

Law
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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

PUBLIC EXPENDITURE IN 1983-84: CORRECTIVE ACTION

This minute sets out an issue which I should like to discuss with you at tomorrow's meeting.

2. At Budget time we forecast a PSBR of £8.2 billion for the current financial year. The summer forecast, just being completed, suggests that this will be overrun by over £3 billion.

3. There is of course a considerable margin of error about this figure, and there may be some grounds for scepticism about new fiscal projections which partially explain it: I shall be examining them closely. But clearly we face a real problem. And the main monetary aggregates are running way ahead of the indicated range published at Budget time. The trade figures for May were poor, and Sterling, though still high, may come under pressure if the upward movement in American interest rates is maintained. I have therefore been considering whether some immediate corrective action is needed to reassure market confidence immediately and (more important) to secure an outturn for the year closer to our original strategy.

4. One possibility, which we are already examining, is the sale of a further tranche of the Government's holding in BP. This could raise up to £500/600 million.

5. But public expenditure accounts for by far the largest part of the forecast PSBR overrun - see attached table. Much of this is higher estimates for non-cash-limited demand-determined programmes, notably agricultural support and social security benefits. Local authority current expenditure is also likely to be rather higher - and rate income lower - than we expected. The



nationalised industries are expected to borrow more than we had allowed for. The forecasters - following the experience of end 82/3 - now expect over £½ billion less shortfall on cash limited expenditure than had been assumed in the Budget. About £300 million of this is on defence votes, and the rest spread across the field.

6. It is not practicable, within the year, to take action to offset the increases on non-cash limited expenditure by changes in agricultural support or social security benefits (where we have only just announced the upratings). But we could take action on cash limits aimed broadly at reducing the overall rate of spending on those programmes to what we had assumed earlier (when we expected shortfall to be higher).

7. I do not think we could avoid some exceptions, notably the pay and running costs of the Civil Service and armed forces, reflecting our agreement earlier in the year to finance the non-industrial Civil Service pay award from within this total, which is as a result already under some strain. In my view the best option would thus be a reduction of 2 per cent on the non-pay element of central government cash limits.

8. This would mean excluding RSG, because it is very doubtful whether any cuts would achieve public expenditure savings. To include capital expenditure of local authorities and certain public bodies might also not be effective, and would clearly run counter to the Government's earlier efforts to avoid under-spending on those programmes. However, central government capital spending would be included.

9. This package would be expected to yield some £300 - 500 million gross in public expenditure savings, though there would be some offset to the extent that under-spending on these programmes was reduced.



10. To discourage a repetition of last year's end-year surge, we could also proceed with a scheme of end-year flexibility of the kind which the previous Chief Secretary proposed to his colleagues earlier in the year. There would be considerable managerial advantages in such a scheme, and introducing it should be welcomed by spending Departments. It would also mean that spending in this financial year would be reduced - by how much is uncertain, but the full amount of under-spending at stake on relevant programmes could be as much as £0.5 billion. This would of course represent some additional pressure in 1984-85 (on which the Chief Secretary has already sent you a minute), but this in turn should be at least partially offset by the carry-forward of the effects of putting a brake on spending now by cutting the non-pay cash limits.

11. Taken together these two measures should reduce public spending and the PSBR by £0.5 billion or more this year. Even with a BP sale as well, that would not dispose of the PSBR problem, but the case for immediate action is nonetheless strong. First, the sooner we decide to reduce expenditure the easier and less damaging it will be. Secondly, an early decision should help to dispel the impression that has got about in the public sector, perhaps partly as a result of last winter's exercise to prevent a PSBR under-shoot, that we are now less determined than we were to insist on strict financial discipline. Thirdly, an early announcement should forestall anxiety within the markets. If we put off action until after the summer recess there is a real risk that we will be forced to take even more severe action as a result of market pressures.

