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cc: M. Grogan (Personal)

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull  
Private Secretary  
No. 10 Downing Street  
LONDON  
SW1

October  
7 ~~September~~ 1983

Dear Andrew

PUBLIC EXPENDITURE SURVEY 1983

When she met the Chancellor of the Exchequer on Wednesday, the Prime Minister asked for short background notes on the main issues outstanding between the Treasury and departments in this year's Public Expenditure Survey. These are now attached. As the Prime Minister asked, the longer notes on defence and social security contain both facts and arguments. The shorter notes are purely factual.

The Prime Minister also asked to see for the weekend as complete as version as possible of the paper which the Chief Secretary will be putting to Cabinet later this month, in readiness for the discussion which she will be having with him and the Chancellor on Monday morning. I am sending this to you separately.

LONDON

Yours sincerely

John Gieve

JOHN GIEVE  
Private Secretary

SECRET

ES 1983: DEFENCE: POSITION AT 7 OCTOBER - Note by the Treasury

£ million cash

	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Baseline*	15719.6	17178.0	18214.4	18192.2
(of which Falklands)	(624.0)	(684.0)	(552.0)	-

\* after adjusting for 1984-85 pay and 1983-84 cash limit cut

Agreed addition for Falklands

The Defence Secretary and Chief Secretary have agreed that Falklands provision for 1986-87 should be £450m cash. The earlier years are unchanged.

Disagreed proposals for increases/reductionsMOD bids:

inflation compensation		+ 59.3	+ 240.0	+ 508.8
service pay awards	+ 90.4	+ 93.1	+ 96.8	+ 99.7
1986-87 3% "real" growth				+ 564.1
<u>Total MOD bids</u>	+ 90.4	+ 152.4	+ 336.8	+1172.6

Treasury reductions

below baseline to hold  
growth to 3% in 1984-85  
and 1985-86

	-	- 267.6	- 280.7	- 289.1
MOD proposed provision	15810.0	17330.4	18551.2	19814.8
Treasury proposed provision	15719.6	16910.4	17933.7	18353.1

COMMENTInflation bid

The MOD bid for inflation compensation is based on the March FSBR forecasts of inflation with an extrapolation for 1986-87 (5½%, 5% and 4½% respectively for 1984-85, 1985-86 and 1986-87).

The Treasury view is that provision should be based - as/ for other programmes - on the Cabinet agreed cash factors (5%, 4% and 3% respectively for 1984-85, 1985-86 and 1986-87). The autumn forecast for 1984-85 is likely to confirm that the cash factor of 5% is adequate. The appropriateness of the cash provision for later years (1985-86 and 1986-87) can be looked at again in subsequent Surveys. This was the basis on which agreement was reached with defence last year.

/ Service Pay Awards

Service Pay Awards

The MOD claim is that, in accordance with past practice, the defence budget should receive additional provision to meet the extra <sup>years of the</sup> cost in all / 1983 AFFRB, TSRB and DDRB pay awards.

The Treasury reject this bid. It is not needed to meet 3% growth. At the end of the 1982 Survey the then Defence Secretary recognised that such compensation of the defence budget might need to be given up after the election. The Treasury is not challenging the commitment to Armed Forces pay comparability but there is no commitment to increase defence provision concomitantly. MOD are in fact planning to accommodate the 1983 awards within this year's cash limit.

Limitation to 3% growth 1984-85 and 1985-86

The Treasury proposal is to limit growth to 3% per annum and no more in 1984-85 and 1985-86. In effect this means calculating 3% growth from the current 1983-84 provision (ie after the July cash limit cut) rather than reverting to a higher baseline. There can be no increases in excess of 3% to "compensate" for the past. Even after the July cash limit cut of £240 million, non-Falklands defence provision 1983-84 is more than 3% higher in real terms than 1982-83 outturn. If the cash limit reduction is not carried through the result will be real growth of more than 5% in 1984-85.

The MOD see presentational difficulties in announcing any provision lower than that made in the 1983 Public Expenditure White Paper. They refer to the 1981 White Paper Cmnd 8288 which stated that "the intention will be provision for 1985-86 21% higher, in real terms, than actual expenditure in 1978-79." They say that an increase of 5.2% in 1984-85 is necessary to catch up on the path to 21%.

The Treasury view remains that public interest is concentrated on the 3% annual commitment (as demanded by NATO) and not the cumulative "21% intention" that has aroused little public or Parliamentary interest for two years. The Treasury see the main presentational difficulty as defending a high and increasing level of defence expenditure in the face of reductions in other public expenditure programmes. But if necessary it can readily be demonstrated that on the Treasury proposals real growth will reach 21% by 1985-86 - by using cost terms, rather than the defence specific deflators, for example, or the Falklands-inclusive figures quoted in the 1983 Statement on the Defence Estimates.

/ 1986-87 growth

1986-87 growth

MOD point out that the agreement by NATO Heads of State and Government - reaffirmed in June 1983 - is to aim for real increases in defence spending of 3% a year up to 1990. MOD therefore bid for a full 3% real growth in non-Falklands provision in 1986-87.

The Treasury view is that the NATO guidance is not binding. After 1985-86 defence must take greater account of public expenditure and economic objectives. There should be no real growth after 1985-86 following increases of 3% in both of the preceding years. Defence provision should be planned in cash like other programmes.

If a gentle run down is desirable a stretching of the commitment to provide for real growth of 3%, 2% and 1% in 1984-85, 1985-86 and 1986-87 could be considered. The following are illustrative examples, including other, increasingly expensive, variants.

		<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
<u>Treasury proposal</u>	3%, 3%, 0%	16910	17934	18353
<u>Variants</u>	3%, 2%, 1%	16910	17763	18355
	3%, 2%, 2%	16910	17763	18532
	3%, 3%, 1%	16910	17934	18532
<u>MOD bids</u>	5.2%, 2.9%, 3.0%	17330	18551	19815

Alternatively a cash addition could be made to the 1986-87 figure of £18353m, without commitment to any specific level of annual growth.

Defence spending and jobs

On the Treasury proposals, defence spending will be increasing at 3% per annum. So ceteris paribus this itself will increase defence-related employment.

Subject to the major reservations below, even higher defence provision could lead to more output, profit and employment in the defence industries. But, for the reasons explained below, it would not lead to more jobs in the economy as a whole. Increasing defence expenditure is no more a solution to unemployment than increasing other forms of public expenditure.

More defence expenditure would mean more public expenditure. This would have to be financed by increased taxation or borrowing. In the short term higher public expenditure might lead to some rise in overall employment; in the longer term this would be offset by the effects of higher taxation, higher interest rates and higher inflation. The environment for enterprise would worsen and recovery of output - and thus employment - would be retarded.

It should be recalled that over the past five years defence procurement expenditure has risen by some 40% in real terms. This has led to indigestion and undignified end-year scrambles to spend funds. In the current year some £350m of cash limit cuts and excess pay awards is being assimilated without cutbacks on programmes. There could well be another substantial underspend.

There are warning signs of skill shortages in the defence industries; this and continuing easy cash positions risk wage and price inflation especially if defence contractors come to realise that with increasing sums available for defence they need not tender keenly.

SOCIAL SECURITY  
SAVINGS AGREED WITH MR FOWLER (4 OCTOBER 1983)

1. No uprating of Supplementary Benefit scale rates for 18-20s in November 1984:

	1984-85	1985-86	1986-87	£m
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	9	25	27	
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2. Abolish non-householder housing addition (nhha)(save for pensioners, sick and disabled) from April 1984:

	86	93	96	
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3. Changes to Housing Benefit tapers:

	150*	150*	150*	
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4. Delay abolition of pensioners' earnings rule by one year:

	30	100	115	
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5. Staged withdrawal of child dependency additions to long-term benefits where spouse's earnings £80 or more:

	5	14	15	
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Total savings	280*	382*	403*	
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\* £50m in each case are reductions in Rate Rebates which do not count as public expenditure.

## SOCIAL SECURITY BENEFITS IN THE SURVEY

ADDITIONAL SAVINGS NOW PROPOSED BY THE TREASURY

Over and above what Mr Fowler has offered in savings the Treasury has proposed three further small measures which, between them, would save a further £31 million a year. All three are intended to reduce expenditure on Housing Benefit.

- i. Minimum award of £1 on both rent benefits and rate rebates. Saves £14 million a year and would increase the minimum payments from the present 20p for rents and 10p for rates to £1 for each. There is a substantial administrative saving to local authorities from a greatly reduced number of beneficiaries - around 500,000.
- ii. Abolish £5 partner's earnings disregard. Earnings of £17.45 for the principal beneficiary and £5 for their partner are disregarded before housing benefit begins to taper. Allied to the needs allowance of £53.50 it means that housing costs are met in full for a childless married couple up to an income of around £86 a week. This proposal would start tapering at a £5 lower income level. Saves £10m a year.
- iii. £1 reduction in principal housing benefit earnings disregard. Saves £7m a year. It is complementary to the abolition of the partner's earnings disregard proposed above. It would ensure that single people have some reduction in benefit as well as married couples.

