Adam Smith Institute
Omega Report

EXPENDITURE AND TAXATION POLICY

Adam Smith Institute

THE OMEGA FILE

EXPENDITURE AND TAXATION PLANS
1985-86 to 1987-88

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CONTENTS

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FOREWORD

The Adam Smith Institute's **OMEGA PROJECT** was conceived to fill a significant gap in the field of policy research. Administrations entering office in democratic societies are often aware of the problems which they face, but lack a developed programme of policy options. The process by which policy innovations are brought forward and examined is often wasteful of time, and unconducive to creative thought.

The **OMEGA PROJECT** was designed to develop new policy initiatives, to research these new ideas, and to bring them forward for public discussion in ways which overcame the conventional difficulties.

Twenty working parties were established more than one year ago to cover each major area of government concern. Each of these groups was structured so as to include those with high academic qualification, those with business experience, those trained in economics, those with expert knowledge of policy discussion, and those with knowledge of parliamentary or legislative procedures. The project as a whole has thus involved the work of more than one hundred specialists for over a year.

Each working party had secretarial and research assistance made available to it, and each began its work with a detailed report on the area of its concern, showing the extent of government power, the statutory duties and the instruments which fell within its remit. Each group has explored in a systematic way the opportunities for developing choice and enterprise within the area of its concern.

The reports of these working parties, containing, as they do, several hundred new policy options, constitute the **OMEGA FILE.** The **OMEGA PROJECT** represents the most complete review of the activity of government ever undertaken in Britain. It presents the most comprehensive range of policy initiatives which has ever been researched under one programme.

These policy options have been costed by a separate working party under the chairmanship of Sir William Clark MP, and the total expenditure savings under each programme have been calculated. A working party chaired by Dr Barry Bracewell-Milnes investigated the reform and reduction of taxes. These two committees then combined to produce this report, which constitutes the most complete and detailed analysis of how public spending and taxes could be reduced in Britain. Those who worked on and produced the report are:- **Sir William Clark MP, Dr Barry Bracewell-Milnes, Ivan Fallon, David Galloway, Russell Lewis, Professor David Myddelton, Christopher Steane, Paul Turnbull, and Brian Quinn.**

The Adam Smith Institute would like to thank all those who participated in this venture. All **OMEGA** reports are the edited summary of work by many individuals and should not be construed as the definitive views of any one author.

1. THE NATURE OF PUBLIC EXPENDITURE

When they were elected to power in 1979 an integral part of the present government's overall economic policy was a future reduction in the share of the nation's resources taken by the state. Detailed plans, incorporated in a 'medium term financial strategy', were laid out in the March 1980 Budget. The aim was to reduce the volume of public spending by 5% between 1979-80 and 1983-84 implying a drop in public expenditure as a proportion of gross domestic product to under 40% by the end of the period. Admirable though these objectives may have been, the reality has been rather different. The volume of spending in 1983-84 was 7% greater than in 1979-80. Moreover, even the latest published plans for 1984-85 show a considerably higher public spending/gdp ratio than the 1979-80 outturn. In short, a government supposedly committed from the outset to a reduction in the scale of public spending has, over a period of five years, achieved very little progress at all. Clearly, a fresh approach is required.

PUBLIC EXPENDITURE - THE FACTS

Although there are several definitions of public expenditure, the most widely quoted measure is the 'public expenditure planning total'. This measure is useful because changes in the planning total are directly related to changes in taxes and/or public sector borrowing. At its simplest, the position is that revenue (taxes plus borrowing) equals expenditure (planning total). It is the planning total which forms the basis of the spending plans outlined each year in the annual edition of the Government's Expenditure Plans. Table 1.1 shows the breakdown of the estimated 1983-84 expenditure on the main programmes, while Table 1.2 outlines recent movements in the overall spending totals. It will be seen that public expenditure in 1983-84 represented 43% of gdp. By contrast, the ratio ranged between 34% and 39% in the 1960s and was lower still in the 1950s.

It is useful to consider the broad pattern of expenditure and its financing. Table 1 shows that over half of public expenditure is now accounted for by three 'welfare state' programmes - social security, education and science, and health and personal social services. These plus defence account for almost two-thirds of total public expenditure.

Recent changes in the pattern

Table 1.3 shows that three of the four main programmes - social security, defence, and health and personal social services - have each recently been growing far more rapidly than public spending as a whole. However, the defence programme is considered sacrosanct, social security payments are largely demand-determined, and major political obstacles stand in the way of

Table 1.1
Public expenditure in 1983/84

Programme:	£m	% of total
Social security	35,324	29.4
Defence	15,716	13.1
Health and personal social services	14,688	12.2
Education and science	13,356	11.1
Scotland, Wales, and Northern Ireland	13,153	10.9
Housing and other environmental services	6,547	5.4
Trade, industry, energy, and employment	6,080	5.1
Law, order, and protective services	4,681	3.9
Transport	4,560	3.8
Overseas aid and other overseas services	2,294	1.9
Agriculture, fisheries, food, and forestry	2,087	1.7
Other programmes	3,040	2.5
Special sales of assets	(1,200)	1.0
Planning total	120,328	100.0

Source: The Government's Expenditure Plans 1984-85 to 1986-87 (London: HMSO, Cmnd 9143, February 1984).

Table 1.2
Movements in the levels of public expenditure

	Planning total £b. cash	At 1982/83 prices	% of GDP
1978/79	65.8	106.8	40.5
1979/80	76.9	107.0	40.5
1980/81	92.7	108.6	42.5
1981/82	104.7	111.6	44
1982/83	113.4	113.4	43.5
1983/84	120.3	114.6	43 [a]
1984/85	126.4	114.6	42 [a]

[a] - estimate

Source: The Government's Expenditure Plans 1984-85 to 1986-87 (London: HMSO, Cmnd 9143, February 1984).

Table 1.3

Changes in the pattern of public expenditure
(in real terms at 1982/83 prices)

	1978/79 £m	1983/84 £m	Increase over period
Social security	26,713	33,642	+ 26%
Defence	12,183	14,968	+ 23%
Health etc	12,067	13,988	+ 16%
Other	56,395	54,868	- 3%
Asset sales	(501)	(2,868)	
Total	106,857	114,598	+ 7%

Source: The Government's Expenditure Plans 1984-85 to 1986-87 (London: HMSO, Cmnd 9143, February 1984).

wholesale cuts in the health service, all of which make it difficult to achieve the politicians' target of overall reductions in the total level of public spending. To achieve that end, drastic pruning of other programmes would be required.

Public spending data must also be considered in the light of rising North Sea revenues. Under the 1974-79 government oil revenues were negligible, totalling only £0.5b in 1978-79. By contrast, latest official estimates point to revenues of £9b for 1983-84 and £12b for 1984-85. It is a sobering thought that in the absence of North Sea oil the basic rate of income tax would have to rise to about 40% in order to finance current levels of public expenditure. But oil revenues are fast approaching peak levels, and will decline sharply from the late 1980s.

Apart from the windfall gains from North Sea revenues, the government's finances have benefitted, and will continue to benefit, from the sums obtained from large sales of public sector assets. The asset sales can be divided into two main categories - share issues associated with denationalization, and council house sales.

Proceeds from asset disposals have reached £10b since 1979. Receipts will continue at high levels in future years, given the likelihood of further substantial sales of council houses and continuing denationalization (including the British Telecom flotation). However, an accounting feature must be noted. The proceeds from asset sales are classified as negative public expenditure. A somewhat false impression of expenditure control may therefore be obtained unless allowance is made for this classification feature. Asset sales are clearly once-for-all in character and it would be inappropriate to consider the resultant fall in public spending as a genuine improvement in the underlying expenditure position.

Table 1.4
Government receipts from N Sea oil and public sector asset sales

	N Sea oil	Equity issues	Council House sales	Total
1979/80	2.2	1.0	0.5	3.7
1980/81	3.8	0.4	0.8	5.0
1981/82	6.4	0.5	1.3	8.2
1982/83	7.8	0.6	1.8	10.2
1983/84	9.0	1.3	1.6	11.9

all figures are in £b.

In Table 1.4 we bring together government receipts from North Sea oil, share issues associated with denationalization and council house sales. The cumulative total over the five years to 1983-84 has been roughly £40b. These receipts have masked the scale of the public expenditure problem and have cushioned individuals from the full tax implications of continuing high net public expenditure levels.

The sectoral composition of expenditure

Table 1.5 shows the relative importance of the three main sectors of government - the central government, the local authorities, and the public corporations - in relation to total public spending.

Table 1.5
The sectoral composition of public expenditure

	1983/84 est. outturn £m
Central government	84.4
Local authorities	32.6
Public corporations	3.3
Total public sector expenditure	120.3

Source: The Government's Expenditure Plans 1984-85 to 1986-87 (London: HMSO, Cmnd 9143, February 1984)

The dominant sector is clearly the central government. However, a sizeable proportion of its spending represents transfer payments, such as social security and pensions, rather than final expenditure on real goods and services. Indeed, from Table 1.6 it can be seen that the local authorities and the public corporations each command a greater share of the nation's real resources than the central government. These two sectors also employ a far larger number of workers.

The lowly position of the public corporations in Table 1.5 might seem somewhat surprising. The explanation is that most of this sector's spending is financed from revenues generated from the sale of its output. It is only the shortfall that is included in public expenditure because it is only the shortfall that has to be financed either from taxes or borrowing. Ignoring initial share proceeds, wholesale privatization of the public corporations would not, therefore, permit large tax reductions; but with better private management, the return to the Chancellor of the Exchequer would be increased.

Table 1.6
The public sector's command over real resources (1982)

	£m	% of gdp
Gdp item:		
Central government	18,846	8.1%
Local authorities	23,674	10.2%
Public corporations	26,115	11.2%
Total public sector	68,635	29.5%
Total gdp	232,553	100.0%
	000s	**% of total**
Numbers employed in:		
Central government		
H M forces	324	1.4%
Civilians	2,022	8.5%
Local authorities	2,931	12.3%
Public corporations	1,759	7.4%
Public sector total	7,036	29.6%
Private sector total	16,729	70.4%
Total employed	23,765	100.0%

Source: National Income and Expenditure 1983, Tables 1.10 & 1.12

NEW STRATEGIES

When a dominant public sector was proposed as an intellectual ideal in the 1920s and 1930s, and when it became a reality in the 1940s, the assumption was that economies of scale and superior planning would mean that public services and the products of public industries would be provided more cheaply, more efficiently, and more rationally. Regrettably, it took many years before the reality of the matter became clear. Because public industries and services typically enjoy monopoly power, they are unresponsive t the needs of their customers and clients; because they face no competitive pressure, they are slow or unable to innovate and preserve expensive, inefficient, and outdated practices; and because they are the responsibility of politicians, they are more likely to serve the political objectives of avoiding unemployment, keeping prices down, or placating sectional interest groups than in serving the general public.

The Conservative government took office in 1979 with the intention of making large reductions in the total of public sector activities. The first strategy it adopted was to set overall programme expenditure limits, so that those operating each programme would have to cut out waste and unnecessary services, leading to a public sector that was not only cheaper but more efficient. This approach has largely failed, as economists of the public choice school predicted it would.

Sources of resistance

Although only theory before 1979, the public choice analysis has since demonstrated its power in practical terms. Its foundation is the empirical proposition that governments find it almost impossible to cut out waste in public expenditure programmes, and face overwhelming political objections when they try to trim it by overall budget limits or cuts. In the first place, it is hard to identify 'waste' in a system that deliberately separates costs from benefits and thus prevents any estimate of profit or loss. Secondly, there is bound to be institutional resistance to cutting out waste, since those whose positions are threatened are well organized, can rely on the support of other public sector workers, and can raise the politically embarrassing spectre of higher unemployment. Thirdly, where cash limits are imposed from above on service providers who are then expected to produce efficiencies themselves, it is unlikely that genuine waste will be cut out. The administrators concerned are more likely to preserve their own jobs and to cut expenditure at the point of service delivery - often cutting out the most politically sensitive services in an effort to demonstrate the need for a continuing large budget. Fourthly, with the continued separation of costs and benefits, and with the impossibility of calculating profit and loss on public activities, waste and inefficiency are likely to creep back in even where they are initially eliminated.

