CONFIDENTIAL

PRIME MINISTER

I am most concerned about DHSS. It looks out of control. We need a meeting with all Ministers + P.U.'s & Treasury. We can't go on like this. Housing Benefit seems similarly out of control. MT

PUBLIC EXPENDITURE REVIEW

The Policy Unit suggested to you recently that it would be useful, before the start of the PES round, to identify areas where public expenditure might be saved. The Policy Unit have had talks with the Treasury which have generated the proposals in the Chief Secretary's minute. In addition to these five subjects, a review of agriculture has already been put in hand and work is continuing on control of Community expenditure (attribution and non-additionality). One area not covered by the Chief Secretary, but which the Policy Unit wish to pursue, is industrial support from INMOS through to British Leyland. They will be preparing a further note on this.

The way forward on each of the Treasury's suggestions appears to be:

(i) Urban Programme: you should minute the Secretary of State for the Environment, using Treasury-provided draft. Treasury can approach P.U. verbally.

(ii) Defence Equipment: paper to be commissioned at next meeting of OD. Yes MT

cf CST's letter to Mr Fowler

(iii) & (iv) Family Practitioner Service and Social Security Benefits: Chief Secretary to approach Mr. Fowler, to set up joint work by their officials.

(v) Territorial Programmes: I believe that Michael Scholar mentioned this to you recently. The Treasury have done a great deal of work which points to the conclusion that spending, in relation to "needs", in Scotland and Northern Ireland is substantially higher than in England and Wales. Before approaching the Ministers responsible, you may want to look at a note by the Treasury setting out the prosecution case. Yes MT

Agree to proceed in this way?

AT

23 December 1983

TODAYS F Times

Treasury shelves work on public spending study

BY MAX WILKINSON, ECONOMICS CORRESPONDENT

[TH]E TREASURY has shelved [pl]ans to publish a strategy docu[me]nt on public spending early [th]is year because of anxieties [ex]pressed by senior ministers.

Mr Nigel Lawson, Chancellor [of] the Exchequer, said last [su]mmer that he wanted to pro[m]ote a debate about public [s]pending programmes over the [n]ext 10 years.

One of his aims was to con[v]ince the nation that public spending could not be allowed [t]o rise nearly as fast as it had [d]one in most of the post-war period if the Government were to stick to its anti-inflation strategy and reduce taxes.

He set the Treasury, in consultation with spending departments, to work out detailed projections for public spending, particularly in the sectors of health, education, defence and social security.

By late autumn, the work was running into difficulties about the future shape of the welfare state and Britain's defence commitments for the next 10 years.

Treasury officials found they could not make sensible projections without some decisions in principle from the highest political level.

An important issue, for example, is whether it should be assured that the National Health Service will provide at least the present standard of care for the whole population, or whether private health schemes will be encouraged to take an increased share of the burden.

Another hot political question is whether pensioners and the unemployed can expect their benefits to be fully protected against inflation beyond the life of this parliament.

A recent study by the Paris-based Organisation for Economic Co-operation and Development has suggested that social benefits will need to be cut in most countries if public spending is to stay under control.

However, in discussions towards the end of last year Cabinet ministers showed reluctance to take controversial or unpalatable decisions on such questions for periods which seem remote in political terms.

The Prime Minister is known to be anxious that the Government should avoid the political controversy which surrounded the Treasury's last long-term public spending exercise, extensively leaked at the time of the last election.

This study suggested that radical decisions would be needed to curb the growth of many spending programmes.

The Treasury also suggested in a commentary on the study that former pledges, like the present commitment to protect pensions against inflation, "should be allowed to expire."

It has since been suggested that the Treasury's assumptions about possible rates of economic growth and Government revenues may have been unduly pessimistic.

The Institute for Fiscal Studies (the independent "think tank" for tax matters) has calculated, for example, that if the economy grows at an average rate of 1½ per cent a year, public spending will remain at about the present proportion of national output without any radical surgery being needed.

In formulating its new study on spending, the Treasury has run up against a problem of presentation. It believes the consequences of very low growth, perhaps ¾ per cent to ½ per cent a year, need to be examined.

But it fears projections based on such "pessimistic" assumptions might be viewed as undermining confidence in the Government's strategy for promoting a "sustainable economic recovery."

Ministers will not be anxious to put their names to hypothetical spending cuts which might not be necessary.

There are, in addition, differences in the Cabinet between ministers like Mr John Biffen, Leader of the House, who does not want to see a radical attack on the welfare state, and other ministers who would like to see a much more "self help" society with lower public spending and lower taxes.

The Treasury has put its work on long-term public spending on the shelf and the idea of a Green Paper on the subject, mooted in the early autumn, appears to have been firmly ruled out for now.