C(82) 31 COPY NO 83

6 September 1982

CABINET

LONGER-TERM OPTIONS

Note by the Secretary of the Cabinet

I attach, as background for the Cabinet's discussion on Thursday 9 September, a memorandum on longer-term options by the Central Policy Review Staff.

Signed ROBERT ARMSTRONG

Cabinet Office

6 September 1982

CABINET

LONGER-TERM OPTIONS

Memorandum by the Central Policy Review Staff

The Chancellor's paper (C(82)30) considers the prospects for public expenditure in the longer term and proposes a new and fundamental look at public spending programmes. The CPRS has been asked to examine some of the long-term options open to the Government, especially as regards the possibilities for major structural changes affecting the larger expenditure programmes.

2. This presents an unusual opportunity for the Government to review prospects over the rest of the decade and beyond, and to consider any major changes of direction. We have therefore considered what changes of approach Ministers might wish to examine in each of the four main programmes. Such changes would involve a major shift of policy, so that Ministers may well not wish to reach decisions now, but instead to arrange for a full review to report within say six months for collective consideration then.

3. Although these four programmes together cover nearly two-thirds of total public expenditure, there may well be room for radical changes of direction in other areas also. Some of these are mentioned briefly in Annex A, so that Ministers can consider whether they want more work done on them (beyond the reviews already taking place in some areas).

4. There is one area, public service manpower, where we believe collective consideration might be valuable, and this is discussed in Annex B. A related objective might be to reduce public spending by holding the relative costs (including wage costs) of public services below the rest of the economy. But the projections by officials already assume public service wages falling relative to "market sector" wages by 10% or more in the decade to 1990, and it seems unrealistic to suppose that a further large permanent shift could be achieved. In any case this turns on future wage negotiations, and we see no distinct "policy option" which could usefully be reviewed at this stage.

5. In considering major options, we suggest that Ministers will wish to measure them against several objectives:-

(i) to improve incentives by reducing the burden of taxation;

(ii) to increase freedom of choice;

(iii) to ensure that those who demand public services appreciate their cost by requiring them to pay;

(iv) to allow increasing demands to be met by market sources rather than constrained by public expenditure limits;

(v) to maintain or increase efficiency;

(vi) (as a minimum) to reduce the nominal total of public expenditure, even without any of these consequences. (This might well be dismissed as "cosmetic", but two possibilities are discussed in Annex C.)

If Ministers decide that any options should be fully reviewed, we suggest that part of the purpose of the review should be to examine how they measure up to these broad objectives. The following paragraphs outline a broad approach to each of the four main programmes and suggest options for review; those are discussed in more detail in Annexes D-K.

Health

6. As living standards rise, individuals are likely to demand more and better health care. There is some social gain from improved health care, but mainly it is a matter of individual wants and choices (income-elastic demand). Hence it is arguably not appropriate for public finance, and puts a strain on the Exchequer by distorting choices and shifting the burden from consumer to taxpayer. Public health services also tend to be led by producers rather than consumers.

7. It is therefore worth considering whether over a period the provision of health care for the bulk of the population could be shifted from the State to privately owned and run medical facilities. Those who could not afford to pay would then have their charges met by the State via some form of rebating or reimbursement. As an exception to the general rule, it might be judged more efficient for the State to continue to provide institutional care for long-stay patients (mentally handicapped, elderly) who clearly could not afford to contribute.

8. This would mean leaving to individuals how far they insured against facing high costs of health care, and it would be important to monitor the growth of private health insurance over the intervening period. Given that the State would in the last resort meet the costs of necessary health care, there could be a danger of under-insurance by a large part of the working population, and thought might therefore have to be given to a scheme for compulsory private insurance.

9. If Ministers accept the broad concept as a longer-term objective, they will want to judge more immediate health options as steps along the road. In particular they will want an examination of how far the switch from public to private provision of health care could be promoted, and whether they are any institutional changes, within the NHS, which could make this switch easier.

10. There has been a departmental review of health service financing options earlier this year. But in this broader context there might be a case for a fuller review of two options, as stages towards the longer-term objective:-

(i) Increased and extended health charges (Annex D)

(ii) Private health insurance (Annex E)

Education

11. The demand for education, as for health, is likely to be "income-elastic" - as living standards rise, people will want to spend a higher proportion of their income on more and better education for their children, and will be increasingly frustrated by the lack of any way of making this choice effective within the State primary and secondary system. In addition, however, there is a social interest, arguably greater than in health, in the quality and quantity of education, because these will determine the capacity and versatility of the next generation of working people. Hence in our judgement it is probably not realistic to envisage, even as a long-term option, the wholesale privatisation of provision for education in schools. However, it may well be desirable to make higher education more market-oriented, giving more choice to consumers and making the system more responsive to the needs of both students and employers.