The resistance to change does not come solely from those who work in the public sector, however. The size and scope of the public sector has built up a large and wide-ranging body of special interests who rely on it for grants, allowances, monopoly privileges, profits, and salaries. When budgetary restraints are proposed, these interest groups are likely to be determined and effective in their opposition, since their livelihood is at stake, their interests are clear, and their case is easy to present. The interests of taxpayers, on the contrary, are far more diffused and more difficult to organize. Faced with political pressure to preserve the flow of funds to determined minorities on one side and an unorganized, quiescent public on the other, politicians often find it easier to abandon their proposed cut-backs.

Tailored approach

Just as failed macroeconomic thinking has given way to new microeconomic models, so the 'macropolitical' approach to public sector problems must now be seen as unrewarding and must be replaced with 'micropolitical' alternatives. Each public service, industry, or activity carries with it its own lobby of special interests; these must be dealt with before any change can be made, and the direction and method of change will naturally have to take their interests and effectiveness into account. Those in genuine need who are harmed by proposed changes must be cared for in other ways; organized opposition by producers must be countered by wider choice or cheaper services for consumers; and new opportunities must be opened up for those who are displaced or who lose their privileged monopoly power.

The strategy running through the various Omega Project reports stems from this public choice approach and the micropolitical methodology it suggests. We have not sought to achieve savings of any particular order of magnitude, and indeed have suggested budgetary increases on certain programmes where these seem appropriate. Rather, the structure of individual services has been examined, and methods of providing the same or better and more responsive service at lower cost have been tailored to fit the individual case. This new way of cutting the cloth has meant that, at the end of the exercise, more is left to be remitted through tax reductions or to be spent on providing better public services for the genuinely needy individuals. The exact disbursement must be a matter of judgement, although we have suggested what we think is a productive approach later in this report. But it should be remembered that the budgetary totals that appear below in a highly summarized form are the results of that tailoring process, and not the initial objective.

For example, in services such as health, education, and welfare, we have proposed completely new structures and delivery techniques, and have not started with an assumption that budgetary reductions are needed (even if they are possible). The objective has been to restructure the public segment of these services in order to concentrate resources at the point of delivery and to ensure that people in need are the main priority. Some points of waste and inefficiency have been identified as sources of potential savings, but these are incidental. More importantly, we have proposed that new competitive pressures on these public services should be encouraged by consciously ending their monopoly and creating new private alternatives. Making the choice to go private less expensive, and bringing the chance to opt out of unresponsive public services 'down market' to the general population, is one method in which we believe that new and better organizational systems will press themselves upon the state sector. It may in fact have an initial cost, but we have accepted this if this new source of competition is the only way to break down the institutional and public choice obstacles. We advocate services attuned more to those in need and to the desires of the general public and less to the pleading of sectional interests and the benefit of politicians.

2. THE INDIVIDUAL SPENDING PROGRAMMES

The proposals contained in the various Omega Project reports do not start with any preconceived view of what the total spending on any programme ought to be: indeed, the net budgetary effect of the reforms is hard to quantify in some cases. Proposals such as cash grants to encourage greater uptake of private health or sickness and disability insurance, the replacement of universal benefits with a new system of cash and voucher aid aimed exclusively at the poor, or the replacement of existing industrial strategies with deregulation to encourage the establishment of new industries for the future - all these should generate choice, competition, and prosperity, although their effect on the public sector budget and on the size of the tax base cannot be defined with great precision.

We have therefore tried to be realistic when assessing the financial results of the proposals. For example, we have suggested that a sizeable cash inducement for people to seek education or health insurance independently of the state would lead to a reduced demand for state services which in turn would mean that spending on them could be reduced: but we have assumed only a modest exodus to the private sector at first, and that continuing overhead costs and the political difficulties of trimming any service, even in the light of falling demand, make the potential for saving even more modest. In other services, where we have suggested that contracting out might be a promising reform, we have not sought to include in our figures the full 40% saving that, empirically, contracting out has proved able to generate on the average in the countless experiments throughout the world:[1] rather, we have supposed that institutional barriers will make the savings gradual, reaching only 20% or so over the first three years of operation. No solution to the problems of the public sector is likely to be quick, and the experience with contracting out so far in the United Kingdom has demonstrated that it could be a long time before the full potential is reached, given the scale of the organized interest-group opposition and the essentially non-commercial organization at present of the public services concerned.

THE INDIVIDUAL PROGRAMMES

Cautionary note

Another point to remember when looking both at the overall pattern of expenditure resulting from our proposed reforms, and at the balance of expenditure within particular programmes, is that the suggestions made in the various Omega Project reports

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1. See E. S. Savas, Privatizing the Public Sector (New Jersey: Chatham House, 1982).

are not intended as a consistent and unambiguous blueprint. In many cases, a range of options has been presented, each of which entails different revenue and expenditure implications. In attempting to draw up budget tables, we have had to make choices between the various options that have been proposed. Furthermore, the fact that the analytical work was undertaken by twenty different working parties, each with an expertise in their particular area, means that there are differences in the degree of optimism about the scale of any efficiencies or saving that can be made in each programme. Consequently, the expenditure tables cannot be construed as the price of 'the' Omega Project proposals - rather, they are the cost of a particular selection of available options identified by the scholars on the working parties, and those making a different selection from the proposed options could come to quite different figures.

Presentation

In laying out the expenditure tables, we have followed the format of The Government's Expenditure Plans. Even though this does not correspond precisely to the breakdown of responsibilities in our working parties, it seemed to be the clearest vehicle of exposition to those who work in the economics of the public sector and who will be familiar with the official presentation. Detailed assumptions have been appended to each table, but some general comments about the particular programmes and the Omega Project strategy for dealing with their problems are given below.

Defence. Because the annual edition of The Government's Expenditure Plans, on which most of our expenditure projections have been based, does not contain a detailed breakdown of defence expenditure, the figures shown in Table 2.1 are based on Table 2.3 of the Statement on the Defence Estimates 1984.[1] A sizeable shift in defence priorities is envisaged in our figures, including the running down of present land forces in Europe and the building up of a new Rapid Deployment Force that is more capable of countering threats to the economic and supply targets that will be the main problem in the future. The figures also reflect expected savings from contracting out non-defence ancillary functions and from the greater use of less expensive, part-time personnel.

Overseas services. A completely new mechanism of foreign aid is proposed in place of the present government-to-government grant system. This present system has certainly produced prestige projects such airports and steel mills (requiring continuing financial support); but it has put power and patronage in the hands of governments and public officials, and there is grave doubt that it has truly benefitted the poorest people. It has not generally gone to liberal countries (Table 2.2.1) and may in

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1. Statement on the Defence Estimates 1984 (London: HMSO Cmnd 9227, 1984) Vol 2, p. 9.

fact entrench existing inequalities of political power and wealth.

Instead we suggest that liberalization of trade with and within recipient countries should be encouraged by the establishment of sizeable freeport zones inside them, with tax concessions being given to UK companies who invest there, so that aid becomes person-to-person. Hence, our figures include a sizeable reduction in government-to-government aid programmes of a bilateral nature, although the multilateral programmes, over which the United Kingdom does not have complete authority, would take longer to rein in and replace with the new system.

Agriculture. The annual expenditure on agriculture now runs at around £2b, the bulk going to market regulation and support under the Common Agricultural Policy. We have suggested that this expenditure is the chief source of surpluses and a principal explanation of high food prices to the consumer. Stockpiles, financed out of the defence budget, would remove the strategic problem while allowing a greater opportunity for market pressures to keep food prices low. Accordingly, we propose an opting out of the costs (and benefits) of the CAP over a period of years.

Our figures also reflect a move towards more direct payment of ancillary service costs. Farmers themselves are the principal beneficiaries of marketing schemes, research establishments, and advisory bodies, although these are presently financed by taxpayers. We have proposed that they should be made the direct responsibility of the farming community itself, as they are in other industries.

Trade and industry. Our theoretical analysis of the generation of new employment opportunities suggests that support for particular areas or particular industries is ineffective as an employment-generating device. Consequently, the figures reveal sizeable reductions in these budgets, matched elsewhere by sizeable tax reductions for industry, especially small businesses, reinforced by an easier regulatory climate. In our judgement, this will generate new and lasting employment at a greater pace than the existing programme of subsidies.

Marketing, research, and development costs are reduced considerably as these are returned directly to the industries involved, although it is presumed that defence considerations will make some continued expenditure on research functions inevitable. Export promotion is likewise reduced, but expenditure still goes to bodies concerned with the general reduction of restrictions and tariffs against international trade.

Energy. The exploitation of new energy resources by the greater licensing of private operations and by the reduction of government distortions of fuel prices will allow gradual reductions in the cost of financing the state utilities and fuel extraction, although the exact pace of this development is hard to predict. Sales of oil exploitation licences should also generate a one-off income, but this is balanced against lower tax receipts.

Employment. Reductions in direct government expenditures on official employment programmes will help the general strategy of reducing the tax and administrative burden on new companies so that new employment can be boosted naturally. The major part of the Department of Employment's spending is now upon special employment and training schemes, such as the Community Programme, Community Industry, the Temporary Short Time Working Compensation Scheme, the Job Release Scheme, the Job Splitting Scheme, the Enterprise Allowance Scheme, the Youth Training Scheme, and the Training Opportunities Programme. Our general strategy proposes that these be replaced by two comprehensive schemes of training vouchers, for young people and for adults. This simplification would yield administrative and overhead savings (the launch advertising for the Job Splitting Scheme alone was £338,000) and would reduce distortion in the job market.

Arts and libraries. Like many nationalized industries, libraries, museums, and art galleries are poorly organized and lack capital to develop. Our figures reflect policies to introduce totally new and independent sources of finance from individuals and companies, stimulated by tax concessions on all gifts to these and other cultural activities. This new source of income is reinforced by better charging policies (since most museum visitors are middle class, and since most library borrowings are fiction, some charging for those not on low incomes seems desirable), savings from contracting out, and the better use of existing assets for advertising and sales promotions.

Transport. The transport figures show a general recapitalization of the road structure. In the long term, it is expected that road pricing can reduce congestion and help the provision of better roads sooner, but this is anticipated to be a longer-term project and does not show up in the figures. There is, however, scope for considerable savings on local authority expenditures on transport provision, arising from the substitution of new private modes of transport for present, inefficient public operations. This does, however, mean that a new system of transport tokens must be introduced for deserving cases, so that those in need can continue to travel on privately operated public transport systems; but greater precision will keep the total cost of fare concessions at present levels.

We have provided also that travellers should bear more directly the cost of their travel, instead of being cross subsidized from other routes (although again, poor people would be spared the greater cost of transport services through a token arrangement). Thus, commuters into London and other large cities would lose the 'public service obligation' support provided to them by taxpayers elsewhere.

Housing. Housing policy has proved particularly counterproductive over the years, and our figures reflect a complete re-think.

In general, we have proposed a system that subsidizes people rather than houses, putting support in the hands of those who need it rather than in scattering resources on providing cheap housing for those who might be well off. Accordingly, most current subsidy systems are ended, but methods to improve the housing market - such as the encouragement of new supplies of rented accommodation by a more liberal environment for new lettings, easier planning rules, and sales of local authority land - would help satisfy the present pent-up demand for housing and would serve to reduce accommodation costs. Meanwhile, more generous provisions in the welfare budget would assist those on lower incomes to afford proper housing at the unsubsidized market cost.

Other environmental services. Although some grants to sectional interests are proposed for abolition and do not appear in these figures, the main sources of saving stem from contracting out. There is also some reliance on charging where a service should legitimately be paid for directly by its consumers, rather than by the general public.

Law and order. Modest changes in the totals for law and protective services are envisaged, although budget items are laid down for the investigation and establishment of new systems of punishment, innovations in the court system, and some reforms in the police. The use of contracted private security, fire, and other services is presumed to bring efficiency improvements, although we have suggested that higher levels of service would make the overall financial savings small. However, the gradual privatization of prisons will lead to larger savings over time.

