 8494 allows for growth in services of 0.5% a year, to be provided by increases in efficiency, subject to further consideration during the 1982 Survey having regard to the availability of resources and the scope for improved efficiency.

11.5 If current policies were broadly maintained, and with no improvements in levels of efficiency, the annual increase in provision necessary at least to meet the pressures exerted by demographic change and medical advances might be of the order of 1-1½ per cent between 1982-83 and 1990-91. There are however many areas of health care where there is a pressing need for more resources: eg to improve standards in the worst mental handicap and other long stay hospitals, to make hip operations, transplants, dialysis etc more widely available, and to introduce minimum standards for maternity care. Expenditure would need to rise at 2-3 per cent a year to make significant progress in all these areas. On the other hand the Government is committed to securing progressive increases in NHS efficiency. The scope for this is subject to review with health authorities. It seems doubtful (though not inconceivable) that a cumulative improvement of 0.5 per cent a year could continue throughout the decade. The growth of the private sector may take a little of the pressure off NHS acute services. There could also be some small increases in income through charges. For these reasons it is suggested that the minimum net real growth in provision will be 0.5 per cent a year after 1984-85, on Scenario B. With a further 0.5 per cent a year efficiency savings, this would barely maintain present standards. If GDP rises faster there will be strong pressures to use some of the extra wealth to improve standards; health service expenditure normally rises as a percentage of GDP as GDP rises, because wealthier populations chose to spend more on health care, including care for the old and handicapped who depend on state services. It is therefore suggested that the net real growth in provision might be at least 1.5 per cent a year after 1984-85 in Scenario A.

11.6 Expenditure on the Family Practitioner Services is assumed to grow by 2 per cent a year in real terms after 1982-83. This is the assumption in Cmnd 8494 for the PES period, and is at present being reviewed.

11.7 These growth rates are based on the judgement that public expenditure cannot be substantially reduced by increasing income from charges within the present system of financing. Public expenditure could be reduced by radical changes within a tax based system (eg new charges, withdrawing certain services) or by shifting part of the

population (voluntarily or compulsorily) to private insurance. Such options would have major political implications and we have not allowed for such radical changes in the calculations in this chapter.

11.8 Capital expenditure on hospital and community health services, and both capital and current expenditure on central health services, are taken to remain constant in real terms.

11.9 Expenditure on the personal social services is estimated to have risen by some 7.1 per cent in real terms between 1978-79 and 1981-82. The provision made for 1982-83 implies a reduction; but these are services where local authorities have their own discretion. As mentioned in paragraph 11.2 above an increase in just over 0.6 per cent per annum would be needed just to keep up with demographic change. There is also pressure for increased services to meet existing deficiencies and to complement Home Office provision for children (residential care orders, intermediate treatment). An increase of 1 per cent a year in current expenditure in volume terms from 1982-83 is assumed here for Scenario B and 3 per cent on Scenario A. Capital expenditure is taken to run level in real terms, income from charges is taken to rise pro rata with current expenditure.

11.10 The relative price effect for pay is calculated for the NHS and personal social services together on the same assumption as those applied to other public services. For the hospital and community health services the RPE on current expenditure other than pay has been estimated at 1.5 per cent over the period 1976-1980. Whether this RPE will continue is very uncertain, but the same figure has been used here for the period beyond 1982-83 for the purposes of calculation only. For the Family Practitioner Services the relative price effect on current expenditure other than pay is put at 2.5 per cent a year over the period 1976-80 and is again used for the purposes of calculation with the same qualifications applying.

TABLE 11.1 EXPENDITURE ON HPSS IN ENGLAND (NET OF CHARGES)

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	10494	11341	14110	13330
% GDP	4.4	4.8	4.8	5.4

12. SOCIAL SECURITY

12.1 The Scenario B projections are based on price protection of all benefit levels, no changes in eligibility for benefit and no changes in current take-up assumptions. Scenario A assumes a 1 per cent per year growth in the real value of existing benefits. This is assumed to cover also any structural improvements. This would not cover any major development such as the introduction of a comprehensive disability benefit (which might cost up to some £3b pa). In both Scenarios benefits are assumed to fall relative to wages.

