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Prime Minister

This will be on the morning of a Questions day, but it was last year without difficulty. I do not think there is much new which will cause controversy, except perhaps defence. We will obtain the briefing referred to at X.

AT 20/1

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

D M Barclay Esq
PS/Prime Minister
10 Downing Street
LONDON
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20 January 1984

Dear David

PUBLICATION OF 1984 PUBLIC EXPENDITURE WHITE PAPER

The preparation of the 1984 White Paper is on schedule for publication in mid-February as planned. If the Prime Minister is content, the Chief Secretary proposes that publication should be on Thursday 16 February. Publication earlier in that week is not possible as the Chief Secretary is attending an OECD Ministerial ~~meetings~~ meeting in Paris from 12 to 15 February. Our consultations show that publication of the White Paper on 16 February would not clash with any other major publication or announcement.

There was no oral statement last year on publication of the White Paper and a statement does not seem necessary on this occasion. It should be sufficient to announce the date and time of publication in a Written Answer shortly before and then place copies in the Vote Office.

As in the past, we expect the Chief Secretary will take an on-the-record press conference on the White Paper at 3.30 pm. on 16 February.

As the White Paper is a long and complex document, we propose to issue Confidential Final Revises (CFRs) on the afternoon of Wednesday 15 February, embargoed until 3.30 pm. on the following day. The Treasury's Press Office, in making their arrangements for publication, will consult and agree these in the usual way with your Press Office at No. 10.

X I am copying this letter to David Heyhoe (Lord Privy Seal's Office). We shall of course provide Mr Biffen with briefing on the White Paper for his meeting with the Lobby on the same day.

Yours sincerely

JSL Gieve

JOHN GIEVE
Private Secretary

CONFIDENTIAL

DRAFT CABINET PAPER

PUBLIC EXPENDITURE AND TAXATION IN THE LONGER TERM
MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

A public debate on the longer-term prospects for public expenditure has been under way for some time. It should prove useful, for our declared aim is to reduce the burden of public spending and taxation, and it will help if we can, by emphasising the fiscal rewards, widen support for reining back the growth in public expenditure and so taxation. I believe that the time has now come for us to contribute to the debate. In any event, the Treasury and Civil Service Committee are about to call for a paper on the issue; and we shall have to comply. The right course is, I believe, to publish a Green Paper, or some other form of discussion document.

2. But obviously this is not without difficulties:-

i. Different expenditure programmes have enormously varying timescales - for example, the full burden of the State earnings-related pension scheme does not arise until well into the next century.

ii. There are major uncertainties - for example about the rate of growth of output. This can be handled by giving alternative projections, but the risk is that these will blur the message.

iii. Some key economic assumptions - for example the rates of decline in unemployment, and of growth of real earnings - may be misrepresented as forecasts or even objectives.

More significantly, the 1982 work on long-term public expenditure, which was leaked to the press, shows the difficulties of projecting individual Departmental programme totals, forecasts of which are at once misrepresented as Government commitments or Treasury aims.

3. To meet these problems the Chief Secretary and I now propose a different approach, which would avoid the need to display any individual programme figures. As explained in

C(84)[ ], I shall need to publish a new medium term financial strategy (MTFS) with the Budget, and I believe that it should extend to 1988-89, thus including expenditure totals for two further years beyond the 1986-87 horizon of this month's Public Expenditure White Paper. I propose the simultaneous publication of a Green Paper projecting overall public expenditure totals forward, on alternative assumptions, for a further 5 years to 1993-94, and showing what this would mean for the burden of taxation.

4. The Green Paper would start with two introductory sections:

i. A section on past public expenditure trends, showing the seemingly inexorable rise over the past 20 years, at an annual average rate of 1½ per cent, taking the total to over 40 per cent of GDP: and, in parallel, the growth in the burden of taxation, now up to 39 per cent of GDP compared with the 1978-79 level of 34 per cent. This section would also show how, notwithstanding the considerable contribution North Sea taxation has made to the public finances, the burden of non-North Sea taxation has grown since 1978-79, from 35 per cent to 39 per cent of non-North Sea GDP.

ii. A section drawing attention to likely pressures for further spending increases over the next decade - eg demography (health and social services), technology (notably defence and health), and capital infrastructure.

5. The central part of the paper would recall our 1979 commitment to reduce public expenditure as a proportion of GDP, and the actual course of events, which saw a sharp rise in this proportion, to a peak of 44 per cent of GDP in 1981-82. It would explain the reasons, which are in no way disreputable, and owe much to the recession. But it would go on to show how the tax burden could be reduced and economic prospects improved if, with recovery well under way, these pressures were held in check, and the public expenditure totals held constant in real terms through to 1993-94.

6. The annex sets out some projections, (which would require reworking before publication). The main case assumes 2% GDP growth, and shows that with expenditure held constant in real terms throughout, the non-North-Sea tax burden would still be above the 1978-79 level (which we denounced at the time as too high) by 1988-89, and around 32% by 1993-94, ie just below the 1973-74 level (33%), but still some way above the level of the early 1960s. This would produce a sharp improvement in incentives. If other taxes

were held constant as a proportion of GDP, the rate of income tax could be reduced to 25p and allowances raised substantially, bringing the married man's allowance to nearly 60% of average male earnings as against 31% now. In practice, of course, some of the revenue would certainly be used to reduce the burden on the corporate sector.