Education and science. The figures project only a small change in public expenditure totals, although they belie the structural reforms which we propose. The encouragement of independent alternatives to state schooling with a new tax rebate payable to those who opt out of the state sector is presumed to cost money at first, although it begins to pay for itself over a three-year period. However, the state sector is likely to be slow to change in response to new patterns of demand, and only small savings are assumed at first.

In universities and colleges, there are similar important changes proposed that do not have a great bearing on the financial figures; but the gradual replacement of student maintenance awards with independent loan systems has its effect. Also important is the shift in university funding to reliance on fees rather than direct government grants, thus making higher education more responsive to student demand.

Health and social services. Once again, the proposed efficiency savings in health care are a small proportion of the total, although it is presumed that some savings are possible by removing non-essential services and concentrating available resources on urgent cases and those in genuine need. Charging for some marginal services would bring in a revenue from better-off patients, while those on lower incomes would be guaranteed treatment free of charge under a new 'credit card' scheme. After a period GPs would be free to set their own charges, with the costs oflow-income patients being paid by the state. The main proposals, however, are intended to bring more resources into health care as a whole, and to reduce the reliance on the NHS of those who are better off. One mechanism proposed is a rebate of £50 for those who remove their demand from the public sector and insure privately, although it is presumed that the savings following from this will be smaller than the percentage of patients who opt out because of institutional and overhead costs.

Social security and pensions. Our proposals for pensions and welfare are more wide-ranging than is clear in the expenditure figures. For pensions, we believe that public expenditure must be increased if the pension system is to evolve from an unfunded and unstable 'chain letter' mechanism towards a system of personal, individuated retirement accounts, since the diversion of contributions into the new retirement funds leaves present beneficiaries still having to be supported. The injustice of an earnings-related pension system which shifts money from general taxpayers to the better-off leads to the phasing out of this element of the pension system.

A range of state benefits, many of which are given regardless of income, are insurable, and we have proposed a new system of compulsory insurance, similar to motor insurance, to deal with them. The premiums of low-income individuals would be paid directly by the state so that choice was still possible even for the poorest. The other benefits which are aimed to eliminate poverty but which often go to assist families who are already on high incomes, are consolidated in a new system of negative income tax.

Other public services. Contracting out of some public services, together with computerization of others, allows some overall savings, but we have assumed that the scope here is modest.

Scotland, Wales, Northern Ireland and local authorities. The individual programme totals in these budgets are calculated on the same general assumptions as those applying to public expenditure overall.

Asset sales. Asset sale revenues are the most difficult item of all to predict with any accuracy. The timing of sales depends entirely upon how quickly particular industries can be put into a state of readiness for sale, and upon the state of the market at the time of the flotation. There are, in addition, a number of ways in which a sale might be effected, and the choice will depend upon the circumstances. It may be possible to sell all of an industry, or only part of it, or to part sell the whole; the ownership may pass to the workforce, to the general public, to investors through the stock exchange, or to a single buyer; and it may require increased public expenditure before the sale to make the whole exercise viable. Accordingly, the figures we have suggested for the immediate future are very tentative. Moreover, since these asset sales are a one-off gain to the Treasury, it is probably unwise to confuse them with the general pattern of the expenditure totals, although they can be used to help with tax reductions or the increase of spending on desired public programmes.

2.1 DEFENCE

Table 2.1	£ million at 1984 prices			
	1984-85	1985-86	1986-87	1988-89
(a) Nuclear forces	384	384	384	384
(b) Navy	2,493	2,193	2,193	2,193
(c) European Army (BAOR)	1,796	1,198	998	898
(d) European Army (UK)	783	783	783	783
(e) Other Army	197	197	197	197
(f) Air Force	3,409	3,409	3,409	3,409
(g) Reserves (Navy)	16	232	32	32
(h) Reserves (Army)	316	474	474	474
(i) Reserves (Air Force)	25	368	88	88
(j) R & D	2,097	1,878	1,778	1,678
(k) Training	1,310	1,148	1,048	1,048
(l) UK Repair facilities	931	745	745	745
(m) Other support	2,811	2,774	2,674	2,674
(n) Other, less receipts	418	418	418	418
(o) Rapid Deployment Force	0	150	150	150
(r) Strategic stockpiles subvention to MAFF	0	200	200	200
TOTAL PROGRAMME	17,033	16,551	15,571	15,371

Assumptions

(b) Assumes Navy regulars reduced by 6,065, but £60m allocated to subsidies for the civilian transport vessels to prepare them for military roles.

(c) Assumes BAOR reductions of 50%, but 5,000 troops reallocated to Rapid Deployment Force.

(g) Numbers of naval reserves doubled, and £200m in 1985-86 on new equipment for RNR.

(h) Army reserve numbers increased by 50%, to reflect lower dependence on expensive regulars.

(i) Two Squadrons of Hawks formed for air defence (£160m capital costs, £22m running costs); 1 maritime squadron Coastguarder aircraft (£60m capital costs, 9m running costs); 1 flight of 3 aircraft for AEW formed (£60m capital costs, £7m running costs); double personnel (£25m).

(j) Assumes 20% savings by competitive procurement and shopping around.

(k) 20% cost savings by privatization and competition.

(l) 20% cost savings by privatization and competition.

(m) Reduce Whitehall costs (£236m) by 20%. Assume £90m savings due to smaller regular force.

2.2 OVERSEAS AID AND OTHER OVERSEAS SERVICES

Table 2.2 — £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Foreign & Commonwealth Office - ODA				
(a) Multilateral overseas aid	1,099}	440	400	350
(b) Bilateral overseas aid	}	400	200	50
(c) Overseas aid administration	26	20	20	20
(d) Other external relations	89	90	90	90
Total	1,214	950	710	510
(e) Crown Agents	-1	0	0	0
(f) Commonwealth Development Corporation	15	10	5	0
Total	14	10	5	0
Foreign & Commonwealth Office - Other				
(g) Overseas representation	336	330	330	330
(h) Overseas information	158	170	180	190
(i) Other external relations	167	170	170	170
(j) Military aid	13	10	10	10
Total	674	680	690	700
Commonwealth War Graves Commission	10	10	10	10
HM Treasury	-5	-10	-10	-10
Total	5	0	0	0
European Community Institutions				
(k) Net payments (excl. overseas aid)	485	485	485	485
* Contributions to reserves	20	20	20	20
* European Coal & Steel grants	-20	-20	-20	-20
* Less contributions to overseas aid	-110	-110	-110	-110
Total	375	375	375	375
TOTAL PROGRAMME	2,283	2,015	1,780	1,585

Assumptions

(a) Multilateral aid that can be influenced and redesigned by the UK is set at 30% of 1984 total, falling modestly over the period

(b) Bilateral aid is systematically phased out and replaced by a new scheme to encourage development by UK investors, through tax relief. This may replace multilateral aid in subsequent years. After 3 years £50m remaining for emergency aid. (See paragraph 3.46, p. 56.)

(h) Rising grants to BBC external services.

(k) We assume EEC contributions remain the same, given uncertainty about level of future payments.

Table 2.2.1

UK aid in 1983

(Main beneficiaries)

		£m cash
Bilateral aid - total		693
the main recipients are:		
India	127	
Sudan	32	
Sri Lanka	29	
Kenya	31	
Tanzania	30	
Bangladesh	24	
Pakistan	16	
Malawi	14	
Zambia	14	
Indonesia	12	
Botswana	13	
Zimbabwe	19	
Egypt	10	
sub-total	371	
Multilateral aid		405
Total		1,028

Source: British Overseas Aid, 1983

2.3 AGRICULTURE, FISHERIES, FOOD, AND FORESTRY

Table 2.3 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Ministry of Agriculture, Fisheries & Food				
(a) Market regulation and support	87	80	60	0
(b) Other agricultural support	161	80	50	30
(c) Animal health	15	10	10	10
(d) Other agricultural and food services	99	40	30	20
(e) Fishing industry: grants and loans	39}	10	5	0
(f) Fishing industry protection & research	}	30	30	30
(g) Land drainage and flood protection	103	55	55	55
(h) Thames tidal defences	7	1	1	1
(i) Research and advisory services	207	170	80	20
(j) RWA land drainage	26	20	20	20
Total MAFF	744	505	341	186
Intervention Board for Agricultural Produce				
(k) Market regulation & support	1,229	800	400	0
(l) Central and miscellaneous service	18	10	7	5
(m) New strategic stockpile scheme	0	200	200	200
(n) Subvention from Ministry of Defence	0	-200	-200	-200
Total IBAP	1,248	810	407	5
Forestry Commission				
(o) Forestry	56	20	10	0
TOTAL PROGRAMME	2,048	1,335	758	191

Assumptions

(a) Mostly administration of UK schemes, phasing out over three years.
(b) Rapid reductions in grants to agriculture and horticulture, except hill farming (an EC scheme) which phases out over four years.

(c) Improved charging and contracting methods allow modest savings to be made.

(d) The figures show rapid reductions in training, certification, and research costs as these are passed on to the industry. Residual support remains for botanic gardens etc., but improved charging practices emerging in later years.

(g) Rural drainage for agricultural purposes is assumed to be no longer subsidized, but expenditure continues on urban and non-agricultural flood protection.

(i) Research services transferred to relevant industries over three years; some residuals.

(k) Mostly support through CAP. Subsidies reduced to 1980-81 expenditure levels, then phased out and replaced by stockpile programme.

(m) Stockpile scheme administered by MAFF but supported by MoD. Existing surpluses put towards initial stockpiles.

(o) Reducing costs reflect sale of assets to private sector.

2.4 TRADE, INDUSTRY, ENERGY AND EMPLOYMENT

Table 2.4			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
Department of Trade and Industry				
Regional & general industrial support				
(a) Regional development grants	385	200	100	0
(b) Provision of land & buildings (EIEC)	29	0	0	0
(c) Selective assistance to regions	66	40	20	0
(d) Selective assistance to firms	115	100	50	0
(e) British Technology Group	–	0	0	0
(f) Other support services	4	3	2	1
(g) Promotion of tourism (BTA & ETB)	34	20	20	0
(h) Future industrial support	8	0	0	0
Total	640	363	192	1
Scientific & technological assistance				
(i) General industrial research & development	269	135	65	25
(j) Aero industry research & devlpt.	34	20	10	10
(k) Space (European Community Project)	65	65	65	65
Total	369	220	140	90
Aerospace, shipbuilding, and vehicles				
(l) Concorde development and production	1	1	0	0
(m) Finance for Rolls-Royce Ltd	-2	0	0	0
(n) Other aero-industry projects	22	15	10	10
(o) Refinancing of home shipbuilding	-27	-27	-27	-27
(p) Interest support costs	11	10	9	8
(q) Assistance to shipbuilding	32	30	20	10
(r) Assistance to steel	53	40	5	0
Total	90	64	13	-7
(s) Export promotion, GATT, etc	29	10	5	5
(t) Domestic trade regulation and services	92	80	70	70
(u) Other central & miscellaneous services	141	120	100	70

Table 2.4 continued			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
(v) Nationalized industries ext. financing	142	100	70	50
Total	404	331	316	313
TOTAL DEPARTMENT OF TRADE AND INDUSTRY	1,503	962	594	287
Department of Energy				
Regional & general industrial support				
(a') Selective assistance, oilrig protection	18	15	12	12
(b') Other support services	5	5	5	5
Total	23	20	17	17
Scientific and technological assistance				
(c') Non-nuclear research & devlpt.	47	30	0	0
(d') Nationalized industries ext. financing	200	200	200	150
Total	247	230	230	180
(e') Support to the coal industry	243	200	100	50
(f') Other central and misc. services	32	30	28	26
(g') Nationalized industries ext. financing	259	200	100	50
Total	534	430	228	126
TOTAL DEPARTMENT OF ENERGY	804	680	475	323
Export Credits Guarantee Department				
(a") Refinancing of export credits	18}			
(b") Cost escalation guarantees	8}			
(c") Interest support costs	130}	0	0	0
(d") Mixed credit matching facility	2}			

Table 2.4 continued				£ million at 1984 prices
	1984-85	1985-86	1986-87	1987-88
Total Export Credits Guarantee Department	159	100	0	0
Friendly Societies Registry and OFT				
(e") Friendly Societies Registry	}			
(f") Office of Fair Trading	} 9	5	5	5
TOTAL FSR/OFT	9	5	5	5
Department of Employment				
(g") General labour market services	669}			
(h") Redundancy & maternity fund	}			
payments	378}	1,900	1,600	1,500
(i") Compensation etc.	388}			
(j") Manpower Services Commission	1,445}			
(k") Careers services grant	13}			
(l") Services for the disabled	91	90	90	90
(m") Central services	48	40	30	24
(n") ACAS	13	10	10	10
(o") Health and safety at work	90	85	80	75
TOTAL DEPARTMENT OF EMPLOYMENT	3,135	2,125	1,810	1,699
Summary by Total				
* Department of Trade and Industry	1,502	962	594	287
* Deparment of Energy	804	680	475	323
* Department of Employment	3,135	2,025	1,710	1,699
* Export Credits Guarantee Department	159	100	0	0
* Other	10	0	0	0
TOTAL PROGRAMME	5,609	3,867	2,879	2,309

Assumptions

(b) Disband English Industrial Estates Corporation and sell its assets.
(e) BTG is to be sold.
(f) Privatization of the small firms service.
(k) Space is mainly an EC programme, and is therefore difficult

to reduce.