12.2 A number of benefits are covered by legislation requiring annual uprating in line with prices. In some cases, such as pensions, there are firm Ministerial commitments to increase benefits in line with inflation. Supplementary benefit and child benefit is in practice increased in line with prices. Child benefit has been increased in line with inflation in 1981 and 1982. In both cases there is considerable political pressure at least to maintain the real value of the benefits.

12.3 The base taken for the projections to 1990-91 is that of the 1982 White Paper. Apart from the uprating assumptions mentioned above, the major determinants of expenditure in 1990-91 are:

i. demographic (in particular the number of pensioners and of children);

ii. unemployment (both number and composition of the unemployed);

iii. the growing maturity of the new pension scheme;

iv. increase in the population qualifying for certain benefits (eg sickness benefit and contributory benefits payable to married women).

12.4 Approximately half of the programme is accounted for by retirement, widows' and invalidity pensions. The number of pensioners will not increase greatly by 1991 (although thereafter the number of retired persons as a percentage of the working population increases rapidly). Nor does the new earnings-related pension scheme

have any major impact during the 1980s. For child benefit the number of 0-16 year olds had been used as an indicator. The population projections show this number falling until 1986 and recovering by 1991 to current levels.

TABLE 12.1 EXPENDITURE ON SOCIAL SECURITY

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	22878	26646	28560	27320
% GDP	9.6	11.3	9.7	11.1

13. OTHER PUBLIC SERVICES

13.1 Expenditure on Other Public Services is subject to periodic increases depending on the timing of Parliamentary elections and censuses. Apart from these items, and the change to Trading Fund status for HMSO, expenditure has been roughly constant in cost terms over the past few years. Most of the programme is accounted for by the costs of the Inland Revenue and Customs and Excise.

13.2 A major item of expenditure occurring after the current Survey period is the computerisation of PAYE, which will involve capital expenditure of around £200m, but result in large savings of staff costs. Apart from this change, the figures below assume that the level of expenditure on this programme remains broadly constant in cost terms.

TABLE 13.1: EXPENDITURE ON OTHER PUBLIC SERVICES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	1143	1140	1160	1140
% GDP	0.5	0.5	0.4	0.5

14. COMMON SERVICES

14.1 Two major items of expenditure under Common Services are accommodation services, provided by PSA, and civil superannuation.

14.2 A recent PSA report suggested that, with the cuts in the civil service presently planned, rationalisation of the estate could lead to savings of £37m pa (including rates) in London alone. However, offestting this saving is the need to catch up with capital and maintenance expenditure which have been postponed to reduce the present level of expenditure. Only modest savings beyond those already identified may therefore be possible, unless civil service numbers are further reduced. The figures below assume further savings in cost terms up to the mid 1980's and thereafter a level programme.

14.3 Expenditure on civil superannuation is also partly dependent on the size of the civil service, both because of the additional costs of early retirement schemes, and through the effects on the total number of public service pensions. While showing quite a considerable increase in present plans, due to a retirement 'bulge' (including voluntary early retirement), expenditure in cost terms is expected to revert to a level about 10 per cent higher than that in 1980-81.

TABLE 14.1 EXPENDITURE ON COMMON SERVICES

	1979-80	1982-83	1990-91	
			A	B
£m (1980-81 cost terms)	1195	1358	1170	1100
% GDP	0.5	0.6	0.4	0.4

15. SCOTLAND, WALES AND NORTHERN IRELAND

15.1 Projections for territorial programmes have been made using present assumptions for the relationship between them and relevant English programmes. Expenditure outside the territorial blocks is assumed to remain broadly at its 1982-83 level in cost terms.

