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Reference No: P 01555

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PRIME MINISTER

CHEQUERS MEETING ON PUBLIC EXPENDITURE, 23 JUNE 1985.

BACKGROUND

You have invited members of the Cabinet to a meeting at Chequers on Sunday, 23 June to discuss public expenditure priorities before the main Public Expenditure Survey Round (with a first Cabinet discussion on 11 July). No papers are being circulated, but you have invited those attending to look again at the Green Paper on Public Expenditure and Taxation into the 1990s (Cmnd 9189) published at the time of the 1984 Budget. This considered the longer-term fiscal prospects up to 1993-94.

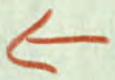
2. You made it clear at Cabinet on 20 June that this occasion was not intended to be the opening discussion of the 1985 Public Expenditure Survey, nor to anticipate the bilaterals which the Chief Secretary would be having with his departmental colleagues about the programmes for 1986-87 and the two following years. It was therefore not an opportunity for Ministers to put forward particular departmental bids or advocate departmental programmes. The intention was to provide an opportunity for the Cabinet collectively to discuss what should be the Government's public expenditure priorities over the medium term, within whatever total was available.

RECENT HISTORY AND FUTURE PROSPECTS

3. The Chief Secretary will give a short presentation of expenditure trends in the recent past and of general future prospects. This is likely to show that public expenditure has on average grown by about 2 per cent a year in real terms since 1979, compared with an average of some 3 per cent a year over the past 20 years. This measure of public spending, however, excludes debt interest (now running at →



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about £18 billion a year) and also takes credit for asset sales (up from about £½ billion in 1978-79 to about £4 billion this year). Thus, while the Government have checked the measured growth rate, they have not stopped it growing, let alone actually cut it. At the same time the overall burden of taxation (albeit with changes in composition) has increased from some 35 per cent of GDP in 1979 to an estimated 39 per cent in 1984-85.

4. The Treasury have not yet circulated details of the Survey figures for the new Public Expenditure Round and will not do so at this meeting. I understand, however, that the 1985 Survey is likely to reveal additional bids by departments of some £7 billion, £7½ billion and £8½ billion for the years 1986-87, 1987-88, and 1988-89 respectively. This means that the task of containing public expenditure this year may well be even more difficult than it was in 1984. Among the main reasons are:-

(i) the current 'blip' in inflation represents the first instance in recent years of a major adverse variation under cash planning between actual and assumed inflation. As a result of this expenditure on social security benefits will be £1-2 billion higher each year than allowed for in the baseline;

(ii) the squeeze on the real volume of expenditure implied by the inflation 'blip' will make other programmes (particularly those of local authorities, which account for about a quarter of public expenditure) more difficult to restrain. Cash plans for discretionary programmes have been built on the basis of "uplift factors" below anticipated inflation (eg 3 per cent for 1986-87 and 2½ per cent for 1987-88);

(iii) with private sector pay settlements now running at



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some 6 per cent (earnings 7½ per cent) strong pay pressures are also likely to emerge in the Survey. Although the additional bids submitted to the Treasury by departments include the pay review body consequentials, they do not allow for pay elsewhere in the public services (some £40 billion in total) exceeding the cash "uplift factors" of 3 per cent or less included in the baseline;

(iv) the rigorous public expenditure exercises of the recent past have squeezed a lot of the obvious "fat" out of spending programmes.

THE SUBSTANCE OF THE DISCUSSION

5. The Chancellor and Chief Secretary will no doubt emphasise the importance of achieving the Green Paper objective of holding expenditure level in real terms so that it declines as a proportion of the Gross Domestic Product, and so opens the way to real reductions in taxation. As indicated above, the Government have secured some reduction in the real rate of growth in public expenditure, despite the impact on social security expenditure of increased unemployment and other pressures. But taxation as a proportion of GDP remains 3-4 per cent above the level of the later 1970s, and the prospective decline of N. Sea oil revenues (now probably at their peak) will put more of the burden on traditional income and expenditure taxes. A very cautious view therefore needs to be taken about the scope for future public expenditure if the virtuous circle of lower taxes and higher real growth is to be established.

6. Departmental Ministers will no doubt be preoccupied by the constraints that apply to their own programmes, and may seek in the discussion to establish some degree of presumption that specially favoured treatment will be given to those programmes. You may therefore wish to make clear again at the outset that they should stand back from their immediate Departmental concerns, and instead



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approach the overall issue of priorities from the standpoint of the Government as a whole.

7. The following are among the specific topics which may be raised in the discussion:

(a) Arguments for higher public expenditure to counter unemployment.

These could take a number of forms:

(i) it is reasonable to accept a higher PSBR at a time of cyclically high unemployment;

(ii) now is the time to give greater emphasis to the backlog of desirable/essential capital expenditure;

(iii) the net impact on the PSBR of increases in expenditure on Community Programmes, etc is very small;

(iv) expenditure designed to make UK industry more efficient and competitive has exceptionally high priority.