(m) Rolls-Royce is to be sold.

(n) Some strategic spending remains.

(u) Contracting out of car registration, patent protection, etc.

(u') The industry is assumed to bear more the direct costs of protection

(a") - (d") Privatization of ECGD.

(g") General services absorbed into MSC budget & various schemes replaced by one training voucher scheme.

(l") Assumes ending of maternity fund and improved facilities under welfare budget.

2.5 ARTS AND LIBRARIES

Table 2.5			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
Central government				
(a) Capital expenditure	12}			
(b) Current expenditure	241}	180	140	120
Local authorities				
(c) Capital expenditure	19}			
(d) Current expenditure	327}	276	276	276
TOTAL PROGRAMME	599	456	416	396

Assumptions

(a) & (b) Museums at present cost £141m; falls to £100m with charges, business sponsorship, etc. Arts Council budget for national institutions reduced to £20m. Tax concessions to business and individuals for donations to arts reduces need for state subsidy.

(c) & (d) Libraries at present cost £286m per annum; we assume £50m in receipts for charging for adult library subscriptions; add £40m for local museums.

2.6 TRANSPORT

Table 2.6				£ million at 1984 prices
	1984-85	1985-86	1986-87	1987-88
Department of Transport				
(a) National road systems, capital	726	750	800	850
(b) National road systems, current	79	85	90	95
Total	805	835	890	940
(c) Local roads, capital expenditure	539	550	550	550
(d) Local car parks, capital	11	8	2	0
(e) Local public transport, capital	250	200	100	0
(f) Local ports, capital	21	20	20	10
(g) Local airports, capital	33	20	0	0
Total local expenditure, capital	854	798	672	560
(h) Local roads, current expenditure	902	850	800	800
(i) Local car parks, net current expenditure	27	0	0	0
(j) Revenue support to public transport	313	300	150	0
(k) Concessionary fares	189	190	190	190
(l) Professional and technical services	178	150	100	100
Subvention from DHSS		-190	-190	-190
Total local expenditure, current	1,555	1,300	1,050	900
(m) British rail public service obligation	865	500	400	200
(n) Level crossing grant	23	23	23	23
(o) BR pension funds, etc.	85	85	85	85
(p) National Freight Co. pension funds	9	9	9	9
(q) New bus grants public/private	2	0	0	0
(r) Freight facilities grants	7	7	7	7
(s) Ports, central government expenditure	89	80	60	40
Total	1,080	704	584	364

Table 2.6 continued				£ million at 1984 prices
	1984-85	1985-86	1986-87	1987-88
(t) Shipping services, coastguard, etc.	41	40	38	36
(u) Civil aviation services	7	7	3	3
(v) Licensing and testing schemes	21	0	0	0
(w) Driver and vehicle licensing	101	100	100	100
Total regulatory activities	170	147	141	139
(x) Central government administration	39	39	39	35
(y) Research and development	33	33	30	30
(z) International subscriptions, etc.	1	1	1	1
Total central services	73	73	70	66
(a') Nationalized industries ext. finance	830	750	600	500
(b') ERDF receipts	-21	-21	-21	-21
TOTAL DEPARTMENT OF TRANSPORT	4,360	3,746	3,247	2,777
Department of the Environment				
(c') Roads & transport administration	5	5	5	5
(d') Transport research and other services	6	6	6	6
TOTAL DEPARTMENT OF THE ENVIRONMENT	11	11	11	11
TOTAL PROGRAMME	4,372	3,767	3,258	2,788

Assumptions

(a) Assumes increased capital for national roads.
(d) Sale of car parks and local public transport services.
(e) Concessionary fares channelled through welfare payments.
(m) No longer any obligation for commuter & inter-city services. Rural areas only.
(t) Contracting out of some of these services.
(u) Contracting out of services and sale of CAA run airports.

2.7 HOUSING

Table 2.7 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Current expenditure & administration				
(a) Central subsidies to housing	305	200	100	0
(b) Rate fund contributions to housing	250	100	0	0
(c) Subsidies to new towns	120	50	0	0
(d) Subsidies to housing associations	28	10	0	0
(e) Central government administration	18	15	10	10
(f) Local authorities' administration	111	80	60	50
(g) Housing corporation grant in aid	16	0	0	0
Total current expenditure	847	455	170	60
Capital expenditure*				
(h) Local authority land expenditure	30	0	0	0
(i) New dwellings, sheltered housing etc	650	400	200	100
(j) Acquisitions	25	0	0	0
(k) HRA improvement investment	965	900	800	700
(l) Non-HRA improvements etc	78	50	40	40
(m) Slum clearance	45	45	40	35
(n) Improvement and insulation grants	770	400	200	0
(o) Gross lending for purchase & improvements	40	0	0	0
(p) Loans and grants to housing associations	140	70	35	0
Total local authority gross expenditure	2,743	1,865	1,315	875
Local authority receipts*				
(q) Sales of land and assets	-120	-120	-120	-120
(r) Receipts from sales of dwellings	-920	-1,000	-1,000	-1,000
(s) Sums outstanding on dwelling sales	-400	-400	-400	-400
(t) Repayment of improvement loans	-260	-260	-100	0
(u) Repayments from housing associations	-25	-25	-15	-5
Total local authority receipts	-1,725	-1,805	-1,635	-1,525
Net local authority expenditure	1,018	-540	-620	-650

Table 2.7 continued			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
(v) New towns gross investment	60	18	10	0
(w) Receipts from sales & repayments	-60	-100	-100	-100
Net new town investment	0	-82	-90	-100
(x) Housing Corporation loans & grants	687	300	100	0
(y) Housing Corporation repayments	-70	-100	-100	-100
(z) Net home loans and other schemes	4	0	0	0
Total	621	200	0	-100
Total capital expenditure	1,650	-522	-720	-850
TOTAL PROGRAMME	2,496	633	-250	-790

* The 1984-85 column shows figures for the previous year because of the time-lag in local authority claims. Official budget totals for 1984-85 are £2,493 million for capital expenditure and £1,465 million for receipts. These figures have been used in the 1984-85 programme total.

2.8 OTHER ENVIRONMENTAL SERVICES

Table 2.8 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
(a) Local services, capital	189	190	190	190
(b) Current	2,105	1,900	1,700	1,600
(c) Local authority rate collection	142	138	131	124
(d) Records of births	13	13	13	13
(e) Derelict land reclamation	74	0	0	0
(f) Urban programme including current	256	200	150	100
(g) Urban development corporations	75	50	25	10
(h) Water services and research	13	13	13	13
(i) Royal palaces and royal parks	25	20	20	20
(j) Historic buildings	65	65	65	65
(k) The Heritage	2	2	2	2
(l) Regional development fund, etc	23	10	0	0
(m) Central services and research	117	100	80	70
(n) Other services and grants	66	46	46	46
(o) Nationalized industries ext. finance	284	241	241	241
TOTAL PROGRAMME	3,451	2,988	2,676	2,494
Of which: financed by ERDF receipts	38	20	20	20

Assumptions

(b) 10% saved in first year; then 15%, and 20%, from contracting.
(c) Advertising & contracting: 10%, 15%, and then 20%.
(i) Improved charging, & contracting out of staffing of parts.
(n) Elimination of grant to Sports Council, and general efficiencies.
(o) Sale of British Waterways Board.

2.9 LAW, ORDER, AND PROTECTIVE SERVICES

Table 2.9 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Home Office, admin. of justice				
(a) Central courts and compensation	40	40	40	40
(b) Local authority capital exp.	21	20	20	20
(c) Local authority current exp.	149	150	140	130
(d) Revenue from fines etc	-145	-160	-190	-210
(e) New arbitration systems	0	10	10	0
Total	64	60	20	-20
Home Office, punishment				
(f) Prisons, capital expenditure	62	80	100	100
(g) Prisons, current expenditure	554	525	500	475
(h) Probation, central capital exp.	1	1	1	1
(i) Probation, central current exp.	21	17	16	15
(j) Probation, local capital exp.	4	0	0	0
(k) Probation, local current exp.	147	135	125	120
(l) New punishment system development	0	20	60	100
Total	793	778	802	811
(m) Police, central capital exp.	31	40	40	40
(n) Police, central current exp.	46	50	50	50
(o) Fire, central capital exp.	1	1	1	1
(p) Fire, central current exp.	9	9	9	9
(q) Police, local capital exp.	96	100	100	100
(r) Police, local current exp.	2,494	2,600	2,680	2,680
(s) Fire, local capital exp.	19	20	20	20
(t) Fire, local current exp.	543	500	475	450
(u) Other protective services, current	18	18	18	18
Total	3,262	3,338	3,393	3,368
(v) Community services, central current exp.	22	10	10	10
(w) Misc. central capital exp.	2	2	2	2
(x) Misc. central current exp.	126	100	100	100
(y) Misc. local current exp.	23	20	20	20
Total	173	132	132	132

Table 2.9 continued		£ million at 1984 prices		
	1984-85	1985-86	1986-87	1987-88
Civil defence				
(t') Capital expenditure	17	10	10	10
(u') Current expenditure	43	40	40	40
TOTAL CIVIL DEFENCE	59	50	50	50
TOTAL PROGRAMME	4,901	4,909	4,938	4,842

Assumptions

(e) Input initial capital to start new systems.
(f) Capital expenditure rises to build more new prisons, but levels off as first new private prisons begin to be built.
(g) Contracting assumed to save 5%, 10% & 15%.
(h) Probation services organized through voluntary bodies, but an expansion of community service orders.
(r) Savings from contracting, co-operatives and part-timers.
(d') Eliminate cost of legal aid for matrimonial cases.

2.10 EDUCATION AND SCIENCE

Table 2.10 — £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Education and science: schools				
(a) Nursery schools, capital exp.	12}			
(b) Nursery schools, current exp.	313}	200	200	200
(c) Capital exp. on other schools	226	226	226	226
(d) Primary schools, current exp.	2,412}			
(e) Secondary schools, current exp.	3,768}	6,124	5,871	5,562
(f) Special schools, current exp.	385	385	385	385
(g) Other supporting services	182	180	180	180
(h) Transport	200	190	180	170
(i) Meals provision	257	225	200	150
(j) Milk	6	6	6	6
(k) Savings from contracting ancillary services	n/a	-175	-175	-175
Total	7,761	7,361	7,067	6,698
Higher and further education				
(l) Universities and colleges: capital	197}			
(m) Universities: current exp.	1,338}			
(n) Voluntary and direct grant: current	98}	2,107	1,997	1,885
(o) Maintained sector advanced: current	} 585}			
(p) Student awards	816	600	400	200
(q) Maintained sector non-advanced: current	962	900	900	900
(r) Adult education	73	50	50	50
Total	4,069	3,657	3,347	3,485
Research, administration, etc				
(s) Youth service: capital	7	7	7	7
(t) Youth service: current	92	92	92	92
(u) Research and other capital exp.	4	4	4	4
(v) Research and other current exp.	60	60	60	60
(w) Administration: capital	2	2	2	2
(x) Administration: current	508	500	500	500
Total	657	665	665	665

Table 2.10 continued £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Science				
(y) Research councils, etc: capital	86	90	90	90
(z) Research councils, etc: current	465	365	265	165
Total	550	455	355	255
TOTAL PROGRAMME	13,052	12,138	11,434	11,103

Assumptions

(a) & (b) Savings arise from the replacement of state services with nursery groups.

