4a-F gcBlot NH6/16M SECRET Treasury Chambers, Parliament Street, SWIP 3AG 01-270 3000 Paul Gray Esq Private Secretary 10 Downing Street LONDON SW1 28 June 1988 Dear Paul, 1988 SURVEY As promised, I attach a paper as background for Wednesday's discussion of the prospects for this year's Survey. Yaux, Mrinz. MOIRA WALLACE



#### PROSPECTS FOR 1988 SURVEY

### Progress to date

1. Our firm grip on public expenditure over recent years has allowed us gradually to reduce general government spending as a share of GDP, to its lowest level since the early 70s, and to balance the Budget, while reducing both the higher and basic rates of income tax. But the overall burden of tax, at 37.7 per cent of GDP (even excluding the North Sea) still remains well above the 34.3 per cent figure we inherited in 1979. There thus remains a major task ahead of us if we are to get below the burden of tax we inherited, which will require more years of public expenditure declining as a share of GDP.

### The existing plans

2. To reduce the burden of tax we need in effect to keep the growth of departmental spending (ie the planning total, including the reserves, but excluding privatisation proceeds) below the growth of GDP. The existing plans imply real increases of around 2½ per cent a year, compared with a assumed trend growth of GDP of 2½ per cent, and are thus consistent with a steady reduction in the tax burden in the medium-term, offering the prospect of getting the basic rate down to 20p in the next Parliament, if not in this. But this is very close to the maximum rate of growth consistent with that objective.

## Prospects for the 1988 Survey

3. It is against this background that we have to assess the bids in the current Survey. These already total £8 $\frac{1}{2}$  billion, £12 billion and £17 billion for the three Survey years, with the

hreat of more to come - not to mention the pressures to do more for particular groups that will inevitably emerge in future Surveys. A proportion of these bids consists of estimating changes that will be difficult to resist; but a much larger proportion this year represents proposals for new policy initiatives. The size of these bids clearly puts our objectives at risk. If we adopted the same pattern of reserves as we did last year (£3.5/7.0/10.5 billion), there would be room in this Survey to draw down the reserves for each year by £3.5 billion, though at the end of the day it may well be prudent to provide slightly higher reserves than this. Hence we can at most add £3.5 billion in each year to programmes without exceeding the planning totals in the White Paper, and possibly less. The bids are thus far in excess of what we can accommodate by drawing down reserves. The Annex shows what the consequences would be if they were accepted in full. Even if we cut the bids back by the same amounts as we did last year, (£3 billion, £4.5 billion and £6 billion), that would imply that: departmental programmes would grow at over 3 per cent a year in real terms - faster than the trend growth of the economy. General Government Expenditure (excluding privatisation proceeds) would grow faster than its average rate of growth since 1978-79, thus marking an end to the progress we have made in reducing the real growth rate of public spending. the fall in the ratio of General Government Expenditure to GDP might slow to a virtual halt around the end of the Survey period; there would no longer be a prospect of a decline in the tax burden (excluding the North Sea); we could make at best only very slow progress towards a 20p basic rate.

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markets. They would say that we had built in massive spending commitments for the period up to 1991 on the basis of a rate of economic growth in 1987 and 1988 which might not be sustained; and that we had lost our grip on public spending, when the battle against inflation clearly requires restraint; compromised the attempt to shift the balance between the public and private sectors; undermined our policy of sound finance; and jeopardised our chances of continuing the tax reductions which have given the British economy its new-found vigour.

### Conclusion

- 6. Clearly we must do better. The bids for health (£1.9 billion in the first year, rising to £3.5 billion in the last) include large bids for capital expenditure which must be scaled down: they are out of proportion to the rest of the programme and would only lead to unsustainable running costs demands in later years. Social security bids total £2.7 billion in the last year: difficult decisions will be needed eg on disability benefits, which are now being reviewed. The bids for education, the Home Office, and Transport represent extraordinary increases (18 per cent, 24 per cent and 26 per cent of the respective baselines in the last year) and will have to be dramatically scaled back. Tough decisions will be needed on defence too. We will have to find savings on industry and agriculture - and, with unemployment falling fast and at its lowest since 1981, we should look for net reductions on the employment programme where, far from savings being offered, increases are sought.
- 7. Within the total bids, those for running costs are also high. They would supply a rise in civil service costs of 5% in real terms in 1989-90, and an increase in civil service numbers to over 600,000 by 1991-92.
- 8. A number of the bids are for increased construction spending. The construction industry is now very stretched and prices are rising faster than inflation for the first time for a number of years. We must in particular avoid adding to the pressures in this sector.

If we are to maintain the policies which have brought success, we will have to put to Cabinet next month the need for determined efforts in all areas.

# PUBLIC EXPENDITURE AND TAX 1978-79 TO 1991-92

	General Government Expenditure excluding privatisation proceeds			Non-oil tax burden
	1	2	3	4
	Total (£bn)	Real growth &	Proportion of GDP (%)	% of GDP
1978-79	74.8		43.2	34.3
1979-80	90.1	3.1	43.2 =	35.2
1980-81	108.9	1.8	46.0	36.2
1981-82	121.0	1.1	46.4	38.7
1982-83	133.0	2.6	46.8	38.2
1983-84	141.3	1.5	45.9	37.8
1984-85	152.3	3.3	46.2	37.9
1985-86	161.0	-0.3	44.5	37.0
1986-87	169.4	1.9	43.9	37.5
1987-88	176.4	-0.6	41.7	37.7
1988-89	187.9	1.7	41.2	37.7
1989-90	202.8	3.8	41.7 (40.7)	37.9
1990-91	214.6	2.2	41.6 (40.0)	38.2
1991-92	227.1	2.7	41.7	38.5

### Notes

- 1) Figures assume concession of all bids; everything else as in FSBR.
- 2) Figures in brackets in column 3 show the ratios of GGE to GDP shown in the FSBR.