

PRIME MINISTER

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PUBLIC EXPENDITURE AND TAXATION IN THE LONGER TERM

You will want to look through the draft Green Paper. It has come out rather well (with much of the credit due to Michael Scholar). Could I draw your attention to the following points:-

- (i) Most of the attention will be focused on Part v beginning at paragraph 48. Despite the suggestions of some Cabinet colleagues that a wide-range of options should be illustrated, table 6 shows only two growth rates for GDP and two for public expenditure, four options in all. The text in paragraph 61 discusses the option of two per cent growth of expenditure. I think any further options would serve only to blur the message.
- (ii) Paragraph 62 seeks to illustrate the options by reference to the effect on income tax.
- (iii) Paragraph 31 no longer refers to possible changes in SERPS. At some stage the Government will have to confront this problem head on, though in the meantime it is probably better not to stir up this hornets nest by an oblique reference in this document.
- (iv) In paragraphs 6 to 7 and in Charts 1 and 2, the ratio of public expenditure to GDP is calculated using general Government expenditure. In the Public Expenditure White Paper the definition of public expenditure was the planning total plus net debt interest. Over the broad sweep of history there is little difference in the trends shown by the two definitions but I think there is a strong case for sticking to the PEWP definition.
- (a) There will be confusion if the public debate is conducted using two definitions.

*I agree.
The other can be deleted.*

- See attached graph ✓
ms
- (b) The PEWP definition showed a fall in the ratio in 1982/3, enabling the Government to claim that the process of reducing expenditure in relation to GDP has already begun. The general Government definition shows a further rise in 1982/3 with the fall not beginning until 1983/4.
- (c) The PEWP definition uses net debt interest which I think makes more sense since it is this which has to be financed from taxation. The general Government definition uses gross debt interest.
- (d) The programme analysis in Chart 4 and tables 1 and 2 is based on the PEWP definition.

The Chancellor has chosen general Government because he believes markets are suspicious about the planning total definition. In my view, the arguments for the White Paper definition are stronger. Which do you prefer? I agree with the PEWP defⁿ

The main criticism that will face the Green Paper is that it poses the question but does not provide the answer, i.e. it seeks to establish that there is a public expenditure problem but does not show what changes in programmes will be made to deal with it. The answer will have to be that the debate needs to start by establishing the argument that there is a need to control public expenditure very tightly, since even this has been challenged. It is not possible to project precisely the costs of individual programmes and an attempt to do so would represent a false degree of precision. The best that can be done is to illustrate, as the Green Paper does, the sources of pressure for higher public expenditure.

