THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

CM(73) 41st
Conclusions

COPY NO 77

CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
THURSDAY 13 SEPTEMBER 1973
at 3.15 pm

PRESENT

The Rt Hon Edward Heath MP
Prime Minister

The Rt Hon Sir Alec Douglas-Home
Secretary of State for Foreign and Commonwealth Affairs

The Rt Hon Lord Hailsham of St Marylebone
Lord Chancellor

The Rt Hon Anthony Barber MP
Chancellor of the Exchequer

The Rt Hon William Whitelaw MP
Secretary of State for Northern Ireland

The Rt Hon Lord Carrington
Secretary of State for Defence

The Rt Hon Robert Carr MP
Secretary of State for the Home Department

The Rt Hon James Prior MP
Lord President of the Council

The Rt Hon Sir Keith Joseph MP
Secretary of State for Social Services

The Rt Hon Geoffrey Rippon QC MP
Secretary of State for the Environment

The Rt Hon Margaret Thatcher MP
Secretary of State for Education and Science

The Rt Hon Gordon Campbell MP
Secretary of State for Scotland

The Rt Hon John Davies MP
Chancellor of the Duchy of Lancaster

The Rt Hon Peter Thomas QC MP
Secretary of State for Wales

The Rt Hon Maurice Macmillan MP
Secretary of State for Employment

The Rt Hon Joseph Godber MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Sir Geoffrey Howe QC MP
Minister for Trade and Consumer Affairs

The Rt Hon Lord Windlesham
Lord Privy Seal

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Patrick Jenkin MP
Chief Secretary, Treasury

The Rt Hon Francis Pym MP
Parliamentary Secretary, Treasury

Lord Rothschild
Head of Central Policy Review Staff

Mr C R Ross
Central Policy Review Staff

Mr R L Wade-Gery
Central Policy Review Staff

SECRETARIAT

Sir John Hunt
Mr J Anson
Mr H F Ellis-Rees

SUBJECT

PUBLIC EXPENDITURE

Previous References: CM(73) 38th Conclusions, Minute 7, and CM(73) 39th Conclusions, Minute 6

The Cabinet resumed their discussion on public expenditure to 1977-78.

THE CHANCELLOR OF THE EXCHEQUER recalled that at their meeting on 26 July the Cabinet had invited him to arrange for further information to be provided by way of background for their consideration of public expenditure programmes. The Central Policy Review Staff (CPRS) would make a presentation accordingly. The issues now before the Cabinet were crucial not only for the success of the Government's policies during their term of office but for the whole future prosperity of the country. We stood now on the verge of an economic breakthrough which had eluded us (though not other nations) since 1945. Although the Government's efforts had been handicapped by the high levels of unemployment two years ago, which it had been their first priority to reduce, the signs of true economic growth were now at last established. But expansion had inevitably been accompanied by increased imports, and the value of sterling had floated down to about 19 per cent below its level in 1971. This trend must now be arrested if the rate of increase in prices was to be held to a level which would enable the Government to secure public acquiescence in Stage 3 of the counter-inflation policy. Moreover, if international confidence was to be effectively sustained, it would be necessary to demonstrate that the country's resources were not being overstretched and that sufficient room had been left for the restoration of a satisfactory balance of payments. There was at present little scope for applying restraint by monetary policies without damaging investment, or through taxation without adding to inflationary pressures; and it was therefore of prime importance to keep public expenditure within bounds. At their discussion on 19 July he had proposed to the Cabinet that public expenditure for the years 1975-76 to 1977-78 should be limited to the totals published in the annual White Paper in December 1972 (Cmnd 5178); and to achieve this would involve reductions in the programmes for these years of £450 million, £700 million and £800 million respectively, without taking account of additional bids since the report of the Public Expenditure Survey Committee had been received. This now appeared to be the absolute minimum action that was required, although it should be noted that even these measures would still only allow for a true contingency reserve of £100 million in each year.