2. These measures complement the housing benefit changes proposed by Mr Fowler. (A steeper taper for housing benefits once income exceeds the needs allowance). They would start the taper at an earlier point and end it more rapidly. The overall package will remove large numbers of people from the poverty trap at the top end but will make the trap more severe for those who remain in it. It will also worsen the unemployment trap, but for those at the top end of the income scale to which it applies, the effect will not be as severe as it can be at lower income levels.

PROPOSALS MADE BY THE TREASURY BUT NOW HELD BACK FOR FURTHER CONSIDERATION IF NECESSARY

Pensioners Earnings Rule

3. Mr Fowler has already agreed to postpone the phased abolition of the pensioners earnings rule by 1 year - so that the first move to abolition would be in November 1985 - when the age limit for application of the rule would be reduced from 70 to  $67\frac{1}{2}$ . The Treasury proposed postponement of this phased introduction by a further year, so that the age reduction would begin in 1986. But as an interim measure there should be a real increase of £10 in the level of the limit in November 1985. This would have achieved savings of £28m in 1985-86 and £65m in 1986-87.

Action on Supplementary Benefit

4. The Treasury proposed a series of changes to reduce Supplementary Benefit payments to the young unemployed and to other non-householders. Integral to these proposals was Mr Fowler's own offer, subsequently withdrawn, to reduce Supplementary Benefit scale rates for 18-20s to that for 16-17s. Together these proposals would have saved:

1984-85	1985-86	1986-87
90	271	285

They would reduce SB rates payable for 16-17s by £2.80 a week; the total loss to other non-householders would have been £8.05 .

5. The Treasury also proposed to extend the qualifying period for the long-term rate of SB from 1 to 2 years. This would affect mostly one parent families and the disabled and reverse the change made in 1980. It would have saved

1984-85	1985-86	1986-87
£m	£m	£m
9	37	57

Death Grant

6. Abolition of death grant is logically justifiable, but the cost of various measures which DHSS proposed to replace it have received little public support.



Maternity Grant

7. Abolition of maternity grant is justifiable on similar grounds - the £25 grant goes nowhere towards meeting the cost of a new baby. But it would be better to consider its abolition when proposals for a new employers' statutory maternity pay scheme come in in about two years time. Abolition would save £20 million a year.

Invalid care allowance

8. This is paid only to single women of working age who are prevented from working because they have to stay at home to care for a disabled person. Exclusion of married women is almost indefensible - but extension to them would cost £60million a year. The disabled person already receives payment because he or she needs attendance - why pay both parties? Abolition would save £5million a year, net.

Review uprating of unprotected benefits

9. The uprating of some benefits is protected by statute - basically the contributed benefits like the Retirement Pension and Unemployment Benefit. Others are protected by pledge - again the retirement pension but also linked long-term benefits. The proposal was to give some or all of the remaining unprotected benefits a nil or reduced uprating in November 1984. The benefits are Child Benefit, One Parent Benefit, FIS, Supplementary Allowance, Mobility Allowance and Housing Benefits.

10. Although it is unpledged, several assurances have been given about Child Benefit: Mr Jenkin, when Secretary of State for Social Services, undertook that the benefit would be uprated provided economic circumstances permitted and the Prime Minister in a letter to Brynmor John before the General Election gave an assurance that there were no plans to change family benefits. Much was made during the General Election campaign that this November Child Benefit would be at its highest ever level in real terms.

11. One-parent Benefit, is associated with Child Benefit and its value has increased by more.

12. Family Income Supplement, goes to low income working families and is very good for the unemployment trap.

13. On Supplementary Allowance, the Treasury made separate suggestions for lowering benefit paid to non-householders. If at the same time those lower rates were not uprated the effect would be very severe. Since Supplementary Benefit tends to be seen as a minimum income level this would be highly controversial.

14. The Government has also taken some pride in its record on Mobility Allowance which will also be at its highest ever level in real terms when uprated in November.

15. The Secretary of State's and the Treasury's proposals on Housing Benefit between them make for very considerable reduction in benefit payments to those on higher income levels (and hence the least "deserving"). To act in addition on the less well-off would have similar problems as those relating to Supplementary Allowance.

S E C R E T

AGRICULTURE

£ million

	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
(i) White Paper baseline	874.7	899.1	923.4
(ii) "Revised Baseline" after increases for demand determined agricultural expenditure	904.4	912.2	932.8

Agriculture Ministers' Proposals

1. Hold totals to slightly less than "revised baseline" ie £ million

(iii)	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	902	910	930

2. Accommodate within these totals:

- a. increased assistance to farmers on 'marginal land' (£14.1 million, £14.4 million, £14.6 million)
- b. larger capital grants to horticulture (£1.9 million, £2.5 million, £2.4 million)
- c. assistance to Sea Fish Industry Authority marketing scheme (£3.0 million, £4.5 million, £6.0 million)

3. Make offsetting reductions including Common Fisheries Policy (reduced forecast of uptake), some reductions in Capital Grants for agriculture.

Chief Secretary's Proposals

4. Reduce totals to:

	<u>£ million</u>		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
(iv)	855	860	870

5. Find savings on capital grants (? halve rates - present average over 30%), land drainage, research and development as well as CFP.

6. Prepared to consider Agriculture Ministers' bids within totals in line (iv).

Gap (line iii minus line iv)

	<u>£ million</u>		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
(v)	47	50	60

FCO (ODA AND DIPLOMATIC WING)ODA

Disagreement remains on the aid programme, as follows:-

	£m		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Baseline	1,096	1,129	1,163
Foreign Secretary's bid	+20	+40	+60
Chief Secretary's proposal	-20	-30	-40
Gap	40	70	100

The Foreign Secretary's bid would restore bilateral country aid to slightly below its 1982-83 level in cost terms. Because of inevitable increases in multilateral aid, provision at the baseline will require some continuing fall in bilateral aid. The Chief Secretary proposes cuts, mainly by reducing the amount within the programme which is at present unallocated.

	£m		
<u>Diplomatic Wing</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Baseline	576	598	606
Foreign Secretary's bid	+10	+10	+23
Chief Secretary's proposal	-	-	+ 9
Gap	10	10	14

The main items in the Foreign Secretary's bid are the BBC External Services (largely extra provision for modernising the monitoring service and for pay), the British Council (to maintain the 1983-84 level of activity) and, for 1986-87, assistance to overseas students. The Chief Secretary accepts the bid for overseas students and does not propose any cuts below the baseline. In his view, however, it should be possible to offset any unavoidable increases on the British Council & BBC by savings on the FCO expenditure on HQ, overseas representation and communications.

INDUSTRIAL R & D

	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Baseline	142	170	196	252	332	351	374	385
% increase	34	19	15	29	32	6	7	3
DTI Bids						360	390	413
% increase which would result						8	8	6
Treasury Proposal						351	364	360

Components of the Programme (1983-84)

- (a) Research and Development Establishments. (£36M) cost of running 4 Research Establishments employing 2,300 people. DTI reviewing prospects of privatising Warren Springs Laboratory.
- (b) Space. (£61M). Mostly UK subscription to the European Space Agency for collaborative space projects e.g. Ariane. Committed to about this level of spend for next 3 - 4 years. Justification for continued ESA membership currently being reviewed.
- (c) Aircraft and Aero-engine Research and Development. (£33M) Mostly assistance to Rolls Royce to develop basic aero-engine technology.
- (d) Support for Innovation. (£202M) Grants to industry to instal new technology and, under the Support for Innovation facility, undertake research and development projects and provision of advisory services.

DTI/ Treasury Disagreement

DTI bids for an extra £9.5M (1984-85), £15.4M (1985-86) and £27.3M (1986-87) to cover extra aero-engine research and to introduce some new schemes to assist innovation.

Chief Secretary has suggested cuts in the current baseline of £10M in 1985-86 and £25M in 1986-87 to be achieved by reducing the maximum rate of grant under the Support for Innovation facility from 33% to 25%. The rate was put up to 33% from 25% for 1 year in the 1982 Budget and was extended until May 1984 in the 1983 Budget.

## NATIONALISED INDUSTRIES

1. The E(A) target is that nationalised industries external finance should be reduced by at least £500m below the baseline in 1984-85, £900m below in 1985-86, and £2 billion below in 1986-87. This implies cuts of around £1 billion a year in industries' initial bids.

2. External finance has now been settled for around half the industries. Final agreement is close on the Scottish Electricity Boards, British Steel, the Post Office, British Airways, the Scottish Transport Group, and the Water Industry. Major differences only remain for those industries sponsored by the Secretary of State for Energy who is expected to make a revised offer early next week.

3. Overall the position compared with the baseline is as follows:

£ million

<u>1984-85</u>		<u>1985-86</u>		<u>1986-87</u>	
Initial Treasury Target	Latest Depts Offers	Initial Treasury Targets	Latest Depts Offers	Initial Treasury Target	Latest Depts Offers
750	- 480	- 1200	- 715	- 2350	- 2015

Our latest assessment is that, provided reasonable agreement can be reached on the energy industries, the outcome will be in the line with or exceed the E(A) targets in each year. However account must also be taken of the Redundant Mineworkers Payments Scheme which is not part of the NCB's EFL but has been considered in that context. Latest estimates of redundancies require increases over the baseline for this scheme of £88m in 1984-85, £89m in 1985-86 and £101m in 1986-87.

