PREM19

23

ECONOMIC POLICY

(Public Spending)

(Part 6)

PREM 19/23

PART 6 ends:-

CAW ~~to~~ RTA 19. 11. 79

PART 7 begins:-

Ch. Sec HMT to S/S DHSS 22.11.79

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(79) 18th Conclusions, Minutes 4,5,6,7 * Limited Circulation Annex	25/10/79
E(79) 61	26/10/79
E(79) 14th Meeting, Minute 1	30/10/79
C(79) 56	30/10/79
CC(79) 19th Conclusions, Minute 5	01/11/79
C(79) 54	06/11/79
CC(79) 20th Conclusions, Minutes 4 & 5	08/11/79

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed D Wayland Date 24 October 2009

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Cmnd. 7746: White Paper - The Government's Expenditure Plans 1980-81
Published by HMSO, November 1979

Signed O Wayland Date 24 October 2009

PREM Records Team

ds

SECRET 7

SIR ROBERT ARMSTRONG
CABINET OFFICE

Public Expenditure

The Prime Minister has seen your minute A0689 of 16 November 1979 to me and agrees with your proposals for arranging for a further review of public expenditure both in 1980/81 and in the later years.

C.A. WHITMORE

19 November 1979

SECRET

Eon 251

Nationalised Industries

Mr. Kenneth Lewis asked the Chancellor of the Exchequer what limits have been set on the external financing of the nationalised industries for the financial year 1980-81.

Mr. Biffen: The limits are as follows:

Nationalised Industries' External Financing Limits 1980-81[1]

	£ million
National Coal Board	834
Electricity Council and Boards	187
North of Scotland Hydroelectric Board	59
South of Scotland Electricity Board	73
British Gas Corporation	−400
British National Oil Corporation	101
British Steel Corporation	450
Post Office	65[2]
British Airways Board	230
British Airports Authority	20
British Railways Board	750
British Transport Docks Board	−10
British Waterways Board	30
National Freight Corporation	24
National Bus Company	85
Scottish Transport Group	9
British Shipbuilders	120

Notes:

(1) No figure is included for British Aerospace in view of the prospect of selling shares in a successor company in 1980/81. In the case of British Airways and the National Freight Corporation, limits have been set in view of the uncertainty about the timing of the proposed sales. As in the past, the forecast shown for BNOC does not represent a limit.

(2) The limit for the Post Office is set before taking account of the expected inflow of funds in 1980-81, resulting from delayed billing following the recent industrial action by computer operators, and will be adjusted when the inflow is known accurately.

House of Commons
Written Answer
16 November 1979

WALES

Rate Support Grant

Mr. Hooson asked the Secretary of State for Wales what is the future of the rate support grant in Wales.

Mr. Nicholas Edwards: I would refer my hon. Friend to the statement made today by my right hon. Friend the Secretary of State for the Environment about our proposals for changing the rate support grant system. I shall be responsible for the operation of the revised system in Wales. This is a major addition to the function of the Welsh Office, which does not at present have responsibility for the rate support grant. It will represent an improvement in the machinery of Government in Wales. I will be consulting the Welsh Counties committee and the Council for the Principality on the implementation of the details of these proposals in due course.

House of Commons
Written Answer
16 November 1979

ENVIRONMENT

Rate Support Grant

Mr. William Shelton asked the Secretary of State for the Environment whether he will make a statement on the rate support grant settlement for 1980-81 and on changes in grant arrangements, especially with reference to dealing with overspending authorities.

Mr. Heseltine: Yes. A copy of the statement I made today at the Consultative Council on Local Government Finance has been placed in the Library.

1980-81 RSG Settlement

Briefly my proposals are that the aggregate Exchequer grant should be at a rate of 61 per cent. on relevant expenditure of £5,737 million (at November 1979 prices). The total of relevant expenditure is based on the White Paper: The Government's Expenditure Plans 1980-81: Cmnd. 7746. The planned level of local authority current expenditure in 1980-81 shows a reduction of about two-and-a-half per cent. below what authorities actually spent in 1978-79.

The additional grant that may be payable under any increase orders relating to 1980-81 will be subject to cash limits. The cash limit on rate support grant will be £1,380 million; on transport supplementary grant £46 million; and on national parks supplementary grant £0·7 million.

1978-79 Second Increase Order

The cash limits for 1978-79 have been revised to take account of the 1978 manual workers' settlement and of changes in the variable items. The cash limit on RSG now stands at £31 million; and on TSG at £0·8 million. Grant will be paid within the cash limits.

1979-80 First Increase Order

The cash limits for 1979-80 were initially set at the time of last year's settlement. The Chancellor of the Exchequer said in his Budget Statement that the Government would take account of pay settlements in calculating the 1979-80 increase orders but would make an across the board reduction of not less than £300 million from the total thus calculated. The Government have decided that a further abatement of £20 million shall be made. Of this £10 million will be added to the £300 million already announced.

The total abatement for RSG purposes will therefore be £310 million. The remaining £10 million will be found through a reduction in other local authority programmes for which I am responsible. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute, and the need to secure the improvements in efficiency and productivity identified in the Clegg report.

The cash limits have also been adjusted for the variable items and now stand as follows:

Rate support grant ...	£493 million
Transport supplementary grant	£ 30 million
National parks supplementary grant	£0·8 million

Grant will be paid accordingly.

1979-80 Second Increase Order

For 1979-80, further adjustments to cash limits will be required to take account of payments falling to be met in 1979-80 in respect of pay settlements and comparability awards yet to be made. However, the Government consider that a limit must be set to the amount of grant payable in respect of 1979-80. I propose, therefore, that the cash limit will be £150 million. (Rate support Grant £148 million, Transport supplementary grant £2 million.) This Order will be made in November 1980.

The amount of National parks supplementary grant will not be further increased.

RSG Distribution

The arrangements used to distribute the grant in recent years have proved neither equitable nor sensible. But in the time available it has not been possible to develop any alternative. I have therefore had to make use of the existing arrangements for 1980-81. However, no new formula is to be used to distribute the grant next year; instead the 1979-80 formula is to be re-applied, using up-dated data for the various factors in the formula. There will be a "safety net" to limit losses in non-London authorities' needs element entitlements—except those resulting from corrections of data errors—to the equivalent of a 1p rate poundage; only four authorities qualify for this. London's overall grant loss will also be constrained to the equivalent of a 1p rate by the London clawback mechanism; further losses to individual London authorities arising from the within-London redistribution will be limited to 2p.

The within-London arrangements are also on a standstill basis, with the 1979-80 formula re-applied to updated data. The national standard rateable value for the distribution of resources element will be £178. Domestic rate relief will be maintained at 1979-80 levels of 18½p in £ in England and 36p in £ in Wales.

Taken together, these measures achieve a welcome degree of stability in the grant distribution while at the same time halting at long last the drift of grant from the non-metropolitan counties that has taken place since 1974-75.

New Grand Arrangements

So far as overspending is concerned, while a majority of local authorities have shown a willingness to keep in step with the Government's guidelines on public expenditure, a minority of authorities persist in maintaining levels of expenditure which the present economic circumstances simply do not justify. It is, however, clearly wrong that the Government's contribution through the rate support grant to local authority expenditure can take no account of whether that expenditure is reasonable or not. That is now the case.

Such is the perversity of the present resources element arrangements that high spending authorities get the same level of support on all additions to expenditure,

at this expense of other authorities. This unacceptable.

I therefore intend to include provisions in the forthcoming Local Government, Planning and Land Bill to replace the needs and resources elements of the existing grant arrangements with a single block grant, payable to all authorities and calculated as the difference between an authority's expenditure and the product of a standard rate poundage, applicable to all authorities of the same type, levied on the authority's total rateable value. Different standard rate poundages will be prescribed for different levels of spending in relation to "standard expenditure".

The schedule of standard rate poundages will be set in such a way that each increment of expenditure beyond a threshold level—to allow for the inevitable variations in local circumstances—above an authority's standard expenditure will attract progressively less grant. Authorities will still be free to determine how much they wish to spend, and how much they wish to raise by rates, but the Government will be able to limit the level of grant support for expenditure above the threshold.

It will continue to be necessary to deal with certain problems—such as the exceptionally high rateable resources and high rate bills of London—by special arrangements, as is done under the present rate support grant system. In addition it will be necessary to ensure that the transition to the new grant is as smooth as possible. To deal with these problems my proposals will provide for multipliers to adjust the standard rate poundages and hence to adjust entitlements to grant. The multipliers will be determined in accordance with general principles applicable to a class or classes of authority and set out in a report to Parliament.

My right hon. Friend the Secretary of State for Wales will be making a separate announcement about the position of Wales under the new scheme.

The Government intend that the new grant system should come into operation in 1981-82. As an interim measure the Bill will provide that authorities' 1980-81 grant entitlements under the existing rate support grant legislation can be adjusted at Increase Order stage next year. Grant entitlements will be abated where budgeted expenditure significantly exceeds assessed need.

We shall consult the local authority associations fully on the mechanics and implementation of the new grant system and on the development of the method of assessment of standard expenditure.

There will be a full opportunity for the House to debate the Settlement. I shall be laying the appropriate Orders for approval within the next few days. The proposals for legislation will be introduced in due course.

Mr. Scott asked the Secretary of State for the Environment what assumptions have been made about rent increases for 1980-81 in the context of the rate support grant settlement.

Mr. **Heseltine**: The total of accepted relevant expenditure contains a forecast of rate fund contributions to local authority housing revenue accounts and other housing expenditure falling directly on the rate fund. The forecast assumes, among other things, that a guideline average rent increase of £1·50 a week will be applied by those authorities statutorily able to do so. It also takes account of the fact that the existing housing subsidy arrangements will continue without major changes throughout 1980-81.

Mr. Ginsburg asked the Secretary of State for the Environment if he will ensure that those authorities like Kirklees, which could be adversely affected by changes in the rate support grant distribution formula, will have the benefit as in the past of damping and safety net arrangements.

Mr. Woolmer asked the Secretary of State for the Environment whether those authorities like Kirklees, which could be adversely affected by changes in the rate support grant distribution formula, will have the benefit as in the past of damping and safety net arrangements.

Mr. Gwilym Roberts asked the Secretary of State for the Environment (1) if he will now make a statement on the rate support grant for 1980-81;

(2) what plans he has for changing the methods of calculating the rate support grant to make allowance for population transfer between counties and the consequent pressure on local authority services;

(3) what plans he has to change the methods of calculating the rate support grant to encourage the provision of adequate minimum standards of services in line with the recommendations of the Green Paper Cmnd. 6813; and if he will make a statement.

Mr. **King**: I refer the hon. Members to the statement made today by my right hon. Friend, in answer to my hon. Friend, the Member for Lambeth, Streatham (Mr. Shelton).

House of Commons
Written Answer
16th November 1979

1.

6

Prime Minister.

I know that you think that we should look again at public expenditure in 1980/81 and later. Are you content to proceed in the way suggested by the Chancellor?

Yes MT 16/11

SECRET

Ref. A0689

MR. WHITMORE

I understand that, following yesterday's discussion in Cabinet, the Chancellor of the Exchequer has it in mind to bring forward proposals to his colleagues which will involve a limited reopening of public expenditure in 1980-81, a more major reopening of the figures for later years, with a review to be carried out during the next two or three months, and a postponement until about the time of the Budget of the publication of figures for the later years.

2. You will remember that we have been discussing arrangements for a Cabinet discussion of economic strategy in the New Year, and that part of that plan included the setting up of a small group which would have a first discussion of the subject before it went to the whole Cabinet. The Chancellor has it in mind that he should discuss his latest proposals on public expenditure in that small group, as a prelude to bringing them to Cabinet.

3. We ought not to put off the start of this process too long, if we are going to proceed as the Chancellor suggests, because the various reviews which he wants to undertake will inevitably take some time, and it will be important to have the results available well before the Budget. If the Prime Minister agrees, therefore, I should like to suggest to the Chancellor that he should circulate his paper for the small group towards the end of next week, in time for a meeting early in the week beginning 26th November. The proposals could then come to the whole Cabinet during the following week - the week beginning 3rd December.

Agreed

4. We have not actually yet set up the small group; so that, if the Prime Minister is content with these proposals, I shall need to make further proposals to her early next week as to the composition and terms of reference of this new small group.

Agreed

RCA

(Robert Armstrong)

16th November, 1979

File

BF 19/11/79

10 DOWNING STREET

From the Private Secretary

16 November 1979

RATE SUPPORT GRANT

This is to confirm that, subject to the views of other Ministers concerned, the Prime Minister is content with the draft Written Answer which you sent with your letter of 15 November.

I am sending copies of this letter to Stephen Locke, (Financial Secretary's Office), Peter Shaw (Department of Education and Science) and George Craig (Welsh Office).

T. P. LANKESTER

D. A. Edmonds, Esq.,
Department of the Environment.

CONFIDENTIAL

DSG

10 DOWNING STREET

From the Private Secretary

16 November 1979

Dear Roger.

NATIONALISED INDUSTRIES' EXTERNAL FINANCING LIMITS

This is to confirm that the Prime Minister is content with the draft Written Answer which you circulated with your letter of 15 November. She has, however, commented that the figures may have to be revised in a downward direction at a later stage.

I am sending copies of this letter to Bill Burroughs (Department of Energy), Ian Fair (Department of Employment), Ian Ellison (Department of Industry), Stuart Hampson (Department of Trade), David Edmonds (Department of the Environment), Godfrey Robson (Scottish Office), Genie Flanagan (Department of Transport), Richard Prescott (Paymaster General's Office) and to the Press Office here at No. 10.

Yours ever,

Tim Lankester.

R. J. T. Watts, Esq.,
H. M. Treasury.

CONFIDENTIAL

1

PRIME MINISTER
To glance
MS
15/XI

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

I didn't know Scotland had quite such ~~expenditure~~ referendum [illegible] 68% on current 61%

Tim Lankester Esq
Private Secretary
No 10 Downing Street
LONDON SW1

15 November 1979

Dear Tim,

My Secretary of State is meeting the Convention of Scottish Local Authorities at 2 pm this Friday, 16 November, to announce our rate support grant settlement. He will be announcing at the same time the detailed implications for Scottish programmes of the public expenditure decisions that have been taken for 1980-81.

He intends to inform the House of the substance of his announcements by means of arranged Questions and Answers on Monday (he cannot, unlike DOE, lay the Answers on Friday because the meeting with COSLA does not take place until Friday afternoon).

I attach copies of the proposed Questions and Answers. My only caveat is that, at the time of writing, I have still not seen DOE's proposed Question and Answer on the same subject: we may conceivably, for consistency, want to amend our texts in the light of these.

I am sending a copy of this letter to David Edmonds at DOE.

Yours sincerely,

Godfrey Robson

GODFREY ROBSON
Private Secretary

MONDAY 19 NOVEMBER 1979 WRITTEN

HOUSE OF COMMONS

To ask the Secretary of State for Scotland if he will provide details of public expenditure within his responsibility equivalent to the figures in Table 2 of the White Paper "The Government's Expenditure Plans 1980-81" (Cmnd 7746).

MR GEORGE YOUNGER:

The information requested is given in the following table. The figures for the years preceding 1980-81 reflect the latest information on outturn.

EXPENDITURE IN SCOTLAND WITHIN THE SECRETARY OF STATE'S RESPONSIBILITY

£million at 1979 survey figures

	1974-75 Outturn	1975-76 Outturn	1976-77 Outturn	1977-78 Outturn	1978-79 Provisional Outturn	1979-80 Expected Outturn	1980-8 Plans
Agriculture Fisheries Food and Forestry	181	118	134	105	95	122	112
Trade Industry Energy and Employment	63	37	111	87	96	112	113
Roads and Transport	304	320	299	307	325	313	308
Housing	752	742	710	671	652	697	627
Other Environmental Services	399	459	387	354	389	396	384
Law Order and Protective Services	198	212	210	199	210	217	221
Education and Libraries Science and Arts	933	979	964	936	941	945	904
Health and Personal Social Services	946	976	990	1000	1038	1041	1069
Other Public Services	32	42	42	42	41	44	46
Common Services	1	1	1	1	-	1	1
TOTAL	3809	3886	3848	3702	3787	3888	3785

SCOTTISH OFFICE

BACKGROUND NOTE

Since the Scottish figures underlying the totals in Cmnd 7746 were provided, some small further adjustments have beeen made to outturn etc. figures, particularly for 1978-79 and 1979-80. To that extent the figures in the Table are not exactly compatible with those underlying Table 2 in Cmnd 7746 but the second sentence of the reply should cover this point without undue emphasis. (The changes in genral marginally improve the position of 1980-81 relative to previous years). There have been no changes, however, in the figures for the key year, 1980-81.

FOR WRITTEN ANSWER
ON
MONDAY 19 NOVEMBER 1979

HOUSE OF COMMONS

: To ask the Secretary of State for Scotland, if he will make a statement about Rate Support Grant in Scotland in 1980-81.

MR GEORGE YOUNGER

As I have intimated to the Convention of Scottish Local Authorities, I intend that the Rate Support Grant for Scottish local authorities in 1980-81 should be derived from total relevant expenditure of £2009.9 million, and that the grant percentage should continue to be 68½ per cent. I have determined relevant expenditure at a level 2 per cent below that for 1979-80 because of the over-riding need to curtail public expenditure in the national interest. The aggregate grant I propose is £1362.8 million, of which Rate Support Grant forms £1247.9 million. I also intend to make provision for additional grant in respect of increased costs of £5.8 million for 1978-79 and £80 million for 1979-80 (with the possibility of a second Increase Order in 1980 of up to £19 million for 1979-80). I also intend that the cash limit for additional grant for cost increases during 1980-81 should be £194 million. This will be a firm cash limit which will not be subject to review. The main object of the formula for the distribution of grant will be to retain the arrangements made for 1979-80, as the Convention have recommended. Within this general objective, however, I propose to reduce the ratio of resources element to needs element from 1:4 to 1:7 so that authorities striking comparatively high rate poundages will thereby secure less additional resources than under the 1979-80 formula. I shall lay the necessary Order for the approval of the House as soon as possible, together with the report required by statute.

68½.

Scottish Office

CONFIDENTIAL

Prime Minister

1

This seems alright (and follows the decisions taken in Cabinet).

Agree?

Treasury Chambers, Parliament Street, SW1P 3AG

T P Lankester Esq
No 10 Downing Street
London SW1

15 November 1979

R
15/11

Yes OK!

Dear Tim

They may have to be revised later - downwards

NATIONALIZED INDUSTRIES' EXTERNAL FINANCING LIMITS

At its meeting on 1 November Cabinet agreed that the Chancellor should arrange for the approved limits on nationalised industries external financing to be published on or about the date of the Government's announcement about the Rate Support Grant.

