



10 DOWNING STREET

Prime Minister

Long Term Public Expenditure

I asked the Treasury what their objectives were for your meeting on ^{5 or 6 May} Tuesday with Mr Fowler, on long term public expenditure options.

With the Chief Secretary's agreement they sent me the attached copy of his brief for the meeting.

You may also like to glance at the minutes of the Sept 9 Cabinet, to see the assumptions underlying Scenario A and B (under the latter, public

expenditure would rise to
47% of GDP if no action
is taken).

MCS 13/12

LONG TERM PUBLIC EXPENDITURE: SOCIAL SECURITY

Social security is the single largest public expenditure programme. At a planned £34 billion in 1983-84, it represents over one-quarter of public expenditure. (The attached table shows how this total cost is broken down between the main benefits). Clearly this programme cannot be exempted if there is a serious commitment to contain the growth of public expenditure over the next 10 years.

LTPE Study*The Long Term Public Expenditure Study*

2. The study by officials in LTPE made the following estimates of expenditure on social security:-

	<u>1979-80</u>	<u>1982-83</u>	<u>1990-91</u> Scenario A	Scenario B
£m (1980-81 cost terms)	22,878	26,646	28,560	27,320
% GDP	9.6	11.3	9.7	11.1

3. In fact, the 1983-84 total of £34 billion equates to £27.3 billion in 1980-81 costs; in other words, the programme has already reached the level forecast under Scenario B. Moreover, the LTPE projections are on a conservative basis; Scenario A assumed a 1 per cent per annum growth in the real value of existing benefits (but no other improvements) and Scenario B no real increase. The current debate over the overshoot in this year's uprating illustrates how precarious these assumptions are. In both Scenarios benefits are assumed to fall relative to wages. It should also be noted that over the decade demographic factors are not unfavourable. The number of pensioners does not increase significantly. The Scenario B unemployment was assumed to fall to 3m by 1990-91, and in Scenario A to 2m. If unemployment were to increase further, then expenditure would be that much higher: the 1983-84 figures quoted above assumed unemployment at 3.2 million but a variation of 100,000 in the unemployed is estimated to vary benefit costs by about £220 million.

Possible Measures to Contain Expenditure

4. Possible means of restricting the growth of the programme include the abolition of one or more major benefits or severe restrictions on eligibility. Neither seems practicable on the major scale that

would be needed to make an impact on the level of expenditure. The alternative is to alter the uprating arrangements so that the Government is no longer statutorily obliged to uprate most benefits in line with inflation.

De-Indexation

5. The broad choices in this projected study lie between on the one hand constructing a legislative formula which would detach benefit uprating from prices (either over the long term or in certain defined circumstances) or allowing Government flexibility in determining the uprating (with or without some indication in the legislation of the factors which would need to be taken into account). The study should cover the various possibilities under each approach.

Fledges

6. It should be noted that while legislation is essential, it is by no means all that is required. Whatever the decision on the form of the legislation, savings would not be achieved over the medium term unless future Governments adhered to the same objectives in their uprating policies. For instance this Government has pledged full price protection of pensions and linked long-term benefits (accounting for 60 per cent of expenditure), although there is no statutory duty to do so, and notwithstanding that there is no statutory requirement or even a pledge to uprate other benefits such as supplementary benefit and child benefit at all, it has been the practice to uprate them in line with inflation.

Possible Savings

7. These are potentially very large. For example, a 5 per cent cut in the real value of all benefits would save about £1½ billion in 1990. But of course the exact size of the savings will depend on decisions taken by future Governments each year between now and then.

Overshoot and Undershoot

8. MISC 88 is examining separately the question of the form of the legislation required to carry into effect the decision that next year's

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benefit uprating should be adjusted to reflect the over-provision this year. As now envisaged, this would be a separate exercise; this session's legislation would simply allow the Government to take into account overshoot as it is already able to take into account undershoot in deciding upon an uprating but would not go any further in the direction of de-indexation.

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Social Security Expenditure: 1983-84 - By Main Benefit

Retirement Pension	13,543
Unemployment Benefit	1,850
Invalidity Benefit	1,838
Supplementary Benefit	5,225
Child Benefit	3,916
Housing Benefit	2,085
Other	4,608

LONG TERM PUBLIC EXPENDITURE: HEALTH AND PERSONAL SOCIAL SERVICES

Long Term Public Expenditure Study

The study by officials on LTPE made the following estimates of expenditure on health and personal social services (net of charges):-

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

Economic Scenario A was optimistic, described as "not far short of the best we can expect".

Scenario B was much less favourable.

2. The main reason for the expected real growth in expenditure is that demographic changes (especially the rising number of very old people) require increases in expenditure of about 0.7 per cent a year to maintain standards. DHSS also argue that increases of 0.5 per cent a year are necessary as a contribution to the costs of medical advances if they are to be met without reducing standards elsewhere. The LTPE work therefore assumed (allowing also for an offsetting increase in efficiency) that the real growth in provision after 1984-85 might be 0.5 per cent a year in Scenario B and 1.5 per cent a year in Scenario A. No substantial allowance was made for increasing charges.

Study of Alternative Health Finance

3. This study, by officials and private sector consultants, completed at the end of 1981, listed three possible strategies for the future financing of health care:-

I. Continuation of the present tax-based system, but with possible major changes to the way services are provided and with increases in charges.

II. Replacement by a social insurance system (employers and employees to pay for health insurance rather as they already pay in this country for national insurance).

III. Replacement by a private insurance system.

In July, health departments' Ministers, and the Chief Secretary discussed how to proceed with further studies of strategy I. It was agreed then to study the scope for:-

- a. Raising more income from charges;
- b. Privatising some parts of the NHS, particularly the General Ophthalmic Dental and Pharmaceutical Services;
- c. Reducing demand for treatment by charging patients the full cost of services received and reimbursing them subsequently (on the lines of the system used in France);
- d. Giving further encouragement to the private health sector through fiscal concessions.

Possible Savings

4. Treasury estimates made earlier this year, not agreed with DHSS, suggested that higher charges might raise £300m or more a year and privatisation of the dental, ophthalmic and pharmaceutical services about the same amount. The effect of c and d above is very difficult to quantify.

Progress So Far

5. Work on the studies which were decided upon in July was held up while the papers on long term public expenditure were being considered. There is now no obstacle to their being pursued in earnest. They would be private, internal studies, which could be carried out without any effect on industrial relations.

6. Other current work which is relevant to the Cabinet remit includes the numerous initiatives on NHS efficiency, and the move to promote increased contracting out of NHS function. These are going ahead separately.

Line to Take

7. You are recommended to tell Mr Fowler that you see vigorous pursuit of the July studies as the main way of meeting the remit on LTPE.