4. The initial gap between the Treasury and the Secretary of State for Energy amounted to about £1100m over the three years of the Survey. Mr Walker has already conceded £200m and the Treasury £300m leaving a gap of about £600m. The main points at issue are the size of the NCB's future investment programme;

the extent to which Mr Walker's desire for a continued freeze in electricity prices can be offset by increases in efficiency coupled with a relatively small squeeze on investment and working capital; and the size of the increase in gas prices from January 1984 and the scope for cutting gas costs. Unless Mr Walker modifies his position significantly in the next few days, these issues will have to go to Cabinet.

# THE CHANCELLOR'S PUBLIC EXPENDITURE HEADACHE

**Gavyn Davies**

The Chancellor has asked for a public debate on the outlook for public expenditure in the medium-term. This has no doubt been precipitated by the Treasury's assessment of future trends in public spending and borrowing. Unfortunately, however, the debate has not yet benefited from full publication of the government's medium-term assessment. Perhaps this will be remedied in the coming weeks or months. In the meantime, this article attempts to see public spending trends through the Treasury's eyes — a task which, given the relative paucity of published information, is not easy for anyone sitting outside Whitehall. The main conclusions of our analysis are summarised below. While the difficulty of holding down the share of public spending in GDP seems in general to have been exaggerated, Mr Lawson might face real problems in keeping government borrowing at its present level up to 1988/89.

1. We assume that the government will wish to aim for growth of 3% p.a. in real defence spending in the rest of this Parliament, though this is not yet an unequivocal public commitment. We further assume that health expenditure will grow by 1% p.a. in real terms, and that the real value of social security benefits will be maintained throughout the Parliament. Volume growth of 1% p.a. is assumed elsewhere in public spending, and the relative price effect remains constant after 1984/85.

2. Tax rates are held at present levels throughout, with nominal allowances and excise duties up-rated in line with inflation. Oil taxes are projected exogenously.

3. Simulations are prepared on three separate assumptions about real GDP growth after 1984/85. The main case assumes 1½% p.a. growth, while simulations 2 and 3 incorporate growth of 2½% and zero respectively. Simulation 4 returns to the assumption of 1½% growth, but (i) allows the relative price effect to deteriorate by 1% p.a. and (ii) allows "miscellaneous" expenditure (all programmes except defence, health and social security) to rise by 2% p.a. in volume terms, instead of 1% p.a.

4. The simulations are run for the years 1985/86 to 1988/89, and the results are summarised below.

	Growth after 1984/85	Unemployment (000)	Levels in 1988/89 Public Exp/GDP (%)	PSBR/GDP (%)
Simulation 1	1½% p.a.	3759	41.8	3.9
Simulation 2	2½% p.a.	3321	39.9	2.6
Simulation 3	Zero	4403	44.7	6.0
Simulation 4	1½% p.a.*	3759	43.2	5.1

\* but see above

5. The table shows that the Chancellor might avoid major problems on the future share of public spending in GDP (which currently stands at over 43%), providing that an economic growth rate of at least 1½% p.a. can be obtained after 1984/85. *Even with zero growth, the public spending share might only rise slightly — contrary to popular belief, demographic trends are by no means adverse in the 1980s.*

6. *The Chancellor's prospective problems are, however, greater in the areas of public revenue and the PSBR.* With oil revenues not likely to be very buoyant in future, economic growth of around 2½% p.a. might be needed (at present tax rates) if the PSBR is to be held below 3% of GDP. With zero growth, the PSBR could have risen to 6% of GDP by 1988/89. Large tax increases would in these circumstances be the only way to hold borrowing down.

7. This is why the Chancellor would like to cut the levels of public spending in the late 1980s. If the Cabinet agrees to such cuts, then taxation might eventually be brought down — as long as economic growth does not fall below about 1½% a year after 1984/85. On the other hand, if the Cabinet does not agree to spending cuts, an unpleasant choice between higher taxes or an increased PSBR might emerge before the next election. Most governments would then let borrowing rise, but this government might not. Mr Lawson would like to avoid the choice — hence the importance he now attaches to reducing the government's medium-term spending plans.

30 September, 1983



## PUBLIC EXPENDITURE RATIOS

For since the present government was elected, it has placed great emphasis on first controlling, and then reducing, the share of public expenditure in national income. Although each successive set of spending plans announced by Sir Geoffrey Howe envisaged a decline in the ratio of public expenditure to GDP in the later years of the relevant survey periods, these intentions were continually thwarted. The officially-estimated ratio of public expenditure to GDP at market prices rose from 41% in 1978/79 to about 44% last year. This reversed the decline which had been achieved in the second half of the Healey Chancellorship: from 1976/77 to 1978/79 the ratio dropped from 44.5% to 41%.

The ratios quoted above include social security payments and other transfer items as well as the public sector's direct purchases of goods and services. Public expenditure on goods and services, taken alone, rose only slightly during the first Thatcher term, from 23% in 1979/80 to 24% last year. Since this latter figure represents the extent to which public transactions absorb real resources (making them unavailable for private use) it may be more relevant than the larger ratio in judging the real burden of public spending on the economy. Social security and debt interest payments, which are included in the larger ratio, do not give the government any additional command over resources: they merely transfer command over resources from one part of the *private* sector to another. When, for example, the government raises taxation to finance an increase in pensions, the Exchequer simply acts as an intermediary between taxpayers and pensioners. While such transactions do not pre-empt resources for the public sector, they need to be financed by taxation, borrowing or money creation — and the government argues that this can have deleterious effects on private activity.

In fact, the government's case for reducing public expenditure as a share of GDP seems to be based on two main premises. The first concerns the **financing** of total public expenditure on goods and services as well as transfer payments. If financing occurs via taxation, then the government believes that productive effort will decline; if it occurs through borrowing, then interest rates might be higher than would otherwise have occurred; while if it occurs through money creation, inflationary pressures might be increased. If these arguments are valid, then the relevant ratio to control would appear to be the share of public expenditure plus debt interest in GDP, since **any form** of financing is dangerous. The second set of arguments for increasing the private sector's share in total income is more political. The government believes that private activity involves greater choice for individuals, and is also more likely to prove economically efficient than public activity. These arguments, which are used in favour of privatising state assets as well as reducing direct government purchases of goods and services, would indicate that the relevant ratio to control is the public

sector's direct call on national income.

In addition to these arguments for controlling public spending, the government is also concerned about alleged links between the PSBR and money growth, and between money growth and inflation. If high public spending is financed by creating money rather than selling bonds or increasing taxes, then the government argues that rapid monetary growth would eventually lead to higher inflation. Consequently, the level of the PSBR must be controlled in addition to the share of public spending in GDP.

In practice, the government's targets for medium-term financial control seem to encompass at least three ratios: the ratio of total public spending to GDP; the ratio of public sector absorption of goods and services to GDP; and the ratio of the PSBR to GDP. None of these is given absolute priority, but all are considered important for the productive health of the real economy as well as for the government's fight to maintain control over monetary growth and inflation. On some occasions, real resource arguments are emphasised ("leaving room" for growth in private activity), while at other times financing arguments appear to dominate. But, for whatever reason, there appears little doubt in the new Chancellor's mind about the need to cut public spending in proportion to GDP during the Conservatives' second term, and early indications from the Treasury have suggested that he will face an uphill struggle. This is perhaps why the Chancellor has asked for a "great debate" on the medium-term future of public spending, though it must be said that so far the Treasury's own contribution to this debate has been singularly lacking.

The Treasury may eventually choose to remedy this by publishing more details than usual of its medium-term economic assessment. In the meantime, however, we have attempted to assess some of the problems which the Chancellor may face in controlling public spending during the present Parliament in the research outlined in this article. The object is to discover whether there are underlying trends which can now be identified (e.g. demographic changes or government commitments to introduce new policies in the next few years) which will place inevitable upward or downward pressure on public spending up to 1988/89. We also project the possible course of public revenue in this period to see whether the PSBR is likely to be rising or falling over the medium-term. We provide simulations on several different assumptions for real GDP growth, unemployment and inflation over the period.

We do not in this paper discuss whether controlling public spending and the PSBR should be treated as over-riding goals of economic policy, or even as desirable in themselves. Instead, we simply accept that the government has a strong belief in cutting public spending for

the reasons outlined above, and concentrate on the problems they may have in achieving their objectives.