All these points of view can, of course, be argued. But there are a number of strong grounds for approaching them with great caution. Much unemployment is not cyclical, but structural, reflecting the need for change in industrial structure and in labour market behaviour; palliative measures risk obstructing essential long-term change; programmes once undertaken develop a momentum which is difficult to stop; and what the Government can do has to take into account how the financial markets and other parts of the economy are likely to react.



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(b) Questions about the treatment of particular programmes

The Chief Secretary is likely to point out that part of the difficulty reflects the limited scope the Government have, for a variety of reasons, to cut back on particular major programmes, so throwing more of the burden of adjustment onto the rest:

(i) local authority expenditure - the difficult problems in this area are under study by E(LF). The scope for reductions in the short-run is likely to be limited. But there must be scope for LAs to make more effective use of the resources they already have, as the Audit Commission are beginning to make clear;

(ii) social security - the Green Paper and the decisions on this year's uprating represents the first steps towards curbing the long-term upward trend in expenditure. There is obvious advantage in any move which proves politically feasible to limit the commitment to the maintenance of the real value of benefits - the more so when the Government are seeking changes in the labour market to facilitate more lower paid employment in services, etc;

(iii) health services - expenditure on the NHS has roughly tripled in real terms since the early 1950s, and the health and personal social services programme has grown by some 20 per cent in real terms since 1978-79. The introduction of stronger professional management into the NHS is helping to counter the upward pressures of higher relative pay for nurses, improving technology/rising expectations, and the rapid growth in the numbers of the very old. An open mind will be



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needed to all suggestions for making more efficient use of the NHS resources or drawing in additional resources from the private sector;

(iv) defence - higher priority for defence (and in particular the provision of better equipment) has been an important element in the Government's overall public expenditure planning. The defence equipment programme is now some 50 per cent higher in real terms than in May 1979. However, the NATO commitment to 3 per cent a year real growth expires this year, and it should be possible to maintain/improve defence capability in future without constantly growing expenditure on equipment. An interdepartmental study is under way of the wider impact of defence research and development on the UK economy; it will be important to take every available step to increase the contribution made by scarce resources in this area to the performance of UK industry.

(c) Treatment of privatisation receipts

By convention privatisation receipts count as negative public expenditure (and so reduce the published overall totals.) In principle, however, such receipts should not serve as the basis for commitments to continuing expenditure programmes, and should be regarded as financing rather than reducing the PSBR. An increase in privatisation receipts (eg from the sale of BGC) would not, therefore, warrant acceptance of higher than planned continuing expenditure on the Government's main programmes. Nevertheless there may be strong practical and political arguments for using extra privatisation receipts to permit some increase in underlying cash expenditure, particularly since the higher price level which is now putting pressure on the public expenditure cash totals should also produce more cash revenue. This is, however, very difficult ground which will need



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delicate treatment later in the discussions; so far as 23 June is concerned, it would seem to be a mistake to allow any conclusion to be reached about the implications of any projected change in privatisation receipts.

HANDLING

① 8. You will wish to open the discussion yourself, making clear again how you see the purpose of the occasion, and how you wish your colleagues to tackle the issues (I understand that the Treasury will be offering some material for this purpose). Thereafter the Chief Secretary, Treasury will make his general presentation, with the aid of a few slides. Other Cabinet members will then want an opportunity to speak about their own concerns, and state their views on priorities. The Chancellor of the Exchequer will wish to contribute to the discussion on the wider economic background to the Public Expenditure Round, and both he and the Chief Secretary may wish to respond to points made in the discussion. You will wish to sum up the discussion, reemphasising that this is not the occasion for reaching any specific conclusions or for anticipating the 1985 Survey Round.

CONCLUSIONS

9. You may be able to draw some or all of the following general conclusions from the discussion:

(i) it remains of fundamental importance to the Government to reduce the relative burden of the public sector on the rest of the economy;

(ii) the need for restraint and a "cultural" change in the approach to future public expenditure planning and priorities is greater than ever, given the pressures that seem likely to develop;

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(iii) all Departments should continue to make every effort to increase the 'output' from public expenditure programmes with the same or less input of resources;

(iv) all the Ministers concerned should be ready to approach all suggestions for changes/reductions in programmes with an open mind, and no programmes should be exempted for the indefinite future from proposals for changes on grounds of previous commitments;

(v) the Treasury will take Cabinet members' views into account in preparing for the discussion at Cabinet (on 11 July) about the wider public expenditure position and the Chief Secretary's subsequent bilaterals with spending Ministers.

J B UNWIN

Cabinet Office
21 June 1985

Value for Money - Andersson

Public Purchase

Debt for budget on pledges

Lord Mather - substantly
using

Andersson - "Keep up the pressure"
Government - "Keep up the pressure"

Lamont performance in
wealth section

Taken decisions?

Pruning - Ed

Lord President

Central Bank
Unit of 1 billion "

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~~✓~~ R.S.

~~✓~~ Character the Debt

~~✓~~ Levy

~~✓~~ Min. of Finance

~~✓~~ Incl

~~✓~~ M. of Finance

~~✓~~ Debt

~~✓~~ Soc. Sec.

~~✓~~ Portfolios

Wealth section Politics

Ed

Wells

Red of Pruning
Fin under Levy
Home for Schuyler

Not spending
more out of each for
rather than merging new of