12. We therefore assume that the State will continue to provide universal facilities for children of primary and secondary school age, and to be concerned about quality. But the parallel system of private-sector schooling will remain, and may expand with increasing prosperity.

More parents could be encouraged to choose the private sector, at the margin, by schemes for vouchers or tax relief; but if such schemes simply relieve parents of part of the cost of education, they are bound to be expensive for the taxpayer. Hence as radical options for schools education, Ministers may wish to consider a substantial reduction in the resources going to the public sector (Annex F), or compulsory charges for schooling (which could be combined with vouchers - Annex G). For higher education (where most of the provision is already private sector though publicly financed) an option might be to charge the full cost of tuition (Annex H).

Social Security

13. The present system indexes most benefits to prices, and a very large number of beneficiaries (9m pensioners, 3m unemployed etc) have the real value of their benefits preserved, even at times when the working population has to suffer a cut in living standards. The Government probably cannot avoid recognising preservation of real value as a benchmark (as for tax thresholds). But it could avoid any commitment to prolong the link between benefits and prices, and take the first legislative opportunity to break the link. With inflation down to a much lower level, the assurance of full protection is arguably less necessary. Given discretion to hold benefits below inflation, it could make a once-for-all cut as a contribution to reducing the tax burden. It would also, of course, have discretion to allow beneficiaries a share in increased prosperity when economic conditions improve, by increasing benefits ahead of prices. This option is discussed in Annex I.

Defence

14. The United Kingdom has been struggling to maintain its NATO commitment, when many other NATO members have not done so. The share of defence spending in GDP in the UK is among the highest, and this arguably reflects some failure in the UK to adjust to poor economic performance and a reduced role in the world. There are serious and complex issues here which Ministers may wish to consider:-

- could there be greater emphasis on mutual defence with fairer sharing arrangements?
- should there be a link between European defence (SACR) and EC budget negotiations?
- if a reduced role has to be accepted, does this have implications for FCO and aid spending as well as defence?

Some of these issues go outside the defence area and are mentioned in Annex A. Within the defence field, the main option would be to halt the real growth of defence spending after 1985/86 (Annex K).

General

15. On the major options there are some general points to make:-

(a) Some options may lead to an increase in the amount of real resources (including labour) devoted to these services. Charges for education and health, for example, might have the effect of increasing the resources consumed by those services, if people chose to buy more of them. So long as the services are provided within the public sector, we think that Ministers will wish to see the claim which they make on resources reduced. But where people choose to pay more for private sector services, they should be free to do so.

(b) Some of the options would involve higher charges for services, and these raise difficult questions about incentives. Assuming no change in the existing tax and social security systems, charging for the full cost of services would cause a massive redistribution of income, in general away from families to people without children. This would exacerbate poverty to a level which we assume Ministers would judge unacceptable. To the extent that it is desired to adjust for these effects, changes in the charging, benefit or tax systems would be needed. If charges were rebated or reimbursed to those below some income threshold, the inevitable result would be high marginal "tax" rates at the bottom of the scale. This adverse effect on the incentive to find a job or earn more would offset the gain from lower direct tax rates made possible by the expenditure saving. A form of graduated income support, probably requiring a fully integrated system for combined tax and benefits, would be preferable; but even then there might be little or no overall gain in incentives, though the effect would be distributed more smoothly up the income scale. If minimal charges for schooling or health insurance were compulsory, they would only reduce the aggregate burden of taxation in a nominal sense; but they could allow more people to make their own decisions at the margin (analogous to a shift from direct to indirect taxation).

(c) Some of the options would make some people worse off. But it is very difficult - in many cases impossible - to effect changes in the role of Government without making some people worse off, particularly where public expenditure and hence taxation are involved. It is therefore necessary to accept that possibility, whilst always recognising that it is the proper function and duty of Government to ensure that no-one is made so much worse off that he or she is subjected to undue hardship. If poverty is thought of as a relative condition, adverse redistributive effects become hard to accept. If, however, it is recognised that there is such a thing as an absolute level of poverty from which people should be protected, and that poor people should share in the increasing wealth of the country, but perhaps not in full proportion, then some redistributive effects can be accepted - as they must be if the amount of wealth available for distribution is to increase.

