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Prime Minister (1)

PRIME MINISTER

MS

Advanced warning about
how public expenditure exercise
is likely to go.

PUBLIC EXPENDITURE - THE 1983 SURVEY AND THE LONGER TERM

MS 29/6

I understand that provisional arrangements have been made for Cabinet to consider public expenditure on 21 July. I have naturally been giving some thought to what I should recommend then. In the normal way, we will need to reach provisional decisions on the public expenditure totals for the three years 1984-85 to 1986-87 covered by this year's Survey as a basis for the bilateral negotiations I will hold with Spending Ministers in the autumn. Related to that is the question of what should be our objectives for public expenditure in the longer term.

Longer Term Prospects

You will recall work done last year which indicated that on modestly optimistic assumptions public expenditure would still account for 39 per cent of GDP by 1990 - 47 per cent on a more pessimistic scenario. To follow this up, in February you invited Ministers "to review their programmes critically with a view to contributing to a substantial reduction in public expenditure in the longer term". I have now completed an analysis of their replies and this is summarised in the attached notes and schedule with brief comments by the Treasury.

The results are disappointing. Few departments appear to have carried out any thorough rethinking of their policies leading to sizeable reductions. About one third of the replies offer no savings at all. Some of the proposals put forward are merely changes of presentation, which would have no real economic effect.

In a number of other cases, notably defence, substantial increases in expenditure are proposed which, if agreed, would offset the savings which might be achieved elsewhere.

The projections made in the official study last summer suggested that to achieve tax cuts equivalent to a basic rate of income tax of 25 pence in 1990-91 (with a borrowing requirement of 2 per cent of GDP) would require savings in expenditure of some £5 billion in cost terms, even on the more optimistic view of the economy. On the more pessimistic scenario, the reduction would need to be over £15 billion. In comparison with this, though the price basis of the departmental replies is not in all cases clearly specified, our best estimate of the gross savings to the PSBR which might be achieved from the recent exercise, would not exceed £2 billion. It is clear, therefore, that we have not yet succeeded in identifying the major savings we need and that to continue on present trends would leave us very little room for reducing taxation even by the end of the decade.

I am sure we cannot let the matter rest there, and I think the best way to take it forward is to relate the longer term objectives to the discussion on the annual Survey. What I have in mind is that, in my paper to Cabinet, I should explain in broad terms the implications for taxation at the end of the decade of current trends in expenditure and should suggest that we set ourselves a target for spending and a path for programmes which would then constrain decisions taken in future Surveys.

This approach will ensure that proper attention is given during the annual discussions to the later years covered by the Survey, though we must not let it distract us from the shorter-term problem discussed later in this minute. I hope it will help us to secure significant reductions in the longer term. Certainly it will be important this year to hold down the expenditure total in 1986-87 where we expect very severe pressure for increases - for example, a bid of possibly over £1 billion on defence. While recognising the legitimate claims of Defence, I will wish to argue strongly that we should not extend beyond 1985-86 our public commitment to meet the NATO objective of a 3 per cent real growth in defence spending. It has been agreed that we must look hard and urgently

(I think
you need
to consider
this very
carefully.

Discuss with
the Chancellor

on Saturday?
Yes.
AUS 30/6
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at local authority spending, which has been under discussion in E(LF). We should consider again all the main areas of subsidy and support (including the nationalised industries). We must, I think, look again/^{also} at some of the more acceptable means of reducing the cost of the Health Service on which work was started earlier this year.

The Survey Period

In addition to this longer term case for expenditure reductions, the position in the next three years also gives cause for concern. We shall not have a clear view of the prospects until a new economic forecast is available at the end of the month. However, it seems likely that, if expenditure follows the plans on which the White Paper was based, tax increases may be needed next year to hold to the Medium Term Financial Strategy set out in the Budget. This is a very unattractive prospect. Both for short and long term reasons, therefore, I expect that I shall have to recommend to Cabinet in July that our objective must be to keep expenditure well within the planned totals for the next three years.

This will not be easy. Our preliminary assessment is that we will face additional bids in 1984-85 amounting to some £5 billion and some of these, totalling at least £2½ billion, we may find difficult to resist - say £1.2 billion for local authority current expenditure, £1 billion for social security, £225 million for health and perhaps £100 million for defence. To meet these, the White Paper shows a provisional reserve of £3 billion, but we need to start the year with a contingency reserve of around £1½ billion. Hence we shall have to find savings elsewhere of the order of £1 billion even to stay within the announced total. For 1985-86, the bargaining will be even harder.

I should add that there are indications, likely to be confirmed later this week, that the PSBR and public expenditure in the current year are running ahead of what was expected at the time of the last Budget. This increases the need to hold down future expenditure plans, and may well create a need for mid-year corrective action this year. The Chancellor will be discussing this with you as soon as the revised forecast is firm, and is likely to make proposals for further action.