TABLE 15.1 EXPENDITURE IN SCOTLAND, WALES AND NORTHERN IRELAND

	1979-80	1982-83	1990-91	
			A	B
Scotland £m (1980-81 cost terms)	5216	5043	5770	5650
Wales £m (1980-81 cost terms)	2087	2016	2290	2250
Northern Ireland £m (1980-81 cost terms)	2888	2950	3130	3110
TOTAL £m (1980-81 cost terms)	10,191	10,009	11,190	11,010
% GDP	4.3	4.4	3.8	4.5

16 NATIONALISED INDUSTRIES

A - GENERAL

Existing Policies

16.1 The Government's policy towards the nationalised industries has three major long-term elements:

i) Financial targets. These take account of the need for investment programmes as a whole to earn a 5 per cent real rate of return, and of further moves to economic pricing. Financial targets are in place for most of the industries, the main current exceptions being loss-makers such as the National Coal Board, the British Steel Corporation and British Shipbuilders. The British Railways Board at present only has financial targets covering Sealink, the Inter-City services and the freight business. Loss-makers in most cases have a long-term duty to break even after grant.

ii) Improvements in efficiency both as a result of closer scrutiny by the Government and the Monopolies and Mergers Commission, and through greater competition. The setting and monitoring of performance aims will also have a part to play.

iii) Privatisation of both whole industries and individual activities and assets. By the early 1990's it is reasonable to assume that the whole of British Airways, and parts of the British Steel Corporation and British Shipbuilders, will have been returned to the private sector, in addition to the British Transport Docks Board and Britoil (which are expected to be privatised within the next year). British Telecom may also have been privatised, although this is still subject to substantial uncertainty. Where an industry or activity with a positive external financing requirement is being returned to the private sector, this will lead to continuing reduction in public expenditure; but most privatisation candidates are

profitable and have small or negative external financing requirements. In these circumstances, there will be no continuing net benefit to the Exchequer after the original sale has been made. The proceeds from sale will generally be counted as part of the special asset disposals programme, and so will have no net effect on total external finance for the nationalised industries.

16.2 Cmnd 8494 carried these policies forward on the basis of a forecast reduction in total external finance for the nationalised industries from £2.7bn in 1982-83 (before adjustment for the effects of the National Insurance Surcharge reduction) to £2.1bn in 1984-85. This expected improvement is also associated with a modest resumption of economic growth.

Long-Term Prospects

16.3 Forecasts of the difference between industries' total revenues and expenditure in cash terms are subject to greater uncertainty than are forecasts of other items of public expenditure; even the later year plans in Cmnd 8494 are subject to large margins of error. Forecasts for the early 1990's cannot give more than a rough indication of possible changes. However, assuming the continued implementation, and success, of the Government's policies, the following general picture emerges:

i) Investment The level of investment will depend in part on economic growth. But many of the industries have excess capacity at present; in others current investment may well be occurring to save costs rather than increase capacity; in yet others output levels and hence investment may be more or less invariant to economic growth. For example, the electricity industry currently has a large quantity of spare capacity; NCB output may be invariant to growth, and the Gas Corporation may well need to invest more with higher growth. Whether the real level of investment changes significantly may well depend above all on changes in technology - eg in the energy sector. Overall, total nationalised industry investment is unlikely to expand very much in real terms from its present level. For the purpose of this paper a reasonable assumption is that it

will remain constant.

ii) Internal resources Assuming some modest continuation of economic growth, continued restraint on current costs and improvements in efficiency, the industries' internal resources should increase steadily, although even this judgment is hazardous. For example, price competition - itself aimed at improving efficiency - would tend to reduce the industries' operating profits. Movements toward economic pricing may in any event be more or less complete by the mid-1980s.

iii) External financing In the absence of a major increase in investment, and assuming that the industries' internal resources continue to improve following the implementation of the Government's policies, the nationalised industries' external financing requirements should continue to decline gradually. Within the total, finance for the two main loss-makers (the National Coal Board and British Rail) - already responsible for threequarters of the nationalised industries total external finance in 1981-82 - will remain predominant. In turn, grant would probably account for the majority of nationalised industry external finance, as is planned for 1982-83. But the pattern depends particularly heavily on the future of British Telecom. If the industry remains in the public sector, and has a continuing large investment programme, there could well be a large external financing requirement - perhaps as high as £500m.