The Chief Secretary proposes to announce the figures in reply to an inspired PQ tabled for answer tomorrow. I attach the text of the written answer which the Chief Secretary proposes to give. This will also be issued as a Treasury press notice. The answer has been cleared with officials of the departments concerned.

There may well be press interest in the NCB limit in view of recent developments in the miners pay negotiations.

I am copying this letter to Bill Burroughs (Energy), Ian Fair (Employment), Andrew Duguid (Industry), Stuart Hampson (Trade), David Edmonds (Environment), Godfrey Robson (Scottish Office), Genie Flanagan (Transport), Richard Prescott (Paymaster-General's Office) and the Chief Press Secretary at No 10.

Yours ever

Roger Watts

R J T WATTS

CONFIDENTIAL

DRAFT WRITTEN PQ FOR ANSWER ON 16 NOVEMBER

To ask the Chief Secretary to the Treasury what limits have been set on the external financing of the nationalised industries for the financial year 1980/81?

DRAFT ANSWER

The limits are as follows:

Nationalised Industries' External Financing Limits 1980-81(1)

National Coal Board	834
Electricity Council and Boards	187
North of Scotland Hydroelectric Board	59
South of Scotland Electricity Board	73
British Gas Corporation	- 400
British National Oil Corporation	101
British Steel Corporation	450
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British Airways Board	230
British Airports Authority	20
British Railways Board	750
British Transport Docks Board	- 10
British Waterways Board	30
National Freight Corporation	24
National Bus Company	85
Scottish Transport Group	9
British Shipbuilders	120

Notes:

(1) No figure is included for British Aerospace in view of the prospect of selling shares in a successor company in 1980/81. In the case of British Airways and the National Freight Corporation limits have been set in view of the uncertainty about the timing of the proposed sales. As in the past, the forecast shown for BNOC does not represent a limit.

(2) The limit for the Post Office is set before taking account of the expected inflow of funds in 1980/81, resulting from delayed billing following the recent industrial action by computer operators, and will be adjusted when the inflow is known accurately.

Notes for Editors

The limits for nationalised industries do not apply to a block of expenditure but to their external financing which is the difference between the very much larger flows of revenue and expenditure, both current and capital. It has therefore been agreed, in response to a suggestion by nationalised industries chairmen, to recognise this difference and the special character of the nationalised industries' limits by describing them as "external financing limits" rather than "cash limits".

2. The limits cover all of an industry's financing from external sources ie, its capital requirements apart from financing from internally generated resources.

3. The cash limits white paper (Cmnd 7515) described how the limits would be applied. It said (paragraph 17): "Such limits cannot be immutable because the revenues and expenditures of the industries, like those of private sector companies, depend on trading conditions. But there is no presumption that any prospective increase in financing requirements will be met by a further injection of external finance, as opposed to other action which the industry can take to offset the increase." This remains the position.

4. The limits have in the past been set at Budget time and published in the FSBR. This year the Government has decided to set them earlier so that they will be taken into account in wage bargaining.

SUPPLEMENTARY BRIEFING

Are these the nationalised industries' cash limits?

These limits are set, as in the past, on each industry's total external financing requirements, that is its borrowing from all sources and its grants which, together with internally generated resources finance its capital requirements. It has however been agreed, in response to a suggestion by the Chairmen of the industries, that it would be appropriate to recognise the special nature of the limits set for the nationalised industries by describing them as "external financing limits". The change of name recognises the fact, which was already set out in the Cash Limits white paper, that the limits, which represent the differences between the very much larger flows of revenue and expenditure of these major trading organisations, are of a different character from cash limits on the public services which are mainly on spending and that, if a need for extra finance arises for reasons which are genuinely outside an industry's control and if other offsetting action is ruled out, changes in the limits may have to be made. However there is no presumption that extra finance will be provided.

Why have the cash limits been set earlier than usual?

The Government is concerned that cash limits should be taken into account in wage negotiations and it is therefore setting limits in advance of major pay negotiations, rather than waiting until settlements have been made and then accommodating them in cash limits, as has sometimes happened in the past.

Government interfering in wage bargaining?

This does not mean that the Government is getting involved in wage bargaining. It is for the industries to conduct their own wage negotiations but they should know in advance where they stand financially, so that they can weigh the various claims on their financial resources.

Reconciliation with White Paper?

[The recently published white paper on public expenditure in 1980-81 contained figures for borrowing by the nationalised industries in 1980-81 amounting to £750 million]. The white paper figures are at survey prices and exclude grants. They cannot therefore be directly compared with the cash limit figures.

What are the pay and price assumptions?

These limits relate to financing , not expenditure. As such they depend on a multitude of elements affecting revenues and costs which vary widely between industries. Overall the assumptions are broadly compatible with those used for the RSG.

Are 17½% pay increases allowed?

The government is looking for a reduction in real unit labour costs wherever possible in the nationalised industries in 1980-81. This means that, assuming constant output, an industry's paybill should rise in 1980-81 by less than the RPI. The paybill depends on increases in productivity as well as increases in pay. [If pressed: The budget forecast put the RPI increase to 1980(Q3) at 13½-14%].

What if the industries face higher costs?

In general, if they incur higher costs, they will have to take action to keep within their limits. However the industries are trading organisations. They can face developments outside their control which affect their prospects - eg an unexpectedly mild winter may reduce the revenues of an energy industry and thus increase its requirement for external finance. [For this reason it has always been accepted that their limits are not as immutable as cash limits in the public service.

Questions on individual industries should be referred to the sponsoring departments concerned.

[Departments will wish to avoid being drawn on the specific assumptions made, eg about miners' pay. The limits do not purport to lay down exactly what should happen on costs, prices, output and investment.]

What do these figures imply about the nationalised industries pricing in 1980/81?

Price increases will be inevitable, in order to offset the impact on the industries' financial performance of increases in their costs and to avoid a sharp deterioration in their internal resources. The size of the price increases will be decided in the light of the increases in costs and announced in the usual way during the year by the industries.

[If asked how these increases square with the statement made in briefing on the white paper that the total effect on the RPI of the changes in public expenditure plans for 1980-81 might be rather under 1 per cent. The bulk of the price increases which are likely to be necessary for nationalised industries does not result from changes of plans but from the need to keep up with rising costs.]

Which takes precedence, the external financing limit or the financial target?

Where financial targets have been set or are under discussion, the limits have been established in that context.

What does the Cash Limit mean for Miners' Wages?

There are various combinations of assumptions about pay and coal prices which would be compatible with the Cash Limit. It is up to the NCB to keep within it.

JE

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

D A Edmonds Esq
Private Secretary to the
Secretary of State for Environment
2 Marsham Street
LONDON SW1P 3EB

15 November 1979

Thank you for sending me a copy of your letter of to-day to Tim Lankester about Mr Heseltine's Answer in the House tomorrow.

Our Secretary of State has the following comments.

Paragraph 2

Insert after "Cmnd 7746" the following words "which set out the Government's view of national priorities between and within local authority services."

Paragraph 3

Insert after "£1380m" the following phrase "including an allowance for the effects of comparability awards which will fall to be paid next year".

Paragraph 5

Mr Carlisle much prefers the presentation of the £20m suggested by Sir Kenneth Berrill in Spence's letter of yesterday to you.

Paragraph 11

Delete the words "so far as overspending is concerned" at the beginning of the first sentence and insert "in receipt of resources grant" after "authorities" in the penultimate sentence.

Paragraph 16

Insert "including the transitional arrangements for 1980-81" after "new grant system".

I am sending copies of this letter to Tim Lankester, Stephen Locke and George Craig.

P A SHAW
Private Secretary

8

Prime Minister

This is inelegant - like the draft statement which we saw last night. But I suggest we let it go (subject to Treasury comments). Agree?

attached MS

TL 15/11

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

15 November 1979

add DoE DBD 16/11

Dear Tim

RATE SUPPORT GRANT

I attach a copy of the written answer which my Secretary of State proposes to give to the House tomorrow with details of the rate support grant settlement. It reflects closely the terms of the statement.

Because of the need to run off vast numbers of copies, I should be grateful for very early comments from you and from those to whom this is copied - Stephen Locke, Financial Secretary's Office, Peter Shaw, Education, and George Craig, Wales.

I will circulate revised copies of the statement later today.

Yours ever

David

D A EDMONDS
PS/Secretary of State

Tim Lankester
Private Secretary to the Prime Minister

HOUSE OF COMMONS

Mr William Shelton (Con - Lambeth, Streatham)

To ask the Secretary of State for the Environment whether he will make a statement on the Rate Support Grant settlement for 1980-81; and on changes in grant arrangements, especially with reference to dealing with overspending authorities.

Mr Michael Heseltine

Yes. A copy of the statement I made today at the Consultative Council on Local Government Finance has been placed in the Library.

1980-81 RSG SETTLEMENT

Briefly my proposals are that the Aggregate Exchequer Grant should be at a rate of 61% on relevant expenditure of £ million (at November 1979 prices). The total of relevant expenditure is based on the White Paper: The Government's Expenditure Plans 1980-81: Cmnd 7746. The planned level of local authority current expenditure in 1980-81 shows a reduction of about two and a half per cent below what authorities actually spent in 1978-79.

The additional grant that may be payable under any Increase Orders relating to 1980-81 will be subject to cash limits. The cash limit on Rate Support Grant will be £1380 million; on Transport Supplementary Grant £46 million; and on National Parks Supplementary Grant £0.7 million.

1978-79 SECOND INCREASE ORDER

The cash limits for 1978-79 have been revised to take account of the 1978 manual workers' settlement and of changes in the variable items. The cash limit on RSG now stands at £31 million; and on TSG at £0.8million Grant will be paid within the cash limits.

1979-80 FIRST INCREASE ORDER

The cash limits for 1979-80 were initially set at the time of last year's settlement. The Chancellor of the Exchequer said in his Budget Statement that the Government would take account of pay settlements in

calculating the 1979-80 Increase Orders but would make an across the board reduction of not less than £300 million from the total thus calculated. The Government has decided that a further abatement of £20 million shall be made. Of this, £10 million will be added to the £300 million already announced. The total abatement for RSG purposes will therefore be £310 million. The remaining £10 million will be found through a reduction in other local authority programmes for which I am responsible. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute.

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The amount of National Parks Supplementary Grant will not be further increased.

RSG DISTRIBUTION

The arrangements used to distribute the grant in recent years have proved neither equitable nor sensible. But in the time available it has not been possible to develop any alternative. I have therefore had to make use of the existing arrangements for 1980/81. However, no new formula is to be used to distribute the grant next year; instead the 1979/80 formula is to be re-applied, using up-dated data for the various factors in the formula. There will be a "safety net" to limit losses in non-London authorities' needs element entitlements to the equivalent

of a 1p rate poundage; only four authorities qualify for this. London's overall grant loss will also be constrained to the equivalent of a 1p rate by the London clawback mechanism; further losses to individual London authorities arising from the within-London redistribution will be limited to 2p. The within-London arrangements are also on a standstill basis, with the 1979-80 formula re-applied to updated data. The National Standard Rateable value for the distribution of resources element will be £178. Doestic rate relief will be maintained at 1979/80 levels of 18½p in £ in England and 36p in £ in Wales.

Taken together, these measures achieve a welcome degree of stability in the grant distribution while at the same time halting at long last the drift of grant from the non-metropolitan counties that has taken place since 1974/75.

NEW GRANT ARRANGEMENTS

So far as overspending is concerned, while a majority of local authorities have shown a willingness to keep in step with the Government's guidelines on public expenditure, a minority of authorities persist in maintaining levels of expenditure which the present economic circumstances simply do not justify. It is, however, clearly wrong that the Government's contribution through the rate support grant to local authority expenditure can take no account of whether that expenditure is reasonable or not. That is now the case. Such is the perversity of the present resources element arrangements that high spending authorities get the same level of support on all additions to expenditure, at the expense of other authorities. This is unacceptable.

I therefore intend to include provisions in the forthcoming Local Government, Planning and Land Bill to replace the needs and resources elements of the existing grant arrangements with a single block grant, payable to all authorities and calculated as the difference between an authority's expenditure and the product of a standard rate poundage, applicable to all authorities of the same type, levied on the authority's total rateable value. Different standard rate poundages will be prescribed for different levels of spending in relation to "standard expenditure".

The schedule of standard rate poundages will be set in such a way that each increment of expenditure beyond a threshold level - to allow for the inevitable variations in local circumstances - above an authority's standard expenditure will attract progressively less grant. Authorities will still be free to determine how much they wish to spend, and how much they wish to raise by rates, but the Government will be able to limit the level of grant support for expenditure above the threshold.

It will continue to be necessary to deal with certain problems -- such as the exceptionally high rateable resources and high rate bills of London -- by special arrangements, as is done under the present rate support grant system. In addition it will be necessary to ensure that the transition to the new grant is as smooth as possible. To deal with these problems my proposals will provide for multipliers to adjust the standard rate poundages and hence to adjust entitlements to grant. The multipliers will be determined in accordance with general principles applicable to a class or classes of authority and set out in a report to Parliament.

My rt hon Friend the Secretary of State for Wales will be making a separate announcement about the position of Wales under the new scheme.

The Government intends that the new grant system should come into operation in 1981/82. As an interim measure the Bill will provide that authorities' 1980/81 grant entitlements under the existing rate support grant legislation can be adjusted at Increase Order stage next year. Grant entitlements will be abated where budgeted expenditure significantly exceeds assessed need.

We shall consult the local authority associations fully on the mechanics and implementation of the new grant system and on the development of the method of assessment of standard expenditure.

There will be a full opportunity for the House to debate the Settlement. I shall be laying the appropriate Orders for approval within the next few days. The proposals for legislation will be introduce in due course.

2

PRIME MINISTER

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: In its final form

Your ref: MS

15 November 1979 15/XI

Dear Tim

RATE SUPPORT GRANT

I attach a revised statement on RSG, which takes into account the comments made yesterday and today by colleagues. The intention is that this will be released to the associations at 10.00 tomorrow; and will be publicly available at 11.00.

I also attach what we hope are the final versions of the 2 PQs to be answered tomorrow.

Copies to the Private Secretaries to all Cabinet Ministers, the Minister of Transport, the Financial Secretary, and Sir Robert Armstrong.

Yours ever

David Edmonds

D A EDMONDS
PS/Secretary of State

Tim Lankester
Private Secretary to the Prime Minister

RATE SUPPORT GRANT SETTLEMENT 1980/81

STATEMENT BY THE SECRETARY OF STATE FOR THE ENVIRONMENT TO THE CONSULTATIVE COUNCIL ON LOCAL GOVERNMENT FINANCE ON 16 NOVEMBER 1979

INTRODUCTION

1. I am announcing the Government's contribution to help local government finance the services which it provides to the community - the Rate Support Grant (RSG) settlement for 1980-81. This is an announcement made in accordance with tradition and convention. But this year, of course, sees the first RSG settlement of a new Government.

2. The last Administration has been replaced by one which is prepared to look realistically at the state of the national economy. And it is not prepared to plan expenditure on the basis of fictional assumptions about economic growth. And as the Chancellor of the Exchequer has already made clear, the Government is not prepared to print money to finance levels of expenditure the country cannot afford.

STATE OF ECONOMY

3. When we took office, the state of the economy compelled us to take immediate action to curb public spending. I therefore took the following steps:

- I asked local authorities to freeze recruitment and reduce their current expenditure in 1979/80 by 3% below the level envisaged in last year's RSG settlement - 1½% below what they spent in 1978/79;
- I announced in July the level of current expenditure which we would accept for 1980-81 - a further reduction of 1%.

We thus gave local authorities this early warning to enable them to make the adjustment to lower levels of expenditure. We then announced further steps which we propose to take to assist them in achieving those reduced levels. These include greater discretion in respect of provision of and charging for school meals, milk and transport, the ability to charge for planning applications and for building regulations and changes in planning legislation including the General Development Order. Further, I expect to issue shortly a consultation paper proposing relaxations in the arrangements for the control of housing capital projects. Our commitment

to lessening Central Government interference is further evidenced by the proposals to remove more than 300 controls and the reductions in the number of Central Government circulars.

5. Our plans for spending by local authorities in 1980-81 are set out in the recent White Paper: The Government's Expenditure Plans 1980-81. A ceiling for the volume of expenditure has been set. We have now taken decisions on the Government's contribution to their financing.

KEY DECISIONS

6. I shall deal with the various components of the settlement later. But I should like to set out the key decisions which will influence local authorities in the drawing up of their budgets.

7. First, the grant percentage. I recognise that the Government is asking a great deal from local authorities. I propose, therefore, to maintain the level of central government assistance unchanged at 61%. This will give a much needed element of stability to the financing of their expenditure.

8. Secondly, the distribution package must also be fair. I have, therefore, as we promised we would, halted the drift of grant from the shire counties which we have witnessed over the last few years.

9. Thirdly, I have set a cash limit for the 1980-81 Increase Order which is realistic and just. It will also be firm. Above this limit there will be no more cash.

THE RSG SETTLEMENT

10. I now turn to the terms of this year's RSG settlement and I shall take the components in turn.

INCREASE ORDERS

11. RSG settlements for the ensuing financial year are made at the price levels applying in the previous November when they are announced. Additional grant to take account of increases in pay and prices, which occur during the year to which the settlement applies, is paid through two

Increase Orders. One of these is made in each of the two successive years following the announcement of the settlement.

SECOND INCREASE ORDER 1978-79

12. We have therefore first to conclude the RSG settlement for 1978-79 by making the second of the Increase Orders for that year and thus finalise the accounts. This covers additional grant payable in respect of pay and price changes between November 1978 and March 1979. The cash limits on RSG and the Transport Supplementary Grant (TSG) have been increased to take account of the local authority manuals settlement. The cash limit on RSG has also been adjusted for changes in the variable items such as interest charges. The cash limit on RSG now stands at £31 million; and on TSG at £0.8 million. Grant will be paid within the cash limits.

FIRST INCREASE ORDER 1979-80

13. I turn now to the first Increase Order for the current year 1979-80, which covers pay and price changes since the settlement last November. The Chancellor said in his Budget statement that the Government would take account of pay settlements in calculating the Increase Orders for the RSG, but would make a significant across-the-board reduction from the total thus calculated. The Government have decided that a further abatement of £10M shall be made in respect of this Increase Order. The total abatement for RSG purposes will therefore be £310M. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute, and the need to secure the improvements in efficiency and productivity identified in the Clegg Report.

14. The cash limits, adjusted for pay settlements, the variable items and this reduction now stand as follows:

Rate Support Grant	£493 million
Transport Supplementary Grant	£ 30 million
National Parks Supplementary Grant	£0.4 million

Grant will be paid accordingly.

