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CP(76) 53

COPY NO 81

13 July 1976

CABINET

PUBLIC EXPENDITURE AND TAXATION 1977-78

Note by the Chancellor of the Exchequer

I attach a memorandum by the Chief Secretary, Treasury.

D W H

Treasury Chambers

13 July 1976

SECRET

PUBLIC EXPENDITURE AND TAXATION 1977-78

Memorandum by the Chief Secretary, Treasury.

1. Following our discussion on 6 July, I deal in Part I of this paper with the question whether the early statement envisaged of action to reduce next year's Public Sector Borrowing Requirement should announce tax changes affecting 1977-78 as well as expenditure reductions. Part II compares the effects of tax and expenditure respectively on employment and the retail price index. In Part III I summarise the results of the bilateral discussions which I have now held on a contingent basis with the spending Ministers concerned. Part IV discusses what would be involved in carrying out expenditure reductions so as to effect a rearrangement of priorities.

2. In the concluding paragraphs of the paper I have set out the broad expenditure issues now requiring decision; and the Annex lists the specific changes in particular programmes on which decisions are required.

SECRET

1 - TAX CHANGES IN 1977-78

3. We are not concerned here with changes in the level of taxation or expenditure affecting the current year. Our taxation proposals have already been put forward in the Budget and the Finance Bill. On expenditure we have said that we will not cut the planned total this year but that we will not allow it to be exceeded; this may require some reductions to offset increases in particular programmes, with no net change in the total.
4. It is on 1977-78 that we now have to take new decisions. The Chancellor has proposed that we should announce our objective of reducing the Public Sector Borrowing Requirement over the next three years, starting in 1977-78. Action to achieve this can take the form both of reductions in planned expenditure and of tax changes. The expenditure decisions have to be taken well in advance, because of the longer gestation period involved. This is particularly so where the measures have to be carried out by other bodies, mainly the local authorities and nationalised industries, but even for the preparation of departmental Estimates a substantial period of preparation is required.
5. We should therefore have to start taking our expenditure decisions now in any case. The special feature of the situation is that, though we have resisted pressures to make arbitrary cuts before completion of the public expenditure Survey, it is now a matter of urgency to take and announce our initial decisions on the Survey affecting 1977-78.
6. The objective of reducing the borrowing requirement next year will mean that, to the extent that expenditure reductions prove to be insufficient for this purpose, the further adjustment required will have to take the form of tax measures.

SECRET

II - EFFECTS ON EMPLOYMENT AND THE RPI

7. The effects which fiscal action to reduce the borrowing requirement produces on the level of economic activity, and therefore on such things as employment and the balance of payments, tend - allowing for the margins of error in all these things - not to diverge very radically over a period of time, whether the reduction is brought about by a general reduction in expenditure or a general increase in taxation. But the particular method adopted can make a difference, especially to the timing and incidence of these effects. When it comes to the effects on the retail price index and on real take home pay, the choice of method can make a very big difference indeed.

8. Expenditure reductions of £1,000 million at 1976 Survey prices involve a bigger expenditure amount in 1977-78 out-turn prices, but probably something less than £1,000 million in terms of reducing the 1977-78 borrowing requirement, after allowing for lower tax revenue and increased outgoings on social security. The expenditure/borrowing ratio will depend on the composition of the package. A £1,000 million expenditure package (in Survey prices) could be constructed from the list under consideration which would reduce the borrowing requirement in 1977-78 by £700-900 million, depending on the package.

9. There is only one cut listed for decision which would have any noticeable effect on the RPI, that is, the £200 million saving in 1977-78 through a faster phasing out of food subsidies; this would have an RPI effect of $\frac{1}{4}$ - $\frac{3}{8}$ %. An increase in prescription charges, if decided upon, would have an insignificant RPI effect, while dental and optical charges do not affect the RPI at all.

10. The list does not include any further reduction in housing subsidies, but the effects of the reduction in these subsidies which would flow from our existing White Paper decisions, in conjunction with the White Paper decisions on school meals and food subsidies, would affect the RPI to the extent of a little over $\frac{1}{2}$ %, which has

SECRET

already been allowed for in our RPI forecasts. There are additional bids for decision which, if approved, would reduce this effect.

11. The temporary addition to unemployment resulting from the whole package of £1,000 million, if confined to 1977-78 on a once-for-all basis, would tend to build up to a maximum of perhaps 75,000 as compared with what it would otherwise be the first half of 1978, but total unemployment should be coming down well before then. The different elements in the package would have different effects. For example, if the cuts were concentrated on building programmes, a high proportion of this effect would naturally fall upon the construction industry. Reductions in items such as mortgage lending or municipalisation, or a postponement of payment of regional development grants, would have little effect on unemployment.