Conclusion

16. Ministers are invited to decide -

(i) whether they wish to commission full strategic reviews of any of the main options discussed in paragraphs 9, 11, 12 and 13 above;

(ii) whether they want to include additionally any of the possibilities listed in Annexes A, B (manpower), and C (accounting changes).

Cabinet Office

6 September 1982

ANNEX A

SMALLER PROGRAMMES

1. Some other programmes outside the four major programmes discussed in the main paper could offer scope for very significant reductions in public expenditure, either by a generalised squeeze or by identifying policy changes. Following is a list of smaller areas where there may be scope for review, with figures for present annual spending (in 1980-81 cost terms, from the LTPE report) -

i. Export credits - the LTPE figure of £0.3 bn does not reflect the full extent of commitments, and there may be scope for review.

ii. Employment - £2.2 bn - much of this reflects policy reactions to the state of the labour market and will continue to do so; but there might be some scope for review:

- the Youth Training Scheme might take the place of the last year of compulsory schooling, instead of following it;
- on the training side, a remissible training tax on employers would reduce public expenditure;
- on employment services, privatisation of job centres might be examined.

iii. Regional - counting together expenditure by the Departments of Industry and Environment, this is of the order of £1 bn a year, and is already being reviewed.

iv. Housing - £2.9 bn - has been falling, but the future trend depends mainly on the real level of rents (as well as rate of sales, new building and improvements); a review of rent policy, and of relating subsidy to current rather than historic values, might be worthwhile (though most of the savings would not count as public expenditure).

Annex A (cont 1)

2. Some other significant areas are -

i. Payments to European Communities - £1.8 bn - depends on future negotiations (in which it may be necessary to bring in the possibility of alternative defence savings, eg in BAOR).

ii. Other local authority services - £10 bn - there may be more scope for increased contracting out and/or charging, analogous to charging for education.

iii. Nationalised industries - £2.3 bn: - privatisation will generate once-for-all gains, but where industries sold are self-financing will have a nil or negative effect on total EFLs thereafter; - continuing deficits might be removed or reduced in the longer term, but this is bound to be a difficult and piecemeal process.

iv. Scotland, Wales, Northern Ireland - £10 bn - extra spending in Scotland in relation to needs has been investigated in the past, and is probably not worth a further full-scale review.

ANNEX B

PUBLIC SERVICE MANPOWER

Proposal

1. Ministers would decide on a target for further reduction of civil service manpower, by say 10 per cent during the next Parliament. This would entail giving a high priority to -

- reducing functions, contracting out etc;
- simplifying policies and procedures (tax, social security etc);
- legislation where necessary to achieve these changes;
- expenditure on information technology.

The overall reduction would be allocated among departments and services according to the scope for such changes.

2. Similar targets would also be set for reductions in NHS and local authority manpower. These could be linked with increasing contracting out and privatisation of services.

Background

3. The pay bill for the civil service (industrial and non-industrial) is about £5 bn this year. Numbers will already have been reduced by about 14 per cent since 1979, so that the scope for further reduction merely by a continuing squeeze on numbers is likely to be small. Hence the need for more radical changes in functions and policies.

4. In principle there should be room for at least equal savings in other public services. The NHS employs approximately 1 million people, and numbers increased by 5 per cent between 1979 and 1981. The Government has set targets for reductions in management costs as a proportion of NHS resources over the next three years (in England, a cut of 10 per cent). Local authorities employ about 2 million people, and have reduced numbers by about 3 per cent since March 1979 - mostly in the education service, which employs nearly half the total.

Annex B (cont 1)

Arguments in Favour

5.

i. Over the rest of this decade, information technology will yield further economies in data processing, storage etc. It is already being applied to Government administrative operations, but the pace could be accelerated.

ii. To achieve anything like a further 10 per cent reduction in civil service numbers would mean a radical review of present functions to achieve contracting out or privatisation of those services where economic costs might be charged (say PSA or ADAS). This would be in line with Ministers' objective of "rolling back the frontiers of the public sector".

iii. Very worthwhile savings might be achieved by subjecting NHS and local authority manpower to the sort of squeeze which has proved successful in the civil service. Pressure on numbers should lead to the contracting out of functions to the private sector, with gains in efficiency.

Problems

6.

i. A good deal of effort has already gone into the reduction in Civil Service numbers to 630,000 by April 1984. Further substantial cuts will be hard to achieve unless Ministers are prepared to give up significant aspects of their present functions.

ii. A separate manpower target can lead to inefficiencies, where it might be more cost-effective to employ staff (eg on social security fraud cases); and if the reduction of unemployment remains a prime objective, any such inefficiencies conflict with that objection.

iii. In the NHS, given the decentralised system of control and the high proportion of staff closely involved in patient care, it will be alleged that any sizeable cut will mean a reduction in the quality of service.

iv. In the local authorities, if the target is to go beyond exhortation some mechanism will be needed for enforcement, with familiar difficulties.

