

Ref. A084/445

PRIME MINISTERPublic Expenditure and Taxation in Longer Term(C(84)6

BACKGROUND

Flag A

The Cabinet have discussed long term prospects for public expenditure and taxation on two recent occasions: on 9 September 1982 (CC(82)41st Conclusions, Minute 4) and 21 July 1983 (CC(83)24th Conclusions, Minute 5). Although there were differing views about the extent to which it might be desirable to pursue the objective of reducing taxation at the expense of other policy objectives, there was agreement on both occasions that it was desirable to stimulate an informed public debate on the issues.

Flag B
Flag C

2. Although there has subsequently been a good deal of public debate, it has often been of a kind unhelpful to the Government. The documents prepared for the Cabinet discussion in 1982 leaked and caused serious embarrassment. It has proved difficult for Ministers to discuss hypothetical figures or measures affecting individual expenditure programmes without being misrepresented. The Government has sometimes been obliged to respond by giving assurances about policy in various areas and the effect may have been to constrain rather than increase the Government's freedom of manoeuvre.

3. In his memorandum C(84)6 the Chancellor of the Exchequer suggests that the time has come for the Government to contribute more positively to the public debate. The Treasury and Civil Service Committee (TCSC) intend to mount an enquiry into public expenditure in the longer term and the Government will have to give extensive evidence. The Chancellor proposes, in effect, that the Government should take the initiative by publishing a Green Paper or other form of discussion document at the time of the Budget.

4. The document would not give figures for individual programmes, though it would draw attention in qualitative terms to particular pressures for increased expenditure, such as demographic factors, technology, and capital infrastructure. In outline it would:

- a. give figures for the past 20 years or so;
- b. draw attention to the pressures mentioned above;
- c. set out global figures for public expenditure, taxation and borrowing for the period up to 1993-94 on the assumption that, for the period up to 1988-89, GDP would grow at 2½ per cent a year and public expenditure would be held constant in real terms (as proposed in C(84)5); and, for the period between 1988-89 and 1993-94:
 - i. public expenditure would either be held constant in real terms (described in paragraph 7 of C(84)6 as the "main case") or grow at 1 per cent a year;
 - ii. GDP would grow either at 2 per cent or at 1½ per cent a year.

A further assumption is that the public sector borrowing requirement (PSBR) at the end of the period would be equal to 1 per cent of GDP.

5. The document would be primarily designed to show (paragraphs 5 and 6 of C(84)6) that by holding public expenditure constant in real terms to 1993-94 and on the assumption of 2 per cent growth in GDP the non-North Sea tax burden could be reduced from 39 per cent now to around 32 per cent (compared with 34.7 per cent in 1978-79 and 33 per cent in 1973-74).

MAIN ISSUES

6. The main issues before the Cabinet are as follows:

Please see
Item 4
on Agenda

- i. Is the approach suggested by the Chancellor of the Exchequer satisfactory as regards its substance?
- ii. If so, should the Government take the initiative and publish it as a contribution to public debate?
- iii. Are the form and timing suggested by the Chancellor of the Exchequer satisfactory?

Substance

7. On the substance of the approach suggested by the Chancellor of the Exchequer, three points in particular may attract comment:

- a. whether it is worthwhile and defensible to talk about public expenditure for ten years ahead without talking about individual programmes;
- b. whether it is desirable to illustrate the consequences both of keeping public expenditure constant in real terms and also of 1 per cent real growth;
- c. whether the assumed level of PSBR in 1993-94 (1 per cent) can and should be justified by positive arguments.

Individual programmes

8. The Cabinet will be familiar with the pitfalls of discussing long term trends in individual expenditure programmes. But it may be argued that an illustration of the taxation consequences of a particular level of total public expenditure, given a particular assumption about the PSBR, is little more than an empty exercise in arithmetic. Although the public may be able to grasp the potential benefits in terms of lower personal taxation, little may be achieved in public education if there is no exposure of the hard choices involved in getting there. Since it is intended to

First establish that there is a problem, then go on to hard choices re proceed step by step.



refer to pressures on public expenditure from demographic changes and other factors, should there not be some illustration of how difficult it may be both to meet these pressures and keep public expenditure constant in real terms? There are undoubtedly political risks in proceeding down this track. On the other hand, is the exercise worth doing at all unless these implications are brought out?