12. If additional bids were approved which reduced the total net saving on expenditure and the borrowing requirement, they would pro tanto abate these effects. If the additional bids were to exceed the reductions, thus increasing planned expenditure, this would increase the borrowing requirement and the balance of payments deficit.

13. For comparison, the following table shows the effects on the borrowing requirement and on the RPI and on unemployment of a number of illustrative tax changes, each of which would yield, at 1977-78 prices additional revenue in the region of £500-600 million, and would reduce the borrowing requirement by £300-350 million. As in the case of expenditure measures the effects of particular taxes, for instance, on unemployment - in any case subject to a substantial margin of uncertainty - will differ, especially as regards timing.

14. The comparison indicates that a bigger gross revenue package is needed to secure a given cut in the public sector borrowing requirement; and that such a cut, if achieved by reductions in public expenditure of the kind illustrated, would have a much smaller effect on the RPI than a cut of the same amount achieved by increases in taxes. The expenditure method would also tend to produce a smaller effect on unemployment.

SECRET

The right time to make these tax changes is in the Spring 1977 Budget. It will not be possible until next Spring to decide how much has to be done, and it also makes sense to decide then which particular tax changes should be used. Otherwise we should be announcing tax increases eight months before they are due to take effect, and without knowing whether the total of the tax increases is right. If Cabinet agree to a £9 billion PSBR target, even with a £1 billion cut in public expenditure, if it were decided the balance must be obtained from indirect tax increases it would be necessary, for the reasons given in paragraph 13 above, to go for a combination of two or more of the items in the attached table.

SECRET

SECRET

ILLUSTRATIVE TAX CHANGES FROM APRIL 1977 TO
RAISE AS NEARLY AS POSSIBLE £500m IN A FULL YEAR

	<u>Revenue</u> full year 1977/78 £m	<u>PSBR</u> 1977/78 £m	<u>RPI</u> 4th quarter after change %	<u>Real GDP</u> 8th quarter after change %	<u>Unemployment</u> 8th quarter after change 000's
Standard rate of VAT 8%-10%	+670	-350	+1.0	-0.5	+70
Tobacco and alcohol duties +7p on packet of cigarettes } +2½p on pint of beer }	+500	-340	+1.3	-0.4	+70
Petrol and Derv +10p a gallon	+500	-310	+0.8	-0.3	+50
Employers' national insurance contributions + 1% on the contribution rate (see Note 3)	+500 (see note 4)	-310	+0.5	-0.3	+30

- Notes:
1. The illustrative tax increases are put as near £500m of revenue yield as administrative possibilities allow (eg the VAT step has in practice to be from 8%-10%).
 2. The PSBR impact from particular tax measures is less than the revenue yield from those measures first, because of time lags; and second, because a lower GDP (whether resulting from tax increases or public expenditure reductions) produces a lower tax yield across the whole field of taxation, while public expenditure - eg. on social security benefits - increases and hence swells the PSBR.
 3. Use of the employers' National Insurance contribution would require autumn legislation which would also have to make the proceeds available for general revenue by diverting them from the National Insurance Fund.
 4. This estimate excludes receipts in respect of employees in the non-trading public sector.

SECRET

SECRET

III - BILATERAL CONSULTATIONS

15. I have held meetings with the Ministers responsible for the spending programmes which make up the bulk of public expenditure. This programme of consultations has naturally had to be highly compressed and I am grateful to my colleagues for their help in fitting in with the timetable. These discussions have helped to clarify the issues and produce a closer assessment of what is realisable in particular cases, and I am able to report agreement on some few particular proposals. For the most part, however, the main issues remain to be resolved collectively.

16. I must remind my colleagues that in my previous paper I posed two general issues - whether we exclude the main social security benefits from the reductions, and whether we content ourselves with observing the existing White Paper figures for local authority current expenditure rather than go below these. If we do this we reduce the total public expenditure programmes available for savings (£53½ billion at 1976 Survey Prices) by £11½ billion in respect of social security and £10½ billion for local authority current expenditure: we would have to secure the reductions over a smaller area of public expenditure.

Defence

17. I believe that we should seek the full reduction of £140 million which I suggested in my previous paper. But the Defence Secretary considers this saving to be unattainable without fundamental consequences for our defence policy.

Overseas Aid

18. In the case of the Aid Programme I am prepared to scale down my appraisal of the reduction which could be obtained without breaking commitments or near-commitments. I now consider that £50 million can and should be secured by this means. But the Minister for Overseas Development considers that as a matter of principle and moral obligation there should be no cut in this programme. This is a clear political issue which can only be resolved collectively.