ANNEX C

ACCOUNTING CHANGES

a. Local Authority Expenditure. Local authorities at present have a large degree of autonomy, including the right to spend more than the Government's current spending target if they raise the money locally (by rates) to pay for it. Ministers have been considering this is MISC 79. If they decide not to impose direct central control over current spending, there is a case for counting as "public expenditure" only that part of local authorities' spending which is not financed from local revenues - as for nationalised industries and water authorities now, and local authorities in many other countries. This would be easier to justify if there were a limit on Exchequer grant, and non-domestic rates, so that expenditure beyond those limits was entirely a "charge" on local ratepayers/electors for extra services provided; both these changes are under consideration in MISC 79.

b. National Insurance Fund. More than half (£19 bn) of social security payments are met from contributions to the Fund. This will increase with the new State pension scheme, where public expenditure will vary accordig to the number "contracted out". In other countries contributory benefits are often treated "off-budget" rather than as part of public expenditure. The case for such a change would be stronger to the extent that contributions are regarded as different from ordinary direct taxation, and as buying an "entitlement" to benefits.

ANNEX D

INCREASED CHARGES FOR HEALTH SERVICES

Proposal

1. The National Health Service (NHS) would remain broadly as now but a higher proportion of costs would be met from charges to patients. Existing charges for drugs, dental treatment and spectacles would be raised, and extended to cover everyone (including children and old people), except those close to supplementary benefit level. A modest charge would be introduced for consulting the general practitioner, and for hospital outpatient visits. Hospital inpatients would also pay a modest charge (say £5 a day). Total savings would depend on the scheme of charges adopted, but would be unlikely to exceed £1 bn a year, even with a drastic reduction in exemptions.

Background

2. Expenditure on the family practitioner services this year is expected to be £2.4 bn, one-eighth of which (£300 m) will be recovered in charges. There are no charges for NHS hospital treatment, which will cost £8.8 bn this year. Demand for all services is expected to increase steadily, partly because the number of the very elderly will increase up to 1990; and the cost of the NHS rises in real terms because it is labour intensive and because scientific advance leads to better but usually more expensive forms of treatment. The number of people covered by private insurance is growing but still represents less than 10 per cent of the population.

3. Increasing the proportion of costs recovered through NHS charges clearly lessens the distinction between NHS and private treatment; and the logical conclusion of the process would be the abolition of NHS entitlement for certain groups of patient. Under a variant of the proposal above, therefore, drugs, spectacles and dental treatment would no longer be provided under the NHS except to limited exempt groups. The rest of the population would have to make private arrangements with the pharmacist, optician or dentist.

Arguments in favour

4.

i. The proposal leaves the basic structure of the NHS intact.

ii. Patients and others would be more aware of the high costs of medical treatment; unnecessary use of the service would be discouraged; and public opinion might act more powerfully to hold down NHS costs (including wage rates).

iii. Heavier NHS charges would, at least modestly, stimulate the growth of private medical insurance and thus relieve pressure on the NHS. Hence it could be seen as a preparatory move before full privatisation (Option E).

Problems

5.

i. To save substantial sums involves raising existing charges and breaking unpopular ground in three areas - imposing charges (eg for drugs) on patients who are now exempt (eg children); charging for seeing the general practitioner; and for hospital treatment.

ii. It would cost money and staff to collect new categories of charges and to carry out means tests (a taper would be necessary above supplementary benefit level). Some of the staff involved (eg general practitioners) would object strongly.

iii. People who genuinely needed treatment might be discouraged from seeking it.

iv. As long as the poorest are exempted from charges, increasing the charges would automatically increase the poverty trap - ie makes it less attractive for people to increase their earnings at the margin.

ANNEX E

PRIVATE HEALTH INSURANCE

Proposal

1. The working population would be obliged by law to obtain insurance to cover the costs of health care for themselves and their dependants. Premiums would relate to the family's risks, not their means, and so the poor would need help with meeting the costs. Either initially or later the scheme could be extended to cover the non-working population, who would obviously need much more subsidy.