12. So my instinct is to try to get these two measures agreed very quickly. I do of course recognise the political difficulties of taking such action so soon after the election, and while taking through the House a Finance Bill confirming tax reliefs, mainly for the better off, amounting to some £250 million. But our commitment to the Finance Bill is firm, and our supporters are more likely to be reassured than dismayed by measures to curb an



increase in planned expenditure.

13. The present problem arises, to a large extent, because it has proved so difficult to provide reliable forecasts of rates of spending, even very late in the year. This is a problem throughout the year, but it is especially acute towards the year-end, as Departments seek to spend up to their cash limits. I intend therefore to seek the co-operation of spending Ministers in improving the financial information flows from their departments to the Treasury during and particularly at the end of the financial year. Detailed proposals will be made at official level shortly.

14. To sum up, in addition to pursuing the possible BP sale, I propose:-

a. a reduction of 2 per cent in the non-pay element of all cash limits - with certain exceptions - to yield up to £300 - £500 million in 1983-84;

b. the introduction of a scheme of end-year flexibility on capital expenditure at the end of 1983-84 which, together with (a), should take the saving this year to £500 million or more; and

c. to seek the co-operation of all spending Ministers in improving information flows to the Treasury about the course of expenditure during the year.

15. If you agree, I will prepare a paper for Cabinet setting out these proposals. It seems to me desirable to separate this exercise from consideration of the public expenditure projections for future years, due on 21 July (see the Chief Secretary's minute of 27 June). I would favour Cabinet considering action on the

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current year as soon as possible, say on 7 July. But we can discuss that tomorrow.

N.

(NL)
29 June 1983

MAIN CHANGES TO THE BUDGET FORECAST OF THE PSBR

Changes to
Expenditure Receipts
£ billion

CommentsCentral Government Receipts

1	Inland Revenue (non-North Sea)	-0.6	Mainly lower forecast of wage and salary bill
2	Total North Sea Receipts	+0.8	Mostly higher production levels.
3	Customs & Excise	0	Forecast of poorer compliance than expected at budget time; offset by higher consumer spending.

Central Government Expenditure

4	Cash-limited items	+0.6	Lower estimate of shortfall reflecting experience in 1982-83 (particularly on defence) and fresh look at historical experience by programme.
5	Non-cash-limited items of which:	+1.1	
	Agricultural Support	(+0.3)	Higher beef production and lower beef prices; higher milk production.
	Grants	(+0.3)	Higher estimates of take-up of housing benefits; higher estimate of number of social security recipients.
	Family Practitioner Services	(+0.1)	Poor estimate at Budget time.
	EC Contributions	(+0.3)	Mainly lower refund.
6	Debt Interest (net)	+0.5	Effects of higher borrowing and estimating revisions.
7	<u>Central Government Financial Transactions</u>	-0.3	Assumed delay in sale by BGC of North Sea oil interests.
8	<u>Local Authorities Borrowing</u>	+0.9	
	of which:		
	Rate Income	(-0.5)	Poor estimate of average rate increases this year.
	Current Expenditure	(+0.3)	Implications of higher overspend than expected in 1982-83.
9	<u>Public Corporations' Borrowing</u>	+0.3	
	of which:		
	Nationalised Industries' Trading Surpluses	(-0.5)	Downward revision to industries' expected sales this year (reflecting new information from industries); some price increases reduced or delayed.
	<u>PSBR total change</u>	<u>+3.5</u>	

In box but not seen by

PM - please PA

SECRET

29 June 1983

Policy Unit

PRIME MINISTER

MCS 30/6

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Prime Minister (2)

cc Defence Budget file

DEFENCE AND PUBLIC EXPENDITURE

Chief Secretary's in the folder for tomorrow's meeting with the Chancellor
MCS 29/6
The Chancellor's paper on The 1983 Survey and The Longer Term leads, I think, to one overwhelming conclusion: that the prime candidate for reduction in expenditure, this year and for the foreseeable future, must be Defence. The overruns are bigger; the commitment up to 1985/86 is larger; the control of expenditure feeble; and the lack of collective discussion the most painfully felt.