SECOND INCREASE ORDER 1979-80

15. There are still significant uncertainties about pay, not only for settlements in the current pay round but for comparability awards remaining from the previous round. It is only right therefore that, for the removal of doubt, I should announce now the Government's intention in respect of the

second Increase Order which will be made next November. Payments under this Order will be subject to a cash limit of £150M (£148M for RSG and £2M for TSG). These limits have been calculated on a realistic basis - compatible with the calculation of the cash limits for 1980-81 which I shall announce in a moment. They relate to payments which will fall to be met in 1979-80 in respect of the forthcoming November settlement for local authority manual workers and craftsmen; and the comparability awards yet to be made for white collar workers, craftsmen and teachers. The amount of National Parks Supplementary Grant will not be further increased. This cash limit is firm and final except for the normal adjustments in respect of the variable items which will be made to grant payable outside the cash limit.

RSG SETTLEMENT 1980-81

16. I have foreshadowed the key decisions on the RSG settlement for 1980-81 earlier in this statement. The details are as follows.

RELEVANT EXPENDITURE

17. The total of relevant expenditure will be £15737 million at November 1979 prices. This figure is consistent with the expenditure totals announced in the recent White Paper.

RENT GUIDELINE

18. The total of accepted relevant expenditure contains a forecast of rate fund contributions to local authority housing revenue account and other housing expenditure falling directly to the rate fund. The forecast assumes, among other things, that a guideline average rent increase of £1.50 a week will be applied by those authorities statutorily able to do so. It also takes account of the fact that the existing housing subsidy arrangements will continue without major changes throughout 1980-81.

GRANT PERCENTAGE

19. The grant percentage will be 61%. The aggregate Exchequer grant will therefore be £9600 million. Specific grants are estimated at £1249 million. Transport Supplementary Grant will be £350 million. National Parks Supplementary Grant will be £4.5 million. The amount available for Rate Support Grant is therefore £7996 million.

ELEM[illegible] OF RSG

20. The first claim on RSG is the amount provided for the domestic element. We propose to continue to protect the domestic ratepayer by maintaining the domestic rate relief at 18½p in the pound for England and 36p in the pound for Wales. The amount of RSG available for the needs and resources element of grant as before will be divided in the ratio of 67½ : 32½.

CASH LIMIT 1980-81

21. The cash limit for the 1980-81 Increase Orders will be an envelope figure which covers the additional grant payable in respect of pay and price changes affecting local authorities between now and March 1981. It is compatible with year on year new pay and price changes affecting local authorities of 13%. The cash limit also includes a carry through of the realistic allowance to cover the effects of outstanding comparability awards which will fall to be paid in 1980-81. Other than for the interest rate variable items for which provision will be made outside the cash limit, the Government intends that there should be no further adjustment to the cash limit.

22. The Government will look to the local authority employers and the trade unions to negotiate in a sensible and moderate fashion to ensure that local authorities can live within this cash limit. Settlements which are excessive will result either in reductions in services or in further burdens being placed on the ratepayers and perpetuate the climate of restraint to which such practices have now led us. If settlements are excessive it will be the clear responsibility of those who negotiated them.

23. Within this total the cash limit on

Rate Support Grant	will be £1380 million
Transport Supplementary Grant	will be £ 46 million
National Parks Supplementary Grant	will be £ 0.7 million

DISTRIBUTION

24. The distribution arrangements this year must be seen against the background of our decision to move to a new system of rate support grant which I shall describe in a moment. We must live with the present arrangements until fresh legislation can be enacted.

25. So far as the distribution of needs element of the RSG is concerned the only acceptable course open to us was to prevent further distortion. The distribution this year will therefore be on a standstill basis. We shall re-use exactly the same formulae as last year both for the national and for the within-London distribution.

26. The freezing of the formulae will not exactly reproduce the pattern for last year, because changes have occurred since then in the data - numbers of school-children, etc - to which the formulae are applied. In order to limit changes from this source, and to preserve the stability of the distribution, we have taken the following additional decisions:

- outside London, needs element losses in real terms, except those resulting from correction of data errors, will be limited to the equivalent of a 1p rate by the use of the "safety net";
- the clawback of London's needs element will be reduced to £234 million so as to ensure that the capital's overall loss due to data changes does not exceed the national 1p limit;
- the within-London distribution will follow, so far as is consistent with the decision to use the same formulae as last year, the "no change" package jointly recommended by the LBA and GLC which includes a within-London "safety net" set 2p below any overall loss for London;
- the redistribution of needs element to non-metropolitan districts will be on exactly the same basis as last year.

27. The overall stability of this distribution is such that only four authorities outside London have losses large enough to qualify for the very tight 1p safety net. Furthermore, the drift of grant from the shire counties is halted: their gain in grant, at an average of 0.8p is larger than that of the metropolitan districts, and for the first time since the present system was introduced the shires actually increase their share of the total needs grant.

28. For the purpose of calculating entitlements to resources element, the National Standard Rateable Value will be set at £178 per head. Rating authorities with rateable values below this figure will be eligible for resources element to bring them up to standard.

THE OVER-SPENDERS

29. I now want to come to one of the most debated aspects of the present RSG system. In essence, the present rate support grant arrangements are based on the assumption that need is demonstrated by authorities' expenditure. Resources element provides the same marginal rate of grant support to a local authority's expenditure regardless of how extravagant that expenditure might be. Furthermore, high spending authorities can actually attract to themselves a larger share of the resources grant at the expense of other more prudent authorities. Needs element is distributed on the basis of an analysis of past expenditure patterns. The consequence of this is that if authorities with high levels of expenditure all decided to maintain or increase their levels they could create a feed-back that enhanced their measured needs.

30. Within such a system it is very difficult to convince authorities that it is in their interest to economise, for to do so might over a period reduce their eligibility for central government support. At its simplest, this phenomenon is known as the "problem of the overspenders". This is a notoriously difficult area. But so great is the volume of public expenditure, and so urgent the need in the interests of the ratepayer and the taxpayer to exercise proper disciplines, that the Government have decided that action is required.

THE BLOCK GRANT

31. The Government therefore proposes to make provision in the forthcoming Local Government, Planning and Land Bill for a new block grant system to come into operation in 1981-82. The system will replace the present needs and resources element with a single grant payable to all authorities. This block grant will bridge the gap between a local authority's "standard expenditure" (assessed on the same basis for all) and the product of a "standard rate poundage" levied on that authority's rateable value.

32. Authorities spending in line with standard expenditure - leaving an allowance for inevitable variations in local circumstances - will get the full rate of government support. Expenditure in excess of "standard expenditure" will also attract grant - as under the present resources element arrangements - but if it is significantly in excess of "standard expenditure" the rate of grant will be reduced, and reduced progressively as expenditure increases still further.

33. This system will still leave authorities free as now to decide how much they wish to spend, and how much income they wish to raise by way of rates. But the Government's contribution through grant will be limited. There will be full consultation with the local authority associations on the detailed mechanics of the new block grant, including the definitions of standard expenditure and standard rate poundage.

34. The new arrangements, when introduced in 1981-82, will be applied separately in England and Wales. The Secretary of State for Wales is making a statement about the arrangements in Wales.

THE TRANSITIONAL ARRANGEMENTS

35. The new block grant cannot be brought into effect until the 1981-82 grant year. We have therefore decided to provide in the legislation for transitional arrangements for 1980-81 which will make it possible to apply as far as practicable the principles of block grant through adjustments of grant entitlements under existing legislation at Increase Order stage.

36. The transitional arrangements will apply primarily through the resources element, but they will also be capable of operating in respect of London authorities that do not receive resources element through the needs element. These arrangements will involve a reduction in entitlements at the stage of the Increase Order for 1980-81 which will be made next November if there are local authorities who overspend substantially. The measure of overspending will be any large difference between an authority's actual rate (with certain adjustments in London) and the "notional uniform rate", implicit in the present grant system, which authorities would have to charge, after taking account of

entitlements to the needs and resources elements, to fund expenditure in line with assessed expenditure needs. Any such reduction in grant will be distributed among all authorities.

37. The "notional uniform rate" will be published in the Report on this year's RSG Order. I recognise that there is a measure of rough justice in using the "notional uniform rate" to distinguish between substantial overspenders and others for grant purposes, because it means that we must consider the spending behaviour of each county and its districts as a single entity. But this is unavoidable under the present system of RSG which does not have separate spending assessments for each local authority, and has different arrangements for the different tiers of local government. And the justice is less rough than it would be if we allowed the present system to continue unmodified for 1980-81.

38. Nothing would give me greater pleasure than to have to make no use of the transitional arrangements. The traditional practice has been for local government - of whatever political colour - to comply with central government guidelines on expenditure. This has reinforced the basis of common trust that has made it possible for local and national government to work together. But I do not see how I can expect the majority of local authorities to curtail their expenditure plans if they see a handful of authorities conspicuously disregarding the national interest by pushing up their expenditure, and actually getting a larger share of the available grant as a result. I threaten nobody. But it would be irresponsible to leave the government powerless in the face of such behaviour should it arise in 1980-81.

RATE INCREASES

39. I turn now to the vital question of rate increases. When I have discussed this settlement with the Consultative Council, you have urged upon me the need to give local government time to adjust to the changed public expenditure climate. You also urged upon me the need to be fair and realistic in my decisions. I have done both. I have fulfilled my share of the bargain.

40. Central Government does not determine rate increases. Nor do the local authority associations. That is a decision for every individual local authority. I do not propose, therefore, to produce calculations and to proclaim a national average figure. That would be meaningless. I will not set a norm or a target. That would encourage some authorities to believe that they were not rating high enough and persuade others that they were being cheated. Instead, I wish to appeal to every elected Councillor in the land. You cannot opt out of the battle against inflation. You have responsibilities both to the country as a whole and to your ratepayers. I urge you therefore to plan your budgets on the basis of this settlement, to rate in accordance with the volume of expenditure I have requested and to make prudent use of the balances you hold. Do not raise a penny more in rates than you must.

HOUSE OF COMMONS

Mr William Shelton (Con - Lambeth, Streatham):

To ask the Secretary of State for the Environment, whether he will make a statement on the rate support grant settlement for 1980-81 and on changes in grant arrangements, especially with reference to dealing with overspending authorities.

MR MICHAEL HESELTINE

Yes. A copy of the statement I made today at the Consultative Council on Local Government Finance has been placed in the Library.

1980-81 RSG SETTLEMENT

Briefly my proposals are that the Aggregate Exchequer Grant should be at a rate of 61% on relevant expenditure of £15,737 million (at November 1979 prices). The total of relevant expenditure is based on the White Paper: The Government's Expenditure Plans 1980-81: Cmnd 7746. The planned level of local authority current expenditure in 1980-81 shows a reduction of about two and a half per cent below what authorities actually spent in 1978-79.

The additional grant that may be payable under any Increase Orders relating to 1980-81 will be subject to cash limits. The casl limit on Rate Support Grant will be £1380 million; on Transport Supplementary Grant £46 million; and on National Parks Supplementary Grant £0.7 million.

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in the formula. There will be a "safety net" to limit losses in non-London authorities' needs element entitlements - except those resulting from corrections of data errors - to the equivalent of a 1p rate poundage; only four authorities qualify for this. London's overall grant loss will also be constrained to the equivalent of a 1p rate by the London clawback mechanism; further losses to individual London authorities arising from the within-London redistribution will be limited to 2p. The within-London arrangements are also on a standstill basis, with the 1979-80 formula re-applied to updated data. The National Standard Rateable value for the distribution of resources element will be £178. Domestic rate relief will be maintained at 1979/80 levels of 18½p in £ in England and 36p in £ in Wales.

Taken together, these measures achieve a welcome degree of stability in the grant distribution while at the same time halting at long last the drift of grant from the non-metropolitan counties that has taken place since 1974/75.

NEW GRANT ARRANGEMENTS

So far as overspending is concerned, while a majority of local authorities have shown a willingness to keep in step with the Government's guidelines on public expenditure, a minority of authorities persist in maintaining levels of expenditure which the present economic circumstances simply do not justify. It is, however, clearly wrong that the Government's contribution through the rate support grant to local authority expenditure can take no account of whether that expenditure is reasonable or not. That is now the case.

Such is the perversity of the present resources element arrangements that high spending authorities get the same level of support on all additions to expenditure, at the expense of other authorities. This is unacceptable.

I therefore intend to include provisions in the forthcoming Local Government, Planning and Land Bill to replace the needs and resources elements of the existing grant arrangements with a single block grant, payable to all authorities and calculated as the difference between an authority's expenditure and the product of a standard rate poundage, applicable to all authorities of the same type, levied on the authority's total rateable value. Different standard rate poundages will be prescribed for different levels of spending in relation to "standard expenditure".

The schedule of standard rate poundages will be set in such a way that each increment of expenditure beyond a threshold level - to allow for the inevitable variations in local circumstances - above an authority's standard expenditure will attract progressively less grant. Authorities will still be free to determine how much they wish to spend, and how much they wish to raise by rates, but the Government will be able to limit the level of grant support for expenditure above the threshold.

It will continue to be necessary to deal with certain problems - such as the exceptionally high rateable resources and high rate bills of London - by special arrangements, as is done under the present rate support grant system. In addition it will be

necessary to ensure that the transition to the new grant is as smooth as possible. To deal with these problems my proposals will provide for multipliers to adjust the standard rate poundages and hence to adjust entitlements to grant. The multipliers will be determined in accordance with general principles applicable to a class or classes of authority and set out in a report to Parliament.

My rt hon Friend the Secretary of State for Wales will be making a separate announcement about the position of Wales under the new scheme.

The Government intends that the new grant system should come into operation in 1981/82. As an interim measure the Bill will provide that authorities' 1980/81 grant entitlements under the existing rate support grant legislation can be adjusted at Increase Order stage next year. Grant entitlements will be abated where budgeted expenditure significantly exceeds assessed need.

We shall consult the local authority associations fully on the mechanics and implementation of the new grant system and on the development of the method of assessment of standard expenditure.

There will be a full opportunity for the House to debate the Settlement. I shall be laying the appropriate Orders for approval within the next few days. The proposals for legislation will be introduced in due couse.

Friday 16 November 1979
Department of the Environment

1328/79/80
(18)

6F

Q. What assumptions have been made about rent increases for 1980/81 in the context of the Rate Support Grant settlement?

Mr Michael Heseltine

A. The total of accepted relevant expenditure contains a forecast of rate fund contributions to local authority housing revenue accounts and other housing expenditure falling directly on the rate fund. The forecast assumes, among other things, that a guideline average rent increase of £1.50 a week will be applied by those authorities statutorily able to do so. It also takes account of the fact that the existing housing subsidy arrangements will continue without major changes throughout 1980/81.

Treasury Chambers, Parliament Street, SW1P 3AG

15 November 1979

D A Edmonds Esq
PS/Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1

Dear David,

RSG 1980-81: DRAFT PARLIAMENTARY ANSWER

Thank you for sending me a copy of your letter of 15 November to Tim Lankester.

The Financial Secretary has two points on the draft answer, both relating to the paragraph dealing with the additional £20 million savings to be found in the current year:-

i) he notes that the answer does not specify where the £10 million reduction from other local authority programmes is to come from. He imagines, however, that your Secretary of State intends to find this from housing capital, and is asking his officials to discuss with DOE officials how this reduction should be affected and reflected in cash limits. In the meantime, he accepts that the details need not be given tomorrow.

ii) at the end of this paragraph, he would like to see an addition made, as in the statement to the Consultative Council, linking the extra abatement with the conclusions of Clegg on the need to secure greater efficiency and productivity (the same wording as in the statement might be used).

I am copying this letter to the recipients of yours.

Yours sincerely,

Stephen Locke.

S A J LOCKE

ZPPS

Treasury Chambers, Parliament Street, SW1P 3AG

24th November 1979

Dear David,

RSG SETTLEMENT 1980-81

Thank you for letting us see a draft of your Secretary of State's statement to the Consultative Council on Local Government Finance with your letter of 13th November to Alistair Pirie. The Financial Secretary has asked me to reply.

In general, he is in agreement with the structure and thrust of your Secretary of State's presentation. He had, however, the following comments on the detailed drafting to which he attaches importance.

First, the reference in paragraph 4 to your Secretary of State's intention to issue a consultation paper on the control of housing capital projects seems premature given that no interdepartmental discussion of the document has yet taken place. The Financial Secretary trusts that there will be opportunity for adequate consideration of the proposed document by Treasury officials, and suggests that the penultimate sentence should either be excised or amended to read:

> "Further, I shall be issuing in due course a consultation paper proposing new arrangements for the control of housing capital projects, which should reduce the need for detailed controls."

Secondly, the Financial Secretary is concerned that the reference to the volume of expenditure in the first sentence of paragraph 5 may wrongly be taken to suggest that volume should be safeguarded, whatever the movement of local authority costs. He would prefer the sentence to be amended as follows:-

> "Firm limits for the volume of expenditure have been set."

/Third, the

D.A. Edmonds, Esq.,
Private Secretary to the
Secretary of State for the Environment

Third, the Financial Secretary suggests that the extra abatement of RSG in the current year should be linked with the conclusions of Clegg by adding at the end of the ante-penultimate sentence of paragraph 13:-

> " ..... and the need to secure the improvements in efficiency and productivity identified by the Clegg report."

He has noted that the explanation of the allocation of the extra £20 million reductions in the current year does not specify the source of the £10 million savings which are not to come from RSG. There is no need for this to be spelt out in the statement but it should be made clear in some way on Friday, for example in your Secretary of State's inspired PQ. I understand that Treasury officials still do not know your Secretary of State's intentions in this respect, and it would be helpful if your officials could let them have his proposal as soon as possible.

As for the two final sentences of paragraph 13, the Financial Secretary wishes to see this announcement, effectively of £50 million more government expenditure, deleted. It seems totally inappropriate in the present stringent financial climate and indeed inconsistent with the overall impression which the statement is intended to convey. Moreover, it is not clear for what purpose the £50 million is intended to be assigned. I should be grateful if you could arrange for your officials to discuss it with the Treasury before your Secretary of State makes any announcement.

While the tenor of paragraph 15 perhaps hints at the intended firmness of the cash limit on the second increase order for 1979-80, the Financial Secretary suggests that it would be desirable to spell this out at the end, by replacing the penultimate sentence by:

> "This cash limit is firm and final but the normal adjustments in respect of the variable items will be made to grant payable outwith the cash limit."

Similarly, the final sentence of paragraph 20, covering the finality of the 1980-81 cash limit, might read:

> "Other than for the interest rate linked variable items, for which provision will be made outside the cash limit, the government intends that there should be no further adjustment to the cash limit."

/In paragraph 21

In paragraph 21, the Financial Secretary considers it important to set out the consequences of an ill-judged response to the RSG settlement by the local authorities. He suggests that the last two sentences should be replaced by:

> "Settlements which are excessive will result either in reductions in services or in further burdens being placed on the ratepayers. If this happens, it will be the clear responsibility of the local authorities."

Finally, there are a number of more minor drafting points on which Treasury officials will be in touch with yours direct.

Copies of this letter go to the recipients of yours.

Yours sincerely,
Stephen Locke.