Background

2. Expenditure on the NHS this year is some £11.7 bn. The main components are some £2.1 bn (net of charges) for the family practitioner services (the services provided by family doctors, dentists, opticians and chemists); and £8.8 bn for hospital and community health services. Demand for all services is expected to increase steadily, partly because the number of the very elderly is incresing; and the cost of the NHS rises in real terms because it is labour intensive and because scientific advance leads to better but usually more expensive forms of treatment.

3. It would be prohibitively expensive to insure against the costs of long-term medical care and so, as in all countries, the state would have to continue to provide for certain types of patient (eg the mentally handicapped). Even so, it is estimated that the cost of basic medical cover for an average family of four would be about £600 a year. Those below average earnings (and possibly others) would need help with these costs and to the extent that this had to be channelled through payments rather than tax reliefs (since the poorest do not pay income tax), the public expenditure savings would be lessened. It is difficult to envisage a scheme which would reduce public expenditure on the NHS by more than say a third (£4 bn).

4. Within an insurance-based system, providers of health care (eg doctors) could be encouraged to set up companies to offer health care to clients in return for an annual subscription. Limited American experience with such Health Maintenance Organisations suggests that they may help to restrain costs.

Arguments in favour

5.

i. This proposal offers the prospect of a very large cut in the costs of health care to the taxpayer.

ii. The public would have its horizon of choice and of responsibility greatly widened.

iii. Patients could (within the limits imposed by their insurers) shop around for health care, so that doctors and hospitals would have to be more responsive to patients' wishes if they wished to stay in business.

iv. Although initially at least NHS hospitals could remain in state ownership, trading like nationalised industries, they could be progressively privatised. This would give much more scope for experiment and for variety in such matters as rates of pay reflecting local market conditions.

Problems

6.

i. Even though a free state service would be retained for the uninsured and possibly for the non-working population, for the majority the change would represent the abolition of the NHS. This would be immensely controversial.

ii. There would be transitional problems in persuading insurance companies to take on the risks before cash reserves had been built up to meet them.

Annex E (cont 2)

iii. While this proposal would reduce the amount of public money spent on health, it would not reduce the community's spending on health care: on the contrary it would probably increase sharply. Some of this would be consumers' preference for higher quality, shorter delays etc. But judging by overseas experience, the providers of health care would also take advantage of the ever buoyant demand and of the inability of patients or of insurance companies to control costs, or in most cases to make informal judgments about the medical treatments on offer. Competition between doctors and hospitals would be on quality more than price.

iv. Providing help for those unable to afford the insurance premiums would raise vast difficulties. All claimants (perhaps over half the adult population) would have to be means-tested and even if the help were graduated, on negative income tax lines, there would be a sharp disincentive effect; increasing one's earnings, or moving into work from unemployment, would become less attractive.

v. Patients would face extra complications (form-filling etc). Patients or their insurers would need to be invoiced for treatment, and subsidies of some kind would need to be provided to a large part of the population. It would also be necessary to police the compulsory insurance system.

ANNEX F

CUTTING EDUCATION SPENDING

Proposal

1. Spending on compulsary education for 5-16 year olds would be cut by about £1 bn a year while every effort would be made to maintain essential standards.

Background

2. Economies should be possible across the range of school provision by concentrating on the essentials and cutting out the peripheral. The process would need to start from an analysis of what schooling is intented to achieve and how the important outputs could be maintained at lower cost. Since 70 per cent of expenditure represents teachers' salaries (£4 bn a year at current prices), it would be impossible to achieve a £1 bn reduction without reducing teacher numbers substantially. But the pupil/teacher ratio in both primary and secondary schools has fallen dramatically since the end of World War II, for example in England between 1950-81 when it fell from 31 to 23 in the primary sector and from 22 to 17 in secondary schools. Although it is often claimed that the pupil/teacher ratio is a measure of the "quality" of education, the relationship between this ratio and academic student performance is far from straight-forward. At present the number of teachers is around 520,000, and the LTPE projections imply a fall to around 440,000 by the end of the decade, roughly in line with the fall in pupil numbers.

Arguments in Favour

3.

i. It would provide an opportunity to weed out the lower qualified and less satisfactory teachers, and achieve a more efficient teaching force, supported by modern information technology to supplement class-room teaching (eg cassette teaching, audio-visual aids, modular courses etc).

ii. The closure of wasteful poorly attended schools with small classes would be speeded up.

iii. Schools would be required to concentrate, particularly at secondary level, on a "core" of academic and vocational subjects, cutting down resources on other non-academic activities (unless on repayment).