(d) & (e) Opting out with the assistance of a £300 rebate is assumed to result in 1%, 5%, & 10% savings, (5% opting out each year).

(h) Transport contracting out saves 5%, 10%, & 15%.

(l)-(o) Student fee certificates.

(q) Independent loan schemes are presumed to replace existing maintenance costs.

(z) Independent support for research is presumed to take on an increasing portion of research costs. Tax concessions can be used to encourage this.

2.11 HEALTH AND PERSONAL SOCIAL SERVICES

Table 2.11	£ million at 1984 prices			
	1984-85	1985-86	1986-87	1987-88
Hospital services				
(a) Treatment and supplies	4,028}			
(b) Medical, paramedical, & support	673}	4,434	4,247	4,013
(c) Other	2,617	2,485	2,355	2,224
Total	7,318	6,919	6,602	6,237
Community health services				
(d) Treatment and supplies	557	425	425	425
(e) Medical, paramedical, & support	78	78	78	78
(f) Other	167	159	150	142
Total	802	662	653	645
Family practitioner services				
(g) General medical	927	800	350	0
(h) Pharmaceutical	1,390	1,090	990	890
(i) General dental	458	350	200	0
(j) General ophthalmic	128	100	50	0
Total	2,903	2,440	1,590	890
Other services				
(k) Ambulance services	247	170	100	100
(l) Blood transfusion services	45	45	45	45
(m) Contractual hospitals & homes	37	37	37	37
(n) Joint care financing	57	57	57	57
(o) Health councils and other	29	29	29	29
Total	415	338	268	268
(p) Administration	411	300	200	200
(q) Subvention from welfare budget for new 'credit card' scheme	-	-500	-500	-500
(r) Spending on welfare case charges	-	500	500	500
Total	411	300	200	200

Table 2.11 continued			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
NET NHS TOTAL	13,138	10,109	9,213	8,240
Personal social services				
(s) Fieldwork	270	200	100	0
(t) Admin.	350	300	200	150
(u) residential care - children	330	290	280	280
(v) residential care - elderly	380	346	336	336
(w) residential care- handicapped	160	150	130	130
(x) Day care - nurseries	80	48	48	48
(y) - other	200	190	190	190
(z) Community care - home help	240	210	200	200
(a') - children	80	80	80	80
(b') - meals	30	30	30	30
(c') - other	50	50	50	50
Total	2,282	1,894	1,644	1,494
Total Health & Personal Social Services	15,421	12,553	10,957	9,734

Assumptions

(a) Hotel charges for hospitals are assumed to raise £200m.
(b) Exit from NHS means reduction of 1%, 5%, & 10%. Exit encouraged by a rebate of £50 for those who insure privately.

(c) Contract out savings of: 5%, 10%, & 15%.
(d) Fewer health visitors.
(f) Mostly admin. etc. - contracting saves 5%, 10%, & 15%.
(g) Cover physicians costs initially by charges, phasing in GP freedom to charge market rates after 3 years.
(h) Charges for non-essential drugs.
(j) Private opthalmology encouraged.
(k) Charges & other moves to eliminate unnecessary trips.
(q) Subvention from welfare budget to cover charges for those on low incomes.

2.12 SOCIAL SECURITY AND PENSIONS

Table 2.12 — £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
Pensions				
(a) Basic retirement pensions	15,348}			
(b) Earnings-related component	87}			
(c) Christmas bonus	104}			
(d) Widow's benefits etc	798}	17,180	18,000	18,800
(e) 'Non-contributory' retirement pensions	38}			
(f) 'Non-contributory' Christmas bonus	6}			
Total	16,381	17,180	18,000	18,800
Unemployment, incapacity, etc				
(g) Unemployment benefit	1,538	1,530	1,500	1,500
(h) Sickness benefit	246	0	0	0
(i) Invalidity benefit: basic	1,828	1,700	1,600	1,500
(j) Invalidity benefit: earnings-related	103	0	0	0
(k) Industrial disablement benefit	377	350	350	350
(l) Other industrial injuries benefit	5	5	5	5
(m) Attendance allowance	571	550	500	450
(n) Invalid care allowance	11	11	11	11
(o) Mobility allowance	356	350	340	330
Total	5,236	4,496	4,306	4,146
Elimination of poverty				
(p) Supplementary pensions	729}			
(q) Supplementary allowance: long-term	1,482}			
(r) Supplementary allowance: short-term	3,883}			
(s) One parent benefit	122}			
(t) Family income supplement	131}			
(u) Rent rebate	2,045}	11,910	10,910	9,910
(v) Rent allowance	416}			
(w) 'Non-contributory' invalidity allowances	201}			
(x) Child benefit	4,291}			
(y) Maternity allowance	191}			
(z) Guardian's allowance etc	2}			
(a') Maternity grant	18	0	0	0
(b') Death grant	18	0	0	0

Table 2.12 continued £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
(c') Subvention to health budget for credit card scheme	0	500	500	500
(d') Subvention to transport budget for concessionary fares	0	190	190	190
Total	13,523	12,600	11,600	10,600
Other grants and allowances				
(e') War pensions	544	544	544	544
Total	14,067	13,144	12,144	11,144
Administration				
(f') Central administration of NIF	725	650	650	650
(g') DHSS 'Non-contributory' benefit admin.	623	500	400	400
(h') Housing benefit local admin.	92	90	90	90
(i') Department of Employment admin.	149	150	150	150
Total	1,589	1,390	1,290	1,290
TOTAL PROGRAMME	37,207	36,210	35,740	35,380

Assumptions

(a) - (f) Increase in pensions expenditure due to transitional costs of privatization.
(b) Abolish earnings-related component except for those already pledged to receive it.
(g) - (o) Compulsory loss of earnings insurance replaces existing benefits.
(p) - (z) Comprehensive new poverty programme provides a guaranteed minimum income based on residence, dependents, and local cost of living indicators such as housing, clothing, education, health, and travel costs.
(a') Maternity grant abolished, but special aid goes to those in genuine need.
(b') Replace death grant with special help to those in genuine need.

2.13 OTHER PUBLIC SERVICES

Table 2.13 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
(a) Parliament	71	71	71	71
(b) Parliamentary elections costs	18	18	18	18
(c) Financial & Bank of England	130	110	110	110
(d) UK coinage	22	22	22	22
(e) Computers & telecommunications	15	15	15	15
(f) Other services	16	16	16	16
(g) Customs and Excise	343	300	250	250
(h) Inland Revenue	895	750	700	700
(i) HMSO	18	18	18	18
(j) Management & personnel office	36	36	36	36
(k) National Savings	150	150	150	150
(l) Records, surveys etc	43	41	39	38
(m) Other	31	31	31	31
TOTAL PROGRAMME	1,788	1,578	1,476	1,475

<u>Assumptions</u>

(g) & (h) Abolition of some taxes and simplification of others leads to a reduction in collection costs.

(l) Contracting saves 5%, 10%, & 15%.

2.14 COMMON SERVICES

Table 2.14				£ million at 1984 prices
	1984-85	1985-86	1986-87	1987-88
Property Services Agency				
(a) Capital expenditure	90	0	0	0
(b) Rent	154	0	0	0
(c) Maintenance & other running costs	129	0	0	0
(d) Miscellaneous services & receipts	-531	0	0	0
(e) Administration	72	0	0	0
Total	-86	0	0	0
Paymaster General's Office				
(f) Civil superannuation	1,046	1,000	1,000	1,000
(g) Other services	12	10	10	10
Total	1,058	1,010	1,010	1,010
(h) Central Office of Information	48	48	48	48
(i) Rates on government property	132	140	140	140
(j) Government Actuary	1	1	1	1
Total	181	189	189	191
TOTAL PROGRAMME	1,105	1,199	1,199	1,199

2.15 SCOTLAND

Table 2.15				£ million at 1984 prices
	1984-85	1985-86	1986-87	1987-88
(a) Agriculture, fisheries, etc	188	100	50	50
(b) Trade, industry, energy, employment	169	100	50	0
(c) Tourism	11	0	0	0
(d) Roads and transport	491	400	300	200
(e) Housing	650	550	450	400
(f) Other environmental	541	440	440	440
(g) Law, order, and protective services	490	490	490	490
(h) Education and science	1,610	1,536	1,461	1,437
(i) Arts and libraries	58	50	50	50
(j) Health and personal social services	2,169	1,913	1,785	1,656
(k) Other public services	100	100	100	100
(l) Common services	1	1	1	1
(m) Other local authority services	75	50	20	0
Total	6,533	5,730	5,247	4,824
(n) Nationalized industries ext. finance	310	100	100	100
TOTAL PROGRAMME	6,860	5,830	5,347	4,924
Of which: financed by ERDF receipts	48	48	48	48

Assumptions

(a) - (m) Totals derive from similar assumptions to those used in general programme analysis.

2.16 WALES

Table 2.16			£ million at 1984 prices	
	1984-85	1985-86	1986-87	1987-88
(a) Agriculture, fisheries, etc	93	50	35	30
(b) Trade, industry, energy, employment	78	0	0	0
(c) Tourism	6	0	0	0
(d) Roads and transport	287	210	170	140
(e) Housing	118	100	90	80
(f) Other environmental	284	260	225	210
(g) Education and science	665	635	604	594
(h) Arts and libraries	28	25	25	25
(i) Health and personal social services	968	854	797	739
(j) Other public services	32	32	32	32
Total		2,164	1,976	1,914
Nationalized industries ext. finance	26	26	26	26
TOTAL PROGRAMME	2,585	2,190	2,002	1,914
Of which: financed by ERDF	29	25	25	25
Financed by govt. support to Welsh language	3	3	3	3

Assumptions

(a) - (j) Totals derive from similar assumptions to those used in general programme analysis.

2.17 NORTHERN IRELAND

Table 2.17 £ million at 1984 prices

	1984-85	1985-86	1986-87	1987-88
(a) Law, order, and protective services (NIO)	398	398	398	398
(b) Other public services (NIO)	7	7	7	7
(c) Agriculture, fisheries, etc	88	60	50	35
(d) Trade, industry, energy, employment	417	200	100	0
(e) Transport	116	85	65	50
(f) Housing	341	310	270	240
(g) Other environmental	158	140	120	100
(h) Law, order, and protective services	17	16	16	16
(i) Education and science, arts and libraries	586	559	531	510
(j) Health and personal social services	659	581	542	503
(k) Social security	1,184	1,067	1,090	1,150
(l) Other public services	21	20	19	18
(m) Common services	39	39	39	39
TOTAL PROGRAMME	4,032	3,482	3,247	3,066
Of which: financed by ERDF	20	20	20	20
: financed by ESF	44	40	40	40

Assumptions

(a) - (m) Totals derive from similar assumptions to those used in general programme analysis.

2.18 ASSET SALE PROGRAMME

Table 2.18 £ million at 1984 prices

	1985-86	1986-87	1987-88
Asset sale revenue already projected by the govt. (BT, BA, NBC, Rolls Royce, etc)	-2,500	-2,500	-2,500
Sale of remaining state shares in private corporations such as BP, Cable & Wireless, Assoc. British Ports, etc	-1,000	-1,000	-1,000
Post Office	-	-500	-700
National Girobank	-	-150	
British Gas (except transmission network)	-100	-700	-1,200
British Airports Authority	-	-450	-
British Rail	-100	-150	-200
BR Property Board	-	-60	-100
British Nuclear Fuels	-	-100	-120
British Leyland	-	-800	-500
SSEB	-	-	-200
Hydro Board	-	-50	-
National Coal Board Mines	-50	-125	-125
New Towns	-200	-200	-300
HMSO	-	-30	-
Local public transport	-25	-25	-50
Royal Mint	-	-	-60
Property Services Agency*	-500	-1,000	-1,000
British Technology Group	-40	-10	-
English Industrial Estate Corporation	-20	-20	-10
Local authority land	-200	-500	-500
Miscellaneous (Inc. Scottish Development Agency, WDA, Local car parks, local airports, HIDB land, Scottish ports, Local authority small holdings, car test centres, etc.)	-40	-45	-45
TOTAL	4,775	8,415	8,610

* The sums listed represent only a very small proportion of the total assets of the PSA, the value of which is difficult to calculate. Very considerable amounts could be raised in future years from the sale of further PSA assets.