The Competition for Resources

In a presentation by the CPRS it was suggested that over the period between 1973 and 1978 the Government's economic strategy would be based on the fundamental objectives of higher investment, growth in the standard of living, a sustainable balance of payments, a reduction in the rate of inflation, no increase in the real burden of personal taxation, and fairness in progress against poverty. All these interconnected objectives were threatened by the projected growth of public expenditure. Our national resources, at present worth about £55,000 million a year, were predicted to grow by an annual average of about £2,000 million (at constant 1972-73 prices). Present projections suggested that of this amount £350 million would go on private investment, £200 million for the balance of payments, and £700 million each for private consumption and public expenditure (based on current policies assuming no cuts, changes or additional bids); these figures implied an annual average rate of increase of only 2.4 per cent for private consumption compared with 2.9 per cent for public expenditure. Private consumers however were unlikely to accept a residuary role which would condemn them to a slower increase in living standards than they had experienced over the last 20 years, and much below the prospects outlined in Cmnd 5178. Higher investment would however be essential to return to levels of the past decade or to catch up with the economic growth rates of our main competitors; and the current deficit on the balance of payments must be moderated if the downward drift of our currency, and the consequent pressure on import prices, was to be arrested. If enough was not allowed for rising living standards, the nation at large would seek them by reducing savings, thus increasing the de facto allocation of resources to private consumption at the expense of investment and the balance of payments, and by insisting on uneconomically high wages, which would be an added stimulus to inflation. And the maintenance of existing tax rates would lead to an increase in the direct tax burden. This led to the general conclusion that in the interests of achieving the Government's strategic objectives, the growth of public expenditure must be restrained. To keep the real tax burden constant and public expenditure growth in line with the Government's published estimates would require restrain t at least to the extent of £1,200 million in 1977: £800 million, as the Chancellor of the Exchequer had already pointed out, was the barest tolerable minimum.

In discussion some criticism was expressed of the assumptions on which the rate of increase in gross domestic product (GDP) over the period had been projected. There was reason to hope that the expansion of industrial investment now under way would produce a significant increase in GDP by 1978. But given that there must be some measure of uncertainty about projections so far ahead, it was better to take a cautious view of likely growth; since, if programmes had to be adjusted, it was always easier to advance than to defer them. The amount available for private consumption had been calculated as the residue when account had been taken of the minimal needs of private investment, of the amount necessary to redress the balance of payments, and of existing public expenditure programmes. But it was questioned whether there was not some element of double counting as between the allocation of public and private expenditure, in that a large part of public expenditure consisted of salaries and wages, which in turn were translated into private expenditure. It was further suggested that too much emphasis should not be placed on the advantages of private consumption to the detriment of public expenditure, since much public expenditure was directly applied to the improvement of living standards, for instance in the fields of education, the environment, and the social services. In order to obtain the benefit of improved public services, people might be prepared to tolerate some of the increase in the real burden of taxation which would arise if tax rates were left unaltered. Nonetheless, the commonly accepted measure of the standard of living was related to personal disposable income rather than to any concept of a social wage. If personal disposable income was too stringently limited, experience had shown that the outcome could be a renewed wage explosion. Moreover, the Government were committed to a progressive reduction in the burden of taxation; and if personal tax allowances were not increased in an inflationary situation, very serious burdens would be placed on the less well-off wage-earner.

The Competition between Programmes

In the second part of the presentation by the CPRS it was stated that over the period to 1978 Departments would need an extra 11 per cent, to fulfil their present programmes, or 12 per cent if the additional bids were accepted. The first part of the presentation had indicated, however, that an increase of 9 per cent was the most that the economy could accommodate; and this in turn suggested that the projected increase in public expenditure programmes over the period would need to be restrained by about a quarter, implying a reduction of some £800 million in the total at present forecast for 1977-78. The growth of some programmes might reflect natural changes outside the Government's control; and cuts imposed across the board would ignore differing priorities between programmes. Little could be expected from the example of other countries, whose priorities in comparable sectors (except defence) and the service of the national debt generally accorded very much with ours; nor could the elimination of waste, a perennial objective, be expected to yield savings of the order required. The restraint of £800 million must therefore be sought from individual programmes. By way of illustrating the scale of considerations involved, the CPRS had made the following broad assessment.

In the field of expenditure on industry, restraint in the employment and training services, the programmes of industrial and regional assistance, or the capital expenditure of the nationalised industries would be highly damaging to the strategic objectives relating to growth and the balance of payments; but £10-£30 million in 1977 might be saved on agriculture.

Social security, health and education together accounted for over 40 per cent of total public expenditure. The strategic objectives of rising living standards and fairness left little scope for restraint in the projected social security programme; but the hospital and personal social services programmes, whose projected annual rate of increase was 3½ per cent and 8½ per cent respectively, might be slowed down to save £50-£100 million in 1977-78. Deferment of some capital expenditure on replacing existing schools and expanding nursery and higher education might save £70-£140 million.