Problems

4.

i. Some mechanism would be required for compelling local education authorities to make the planned cuts, eg in teacher numbers. This would entail new powers of central control, with a fall-back power to take over the functions of LEAs.

ii. There would be other formidable problems in implementing this proposal. In particular -

a. Unless the curriculum were severely pruned - see 3 iii above - schools could be left with a core of teachers each of whom would be required to teach a wide range of subjects.

b. There would be major resistance from the teaching profession.

c. There would be considerable redundancy costs.

iii. There might be a significant fall in the overall quality of education provided by the State system, even if this fall were not immediately reflected in public examination results.

iv. Pupils would have to work more on their own and this could have deleterious effects on classroom discipline and on the morale and achievement of the less able. On the other hand, it might help those who go on to higher education.

v. This approach is distinct from, and probably not compatible with the charging approach discussed in Annex G.

ANNEX G

CHARGING FOR SCHOOLING

Proposal

1. Parents able to afford it would be required to pay the cost of their children's education, whether in the State system (where schools would be required to charge fees which covered their costs) or in competing private schools. It would still be compulsory to have children educated, normally at a school which met statutory minimum educational standards. Those with incomes too low to afford to pay would either have fees rebated or (preferably) would be subsidised via some form of income support.

Background

2. Schools expenditure this year is £7.4 bn, or 6½ per cent of total public expenditure. Nearly all of this is spent by local authorities at their own discretion, and it is about a third of their total current spending. The average cost per pupil is about £950 a year. Numbers of pupils will decline to 1990, and hence spending is projected to fall (but less than proportionately). Education in maintained schools will remain one of the largest social services, with private-sector education for compulsory school-age pupils (at present 5 per cent of all such pupils) remaining small.

3. A scheme for issuing vouchers to parents is sometimes suggested, as a less radical alternative to charging. It could help to promote wider choice, and would make it cheaper to send children to private schools if vouchers had a reimbursable "face value". But it would do nothing to reduce public expenditure, unless as an adjunct to charging with vouchers covering less than the full costs. Indeed there would be increased expenditure to meet any reimbursement for private education. Hence it is not put forward as an option here.

Arguments in Favour

4.

i. The saving could be as large as £3-4 bn, depending on the scale or rebating and whether it counted as public expenditure.

ii. Parents who wanted to secure a higher-quality education for their children, and were prepared to spend more, could do so by shopping around within the State sector or by going to private schools (and they would no longer be contributing to the cost of State schooling via central and local taxation). As real incomes rise, it is right to allow more resources to go into education to the extent that parents wish to purchase more and better schooling for their children.

iii. State schools would need to become more competitive and cost-conscious, and to pay more attention to parents' concerns (examination results, vocationally relevant courses, etc).

Problems

5.

i. There would be formidable political and administrative problems. Some mechanism would be needed for compelling local education authorities to charge "adequate" fees, which would entail new powers of central control and if necessary take-over.

ii. Cost differences do not only reflect differences in quality, and in particular schools in inner city areas tend to have higher costs. Some form of central government equalisation grant would probably still be needed to offset this.

iii. Students taking A-level courses in further education colleges would also be required to pay fees (to match the treatment of sixth-formers in schools). This would increase the discrimination between those in further education colleges undergoing training (on training allowances) and those on "school equivalent" courses (paying fees).

iv. There would be a wholesale redistribution of disposable income from paying parents to tax-paying non-parents. One way to offset this would be to raise child benefit to cover (standard) school fees, but this would defeat the main object of reducing public expenditure and taxation. An alternative would be to re-introduce child tax allowance, but this would be sharply regressive, helping only parents with taxable incomes.

v. Given that fees would need to be rebated for parents with low family incomes, this would inevitably mean high marginal "tax" rates at the bottom of the scale, with bad effects on poverty trap and in-work/out-of-work incentives. Hence a form of graduated income support, on "negative income tax" lines, would be preferable - but previous tax credit schemes have been extremely costly, and the basic disincentive effect would remain, however distributed up the income scale.

vi. Since children could not be refused schooling, the business of collecting fees would be difficult and administratively expensive.

ANNEX H

CHARGING FOR HIGHER EDUCATION

Proposal

1. A significant saving could be achieved by charging degree students at universities etc for their degree courses. The size of this saving would depend on the amount of State assistance it was decided to make available to higher education students; but £1 bn a year could be saved by charging the full cost of degree courses, while still providing assistance in the form of scholarships and/or State-guaranteed loans to, say, 300,000 students (the exact number of students who could be assisted for the same cost would depend on the way this assistance was distributed as between scholarships and loans).

