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Ref.A083/1999

PRIME MINISTER

Public Expenditure in 1983-84: C(83) 21

BACKGROUND

The Public Expenditure White Paper (Cmnd.8789) gave a planning total for public expenditure in 1983-84 of £119.6 billion, made up as follows.

	£ billion
Programmes	120.3
Adjustments	
Contingency reserve	1.5
Shortfall allowance	- 1.2
Other	- 1.0
Planning total	119.6

The Financial Statement and Budget Report forecast the public sector borrowing requirement (PSBR) for 1983-84 as £8.2 billion, made up as follows.

		£ billion
Central Government	11.5	
less on - lending	- 3.0	
Central Government own account		8.5
Local authorities		- 0.2
Public Corporations		1.1
Unallocated		- 1.3
PSBR		8.2

2. Current indications are that both public expenditure and the PSBR are going off course. Borrowing by central Government is running well above the level for the comparable period in 1982-83; though individual cash-limited programmes are running within their limits, aggregate expenditure on cash-limited programmes is running ahead of profile, which suggests at least

that there is likely to be less shortfall than allowed for in the forecasts and expenditure on non-cash-limited (demand-determined) programmes is also above forecast. The current internal and confidential Treasury estimate is that unless corrective action is taken the PSBR this year will be about £3½ billion above the Budget forecast.

3. Of this excess, about half (£1.7 billion) is due to excess central Government expenditure. £0.6 billion reflects the expectation that shortfall on cash-limited programmes will be less than allowed for; the remaining £1.1 billion is largely due to demand-determined expenditure on agricultural support (a reflection of over-spending on the Common Agricultural Policy) and on social security benefits (reflecting a higher take-up of benefits than expected).

4. Indications of these trends will soon become public. Last month's money supply figures were published this week and have attracted unfavourable comment. Summer Supplementary Estimates totalling some £1 billion will be published on Friday. The central Government borrowing requirement figures for the first quarter will be published on 11 July.

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5. In this memorandum C(83) 21, the Chancellor of the Exchequer argues that the Government must take immediate action to show that it is determined to control expenditure and borrowing. Otherwise the publication of adverse figures could have serious effects on market confidence and interest rates. He proposes action on public expenditure designed to produce overall savings of some £600 million (the amount of which expenditure on cash-limited programmes seems likely to exceed expectation).

6. Specifically, the Chancellor invites his colleagues to explore possible ways of limiting demand-determined expenditure (but clearly without any expectation of significant savings), and proposes:

(i) a reduction of 2 per cent in non-pay central Government cash limits (saving £350 million);

(ii) a reduction of 1 per cent in pay and general administrative expenditure (GAE) central Government cash limits (saving £100 million);

(iii) a reduction of 2 per cent in the aggregate external financing limits of the nationalised industries (saving £55 to 60 million);

(iv) the introduction of a scheme of end-year flexibility on central Government capital expenditure, which should reduce expenditure in the current year (perhaps by some £100 million), though at the cost of adding to likely expenditure in 1984-85.

He proposes no reduction in the Rate Support Grant to local authorities; the Secretary of State for the Environment, has recently announced hold-back of grant amounting to £280 million in 1983-84.

7. I understand that the Chancellor of the Exchequer intends, if the Cabinet approves these proposals, to make an announcement in general terms the same afternoon and to follow it as soon as possible - and certainly before the Summer Recess - with detailed figures for individual cash limits.

8. Finally, the Chancellor indicates that proposals will be put forward at official level for improving the flow of financial information to the Treasury.

MAIN ISSUES

9. The essential issues before the Cabinet are whether immediate action on the scale proposed in C(83) 21 is necessary; and if so, whether the Chancellor of the Exchequer's specific proposals are acceptable.

GENERAL SITUATION

10. Your colleagues will naturally be conscious of the political difficulty in any significant action on public expenditure so soon after the General Election. They will be sensitive to changes there there was after all a "secret manifesto" and this

is the first visible sign of it. Moreover, although the Chancellor is correct in saying (paragraph 5 of C(83) 21) that he is not asking for a reduction in the expenditure total, since the proposed reduction in cash limits simply offsets lower than expected shortfall, he is seeking a significant reduction in certain programmes: the Ministers responsible for cash-limited programmes which are within these limits will argue that it is unfair to ask them to find savings to offset not only overruns elsewhere but also the Treasury's underestimate of shortfall on aggregate cash-limited expenditure.

11. Some Ministers may feel that what is proposed is a negation of the cash limits system and of the drive for better financial management, and that a public expenditure system which requires sudden adjustments to planned programmes when cash limits have already been set is fundamentally unsatisfactory. They may question whether a total saving for the year of only £600 million is worth the political passions which will be aroused both generally and in relation to particular programmes. One option which might be ventilated is whether the Government would not be better advised to reduce the borrowing requirement by raising revenue, for example by using the regulator on indirect taxes: but that while dealing with the immediate problem of the monetary numbers, might not impress markets unless it was accompanied by action which showed a clear determination to restore control over spending. Others may say that, if action is required on public expenditure, it ought not to take the form of a general squeeze but that savings should be sought in a more discriminating way from selected programmes.

12. The Chancellor is likely to argue in reply that it is essential to the Government's strategy that the corrective action required should take the form of tightening the control on public expenditure. It is public expenditure that is off course. If the Government is to control public expenditure in the current year it must operate on those programmes which it can change in the short term, however unfair this may appear to those who are not responsible for the potential overrun. Since very early action is required, there is no time to work out a programme of selective cuts.