**Table 1: Share of Public Spending and Borrowing in Nominal GDP (%)**

	Public Expenditure		PSBR
	Total*	Goods and Services	
1976/77	44½	26	6½
1977/78	40	23½	3½
1978/79	41	23	5½
1979/80	40½	23	5
1980/81	43	24	5½
1981/82	44½	24	3½
1982/83(e)	44	24	3
1983/84(f)	43	24	3

\* including debt interest

## METHODOLOGY

We have developed a simple system for projecting public revenue and expenditure in the years after 1985/86, given certain assumptions about government policy, and the growth rate in the economy as a whole. If we plug in assumptions about economic growth, tax rates and expenditure plans, the model calculates a set of government accounts from these assumptions. In order to do this, it must obviously produce unemployment forecasts from the economic growth assumptions given, and it must then calculate the impact of employment changes on revenue and expenditure. This process is achieved by a conventional employment/output equation, and a series of straight-forward relationships between social security payments and unemployment, as well as relationships between tax revenue and tax bases (for example the wages and salaries bill). The system is not a fully specified economic model where a complete set of economic relationships is proxied by a simultaneous set of equations. We have avoided this because use of such a model inevitably raises contentious macro-economic questions, concerning for example the relationship between unemployment and inflation, or fiscal policy and output. We do not wish to address these problems in this paper, since they are not directly relevant for our purpose. In particular, the rate of inflation (if it is neutral between public and private sectors) need have no impact on the share of the PSBR or public spending in GDP. However, the model does enable us to estimate the impact of higher or lower inflation in the public sector relative to the economy as a whole, and this is done separately from the growth assumption. We can therefore model the effect of, say, 3% real growth with a wide range of inflation assumptions.

In order to produce the **public expenditure projections**, we have split programme expenditure into four major categories: defence, health, social security and the rest.

The three major programmes which are separately identified are not only the largest, but are also subject to particular government commitments: 3% real growth in defence spending, maintaining the level of services in the

NHS, and maintaining the real level of pensions etc. In each of the programmes separately identified, and also in the miscellaneous sector, we separately identify five categories of spending: pay, subsidies and current grants, other current expenditure, gross domestic fixed capital formation, and, finally, capital grants and other capital spending. Totals for programme expenditure in each of these categories are then produced. Finally, projections for the contingency reserve, asset sales, public corporation borrowing and shortfall are added to produce the planning total, and this is adjusted to national accounts definitions to provide the conventional measure of the ratio of public spending to GDP.

On the **revenue** side, we separately identify oil taxes (which are exogenous), income tax, corporation tax, expenditure taxes, rates, national insurance contributions and other taxes. Yields from these major categories of tax are estimated on the assumption that tax rates remain unchanged in real terms (with allowances and specific duties indexed in line with inflation), though oil taxation is provided separately.

We also forecast exogenously expenditure levels for both 1983/84 and 1984/85, since these two years cannot be affected by medium-term spending decisions. The calculations produced by the model therefore apply to the four years 1985/86 to 1988/89.

## THE NEXT TWO YEARS

Since the last Public Expenditure White Paper was published in February, it appears that programme expenditure has been running somewhat higher than the White Paper projections implied. For example, in the 1982/83 financial year, the outturn level of public expenditure (on a planning total basis) exceeded the White Paper estimate by £700m and, even after the July package of public expenditure cuts, this year's total also seems to be running slightly higher than intended. However, we have assumed that any overshoot will be restrained by the high level of asset sales planned for this year, and by the full use of the contingency reserve. **For 1984/85, we assume that the Cabinet discussions now underway will be broadly successful in restraining the planning total to the level of spending implied in the last Budget (£126.5bn)** though this seems likely to entail a higher level of asset sales than originally planned. If this proves to be the case, revenue is likely to be sufficiently buoyant to result in a PSBR of about £8.5-9bn this year, and about £8bn next year. This latter figure would be about 2.4% of nominal GDP (at market prices), roughly half the level which Sir Geoffrey Howe inherited in 1979/80.

## DETAILS OF THE SIMULATIONS

For the years after 1984/85, the shape of our simulations is heavily dependent on the assumptions made in the areas of defence, health and social security and these assumptions need to be discussed in more detail.

**Defence:** The government is publicly committed to maintaining a growth rate of 3% per annum in real defence expenditure until 1985/86. Although it is not absolutely clear whether this commitment will be extended after 1985/86, the government has expressed sympathy with the 1981 NATO ministerial decision to extend the 3% commitment as far as 1988/89. Furthermore, the rapid rates of increase in defence expenditure in the past few years have gained a momentum of their own, and it would be extremely difficult to reduce real expenditure sharply unless major defence commitments (such as the defence of the Falklands, or the British presence in Germany) were to be reconsidered. The Prime Minister certainly does not appear to be in a mood to contemplate major reductions in the rate of growth of defence spending in the near future; and the room for manoeuvre has been further reduced by linking armed forces' pay to movements in private sector average earnings. Overall, therefore, we consider it realistic to assume that a target of 3% real increases in defence spending will be maintained until the end of the current Parliament. This will almost certainly result in a further rise in the share of public spending devoted to defence in the next five years — this share has already risen from 11.4% in 1978/79 to 13.5% this year.

**(ii) Health:** In the last election campaign, the government was sensitive to charges that they intended to cut health spending and they campaigned on the slogan "the health service is safe with us". The problem in the next few years is that as the number of very old people increases, the real level of health spending will also need to increase simply to maintain standards unchanged for the population as a whole. The DHSS has estimated that demographic trends require an increase of 0.7% per annum in real health spending simply to leave average standards unchanged. On top of this, there will be pressure to provide additional spending to improve services in line with medical advances, and to improve the geographical distribution of health care while minimising cuts in the well-provided areas. While the increases for these two latter reasons could be very large, we have made the miserly assumption that they will be held down to 0.3% per annum, and have therefore constrained public health spending to rise by 1% per annum in real terms. (This also applies to personal social services.) Of course, it is possible that the community as a whole would in these circumstances decide to increase its total expenditure on health by wider participation in private insurance schemes. This would not be unwelcome to the government, since it would not have adverse consequences for borrowing or taxation.

**(iii) Social Security:** The social security programme now accounts for about 29% of total public spending, compared with 25% in 1978/79. Retirement pensions comprise almost half of total spending in this category, and much of the rest is related either directly or indirectly to the level of unemployment. On retirement pensions, the government is committed at least to increasing the pen-

sion level in line with price inflation, and we have assumed that no more than this is done in the period to 1988/89. However, the provision of pensions is also affected by the number of retired people, which has increased by about 750,000 since 1978/79. The worst of this trend will be over by 1985/86, and in the 5 subsequent years the government actuary estimates that the number of pensioners will increase by only about 150,000. While these demographic trends should be manageable in the 1980s, and should improve in the 1990s (when the number of pensioners is projected to decline), there is likely to be a very sharp increase in numbers in the first two decades of the next century. Furthermore, the major impact of the state earnings-related pension scheme will by then be taking effect and, according to estimates made at the Institute for Fiscal Studies, the cost of financing the new state scheme in the year 2011 may be equivalent to 5–7% of the average earnings of the working population at that time. This very high cost, which is projected to continue increasing thereafter, may eventually necessitate a reconsideration of the benefits offered under the new pension scheme, but this will have only a very small impact on public expenditure up to the year 1988/89. We have made an allowance of around £150m to allow for the extra cost of the earnings-related scheme in the last year of our analysis. (Since the new scheme is based on earnings in the best 20 years of an individual's working life, it will be several decades before its full impact is visible.)

Another relatively favourable demographic trend is that the number of children in the economy is currently dropping fairly sharply, which will reduce the cost of child benefit. This trend is projected to continue until at least 1986, after which official projections show some increase in the number of children below the age of 16, and the best guess is that by 1990 the number may have returned to its 1980 level. However, these figures are sensitive to the birth rate over the next few years, which is as yet showing few signs of picking up after the recession. It is probably safe to assume that the number of child benefit recipients in 1988/89 will be marginally lower than the number this year. On the question of up-rating child benefit, the government has no formal commitments, but there are very strong political pressures to maintain the level in real terms. We have consequently assumed that they will be up-rated in line with price inflation.

Other major items in the social security programme are affected to varying degrees by the level of unemployment. Again, we have assumed that benefits will be up-rated in line with price inflation, though the government is not specifically committed to this. In our base simulation, we assume that there will be no change in the number of recipients in the remainder of the social security programme between now and 1988/89, but as unemployment varies in our simulations, this adds to the social security programme as a whole. The DHSS estimates that (at 1982/83 prices) an extra 100,000 unemployed persons adds roughly £175m to social security benefits. We use this ratio in

estimating the sensitivity of social security to the levels of unemployment implied by the economic growth rates in our projections. If it were not for the threat of rising

Table 2: UK Demographic Trends

	1979	1989	1999	2009	2029
<b>Thousands</b>					
Children (0—15)	12545	11716	13258	12312	13047
Working Age	32407	33751	33878	35047	34379
Over Pension Age*	9456	9799	9432	9671	11713
<b>Percent</b>					
Children (0—15)	23.1	21.2	23.4	21.6	22.1
Working Age	59.6	61.1	59.9	61.5	58.4
Over Pension Age*	17.4	17.7	16.7	17.0	19.8

\*60 for women, 65 for men

Source: Government Actuary Report, July 1982

unemployment, there would probably be no need to fear any significant increase in the burden of social security payments on the economy during the current decade, since demographic trends are by no means as adverse as is commonly supposed, and the earnings-related pensions scheme will not have much effect until the very end of the century. However, demographic trends appear likely to deteriorate late in this century, and the present government may be giving some early consideration now to this problem.