Background

2. On present projections, there will be about 450,000 students in higher education in 1985-86 of whom 35,000 will be from overseas. The cost of providing courses to these students varies considerably as between the arts and sciences but the average cost (at 1980-81 prices) of a university course is about £4,000 per year and that of a polytechnic is £3,000. At present, all State-assisted institutions of higher education charge all United Kingdom resident students the same fees, (£480); these are met by a grant of £480 from the local authority. The rest of the cost is met by central government grants to universities (£1,263 million in 1982-83) and to other advanced further education institutions (£538 m); although some of this expenditure is for research.

3. Under this proposal, universities and other higher education institutions would receive no funds direct from government (except for research) but would be funded entirely through student fees, plus any outside endowment funds they could raise.

4. This proposal is distinct from the scheme for replacing present maintenance grants, for students' living expenses, with State guaranteed loans, which would only save some £200 m a year. But the two schemes could be combined, by offering loans to cover both tuition costs and maintenance.

Arguments in Favour

5.

i. Charging full cost fees would increase the pressure on institutions of higher education to recruit students and add the dimension of "value for money" to decisions about higher education. This would make them more responsive to the demands of potential consumers, as well as more conscious of the need to control costs and to improve the quality of their "products" (eg it might encourage the development of two-year courses).

ii. More competition between students, for a smaller amount of Government aid, should lead them to appreciate the full value of their courses and to take them more seriously. It would encourage students to seek financial support from non-governmental sources (eg industry) or to find ways of supporting themselves eg by working part-time, during vacations, before going to university, during years-off between academic years etc.

iii. It would encourage closer links between institutions of higher education and industry and commerce. The universities would have to make greater efforts to seek financial support from industry while firms would want to safeguard their share of the supply of trained manpower. They could do this by providing scholarships to able students who would be required to work for their "supporting" firms for a limited period after having received their degrees.

iv. To the extent that universities etc did not meet demands and raise finance for themselves, they would need to cut back on teaching resources, and student numbers would fall.

Annex H (cont 2)

Problems
6.

i. This proposal would attract fierce opposition from the academic community, as giving rise to fluctuating demands and making planning impossible.

ii. If the effect of this proposal were to be a significant reduction in total student numbers, this could mean a less qualified work force. But charging for degree courses could lead to more students choosing "industrially-relevant" courses or more mid-career study and this should have beneficial effects on economic performance.

iii. Those who did not qualify for any form of State assistance and did not manage to secure support from industry or other private sources could face a bill of at least £12,000 (or more if maintenance costs were included) for a 3-year degree course. The burden of servicing and paying off a loan of this scale would be a considerable disincentive to higher education.

iv. Because higher education is effectively a life-long investment, those who borrow to finance it would wish to be able to repay their loan over long periods. There could be difficulty in developing a private sector market for such long-term student loans.

v. This proposal might encourage many students to seek higher education in those EEC countries in which fees are subsidised, with some resulting permanent loss of highly skilled manpower.

vi. As science and technology courses are likely to be very much more expensive than arts ones (unless the universities decide to subsidise the former from fees earned from the latter), students might consider the arts courses better "value for money" in terms of potential career advancement, and it might be difficult to attract enough students to the most expensive courses such as medicine.

ANNEX J

CUTTING THE REAL VALUE OF SOCIAL SECURITY BENEFITS

Proposal

1. The present laws which require most benefits to be increased annually by at least as much as prices would be repealed. New legislation would bring these benefits into line with the present arrangements for child benefit: upratings would become a matter of discretion for the Secretary of State who would attempt to preserve their real purchasing power but only as far as economic circumstances permit. If desired the Government could take the opportunity during the first year of operation of the new legislation to uprate some or all benefits by amounts which would effect substantial, once-for-all cuts in the real value of benefits. The bolder these initial cuts were the less need there would be in future years to hold down upratings below the level of inflation.

Background

2. Social Security expenditure in the current year is estimated at £32 bn, (28 per cent of total expenditure). In the three years to 1981-82 social security expenditure rose by 74 per cent, whilst public expenditure in total rose by 61 per cent; but the disproportionate increase was in large part due to the rise in the number of unemployed receiving benefit. At present most benefits must by law be increased annually at least in line with prices. Since 1972 the basic retirement pension has risen by 28 per cent in real terms while real national disposable income has risen by some 10 per cent. (Nearly all this very large improvement in the value of the pension occurred before 1979).