All these defects are obvious in the way Michael Heseltine has presented the Harm/Alarm decision. You will not need the arguments rehearsed yet again. But there is no other area of Government expenditure where £150 million could be so easily saved and performance of the function actually improved. I know of your concern to keep high technology teams together and keep Britain in the forefront of that technology, but so long as defence is the most obvious "soft touch" in the public sector:

- (i) Our research effort will continue to be over-concentrated on Defence, to the detriment of our ability to compete in all other industries.
- (ii) The commercial aspects will continue to predominate over military priorities. I understand that not only the military but also the officials in the MOD are united, almost to a man, in preferring Harm.
- (iii) The MOD will continue to keep these issues in-house and try to avoid thorough collective discussion as far as possible, because they know how weak their case is.

There are other reasons for preferring Harm to Alarm, eg the difficulty of persuading the Americans to buy our advanced military hardware if we refuse to buy theirs, when it is evidently cheaper and superior. But I think the most crucial one for the future of this Government is that, at the outset of the second term, with all the public expenditure difficulties which we now face, we should show that we mean business in controlling expenditure in the Department where the need is greatest.

FERDINAND MOUNT

fm

SECRET



Michael.

A personal preview.

Something like this
will reach you tonight.

John

29.6.83

Secret



25
FROM: J O KERR

DATE: 29 JUNE 1983

cc Chief Secretary
Mr Middleton
Sir T Burns
Mr Battishill
Mr Mountfield
Mr Hart
Mr Stibbard
Mr Ridley

MR A M BAILEY

PUBLIC EXPENDITURE AND PSBR: 1983-84

The Chancellor has worked over-night on the draft minute to the Prime Minister which you submitted on 28 June. He is clear that he does want to send such a minute, and to do so today: but he proposes a number of changes to the draft. I attach a clean version.

The Chancellor asked the Chief Secretary to let him have advice on these papers during the course of the day. It might be helpful if you could route your reactions to the attached text to the Chancellor via the Chief Secretary.

J.O.K.

J O KERR



Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

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3. There are grounds for scepticism about new fiscal projections explaining part of the increase in the forecast PSBR, and I shall be examining them closely. But public expenditure accounts for by far the largest part: see attached table. Much of this is raised estimates for non-cash-limited demand-determined programmes, notably agricultural support and social security benefits. Local authority current expenditure is also likely to be rather higher - and rate income lower - than we expected. The nationalised industries are expected to borrow more than we had allowed for. The forecasters - following the experience of end 82/3 - now expect over £½ billion less shortfall on cash limited expenditure than had been assumed in the Budget. About £300 million of this is on defence votes, and the rest spread across the field.

4. It is not practicable, within the year, to take action to offset the increases on non-cash limited expenditure by changes in agricultural support or social security benefits (where we have only just announced the upratings.) But we could take action to reduce the rate of spending on cash-limited programmes to



what we had assumed earlier (when we expected shortfall to be higher). In my view the best option is a reduction of 2 per cent on the non-pay element of central government cash limits.

5. I do not think we can avoid some exceptions, notably the running costs of the Civil Service and armed forces, rate support grant to local authorities, and the capital expenditure of local authorities and certain public corporations. The exception of pay and running costs reflects our agreement earlier in the year to finance the non-industrial Civil Service pay award from within this total, which is therefore already under some strain. RSG is excluded because it is very doubtful whether any cuts would achieve public expenditure savings. To include capital expenditure of local authorities and certain public bodies might also not be effective, and would clearly run counter to the Government's earlier efforts to avoid under-spending on those programmes. However, central government capital spending would be included. This package is expected to yield some £300-350m in public expenditure savings, though there will be some PSBR offset to the extent that under-spending on these programmes is reduced.