(S.A.J. LOCKE)

CONFIDENTIAL

from PAS.

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

D A Edmonds Esq
Private Secretary to the
Secretary of State for the Environment
2 Marsham Street
London SW1P 3EB

14 November 1979

Dear David

RSG STATEMENT 1980-81

Thank you for sending me copies of your letters of 13 and 14 November to Alistair Pirie and of the draft statement.

My Secretary of State is in general content with the draft. However, although he agrees with yours that the total figure of 19 per cent for the 1980-81 cash limit should not be mentioned, he does not think it sensible to avoid mentioning the allowance of 6 per cent of total expenditure for the comparability awards referred to in the fourth sentence of paragraph 20. This figure has already been mentioned in the Press and can in any case be deduced from the sums to be quoted in paragraphs 20 and 22. He would therefore propose to insert "an increase of 6 per cent as" after "includes" in that sentence.

Whether or not the 6 per cent is quoted, Ministers will immediately be asked how the "realistic allowance" has been calculated. Mr Carlisle thinks it important to avoid prejudging the findings of Clegg by going into any detail on this.

The annex to this letter contains a number of other amendments which my Secretary of State would like to see made in the draft statement.

I am copying this to the private secretaries to all members of the Cabinet, the Minister of Transport and Sir Robert Armstrong.

Yours faithfully

Pete Shaw

P A SHAW
Private Secretary

CONFIDENTIAL

ANNEX

Paragraph 4, third sentence

Insert "provision of and" before "charging".

Paragraph 11, first sentence

substitute "financial" for the (American) "fiscal".

Paragraph 20, first sentence, and paragraph 32, second sentence

Surely "Increase Orders"?

Paragraph 26B, fourth sentence (see also paragraph 34 below

Insert "in receipt of resources grant" after the first "authorities".

Paragraph 31, second sentence

Substitute "one of the" for "the broad".

Paragraph 32

Add at end "Any such reduction in grant will of course be available for distribution among the remaining authorities."

Paragraph 33, second sentence

Insert "not least" before "because".

Paragraph 33

Add at end "We shall however consult the local authority associations about the details of these transitional arrangements."

Paragraph 34, fourth sentence

Insert "in many cases" before "actually",

Paragraph 36, penultimate sentence

Substitute "and the Government's priorities between and within services set out in Cmnd 7746" for "I have requested".

PL
14/11

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

14 November 1979

Dear Alistair

RSG SETTLEMENT 1980/81

I circulated yesterday evening what I thought was a full text of the draft statement on RSG. Unfortunately, a section had been omitted. With apologies, I now enclose additional paragraphs 26A, 26B, 26C for insertion in the text after the existing paragraph 26.

Copies go to the recipients of my letter of yesterday.

Yours ever

David

D A EDMONDS
PS/Secretary of State

Alistair Pirie Esq
Private Secretary to the Chief Secretary

26A. For the purpose of calculating entitlements to resources element, the National Standard Rateable Value will be set at £178 per head. Rating Authorities with rateable values below this figure will be eligible for resources element to bring them up to standard.

The Overspenders

26B. I now want to come to one of the most debated aspects of the present RSG system. In essence, the present rate support grant arrangements are based on the assumption that need is demonstrated by authorities' expenditure. It provides the same marginal rate of grant support to a local authority's expenditure regardless of how extravagant that expenditure might be. Furthermore, high spending authorities can actually attract to themselves a larger share of the resources grant at the expense of other more prudent authorities. Needs element is distributed on the basis on an analysis of past expenditure patterns. The consequence of this is that if authorities with high levels of expenditure all decided to maintain or increase these levels they could create a feed-back that enhanced their measured needs.

26C. Within such a system it is very difficult to convince authorities that it is in their interest to economise, for to do so might over a period reduce their eligibility for central government support. At its simplest, this phenomenon is known as the "problem of the overspenders" This is a notoriously difficult area. But so great is the volume of public expenditure, and so urgent the need in interests of the ratepayer and the taxpayer to exercise proper disciplines, that the Government have decided that action is required.

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: Sir Kenneth Berrill KCB

Qa 04345

14 November 1979

Dear David,

Rate Support Grant Settlement 1980/81

Sir Kenneth Berrill has seen your letter to Alistair Pirie of 13 November and would like to suggest the following amendments to the Secretary of State's draft statement:

Paragraph 12: Delete the 4th and 5th sentences and amend the final sentence to read -

> "After adjustments for last year's local authority manuals' settlement and for variable items such as interest rates, the cash limit on RSG now stands....."

(The existing draft rather creates the impression of a series of automatic adjustments to cash limits which does not correspond with the tone of the later part of the statement.)

Paragraph 13: 3rd, 4th and 5th sentences to read -

> "The Government have decided that a total abatement of £310m. shall be made. This is £10m. more than the figure already announced. A further £10m. will be found through a reduction in other local authority programmes for which I am responsible."

Paragraph 20: We suggest that your intention of avoiding the impression of a 'going rate' could be reinforced if the third sentence were replaced by the following -

> "It is compatible with year-on-year changes affecting local authorities of 13 per cent in pay and prices combined. This combined figure would itself be compatible with a range of outcomes for pay and prices taken separately."

Paragraph 21: Last two sentences to read -

> "Settlements which are excessive will result either in the need to achieve further volume reductions or in further burdens being placed on the ratepayer. In either case this would be the clear responsibility of the employers and unions concerned."

I am sending a copy of this letter to the recipients of yours.

Yours

G.B Spence
Private Secretary

D A Edmonds Esq

CONFIDENTIAL

JS

BF 15/11/79 cc last para

10 DOWNING STREET

From the Private Secretary

14 November 1979

Dear David.

RATE SUPPORT GRANT SETTLEMENT 1980/81

I have shown the Prime Minister the draft statement which you sent with your letter of 13 November.

The Prime Minister does not think that the draft is as clear as it might be. She has asked me to suggest the following amendments.

(1) Paragraph 2, second sentence, to read:
"And it is not prepared to plan expenditure on the basis of ....."

(2) Paragraph 3, first sentence, to read:
"When we took office, the state of the economy compelled us to take immediate action to curb public spending."

(3) Delete paragraph 5 altogether and substitute:
"Our plans for spending by local authorities in 1980/81 are set out in the recent White Paper. We have now taken decisions on the Government's contribution to their financing."
The Prime Minister feels that the sentence "The volume of expenditure has been firmly set" would be a damaging hostage to fortune: at the very least, it needs to be qualified by the point that volume will be less if prices and wages go up too much.

(4) Paragraph 13 - the penultimate sentence should presumably come before the sentence preceding it in the present draft.

(5) Paragraph 21, third sentence, to read:
"If settlements are excessive, it will be the clear responsibility of those who negotiated them."

(6) Paragraph 27: delete "therefore" in the first sentence.

/(7)

JS

(7) Paragraph 30, second sentence, to read:
"The Secretary of State for Wales is making a statement about the arrangements for Wales."

I understand that the main points in the statement will be set out in a Written Answer on Friday. We would be grateful if we could see this in draft.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet, the Minister of Transport and Sir Robert Armstrong.

Yours ever

Tim Lankester.

D.A. Edmonds, Esq.,
Department of the Environment.

CONFIDENTIAL

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

Rt Hon John Biffen MP
Chief Secretary to the Treasury
Parliament Street
LONDON
SW1P 3AG

13th November 1979

1. Mr Alexander Rec'd
2. C.F.

14/11

MEAT INDUSTRY EMPLOYMENT SCHEME

Thank you for your letter of ~~23~~ 25 October 1979.

I am very pleased that you have been able to accept that the cost of MIES from mid July 1979 to 31 March 1980, up to a maximum of £10m may be met from the Contingency Reserve. This will be particularly helpful to me in dealing with my resources problems in the current year and I am most grateful that you have managed to assist me in this way.

I note what you say about the future. As I indicated in my previous letter, a further significant devaluation of our Green Pound would be highly beneficial not merely in the context of the meat industry but in relation to my difficulties on the milk front also. Be that as it may, you can, however, be assured that I am keeping the future of the Meat Industry Employment Scheme under continuous review - bearing in mind the acute difficulties posed by North/South price differentials but being very conscious also that resources will be extremely tight in 1980/81 and that this Scheme, like others, must therefore be exposed to rigorous scrutiny.

A copy of this letter goes to all members of the Cabinet and to Sir Robert Armstrong.

CONFIDENTIAL

Prime Minister 1

I don't much like this statement. But it is not for Parliament, and DoE say that there will be a written Answer on Friday summarising the key points. I have suggested some amendments, which - if you agree - I will pass on to DoE.

Dear Alistair

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

13 November 1979

RATE SUPPORT GRANT (RSG) SETTLEMENT 1980/81

I enclose a draft of a statement which my Secretary of State intends to make at the "statutory meeting" of the Consultative Council on Local Government Finance on 16 November. The statement deals with the RSG settlement for 1980/81, the proposals to introduce a new block grant system in 1981/82, and the proposal for adapting the existing system to deal with overspenders next year.

The draft reflects the decisions taken by colleagues (CC(79)18 Minute 6 and H(79)13th Minute 1). The Secretary of State would however like to draw the Chief Secretary's attention to one point.

The Secretary of State regards the presentation of the 1980/81 cash limit (paragraphs 21 and 22 of the statement) as crucial. He is firmly of the view that we should not refer to a figure of 19% - which would embrace the carry through of the cost of comparability and the year on year increases in pay and prices affecting local authorities in 1980/81 - because it would be open to wide misinterpretation. 19% taken out of context could easily be represented as the "going rate" for new settlements. You will see, therefore, that he intends to adopt a "cash envelope presentation" which wraps up everything, including comparability, and that the only percentage figure proposed to use is 13%.

I apologise for the deadline, but I should be very grateful for any comments by close of play tomorrow (Wednesday 14 November).

I am copying this letter to the Private Secretaries to all Members of Cabinet, and to the Minister of Transport and to Sir Robert Armstrong.

Yours ever

David

D A EDMONDS
PS/Secretary of State

Alistair Pirie Esq,
Private Secretary to the Chief Secretary

(THIRD DRAFT 13.11.79)

RATE SUPPORT GRANT SETTLEMENT 1980/81

STATEMENT BY THE SECRETARY OF STATE FOR THE ENVIRONMENT TO THE CONSULTATIVE COUNCIL ON LOCAL GOVERNMENT FINANCE ON 16 NOVEMBER 1979

INTRODUCTION

1. I am announcing the Government's contribution to help local government finance the services which it provides to the community - the Rate Support Grant (RSG) settlement for 1980-81. This is an announcement made in accordance with tradition and convention. But this year, of course, sees the first RSG settlement of a new Government.

2. The last Administration has been replaced by one which is prepared to recognise that the national economy is in a mess. And it is not prepared to accept further spending programmes planned on the basis of fictional assumptions about economic growth.

STATE OF ECONOMY

3. When we took office, the state of the economy compelled us urgently to take those decisions which we recognised as inevitable. I therefore took the following steps:

- I asked local authorities to freeze recruitment and reduce their current expenditure in 1979/80 by 3% below the level envisaged in last year's RSG settlement - 1½% below what they spent in 1978/79;

- I announced in July the level of current expenditure which we would accept for 1980-81 - a further reduction of 1%.

4. We thus gave local authorities this early warning to enable them to make the adjustment to lower levels of expenditure. We then announced further steps which we propose to take to assist them in achieving those reduced levels. These include greater discretion in respect of charging for school meals, milk and transport, the ability

to charge for planning applications and for building regulations and changes in planning legislation including the General Development Order. Further, I expect to issue shortly a consultation paper proposing far-reaching relaxations in the arrangements for the control of housing capital projects. Our commitment to lessening Central Government interference is further evidenced by the proposals to remove more then 300 controls and the reductions in the number of Central Government circulars.

"Our plans for spending by local authorities in 1980/81 are set out in the recent White Paper. We have now taken decisions on the Government's contribution to their financing."

5. [The volume of expenditure has been firmly set. We must now decide the traditional apportionment of the bills which is implicit in every RSG settlement. Inevitably, this must strike a balance between what the ratepayer and the taxpayer can afford.]

6. I shall deal with the various components of the RSG settlement later. But I should like to set out the key decisions which will influence local authorities in the drawing up of their budgets.

7. First, the grant percentage. I recognise that the Government is asking a great deal from local authorities. I propose, therefore, to maintain the level of central government assistance unchanged at 61%. This will give a much needed element of stability to the financing of their expenditure.

8. Secondly, the distribution package must also be fair. I have, therefore, as we promised we would, halted the drift of grant from the shire counties which we have witnessed over the last few years.

9. Thirdly, I have set a cash limit for the 1980-81 Increase Order which is realistic and just. It will also be firm. Above these limits there will be no more cash.

THE RSG GRANT SETTLEMENT

10. I now turn to the terms of this year's RSG settlement and I shall take the components in turn.

INCREASE ORDERS

11. RSG settlements for the ensuing fiscal year are made at the price levels then applying in the previous November when they are announced. Additional grant to take account of

increases in pay and prices, which occur during the year to which the settlement applies, is paid through two Increase Orders. One of these is made in each of the two successive years following the announcement of the settlement.

12. We have first to conclude the RSG settlement for 1978/79 by making the second of the Increase Orders for that year. This covers additional grant payable in respect of pay and price changes between November 1978 and March 1979. The first Increase Order for 1978/79, made last November, did not exhaust the cash limit on RSG as it then stood. The cash limits on RSG and the Transport Supplementary Grant (TSG) have since been increased to take account of the local authority manauals settlement. The cash limit on RSG has also been adjusted for changes in the variable items such as interest charges. The cash limit on RSG now stands at £ million; and on TSG at £ million. Grant will be paid within the cash limit.

FIRST INCREASE ORDER 1979-80

13. I turn now to the first Increase Order for the current year 1979-80, which covers pay and price changes since the settlement last November. The Chancellor said in his Budget statement that the Government would take account of pay settlements in calculating the Increase Orders for the RSG, but would make a significant across-the-board reduction from the total thus calculated. The Government have decided that a further abatement of £20M shall be made. Of this, £10M will be added to the £300M already announced. A further £10M will be found through a reduction in other local authority programmes for which I am responsible. abatement for RSG purposes will therefore be £310M. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute.

In the course of reviewing my programmes I have however decided that in the light of prospective capital expenditure on housing I can now release the £50M which I retained earlier as a safety margin. This will take the form of a supplementary allocation to local authorities under the HIP arrangements.

14. The cash limits, adjusted for pay settlements, the variable items and this reduction now stands as follows:

Rate Support Grant	£	million
Transport Supplementary Grant	£	million
National Parks Supplementary Grant	£	million

Grant will be paid accordingly.

SECOND INCREASE ORDER 1979-80

15. There are still significant uncertainties about pay, not only for settlements in the current pay round but for comparability awards remaining from the previous round. It is only right therefore that, for the removal of doubt, I should announce now the Government's intention in respect of the second Increase Order Payments under this Order will be subject to a cash limit which in the case of RSG will be £ million and in the case of TSG will be £ million. These limits have been calculated on a realistic basis - compatible with the calculation of the cash limits for 1980-81 which I shall announce in a moment. They relate to payments which will fall to be met in 1979-80 in respect of the forthcoming November settlement for local authority manual workers and craftsmen; and the comparability awards yet to be made for white collar workers, craftsmen and teachers. The cash limit on RSG will be adjusted in the usual way in respect of the variable items. The amount of National Parks Supplementary Grant will not be further increased.

RSG SETTLEMENT 1980/81

16. I have foreshadowed the key decisions earlier in this statement. The details are as follows.

RELEVANT EXPENDITURE

17. The total of relevant expenditure will be £ million at November 1979 prices. This figure is consistent with the expenditure totals announced in the White Paper: The Government's Expenditure Plans 1980-81. (Cmnd 7746).

GRANT PERCENTAGE

18. The grant percentage will be 61%. The aggregate Exchequer grant will therefore be £ million. Specific grants are estimated at £ million. Transport Supplementary Grant will be £ million. National Parks Supplementary Grant will take £ million. The amount available for Rate Support Grant is therefore £ million.

ELEMENTS OF RSG

19. The first claim on RSG is the amount provided for the domestic element. We propose to continue to protect the domestic ratepayer by maintaining the domestic rate relief at 18½p in the pound for England and by 36p in the pound for Wales. The amount of RSG available for the needs and resources elements of grant as before will be divided in the ratio of 67½ : 32½.

CASH LIMIT 1980/81

20. The cash limit for the 1980/81 Increase Order will be £ million. This is an envelope figure which covers the additional grant payable in respect of pay and price changes (other than variable items) affecting local authorities which will occur between now and March 1981. It is compatible

with year on year pay and price changes affecting local authorities of 13%. The cash limit also includes a carry through of the realistic allowance to cover the effects of comparability awards which have yet to be agreed and will fall to be paid in 1980-81. Other than for the variable items which arise from fluctuations in interest rates it is not our intention that there should be any further adjustment to the cash limit.

21. The Government will look to the local authority employers and the trade unions to negotiate in a sensible and moderate fashion to ensure that local authorities can live within this cash limit. Settlements which are excessive will result in further burdens being placed on the ratepayer. If they do so, it will be their clear responsibility.

If settlements are excessive, it will be the clear responsibility of those who negotiate them.

22. Within this total the cash limit on

Rate Support Grant	will be £		million
Transport Supplementary Grant	will be £		million
National Parks Supplementary Grant	will be £		million.

STRIBUTION 23. The distribution arrangements this year must be seen against the background of our decision to move to a new system of rate support grant which I shall describe in a moment. We must live with the present arrangements until fresh legislation can be enacted.

24. So far as the distribution of needs element of the RSG is concerned the only acceptable course open to us was to prevent further damage. The distribution this year will therefore be on a standstill basis. We shall re-use exactly the same formulae as last year both for the national and for the within-London distribution.

25. The freezing of the formulae will not exactly reproduce the pattern for last year, because changes have occurred since then in the data - numbers of school-children, etc - to which the formulae are applied. In order to limit changes from this source, and to preserve the stability of the distribution, we have taken the following additional decisions:

- outside London, needs element losses in real terms will be limited to the equivalent of a 1p rate by the use of the "safety net";

- the clawback of London's needs element will be reduced by [£ million] so as to ensure that the capital's overall loss due to data changes does not exceed the national 1p limit;

- the within-London distribution will follow, so far as is consistent with the decision to use the same formulae as last year, the "no change" package jointly recommended by the LBA and GLC which includes a within-London "safety net" set 2p below any overall loss for London;

- the redistribution of needs element to non-metropolitan districts will be on exactly the same basis as last year.

26. The overall stability of this distribution is such that only [three] authorities outside London have losses large enough to qualify for the very tight 1p safety net. Furthermore, the drift of grant from the shire counties is halted: their gain in

grant, at an average of [ ] is [the same] as that of the metropolitan districts, and for the first time since the present system was introduced the shires actually increase their share of the total needs grant.

