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Policy Unit

PRIME MINISTER

CABINET: BUDGET BACKGROUND

The paper on capital and current expenditure is excellent. It answers the criticism that we have been spending insufficient on capital account by demonstrating that capital spending has been level in cost terms since 1978/9.

Capital spending is not a good in itself. It is only worthwhile if it improves services, or if it is a commercial investment that earns a good return. All too often in the past, far too much money has been squandered in eg steel, shipbuilding, motor cars - only to see the new plants closed down, the men made redundant, and the capital written off a few years later.

There is no point whatsoever in spending on capital account to build more buildings like schools when demand for the service is falling.

It is dangerous to assume that you can judge a suitable overall level of public capital expenditure. Stressing the argument that expenditure has not fallen could imply that the Government should be judged by the aggregate amount of capital spending. Instead, you should be judged by the return generated on public investment projects, and by success or failure in maintaining a decent infrastructure for the rest of the economy.

Those who seek more capital expenditure are often driven to speak for new sewers. Results from surveys of the sewer system are often reassuring rather than disturbing. There is no need to dig up all the streets and replace all the sewers that are currently there. The best way of knowing when a sewer's useful life is over is still to wait for it to collapse. New technology is also coming to our aid. Spray-on and plastic linings are possible, rather than complete replacement. The DoE agree that there is no major problem with sewer replacement. The current programme is running at over £200 million per annum. The Government could say that those who want to replace all the sewers do not know what they are talking about, and would inflict unnecessary costs with traffic dislocation and noise.

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Public expenditure and taxation in the longer term

As recommended, the Green Paper should have an introductory section setting out the inexorable growth of the last 20 years.

The section drawing attention to likely pressures for further spending should not make too much of the demands for new capital infrastructure (see above).

The Green Paper could be used as an opportunity to state the case in favour of making most of the commercial industrial investment in the private rather than the public sector. In this connection, the recent trend of decisions is disturbing. In the last 2 weeks alone, the Government has accepted from the DTI the expenditure of up to £220 million on A320, up to £60 million on Rolls Royce, up to £100 million on Nissan, and £80 million plus on Scott Lithgow. At this rate, taxes will have to go up. A Government which does not believe in interfering in business, and believes in letting the market take more of the strain, has to be careful lest it gets dragged back in to an enormous programme of subsidy and expenditure on industrial matters.

In setting out the general projections, there would be some merit in showing three cases. The three public expenditure cases could be: a 1 per cent per annum reduction; holding constant in real terms; and a 1 per cent per annum increase. The growth variables could also be three in number. The paper could take: 1 per cent (comparable to the experience of the last 10 years); the central case of 2 per cent, as outlined in the Treasury paper; and a more optimistic 3 per cent.

If all these variables were put together in a table of possibilities, it would provide the necessary background for an informed public debate. The danger of narrowing the options too far would be to invite the criticism that:

(a) the Government have given up any hope of ever reducing public spending;

(b) it was attempting to fiddle the figures by taking an unduly optimistic growth rate for the economy as a whole; and

(c) on any reasonable balance of the figures provided by the Government, there was no chance whatsoever in getting tax down below the 1978/79 level which the Conservative Party in Opposition so roundly condemned.

It would also be helpful if some more optimism could be injected into the general debate about the considerable opportunities there are for reducing public spending. The list beneath shows some of the avenues that could be explored more vigorously:

DHSS:

Making Child Benefit contributory (£4 billion expenditure).

Abolishing state earnings-related pension schemes (saving £10 billion per annum by 2010).

Making Griffiths work, and squeezing an extra 2 per cent efficiency out of the NHS, a modest target (£300 million).

DTI:

Reducing the budget for money wasted on unproductive industrial support and subsidy, c.£500 million.

Regional Policy:

A further £250 million.

Transport:

Reducing bus and train subsidies, c.£400 million.

Agriculture:

Reducing MAFF assistance, c.£300 million.

Government Procurement:

Better practices, £750 million.

Public Sector Pay:

Better control, say £300 million.

In summary, the best economic strategy for this Government remains to reduce taxation, whilst not relenting on the pressure to reduce the PSBR and money supply. In order to deliver, some of those spending programmes which do not reflect the Government's general philosophy not only have to be questioned, but have to be stopped.

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