16.4 The projections assume continued implementation and success of government policies in all industries and the picture they show is thus arguably an optimistic one. Some account needs to be taken of important risks - for example that growth will be lower than expected, that hoped-for improvements in efficiency will not fully materialise; and that world energy prices grow more slowly than at present projected. Adverse developments even in one or two industries could well cause the outturn to be significantly worse than the total of the individual industry figures implies. To provide a more realistic view of the prospect for nationalised industries as a whole, a contingency margin of £300m - not allocated

to any individual industry - has been included in the aggregate figures for Scenario A and Scenario B.

16.5 This produces the following picture for the nationalised industries as a whole (including in both cases an assumed £500m for British Telecom).

Table 16.1

NATIONALISED INDUSTRIES' EXTERNAL FINANCE
(excluding Civil Aviation Authority)

£ million, 1980-81 cost terms

	1979-80	1982-83*	1990-91	
			A	B
Borrowing	1,796	778	700	690
Grants	1,280	1,515	870	920
Total of individual industries' external finance	3,076	2,293	1,570	1,610
Contingency margin	-	-	300	300
Total external finance	3,076	2,293	1,870	1,910
% GDP	1.3	1.0	0.6	0.8

*Figures do not take account of adjustments to EFLs in light of NIS reduction and other changes.

NOTE: Rough adjustments have been made to Programmes 4,6, 8 and 15 to take account of grants to nationalised industries scored as external finance.

National Coal Board

The plans prepared by the Board project declining external financing requirements, particularly through the late 1980's, and a return to profitability. These are also the aims of Government policy. Although capital investment might grow in real terms towards the end of the decade, the key question is how fast the Board's performance on revenue account can improve. Given the difficulties

of adjusting NCB output, higher economic growth with attendant increased energy demands ought to improve this performance and continued emphasis on cutting costs should also lead to a marked improvement over the coming years. In 1980-81 cost terms, it is assumed that the total external financing requirements of the Board will fall from some £1100m in 1981-82 including some £500m in grants to some £200m-£400m, including £100m-£200m in grants, in 1990-91 in Scenarios A and B respectively.

Electricity Supply Industry

The Electricity Supply Industry in England and Wales is projecting some real increase in capital investment during the latter half of the 1980's. Assuming that no significant change is made to the current approach to pricing, the industry should continue to make significant profits before interest. It has been assumed, therefore, that the current negative external financing requirement would become zero by 1990-1991. It has been assumed that there will be no further investment in generation in Scotland following Torness so that the combined external financing requirements of the Scottish Electricity Boards might also fall to zero by 1990-1991.

British Gas Corporation

British Gas Corporation's investment is currently at a high level, owing to the development of the Rough and Morecambe fields and the strengthening of the national transmission system. As these projects are completed and with the privatisation of the Corporation's peripheral activities, there should be a substantial reduction in the Corporation's investment in the later 1980's. On the revenue side, the gas levy can be adjusted to fine-tune the Corporation's net income. Assuming a continued policy of economic pricing, it is likely that BGC will have a zero or negative external financing requirement in 1990-91. In Scenario B, it could have a more substantial negative EFR, at the same rate of gas levy, since the need to develop new capacity and more costly sources of gas would be deferred.

BNOC

BNOC should be taken out of the calculations given the planned

privatisation of Britoil. It is assumed that the external financing requirement of the residual trading body will be negligible.

British Steel

Present policy is to return individual businesses to private hands and to close any unprofitable rump. The speed of moves in this direction will only partially depend on UK economic growth and steel demand, and the £/DM exchange rate (European steel prices are effectively denominated in DM). The assumption is that privatisation and/or closure is complete or at least that any plant remaining in the hands of the State has no EFR.

British Telecommunications

If BT has not been privatised by 1990-91, its external finance will depand on 3 main factors: its efficiency; the extent to which competition (where it can be introduced) still enables it to maintain a high self-financing ratio; and the scale of its investment programme. One possibility is that its investment requirements may tail off after the present bout of modernisation is completed in the late 1980's. But technological change and the wider exploitation of profitable opportunities in "teletronics" could well mean a continuing high investment programme. On this assumption, a figure of £500 million has been included in both scenarios.