(iv) **Other Expenditure:** We have not attempted to model other programmes separately, partly for reasons of complexity, and partly because the government's commitments are much less clear than in defence, health and social security. Overall, we have made the assumption that 1% per annum real growth in capital and current expenditure in these miscellaneous programmes will be sufficient to fulfil the government's major objectives, and to permit some increase in the standard of services. This is roughly the rate of increase which was achieved in real public expenditure as a whole during the government's first term, though the Chancellor may ideally wish to depress this growth rate further during the second term. In addition, we have assumed that public sector pay and procurement costs will rise at the same rate as the GDP deflator after 1985/86. This is based on the assumption that the government cannot forever depress public sector earnings relative to those in the private sector, however much they would like to do so.

Apart from programme expenditure, we need to make assumptions about below-the-line adjustments to the expenditure total. Of these, the contingency reserve and short-fall assumptions are fairly conventional: we have projected a reserve of £4,000m a year at the end of the period, with short-fall of £800m. Public corporation net borrowing is assumed to continue to be mildly negative (i.e. implying net repayment of debt) and asset sales, after peaking at £2,000m in 1985/86, are projected to decline to £500m in the last year of the period.

Turning to **government revenue**, most of the major sources of revenue are assumed to be proportional to their tax

bases, and are thus sensitive to variations in economic growth and the level of employment. However, oil taxation is treated exogenously, and we have assumed that the sum total of oil taxes will rise from £7.5bn in 1983/84 to £11.3bn in the last year of the simulation period. As we explained in the July edition of 'The Economics Analyst' (pp20—21), we do not share the alarmist projections for oil revenue which have emerged from other quarters in the City in the past few months, since we believe that oil production will be on a plateau for much of the second half of this decade. Oil prices in dollar terms are assumed to rise 2% per annum more rapidly than OECD manufactured goods prices, but the average government tax take in new fields is assumed to fall sharply. These assumptions suggest that the level of government receipts from the North Sea will remain roughly constant as a share of nominal GDP from now till the end of this Parliament. However, it must be strongly emphasised that this projection is very sensitive to fairly small changes in oil prices and oil production.

## MAIN RESULTS

We have conducted four simulations on the assumptions outlined above, and the results are given in some detail in the tables at the end of this article. To a large extent, these figures can speak for themselves, but it is worth summarising the main conclusions. The 'central' simulation is based on the assumption that real GDP growth of 1.5% per annum will be attained on average between 1984/85 and 1988/89. Although this may seem a somewhat pessimistic assumption, it should be remembered that the recorded rate of growth between 1973 and 1984 will probably be only about 0.5% per annum including oil, and very close to zero excluding oil. An assumption of 1.5% growth over a medium-term period implies that the British economy will be able to achieve a rate of growth somewhere between the high level of the 1950's and 1960's on the one hand, and the very low level of the last decade on the other hand. In addition to this main case, however, we present other scenarios where the growth rate in the medium-term is allowed to vary. Simulation II is based on the optimistic assumption that 2½% per annum growth will be recorded in the 4 years of our projection, while simulation III makes the pessimistic assumption that zero growth will be possible in the years after 1984/85. The first three simulations assume that the rate of increase in public sector costs and pay will be the same as that in the private sector (i.e. roughly 6% per annum) and that the real level of capital and current expenditure in the miscellaneous expenditure category will rise by 1% per annum. In Simulation IV, we relax these latter assumptions, and assume instead that public sector costs (including pay) increase by 1% per annum faster than those in the private sector, and that the volume of spending in the miscellaneous categories rises by 2% per annum instead of 1%. This last simulation is based on our main assumption of 1½% real GDP growth in the years after 1984/85.

The results of our simulations show how sensitive the government accounts are to the assumed rate of growth of the economy. Simulation I (1.5% per annum growth) shows the share of total public expenditure in GDP remaining roughly constant at about 41.8% from 1984/85 to 1988/89. A slight rise in the share of public spending taken by defence and social security is offset by a declining share of health and other expenditure categories. (The public expenditure definition used in this case

Table 3: Simulation Results

	SIMULATION			
	I	II	III	IV
<b>Share of Total Public Spending in GDP (%)</b>				
1982/83	43.8	43.8	43.8	43.8
1983/84	43.0	43.0	43.0	43.0
1984/85	41.8	41.8	41.8	41.8
1985/86	41.9	41.5	42.6	42.3
1986/87	42.0	41.1	43.4	42.7
1987/88	41.9	40.5	44.1	42.9
1988/89	41.8	39.9	44.7	43.2
<b>Ratio of PSBR to GDP (%)</b>				
1982/83	3.2	3.2	3.2	3.2
1983/84	2.9	2.9	2.9	2.9
1984/85	2.4	2.4	2.4	2.4
1985/86	2.6	2.4	3.0	2.9
1986/87	3.2	2.6	4.1	3.8
1987/88	3.5	2.6	5.0	4.4
1988/89	3.9	2.6	6.0	5.1

Note: See text for simulation details.

is equal to the planning total plus debt interest and other adjustments, as defined in Chart 1.6 of the February 1983 Public Expenditure White Paper.) Government revenue, on the other hand, does not quite maintain its share of GDP after 1984/85, mainly because of the lack of buoyancy in local authority rates, corporation tax and oil taxation after next year. Specifically, government receipts drop from about 42% of nominal GDP in 1984/85 to a little less than 40% in the last year of the projection period. This produces a slight increase in the PSBR as a percentage of GDP, up from a possible 2.4% in 1984/85 to just under 4% in 1988/89. *Expressed as a share of GDP, this increase does not appear by any means drastic* — it would, for example, leave the PSBR ratio below that attained by the Conservatives in 1979/80 or 1980/81. However, it would reverse the decline in public borrowing observed in the last 3 years, and would of course entail a considerable rise in the absolute level of the PSBR during the present Parliament. Specifically, the PSBR may rise from about £9bn this year to roughly £17bn in 1988/89.

The problem of increasing borrowing disappears almost entirely if we assume that 2.5% real GDP growth can be attained from 1984/85 onwards (Simulation II). On this assumption, the level of unemployment at the end of the period is reduced to about 3.3m (compared with 3.8m in

Simulation I), and the total share of public spending in GDP declines to a little under 40% by the end of the period. This is sufficient to allow the PSBR to stabilise as a percentage of GDP (at around 2½%) and in money terms public borrowing is restrained to only about £12bn in 1988/89.

These relatively favourable trends are sharply reversed in Simulation III, which is prepared on the assumption of zero growth from 1984/85 onwards. The 3% per annum increase in defence expenditure, with 1% per annum increases in other areas, and the rise in unemployment to 4.4m by 1988/89, results in the share of public expenditure in GDP jumping to 44.7% at the end of the period, higher than it has been at any time since the mid-1970's. Furthermore, government receipts move down sharply in response to the lower tax base, and the PSBR rockets upwards. By 1988/89, the PSBR ratio is shown at 6%, again considerably higher than at any time since the mid-1970's. In terms of nominal prices, the PSBR rises to about £25bn by the end of the period.

The final projection (Simulation IV) also shows the PSBR increasing as a percentage of GDP, despite the fact that for this case we have returned to our main assumption of 1½% real GDP growth. The damage in Simulation IV stems from the assumption that public sector pay and procurement costs increase by 1% per annum more rapidly than the GDP deflator, while the rate of increase in the volume of expenditure in the miscellaneous sectors (i.e. those other than defence, health and social security) is increased from 1% per annum to 2% per annum. On these assumptions the share of public spending in GDP rises from 41.8% next year to 43.2% in 1988/89, and the PSBR at the end of the period stands at about £22bn or 5.1% of GDP.

## CONCLUSION

This article has not attempted to question the desirability of reducing public expenditure and public borrowing in the course of the present Parliament, though clients will be aware that some schools of economists would question these presumptions very strongly. Instead, we have attempted to explain *why* the government considers it desirable to cut spending and *how* it may prove problematic to do so. Apart from the many imponderables attached to the projection of oil revenues, the main determinant of the likely level of spending and borrowing in the remainder of this Parliament will be the rate of growth achieved in the real economy.

If the Treasury simulations are in any way similar to those outlined in this paper, then it is easy to see why the present Chancellor's economic philosophy would lead him to be worried about the outlook for public borrowing. *Even with the assumption of 1.5% per annum growth in the economy*, the Chancellor might need to contemplate increased tax rates in order to hold the PSBR constant as a proportion of GDP. Furthermore, the situation would worsen considerably if growth fell below 1.5% per

annum. *On the assumption of zero growth after 1984/85* (even with no deterioration in relative prices), taxes might need to be increased by 3½–4% of GDP by the end of the period to hold the PSBR ratio constant. If this tax change were to be accomplished simply through income tax, it would require an increase in the basic rate of between 10p and 15p in the £, depending on how the tax base contracted in response to higher marginal tax rates. Of course, it is highly unlikely that any sane Chancellor would choose to place the entire burden of extra taxation on income tax, but spreading the burden elsewhere would also be extremely painful.