THE BLOCK GRANT

27. The Government [~~therefore~~] proposes to make provision in the forthcoming Local Government, Planning and Land Bill for a new block grant system to come into operation in 1981/82. The system will replace the present needs and resources elements with a single grant payable to all authorities. This block grant will bridge the gap between a local authority's "standard expenditure" (the typical expenditure of similar authorities) and the product of a "standard rate poundage" levied on that authority's rateable value.

28. Authorities spending in line with standard expenditure - leaving an allowance for inevitable variations in local circumstances - will get the full rate of government support. Expenditure in excess of "standard expenditure" will also attract grant - as under the present resources element arrangements - but if it is substantially in excess of "standard expenditure" the rate of grant will be reduced, and reduced progressively as expenditure increases still further.

29. This system will still leave authorities free as now to decide how much they wish to spend, and how much income they wish to raise by way of rates. But the government's contribution through grant will be limited. There will be full consultation with the local authority associations on the detailed mechanics of the new block grant, including the definitions of standard expenditure and standard rate poundage.

30. The new arrangements, when introduced in 1981/82, will be applied separately in England and Wales. The Secretary of State for Wales is making a statement about [that.] the arrangements for Wales.

THE TRANSITIONAL ARRANGEMENTS

31. The new block grant cannot be brought into effect until the 1981/82 grant year. We have therefore decided to provide in the legislation for transitional arrangements for 1980/81 which will make it possible to apply the broad principles of block grant through adjustments of grant entitlements under existing legislation at Increase Order stage.

32. The transitional arrangements will apply primarily through the resources element, but they will also be capable of operating in respect of London authorities that do not receive resources element through the needs element. These arrangements will involve a reduction in entitlements at the stage of the Increase Order for 1980/81 which will be made next November if there are local authorities who overspend substantially. The measure of overspending will be any large difference between an authority's actual rate and the "notional uniform rate", implicit in the present grant system, which authorities would have to charge, after taking account of entitlements to the needs and resources elements, to fund expenditure in line with assessed expenditure needs.

33. The "notional uniform rate" will be published in the Report on this year's RSG Order. I recognise that there is a measure of rough justice in using the "notional uniform rate" to distinguish between substantial overspenders and others for grant purposes, because it means that we must consider the spending behaviour of each county and its districts as a single entity. But this is unavoidable under the present system of RSG which does not have separate spending assessments for each local authority, and has different grant arrangements for the different tiers of local government. And the justice is less rough than it would be if we allowed the present system to continue unmodified for 1980/81.

34. Nothing would give me greater pleasure than to have to make no use of the transitional arrangements. The traditional practice has been for local government - of whatever political colour - to comply with central government guidelines on expenditure. This has reinforced the basis of common trust that has made it possible for local and national government to work together. But I do not see how I can expect the majority of local authorities to curtail their expenditure plans if they see a handful of authorities conspicuously disregarding the national interest by pushing up their expenditure, and actually getting a larger share of the available grant as a result. I threaten nobody. But it would be irresponsible to leave the government powerless in the face of such behaviour should it arise in 1980/81.

RATE INCREASES

35. I turn now to the vital question of rate increases. When I have discussed this settlement with the Consultative Council, you have urged upon me the need to give local government time to adjust to the changed public expenditure climate. You also urged upon me the need to be fair and realistic in my decisions. I have done both. I have fulfilled my share of the bargain.

36. Central Government does not determine rate increases. Nor do the local authority associations. That is a decision for every individual local authority. I do not propose, therefore, to produce calculations and to proclaim a national average figure. That would be meaningless. I will not set a norm or a target. That would encourage some authorities to believe that they were not rating high enough and persuade others that they were being cheated. Instead, I wish to appeal to every elected Councillor in the land. You cannot opt out of the battle against inflation. You have responsibilities both to the country as a whole and to your ratepayers. I urge you therefore to plan your budgets on the basis of this settlement, to rate in accordance with the volume of expenditure I have requested and to make prudent use of the balances you hold. Do not raise a penny more in rates than you must.

CONFIDENTIAL

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765
From: Sir Kenneth Berrill KCB

Qa 04343

13 November 1979

Dear Secretary of State.

British Gas Corporation: Cash Limit 1980/81

I wrote to you suggesting that the British Gas Corporation cash limit for 1980/81 be linked to the price of oil.

The Chief Secretary in his letter to you of 7 November would accept that BGC's financial targets for the next three years might be linked ~~limited~~ to the performance of the oil price. But he is reluctant to link in advance next year's cash limit and the oil price. He would prefer your Department to monitor the oil price movements in relation to the levels assumed when the cash limit was fixed so that a revision to the 1980/81 cash limit can be considered if circumstances warrant.

This letter is to say that I would be content with the action proposed by the Chief Secretary.

I am sending copies of this letter to the Prime Minister, other members of E Committee, and to Sir Robert Armstrong.

Yours sincerely,
Kenneth Berrill

KENNETH BERRILL

The Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
S W 1

CONFIDENTIAL

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CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: Sir Kenneth Berrill KCB

Qa 04341

12 November 1979

Dear Chief Secretary,

Cash Limits: Flexibility between Financial Years

I have seen your letter of 18 October to the Secretary of State for Energy, and subsequent correspondence, about the question of end-year flexibility for nationalised industry cash limits (external financing requirements). May I offer one or two comments?

It is, as you say, true that the external financing requirements (EFR) of the nationalised industries, being the balance between very much larger flows of revenue and expenditure, cannot be as firmly held to as cash limits where the income side is usually small and it is the total expenditure which has to be held to. Like you, however, I am doubtful whether an appropriate response to this problem is flexibility between financial years. The following seem to me to be among the relevant considerations:

(i) the industries have, to a greater or lesser extent, some flexibility to influence their EFR through prices, capital investment, stocks or end-year financial adjustments.

(ii) Of course, there may be circumstances which arise in which the industries cannot (and should not) adhere to their cash limits. It would, for example, be perverse if an industry had to stop desirable redundancies, or avoid a necessary industrial dispute, because the consequences might be more expensive than taking the easier way out. Or the conditions facing the industry might radically change, e.g. because of an abnormal winter.

(iii) But in those cases the right course could well be that the industry should be required to take stock; to examine the possibilities for compensating policy or accounting changes; and, if necessary, to make out a case to Government (as a private company would to its bank) for a change in its financial limit. This would seem a better discipline than allowing the industry to take one year with another and perhaps avoid difficult decisions in the hope that something would turn up (how many years have to pass before it is clear that the cash limits are not being kept?).

The Rt Hon John Biffen MP
HM TREASURY
S W 1

This would suggest that the industries should be expected, as a general rule, to take every reasonable step to keep within cash limits on the basis of a regular flow of information; but that, as a corollary, Government should acknowledge that there may be circumstances (e.g. an abnormal winter or an industrial dispute) in which it would be prepared to consider an adjustment of the cash limits. There is a balance to be struck between enforcing a financial discipline on the one hand and forcing industries into undesirable short-term expedients on the other.

There remains the question of sanctions against industries which do not keep within their cash limits. Clearly if they have made every reasonable effort, and the case for an adjustment of cash limits has been agreed, the question of sanctions does not arise. But it seems to me that Boards should be left under no illusion that anything short of this will not be acceptable and that continued failure will mean management changes.

I am sending copies of this letter to the other members of the Cabinet, to Sir Robert Armstrong and to Sir Derek Rayner.

Yours sincerely,

Kenneth Berrill

KENNETH BERRILL

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

12 November 1979

I have shown the Prime Minister your letter of 6 November and its accompanying memorandum about the presentation of public expenditure figures for the years after 1980-81.

The Prime Minister is content with the general approach proposed in the memorandum, though she has commented that the fact that spending authorities need to know their allocations for 1981-82 is not in itself necessarily a sufficient reason for publishing those allocations in detail in the forthcoming White Paper: if that was the only consideration, it should not be conclusive against some degree of aggregation and rounding in the White Paper even if spending authorities were going to be given their own allocations in more detail.

Given that the Prime Minister is content with the general approach, she thinks that it may be premature to hold a meeting at this stage. It will be easier for her, and for Treasury Ministers, to take a view on the effects of applying this approach when the results of doing so are available, in the shape of the outline draft of the White Paper to be submitted later this month. She therefore suggests that work should proceed on the outline draft in accordance with the approach suggested in the memorandum (and subject to the point to which I have referred in the previous paragraph). She will consider whether it would be advantageous to have a meeting when that outline draft is available.

I am sending copies of this letter to Tony Battishill and Martin Vile.

E.B. LANKESTER

A.C. Pirie, Esq.,
H.M. Treasury.

CONFIDENTIAL

CONFIDENTIAL

cc Mr Hodgson
Mr Ibbs

PRIME MINISTER

Prime Minister 2
Simply to note. (The Treasury have conceded in line with the views expressed in Cabinet: a pity in the light of this afternoon's sombre discussion.)

TL
9/11

NATIONALISED INDUSTRIES: EXTERNAL FINANCING LIMITS

At the meeting of Cabinet on 1 November (CC(79)19th), I was asked to agree with the other Ministers concerned revised external financing limits for 1980/81 for British Rail, National Bus Company and British Airways. This minute sets out the figures which we have since agreed. These revised limits, together with the limits already agreed for the other industries, including the energy industries, can be accommodated within the total in last week's White Paper.

British Rail and National Bus Company

2. Having discussed the options open to British Rail with Norman Fowler, I have accepted his case for a limit in 1980/81 higher than that proposed in the Chancellor's paper (C(79)48). This recognises the limited room for manoeuvre open to British Rail on wages and fares as well as the impact on their business results of lower economic activity and reductions in support for the passenger railway. Norman Fowler represented to me strongly the importance of a realistic cash limit in retaining the commitment of the management to the cash limit system.

3. He also reaffirmed his acceptance of the volume financing figures agreed for the later years and the need to ensure that British Rail takes the necessary steps to keep within these, which will demand very considerable efforts on their part. In these circumstances, we agreed that a limit of £750 million for 1980/81 - some £40-50 million less than British Rail would have liked - would be appropriate.

4. The position on National Bus Company (NBC) is similar and I have accepted Norman Fowler's proposal of an £85 million limit for NBC in 1980/81. Here too considerable effort will be needed to keep to the agreed figures for later years. We have therefore asked our officials to discuss with both industries their plans for that period.

British Airways

5. After a discussion with John Nott I have come to the conclusion that it would be reasonable to set a limit on external financing of £230 million for British Airways, rather than the £205 million implied by the revaluing of the review figures after an option cut of some £50 million (at outturn prices). We shall still have secured half of our previously proposed cut, in the face of a severe deterioration in the immediate prospects for the whole airline industry. John Nott feels that to set any lower limit would run a real risk of precipitating either costly industrial trouble (even the £230 million figure assumes that real unit labour costs will fall), or the need to sell newly-delivered aircraft, and that this could well prejudice our plans for selling shares in British Airways and provide a source of potential embarrassment for us, during the passage of the Civil Aviation Bill. He will, however, expect the airline to keep to its plan to include a five per cent staff reduction as part of the settlement for the coming pay round.

6. I am sending copies of this minute to Cabinet colleagues, Norman Fowler and Sir Robert Armstrong.

WJB

JOHN BIFFEN
9 November 1979

Prime Minister 1

You said we should have an early meeting on this. Robert Armstrong suggests putting it off until we have an outline of the White Paper. Shall I write as per his draft?

Ref: A0608

CONFIDENTIAL

MR. LANKESTER

I have seen the letter which the Chief Secretary's Private Secretary sent to you on 6th November, and the Treasury memorandum on the presentation of public expenditure figures for the years after 1980-81.

2. I find it difficult to see what other methods might be adopted for taking the spurious precision out of figures for the later years than some aggregation and rounding; and that is what the Treasury propose. It is clearly difficult to comment on the effects of doing this without seeing the actual results: one particular programme as an example is not really enough to go on. This makes me wonder whether there is much point in the Prime Minister having a meeting with the Chancellor of the Exchequer and the Chief Secretary at this stage: it might be more to the point to have a meeting - if one is necessary - when an outline draft of the White Paper is available, later this month.

3. If this approach commends itself to the Prime Minister, you may like to write to the Chief Secretary's Private Secretary on the lines of the draft attached.

RA

(Robert Armstrong)

8th November 1979

DRAFT

CONFIDENTIAL

LETTER FROM MR. LANKESTER TO
A. C. PIRIE, Esq., TREASURY

I have shown the Prime Minister your letter of 6th November and its accompanying memorandum about the presentation of public expenditure figures for the years after 1980-81.

The Prime Minister is content with the general approach proposed in the memorandum, though she has commented that the fact that spending authorities need to know their allocations for 1981-82 is not in itself necessarily a sufficient reason for publishing those allocations in detail in the forthcoming White Paper: if that was the only consideration, it should not be conclusive against some degree of aggregation and rounding in the White Paper even if spending authorities were going to be given their own allocations in more detail.

Given that the Prime Minister is content with the general approach, she thinks that it may be premature to hold a meeting at this stage. It will be easier for her, and for Treasury Ministers, to take a view on the effects of applying this approach when the results of doing so are available, in the shape of the outline draft of the White Paper to be submitted later this month. She therefore suggests that work should proceed on the outline draft in accordance with the approach suggested in the memorandum (and subject to the point to which I have referred in the ~~second~~ previous paragraph ~~of this letter~~). She will consider whether it would be advantageous to have a meeting when that outline draft is available.

I am sending copies of this letter to Tony Battishill and Martin Vile.

CONFIDENTIAL

Ref. A0597

PRIME MINISTER

Public Expenditure 1981-82 to 1983-84

(C(79) 54, the Chief Secretary's minute to you of 6th November about housing and his letter of 31st October to the Secretary of State for Education and Science)

BACKGROUND

Cabinet had an inconclusive discussion on the "later years" on 25th October, and you asked the Chief Secretary, Treasury, to pursue the outstanding issues bilaterally with the Ministers concerned. This paper (which summarily reports agreements set out more fully in the related correspondence) is the result.

2. The paper says nothing about defence. I understand that you agreed with the Chancellor of the Exchequer and the Secretary of State for Defence on Monday night that this need not be raised at Cabinet at all this week.

3. So I think you should be able to dispose of this item very briefly. There are no points for decision today, and other Ministers are unlikely to be very interested in the details of the deals which the Chief Secretary has done. (It is arguable that they should be, as you will see from the detailed notes I attach in an annex; but that is another matter.) The resulting figures will then be embodied in the second Public Expenditure White Paper. You are due to discuss shortly with the Chancellor and the Chief Secretary the degree of detail which should go into that White Paper.

HANDLING

4. I suggest, therefore, that you invite the Chief Secretary to introduce his paper as briefly as possible, merely reporting the circumstances in which he has reached agreement on environment and education, and indicating the basis on which the figures for agriculture have been left. You might then get the three Ministers concerned (the Secretaries of State for the Environment and for Education and Science, and the Minister of Agriculture, Fisheries and Food) to confirm that they accept these deals (this has of course been fixed up behind the scenes already), and simply record Cabinet endorsement.

CONFIDENTIAL

CONCLUSIONS

5. Subject to discussion, I think you should be able to record simply:

(i) That the Cabinet takes note of the revised figures for housing and for education.

(ii) That it agrees to resume its discussion of agriculture at the meeting on 6th December.

(iii) That the figures for Civil Service manpower may need revision in the light of discussions in Cabinet on 22nd November.

(iv) That the nationalised industry figures arise on the next item on the agenda.

(v) Invite the Chief Secretary, Treasury, to bring a draft of the Public Expenditure White Paper for these years to Cabinet on 20th December.

RGA

ROBERT ARMSTRONG

7th November, 1979

CONFIDENTIAL

ANNEX

Here are some notes on the points of substance, in case anybody raises them in the course of discussion.

Environment (Housing)

2. Mr. Heseltine has won on two points: he has secured a reduction in the Chief Secretary's bid, and he has got agreement that he should be free to decide how the available finance will be allocated. In theory, this conforms to your ruling, at the beginning of this Administration, that Departmental Ministers should be free to allocate their own programmes. In practice, it leaves the Chief Secretary in a slightly weak position next summer. There will be no decision in principle in favour of further increases in council house rents, and there will be no Government commitment on record. It would have been preferable, from the point of view of Cabinet as a whole, to have taken those decisions now and to have announced them. But, given the agreement which the Chief Secretary has reached, I do not think you will wish to reopen this issue in Cabinet.

Education

3. The argument last time was about the dis-economies of falling school numbers. The Chief Secretary has gone some way to meet the Secretary of State for Education and Science on this point, by building in a bigger allowance to cover these costs. He has also agreed a number of other changes, resulting in a significantly better deal for the Secretary of State for Education and Science than before. In particular, the package is now biased in favour of non-advanced further education (meeting a generally expressed wish in Cabinet) at the expense of some modification in the new "assisted places" scheme: this may be seen as a degree of back-tracking by the Government on a Manifesto commitment, but again I doubt whether Cabinet will wish to reopen the deal.

Agriculture

4. Mr. Walker may protest that the figures used in the table attached to the Chief Secretary's paper assume that the Treasury wins. But paragraph 2(1) makes it clear that "this is entirely without prejudice to the eventual decision between the Treasury's proposals and those put forward by the Minister of Agriculture ...". If the Minister of Agriculture raises this, you might simply

say that discussion must wait until Cabinet returns to the question of agriculture at the meeting on 6th December.

EEC Contribution

5. Mr. Walker may also seek to revert to the point he has made previously in Cabinet - and on which he has corresponded at length with the Chief Secretary - that the White Paper overprovides for our future EEC contribution. If he does so, you might ask the Chief Secretary to comment and then rule on the lines of not counting our chickens before they are hatched. Anything else might tempt other spending Ministers to join Mr. Walker in the hopes of recovering ground they have lost in the Cabinet's discussion on their programmes.

Staff Savings

6. It now looks likely that the Lord President's paper on staff savings will be postponed until 22nd November. It should not be allowed to slip further, or the timetable for the Public Expenditure White Paper will slip again.

Nationalised Industries

7. The figures in Annex A reflect the results of separate bilaterals with the sponsor Ministers which are reported in C(79) 56 - next item on the agenda.

Gas Prices

8. The nationalised industry figures in Annex A assume agreement on the future pattern of gas prices. A paper on this is due to go to E on 13th November. You might remind Mr. Howell that this timetable must not be allowed to slip either.

CONFIDENTIAL

Ref. A0596

PRIME MINISTER

Nationalised Industries' Investment and Financing

(C(79) 56)

BACKGROUND

This paper, like the previous item on the Agenda (C(79) 54), is a report back by the Chief Secretary on some bilateral discussions he undertook last month. It was ready last week, but discussion was postponed so that it could be taken at the same time as the report back on the Departmental expenditure bilaterals.

