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PRIME MINISTER

Public Expenditure and Economic Prospects
(C(82) 27 and 28)

BACKGROUND

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This is the first substantive discussion by Ministers collectively of the 1982 Public Expenditure Survey. Of the two memoranda on the agenda, the Chancellor of the Exchequer's paper (C(82) 27) sets the economic background; that by the Chief Secretary, Treasury (C(82) 28) is the one requiring decisions. These decisions relate to overall totals, and would provide the framework for ensuing discussions on individual programmes.

Economic Prospects

2. It has been clear, from the discussion in the Ministerial Committee on Economic Strategy and from other indications, that some Ministers, and notably the Secretary of State for Northern Ireland, may want not so much to challenge the Chancellor's judgment on economic prospects on the basis of present policies as to argue that, because economic recovery is late in coming and likely to be slow to get under way on the basis of those policies, there is an economic and political case for relaxing the strategy so as to allow a little more stimulus than is implied in the Chancellor's judgments and forecasts.

3. The Secretary of State for the Environment may well renew his argument for encouraging more investment, if necessary at the expense of some of the existing commitments on the indexing of transfer payments.

4. You will no doubt feel that you should let this discussion happen. It seems likely that the broad consensus of the Cabinet will be to the effect that the Government's financial strategy is beginning to bear fruit, and that this is no time to depart from it.

5. Moreover, if there is room for fiscal manoeuvre in the 1983 Budget, you and the Chancellor - and your colleagues - will want to have as much as possible of it available for tax reductions, which would have political as well

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as economic priority. You would not want, by relaxing the grip on public expenditure, to pre-empt or unduly to limit the possibility of easing the burden of taxation. In that sense, the discussion on economic prospects ought not to provide - at any rate at this early stage - a reason for a different judgment on public expenditure totals and objectives than those suggested in the Chief Secretary's paper.

Public Expenditure

6. The present public expenditure planning totals are £120.5 billion for 1983-84 (compared with £113.9 billion in the March 1981 White Paper); and £127.7 billion for 1984-85. The base-line for 1985-86 is £133.3 billion; but that is arrived at not on the basis of a review of individual programmes but by increasing most programme figures for 1984-85 by 4 per cent. It was estimated at the time of the last Budget that the plans would allow room for tax reductions (beyond revalorization) of £0.5 billion in 1983-84; the latest economic forecasts apparently do not greatly change the position.

7. Bids from Departments for additional expenditure total some £6 billion in 1983-84 and £7³/₄ billion in 1984-85 (apart from any Falklands consequentials, on which the Chief Secretary puts a provisional figure of £250 million a year). To hold the planning totals will require most of the bids to be withdrawn, or offset by savings elsewhere.

8. The Chief Secretary therefore asks that the aim should be to hold to the present planning totals for public expenditure in 1983-84 and 1984-85 and that he should hold bilateral discussions with spending Ministers, with a view to reporting back to Cabinet in October. He also proposes that the Civil Service manpower figures for 1st April 1984 in the 1982 PESC report (totalling 630,000, detailed breakdown in Table E.2 on page 185) should be treated as firm limits: that is, no Department should have a higher figure; but he would be free to propose lower figures in particular cases.

End-Year Flexibility

9. Finally, a further memorandum by the Chief Secretary, Treasury (C(82) 29), on end-year flexibility, has been circulated. You have indicated that you do not wish the substance of it to be discussed.

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MAIN ISSUES

10. Ministers will be acutely aware that, however desirable it is to stick to the published public expenditure totals, that will entail some very difficult decisions. Some may question the wisdom of such decisions in the run-up to a General Election. Of the bids listed in the Annex to C(82) 28, those for the Export Credits Guarantee Department, social security and local authority current expenditure are virtually inescapable; and no doubt some of the others will have to be conceded in whole or in part. It may be reasonable to reckon on additions of about £2½ billion being unavoidable. To offset them may well require contentious measures to find savings - besides the withdrawal of all 'optional' bids.

11. Ministers may therefore ask whether these difficult choices can be avoided, for example:-

- (a) by using the Contingency Reserve;
- (b) by assuming more buoyant revenue (thus permitting both tax reductions and somewhat higher public expenditure)
- (c) by arguing that the inflation factor for 1983-84 and thus the cash total for that year should be revised upwards;
- (d) by arguing that the PSBR will again, as in 1981-82, be lower than forecast.

Brief comments on each of these points are set out below.