13. The Chancellor's understandable reluctance to set out the details of the latest forecasts may well increase the difficulties of securing agreement from his colleagues to his present proposals. You will wish to judge as the discussion proceeds how far to encourage the Chancellor to reveal fuller details of the underlying forecasts. He is likely to lay considerable weight on the accumulation of unfavourable trends: the overshoot in the PSBR at the end of 1982-83, and the borrowing and expenditure figures for the first quarter of the current year. He may also argue that if the Government does not take early action now it may later be forced into much more stringent action should the present trends continue. Moreover a major objective is to provide a sounder base for the next Public Expenditure Survey round which the Cabinet will be discussing on 21 July.

PARTICULAR POINTS

14. Particular points raised in discussion may include the following:

(i) Contingency Reserve. It may be suggested that all or part of the proposed reduction should be found by reducing the contingency reserve rather than cash limits. But the contingency reserve (at £1.5 billion) is small by the standards of previous years; and it would be imprudent to reduce it further so early in the year. It seems unlikely that spending Ministers would subscribe to an undertaking that in no circumstances whatever would they ask for additional provision during the current year. Moreover, part of the reserve is likely to be needed to cover an overrun in nationalised industry borrowing (an overrun of £250 million is currently forecast).

(ii) Central Government Pay. Substantial economies have already been assumed on the pay and GAE cash limits in order to cover the Civil Service pay award of nearly 5 per cent (the provision was based on an increase of 3½ per cent). Some Ministers may suggest that it will be impossible to find savings of 1 per cent without an unacceptable effect on services. Certainly redundancies will not help, since they have a substantial first-year cost. There may well be a risk that even if Ministers agreed to find savings of 1 per cent, it will in the event prove impossible to deliver them.

Against all this is the obvious difficulty of appearing to exempt the Civil Service from the effects of reductions in expenditure elsewhere.

(iii) Other Pay. The figures in C(83) 21 assume that the 2 per cent reduction in non-pay items would apply to grants to bodies outside central Government ("central Government" for this purpose includes the National Health Service). But grants to some organisations, notably the universities and other educational bodies, are calculated on the basis of a notional split between pay and other inputs. The pay element in this year's grant allowed for a 3½ per cent increase, as for the Civil Service. The Ministers concerned can be expected to argue strongly that it is unreasonable to impose on the pay element of the grants a more severe reduction than that applied to expenditure on Civil Service pay and GAE. You will not wish to go into the details of the various services that may be affected; but it does not seem unreasonable to agree that if the calculation of grant was based on an explicit treatment of pay costs on the same lines as for Civil Service pay and GAE, a reduction of only 1 per cent should be applied. Details could be left to be settled bilaterally between the Ministers concerned and the Chief Secretary.

(iv) Switches between Cash Limits. Several Ministers are likely to wish to be free to find savings, within whatever total may be agreed, on a different pattern from that which would result from the strict application of the Chancellor's proposals to each and every cash limit. In particular, the Revenue Departments would be inclined to argue that the loss of revenue resulting from further staff cuts would far outweigh the financial savings (which might well be negligible if the cuts involved redundancies). The Cabinet will probably agree that some flexibility is desirable; but that, if it is decided that central Government pay cash limits should be reduced by 1 per cent, Departments should not be able to avoid the effects to any significant degree by finding offsetting savings on other items. Subject to this and any other points that may be agreed, the Chief Secretary might be invited to agree figures for individual cash limits with the responsible Ministers.

(v) Demand-determined Services. It may be suggested that reductions in expenditure on demand-determined services should be accepted in place of reductions in cash limits. C(83) 21 envisages that reductions in expenditure on demand-determined services should be additional to reductions in cash limits, though no specific suggestions for savings are advanced. The difficulty in finding savings is partly political (the only suggestion so far put forward in inter-departmental discussions is a reduction in student grants, which has so far found no favour with the Cabinet) and partly technical (reductions in demand-determined expenditure are always less certain than reductions in cash-limited expenditure). But if any specific proposals are put forward which seem prima facie acceptable, they could be left for discussion bilaterally, at least in the first instance, between the Ministers concerned and the Chief Secretary.

END-YEAR FLEXIBILITY

15. The proposed scheme of end-year flexibility is described in summary terms in C(83) 21, but is intended to be the scheme set out in more detail in the attachment to C(82) 29. It would apply only to capital expenditure and certain procurement programmes and would not extend beyond central Government. Your colleagues are likely to welcome the proposal in general terms; but two main types of point may be raised.

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16. First, it may be suggested that the coverage of the scheme should be extended and, in particular, that local authorities should be covered. Treasury Ministers are likely to reply that this would create too great a likelihood of higher expenditure in 1984-85.

17. Secondly, detailed points may be raised on the mechanics of the scheme. You will not wish to spend time on these.

18. If the Cabinet endorses the proposed scheme in principle, you might invite the Chief Secretary to arrange for officials to prepare a more detailed outline for eventual approval by Ministers collectively.

ANNOUNCEMENTS

19. Depending on the decisions reached the Cabinet will wish to consider the form and timing of any announcement.

IMPROVING FLOWS OF INFORMATION

20. There is unlikely to be any objection to the proposal that information flows should be improved.

HANDLING

21. You will wish to invite the Chancellor of the Exchequer to introduce his memorandum. Thereafter all members of the Cabinet are likely to wish to contribute, both from their Departmental and from the general political standpoint.

CONCLUSIONS

22. You will wish the Cabinet to reach conclusions on the proposals in paragraph 15 of C(83) 21 and, if those proposals are endorsed, the form and timing of any announcement.

approved by ROBERT ARMSTRONG
and signed in his absence

Lindsay Wilkinson

6 July 1983