S E C R E T

Agriculture, Fisheries and Forestry

19. I have proposed that the additional bids of £9 million should be off-set by implementing in full the policy options set out in the PESC report; and that there should be further savings of £25 million. These further savings could, I suggest, comprise: a reduction of £3 million in forestry expenditure (eg through an embargo on land purchases); a cut of £3 million in R & D expenditure; and a deferral of the payment of capital grants and (if necessary) other agricultural grants and subsidies. The Minister of Agriculture has taken note of these proposals and is considering them with his agricultural colleagues.

20. I remain of the opinion that it would be feasible to secure total net savings of £25 million by these or other means.

Food Subsidies

21. The proposal in CP(76)42 was a faster phasing out of the food subsidy programme to save £200 million. The Secretary of State believes that this rate of rundown would be unacceptable given the reductions already made in the 1975 White Paper, the sharp increases in prices of essential foodstuffs arising for other reasons, eg, under EEC transitional arrangements, and the bunching of increases at a critical period of the 4½% pay policy. The most she felt able to accept was a reduction of £50 million.

22. We have already agreed to phase out food subsidies. Significant price increases are unavoidable and advancing rundown by a year would of itself add only about ¼% to the RPI over 1977-78. To provide some greater room for manoeuvre, however, in the programme of reductions I propose that the saving on the Secretary of State's programme should be in the range of £150-£200 million-provided that sufficient savings are identified elsewhere to make up the target total.

S E C R E T

S E C R E T

Energy

23. The main problem here is BNOC, for which there was no provision beyond 1976-77 in Cmnd 6393. BNOC's existing commitments amount to £167 million, and the Secretary of State considers that £30 million should be added to this to cover new requirements which cannot yet be identified. Against this excess of £197 million, the Secretary of State has undertaken to consider, with the Chairmen of the nationalised energy industries and of the AEA, whether cuts of up to £100 million can be made in their existing programmes. Any other possible requirements for BNOC above the £197 million would count as potential claims against the contingency reserve. In addition, I have agreed with him that his additional bid for British Nuclear Fuels Limited (£52.6 million) should be dropped, on the understanding that the company can borrow from the banking sector to finance its development; and that one small additional item of £1.8 million already approved by Ministers should be added to his programme. I have asked him to see whether his other additional bids totalling £34.4 million can be offset by savings within his programme or those of the nationalised energy industries.

Industry

24. Additional bids, under Programme 4, total some £19 million. Of this figure, some £9.4 million including the bulk of the Concorde provision, seem unavoidable. A further £9.2 million reflects a forecast increase in payment of regional development grant. The Secretary of State has offered savings of £1 million in the Concorde provision and £4 million on R & D expenditure, and has suggested a reduction of £10 million on the provision for selective assistance and minor rescues under Section 7 of the Industry Act. Beyond this he has indicated readiness to contemplate some savings through deferral of payment and reduced industrial coverage of regional development grant (£30 million).

S E C R E T

S E C R E T

25. I welcome the savings offered on Concorde and R & D but since those suggested on Section 7 are largely in the nature of estimating changes, I would only score £5 million under this head. As regards regional development grants I propose net savings of £120 million primarily in the form of deferred payment, the details to be settled in agreement with the Secretary of State.

26. Provision of £64 million is proposed under Programme 5 for British Shipbuilders (£56 million) and British Aerospace (£8 million). The Secretary of State would be prepared to accept a reduction of £6 million. Given the uncertainties in this area at this stage, and the absence of a corporate plan, I suggest that the programme provision should be limited to schemes already in progress plus essential renewals and stocks. On this basis I propose a provision of £35 million (including £2 million for British Aerospace), leaving any further provision necessary to be borne on the contingency reserve.

27. The Secretary of State has offered savings of £40 million from the British Steel Corporation and the Post Office.

Trade

28. The additional bids appear unavoidable but the Secretary of State is prepared to make savings of £5 million from the programme for tourism, export promotion, and assistance to the film industry. He has agreed that the investment programmes of British Airways and the British Airports Authority should be cut by a total of £15 million.

Employment

29. Additional bids on these programmes ^{amount} to £94 million, including the equalisation of men and women's rates of REP at £3 (costing £35 million), the collective funding of apprentice training (£30 million) and miscellaneous items (£29 million).

S E C R E T

30. I proposed in CP(76)42 a net saving of £50 million, by equalising REP at £2 a week after eliminating or offsetting the other additional bids and accepting the 2½% options offered. On REP I now propose a larger saving of about £80 million net by equalising the mens and womens rates of REP at £3 in Special Development Areas only (costing £17 million) and abolishing it in Development Areas (saving about £100 million). This can be done by Statutory Order.