**What are the Chancellor's options in responding to these potential problems?** The simplest option — which would be in line with past Treasury practice — would be to make a relatively optimistic growth assumption when publishing medium-term spending plans. For example, if the Treasury runs forward the 2½% growth assumption incorporated in its last White Paper up to 1985/86, then no major borrowing or spending problems would show up in the medium-term assessment. However, even then the Chancellor would be left with little or no room to make major tax cuts during this Parliament if he wished to constrain borrowing to around 2–2½% of GDP; and if the growth rate under-performed expectations, then the government might later be forced into making emergency packages of expenditure cuts. A second option would be to announce plans on more pessimistic (or realistic) assumptions about economic growth, and simply to accept that public borrowing would be likely to rise somewhat during the next few years, unless oil taxation rose unexpectedly rapidly, or growth out-performed expectations. While this option would probably be acceptable to a Labour or an Alliance Chancellor — since it would be unlikely to leave British government borrowing any higher than the OECD average by the end of the period — it will probably not commend itself to the present Conservative incumbent of No.11. Nor would option No.3 — a planned increase in taxation — look particularly appealing to Mr. Lawson.

For these reasons, the Chancellor seems to have fallen back to option No.4, that of a planned reduction in public expenditure. If planned expenditure in the medium-term can be reduced substantially from the levels which now appear likely to occur, then the threat of much higher taxation towards the end of the Parliament can probably be headed off, even if growth rates are disappointing. Furthermore, if expenditure can be reduced and growth out-performs present expectations, then attractive tax cuts might come into view. It is obvious why this option looks particularly attractive from the Treasury's stand-point, but a good deal less attractive from the view-point of spending ministers who would have to live in constrained circumstances even if the economy performed fairly well. It would be surprising if this Cabinet conflict of interest were settled either easily or rapidly, which is perhaps why the Treasury apparently sees public opinion as a valuable ally in its internal battles.

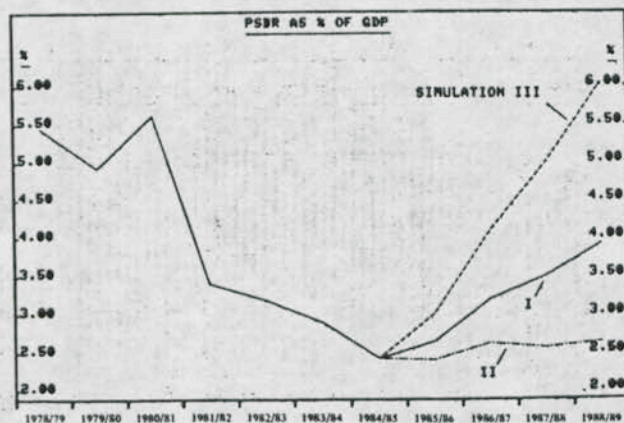
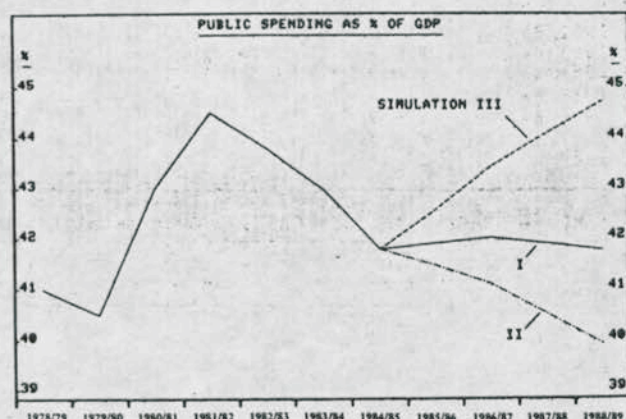
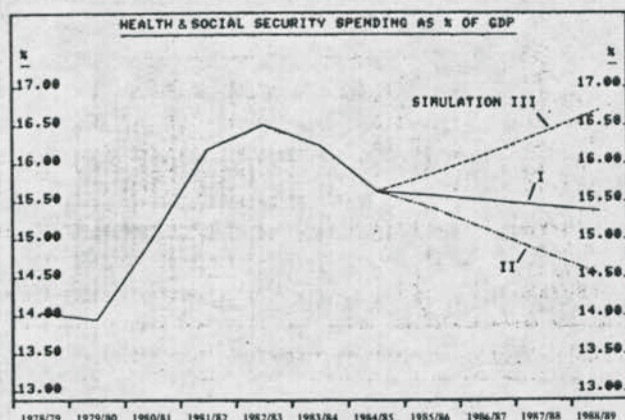
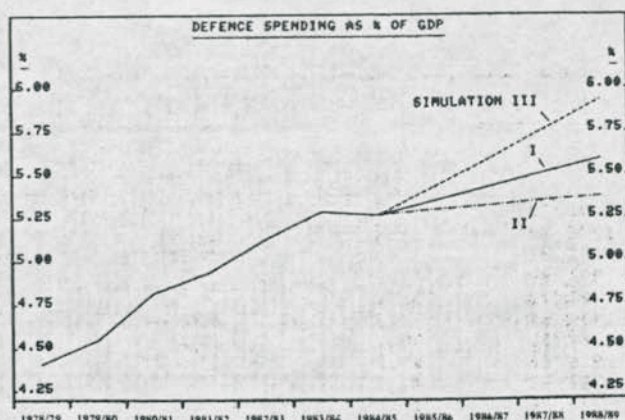


TABLE 1. CASE WITH 1.5% GROWTH PROGRAMME EXPENDITURE £BN.

	PAY	OTHER CURRENT	GRANTS +SUBS.	TOTAL CURRENT	GDPCF	TOTAL CAPITAL
1978/79	20.9	11.5	24.2	56.6	5.2	8.7
1979/80	24.8	14.0	28.8	67.7	6.0	10.8
1980/81	30.8	16.7	34.4	82.0	6.2	11.8
1981/82	34.2	19.6	40.0	93.8	5.0	10.5
1982/83	36.0	23.2	45.1	104.3	4.6	11.0
1983/84	37.8	25.0	47.1	110.0	5.8	11.8
1984/85	39.2	27.4	49.7	116.3	5.8	11.8
1985/86	41.8	29.6	53.3	124.7	6.2	12.6
1986/87	44.6	31.9	57.2	133.7	6.6	13.5
1987/88	47.5	34.5	61.3	143.3	7.1	14.5
1988/89	50.7	37.2	65.7	153.6	7.6	15.5

TABLE 2. CASE WITH 1.5% GROWTH PLANNING TOTAL £BN.

	TOTAL PROGS.	P-CORP BORROW.	ASSET SALES	CONT. RESERVE	SHORT- FALL	PLANNING TOTAL
1978/79	65.3	0.4	0.0	0.0	0.0	65.7
1979/80	78.4	-0.5	-1.0	0.0	0.0	76.9
1980/81	93.8	-0.6	-0.4	0.0	0.0	92.8
1981/82	104.3	0.3	0.1	0.0	0.0	104.7
1982/83	115.3	-1.1	-0.6	0.0	0.0	113.7
1983/84	121.8	-0.3	-1.3	0.0	-0.5	119.8
1984/85	128.1	-0.4	-1.5	1.5	-0.8	126.9
1985/86	137.4	-0.2	-2.0	3.0	-0.8	137.4
1986/87	147.2	-0.2	-1.5	4.0	-0.8	148.7
1987/88	157.8	-0.2	-1.0	4.0	-0.8	159.8
1988/89	169.1	-0.2	-0.5	4.0	-0.8	171.6

TABLE 3. CASE WITH 1.5% GROWTH SHARE OF PUBLIC SPENDING IN GDP

	PLANNING TOTAL	ADJ.	WHITE PAPER TOTAL	% OF GDP	UNEMP. (THOUS.)	NOMINAL GDP (£)
1978/79	65.7	4.0	69.7	41.0	1326.0	170.0
1979/80	76.9	5.3	82.2	40.5	1233.0	203.0
1980/81	92.8	7.0	99.8	43.0	1469.0	232.0
1981/82	104.7	8.8	113.5	44.5	2417.0	255.0
1982/83	113.7	9.4	123.1	43.8	2772.0	281.0
1983/84	119.8	10.0	129.8	43.0	2970.0	302.0
1984/85	126.9	10.2	137.1	41.8	3020.0	328.0
1985/86	137.4	10.5	147.9	41.9	3194.0	352.9
1986/87	148.7	10.8	159.5	42.0	3382.4	379.7
1987/88	159.8	11.4	171.2	41.9	3571.0	408.5
1988/89	171.6	12.0	183.6	41.8	3759.2	439.5

TABLE 4. CASE WITH 1.5% GROWTH GOVERNMENT REVENUE £BN.