S E C R E T

I will not be in a position to put forward firm proposals for the Survey years until the final bids are received from the Departments and the latest economic forecast is available at the end of the month. I will then want to show my paper to you in draft well in advance of Cabinet on 21st July. However I thought you would want an early indication of the approach I had in mind.

I am sending copies of the minute to the Chancellor of the Exchequer, with whom of course I have discussed it, and to Sir Robert Armstrong.



PETER REES
27 JUNE 1983

S E C R E T

EMPLOYMENT

Small reductions (£30 million rising to £90 million in 1990-91) identified. Little scope for significant savings unless unemployment falls (reduction of 100,000 reduces expenditure by £30 million)

TRANSPORT

For railways savings of £220 million might be achieved by 1986-87 but doubts about feasibility. No other reductions identified. Maintenance of "real" value of road programme proposed. Little possibility seen of cutting transport subsidies.

ENVIRONMENT

Report outlines a possible strategy for reducing expenditure in the longer term through control of local authority current expenditure, privatisation, ending of housing subsidy and by encouraging demand for private sector housing. But proposals largely unquantified and report demonstrates difficulty of cutting local authority expenditure, and pressures for increases.

HOME OFFICE

Effectively a nil return. 80% of expenditure on law and order. Prime Minister has commented that "it would be unreasonable to expect reductions in expenditure on prisons or on law and order generally".

LORD CHANCELLOR'S DEPARTMENT

Realistic but small-scale reductions identified. Scope for reductions limited by nature of programme.

EDUCATION AND SCIENCE

No strong runners. Two measures, very difficult to achieve (restraining teachers' real pay and reducing numbers), would together yield savings of £300 million a year. Student loans would provide worthwhile savings but only in face of considerable backbench resistance.

ARTS AND LIBRARIES

Small reductions identified from greater efficiency, increased private sponsorship of the arts and private finance for some British Library operations. Small scale but probably achievable.

DEFENCE

No reductions identified. Proposes extension of 3 per cent real growth undertaking

AID AND OVERSEAS SERVICES

No reductions identified

AGRICULTURE

No reductions identified. Some increases in existing programme proposed.

INDUSTRY

Reductions of £100 million in 1985-86 rising to £285 million in 1990-91. Possible reduction in regional support building up to £260 million a year over the period.

Reduction in support for British Steel of up to £100 million a year by 1990. No proposal for privatisation of the Post Office but EFL expected to be negative.

Some further scope for savings in expenditure on aerospace, R and D and advisory services.

ENERGY

Substantial reductions in EFL's of the Coal Board (reduction estimated at possibly £500 million a year by 1990-91 but some doubts over feasibility of necessary pit closures - British Gas and Electricity Supply Industry, £500 million to £1500 million p.a. together.) Alternatively British Gas and Electricity Supply Industry could be privatised.

Reductions of up to £100 million a year in nuclear R and D by 1990-91. But possible offset due to increasing costs of expenditure on nuclear safety.

TRADE

No firm proposals. Very limited scope for reductions in programmes but substantial possibilities for privatisation (British Airways, British Airports Authority, Civil Aviation Authority Aerodromes).

ECGD

No reductions quantified. Expenditure determined by interest rates, market conditions and the Consensus Agreement. Some reductions possible through restrictions on export subsidies but offsetting increase could be caused by Consensus decisions.

HEALTH

Only small and uncertain reductions (£20 million rising to £80 million a year over the period) identified. More radical measures ruled out by Department. Some non-extreme earlier options not pursued.

SOCIAL SECURITY

Four options identified, with no PSBR effect, but large (cosmetic) public expenditure effect. No change to policies or benefit levels proposed.

SCOTLAND

WALES

NORTHERN IRELAND

No specific reductions identified. The three Secretaries of State consider that the present formula arrangements should continue; savings would accrue pari passu with savings on English programmes.

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PUBLIC EXPENDITURE IN THE LONGER TERM

AMOUNTS: £MILLION

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9	1989-90	1990-1	COMMENTS
MINISTRY OF DEFENCE:base	15,987	17,290	18,330	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	
FOREIGN AND COMMONWEALTH OFFICE:base	1,790	1,860	1,920	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	
MINISTRY OF AGRICULTURE FISHERIES AND FOOD:base	1,754	1,650	1,730	-	-	-	-	-	No savings identified. Additional expenditure of the order of £20m per annum for each of the years 1983-4 to 1985-6 proposed.
None identified	0	0	0	0	0	0	0	0	
DEPT OF INDUSTRY:base	1,148	1,110	1,090	-	-	-	-	-	
i) Projected Science and Technology Act support					40			90	
ii) Cuts in Launch Aid projections					15			25	
iii) Reduced provision for investment support etc (Section 8, Industry Act)					30			70	
iv) British Steel Corp-revised EFL's			100		up to 200			up to 100	
Total Savings			100		up to 285			up to 285	Figures only available for the years stated.
DEPT OF ENERGY:base	313	310	310	-	-	-	-	-	
i) Nuclear R&D (UKAEA)	4			5				40	
ii) Coal industry (including redundancy payments)								300-500	
iii) Electricity and Gas								500-1500	
Total Savings	4+			5+				840-2040	Figures only available for the years shown
DEPT OF TRADE:base	288	290	310	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	
ECGD:base	145	160	40	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	