31. On the other items the Secretary of State offered to reduce expenditure on collective funding in 1977-78 to £15 million; and to save £18 million by reducing the employers' rebate on redundancy payments from 50% to 40%, and £15 million by transferring part of the administrative costs of industrial training boards (ITBs) to employers. The last two items would require legislation, and the MSC would need to be consulted on ITBs and collective funding. I still consider that the whole of the additional bids should be offset, which could be done by a further transfer of ITB expenses on the costs of collective funding to employers, bringing the total saving on either of those items to £26 million.

Roads and Transport

England

32. If the Government and local authorities imposed a moratorium on the construction of all new roads in England for one year, the savings would be £240 million, of which £150 million would come from the programme for motorways and trunk roads and the other £90 million from local roads. The Secretary of State for the Environment is prepared to impose a moratorium on the construction of new roads by local authorities which would save the £90 million but he will need that sum to cover the prospective overspending by English local authorities mainly on concessionary fares and on revenue support. The Secretary of State is also prepared to offer savings of £40 million by imposing a moratorium on the construction of new trunk roads in categories III and IV. He would therefore be providing net savings on roads and transport of £40 million. I realise the economic

S E C R E T

disadvantage of a larger cut, but I think we should seek some savings on the construction of trunk roads in categories I and II as well and about a 10 per cent reduction in expenditure on trunk road maintenance. Together these measures could produce a further £35 million and that would still leave a programme of £80 million for new trunk roads. I therefore propose a net saving on this programme of £75 million.

Scotland

33. The Secretary of State for Scotland is willing to take 10 per cent of whatever total cut on roads is agreed for the country as a whole and I therefore propose a net saving on this programme of £8 million.

Wales

34. The Secretary of State for Wales is not prepared to offer savings of more than £2 million because of the need to complete construction of the M4 motorway. I consider however that, as his total programme for motorways and trunk roads is £59 million, he should be able to take a cut of £4 million.

35. Thus I propose a total reduction in this programme of £87 million.

Surface Transport Industries

36. The Secretary of State for the Environment has said that the investment programmes of the minor surface transport industries could be reduced by £5 million if there is a general cut in nationalised industry investment and if the saving can be used to offset additional grant needed for the National Freight Corporation

S E C R E T

HousingEngland

37. On the latest information about local authority expenditure and views of feasible rent increases in 1977-78, and trends in housing approvals, there is a prospective overspend in 1977-78 of at least £250 million. Of this, about £150 million would be on new housebuilding, and £100 million on housing subsidies. The Secretary of State has indicated that he is willing to impose immediate control on the new housebuilding programme, which is now open-ended, and to cut the rate of approvals by local authorities from its present level of about 10,000 a month to around 6,000 to 7,000 a month. This would avoid the prospective overspend on this item. In addition, the Secretary of State is willing to find savings of £100 million (gross) on local authority lending, municipalisation, and improvement work.

38. Moreover, if it proves possible to persuade the building societies and banks to replace or refinance a substantial part of local authority lending, he might be able to increase substantially the savings of £100 million (gross). While rejecting the idea of abolishing improvement grants by legislation, he is prepared to see what savings can be achieved by administrative means. Unless a significant contribution can be obtained from these two sources, there would still be no net reduction.

Scotland

39. If a net reduction is made in this programme for Great Britain as a whole, the Secretary of State for Scotland is willing to make a proportionate reduction in expenditure, and to introduce control over new housebuilding, in Scotland.

Wales

40. The Secretary of State for Wales considers that the Survey figures for housing in Wales should be increased by £78 million to

S E C R E T

take account of recent trends in housing approvals, and a proposed increase in improvements, municipalisation and mortgage lending. If the Survey figures were so increased, he would be prepared to contribute proportionately to any net reduction for Great Britain as a whole and to introduce control over new house-building in Wales.

Great Britain

41. To reach a target of £1 billion, however, I believe we must have a substantial net saving from this programme, at least of the order of £3-400 million.

Other Environmental Services

42. The Secretary of State for the Environment does not agree to cuts in the community land scheme, but is examining the scope for cuts in capital expenditure of local authorities and regional water authorities. The Secretaries of State for Scotland and Wales would be prepared to make proportionate cuts in their programmes.

43. For Great Britain as a whole it still seems reasonable to seek net savings of £100 million.

Law, Order and Protective Services

44. In Home Office services, the additional bids for England and Wales amount to £21 million. The Home Secretary has indicated that he is prepared to absorb £16 million for inescapable commitments, and to withdraw £4 million of bids for items of lower priority. The bid of £1 million for the urban programme can be left for later decision. In Scotland, the additional bids amount to £8 million. Of this, £5 million can be treated in the same way as the Home Office bids. The remaining £3 million is for local authority current expenditure and will fall to be considered in that context.