	OIL TAXES	TAXES ON INCOME	TAXES ON EXPENDITURE	RATES	TOTAL REVENUE	% OF GDP
1978/79	0.5	34.7	13.8	5.8	65.4	38.5
1979/80	2.1	40.1	18.3	6.9	79.1	39.0
1980/81	3.8	46.3	22.0	8.7	94.5	40.7
1981/82	6.4	53.0	25.2	11.0	111.5	43.7
1982/83	7.8	57.0	28.0	12.3	121.9	43.4
1983/84	7.5	60.1	29.7	13.0	128.5	42.5
1984/85	8.0	64.8	31.5	13.8	137.9	42.0
1985/86	9.2	68.5	33.2	14.6	146.8	41.6
1986/87	10.3	72.3	35.0	15.5	156.0	41.1
1987/88	10.8	76.3	36.9	16.4	165.2	40.4
1988/89	11.3	80.6	38.9	17.4	174.8	39.8

TABLE 5. CASE WITH 1.5% GROWTH GOVERNMENT BORROWING £BN.

	GEN. GOVT. REVENUE	GEN. GOVT. EXPENDITURE	GGBR	GGBR AS % OF GDP	PSBR	PSBR AS % OF GDP
1978/79	65.4	74.4	9.0	5.3	9.3	5.4
1979/80	79.1	89.5	10.4	5.1	10.0	4.9
1980/81	94.5	108.1	13.6	5.9	13.0	5.6
1981/82	111.5	120.2	8.7	3.4	8.7	3.4
1982/83	121.9	132.1	10.2	3.6	9.0	3.2
1983/84	128.5	138.8	10.3	3.4	8.8	2.9
1984/85	137.9	146.4	8.5	2.6	8.0	2.4
1985/86	146.8	156.7	9.8	2.8	9.3	2.6
1986/87	156.0	168.7	12.6	3.3	12.1	3.2
1987/88	165.2	180.0	14.8	3.6	14.3	3.5
1988/89	174.8	192.6	17.8	4.0	17.3	3.9

TABLE 1. CASE WITH 2.5% GROWTH PROGRAMME EXPENDITURE £BN.

	PAY	OTHER CURRENT	GRANTS +SUBS.	TOTAL CURRENT	GDFCF	TOTAL CAPITAL
1978/79	20.9	11.5	24.2	56.6	5.2	8.7
1979/80	24.8	14.0	28.8	67.7	6.0	10.8
1980/81	30.8	16.7	34.4	82.0	6.2	11.8
1981/82	34.2	19.6	40.0	93.8	5.0	10.5
1982/83	36.0	23.2	45.1	104.3	4.6	11.0
1983/84	37.8	25.0	47.1	110.0	5.8	11.8
1984/85	39.2	27.4	49.7	116.3	5.8	11.8
1985/86	41.8	29.6	53.2	124.7	6.2	12.6
1986/87	44.6	31.9	56.8	133.3	6.6	13.5
1987/88	47.5	34.5	60.6	142.6	7.1	14.5
1988/89	50.7	37.2	64.6	152.5	7.6	15.5

TABLE 2. CASE WITH 2.5% GROWTH PLANNING TOTAL £BN.

	TOTAL PROGS.	P.CORP BORROW.	ASSET SALES	CONT. RESERVE	SHORT-FALL	PLANNING TOTAL
1978/79	65.3	0.4	0.0	0.0	0.0	65.7
1979/80	78.4	-0.5	-1.0	0.0	0.0	76.9
1980/81	93.8	-0.6	-0.4	0.0	0.0	92.8
1981/82	104.3	0.3	0.1	0.0	0.0	104.7
1982/83	115.3	-1.1	-0.6	0.0	0.0	113.7
1983/84	121.8	-0.3	-1.3	0.0	-0.5	119.8
1984/85	128.1	-0.4	-1.5	1.5	-0.8	126.9
1985/86	137.3	-0.2	-2.0	3.0	-0.8	137.3
1986/87	146.8	-0.2	-1.5	4.0	-0.8	148.3
1987/88	157.1	-0.2	-1.0	4.0	-0.8	159.1
1988/89	168.0	-0.2	-0.5	4.0	-0.8	170.5

TABLE 3. CASE WITH 2.5% GROWTH SHARE OF PUBLIC SPENDING IN GDP

	PLANNING TOTAL	ADJ.	WHITE PAPER TOTAL	% OF GDP	UNEMP. (THOUS.)	NOMINAL GDP (£)
1978/79	65.7	4.0	69.7	41.0	1326.0	170.0
1979/80	76.9	5.3	82.2	40.5	1233.0	203.0
1980/81	92.8	7.0	99.8	43.0	1469.0	232.0
1981/82	104.7	8.8	113.5	44.5	2417.0	255.0
1982/83	113.7	9.4	123.1	43.8	2772.0	281.0
1983/84	119.8	10.0	129.8	43.0	2970.0	302.0
1984/85	126.9	10.2	137.1	41.8	3020.0	328.0
1985/86	137.3	10.5	147.8	41.5	3151.4	356.4
1986/87	148.3	10.8	159.2	41.1	3226.5	387.2
1987/88	159.1	11.4	170.5	40.5	3273.8	420.7
1988/89	170.5	12.0	182.5	39.9	3320.9	457.1

TABLE 4. CASE WITH 2.5% GROWTH GOVERNMENT REVENUE £BN.

	OIL TAXES	TAXES ON INCOME	TAXES ON EXPENDITURE	RATES	TOTAL REVENUE	% OF GDP
1978/79	0.5	34.7	13.8	5.8	65.4	38.5
1979/80	2.1	40.1	18.3	6.9	79.1	39.0
1980/81	3.8	46.3	22.0	8.7	94.5	40.7
1981/82	6.4	53.0	25.2	11.0	111.5	43.7
1982/83	7.8	57.0	28.0	12.3	121.9	43.4
1983/84	7.5	60.1	29.7	13.0	128.5	42.5
1984/85	8.0	64.8	31.5	13.8	137.9	42.0
1985/86	9.2	68.6	33.5	14.6	147.5	41.4
1986/87	10.3	72.8	35.7	15.5	157.7	40.7
1987/88	10.8	77.3	38.0	16.4	168.0	39.9
1988/89	11.3	82.1	40.5	17.4	178.9	39.1

TABLE 5. CASE WITH 2.5% GROWTH GOVERNMENT BORROWING £BN.

	GEN.GOV'T. REVENUE	GEN.GOV'T. EXPENDITURE	GGBR	GGBR AS % OF GDP	PSBR	PSBR AS % OF GDP
1978/79	65.4	74.4	9.0	5.3	9.3	5.4
1979/80	79.1	89.5	10.4	5.1	10.0	4.9
1980/81	94.5	108.1	13.6	5.9	13.0	5.6
1981/82	111.5	120.2	8.7	3.4	8.7	3.4
1982/83	121.9	132.1	10.2	3.6	9.0	3.2
1983/84	128.5	138.8	10.3	3.4	8.8	2.9
1984/85	137.9	146.4	8.5	2.6	8.0	2.4
1985/86	147.5	156.6	9.1	2.6	8.6	2.4
1986/87	157.7	168.3	10.7	2.8	10.2	2.6
1987/88	168.0	179.3	11.3	2.7	10.8	2.6
1988/89	178.9	191.5	12.6	2.8	12.1	2.6



TABLE 1. CASE WITH ZERO GROWTH PROGRAMME EXPENDITURE EBN.

	PAY	OTHER CURRENT	GRANTS +SUBS.	TOTAL CURRENT	GDFCF	TOTAL CAPITAL
1978/79	20.9	11.5	24.2	56.6	5.2	8.7
1979/80	24.8	14.0	28.8	67.7	6.0	10.8
1980/81	30.8	16.7	34.4	82.0	6.2	11.8
1981/82	34.2	19.6	40.0	93.8	5.0	10.5
1982/83	36.0	23.2	45.1	104.3	4.6	11.0
1983/84	37.8	25.0	47.1	110.0	5.8	11.8
1984/85	39.2	27.4	49.7	116.3	5.8	11.8
1985/86	41.8	29.6	53.5	124.9	6.2	12.6
1986/87	44.6	31.9	57.7	134.2	6.6	13.5
1987/88	47.5	34.5	62.3	144.3	7.1	14.5
1988/89	50.7	37.2	67.3	155.2	7.6	15.5

TABLE 2. CASE WITH ZERO GROWTH PLANNING TOTAL EBN.