2. The Chief Secretary reports agreement with all the sponsoring Ministers (save for an outstanding point on gas prices, which is to come to E Committee next week). There should thus be no need to discuss the paper, and the Cabinet should be able simply to 'take note'.

3. The figures in the Annex to the paper are those which would be published, either in aggregate, or broken down by industries, in the forthcoming 'later years' Public Expenditure White Paper. They are in 'Survey' prices, and, unlike the figures for 1980-81, do not have to be turned into cash limits this year. (Cabinet has, of course, already settled the cash limits for the industries for 1980-81). They relate only to the net external financing requirements of the industries, and not to their total investment: they are thus necessarily very tentative at this distance.

HANDLING

4. I suggest that you invite the Chief Secretary to report, briefly, on his discussions with the sponsor Ministers, and then ask whether any Ministers wish to raise points on this paper. Our information is that there are no outstanding issues left to resolve.

CONCLUSIONS

5. It should therefore be possible for you to sum up that the Cabinet:

(i) takes note of the position reached and approves these figures for inclusion in the Public Expenditure White Paper (leaving open, for the moment, the degree of detail to be included there);

(ii) takes note that the outstanding issue on gas prices will be considered by E next week.

RGA

(Robert Armstrong)

7th November, 1979

CONFIDENTIAL

Prime Minister

R

7/11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7th November, 1979

Dear Tim,

PUBLIC EXPENDITURE: LATER YEARS

..... The Chancellor thought the Prime Minister might find the attached memorandum by Treasury officials useful as background to item 4 of tomorrow's Cabinet discussion.

Yours ever,

MK

(M.A. HALL)
Private Secretary

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

CONFIDENTIAL

PUBLIC EXPENDITURE: LATER YEARS

1. Treasury Ministers may wish to have a note on the overall picture for public expenditure in the light of recent decisions about later years.

2. The annexed table shows that, if the changes still under discussion (nationalised industries, agriculture, civil service) yield the savings hoped for, the total for 1981-82 will be slightly below the White Paper total for 1980-81, and the two later years rather lower than that. Hence the Government will have achieved its objective of a stable public expenditure programme starting from the 1978-79 level, with a small amount of leeway in 1982-83 and 1983-84.

3. But there are two important qualifications - will the programme be achieved in practice, and is it low enough?

A. Threats to Achievement

4. In the first place, there are the "changes still under discussion" already mentioned:

(i) On the nationalised industries the figures in line 5(ii) are £450 million worse than proposed earlier for 1981-82, but better in 1983-84. They assume that the phasing of gas pricing is resolved favourably (worth about £100 million in 1982-83 and £400 million in 1983-84); and that Mr. Nott's criticism of over-pricing for telecommunications does not prevail.

(ii) There is approaching £100 million a year at stake in the review of agriculture (line 5(i)), not now to be decided before December.

(iii) The assumed extra civil service staff savings (line 5(iii)) seemed optimistic to us even before last week's Cabinet, and in the light of Cabinet discussion

it now seems probable that they are over-estimated by at least £100 million a year. These savings too will probably not be settled until around the end of the month.

5. In addition, there are several variations in the figures which are already foreseeable:

(i) As C(79)56 points out, the nationalised industry figures are likely to be revised downwards in next year's Investment and Financing Review. They assume success on pricing and on the loss-making industries (e.g. nil borrowing by BSC from 1982-83 onwards), and are optimistic about economic growth.

(ii) Social security spending rests on the June assumptions for prices and unemployment which may need revision in either direction; in the economists' view the unemployment figure is more likely to be too low, and an extra 100,000 would add £100 million.

(iii) Local authorities may be unable or unwilling to make the full savings in current expenditure which have been counted into the totals, e.g. on school meals and transport. Instead they may choose a further increase in the rates, adding to public expenditure overall.

(iv) On the other hand, the figures included for EEC contributions take no credit for success in renegotiating the basis for contributions, so that there could be some gain on that front.

(v) In the industry programme, extra provision may be needed for Rolls Royce and British Leyland.

(vi) The employment programme makes no provision for continuing temporary employment measures, nor for any increase in redundancy rebates (which could add £100 million a year).

6. To meet these claims, and others not yet foreseeable, there is provision in the contingency reserve of £1,500 million, £2,000 million and £2,500 million in the three years. This is certianly not more than adequate, given that child benefit uprating, which is not provided for in the social security programme, will be virtually inescapable and could cost £500 million in 1981-82 rising to nearly £1,000 million in 1983-84.

B. Adequacy of Cuts

7. The annexed table shows that the cuts in Departments' programmes so far secured fall short of the original Treasury proposals by:

1981-82	1982-83	1983-84
888	1213	1304

As a result, even counting in the extra savings not yet agreed (paragraph 4 above), the totals achieve stability but make no significant progress towards the 1977-78 level which Treasury Ministers had earlier taken as a target - and which the Chancellor's paper C(79)30 said would still (according to current projections) leave no room for real tax cuts in the 1980 and 1981 Budgets.

APPENDIX

	£m at 1979 survey prices		
	81-82	82-83	83-84
1. Total (projected outturn) before changes	75977	77220	77200
2. Changes proposed or assumed in C(79)35:			
(i) major spending Departments	-5658	-7269	-7117
(ii) nationalised industries	-750	-950	-1250
(iii) staff savings additional to (i)	-175	-250	-300
(iv) contingency reserve	-697	-750	-250
(v) sales of assets	-50	+50	+50
3. Resulting total (1 + 2)	68647	68051	68333
4. Changes agreed so far:			
(i) major spending Departments	-4770	-6056	-5813
(iv) contingency reserve	-697	-750	-250
(v) sales of assets	-200	-100	-100
5. Changes still under discussion			
(i) agriculture (UK)	-72	-96	-92
(ii) nationalised industries	-300	-1000	-1650
(iii) staff savings additional to 4(i) and 5(i) suggested by CSD	-175	-250	-275
6. Total (1 + 4 + 5)	69763	68968	69020

Earlier years	77-78	78-79	79-80	80-81
7. Total (outturn) as in Cmnd 7746	65848	69767	69797	69829
8. Total for 1980-81 proposed in C(79)26				68000

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1

7 November 1979

Dear David,

BRITISH GAS CORPORATION: CASH LIMIT 1980-81

Sir Kenneth Berrill sent me a copy of his letter to you of 1 November suggesting that the BGC's cash limit for 1980-81 of £400 million might be linked in some way to the performance of the oil price.

I certainly sympathise with the thought behind Sir Kenneth's suggestion. Once the Energy Conservation Bill is enacted, the implicit link between contract gas prices and domestic tariff prices will have been removed. In these circumstances if oil prices rise faster than assumed for the calculation of BGC's cash limit, the Corporation could, if they so choose, reduce the increase in domestic tariffs and still keep within their cash limit. In these circumstances the industrial consumer would be subsidising the domestic consumer. This would be undesirable for both industrial and energy policies and, as Sir Kenneth says, the PSBR would be higher than it might otherwise be.

A link between the cash limit and the performance of the oil price might indeed be one way of dealing with this problem. But the disadvantage of this course is that it would introduce an explicit and automatic element of conditionality into the cash limit (or more properly the external financing limit as the nationalised industries' cash limits are now known). This might work in our favour in BGC's case but my judgement is that we have more to lose with conditionality than we have to gain so far as the other nationalised industries are concerned. I am reinforced in this view by some of the proposals in the paper which the Chairman of the Chairmen's Group sent to the Chancellor on "a framework of financial discipline for the public sector corporations".

I am therefore hesitant about Sir Kenneth's suggestion of linking the cash limit and the oil price in the way suggested

and I would like to propose an alternative procedure which would go some way to meet his point. I suggest that when you write to the BGC informing them of their cash limit, you should make clear our understanding of the oil price asumptions implicit in their cash limit both for BGC's purchases and sales of gas. Your Department should then monitor movements of oil prices against those assumed in BGC's cash limit so that we can consider setting BGC a new limit if oil prices warrant it.

Sir Kenneth's suggestion is also relevant to the Corporation's financing target which we will shortly agree with them. This will require assumptions about oil prices over the next 3 years and will raise in even more acute form the difficulty to which Sir Kenneth has drawn attention. I see much less difficulty in making the financial targets conditional on oil prices and I suggest that our officials, in consultation with the Corporation, should try to devise a formula for the target which links it to rises in oil prices. Otherwise we could well find that the financial discipline implied in the target is eroded by unexpected increases in oil prices.

I am sending copies of this letter to the Prime Minister, other members of E Committee and Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

CONFIDENTIAL

Prime Minister

You will want to discuss this with Treasury Ministers, (meeting fixed for next Thursday).

Yes. 7/11

Treasury Chambers, Parliament Street, SW1P 3AG

T P Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

6 November 1979

Dear Tim,

THE PUBLIC EXPENDITURE WHITE PAPER COVERING THE YEARS AFTER 1980-81

I attach a note setting out proposals on the degree of detail to be given for the later years, in response to the Prime Minister's request conveyed in Martin Vile's letter of 5 November.

I should perhaps mention that, now that the main decisions on the 1979 public expenditure Survey have been taken, the Treasury has launched a review, with the spending Departments, of the way in which the Survey is conducted and the material is presented to Ministers. This will include the possibility of looking at programmes for the later years in less detail, and with more grouping, in future.

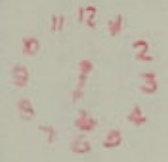
I am copying this letter to Tony Battishill and Martin Vile.

Yours sincerely,

Alistair Pirie

A C PIRIE
(Private Secretary)

CONFIDENTIAL



PRESENTATION OF PUBLIC EXPENDITURE FIGURES
FOR THE YEARS AFTER 1980-81

1. This note concerns the form in which the public expenditure decisions for the later years should be published. The Cabinet decided on 13th September that the White Paper covering the later years should contain totals for expenditure on the main programmes and an appropriate amount of detail for certain programmes such as education and law and order, but that the detail for other local authority services should be kept to a minimum. They considered that the tentative nature of the figures for the later years should be emphasised.

2. Discussions between the Treasury and Departments at official level have indicated that the spending Departments feel themselves faced with a dilemma. They accept that the tentative nature of the later figures should be stressed. They recognise the spuriousness of publishing plans up to four years ahead in great detail. But given the importance of influencing expectations, they want to give enough detail about the later years to convince outside observers that the Government's plans for stabilising expenditure are well-founded and will be achieved. They know that their Ministers will come under close questioning in Parliament and in the new departmental Select Committees. They will in any case be giving some details to spending authorities as the basis for forward planning.

3. Treasury officials have envisaged that the White Paper would give figures for the years up to and including 1980-81 in the usual detail, and that the figures for the later years would be given in a rounded form and in much less detail. For some programmes, where spending authorities will need to know their allocations for 1981-82 before next year's White Paper is published, there will be advantage in including detail for 1981-82 also, and rounding the figures for the last two years. An example of what is envisaged is the attached illustrative table for Programme 2 (on which we have not yet consulted the FCO). For other programmes, such as housing, the Ministers concerned will probably not want to give a detailed breakdown even for 1981-82. For yet others, such as the examples of education and law and order mentioned at Cabinet, it

may be desired to give more details for the later years. It is not essential to treat all programmes identically.

4. Apart from the reduction in detail about programmes in the later years, we have envisaged that the spread of information given by the White Paper would be much the same as in previous years. That is to say, the programme chapters would contain comment on spending in the last complete year, and on what has been achieved by the programme and is planned to be achieved, plus a bibliography of other sources of information. The rest of the White Paper would contain the normal analyses and statistical breakdowns, including changes from the previous plans, public expenditure in cost terms and by economic category: but the analysis in cost terms and by economic category will probably not extend beyond 1980-81, because some of the programme chapters will not provide the detail on which to base the analysis. For local authority expenditure, the agreement that the Secretary of State for the Environment should keep his options open on ways of achieving the agreed reductions in housing means that it will not be possible to include figures of this major component of local authority expenditure after 1980-81.

But for defence there would be advantage. PL

5. It would theoretically be possible to have a still more summary presentation, but we do not recommend it. If, for example, the Government were to publish for the later years no more than what is in the short White Paper on 1980-81, i.e. figures for the volume of expenditure on the main programmes and a paragraph or two on each programme, this would (in the Parliamentary context) put the clock back to the very early years of these White Papers. The new Select Committees have been set up to achieve a more effective scrutiny of Departments than the previous Expenditure Committee. To tell them that the Government would provide a good deal less information even about the years up to 1980-81 than the previous Committee was given would provoke strong criticism in Parliament. Even the reduced detail we propose in paragraph 3 above may encounter some unfavourable comment of this kind. Where information is omitted, Select Committees and individual MPs can be expected to press Departments for the missing information.

Recommendation

6. Our recommendation is that the White Paper should contain the

same spread of information for the years up to 1980-81 as in previous White Papers. The amount of detail to be given for the later years should be considered programme by programme, but in general only summary and rounded figures of planned expenditure should be given at least for 1982-83 and 1983-84, and in some cases for 1981-82 also. Accordingly, most of the special analyses and statistical breakdowns of the expenditure plans would not extend beyond 1980-81. If this is agreed, the Treasury will discuss with each Department on this basis the information which they would want to give, and submit an outline draft of the White Paper later this month.

OVERSEAS AID AND OTHER OVERSEAS SERVICES

	'1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Overseas aid	628	699	671	718	786	790	782	738	700	700
Overseas aid administration	10	13	12	12	11	13	13	14		
Overseas representation	212	216	202	183	187	187	192	192		
Overseas information	70	72	72	68	68	70	70	69	-	380	380
Other external relations	100	109	106	114	130	146	130	120		
Military aid	5	2	2	3	3	10	3	2		
Total	1025	1110	1064	1097	1186	1216	1192	1134	1080	1080
Contribution to the European Communities (net) and to the European Investment Bank	-13	16	281	632	774	919	1000	1100	1300	1550
Sterling area guarantees	140	-	-	-	-	-	-	-	-	-
Special assistance to the Crown Agents	162	-	-	107	-	-	-	-	-	-
Total	1314	1127	1345	1836	1960	2135	2191	2234	2380	2630

CONFIDENTIAL

Prime Minister 2

Mr. Heseltine has achieved the savings required by Cabinet.

PRIME MINISTER

6/11

PUBLIC EXPENDITURE FOR THE LATER YEARS: HOUSING

Cabinet on 18 October invited the Secretary of State for the Environment and myself to agree on a course of public expenditure savings somewhere between Options C and D as described in the Secretary of State's memorandum on rents and subsidies (C(79)44). We have met twice, and agreed on a course which does so.

Flag A

2. The Secretary of State has agreed to achieve the reductions in his housing programme which will deliver (net of increases in rebates and supplementary benefit) the following amounts (over and above those previously agreed):-

£ million 1979 survey prices

1981-82	1982-83	1983-84	Total
285	395	525	1,205

3. Options C and D related to savings in housing subsidies, chiefly from rent increases. The Secretary of State, however, considers that he should have as much flexibility as possible within his future programme. He therefore proposes - and I agree - that he should achieve these savings without commitment to particular levels of rent increase (or subsidy reduction) in the later years, or to any precise division between capital and current expenditure. We shall need to settle at the appropriate time each year the composition of the programme for the following year.

CONFIDENTIAL

4. The total net savings thus agreed for the Housing Programme are as follows:-

£ million

1981-82	1982-83	1983-84	Total
1,422	1,798	2,038	5,258

5. I am sending copies of this minute to the other members of Cabinet and to Sir Robert Armstrong.

WJB

6 November 1979

CONFIDENTIAL

Prime Minister

You will want to discuss this with Treasury Ministers, (meeting fixed for next Thursday)

7/11

Treasury Chambers, Parliament Street, SWIP 3AG

T P Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

6 November 1979

Dear Tim,

THE PUBLIC EXPENDITURE WHITE PAPER COVERING THE YEARS AFTER 1980-81

I attach a note setting out proposals on the degree of detail to be given for the later years, in response to the Prime Minister's request conveyed in Martin Vile's letter of 5 November.

I should perhaps mention that, now that the main decisions on the 1979 public expenditure Survey have been taken, the Treasury has launched a review, with the spending Departments, of the way in which the Survey is conducted and the material is presented to Ministers. This will include the possibility of looking at programmes for the later years in less detail, and with more grouping, in future.

I am copying this letter to Tony Battishill and Martin Vile.

Yours sincerely,

Alistair Pirie

A C PIRIE
(Private Secretary)

CONFIDENTIAL

PRESENTATION OF PUBLIC EXPENDITURE FIGURES FOR THE YEARS AFTER 1980-81

1. This note concerns the form in which the public expenditure decisions for the later years should be published. The Cabinet decided on 13th September that the White Paper covering the later years should contain totals for expenditure on the main programmes and an appropriate amount of detail for certain programmes such as education and law and order, but that the detail for other local authority services should be kept to a minimum. They considered that the tentative nature of the figures for the later years should be emphasised.

2. Discussions between the Treasury and Departments at official level have indicated that the spending Departments feel themselves faced with a dilemma. They accept that the tentative nature of the later figures should be stressed. They recognise the spuriousness of publishing plans up to four years ahead in great detail. But given the importance of influencing expectations, they want to give enough detail about the later years to convince outside observers that the Government's plans for stabilising expenditure are well-founded and will be achieved. They know that their Ministers will come under close questioning in Parliament and in the new departmental Select Committees. They will in any case be giving some details to spending authorities as the basis for forward planning.

3. Treasury officials have envisaged that the White Paper would give figures for the years up to and including 1980-81 in the usual detail, and that the figures for the later years would be given in a rounded form and in much less detail. For some programmes, where spending authorities will need to know their allocations for 1981-82 before next year's White Paper is published, there will be advantage in including detail for 1981-82 also, and rounding the figures for the last two years. An example of what is envisaged is the attached illustrative table for Programme 2 (on which we have not yet consulted the FCO). For other programmes, such as housing, the Ministers concerned will probably not want to give a detailed breakdown even for 1981-82. For yet others, such as the examples of education and law and order mentioned at Cabinet, it

may be desired to give more details for the later years. It is not essential to treat all programmes identically.

4. Apart from the reduction in detail about programmes in the later years, we have envisaged that the spread of information given by the White Paper would be much the same as in previous years. That is to say, the programme chapters would contain comment on spending in the last complete year, and on what has been achieved by the programme and is planned to be achieved, plus a bibliography of other sources of information. The rest of the White Paper would contain the normal analyses and statistical breakdowns, including changes from the previous plans, public expenditure in cost terms and by economic category: but the analysis in cost terms and by economic category will probably not extend beyond 1980-81, because some of the programme chapters will not provide the detail on which to base the analysis. For local authority expenditure, the agreement that the Secretary of State for the Environment should keep his options open on ways of achieving the agreed reductions in housing means that it will not be possible to include figures of this major component of local authority expenditure after 1980-81.