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Chart 1

PUBLIC EXPENDITURE IN REAL TERMS 1

£ billion

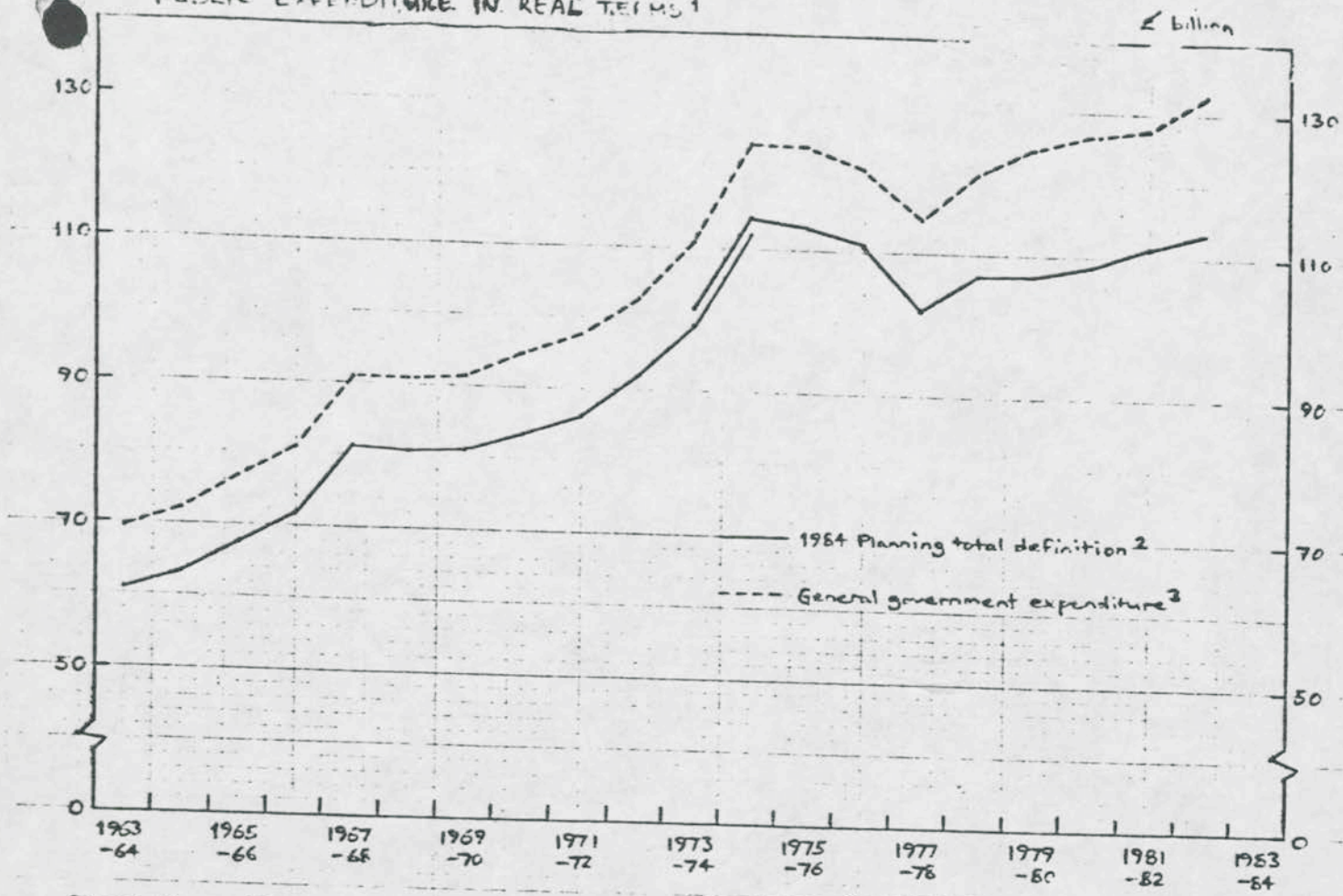
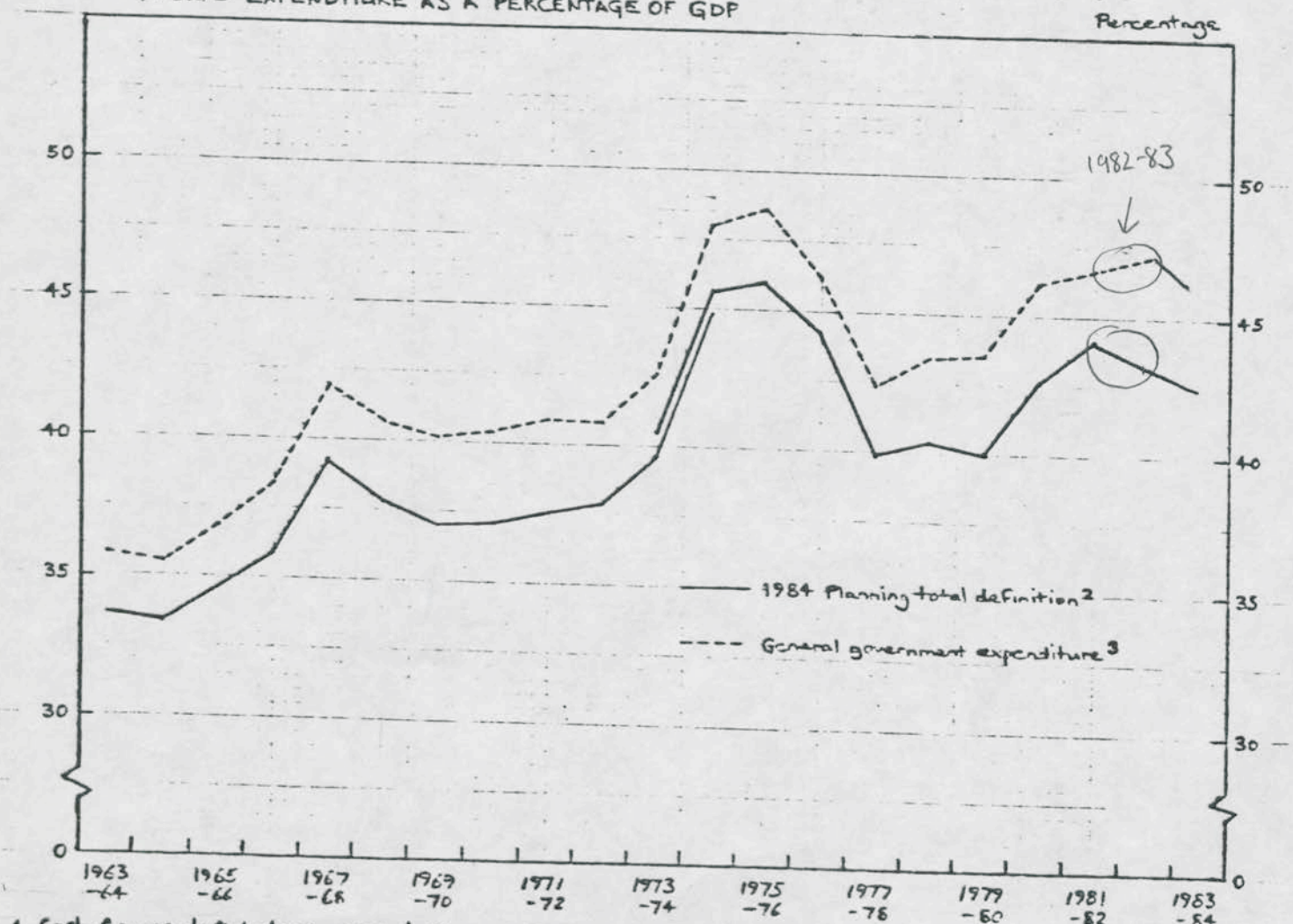


Chart 2

PUBLIC EXPENDITURE AS A PERCENTAGE OF GDP

Percentage



1 Cash figures deflated using GDP deflator 1982-83 = 100.

2 Two overlapping series are given for this definition. The earlier series excludes PC's market's overseas borrowing.

3 National accounts source.