2.19 SUMMARY OF PROGRAMME EXPENDITURE

Table 2.19 £ million at 1984 prices

		1984-85	1985-86	1986-87	1987-88
(2.1)	Defence	17,033	16,551	15,571	15,371
(2.2)	Overseas aid & other services	2,283	2,015	1,780	1,585
(2.3)	Agriculture, fisheries, forestry	2,048	1,335	758	191
(2.4)	Trade, industry, energy, employment	5,609	3,867	2,879	2,309
(2.5)	Arts and Libraries	599	456	416	396
(2.6)	Transport	4,372	3,767	3,258	2,788
(2.7)	Housing	2,496	633	-250	-790
(2.8)	Other environmental services	3,451	2,988	2,676	2,494
(2.9)	Law, order, protective servs.	4,901	4,909	4,938	4,842
(2.10)	Education and science	13,052	12,138	11,434	11,103
(2.11)	Health & personal social services	15,421	12,553	10,957	9,734
(2.12)	Social security and pensions	37,207	36,210	35,740	35,380
(2.13)	Other public services	1,788	1,578	1,476	1,475
(2.14)	Common services	1,105	1,199	1,199	1,199
(2.15)	Scotland	6,860	5,830	5,347	4,924
(2.16)	Wales	2,585	2,190	2,002	1,914
(2.17)	Northern Ireland	4,032	3,482	3,247	3,066
(2.18)	Special sales of assets	-1,900	-4,775	-8,415	-8,610
	Reserve	2,750	2,750	2,750	2,750
	Local authority expenditure not allocated in other programmes	660	300	0	0
PLANNING TOTAL (Excluding Asset Sales)		128,252	114,751	106,178	100,731
PLANNING TOTAL (NET)		126,352	109,976	97,763	92,121

3. TAXATION PLANS

THE DIRECTION OF REFORM

3.1 The reforms we propose below are desirable not only economically but also politically and socially. Our aim is to move to a system with few, simple taxes at low rates. Thus, tax reform is combined with tax reduction. Our purpose is not to mitigate an excessive tax load by shifting the burden from one tax to another, but to reduce the burden while improving the structure of taxation by concentrating tax cuts on the most damaging and objectionable taxes. The large cuts which we are recommending in government spending will provide the resources to mount an attack on the worst features of the tax system without the need for any countervailing tax increase. Our priorities for reduction are the taxes on income and capital.

3.2 The scope for major reductions in taxation depends on major reductions in government expenditure, and the Omega policy reports show that these are both possible and desirable. If the potential for privatizing government services is systematically exploited, it should be possible over a period of some ten years to reduce the proportion of the national income taken in taxation to less than twenty five per cent. Even this proportion is grossly excessive; as a longer-term aim, the proportion should be reduced again to some ten per cent. This should be enough to provide defence, law and order and the legal framework of capitalism.

3.3 Government expenditure should be drastically reduced by restoring choice to the taxpayer in spending decisions which are properly his. Until this is done, there is a strict limit to the scope for reducing the major revenue-raising taxes such as the standard rate of value added tax and the basic rate of income tax. That is why we emphasize the desirability of privatizing expenditure undertaken by the government.

3.4 A number of other taxes, by contrast, cannot be justified by the 'need' to raise revenue. Capital transfer tax, capital gains tax and the higher rates of income tax, for example, yield little if any net revenue. They are disproportionately damaging because they fall largely on the process of wealth creation through saving and enterprise; their abolition could be expected to generate additional taxpaying activity, and this activity would reduce the revenue cost of their abolition and might even turn it negative.

3.5 The initial effect of abolishing these taxes is to benefit richer taxpayers more than poorer because the burden they impose is concentrated in the upper range of the income scale. This is sometimes regarded as a point to criticize in a tax reduction; but any such criticism is doubly mistaken. First, it is a logical necessity that, if taxes are levied on the rich, the rich are the beneficiaries of their reduction; if this consequence were unacceptable, these taxes could never be cut, however strong the case for cutting them on other grounds. Second, and more substantially, the criticism confuses the initial effect of a tax reduction with its ultimate effect. The ultimate effect of reductions in taxes on the rich is an increase in economic prosperity; and this increase raises the living standards of the poor more than of the rich because the rich save proportionately more of their income than the poor. (There is much less equality of living standards in the developing countries than there is in the industrialized West).

The tax system and capitalism

3.6 The system we recommend is favourable to capitalism in two separate senses. First, low rates of tax cause the minimum distortion of the market economy; and second, the reduction of taxes on saving and capital facilitates the ownership of property by individuals (a property-owning democracy). The present system, by contrast, is unfavourable to capitalism in both these senses.

Few beneficiaries of the present system

3.7 Few people gain from the present system of high taxes and high government expenditure, and many lose. The CSO article The effects of taxes and benefits on household income, 1982 (Economic Trends, November 1983) shows that only some forty per cent of households gained in 1982 from the combined effects of taxes and benefits, either absolutely (Table A in the Trends article) or relatively (Table G). As the CSO say (Economic Trends, December 1982), 'over half the households are in broadly the same relative position on the income scale after taxes and benefits as before redistribution'. But most of the forty per cent who gain pay a high price: they are caught in the poverty trap or the unemployment trap or both. In The Moral Hazard of Social Benefit (Institute of Economic Affairs Research Monograph 37, 1982) Mrs Hermione Parker has estimated the number of people at risk from one or both traps as unlikely to be less than 5.5 million adults (over 20 per cent of the workforce) in 1982. Although workforce figures are not strictly comparable with figures for households (+/- 19 million), it appears that less than one household in five gains from the system of taxes and benefits without being caught by that system in the poverty trap or the unemployment trap or both.

3.8 The trouble with the present system is that it has for years been based on 'relative poverty' rather than 'absolute poverty': benefits have therefore risen not merely with prices but with earnings. A concept of need based on relative poverty is artificial and pernicious; its influence on policy has been a main cause of the poverty trap and a more important cause than the relative decline in income tax thresholds. (We explain elsewhere that we should like the main emphasis of income tax reduction to be put on cuts in the rates, not increases in the thresholds). Benefits should not be linked to earnings; even full indexation for prices may be considered excessive, since it is far from clear why recipients of benefits should be fully protected from price rises to which large numbers of taxpayers are completely exposed.

Proportional, 'progressive'/'degressive' and 'regressive' structures

3.9 We reject the argument that proportional taxes on spending are 'regressive' because poorer people spend a larger proportion of their income than richer people. Taxes on spending fall on saving as well: the value of saving is what it will buy, and this value is reduced by taxes on spending.

3.10 All taxes should be proportional, except that an element of 'progression' is desirable in the form of an initial tax-free band for income tax. This structure is sometimes called 'degressive'.

Administrative and compliance costs

3.11 A system consisting of few low-rate proportional taxes would substantially reduce both the administrative costs falling on the Inland Revenue and Customs and Excise and the compliance costs falling on the taxpayer, which may be a large multiple of the official costs of administration.

Income or spending

3.12 The combination of an income tax with a broadly based tax on spending catches income once as it is earned and a second time as it is spent or saved. This systematic double taxation implies that both taxes should be levied at low proportional rates. This is what we propose.

3.13 We oppose the idea of a shift from taxes on earnings to taxes on spending, because the difference would be more apparent than real. There would be no difference for the large proportion of the population who spend their income as it is earned. Moreover, the revenue from additional taxes on spending is more likely to be spent by the government than returned to the taxpayer through reductions in taxes on income. It is not only taxes on income and capital that are too high; taxes on spending are too high also. We oppose any addition to the present taxation of spending; on the contrary, taxes on spending should be cut on the lines we explain below. Increases in the tax base and reduction or withdrawal of tax reliefs and allowances should form no part of a tax-cutting strategy.

Allowances and reliefs

3.14 We oppose the idea of paying for a cut in tax rates by reducing allowances and reliefs. First, it conflicts with our general principle of not increasing tax. Second, while tax rates remain high, allowances and reliefs serve the useful purpose of restoring market relationships over at least a substantial proportion of economic activity.

3.15 Existing allowances and reliefs against income tax and other taxes should be retained, and monetary limits on them should be indexed for inflation. Their value to the taxpayer will fall as tax rates fall. A sustained programme of tax reduction should eventually make most existing allowances and reliefs unnecessary.

3.16 We distinguish sharply between increases in government spending (which we oppose) and reductions in taxation (which we favour). We reject the concept of 'tax expenditures', which seeks to blur this distinction. Reductions in government spending, like reductions in taxation, increase economic freedom and efficiency through a shift of spending power away from the government and into the hands of the public. Tax allowances and reliefs reduce taxation and are for this reason superior to the use of government spending for similar purposes; for example, this is why investment allowances are superior to investment grants. It is also an advantage of tax allowances over cash benefits that it is administratively cheaper for the taxpayer to keep his own money than for tax revenue to be paid out again as government expenditure: tax allowances avoid this double journey.

3.17 In order to diminish the damage done by taxation to the market economy, tax losses and credits should be generally eligible for carry-forward without time limit, and for carry-back up to ten years.

Avoidance and anti-avoidance

3.18 Tax avoidance helps to circumvent fiscal obstacles to economic activity. Anti-avoidance legislation generally does more harm than good, because its purpose is to suppress avoidance irrespective of other consequences including the damage done by taxation through the reduction of economic activity. At high tax rates, avoidance is both more attractive to the avoider and more necessary for the economy. The only real solution to the 'problem' of avoidance is to bring down tax rates in general and high rates of tax in particular.

Enforcement powers of Customs and Excise and Inland Revenue

3.19 The present search powers of the two Departments should be reduced and preferably abolished (except that Customs and Excise powers to search for noxious substances are not within our purview). First, we do not regard tax fraud as a serious crime, even if the sums at stake are large, which they often are not. Second, officials investigating other complex crimes, such as commercial fraud, do not have search powers of their own but work in co-operation with the police; and this is what the Revenue Departments should do. Third, some methods of suppressing crime are more objectionable than the activities they are intended to control; tax fraud is far less offensive than the Revenue Departments' search powers and their use.

3.20 Searches of persons suspected of tax fraud, like searches of other criminal suspects, should be the responsibility of the police. If search powers in financial cases are retained by the Revenue Departments, victims of searches should have all the legal rights as against their inquisitors that they would have as against the police. We regret that the Keith of Kinkel Committee missed the opportunity to propose reforms in this direction. [Report of the Committee on Enforcement Powers of The Revenue Departments (Chairman, The Rt Hon The Lord Keith of Kinkel, PC) Cmnd 8822, March 1983, especially Volume I, 9.23]

Self-employment

3.21 It ought to be an aim of fiscal and other policy to encourage and foster self-employment. This is not only for economic reasons (reduction of unemployment, reduction of strikes), but for political reasons as well: the self-employed are a main bastion of the market economy and against collectivism. The Inland Revenue should stop seeking to classify as employees workers who are treated as self-employed for non-tax purposes; in particular, it should be made a sufficient defence against classification by the Revenue as an employee that the worker is not covered by the Employment Protection Act.

Incentives

3.22 Our attitude to tax reductions, as to self-employment, is as much political as economic. We favour them for their own sake as well as for the economic benefits they may bring.

3.23 Incentive arguments are at their strongest where tax rates are highest (capital transfer tax, capital gains tax, higher rates of income tax). At the top of the scale, it is reasonable to expect a tax cut to pay for itself: the reduction in tax revenue due to the cut in the rate of tax would be more than offset by the consequent increase in taxable economic activity. Any such expectation would be hazardous at the level of the basic rate of income tax or below.

