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cc Mr Mount
Sir Alan Walters

PUBLIC EXPENDITURE: THE LONG TERM AND THE SHORT

The Chancellor may well present a picture such as this:- The Government's problem on expenditure is that it has made steady gains, by a process of attrition, in wearing down public expenditure by means of a cash squeeze on spending departments. These have been achieved largely by bilateral discussions; very few disagreements, on politically sensitive subjects (eg student loans, council house rents), have had to be resolved at Cabinet level. Yet the long-term position looks very worrying. The Forward Look exercise failed to yield proposals for substantial savings. On the contrary, the departments involved collectively forecast increases in real terms of £5 billion. This would imply a constant ratio of spending to GDP on the most optimistic growth assumptions.

On less optimistic forecasts this proportion would increase. Far from being rolled back the frontiers of the state could roll on top of the Government. A standard rate of tax of 25% is not deliverable on present plans.

Clearly there is a need for a strategy which spells out

- where the Government wants to be in 1988 in terms of its borrowing, its levels of taxation, and its spending.

- the path by which it hopes to get there.

If the control of inflation objective rules out increases in borrowing it follows that the reduction in levels of taxation can only be achieved by reduced expenditure. The strategy therefore needs to relate all short-term expenditure plans, including the next year's, to this long-term objective. Unless this objective is understood and agreed there can be no basis for resolving arguments about the means, which will be difficult. Better housekeeping will not be enough; some major programmes will have to go. Departments themselves have too many vested interests in these programmes and cannot be relied upon to propose major sacrifices. They failed to do so in the Forward Look exercise and they are failing to do so in the latest LTPE exercise.

The Prime Minister will wish to discuss with the Chancellor how such a pruning exercise might be handled. A crude formula of equal misery for all departments is out of the question: demographic and social pressures will be pushing up some major items (pensions, health and education).

A better, perhaps the only solution would be to phase out those items of discretionary expenditure which are inconsistent with the Government's market philosophy, such as:

- investment subsidies of various kinds for industry, trade and agriculture;

- operating subsidies for the coal industry and the railways;

- the protectionist stance towards the defence equipment industries which results in premia over off-the-shelf "alternatives" of anything up to 60% (cf HARM/ALARM). The defence equipment bill is expected to reach £8 billion by 1985/86. Savings of, say, 20% on this could yield £1600 m.

Options such as these raise intensively difficult questions but unless a start is made now to tackle them, under Treasury chairmanship, it is difficult to see how a 25% standard rate of tax could be delivered by 1988.

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