S E C R E T

S E C R E T

45. In view of the savings required to offset inescapable increases I am not now suggesting an overall net cut in this programme, although a modest net saving might need to be considered if sufficient savings cannot be found elsewhere.

46. On the remainder of this programme, it should be possible for the Lord Chancellor's additional bids to be fully offset; and the Minister of Agriculture is prepared to withdraw his bid for the food stockpile. No provision need be made at this stage for the contingent bid for Rhodesian refugees.

Education and Libraries, Science and Arts

47. Some four-fifths of this programme consists of local authority current expenditure. Some of the "policy options" affecting that expenditure will be needed to offset the additional bids of £41 million and to reduce a prospective excess on local authority current expenditure generally: thus they cannot be scored as a contribution to a net saving.

48. I therefore discussed three matters with the Secretary of State for Education and Science:

(i) Additional bid for school meals

We have undertaken to the TUC that the present school meal charge of 15p will not be raised during this financial year. To keep to the expenditure figures in Cmd 6393 for 1977-78 the charge would have to be raised by 9p in April 1977; or by 12p in September 1977; or by 5p in April 1977 and a further 5p in the following September. The Secretary of State could recommend only one increase of 5p in September 1977: the consequence of this is an additional bid of £43 million (GB). It is for consideration whether charges should be raised to offset this bid in whole or in part. A single increase of 10p in September 1977 would reduce the additional bid to about £15 million. The charge would then have remained unchanged for 2½ years. The current cost of a school meal.

S E C R E T

S E C R E T

is 42p. Net expenditure on school meals (excluding free meals) is running at £285 million a year.

(ii) Net savings on education and libraries

The Secretary of State is prepared to offer savings of £25 million mainly by reducing expenditure on university furniture and equipment, and on computers. I think it should be possible to save a further £23 million by slowing down the growth in the number of full-time students in higher education and limiting the building starts programmes for 1977-78 to those required to meet basic needs for additional places in primary and secondary schools. I should look for a corresponding saving of £2 million from the comparable Scottish programmes, bringing the net saving on education and libraries to £50 million.

(iii) Net savings on science and arts

The Secretary of State for Education and Science is prepared to offer £4 million on this part of the programme. I still consider that it should be possible to make savings of £8 million on science and £2 million on the arts programme, making a total of £10 million.

Health and Personal Social Services

49. The discussion with the Secretary of State for Social Services covered:-

(i) Charges

The Secretary of State is ready to raise £20 million (GB) by increasing dental and optical charges (though the Scots reserved their position) This would involve charging in full for the supply and dispensing of lenses and a rise in the flat rate charge for dental treatment from £3.50 to £6, as well as increases in denture charges.

S E C R E T

S E C R E T

Prescription charges were also discussed, and I may wish to come back to this if the overall savings cannot be secured in other ways.

(ii) Capital Expenditure

The Secretary of State is unwilling to see reductions, although the Scots would prefer this to raising charges. An immediate one/^{year} moratorium on all new starts on the health programme would save £35 million (GB) and reduced allocations for minor works should also be possible. I believe a saving of £30 million on the health side would be reasonable, and £70 million on the personal social services capital programme. These are GB figures and each country would contribute its share.

(iii) Current Expenditure

The Secretary of State is not willing to consider any reduction. There is an additional bid of £12 million for the Jubilee holiday, and health authorities are already committed to offset the additional cost of the junior hospital doctors' contract. These additional costs should be absorbed and some savings may also be possible on research. No prospect is seen of securing any reduction in current expenditure on local authority personal social services.

(iv) Levy on Motor Insurers for Road Accident Costs

The Secretary of State proposed the introduction of a statutory levy on motor insurers to cover the full costs of NHS treatment arising from traffic accidents to yield £40 million in 1977-78. I agree that this should be looked at in detail but no feasible proposals have been worked out and it would not be realistic to count on any yield from this in 1977-78.