Alternative public expenditure assumptions

9. Some may argue that the kind of document envisaged by the Chancellor already ties the Government's hands too much by its emphasis on the benefit of holding public expenditure constant in real terms to 1993-94. They may say that this will provide the Government's opponents with a too convenient Aunt Sally. It may even be seen as a covert attempt by the Treasury to preempt decisions on the overall level of public expenditure not just for the remainder of this Parliament (through the extended MTFS discussed under the previous item) but in the next Parliament as well.

10. There may be criticism from the opposite direction that, although the main case illustrated in the document will be constant public expenditure in real terms, it is also intended to illustrate 1 per cent real growth in public expenditure. It may be argued that this will present a confusing public message. The Chancellor would no doubt reply that the alternative assumption is useful in showing that, for the same level of growth in GDP, a 1 per cent real growth in public expenditure means that the burden of taxation will be nearly two percentage points higher. But it will be necessary for the Government to be clear in its own mind about the purpose of the alternative 1 per cent growth assumption for public expenditure. Is it intended to suggest that the Government has an open mind about the path of public expenditure growth in the 1990s, or is it intended to reinforce the case for holding public expenditure constant?

PSBR assumption

11. The level of PSBR in 1983-84 is obviously an important element in the calculations in the proposed document. In paragraph 6 of the Annex to C(84)6 a figure of 1 per cent of GDP by that year (compared with 2½ per cent in the current MTFS for 1984-85) is presented as an arbitrary statistical assumption required by falling inflation and interest rates. Some Ministers may argue that this is critical to the argument. If a higher PSBR was allowed the calculations would probably show that it was possible to achieve a greater reduction in taxation or less restraint in public expenditure or some mix of the two. If so, it becomes important to establish what benefits can be derived from the assumed level of PSBR in terms of price stability. Should not the document therefore contain some positive argument on this point? If it is thought that such arguments would be difficult to deploy convincingly, may this not be a serious weakness in the document?

Should the Government volunteer its views?

12. The discussion on the substance should have clarified the Cabinet's position on public expenditure in the longer term and the nature of any message which it might want to get across. This will have an important bearing on how far the Government should take an initiative by publishing a document and how far it should merely respond to enquiries from the TCSC.

13. The arguments in favour of taking the initiative are that the Government wishes to encourage public debate and should itself contribute to that debate; and that since it will be necessary to produce a good deal of material in response to requests from the TCSC, there is much to be said for a single considered presentation rather than piecemeal and reactive material, which the TCSC will use in their own way.



14. On the other hand, some members of the Cabinet may feel that the difficulties involved both in the papers prepared for the discussion in 1982 and in the new approach suggested by the Chancellor of the Exchequer are so great as to make it undesirable to volunteer material, and that it would be better simply to respond to requests from the TCSC.

a document of some kind has been more or less promised.

Form and timing

15. The form and timing of any document will inevitably depend on its content. Some members of the Cabinet may feel that the content of the document envisaged in C(84)6 does not quite justify a Green Paper, and that something less formal would be more appropriate.

16. The proposal to publish at the time of the Budget has advantages. In particular, it could be presented as a natural extension of the rolling forward of the medium term financial strategy proposed in C(84)5. Moreover there might be less temptation to criticise the document as too thin and arithmetical if it was presented along with the mass of material at Budget time.

Further action

17. If the Cabinet agree that a document should be prepared, they will no doubt wish to invite the Chancellor of the Exchequer to circulate it in draft for clearance before publication. The strategic importance of a paper of this kind is so great that I believe that the paper should be seen, discussed and endorsed by the whole Cabinet, so that collective responsibility for it is fully engaged. It is indeed possible that the Cabinet may be unwilling to reach final decisions until they have been able to study a full text. If this is right, it will be desirable to invite the Chancellor of the Exchequer to circulate any document in sufficient time to allow Cabinet discussion and time for amendment before publication.

HANDLING

18. You will wish to invite the Chancellor of the Exchequer to introduce his memorandum. All members of the Cabinet are likely to wish to contribute to the discussion. The Lord Privy Seal may have particular comments from the standpoint of relations with the TCSC, and the Lord President of the Council from the standpoint of presentation of the Government's policies.

CONCLUSIONS

19. You will wish the Cabinet to reach conclusions on the following:

- i. Is the substance of the Government's contribution to the public debate on long term prospects for public expenditure and taxation, as proposed in C(84)6, acceptable?
- ii. Should the Government volunteer such a contribution, or await questioning from the TCSC?
- iii. What should be the form and timing of any contribution?



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8 February 1984