First-year and full-year costs

3.24 An additional advantage is obtainable from reductions in taxes collected in arrears: the incentive and other benefits are obtainable immediately, while the cost accrues to the revenue only after a period which may extend over several years. The argument applies in particular to capital transfer tax and capital gains tax.

Revenue maximization

3.25 The only virtue of the principle of revenue maximization or 'charging what the traffic will bear' is a negative one: if a tax rate is above the level of revenue maximization, it is unequivocally too high. We oppose revenue maximization as an aim of policy (at present applied, in particular, to the taxation of spirits and tobacco). If a private monopolist succeeds in maximizing his monopoly income, the public interest suffers; and the argument holds good equally for the Inland Revenue and Customs and Excise.

Conclusion

3.26 A tax system with low, proportional taxes and only about a tenth of national income taken in tax revenue is both desirable and attainable in the United Kingdom. This goal must be approached in stages, and in what follows we specify our order of priorities. But only a limited range of taxes (notably value added tax and the basic rate of income tax) make a major contribution to government expenditure so that the reduction of these taxes is conditional on the reduction of spending by the government. For a number of other taxes this constraint is of little significance, at least over a period of years. It is therefore possible to advance on a broad front, making major reductions early in the taxes that yield relatively little revenue, or preferably abolishing them outright.

CAPITAL TAXES

3.27 The capital taxes are capital transfer tax, capital gains tax, development land tax, stamp duties. All these taxes should be abolished. They are wrong in principle and damaging to the economy. Their combined yield is only some two per cent of total tax revenue, so that revenue constraints are not a serious obstacle to their abolition. Moreover, the taxes on capital are either themselves levied at very high rates (capital transfer tax, development land tax) or in combination they constitute a heavy burden on investment income and its parent capital (capital transfer tax, capital gains tax, stamp duties): in either case, the 'supply-side' argument that tax revenue will rise rather than fall as taxes are cut is at its strongest when tax rates are high. It is reasonable to expect cuts in capital taxes to pay for themselves in revenue terms, largely or wholly, although there are few other taxes for which this argument holds good. Similarly, any revenue costs of cutting taxes on capital can reasonably be met by selling government assets.

3.28 The capital taxes are damaging because they attack the heart of the market economy, which is the ability of people to take decisions with their own money. A market economy cannot function efficiently without substantial holdings of wealth in private hands. Similarly, reductions in capital taxes are a cost-effective method of invigorating the economy and improving the quality of investment decisions. The taxes on capital should be drastically reduced, and preferably abolished, in the first major tax-cutting Budget.

Capital transfer tax

3.29 The yield of capital transfer tax, at £680 million a year, is only half of one per cent of total tax revenue, even though the rates of tax rise to maximum levels twice as high as in the rest of Europe for bequests in the direct line. In 1908-9, by contrast, when rates of tax were much lower, estate duty contributed nearly a fifth of the total yield of taxes administered by the Inland Revenue. The principal reason for the change is that capital has been continually taxed out of private hands, so that the tax has been levied on a wasting asset. This fiscal destruction of private capital should be halted; and capital should be allowed to accumulate in private hands once again. The transmission of substantial amounts of private capital from one generation to the next is indispensable for an efficient market economy; the fact that this transmission has been difficult or impossible in Britain for tax reasons in recent years is a major reason why the British economy has performed so poorly. The <u>impossibility</u> of transmitting <u>substantial</u> amounts of capital epitomizes the <u>discouragement</u> to capitalism at <u>every</u> level.

3.30 Until such time as capital transfer tax is abolished, the first priority for reform is the abolition of tax on lifetime transfers. This part of capital transfer tax produces a derisory yield (£38 million in 1982-83, or well under a tenth of the total yield) and does the most damage per pound of revenue: if the taxable assets are shares in a private company or are otherwise actively managed, it is economically sensible that they should be transmitted in good order during the owner's lifetime rather than in the crisis caused by his death. In addition, the transmission of assets without tax charge during the taxpayer's life promotes the wider distribution of wealth, and this process of voluntary redistribution is inhibited by the charging of tax on gifts. The second priority is to reduce the schedule of rates, especially at the top, where the present pattern of rates is still deeply hostile to the market economy. More generally, there is no good reason for levying tax on any transfers, whether during the transferor's life or at his death, and we propose that capital transfer tax be abolished in its entirety.

Capital gains tax

3.31 Capital gains tax has always been predominantly a tax on inflation. Now that most inflation from 1982 onwards has been indexed out of tax liability, the tax remains as either (a) a tax on inflationary gains in the first year an asset is held or on pre-1982 inflationary gains (including post-1982 gains on assets acquired before 1982), or (b) a complicated and damaging tax on the small proportion of capital gains that is not inflationary.

3.32 The damage done by capital gains tax would be much reduced by taking out of charge to tax all assets that have been held for more than a stated period such as five years. Virtually every other European country that taxes capital gains has a relieving provision of this kind.

3.33 The radical solution is to abolish capital gains tax, since the yield from non-inflationary gains is very small (less than a halfpenny on the basic rate of income tax). The principal argument against introducing this reform immediately is a disreputable one - the revenue cost of forgoing tax on inflationary gains from assets acquired before 1982. We show in Table 3.1 below how the funds required for the abolition of capital gains tax can be found.

Development land tax

3.34 The Government appear to agree with the Adam Smith Institute that there is no substantial case for taxing development gains; otherwise the yield of development gains tax would be significant instead of amounting (at £75 million a year in 1984-85) to no more than the profit from a single medium-sized development. Development land tax is in practice almost entirely avoidable; but heavy economic costs are incurred in this avoidance. It would be much better to abolish the tax.

Stamp duties

3.35 The yield of stamp duties (at £860 million in 1984-85) is not negligible and they have the attraction for government of being amongst the easiest taxes to collect. They are also less damaging relatively to their yield than the other three taxes on capital. They are nevertheless an obstacle to geographical mobility when levied on real property and to financial mobility when levied on financial assets; they are a large proportion of the cost of moving house and an even larger proportion of the cost of transactions in stocks and shares. They should be abolished as soon as resources permit. Our figures indicate that stamp duties could be included in the general abolition of capital taxes in the first year of major tax cuts.

TAXES ON INCOME

3.36 Our objective is to reduce income tax to about 10 per cent and to reduce corporation tax to the level of income tax. This objective will take longer to realise than the three-year period covered in the present report; but Table 3.1 below indicates that over three-quarters of the cost involved in these tax reductions could be incurred and paid for by 1987-88.

Income tax

3.37 The most expensive item in our tax-cutting programme is the reduction in the basic rate of income tax. This accounts for more than half of the cost of our proposed tax cuts up to 1987-88. Further substantial costs would be incurred in future years through reducing the basic rate from 14 per cent to about 10 per cent. The funds required to meet these costs would be found from the continuation of the privatization programme after 1987-88.

3.38 As long as the basic rate remains at or near present levels, increasing tax thresholds merely shifts the burden from one group of taxpayers to another group in not dissimilar circumstances. As the basic rate is reduced the tax burden imposed by thresholds at or near their present levels is lightened and the case for increasing thresholds is weakened correspondingly.

3.39 We oppose all extensions of the income tax base through reductions in reliefs and allowances. The problem is not that reliefs and allowances are unduly generous but that the basic rate of income tax is too high. If the basic rate is reduced as we recommend, the value of reliefs and allowances is reduced correspondingly, and this is a development which we should welcome.

3.40 Income tax at rates above the basic rate should be abolished. Above the personal allowances, income tax should be charged equiproportionately, like value added tax. The yield of the higher rates of income tax is little more than one penny on the basic rate; the damage done by the higher rates to the economy, or even to the Revenue, could amount to much more than this.

3.41 Workers who forgo or are denied such benefits of employment status as paid holidays, paid sick leave and statutory employment protection should be entitled to be treated as self-employed for purposes of income taxation.

Corporation tax

3.42 We welcome the reduction in the rate of corporation tax from 52 per cent to an eventual 35 per cent. This process of tax reduction should continue.

3.43 The present British corporation tax, like many corporation taxes abroad, still contains three elements of discrimination:-

(a) against the corporation as such;
(b) against distributed profits;
(c) against income from abroad.

3.44 All three types of discrimination are undesirable.

(a) If a corporation ought to pay for the privilege of incorporation, this payment should take the form of a small registration fee of the same amount for all companies; it should not be embodied in the corporation tax.

(b) Discrimination against distributed profits is undesirable because it encourages companies to retain and reinvest profits without any market scrutiny of the reinvestment; this discrimination, which was expelled from the front door by the Finance Act 1972, has returned through the back door because 'fiscal starvation' (lack of profits subject to mainstream corporation tax) has left many manufacturing and other companies paying advance corporation tax as a discriminatory tax on dividends.

(c) Similarly, companies paying dividends out of income earned abroad pay an additional tax on the dividends that would be avoided if the profits were retained.

3.45 All three types of discrimination are unnecessary.

(a) Discrimination against the corporation as such can be avoided by taxing corporations at the basic rate of income tax.

(b) Retained and distributed profits would both be taxed at the same (basic) rate. The argument that retention protects profits from the higher rates of income tax disappears when the higher rates are abolished. Even within the present system, the problem of 'fiscal starvation' can be resolved by a market in corporation tax losses enabling any taxpayer who is able to use a tax credit or relief to buy it from a taxpayer in whose hands it is less valuable or valueless.

(c) A market in corporation tax losses would also resolve the problem of discrimination against income from abroad. Even within the present system, the problem is resolved if foreign tax credit is available for set-off against advance corporation tax.

3.46 In Section 2.2, Assumption (b), we propose that most bilateral aid be phased out and replaced by a new scheme to encourage development by UK investors through tax relief (or, more accurately, to remove the present discouragements to development caused by the UK tax system). First, the pre-1965 system of the 'net UK rate' should be reintroduced: dividends distributed by UK resident companies to UK resident shareholders should enjoy credit for tax paid on the income overseas. Second, the United Kingdom 'per country' limitation on relief for international double taxation should be replaced by the United States system of 'averaging', so that less relief for tax paid overseas would be wasted. In addition, relief for tax 'spared' overseas should be general and not confined to the small number of countries whose double-tax treaties with the UK provide for this relief: if an overseas country cuts its taxes to encourage inward investment, it is right that the benefit of the tax cut should accrue to the UK investor and wrong that it should accrue to the UK Treasury.

3.47 The tax on dividends should remain at the basic rate of income tax and the rate of corporation tax should be reduced towards this level as financial resources permit. We envisage an eventual rate of about 10 per cent.

3.48 The legislation on controlled foreign companies (FA 1984, Chapter VI) is wrong in principle because it seeks to levy UK tax on profits genuinely earned and retained abroad. It is also largely redundant now that corporation tax is being reduced to 35 per cent. It will be entirely redundant when corporation tax is reduced to the level we propose. We look forward to its early repeal.

TAXES ON SPENDING

3.49 We oppose any shift from direct to indirect taxation involving an increase in taxes on spending. Taxes on spending should be reduced, not increased. The shift from direct to indirect taxes should take the form of reducing direct taxes more than indirect, because direct taxes are generally higher. High rates of indirect tax (excise duties) should be reduced proportionately more than low rates (value added tax) as financial resources permit.

Value added tax

3.50 The rate of tax at 15 per cent is too high and should be reduced to 12 per cent in 1985-86 and ultimately to about 10 per cent. (Table 3.1 below).

3.51 We oppose all extensions in the coverage of value added tax, whether through a wider coverage of the standard rate or a narrower coverage of the zero rate. The switch from direct to indirect taxation should take the form of reducing income tax more than value added tax.

3.52 The threshold for compulsory registration, at £18,700, is much too low. It should be raised to £100,000 in 1985-86 and indexed for inflation thereafter. In 1983-84, more than three-quarters of registered persons (1,084,000) had taxable turnover below £100,000; but they accounted for less than 7 per cent of net receipts. The nominal cost of raising the threshold to £100,000 would be £1015 million on the basis of 1983-84 net receipts plus a small amount for repayments to traders below the £100,000 threshold who were permitted to remain on the register at their request. However, this figure of more than £1 billion grossly exaggerates the true revenue cost, for the following reasons.