S E C R E T

S E C R E T

Social Security

50. Additional bids of £134 million arise from changes in demographic factors and economic assumptions. These are unavoidable but I discussed the following ^{matters} with the Secretary of State:-

- (i) **Mobility allowance.**
An additional bid of £2 million arises from proposals to extend eligibility and uprate the allowance to £7 in November 1977 (and by prices at 2 yearly intervals thereafter). The Secretary of State agreed to offset the costs of extension by slowing down the take-on programme but is unwilling however to withdraw the uprating bid. Even though, with slower phasing, this might now cost little or nothing extra in 1977-78, I must oppose it in view of the substantial additions that would arise in later years.
- (ii) **Non-contributory invalidity pension for housewives.**
This is due to be introduced in 1977-78, though there is no precise commitment to a date in that year. The Secretary of State is prepared to consider postponing introduction to about half way through that year, saving some £10 million. I think it should be possible to double this saving by postponing introduction until the end of the year.
- (iii) **Unemployment benefit for occupational pensioners.**
The Secretary of State is prepared to include in the Social Security Amendment Bill early next session a provision to restrict unemployment benefit for occupational pensioners. The reduction would affect those with occupational pensions over, say, £25 and might save about £10 million in 1977-78 (twice as much in a full year). We are agreed on the merits of

S E C R E T

S E C R E T

this proposal and I recommend that it should be adopted and an early announcement made.

Assistance to Poorer Energy Consumers

51. There is an additional bid for £25 million (of which some £10 million would fall in 1977-78) for a package of measures to help poor consumers next winter. I have discussed this with both the Secretary of State for Energy and the Secretary of State for Social Services. Since neither is prepared to sponsor the scheme in his programme or to find offsetting savings for it, I recommend that the proposal should now be dropped.

Scotland

52. For the generality of programmes, the Secretary of State will accept reduction on the lines of those agreed for the rest of the country. However, he does wish to retain flexibility about priorities in expenditure. He accepted that the open-ended nature of the house-building programme should be ended and thought that savings could be found in the housing programme. For local authority current expenditure, he argued that an extra £22 million is necessary to maintain Cmd 6393 policies affecting this expenditure in 1976-77; without this, he said a painful readjustment of policies would be required. Of course, this applies to the rest of the UK as well. I cannot therefore recommend acceptance of additional expenditure here.

Scottish Nationalised Industries

53. Following my meeting with the Secretary of State officials' are to examine the possibility of reducing the investment programmes of the Scottish nationalised industries by £10 million.

Wales

54. Apart from the housing and roads programmes, the Secretary of State will make reductions equivalent to those agreed for the rest of the UK. While he accepts that the open-ended nature of

S E C R E T

S E C R E T

the housing programme should be ended, he feels that the base-line for housing in Wales is too low and that it should be increased by some £80 million before net reductions are made comparable to those in England and Scotland. For roads he is concerned about progress on the M4 and has only offered savings of £2 million against the £5 million which I have sought. As indicated in paragraph 34 above I believe the savings here should be £4 million.

S E C R E T

SECRET

IV

ADDITIONAL BIDS -
REARRANGEMENT OF PRIORITIES

55. I understand very well the point of view that, even when we have to restrict or reduce public expenditure as a whole, it should be possible to find room for extra expenditure on programmes of special priority, and that general reductions may be politically more acceptable if they can be accompanied by some particular increases of this kind. The practical difficulties of giving effect to this will be different in 1977-78 from those with which we have to deal in the current year.

56. In planning ahead for 1977-78, if we set ourselves a target for reducing the planned total of expenditure, we can deal with proposals for additions to the Survey programmes in one of the following ways:-

- (a) Decide on gross reductions going beyond the target figure, so that some additional bids can be approved while still securing the target figure of net reductions.
- (b) Approve additional bids now as claims on the contingency reserve for 1977-78, thus reducing the size of the contingency reserve for that year.
- (c) Withhold approval from additional bids now, on the basis that they can be considered as potential claims against the contingency reserve in the course of 1977-78 itself, according to the state of the contingency reserve at that time.

57. I should see great difficulties over courses (b) or (c), since even now, nine months before the beginning of the next financial year, the contingency reserve for 1977-78 has already been substantially depleted. It is at present reduced rather below the amount for the corresponding year in the last public expenditure White Paper (Cmd 6393). To publish anything lower than that as a contingency reserve would not carry conviction. Equally, to leave a large overhang of proposals as potential claims on the contingency reserve would be courting the risk of publishing a plan and not being able

SECRET

to stick to it. I conclude therefore in favour of course (a), ie that we must only approve additional bids to the extent that they can be balanced by additional gross reductions yielding our net target reduction in planned expenditure compared with the last White Paper, and that potential claims on the contingency reserve should be kept to a minimum.

58. One suggestion put to me in the course of the bilateral discussions was that we should make a proportionate percentage cut in all programmes across the board, excluding social security, where our freedom of action is limited by our statutory commitments, and excluding local authority current expenditure, for reasons with which we are now familiar. As indicated in paragraph 16, these exclusions considerably reduce the total from which savings can be made, and in order to achieve a net reduction of £1,000 million on the remainder of public expenditure by a standard percentage cut, we should have, not merely to reject all additional bids or require them to be absorbed, but to scale all the programmes concerned down by over 3%. If the programmes of industrial expenditure were also excluded from the cuts, remaining programmes would have to be reduced by 3½%. I do not believe that this would be a practicable approach. For some programmes it would fall far short of what is feasible, while for others it would require bigger savings than can be secured in 1977-78.