5. It would theoretically be possible to have a still more summary presentation, but we do not recommend it. If, for example, the Government were to publish for the later years no more than what is in the short White Paper on 1980-81, i.e. figures for the volume of expenditure on the main programmes and a paragraph or two on each programme, this would (in the Parliamentary context) put the clock back to the very early years of these White Papers. The new Select Committees have been set up to achieve a more effective scrutiny of Departments than the previous Expenditure Committee. To tell them that the Government would provide a good deal less information even about the years up to 1980-81 than the previous Committee was given would provoke strong criticism in Parliament. Even the reduced detail we propose in paragraph 3 above may encounter some unfavourable comment of this kind. Where information is omitted, Select Committees and individual MPs can be expected to press Departments for the missing information.

Recommendation

6. Our recommendation is that the White Paper should contain the

same spread of information for the years up to 1980-81 as in previous White Papers. The amount of detail to be given for the later years should be considered programme by programme, but in general only summary and rounded figures of planned expenditure should be given at least for 1982-83 and 1983-84, and in some cases for 1981-82 also. Accordingly, most of the special analyses and statistical breakdowns of the expenditure plans would not extend beyond 1980-81. If this is agreed, the Treasury will discuss with each Department on this basis the information which they would want to give, and submit an outline draft of the White Paper later this month.

OVERSEAS AID AND OTHER OVERSEAS SERVICES

	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Overseas aid	628	699	671	718	786	790	782	738	700	700
Overseas aid administration	10	13	12	12	11	13	13	14		
Overseas representation	212	216	202	183	187	187	192	192		
Overseas information	70	72	72	68	68	70	70	69	-	380	380
Other external relations	100	109	106	114	130	146	130	120		
Military aid	5	2	2	3	3	10	3	2		
Total	1025	1110	1064	1097	1186	1216	1192	1134	1080	1080
Contribution to the European Communities (net) and to the European Investment Bank	-13	16	281	632	774	919	1000	1100	1300	1550
Sterling area guarantees	140	-	-	-	-	-	-	-	-	-
Special assistance to the Crown Agents	162	-	-	107	-	-	-	-	-	-
Total	1314	1127	1345	1836	1960	2135	2191	2234	2380	2630

Subject file
Econ Pol - Public Exp
Strategy Pt 4

Chancellor

bc Wolfson
Vile (ca)

10 DOWNING STREET

From the Private Secretary

5 November 1979

KRB

The Chancellor of the Exchequer called on the Prime Minister at 1730 hours today to discuss his proposals for the Bray forecast and for the economic assumptions to be given to the Government Actuary. (These proposals were set out in his minute of 2 November.)

They agreed on the following forecasts/assumptions:

(i) RPI per cent increase 4th quarter of 1980 on 4th quarter of 1979 (or for the Actuary's report, November 1980 on November 1979) - 14%.

(ii) Average earnings increase financial year 1980/81 on 1979/80 - 14%.

(iii) Average number wholly unemployed (Great Britain) financial year 1980/81 - 1.6 million.

(iv) Average number wholly unemployed (Great Britain) financial year 1979/80 - 1.25 million.

The Chancellor and the Prime Minister agreed that the Treasury forecast should not be circulated ~~widely~~ in Whitehall.

The Chancellor raised the question of whether there should be an economic strategy discussion in Cabinet. He said that he would find it helpful to have such a discussion in order to persuade more Cabinet colleagues

 / of the rightness

of the rightness of the overall strategy. He suggested that, before putting a paper to Cabinet, a draft might be considered by a small group of senior Ministers. The Prime Minister agreed that a strategy discussion in Cabinet would be useful, and that this should be preceded by a smaller meeting. Ministers for this smaller meeting should include the Secretary of State for Employment, the Lord President, the Home Secretary and the Secretary of State for Social Services. The Chancellor should aim for this initial discussion within the next few weeks.

The Chancellor reported that Treasury officials were examining the options for the presentation of the figures in the Public Expenditure White Paper for the later years of the P.E.S.C. period. He was hoping to have a meeting with Treasury Ministers to consider a paper by officials in the near future, and would then be ready to discuss the question with the Prime Minister.

T. P. LANKESTER

A. M. W. Battishill, Esq.,
H.M. Treasury.

SECRET

FCO RP 5

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref: A0572

5th November 1979

12.45

Public Expenditure to 1983-84

The Prime Minister thinks that it would be useful if the Chief Secretary could circulate a brief memorandum to the Cabinet for its meeting on 8th November, reporting the outcome of the various bilateral discussions left over from the discussion on 25th October.

This memorandum would report the outcome of the Chief Secretary's discussions with the Secretaries of State for the Environment, and Education and Science on housing and education. On agricultural grants, the memorandum could invite the Cabinet to agree that a decision should be held over until Sir Kenneth Berrill's group has reported, which will be (I understand) by the end of November. If the matter can then be resolved by agreement between the Chief Secretary and the Minister of Agriculture, well and good; if not, it can come to the Cabinet on 6th December.

I am sending copies of this letter to Tim Lankester, Tony Battishill, Garth Waters, David Edmonds and Philip Hunter.

M. J. VILE

(M. J. Vile)

A. C. Pirie, Esq

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

12 Nov

5 November 1979

CASH LIMITS: FLEXIBILITY BETWEEN FINANCIAL YEARS

I have seen a copy of your letter of 18 October to David Howell. I agree that the immediate question of including nationalised industries in the proposed study of the application of accounting conventions to Government business is for Sir Derek to consider. I believe however that the arguments for allowing nationalised industries a greater degree of flexibility in meeting their cash limits in the individual years are stronger than your letter suggests, at least in the case of the industries which I sponsor.

You are already aware from my letter of 24 September that the Scottish Electricity Boards are facing extreme difficulties in meeting their cash limits for the current year, largely as a result of the unpredictable timing of their expenditure, which spilled over into this year. We all recognise this weakness in the cash limits system; but your rejection (to which I shall return separately) of any adjustment to the Boards' cash limits conveys that, contrary to the acknowledgement in your letter, the cash limits are immutable. The consequence may well be that the industries will revert to building headroom into their estimates, on the basis that there is only one direction in which these estimates are ever adjusted, and that the limited discipline imposed on their operations by cash limits at present will disappear entirely.

Your letter goes on to argue that the nationalised industries have ample scope for adjusting their plans to meet cash limits. I do not believe this to be true of the electricity industry. Nor do I think that to encourage the industries to manipulate their accounts in order to stay within cash limits necessarily serves our overall objective of controlling public borrowing.

As the Chancellor's paper for E Committee (E(79)35) brought out, the pressure exerted by cash limits for responsible pay bargaining depends on the make-up of the industry's costs. In the case of the electricity industry in Scotland it is not possible to set a cash limit for the Boards with sufficient precision to exert any direct influence in this area, for the simple reason that a day's delay in the settlement of a single contractual claim can have more effect on a Board's cash limit than any conceivable irresponsibility in its settlement of a wages claim.

My fear is that if we maintain our present inflexible position on cash limits for nationalised industries the system will, in its broader application, become discredited. I hope, therefore, that we can give some further thought over the coming months to the operation of the cash limit system for nationalised industries (I am sure that the industries themselves will continue to press for a more flexible approach) and that we shall not be unduly inhibited by decisions taken for presentational reasons in the context of a demanding PES timetable.

I am copying this letter to the recipients of yours.

With the Compliments
of the
Private Secretary
to the
Secretary of the Cabinet

T. P. Lankester, Esq

No meeting to be called.

12/11

Cabinet Office,
London, S.W.1.

12th

CONFIDENTIAL

1. Clive Whitmore 6/11
2. Caroline

The Chancellor won't be ready to discuss this until next week.
Could you (Caroline) fix a time with Chancellor's office.
PL
6/11

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref: A0571

5th November 1979

Public Expenditure White Paper

The Prime Minister believes that it is neither necessary nor desirable that, in the White Paper on Public Expenditure to 1983-84, the figures for the later years should be given with the degree of detail and precision which is no doubt appropriate for those for 1980-81. She would like to discuss with the Chancellor of the Exchequer and the Chief Secretary, and with Treasury officials as appropriate, how the figures for later years might be aggregated and rounded and the extent to which this process should be taken.

She understands that some thought has been given to this possibility in the Treasury, and she would be grateful if the Chief Secretary would prepare a note setting out proposals to achieve these results. If that note could be circulated within the next two days the Prime Minister would hope to have a meeting later this week. I understand that this would enable decisions to be taken in time to be taken into account in the final preparations of the White Paper.

I am copying this letter to Tim Lankester and Tony Battishill.

M. J. VILE

(M. J. Vile)

A. C. Pirie, Esq

COVERING - SECRET

4

10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG
CABINET OFFICE

Public Expenditure

The Prime Minister was grateful for your minute of 1 November (Ref. A0543).

The Prime Minister is content to postpone the public expenditure decisions on agriculture until 6 December; and since agreement has now been reached on housing and education expenditure, she agrees that there is no need to set up the small group under her Chairmanship which had been suggested earlier. She also thinks it would be a good idea if the Chief Secretary could circulate a brief report to Cabinet next week on the outcome of his further bilaterals with a proposal also on the lines suggested in your minute for dealing with agricultural grants.

On the question of the defence programme, we hope to arrange a meeting for the Prime Minister with the Defence Secretary, the Chancellor and the Chief Secretary to discuss the handling early next week. I am sure the Prime Minister would be grateful for a speaking note in the light of that meeting. (I am attaching a copy of the Chancellor's minute recording the agreement which has been reached.)

T. P. LANKESTER

KRB

2 November 1979

Treasury Chambers, Parliament Street, SW1P 3AG

Tim Lankester Esq
10 Downing Street
LONDON SW1

2 November 1979

Dear Tim

PUBLIC EXPENDITURE WHITE PAPER ON 1980-81: BRIEFING

We agreed on the telephone that I would send you the attached revisions to the briefing.

Yours ever

Roger Watts

R J T WATTS

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir L Airey
Sir F Atkinson
COGPEC
Mr Mower
Mr Ridley
Mr Cardona
GECS

WHITE PAPER ON PUBLIC EXPENDITURE 1980-81 : BRIEFING

I attach further briefing, as follows:

(a) B4 (Addendum), on what to say if asked about the economic assumptions, ie earnings and prices, including the pay assumptions to be included in the cash limits, and (for others) unemployment. The relative price effect is also covered, in response to a question from the Financial Secretary. Interest rates are covered in C4(R) factual point (v).

(b) B5 (Addendum), giving some additional figures for the ratio of public expenditure to GDP and what to say about international comparisons.

(c) C2(R), with a firm figure for the sale in 1979-80 of BP shares (£280m net benefit to the PSBR).

(d) C4(R) (Addendum), showing what happens if debt interest is added to the planning total.

[as subsequently circulated on 2nd Nov] (e) E10(R), giving the split of the programme between education and science on the one hand and arts and libraries on the other.

2. On British Leyland, I am advised that there is nothing to add to E4A(R), defensive point (iii), other than what you and colleagues may have decided at Cabinet.

3. On the 8p increase on basic rate, please delete second sentence of B2(R) defensive point (3).

Amended STP. 2.11.79.

MISS M E PEIRSON

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir L Airey
Sir F Atkinson
COGPEC
Mr Mower
Mr Ridley
Mr Cardona
GECS

PUBLIC EXPENDITURE WHITE PAPER ON 1980-81 : BRIEFING

Further again to Mr Perfect's submission of last night, I attach:

A5: the brief on year-on-year changes and differences compared with Cmnd 7439.

A2, 1st page, second revise.

B3, revise.

D1, 1st page, revise.

Amended SOP 2.11.79.

MISS M E PEIRSON
31 October 1979

CONFIDENTIAL

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765
From: Sir Kenneth Berrill KCB

Qa 04326

1 November 1979

Dear Secretary of State

British Gas Corporation: Cash Limit 1980/81

I have read your minute of yesterday to the Chancellor of the Exchequer proposing a cash limit for the British Gas Corporation (BGC) for 1980/81 of -£400m. at outturn prices and setting out the basis underlying this proposal.

The first two items in the list of assumptions concern the non-domestic tariff increasing by 10 per cent on 1 April 1980, and the contract prices for gas to industry moving in line with the non-domestic tariff until 1 July. The passing of the Energy Conservation Bill is assumed to have removed the links between contract prices and the domestic tariff after that date.

Since non-domestic gas sales are of the order of half BGC's total revenue, the terms on which these are sold are clearly of great importance to the setting of cash limits.

One important determinant of the level of non-domestic gas prices is the price of the equivalent heating oil. The chances that the money price of oil on world markets will rise during 1980/81 are clearly considerable but hard to estimate now. This means that it is difficult to set the cash limits for BGC in a way which will both recognise the possible level of non-domestic gas prices and require them to put up the price for domestic gas on the terms agreed by E Committee last Tuesday.

Might one link the £400m. in some way to the performance of the oil price? I raise this because quite large sums are potentially at stake which, if the oil price does go up more than presently assumed in the calculations, could be used to help the Chancellor's PSBR.

I am sending copies of this letter to the Chancellor of the Exchequer and the other members of E, and to Sir Robert Armstrong.

Yours sincerely.

Kenneth Berrill

KENNETH BERRILL

The Rt Hon David Howell MP

CONFIDENTIAL

CC NJS

CONFIDENTIAL

PA
NJS

Treasury Chambers, Parliament Street, SW1P 3AG

Tim Lankester Esq
10 Downing Street
LONDON SW1

1 November 1979

Dear Tim

CHIEF SECRETARY'S STATEMENT ON PUBLIC EXPENDITURE

I attach the final version of the statement which the Chief Secretary proposes to make to the House at 3.30 pm today.

The word "gross" in the sentence on the NHS in the third paragraph has been omitted to meet the Prime Minister's wishes.

I am sending a copy of this letter with the attached statement to John Stevens (Chancellor of the Duchy's office), Murdo Maclean (Chief Whip's office - 6 copies), Richard Prescott (Paymaster General's office) and to the Press Secretary at No 10.

Yours ever

Roger Watts

R J T WATTS

CONFIDENTIAL UNTIL 3.30 pm ON THURSDAY 1 NOVEMBER 1979

STATEMENT BY CHIEF SECRETARY TO THE TREASURY

THE GOVERNMENT'S EXPENDITURE PLANS 1980-81

H M Treasury
1 November 1979

PARLIAMENTARY STATEMENT

Mr Speaker, with permission I will make a statement about the White Paper, published today, on the Government's expenditure plans for 1980-81. Copies are available in the Vote Office.

The Government's strategy is to stabilise total public spending in volume terms. The outturn for last year, 1978-79, is now put at £69¾ billion at 1979 Survey prices. Estimates for the current year, 1979-80, are still speculative, but the outturn is not expected significantly to exceed last year's expenditure. We plan to hold the total for next year, 1980-81, at the same level.

Within the total planned for 1980-81, provision is made for growth in some programmes, offset by reductions in others. Provision for defence increases by 3 per cent in 1980-81 over the expected outturn in the current year, and provision for law and order increases by 3½ per cent. Expenditure on the National Health Service is maintained; whilst a rise in spending on social security partly reflects the recent pension uprating.

For local authorities, the plans provide for a reduction of 3 per cent in their capital and current expenditure over the two year period, 1978-79 to 1980-81. The reduction in their current expenditure is rather less and in line with the figures on which they have been consulted. The allocation between services shown in the White Paper is tentative. It will be for the authorities themselves to decide the pattern of their current expenditure in the light of local needs and conditions.

The plans also provide for a further programme of public sector asset sales aimed at a figure of some £½ billion in 1980-81 compared with £1 billion in 1979-80.

The Government consider that the plans in the White Paper take realistic account of the poor prospects for growth in the domestic and world economies, and of the need to bring government borrowing and the money supply under firm control without unacceptable consequences for taxation and interest rates. They will form the basis for setting the cash limits for 1980-81.

The Government's general intention is to publish the cash limits in time for spending authorities to take account of them in making major decisions affecting their costs in 1980-81, including the costs of pay settlements. We intend to exert a firm control on spending through the cash limits. Spending authorities must expect that, if they incur higher costs than provided for in the cash limits, it will not be possible to implement the full volume plans in this White Paper.

We aim to publish the cash limits on the rate support grants and the limits on the external financing requirements of the individual nationalised industries later this month. Other public service cash limits will be published nearer the start of the financial year.

The Government are also preparing provisional expenditure plans for the years up to 1983-84. These will be published in a subsequent White Paper.

SIR ROBERT ARMSTRONG

Public Expenditure

The Prime Minister has seen your minute A0525 of 30 October about public expenditure.

You mentioned this morning that it now looked as though the outstanding issues between Departmental Ministers and the Treasury would be reduced to agriculture and that there was no need to set up a formal group under the Prime Minister's chairmanship to deal with this.

As rggards the presentation of the figures in the later years in the White Paper on Public Expenditure to 1983/84, the Prime Minister prefers course (c) of the three options set out in paragraph 7 of your minute, and on the basis of the paper which the Treasury would produce under that course, she would be content to have a meeting in London during the week. I should be grateful if you could now arrange for the Treasury to produce their paper, while we, in the meantime, fix the meeting for the latter half of next week.

CAW

1 November 1979

oio

B.

SPEAKING NOTES FOR MINISTERS ON PUBLIC EXPENDITURE WHITE PAPER

ECONOMIC BACKGROUND

The Government's strategy is to hold total public spending at its present level in volume terms for the time being. The projected outturn for the current year, 1979/80 and next year 1980/81 is very close to the estimated outturn of 1978-79.

The immediate prospect for output is poor both at home and abroad. The growth of world trade is slow. The recent increase in the oil price has made matters worse. Unless the Government stabilises public spending, there can be no possibility of lower taxes, lower borrowing or lower interest rates.

The previous Government's plans for 1980/81 let alone subsequent years, involved a level of expenditure which could not be sustained. To pay for the additional £3¼ billion they planned would have required sharply higher taxes or borrowing.

The increase in the basic rate of income tax required to raise an additional £3¼ billion of revenue is about 8p.

The Chief Secretary in the previous administration has acknowledged that they would have had to make cuts in their planned expenditure. So did the previous Chancellor at the time of the Budget. And Mr Callaghan said, as long ago as 1976, that public spending should take a falling share of the nation's output.

The Government's central objectives are:

- to bring down the rate of inflation, through firm control of the money supply and Government borrowing.

- to restore incentives, through holding down and if possible reducing taxes, particularly on incomes.

- to plan for spending no greater than is compatible with these objectives, given the poor short term prospects for output.

This is not to deny that many public services need improvement. It is rather to recognise that improvement can only be secured through earning the money and resources needed to pay for them by higher output.

To plan for more expenditure before the necessary growth in output is available would only prevent that growth. We have seen the results of this approach over the years.

- Increases in taxes have made inflationary pressures worse and reduced incentives.

- High government borrowing has fuelled inflation and raised interest rates.

- High inflation has increased the risks and uncertainties faced by industry and gravely damaged investment, production and jobs.