	TOTAL PROGS.	P. CORP BORROW.	ASSET SALES	CONT. RESERVE	SHORT- FALL	PLANNING TOTAL
1978/79	65.3	0.4	0.0	0.0	0.0	65.7
1979/80	78.4	-0.5	-1.0	0.0	0.0	76.9
1980/81	93.8	-0.6	-0.4	0.0	0.0	92.8
1981/82	104.3	0.3	0.1	0.0	0.0	104.7
1982/83	115.3	-1.1	-0.6	0.0	0.0	113.7
1983/84	121.8	-0.3	-1.3	0.0	-0.5	119.8
1984/85	128.1	-0.4	-1.5	1.5	-0.8	126.9
1985/86	137.5	-0.2	-2.0	3.0	-0.8	137.5
1986/87	147.7	-0.2	-1.5	4.0	-0.8	149.2
1987/88	158.8	-0.2	-1.0	4.0	-0.8	160.8
1988/89	170.7	-0.2	-0.5	4.0	-0.8	173.2

TABLE 3. CASE WITH ZERO GROWTH SHARE OF PUBLIC SPENDING IN GDP

	PLANNING TOTAL	ADJ.	WHITE PAPER TOTAL	% OF GDP	UNEMP. (THOUS.)	NOMINAL GDP (E)
1978/79	65.7	4.0	69.7	41.0	1326.0	170.0
1979/80	76.9	5.3	82.2	40.5	1233.0	203.0
1980/81	92.8	7.0	99.8	43.0	1469.0	232.0
1981/82	104.7	8.8	113.5	44.5	2417.0	255.0
1982/83	113.7	9.4	123.1	43.8	2772.0	281.0
1983/84	119.8	10.0	129.8	43.0	2970.0	302.0
1984/85	126.9	10.2	137.1	41.8	3020.0	328.0
1985/86	137.5	10.5	148.0	42.6	3258.0	347.7
1986/87	149.2	10.9	160.1	43.4	3615.4	368.5
1987/88	160.8	11.4	172.2	44.1	4011.9	390.7
1988/89	173.2	12.0	185.2	44.7	4403.9	414.1

TABLE 4. CASE WITH ZERO GROWTH GOVERNMENT REVENUE EBN.

	OIL TAXES	TAXES ON INCOME	TAXES ON EXPENDITURE	RATES	TOTAL REVENUE	% OF GDP
1978/79	0.5	34.7	13.8	5.8	65.4	38.5
1979/80	2.1	40.1	18.3	6.9	79.1	39.0
1980/81	3.8	46.3	22.0	8.7	94.5	40.7
1981/82	6.4	53.0	25.2	11.0	111.5	43.7
1982/83	7.8	57.0	28.0	12.3	121.9	43.4
1983/84	7.5	60.1	29.7	13.0	128.5	42.5
1984/85	8.0	64.8	31.5	13.8	137.9	42.0
1985/86	9.2	68.3	32.7	14.6	145.8	41.9
1986/87	10.3	71.6	34.0	15.5	153.6	41.7
1987/88	10.8	74.9	35.3	16.4	161.0	41.2
1988/89	11.3	78.4	36.7	17.4	168.8	40.8

TABLE 5. CASE WITH ZERO GROWTH GOVERNMENT BORROWING EBN.

	GEN. GOVT. REVENUE	GEN. GOVT. EXPENDITURE	GGBR	GGBR AS % OF GDP	PSBR	PSBR AS % OF GDP
1978/79	65.4	74.4	9.0	5.3	9.3	5.4
1979/80	79.1	89.5	10.4	5.1	10.0	4.9
1980/81	94.5	108.1	13.6	5.9	13.0	5.6
1981/82	111.5	120.2	8.7	3.4	8.7	3.4
1982/83	121.9	132.1	10.2	3.6	9.0	3.2
1983/84	128.5	138.8	10.3	3.4	8.8	2.9
1984/85	137.9	146.4	8.5	2.6	8.0	2.4
1985/86	145.8	156.8	11.0	3.2	10.5	3.0
1986/87	153.6	169.2	15.6	4.2	15.1	4.1
1987/88	161.0	181.0	19.9	5.1	19.4	5.0
1988/89	168.8	194.2	25.4	6.1	24.9	6.0

TABLE 1. CASE WITH 1.5% GROWTH AND 1% RPE DETERIORATION, ETC. PROGRAMME EXPENDITURE EBN.

	PAY	OTHER CURRENT	GRANTS + SUBS.	TOTAL CURRENT	GDFCF	TOTAL CAPITAL
1978/79	20.9	11.5	24.2	56.6	5.2	8.7
1979/80	24.8	14.0	28.8	67.7	6.0	10.8
1980/81	30.8	16.7	34.4	82.0	6.2	11.8
1981/82	34.2	19.6	40.0	93.8	5.0	10.5
1982/83	36.0	23.2	45.1	104.3	4.6	11.0
1983/84	37.8	25.0	47.1	110.0	5.8	11.8
1984/85	39.2	27.4	49.7	116.3	5.8	11.8
1985/86	42.1	29.8	53.6	125.5	6.3	12.8
1986/87	45.1	32.4	57.8	135.4	6.8	14.0
1987/88	48.4	35.2	62.4	146.0	7.4	15.2
1988/89	51.9	38.3	67.3	157.5	8.1	16.6

TABLE 2. CASE WITH 1.5% GROWTH AND 1% RPE DETERIORATION, ETC. PLANNING TOTAL EBN.

	TOTAL PROGS.	P. CORP BORROW.	ASSET SALES	CONT. RESERVE	SHORT-FALL	PLANNING TOTAL
1978/79	65.3	0.4	0.0	0.0	0.0	65.7
1979/80	78.4	-0.5	-1.0	0.0	0.0	76.9
1980/81	93.8	-0.6	-0.4	0.0	0.0	92.8
1981/82	104.3	0.3	0.1	0.0	0.0	104.7
1982/83	115.3	-1.1	-0.6	0.0	0.0	113.7
1983/84	121.8	-0.3	-1.3	0.0	-0.5	119.8
1984/85	128.1	-0.4	-1.5	1.5	-0.8	126.9
1985/86	138.4	-0.2	-2.0	3.0	-0.8	138.4
1986/87	149.3	-0.2	-1.5	4.0	-0.8	150.8
1987/88	161.2	-0.2	-1.0	4.0	-0.8	163.2
1988/89	174.1	-0.2	-0.5	4.0	-0.8	176.6

TABLE 3. CASE WITH 1.5% GROWTH AND 1% RPE DETERIORATION, ETC. SHARE OF PUBLIC SPENDING IN GDP

	PLANNING TOTAL	ADJ.	WHITE PAPER TOTAL	% OF GDP	UNEMP. (THOUS.)	NOMINAL GDP (E)
1978/79	65.7	4.0	69.7	41.0	1326.0	170.0
1979/80	76.9	5.3	82.2	40.5	1233.0	203.0
1980/81	92.8	7.0	99.8	43.0	1469.0	232.0
1981/82	104.7	8.8	113.5	44.5	2417.0	255.0
1982/83	113.7	9.4	123.1	43.8	2772.0	281.0
1983/84	119.8	10.0	129.8	43.0	2970.0	302.0
1984/85	126.9	10.2	137.1	41.8	3020.0	328.0
1985/86	138.4	10.6	148.9	42.2	3194.0	352.9
1986/87	150.8	10.9	161.8	42.6	3382.4	379.7
1987/88	163.2	11.5	174.8	42.8	3571.0	408.5
1988/89	176.6	12.1	188.7	42.9	3759.2	439.5

TABLE 4. CASE WITH 1.5% GROWTH AND 1% RPE DETERIORATION, ETC. GOVERNMENT REVENUE EBN.

	OIL TAXES	TAXES ON INCOME	TAXES ON EXPENDITURE	RATES	TOTAL REVENUE	% OF GDP
1978/79	0.5	34.7	13.8	5.8	65.4	38.5
1979/80	2.1	40.1	18.3	6.9	79.1	39.0
1980/81	3.8	46.3	22.0	8.7	94.5	40.7
1981/82	6.4	53.0	25.2	11.0	111.5	43.7
1982/83	7.8	57.0	28.0	12.3	121.9	43.4
1983/84	7.5	60.1	29.7	13.0	128.5	42.5
1984/85	8.0	64.8	31.5	13.8	137.9	42.0
1985/86	9.2	68.6	33.2	14.6	147.0	41.7
1986/87	10.3	72.7	35.0	15.5	156.4	41.2
1987/88	10.8	76.9	36.9	16.4	165.8	40.6
1988/89	11.3	81.4	38.9	17.4	175.6	40.0

TABLE 5. CASE WITH 1.5% GROWTH AND 1% RPE DETERIORATION, ETC. GOVERNMENT BORROWING EBN.

	GEN. GOVT. REVENUE	GEN. GOVT. EXPENDITURE	GGBR	GGBR AS % OF GDP	PSBR	PSBR AS % OF GDP
1978/79	65.4	74.4	9.0	5.3	9.3	5.4
1979/80	79.1	89.5	10.4	5.1	10.0	4.9
1980/81	94.5	108.1	13.6	5.9	13.0	5.6
1981/82	111.5	120.2	8.7	3.4	8.7	3.4
1982/83	121.9	132.1	10.2	3.6	9.0	3.2
1983/84	128.5	138.8	10.3	3.4	8.8	2.9
1984/85	137.9	146.4	8.5	2.6	8.0	2.4
1985/86	147.0	157.7	10.7	3.0	10.2	2.9
1986/87	156.4	170.8	14.4	3.8	13.9	3.7
1987/88	165.8	183.4	17.7	4.3	17.2	4.2
1988/89	175.6	197.6	22.0	5.0	21.5	4.9

See text for details