SECRET

SECRET

V CONCLUSIONS

59. It remains my view that the composition of any package which we announce must be made up out of the items which I list for decision in the Annex to this paper though, as I have already indicated, my assessment of the potential amounts in particular cases has been revised in the light of my consultations with the Ministers concerned. Before we come to decide on these programmes I should like to draw attention again to two general issues which are relevant to our decisions:-

- (a) Whether we rule out any significant amendment to our statutory commitment on social security payments, which constitute the largest single expenditure block;
- (b) whether we confine ourselves to attempting to secure observance of the existing White Paper figures for local authority current expenditure in 1977-78, rather than seek to bring about some further reduction. There is also a question whether the same approach should hold good in this respect for Scotland as for England and Wales; and a further question whether, notwithstanding this general approach, we should allow an increase in that part of local authority current expenditure which goes on fare subsidies.

60. We have to decide not only on possible programme reductions but also on the main additional bids; otherwise we will not know whether total public expenditure is really being reduced or by how much. There are a number of relatively small additional bids which we may not be able to settle in detail now, but if so it would be desirable slightly to overshoot our target in order to accommodate the most pressing cases later. For the rest, I have given an indication in the attached Annex of possible gross reductions in Survey programmes (before taking account of the additional bids); the main additional bids which are still outstanding after our

SECRET

S E C R E T

bilateral discussions; and my proposals for the net reductions on each main programme from which we should make a choice. The total of these proposals for net reductions adds up to rather over £1 billion in order to leave some room for choice assuming that Cabinet decides that that should be the target figure.

S E C R E T

PUBLIC EXPENDITURE 1977-78 : ISSUES FOR DECISION

<u>Programme</u>	Possible gross reductions (before additional bids)	Main remaining additional bids for decision	Proposed <u>net</u> reductions on Survey figures to be selected from the following	<u>Comment</u>
1. DEFENCE	140	-	140	Mainly deferrals.
2. OVERSEAS AID, ETC.				
Aid programme	50	-	50	Reduced from £100 million for reasons given in paragraph 18.
3. AGRICULTURE, ETC.				
Agriculture, fisheries and forestry	34	9	25	Net savings of £25m (GB) (after absorption of additional bids) to be achieved mainly by deferral of payment of grants and embargo on purchases of forestry land.
Food subsidies	150-200	-	150-200	Secretary of State has offered 50.

S E C R E T

<u>Programme</u>	<u>Possible gross reductions (before additional bids)</u>	<u>Main remaining additional bids for decision</u>	<u>Proposed net reductions on Survey figures to be selected from the following</u>	<u>Comment</u>
4. TRADE, INDUSTRY AND EMPLOYMENT				
Industry	139	18	121	Net savings to be obtained from provision for Section 7 assistance (£5m) and R & D (£4m); and by deferral of payments (£110m) and reduced industrial coverage (£20m) of regional development grants.
Energy	34	36	-2	By absorption of most additional bids within existing programmes.
Employment		94	80	Additional bids (other than for REP) to be absorbed by a combination of reduced provision for collective funding, lower employers' rebate on redundancy payments, and transferring most of cost of ITBs to employers through the levy. Last two require legislation. Net saving of £80m to be obtained by equalising REP at £3 in special development areas and nil elsewhere.
Trade	5	3	2	Additional bids to be offset by agreed gross saving of 5.
DPCP		3½	-2½	Accept continuation of Price commission.
Export credit and shipbuilding refinance		100-200	-	Additional bid to be offset by negotiating increased contribution from the banks (from 18% to 20% of current deposits).

S E C R E T

<u>Programme</u>	<u>Possible gross reductions (before additional bids)</u>	<u>Main remaining additional bids for decision</u>	<u>Proposed net reductions on Survey figures to be selected from the following</u>	<u>Comment</u>
5. NATIONALISED INDUSTRY INVESTMENT				
BNOG	-	197	-197	
British shipbuilders)	-	58	-35	By limiting provision to existing schemes and essential renewals and stocks. An alternative would be to leave the provision for these two industries as a claim on the contingency reserve.
British Aerospace)				
Other nationalised industries	140-240	45	95-195	No major reductions agreed, but small savings from most programmes should be possible without serious damage to investments plans.