3. For the purpose of illustration, this option would yield some £3 bn a year by 1990-91 if a 10 per cent reduction in the LTPE projections is assumed. The effect on the real value of benefits depends on future economic performance. On the poor performance case - where the LTPE projections assumed that benefits would be maintained in real terms - benefits in 1990-91 would be 10 per cent below their current level in real terms. On the improved

economic performance case - where the LTPE projections assumed a 1 per cent per annum real improvement in social security expenditure ie increased real value of benefits and coverage - benefits in 1990-91 would perhaps be only a little below their existing real value.

Arguments in Favour

4.

i. The real increases in benefit rates during the 1970s have imposed a very large extra burden on the tax payer and those in work. Implementing the proposal could produce very large savings in public expenditure and lighten the burden on employers and the working population. In relation to the 1982 uprating each 1 per cent point reduction would have saved about £0.3 bn in public expenditure, a third of this being reflected in a reduction in the employer's contribution to the National Insurance Fund.

ii. The reduction in the real value of benefits for those of working age would increase incentives to work and increase the attraction of low-paid jobs.

iii. There would be a consequential saving on public service occupational pensions (eg those for civil servants, local government employees, NHS staff, the armed forces). This is because increases in these occupational pensions are statutorily linked to increases in the state retirement pension. A 10 per cent reduction in the value of these public sector pensions would yield about £300 m a year.

Problems

5.

i. Cutting the real value of benefits would be unpopular, particular in relation to the benefits for pensioners where the largest savings can be made. Pensioners would receive a lower share of the nation's wealth than

ANNEX J (cont 2)

they do now , at least until the benefits of the new pension scheme become significant (after 1990); this would contrast starkly with what Labour once provided (upratings based on higher prices or earnings).

ii. There would be an increase in real poverty and current problems of social deprivation would be worsened (crime, poor care of children, illness from cold homes and poor nutrition etc).

ANNEX K

DEFENCE

Proposal

1. LTPE projections assumed that defence spending would increase in volume terms by 3 per cent a year from 1982-83 until 1988-89, with 1 per cent a year thereafter. The United Kingdom commitment to the 3 per cent growth target currently runs only to 1985-86. The proposal is to maintain the 1985-86 level in real terms, which would save about £1½ bn a year by 1990-91 as against LTPE. Internal forward planning in the Ministry of Defence currently assumes no growth in the defence budget after 1985-86. Hence this option could be achieved either by providing for no additions to spending at present planned, or by reductions to make room for some inescapable additions, eg by cancelling Trident. But the present planning assumption is deliberately cautious, to allow for some flexibility, so it does not follow that the option could be achieved without affecting military capabilities.

2. The political and diplomatic difficulties of this option would be reduced if NATO could be persuaded to reduce the 3 per cent target to a level which all or most member countries could realistically be expected to achieve.

Background

3. The present defence base-line is uncertain, in relation both to the level of spending in 1982-83 and to any revisions of plans in the immediate aftermath of the Falkland conflict. But defence spending cannot be ignored in this exercise. It now accounts for about 12 per cent of total public expenditure programmes, and on the basis of the LTPE assumptions (including the assumption that defence prices rise 2 per cent faster than prices generally) it will account for 15 per cent in 1990-91. On these projections, defence is responsible for more than a third of the total expenditure increase (in cost terms) from 1982-83 to 1990-91 - a much larger share than any other programme - though a different base year, or a different assumption about relative prices, would give different results.

Arguments in Favour

4.

i. If defence spending is not slowed down, it will continue to rise in relation to GDP, to around 6 per cent on the projection we have taken. Sooner or later, depending on the performance of the economy, this rise is very likely to be found unsustainable, so that drastic cuts will have to be made. It would be more sensible to plan from the outset for a sustainable rate of defence spending, as in the proposal.

ii. In the past a number of other countries have failed to meet the NATO target (even among those with GDP growth rates higher than the United Kingdom), and after 1980 (the last year for which comparative figures are available) their performance is likely to continue to fall short.

iii. The lower expenditure path would be feasible. It would be broadly in line with the forward planning now being undertaken in the MOD (though this deliberately leaves room for flexibility - para 1). Spending with British industry could still be higher than it is today (£6-7 bn per annum).

iv. A lower rate of spend on defence R & D would free scarce resources (high-quality scientists and engineers) for employment in civil R & D.

Problems

5.

i. There would be political problems, international and domestic, in changing course after 1985-86. Last year the United Kingdom supported the NATO Ministerial Guidance extending the commitment to 1988. Present political pressures are for more defence spending, not less.

ii. The absence of real growth in the defence budget, as against the increase in complexity and cost of major equipment, would entail a reduction in United Kingdom military capabilities.