Post Office

In recent years the PO has been a small net repayer of debt. In spite of changes which may affect its business during the 1980's - electronic mail, cable systems, etc, it is assumed that there will be no external finance requirement in either scenario.

British Airways

The Government's policy is to privatise British Airways as soon as practicable. It is assumed that profitability and/or capital reconstruction allows this to occur by the middle 1980's.

National Bus

NBC has been set financial targets which, if met, ought to ensure that there is an operating surplus which, together with depreciation, should cover investment. Such a position should obtain in both scenarios A and B. NBC also receive grants from local authorities which are expected to remain constant in real terms, at around £50m in 1980-81 prices.

British Waterways Board

In both scenarios, grant to the BWB is assumed to remain at around its present real level, at £30m (1980-81 cost terms). Borrowing is assumed to be negligible.

British Transport Docks Board

Assumed to be privatised.

Scottish Transport Group

The STG is not expected to be a net borrower in either scenario but is assumed to receive local authority grant totalling £15m in 1980-81 prices.

British Shipbuilders

The present policy is to eliminate subsidies and to privatise. Disposal of BS Ship repair interests and peripheral engineering establishments could take place before the election and privatisation of Vickers after the election, but the prospects are speculative. While direct production subsidies for merchant ships will have ended (the Home Credit Scheme continuing) both merchant shipbuilding and offshore rig building are highly cyclical industries, and BS could well need further finance to cover losses on the downslopes of the cycles or to finance further contraction in both these areas. It is unlikely that contraction in BS will have run its course as early as 1999-91 but in the good years of the cycles BS could be profitable and dividend-paying though much will depend on the intensity of the Japanese and South Korean competition.

British Airports Authority

The BAA is in normal circumstances self-financing but this will not be possible during the proposed major expansion of its South East airports. On the present timetable the major part of the expenditure on this programme is not expected to be completed until 1990 at the earliest. Depending on the growth of traffic the programme could be extended into the mid-1990s. In any case a requirement for a small EFL (of say £30m in 1990-91) could emerge.

British Rail

In both scenarios the level of grant might be expected to decline from its present historically high point which is due in part to the depth of the recession. Borrowing, on the other hand, is at a historically low level, due to the historically low levels of investment which result from the Board's decision to restrict capital expenditure to reduce their need for external finance.

The future level of both grant and borrowing will depend on BR's ability to restrain their current costs. The forecast assumes that the Board will succeed in reducing their costs in accordance with Government policies and make other changes, including investment, to adapt the railway to the needs of the modern community.

Assuming grant declines to the mid-1980s and then remains constant, and a modest programme of investment (including electrification) peaking in the mid-1980s, the Scenario A case produces borrowing figures of £30m-£50m at 1980-81 prices in 1990-91 and grant of £650m-£700m. Scenario B assumes lower investment and net borrowing of some £20m-£40m. Grant, of around £600m-£650m, would however be likely to be lower than in Scenario A because of the lower assumed growth of wages. (For the purpose of constructing aggregate figures, the mid-points of these ranges have been taken.)

Civil Aviation Authority /not strictly a nationalised industry/

Once the major programme of re-equipment is completed capital expenditure should decline and a zero borrowing requirement is projected for the early 1990's. The requirement for a Scottish Development Department grant towards the costs of Highlands and Islands aerodromes is expected to remain constant in real terms, at around £4m at current prices.

17. ASSET SALES, CONTINGENCY RESERVE AND DEBT INTEREST

17.1 Asset sales are assumed to be largely complete by 1990-91, but this depends on the timing of decisions yet to be taken. The assumed rate of sales during the 1980's affects the projected demand for external finance for nationalised industries at the end of the decade.

17.2 The Programme Totals for 1990-91 include a 2 per cent Contingency Reserve, similar to that for 1982-83.

17.3 Projections of net debt interest are very uncertain. However, it is assumed to decline to 2 per cent of GDP in Scenario B; and in Scenario A, with lower inflation and interest rates, it is assumed to decline to 1.5 per cent of GDP.