Use of the Contingency Reserve

12. The planning figures include contingency reserves of £4 billion in 1983-84 and £6 billion in 1984-85. The Chancellor is likely to accept that it would be reasonable at this stage to allocate some part of the Contingency Reserve for 1983-84 to individual programmes. But it would be imprudent to use the whole reserve before the start of the year: the Chancellor and the Chief Secretary will want to have an uncommitted reserve of at least £2 billion (at the start of 1982-83, the reserve was £2.4 billion). Thus if a reasonable uncommitted reserve is to be maintained, it will not cover the whole of the bids likely to be found inescapable, let alone others.

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Buoyancy of the Revenue

13. Part of the reason for the bids for additional expenditure is that pay settlements have been higher than allowed for in the planning totals. It may therefore be argued that higher incomes will generate higher revenue. However, we understand that the calculations behind the Chief Secretary's memorandum already allow for this effect: it therefore does not increase the room for a positive fiscal adjustment or reduce the need to keep public expenditure within planning totals.

Inflation Factor


14. The general inflation factor used for this year in the public expenditure plans is 6 per cent. The current forecast for price inflation is around 7 per cent; and Ministers endorsed the proposals in the Chancellor of the Exchequer's recent note on the next pay round (E(82) 53) to go for an increase in public service earnings substantially below the level of the current round. There would not therefore seem to be a case at present for justifying an increase in the 1983-84 total on the grounds that the inflation factor may need to be revised.

Uncertainty of the Forecasts

15. The Chancellor recalls in paragraph 10 of C(82) 27 that the 1981-82 PSBR was £1½ billion below forecast. Some Ministers may feel that in the public expenditure discussions last autumn they agreed on the basis of gloomy PSBR forecasts to restrain expenditure more than they would have wished and that the same may happen in this round. However the Chancellor argues that analysis suggests that the 1981-82 shortfall will not be carried through into future years: there may be a small shortfall in 1982-83, but if there is any it is likely to be much less than last year. There will be an opportunity to review the position in the autumn.

Other Points

16. Other points may be raised in discussion about manpower, where the Chief Secretary is now proposing to convert the 1st April 1984 targets into firm limits, and about the Chancellor's ideas for "positive action" in paragraphs 14 to 17 of C(82) 27. In both cases any points might best be pursued separately with the Ministers concerned.


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17. In this latter context there may be some discussion of the suggestions in the Secretary of State for Industry's letter of 13th July arguing for an "autumn package" of measures worth about £1 billion to industry's cash flow, including a further reduction in the National Insurance Surcharge, some specific proposals involving public expenditure and some relaxation of hire purchase controls. Treasury Ministers are likely to argue that the expenditure proposals will have to be considered in the course of the bilateral discussions in the normal way and that the time to reach decisions on these and on any further reduction in the National Insurance Surcharge is the autumn.

HANDLING

18. You will wish to open the discussion, perhaps by a brief political scene-setting, and then to invite the Chancellor of the Exchequer to speak to his paper on the economic prospects. I suggest that it would be best to let the discussion run on this general level for a time, until you are in a position to express some kind of consensus, before inviting the Chief Secretary, Treasury to introduce his proposals on public expenditure. You may want to make sure of eliciting contributions to the ensuing discussion from the "big spenders", and particularly the Secretaries of State for Defence, Education and Science, the Environment (for local government) and Social Services. The Lord Privy Seal may want to comment on the proposal that the Civil Service manpower forecasts for 1st April 1984 should now be treated as firm limits.

CONCLUSIONS

19. You will wish to reach conclusions on the following lines:
- (a) In relation to the Chancellor of the Exchequer's paper, C(82) 27:
 - (i) Taking note of the economic assessment and broad strategy.
 - (ii) Developing, if appropriate in the light of the discussion, the references in paragraphs 14 to 17 of the paper to positive action relating to unemployment, enterprise and the competitiveness of industry. - (b) In relation to the Chief Secretary's paper, C(82) 28:
 - (i) Endorsing or otherwise the aim of holding to the present planning totals for expenditure in 1983-84 and 1984-85



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(noting that this means only the minimum additions to programmes and compensating reductions in other programmes);

- (ii) Adopting, subject to any points made in discussion, the Civil Service manpower totals for 1st April 1984 as firm limits.
- (iii) Inviting the Chief Secretary to have bilateral discussions with spending Ministers and to report back to the Cabinet in October.

RIA

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