6. To discourage a repetition of last year's end-year surge, I propose that we should also proceed with a scheme of end-year flexibility of the kind which the previous Chief Secretary proposed to his colleagues earlier in the year. There are considerable managerial advantages in such a scheme, and introducing it should be welcomed by spending Departments. It will also mean that spending this financial year is reduced by some £0.5 B. This will of course be balanced by some additional pressure in 1984/85 (on which the Chief Secretary has already sent you a minute), but this in turn should be at least partially offset by the carry-forward of the effects of putting a brake on spending now by cutting the non-pay cash limits.

7. Even taken together these two measures will not dispose of the PSBR problem but they will help, and should change the climate on spending issues. This is crucial, for it seems clear that, perhaps partly as a result of last winter's exercise to prevent a PSBR under-shoot, the impression has got about that we are now less determined than we were to insist on strict financial discipline. It is of course unfortunate that we have to act so soon after the Election, but we



have in fact little choice . To delay until September would make the cut in cash limits very much harder to impose and implement.

8. The present problem arises to a large extent, because it has proved so difficult to provide reliable forecasts of rates of spending, even very late in the year. I intend therefore to seek the co-operation of spending Ministers in improving the financial information flows from their departments to the Treasury during and particularly at the end of the financial year. Detailed proposals will be made at official level shortly.

9. To sum up, I propose:

a. a reduction of 2 per cent in the non-pay element of all cash limits - with certain exceptions - to yield up to £300-£350 million in 1983-84;

b. the introduction of a scheme of end-year flexibility on capital expenditure at the end of 1983-84 which should reduce spending this year by up to a further £500 million;

c. to seek the co-operation of all spending Ministers in improving information flows to the Treasury about the course of expenditure during the year.

10. If you agree, I will prepare a paper for Cabinet setting out these proposals. It seems to me desirable to separate this exercise from consideration of the public expenditure projections for future years, due on 21 July (see the Chief Secretary's minute of 27 June). I would favour Cabinet considering action on the current year as soon as possible, say on 7 July. But we can discuss that tomorrow.

(N.L.)

29 June 1983

MAIN CHANGES TO THE BUDGET FORECAST OF THE PSBR

	<u>Changes to</u>		
	<u>Expenditure</u>	<u>Receipts</u>	<u>Comments</u>
	<u>£ billion</u>		
<u>Central Govt Receipts</u>			
<u>Inland Revenue (non-N/Sea)</u>		- 0.6	Lower employment and earnings; more tax relief on mortgage interest. <i>because interest rates higher</i>
North Sea Receipts (PRT, SPD, Royalties)		+ 0.8	Mainly higher production levels.
Customs & Excise		0	Effects of poorer compliance and lower prices offset by higher expenditure volumes.
<u>Central Government Expenditure</u>			Lower estimate of shortfall reflecting experience in 1982-83 (particularly on defence) and fresh look at historical experience by programme.
Cash-limited items	+ 0.6		
Non-cash-limited items of which:	+ 0.8		
Agricultural Support	(0.3)		Supplementary estimate already presented
Grants	(0.3)		Upward estimating revisions on take-up of housing benefits plus social security and student awards.
Family Practitioner Services	(0.1)		Poor estimate at Budget time
EC Contributions	0.3		Lower refund
Debt Interest (Net)	0.5		Higher borrowing and estimating revisions
<u>Central Government Financial Transactions</u>		- 0.3	Delayed sale by BGC of "Holdings"
<u>Local Authorities Borrowing</u>		+0.9	
of which:			Bad estimate of average rate increases this year.
Rate Income		- 0.5	
Current Expenditure	0.3		Higher overspend than expected in 1982-83
<u>Public Corporations' Borrowing</u>		+0.3	
of which:			Downward revision to NIs' expected output this year (reflecting new information from industries) and some price increases reduced or delayed.
National Industries' Trading Surpluses		- 0.5	
<u>SBR total change</u>		<u>3.5</u>	