7. It would of course be possible to illustrate other cases - for example an annual growth in expenditure of ½% or 1% after 1988-89. But if we do not leave ourselves room for substantial tax reductions, the rate of GDP growth would be unlikely to maintain the 2% average: the average over the past decade was only 0.9%. The annex takes 1½% GDP growth as a lower variant, and shows that with 1% growth in expenditure we could expect to get the non-North-Sea tax burden back to the 1978-79 level only at the very end of the 10 year period.

8. If Cabinet agrees to the principle of publishing a Green Paper at Budget time, I would welcome views on the appropriate spending assumption for the period after 1988-89, and would circulate a full text for clearance within the next fortnight.

ANNEX: PROJECTIONS OF PUBLIC FINANCES TO 1993-94

1. The projections discussed here illustrate various paths of public expenditure over the next decade, and their implications for the burden of taxation.

2. A key factor in the projections is the assumed rate of economic growth. This affects not only the amount of tax which is collected for given rates and allowances, but also the burden of taxation associated with given paths of public expenditure and borrowing. For the first five years of the projections, to 1988-89, GDP is assumed to grow by an average 2¼% per annum. Thereafter, there are two factors pointing to some slow down in the growth rate: the North Sea sector will by then be contributing minus ½% per annum to total GDP growth; and the growth of the labour supply will be somewhat less than in the first half of the decade.

3. The growth rate after 1988-89 will depend in part on the success of policy in bringing down the share of public expenditure and the burden of taxation. Accordingly we consider two cases. In the first, total GDP grows by 2% per annum, equivalent to about 2½% per annum for the non-North Sea sector. This is about the average for the post-war period, and significantly better than the last decade. In the second case total GDP grows at 1½% annum, equivalent to about 2% for the non-North Sea sector. Higher growth is more likely, the greater the reduction in the tax burden.

4. The path of North Sea tax revenues has an important bearing on the burden of non-North Sea taxation. Apart from the profile of production, the behaviour of real oil prices is of key importance. It is assumed here that after falling over the next two years or so in real terms, they flatten off and then start to rise again as the balance of supply and demand becomes progressively tighter. From 1988-89 they may be rising by 2-3% per annum, but even so North Sea revenues fall from about 3% of GDP in 1984-85 to about 1½% in 1993-94 as output falls.

5. Another important feature of the projections is the path of net debt interest payments. This reflects the paths of public sector borrowing and interest rates. On the latter, some fall in real interest rates from present high levels is to be expected, with the path depending on the course of the PSBR and world interest rates. Falling inflation also points to lower nominal rates. If stable prices are achieved by the end of the period and real interest rates have come down to more normal levels, then net debt interest may fall from about 3% in 1983-84 to a bit under 1½% in 1993-94. This more than offsets the fall in North Sea taxes.

6. Falling inflation and interest rates require a reduction in the PSBR as a percentage of GDP. It is not possible at this stage to anticipate the path in the MTFS, but for the purposes of this exercise we assume that it falls gradually to 1% by the end of the period.

7. It follows from these assumptions that the non-North Sea tax burden can be lightened to the extent that the fall in public expenditure relative to GDP exceeds the required reduction in the PSBR. By 1988-89, even if the public expenditure planning total is held flat in real terms - in line with the MTFS, but 2 years longer than in the Public Expenditure White Paper - the non-North Sea tax burden would still be above its level in 1978-79*. The figures are shown below.

I assume this is the 2¼ growth case.

The Burden of Taxation in the MTFS period

	1978-79	1983-84	1988-89
Non-North Sea Tax	34.7	38.6	35½
Total Taxes	34.1	38.8	36

8. By 1993-94, some further reduction in the tax burden should be possible if the growth of public expenditure is held in check. Figures are presented here, for the two GDP paths discussed earlier, on two different assumptions about public expenditure. The assumptions are for growth in the planning total of zero and 1% per annum in real terms after 1988-89. The tax implications are summarised in the table below.

The Burden of Non-North Sea Taxation in 1993-94

	Public Expenditure Growth (pa)	
GDP growth (pa)	zero	1%
1½%	32¾	34½ ← ie about starting point ~ 1978-79
2%	31¾	33½

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*The burden of non-North Sea taxes is defined as non-North Sea tax revenues as a share of non-North Sea GDP. It falls more than the share of non-North Sea taxes in total GDP because of the declining contribution of North Sea output total GDP. Recent data for the total tax burden are as follows:

1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
36.5	36.4	35.4	34.7	35.7	36.9	39.6	39.5	38.6

9. If the public expenditure planning total were to be held flat, the burden of non-North Sea tax could be brought down to well below its 1978-79 level of 34.7% by 1993-94. The higher growth assumption is more likely to be the appropriate one in this case. But even so, the tax burden would be only fractionally lower than it was in 1973-74, the end of the previous Conservative administration, and still some way above the level of the early 1960s.** With 1% growth of public expenditure the picture would be worse. After a decade, the tax burden would be only marginally lower than the 1978-79 figure, which was widely held to be excessively high.

** Figures for the (non-North Sea) tax burden in selected earlier years are:

1963-64	1973-74	1978-79
30%	33%	34.7%