Housing and road programmes of importance to industrial growth should be protected, but other road programmes could be pressed ahead more slowly to save £100-£200 million in 1977-78; some expenditure connected with Maplin and the Channel Tunnel might be briefly deferred, to save about £90 million; and the rate of improvement in local services might be reduced, to save £50-£100 million.

An important general point was that the non-capital expenditure of local authorities seemed likely to rise more than twice as fast as public expenditure as a whole. There would be need to control this by explicit directives as well as through pressure from the Rate Support Grant.

Measures of this nature might save about £600 million in 1977-78. The balance of £200 million would need to be sought from programmes relating either to defence or industry. International comparisons showed that although the United Kingdom's defence burden, as a percentage of gross national product, had been falling since the mid-1950s and was still due to decline, it yet remained substantially higher than the average of our European allies. If the percentage were to fall by 1977-78 to the present European average level, £700 million would be saved, which would almost remove the need for restraint in other public expenditure programmes. By contrast, if the Ministry of Defence's extra bid of £300 million for that year were admitted, the minimum target for public expenditure savings would rise to £1,100 million. To the extent that the remaining savings required could not be found from defence, they would have to be found from industrial programmes which underlay our economic growth. The Cabinet's decision would need to turn on their assessment of the relative importance of the economic and military dangers which confronted the country.

In discussion it was suggested that any consideration of possible measures of restraint in the three latter years of the period to 1978 must take account of the economies already achieved in the earlier years, to which the road programme in particular had made a notable contribution. Moreover, in the field of the social services, urgent pressures must be expected to provide more help for certain groups of the population which would command widespread public sympathy; and from this point of view it would be desirable to make more room for manoeuvre in the programmes as at present projected. There were evident political difficulties at this juncture in announcing reductions in public expenditure programmes, even if, in most cases, these would not be absolute cuts but adjustments in the rate of growth. Nonetheless, the Cabinet had already accepted the principle that the total of public expenditure programmes shown in the 1973 White Paper should not be out of line with those shown in Cmnd 5178. In this connection it was already a cause for concern that, when the 1973 White Paper came to be published, the savings of £500 million over the first two years of the period, which the Government had secured earlier that year, would be seen to be offset by increases of some £350 million, or more if additional expenditure was authorised for counter-inflationary purposes.

On the other hand, it was suggested that there were ways of increasing the effective burden of taxation, which might prove more acceptable than cuts in particular services. If rates of personal taxation were not reduced, the yield would increase; and though this might be thought to bear heavily on the lower-paid, it could to some extent be offset by improvements to the pay of the lower-paid workers, on which the Government's counter-inflationary policies laid emphasis. However, the proposed reduction of £800 million did in fact already assume some increase in the burden of real taxes; and the problem remained that any public expenditure programme published now which exceeded, in real terms, the totals proposed in the 1972 White Paper would be damaging to international confidence in the economic prospects.

In further discussion the following points were made -

a. A reduction in the defence budget might well command considerable public sympathy. Reductions in the defence budget would, however, have major implications for foreign policy and might particularly affect the situation in Northern Ireland. The Secretary of State for Defence did not accept that the figure of £300 million, which had been left unresolved in the 1972 programme, should be treated as an additional bid for 1973; and it was urged that before further consideration was given to a reduction in the defence budget there would be advantage in the Cabinet being given a detailed account of the full implications.

b. Consideration should be given to improving the presentation of future public expenditure surveys, so that it would be easier to treat separately items like productive industrial investment, and transfer payments which were largely financed through national insurance contributions and which represented disposable income in the hands of the recipients.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had had a useful preliminary exchange of views on some major issues which would be coming forward. The Chancellor of the Exchequer should now continue his discussions with the Ministers in charge of expenditure programmes with a view to ensuring that the total of public expenditure for the years to 1977-78 was kept in line with that projected in Cmnd 5178, and taking account of the points made in discussion including the presentational aspects. The Cabinet would wish to resume their collective consideration of public expenditure the following month, when decisions could be taken on the total of the programme and on any further measures necessary to achieve it.

The Cabinet -

1. Took note, with approval, of the summing up of their discussion by the Prime Minister.

2. Invited the Chancellor of the Exchequer to continue his discussions with the Ministers concerned on public expenditure programmes to 1977-78.

3. Agreed to resume their discussion in the course of the following month.

Cabinet Office

17 September 1973