<u>Programme</u>	<u>Possible gross reductions (before additional bids)</u>	<u>Main remaining additional bids for decision</u>	<u>Proposed net reductions on Survey figures to be selected from the following</u>	<u>Comment</u>
6. ROADS AND TRANSPORT				
England				The additional bid is for fare subsidies which are part of local authority current expenditure. If this is approved bigger capital cuts are required than the Secretary of State has proposed.
Roads capital	165	-	75	
Fare subsidies	-	90		
Scotland	8	-	8	Capital expenditure on roads.
Wales	4	-	4	" " " "
7. HOUSING				
England)	380-480	(-)	300-400	Secretaries of State are prepared to introduce control of new house-building to remove additional bid for that item. There is an additional bid for housing subsidies in England which the Secretary of State is prepared to offset by savings in improvement, mortgage lending and municipalisation. Suggested net reduction would require further savings in improvements, mortgage lending, municipalisation, housing associations and new towns; and would be shared proportionately between England, Scotland and Wales.
Scotland)		(-)		
Wales)		(78)		

Programme	Possible Gross reductions (before additional bids)	Main Additional bids for decision	Proposed <u>net</u> reduction on Survey figures to be selected from the following	Comment
8. OTHER ENVIRONMENTAL SERVICES	100	8	100	Additional bid is for local authority current expenditure in Scotland. Net savings of 100 (GB) on programme as a whole could be obtained by reductions in local authority capital projects; postponing some capital expenditure by water authorities; postponing some community land purchases.
9. LAW, ORDER AND PROTECTIVE SERVICES	-	35	-	Additional bids should be withdrawn or offset by savings elsewhere in the programme.
10. EDUCATION, LIBRARIES, SCIENCE & ARTS	50	41	50	Additional bids are mainly in local authority current expenditure and would need to be dealt with in that context. Saving would fall mainly on building projects and university expenditure. Secretary of State for Education has offered 25.
Education and libraries				
School meals		43	-15	Additional bid could be reduced to 15, by an increase of 10p instead of 5p in the charge in September 1977.
Science and Arts	10	-	10	Net saving of 8 on science budget and 2 on arts. Secretary of State for Education has offered 4.

SECRET

Programme	Possible gross reductions (before additional bids)	Main remaining additional bids for decision	Proposed net reductions on Survey figures to be selected from the following	Comment
11. HEALTH AND PERSONAL SOCIAL SERVICES				
Dental and optical charges	20	-	20	Charge full cost for lenses and increase dental charges.
Prescription charges	25-35	-	-	20p increase
Capital expenditure	40	-	40	30 on health and 10 on personal social services. GB figures to be shared among England, Scotland and Wales.
Current expenditure	30	21	30	Additional bids for cost of Jubilee holiday etc., to be absorbed within existing provision.
Levy on Motor insurers	40	-	-	Proposed by Secretary of State, but legislation required and no feasible proposal yet worked out.

SECRET

SECRET

Programme	Possible gross reductions (before additional bids)	Main remaining additional bids for decision	Proposed net reductions on Survey figures to be selected from the following	Comment
12. SOCIAL SECURITY				
Changed demographic factors and economic assumptions	-	134	[- 134]	This estimate is subject to revision before the public expenditure White Paper.
Mobility allowance		2	-	Defer. (Cost rises substantially later years).
Non-contributory invalidity pension for housewives	20	-	20	Defer for 1 year. Secretary of State is prepared to consider saving of £10m by 6-month deferment.
Restrict unemployment benefit for occupational pensioners	10	-	10	Agreed proposal. Legislation could be included in Social Security Amendment Bill for introduction early next session.
Assistance to poorer energy consumers		10	-	Withdraw. (Neither Energy Secretary nor Social Services Secretary are prepared to find room for this within their programmes.)

SECRET

Programme	Possible gross reductions (before additional bids)	Main remaining additional bids for decision	Proposed net reductions on Survey figures to be selected from the following	Comment
13. OTHER PUBLIC SERVICES				
Devolution	-	17	-	Unavoidable once the Devolution Bill is enacted, but can be left as a claim on the contingency reserve.
Broadcasting	-	4	-	4th TV Channel (for Wales) should be postponed. Remainder is mostly unavoidable and should be offset against BBC capital expenditure
14. COMMON SERVICES				
	10	9	10	Additional bid is inescapable addition to rent bill. Overall net saving of 10 requires 10% of maintenance and new capital expenditure on Government office accommodation.
15. NORTHERN IRELAND				
	25	-	25	The Secretary of State is prepared to accept a proportionate share (of about £25m) assuming an overall total of £1 billion cuts.

TOTAL NET REDUCTIONS
ON SURVEY FIGURES

979-1229

[excluding estimating change
on social security]

[1113-1363]