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PUBLIC EXPENDITURE IN THE LONGER TERM

AMOUNTS: £ MILLION

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9	1989-90	1990-1	COMMENTS
DEPT OF EMPLOYMENT:base	3,021	3,320	3,340	-	-	-	-	-	Additional possible savings identified but not quantified.
i) Unemployment benefit service computerisation	0	10	12	14	15	15	15	15	
ii) Abolition of signing on for unemployment benefit	0	0	0	0	5	5	5	5	
iii) MSC manpower reductions	0	14	14	14	14	14	14	14	
iv) Skill centres	0	5	10	15	20	30	40	50	
Total Savings	0	29	36	43	54	64	74	84	
OFFICE OF ARTS AND LIBRARIES:base	563	580	600	-	-	-	-	-	Small savings identified but not quantified.
i) More efficiency in arts bodies	0	0	0	-	-	-	-	-	
ii) More private sponsorship	0	0	0	-	-	-	-	-	
iii) Income generation in local libraries	0	0	0	-	-	-	-	-	
iv) Private financing for British Library	0	0	0	3	3	3	3	3	
Total Savings	0	0	0	3	3	3	3	3	
DEPARTMENT OF TRANSPORT:base	4,301	4,530	4,690	-	-	-	-	-	
i) Railways				220	220	220	220	220	
DEPARTMENT OF THE ENVIRONMENT - HOUSING:base	2,792	2,990	3,110	-	-	-	-	-	Possible savings not quantified.
None identified	0	0	0	0	0	0	0	0	
OTHER ENVIRONMENTAL SERVICES:base	3,564	3,680	3,800	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	
PROPERTY SERVICES AGENCY:base	141	120	120	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	

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PUBLIC EXPENDITURE IN THE LONGER TERM

AMOUNTS: £MILLION

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9	1989-90	1990-1	COMMENTS
HOME OFFICE:base	4,045	4,240	4,410	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	
LORD CHANCELLOR'S DEPARTMENT:base	465	510	550	-	-	-	-	-	Potential savings, unquantified but not likely to be substantial.
i) Possible merger of High Court and County Court; possible Family Court	0	0	0	0	0	0	0	0	
ii) Formation of a single Estate Management Office	0	0	0	0	0	0	0	0	
iii) Greater control over legal aid	0	0	0	0	0	0	0	0	
Total Savings	0	0	0	0	0	0	0	0	
DEPARTMENT OF EDUCATION AND SCIENCE:base	12,560	12,910	13,340	-	-	-	-	-	
i) Teachers' pay									
ii) Teacher numbers									=150
iii) Teachers' pay/numbers									=150
									=1,000
Total Savings									Possible savings of £300 million or £1000 million a year, commencing from implementation.

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PUBLIC EXPENDITURE IN THE LONGER TERM

AMOUNT: £ MILLION

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9	1989-90	1990-1	COMMENTS

DHSS - HEALTH AND PERSONAL SOCIAL SERVICES:base	14,608	15,380	16,070	-	-	-	-	-	
i) Review of General Ophthalmic Service	0	0	40	40	40	40	40	40	
ii) Review of Pharmaceutical Price Regulation Scheme	0	10	20	30	30	30	30	30	
iii) More effective prescribing	0	10	10	10	10	10	10	10	
iv) Fiscal help for private health insurance for the over 65s	0	0	0	0	0	0	0	0) Effect not quantified
v) Experimental contract for private management of a NHS hospital	0	0	0	0	0	0	0	0	

Total Savings	0	20	70	80	80	80	80	80	

DHSS - SOCIAL SECURITY:base	32,473	35,900	37,900	-	-	-	-	-	
i) Contracting out benefits to employers	0	1,000	+	+	+	+	+	+) Reduction in public expenditure totals; no effect on PSBR. + Rising over period
ii) Redefine scope of public expenditure	0	24,800	+	+	+	+	+	+	
Total Savings	0	25,800	+	+	+	+	+	+	

SCOTLAND:base	6,384	6,580	6,790	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	Formula savings will apply.

WALES:base	2,528	2,610	2,720	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	Formula savings will apply.

NORTHERN IRELAND:base	3,866	4,020	4,210	-	-	-	-	-	
None identified	0	0	0	0	0	0	0	0	Formula savings will apply.

SECRET

27 JUN 1969