3.53 First, the cost of administering value added tax is well over 1 per cent of the 1983-84 net receipts figure of £15,220 million, and must be largely concentrated on the 76 per cent of registered persons below a turnover of £100,000. A saving of not less than £100 million on administrative costs should be possible if the threshold were raised to £100,000.

3.54 Second, the compliance cost of value added tax is a heavy one, as is shown by the work of Sandford and Godwin of Bath University. In the bottom quarter of the turnover scale, where there is least scope for automation, we would put compliance costs at a substantial multiple of administrative costs: a multiple of four may well be unduly conservative. On this basis, there would be a gain of not less than £400 million from the reduction of compliance costs, even if less than this £400 million returned to the Exchequer by way of additional tax revenue.

3.55 Third, we would expect more rather than less of this £400 million to return to the Exchequer by way of additional tax revenue when due account is taken of the effects on incentives, The compliance cost of value added tax in the lowest quartile of turnover is a central example of fiscal obstacles to the creation of wealth. The compliance cost is often in practice imposed on the labour of the proprietor or entrepreneur and thus displaces more profitable uses of his time; even if he is able to delegate the task to staff or an outside advisor, the cost of so doing is an additional overhead, like rates, unrelated to profit. It is not surprising that businesses with the opportunity of so doing decide to restrict their turnover to below the value added tax threshold, a decision which illustrates the fiscal discouragement of wealth creation in quintessential form: the value added tax threshold becomes an absolute barrier to expansion. Although a value added tax threshold is an obstacle to expansion at whatever level it is imposed, the obstacle is much more easily surmounted at a higher turnover figure like £100,000 than at the present £18,700.

3.56 Value added tax is a powerful discouragement to people trying to set up in business for the first time. It is a frequent cause of bankruptcy among small firms; in order to escape it, many small painters, decorators, plumbers, car repairers and the like move into the black economy where everything is done for cash. Abolishing value added tax for the great mass of present payers should therefore stimulate small business formation and growth while enticing many more out of the black into the taxpaying economy. It would also spell the end of most of the oppressive VAT raids by Customs and Excise which mar the present system.

3.57 The problem of those low-turnover businesses which volunteer for inclusion in value added tax could be surmounted by getting rid of all VAT payments between registered traders, which would make VAT more like a point of sales tax.

3.58 Obligations on the United Kingdom government under the Treaty of Rome are not a real barrier to raising the VAT exemption limit and should not be allowed to stand in the way of reform.

Excise duties

3.59 Excise duties can be divided into three categories:- (1) duties on oil and petrol, which are justifiable so long as the international oil cartel continues in operation (net receipts were £5,603.1 million in 1983-84); (2) duties on tobacco, which are major revenue raisers (net receipts in 1983-84 were £3,700m); and (3) duties on beer, spirits, and wine, which are minor revenue raisers (net receipts in 1983-84 were £1,678.8m, £1,701.6, and £613.4m respectively).

3.60 The social case for levying excise duties on the second and third categories is unpersuasive: most of the burden falls on the moderate smoker and drinker, while the addict is unlikely to be deterred by the tax. The abolition of these duties should be a long-term aim of government policy, subject to budgetary constraints. The discouragement of immoderate smoking and drinking is not an essential function of government and should in any case be pursued through non-fiscal measures.

3.61 The evidence (including shortfalls below budgetary estimates) suggests that excise duties on spirits and tobacco may have passed the point of maximum revenue yield, at least from time to time in recent years. The large increase in wine sales following the cut in the excise duty in the 1984 Budget illustrates the price sensitivity in this area of consumer demand. The first priority is a commitment to a reduction in the rates of duty to no more than the most honest estimate of maximum revenue yield. This suggests cuts in the duties, first on spirits and then on tobacco. These duties and the duties on wine and beer should then be gradually reduced to zero, so that these goods would be liable only to the same rate of value added tax as other consumer goods.

3.62 We recommend a reduction of 20 per cent in the yield from excise duties on drink over the period to 1987-88 and a reduction of 10 per cent in the yield from excise duties on tobacco.

THE PROGRAMME OF TAX REDUCTION

3.63 Table 3.1 shows the programme of tax reduction over the three-year period 1985-86 to 1987-88. The sources of funds are reductions in government spending and public sector asset sales. These funds are used, first, to abolish the taxes on capital; second, to reduce the taxes on income; third, to reduce the taxes on spending; fourth, to provide additional tax reliefs and rebates. No tax is increased and no relief or allowance is withdrawn. The shift in the tax burden from income to spending takes the form of reducing taxes on spending less than taxes on income (and capital).

3.64 The table shows the cost of the tax reductions in each of the three years. For capital gains tax and development land tax, the full-year cost of abolition in 1985-86 is not incurred until some time after 1987-88. (Notes (1) and (2) refer).

3.65 By the end of the three-year period, income tax has been cut to 14 per cent and corporation tax to 25 per cent. The taxes on capital and the higher rates of income tax have been abolished, as have the minor excise duties. Value added tax has been cut to 12 per cent and excise duties have been cut by one-tenth or one-fifth. The VAT threshold has been increased to £100,000.

3.66 This is not the end of the story. Privatization is a long-term exercise in certain areas (notably health, education, and pensions), and additional economies in government spending will continue to accrue for a generation or more. These funds should be used to reduce both income tax and value added tax to 10 per cent and to effect further reductions in the excise duties on drink and tobacco. Corporation tax should eventually be charged at the same rate as income tax; any additional tax on corporations should take the form of a small fixed annual charge.

3.67 The large reduction that we are proposing in the basic rate of income tax would do much to alleviate the poverty and unemployment traps even if tax thresholds remained unchanged. At a less onerous rate, it is right that income tax should be borne by the large majority of households. The fault of the present system is not the low thresholds but the high basic rate. We are proposing an increase of just over 15 per cent in the main personal allowances for income tax, in addition to statutory indexation; beyond this, all the resources available for reductions in income tax should go to reducing the basic rate.

3.69 We do not recommend that any of the resources available for tax reduction should be used to reduce national insurance contributions under the present system. The defects of the present system should be removed through a process of gradual privatization. This will in itself involve a gradual reduction in the yield from contributions.

CONCLUSION

3.69 Our ultimate aim is a tax system reposing mainly on a low rate of income tax and a low rate of value added tax or other retail sales tax (say 10 per cent for each tax); corporation tax would be charged at the same rate as income tax. Our figures show that this aim is not utopian.

3.70 The case for levying additional taxes on cars and fuel weakens in so far as the international oil cartel loses influence, as nationalized energy producers, the railways, and the provision and maintenance of roads are privatized and as a congestion tax is imposed on the users of busy roads. Similarly, the privatization of the British Broadcasting Corporation (at least as concerns its activities for listeners and viewers in the United Kingdom) would remove the need for broadcast receiving licences. Betting and gaming should not be taxed at more than the standard rate of value added tax. Present incomings from interest and dividends would be more than offset on privatization by reductions in interest on the national debt.

3.71 When the basic rate of income tax and the standard rate of value added tax have both been reduced to about 10 per cent, it might be useful to consider whether the base of value added tax should be extended in the interest of cutting income tax further. We oppose any extension of the value added tax base (or the income tax base) so long as taxes remain at anywhere near their present levels.

Table 3.1
The programme of tax reduction

	£ million at 1984 prices		
	1985-86	1986-87	1987-88
1985-86			
Abolish capital transfer tax	270	680	680
Abolish capital gains tax	-	464	870
Abolish development land tax	7	47	65
Abolish stamp duties	840	860	860
Abolish higher rates of income tax	675	1,350	1,350
Income tax basic rate to 22%	8,400	9,000	9,000
Income tax thresholds increased by 10%	1,600	1,995	1,995
Corporation tax to 30% (announce)	-	700	1,200
Value added tax rate to 12%	1,875	2,520	2,520
VAT threshold to £50,000	200	300	300
Abolish minor excise duties	20	20	20
Reduce excise duties on drinks	360	400	400
Reduce excise duties on tobacco	180	200	200
	14,427	18,536	19,460
Tax relief on overseas investment	-	55	100
Tax relief on donations to the arts	50	100	100
Tax rebate (£300) for those opting out of State schooling	259	368	477
Tax rebate for those insuring their health privately	300	400	500
	15,036	19,459	20,637
1986-87			
Income tax basic rate to 16%		6,300	6,750
VAT threshold to £100,000		205	310
Reduce excise duties on drinks		360	400
Reduce excise duties on tobacco		180	200
		26,504	28,297
1987-88			
Income tax basic rate to 14%			2,100
Income tax thresholds increased by 5%			880
Corporation tax to 25% (announce)			-
			31,277

Table 3.1 continued

	£ million at 1984 prices		
	1985-86	1986-87	1987-88
Safety margin/reduce PSBR	4,740	3,985	4,854
	19,766	30,489	36,131
Reductions in government spending	13,501	22,074	27,521
Public sector asset sales	4,775	8,415	8,610
Fiscal adjustment	1,500	-	-
	19,766	30,489	36,131

Notes:

(1) Most of the yield of capital gains tax is collected in the three years following the year of disposal, about 5 per cent in the three years thereafter. (Inland Revenue Statistics 1984, Table 5.1). The full-year cost of abolition is about £1,160 million.

(2) The full-year cost of abolishing development land tax is £75 million. The amounts in the first three years follow the pattern in Inland Revenue Statistics 1984, Table 6.1.

(3) The increase of 10 per cent in income tax thresholds in 1985-86 is based on the thresholds in 1984-85 and the figures in the Autumn Statement 1984. The increase in 1987-88 is thus based on 110% of the 1984-85 figures.

(4) The cuts in corporation tax would be announced in advance. The first (to 30% per cent) would be announced in 1985, the first-year cost would come in 1986-87 and the full-year cost in 1987-88.

(5) Net receipts from registered persons with a taxable turnover between £17,600 and £50,000 were £460 million in the year ended 31 March 1984. We have adjusted this figure to £300 million in a full year to take account of the reduction in administrative and compliance costs. Net receipts from the range of turnovers between £50,000 and £100,000 were £465 million, which we have similarly adjusted to £310 million (Customs and Excise Report for the year ended 31 March 1984, Tables 15,16).

(6) If the safety margin is used to reduce the public sector

borrowing requirement, it provides for a non-cumulative reduction of some £4.5 billion a year over the three-year period.

(7) The cost of abolishing the taxes on capital is more than covered in the three years 1985-86 to 1987-88 by receipts on capital account from the sale of public sector assets. Funds from this source will eventually be exhausted; the gap will be filled by additional economies in public spending as privatization is extended year by year.

(8) The table excludes the net cost of the inflation adjustment on conventional assumptions (namely that statutory indexation of tax thresholds and bands will be implemented and that excise duties will be revalorised by the retail prices index). The cost of indexation at present exceeds the gain from revalorisation by some £300 million a year. This net cost is also excluded from the fiscal adjustment, which is calculated (as is our table) after adjustment for inflation. The excise duties on drinks and tobacco would be revalorised before being cut, so that the net cut in current prices would be less than that shown in the table at constant prices. The cut of 10 per cent in 1985-86 in the yield of excise duties on drinks and tobacco would cover two years inflation at 5 per cent; in practice, it would be simpler for the reduction in these excise duties to take the form of discontinuing the practice of revalorisation. The duties would no longer be raised each year and in real terms (or constant prices) they would fall as long as inflation persisted. When inflation has fallen to zero or thereabouts, reduction in the burden of excise duties must take the form of cuts in the rates of duty.

(9) The table gives the same figure for the fiscal adjustment (scope for tax cuts in 1985-86) as was given in the Autumn Statement.

(10) The increase in the Government's spending total from £128 billion in 1984-85 to £132 billion in 1985-86 is irrelevant for present purposes since most of the increase is due to inflation. Real increases are covered by our proposed move from the Government's figures for 1984-85 to ours for 1985-86.

(11) Except for the increase in the value added tax threshold, the figures make no allowance for 'supply side' or 'second round' effects (the increase in economic activity and thus in the tax base consequent on the reduction in tax rates and the improvement in incentives). We believe that these effects would be substantial; they represent a large (though unquantifiable) safety margin.