So there is no real alternative to the policies we are following.

OVERALL PLAN

The Government have provided for growth in some programmes, particularly defence, law and order and social security (partly reflecting this month's record pension uprating), and for the higher pay scales which will follow from the awards of the Clegg Commission on comparability. Within the total, reductions have therefore been made in some other services including education, housing, and roads and transport.

Local authorities The Government's White Paper shows a broad distribution of local authority current expenditure which reflects the Government's view of national priorities. It is for individual authorities, however, to decide the eventual distribution in the light of local needs and conditions.

SOME SELECTED POINTS

Defence The 3 per cent increase for 1980/81 reflects the Government's determination to give priority to strengthening the nation's defences.

Overseas aid	About the same level in 1980/81 as in the current year.
FCO	23 overseas posts to be closed or reduced in size.
Price Commission	Abolition expected to save £7 million in 1980/81.
Roads and transport	Reduction in overall programme in 1980/81 but allowance for increased expenditure on motorway maintenance. About half of reduction intended to come from local transport; much of rest from changes, in agreements for funding of British Rail and National Freight Corporation pension schemes.
Housing	Reduction in 1980/81 expected, largely as consequence of reductions in local authority housebuilding in recent years. Over a period of years Government intend to reduce level of housing subsidies.
Law and order and protective services	£88 million more in 1980/81 (£23m more than previously planned for that year) will allow an increase in numbers of police and in provision for probation and after-care services and magistrates' courts, and enable existing standards of fire cover to be maintained.
Education	Reduction reflects falling numbers of pupils and expected savings on school milk, meals and transport. No reduction in provision for capital spending on school basic needs : but building programmes for school improvements, under fives and further/higher education to be reduced. New overseas students (or their sponsors) to meet full cost of tuition.

Health	1980/81 spending on NHS to be maintained at level proposed by last Administration. Net cost to taxpayer reduced : prescription charges increased to 70p next April - only slightly higher in real terms than when re-introduced in 1971. Dental charges will be revised to maintain their 1979/80 level in real terms. Measures to eliminate waste and simplify administration.
Personal social services	Government expect that local authority savings will as far as possible be made by further increases in efficiency, collaboration with the voluntary sector, elimination of low priority provision and policies to help people help themselves. Local authorities asked to protect the more vulnerable, and to give priority to children's services concerned with prevention and treatment of delinquency.
Social security	Provision reflects Government's intention to intensify efforts against fraud and abuse.

Paymaster General's Office
Privy Council Office
68 Whitehall
London SW1A 2AT

01-233-8632/8744/4827

1 November 1979

PUBLIC EXPENDITURE (WHITE PAPER)

The Chief Secretary to the Treasury (Mr. John Biffen): With permission, Mr. Speaker, I will make a statement about the White Paper, published today, on the Government's expenditure plans for 1980-81. Copies are available in the Vote Office.

The Government's strategy is to stabilise total public spending in volume terms. The outturn for last year, 1978-79, is now put at £69¾ billion at 1979 survey prices. Estimates for the current year, 1979-80, are still speculative, but the outturn is not expected significantly to exceed last year's expenditure. We plan to hold the total for next year, 1980-81, at the same level.

Within the total planned for 1980-81, provision is made for growth in some programmes, offset by reductions in others. Provision for defence increases by 3 per cent. in 1980-81 over the expected outturn in the current year, and provision for law and order increases by 3½ per cent. Expenditure on the National Health Service is maintained, whilst a rise in spending on social security partly reflects the recent pension uprating.

For local authorities, the plans provide for a reduction of 3 per cent. in their capital and current expenditure over the two-year period 1978-79 to 1980-81. The reduction in their current expenditure is rather less and in line with the figures on which they have been consulted. The allocation between services shown in the White Paper is tentative. It will be for the authorities themselves to decide the pattern of their current expenditure in the light of local needs and conditions.

The plans also provide for a further programme of public sector asset sales aimed at a figure of some £¼ billion in 1980-81 compared with £1 billion in 1979-80.

The Government consider that the plans in the White Paper take realistic account of the poor prospects for growth in the domestic and world economies, and of the need to bring Government borrowing and the money supply under firm control without unacceptable consequences for taxation and interest rates. They will form the basis for setting the cash limits for 1980-81.

The Government's general intention is to publish the cash limits in time for spending authorities to take account of them in making major decisions affecting their costs in 1980-81, including the costs of pay settlements. We intend to exert a firm control on spending through the cash limits. Spending authorities must expect that, if they incur higher costs than provided for in the cash limits, it will not be possible to implement the full volume plans in this White Paper.

We aim to publish the cash limits on the rate support grants and the limits on the external financing requirements of the individual nationalised industries later this month. Other public service cash limits will be published nearer the start of the financial year.

The Government are also preparing provisional expenditure plans for the years up to 1983-84. These will be published in a subsequent White Paper.

Mr. Healey: If I did not know the right hon. Gentleman better, I would suspect that he was rather ashamed of what he had to tell us. His statement was even thinner than the White Paper, which is the most uninformative to come before the House for many years. Is it not the case that he is planning a cut of £3,500 million on previous plans and that this is the price that the people of this country are having to pay for the fact that the Government's economic policy has given Britain the highest inflation and the lowest growth in the whole of the Western world? It has led to a total collapse in business confidence since the Budget.

Even so, why does not the right hon. Gentleman accept the view of his newly appointed economic adviser that the Government should allow the public sector borrowing requirement to rise when unemployment rises and activity falls? Is he aware that these cuts will make the recession deeper? The way in which they are composed means that their main effect will fall on activity and cash flow in the private sector of the economy.

On the distribution of the cuts, how can the right hon. Gentleman, against this background, justify increasing defence expenditure, in real terms, by 3 per cent.

when he is expecting a
in this country? In
Germany is planning an
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increase in her growth ra
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HS

1 November 1979

The Prime Minister has considered the Chief Secretary's minute of 30 October about the disclosure of the unemployment assumptions in the context of the Public Expenditure White Paper. This is to confirm that she is content with the Chief Secretary's proposals for handling this. She has also noted that there is no way of not revealing the unemployment assumptions in the Government Actuary's report.

T.P. LANKESTER

A.C. Pirie, Esq.,
Chief Secretary's Office.

PRIME MINISTER

Nationalised Industry Cash Limits

Paragraph 8(iv) in the Cabinet Office brief - which says that the Treasury have "in most cases uprated the volume totals agreed in the summer by a standard figure of 17%" - is not right. The correct position is as follows.

The volume figures already agreed are expressed in 1978/79 prices. To arrive at 1980/81 prices for cash limits purposes, they have either been uprated by 32% for the two year period - this works out at 16% between 1978/79 and 1979/80 and 14% for 1979/80 to 1980/81; or where their own forecasts work out at lower than 14% for 1980/81, the volume figure has been uprated by that lower figure.

The Chancellor has been briefed on this basis, but I am none the less showing him a copy of this note just to confirm.

T. P. LANKESTER

1 November 1979

CONFIDENTIAL

Ref. A0543

MR. LANKESTER

Public Expenditure

When the Prime Minister decided earlier this week to defer the resumed discussion of public expenditure for 1983-84 from today's to next week's Cabinet, she envisaged chairing a meeting of a small group of Ministers early next week to try and resolve the outstanding issues in advance of Cabinet.

2. I understand that the Chief Secretary has reached agreement with the Secretary of State for the Environment on housing, and with the Secretary of State for Education and Science on education; and that the Chancellor of the Exchequer and the Secretary of State for Defence are now in agreement on defence. All these agreements are being reported to the Prime Minister. If she is content with them, only the level of agricultural capital grants remains outstanding.

3. As you know, Sir Kenneth Berrill is chairing an official review of agricultural support policy generally, against the EEC and domestic backgrounds. This group has prepared an interim report on capital grants, but this does no more than rehearse the arguments advanced by the Ministry of Agriculture and the Treasury respectively, and state the options as: adoption of the MAFF figures (an increase of £30 million on the baseline figures): adoption of the Treasury figures (a £60 million cut in the baseline figures); or adoption of the existing baseline or some other compromise figure.

4. Any decision at present on capital grants could only be ad interim: it would not make sense for final decisions on the level of grants over the next four years to be taken in advance of completion of Sir Kenneth Berrill's review, due at the end of November. I believe that the best course at this stage would be to leave agricultural grants on one side for the time being, with a view to a decision being taken by Cabinet on 6th December. A decision is required by then, because any order cutting grants would have to be introduced before Christmas. The Treasury could be asked to prepare the White Paper for the present on the basis of the baseline figures, entirely without prejudice to later decisions. The figures could be adjusted as necessary at the proof stage, though if the decision was a

radical one which involved more than a sentence or two of the accompanying text, they would probably have to resort to devices such as footnotes. This should not delay the White Paper beyond the mid-January date to which the Treasury is in any case now working.

5. If the Prime Minister agrees to proceed on this basis, we do not need to have a small group at this stage. The Chief Secretary might be invited to prepare for next week's Cabinet a brief report on the outcome of his further bilaterals and a proposal along the above lines for dealing with agricultural grants.

6. As to the defence programme, few other members of the Cabinet will be aware that there has been a disagreement here. The outcome will have to be presented to Cabinet at some stage, and I think it would be right to do this at next week's Cabinet so that public expenditure can be wrapped up completely (bar agriculture). This will require careful presentation: the Chancellor is apprehensive that there will be some resentment at Mr. Pym's apparently privileged access to the Contingency Reserve. I am inclined to think that the Prime Minister should present this outcome herself, at the end of the discussion; and I will let you have a speaking note in good time.

RtA

ROBERT ARMSTRONG

1st November, 1979

This doc. for
Econ. Pol. Ptg,
Pub. Expn.

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

copy on: Nat. Inds.
Sept 79,
Gas on Electricity prices

Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3HE

31 October 1979

12/11

Dear Secretary

BRITISH GAS CORPORATION: CASH LIMIT 1980/81

Cabinet agreed on 25 October that domestic gas prices should rise next year by an amount equal to the increase on the Retail Price Index in April, and by a further 10% in October. On the basis of these increases I propose a cash limit for BGC for 1980/81 of minus £400m at outturn prices (£300m at survey prices). This is £100m higher than British Gas originally forecast and has been arrived at only after they have been pressed very hard. The key assumptions underlying the £400m proposed are now as follows:

a) the non-domestic tariff to be increased by 10% on 1 April 1980;

b) contract prices for gas to industry to move in line with the non-domestic tariff until 1 July 1980 by which time it is assumed that amendments to gas legislation which I am proposing for inclusion in the Energy Conservation etc Bill will have been enacted to remove the links between contract prices and the domestic tariff;

c) increased efficiency including a £25m reduction in their personnel budget which would be consistent with markedly lower pay assumptions than BGC were originally forecasting;

d) trading costs (other than gas purchase) per therm will fall in real terms by 10% between now and 1983/84;

e) wholesale prices (the relevant indicator for BGC) will increase by 13%.

3. I am satisfied that such cash limits will stretch BGC in terms of overall efficiency and, in particular, in skill at pay bargaining.

4. BGC have not yet been formally consulted on the cash limit and I invite you to agree that I should now do so with a view to agreeing

a cash limit of minus £400m.

5. I am sending a copy of this letter to our colleagues in Cabinet and to Sir Robert Armstrong.

Yours ever

David

D A R Howell

MO&A to see
Ld MAP 31/x

Foreign and Commonwealth Office

London S.W.1

31 October 1979

Dear Mike,

Public Expenditure White Paper

With my letter of 29 October I enclosed the text of the press release which we are proposing to issue at the same time as the publication of the White Paper on public expenditure 1980/81. In view of the widespread publicity that is being given to the cuts that the BBC External Services will have to bear and also of the Adjournment Debate in the House of Commons on 2 November, we think it important that the cuts that the FCO will be making are seen in their proper context. Comparisons between our cuts and those in the BBC External Services are certain to be drawn. However, the full extent of our cuts will not be evident until the Lord President's Exercise on Civil Service Manpower has been completed.

FCO Ministers therefore think it important to get on to the record that apart from what is stated in the White Paper about FCO expenditure in 1980/81, the FCO will be facing further substantial cuts in later years as a result of the Lord President's Exercise. Making this clear at the start will help to reduce criticism of the cuts to the BBC External Services, which will not be affected by the Lord President's exercise.

I am enclosing the text of a revised press release in which paragraph 2 has been amended to take account of these points.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, the Lord President of the Council and the Paymaster General.

Yours ever

Paul

Paul Lever
Private Secretary

M Pattison Esq
10 Downing Street

PRESS RELEASE

(following publication of White Paper)

The White Paper on the Government's Expenditure Plans for 1980/81, published today, refers to economies which are to be made by the Foreign and Commonwealth Office. These economies will produce an annual saving in FCO expenditure (excluding that on Aid and related items) of £12 million as follows:

Overseas Representation - £5.8 million

In addition to the closure or pruning of Consular Posts abroad announced on 17 October, about 120 jobs are to be abolished in the FCO. Expenditure on building work and accommodation services overseas will be reduced or rephased. Further substantial savings from the Diplomatic Service are being considered in the context of the Lord President of the Council's exercise to reduce Civil Service manpower.

British Council

The grant-in-aid paid by the FCO to the Council will be reduced by £3 million. In addition the contributions paid to the Council by the Overseas Development Administration will be reduced by £2.2 million.

BBC External Services

The grant-in-aid paid by the FCO to the BBC for the operation of the External Services will be reduced by £2.7 million.

Other Overseas Expenditure

Cuts totalling £500,000 will be made in some miscellaneous items and grants-in-aid to various bodies.

Foreign and Commonwealth Office

Put with Public Exp. Papers

MH.

1.

PRIVY COUNCIL OFFICE
WHITEHALL. LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

October 31 1979.

Prime Minister.

I am a little concerned about the very drastic reductions in the Assisted Places Scheme in financial terms. As this was such a firm pledge and so many people voted Tory a lot alone

PRIVY COUNCIL OFFICE
WHITEHALL. LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

I hope you will have a
fun with look at it.
The £50 million scheme has
gone right down to £16
million. I am sure some of the
DES civil servants.

Yours Steve.

31.10.79

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

copy on: Nat Inds, Gas and Elect. pricing, Sept 79.

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

NATIONALISED INDUSTRY CASH LIMITS 1980/81: SCOTTISH ELECTRICITY BOARDS

1. Following the decisions taken by Cabinet last week on gas and electricity pricing in 1980/81 my officials have had discussions with the Scottish Electricity Boards about the setting of their cash limits for that year. This minute reports the outcome. I am afraid that I shall not be able to take part in the Cabinet discussion tomorrow as I am to be in attendance upon The Queen on Her visit to Glasgow.

2. On the assumption of a tariff increase from April 1980 at the level of the increase in the RPI and a further increase of 5% from October 1980, the anticipated borrowing requirements in 1980/81 at outturn prices amount to £42m for the North of Scotland Hydro-Electric Board (NSHEB) and £73m for the South of Scotland Electricity Board (SSEB). The Board's forecasts assume coal price increases of 17½% from 1 March 1980 and 7½% from 1 November 1980, and oil price increases of 10½% from 1 January 1980, 7½% from 1 July 1980 and 7½% from 1 January 1981. Wages and salaries, which amount to no more than about 16% of the Boards' costs, are expected to increase by 16½% next Spring, in line with the guidance given to the Boards that there should be a reduction in unit wage costs in real terms.

3. For cash limit purposes, compensation to be paid to NSHEB in respect of deficits arising on the Board's smelter account falls to be added to the borrowing requirement. The current estimate of the sum to be reimbursed in 1980/81 is £17m. I propose, therefore, that the cash limits to be set for NSHEB and SSEB for 1980/81 should be £59m and £73m respectively.

4. The combined external financing requirement for 1980/81 of the two Boards is some £19m in excess of the aggregate of the limits (at outturn prices) agreed by Cabinet in July. This increase in the Board's requirements has come about largely as a result of Cabinet's decision on electricity

pricing policy. In the case of NSHEB there has in addition been a substantial increase in the forecast smelter deficit, arising out of a revised assessment of the timing of completion of repairs to reactor 4 at Hunterston B power station and increases in the costs of make-up units from fossil-fuelled stations, which affects the level of the Board's external financing requirement.

5. The external financing limits which I have proposed would be acceptable to the two Chairmen, and I am satisfied that they represent realistic limits which will exercise an appropriate degree of pressure on the Board's operations. I should make it clear, however, that they assume that the Boards will not be obliged to impose further deferments of capital expenditure from the current year to 1980/81 in order to avoid breaching the 1979/80 cash limits. If such further deferments turn out to be necessary, next year's cash limits would have to be revised to accommodate the deferred expenditure. I intend to have further correspondence with John Biffen about this year's cash limits for the Boards.

6. I am copying this minute to the Prime Minister, the other members of Cabinet and Sir Robert Armstrong.

GH.

SCOTTISH OFFICE
31 OCTOBER 1979

Ref. P.0130

CONFIDENTIAL

PRIME MINISTER

NATIONALISED INDUSTRIES' CASH LIMITS - Revised brief
C(79) 48 and associated correspondence.

BACKGROUND

There was not time to discuss this paper at Cabinet on 25 October. Much of the brief you had then still stands but there have been a number of new moves. For convenience we have incorporated the fresh material in a single updated brief.

2. At its last discussion of cash limits, E Committee endorsed the general approach to the nationalised industries. The main components were:-

(i) to make allowances for the differing circumstances of each industry;

(ii) to note that their cash limits (which apply to external finance only) are the residuals of very much larger figures, and correspondingly volatile;

(iii) to agree, nevertheless, to use cash limits to put pressure on pay;

(iv) to start from the assumption that increases in wage costs (not necessarily increases for individuals) should be somewhat less than the predicted increase in the RPI - how much less, to be settled case by case.

3. At the same meeting, E decided on the general line on the Rate Support Grant cash limit; this was, of course, later remitted to MISC 21 and agreed by Cabinet last week. The fairly tight line endorsed by Cabinet for local authority cash limits is broadly consistent with the proposals in the Chancellor's paper.

4. There was one urgent issue left over from last week's Cabinet - the cash limit for the NCB, which it was essential to settle before the negotiating meeting on 30 October. As you know, that has now been agreed, and Mr Howell's

minute to you of 29 October reports a settlement with the Chief Secretary on a figure of £834 million. This represents a concession by the Chief Secretary, which he insists should not be taken as a precedent for other industries. But the real question is whether the likely pay deal for the miners can be accommodated within this figure. You may want to use the opportunity of this meeting to seek a progress report from Mr Howell.

5. The Chancellor hopes to get decisions on all the other cash limits at this meeting. Most of them are listed in the paper. Those for gas and electricity are set out in Mr Howell's letters of 30 October (electricity) and 31 October (gas) and in the Secretary of State for Scotland's minute of 31 October (Scottish electricity). These proposals follow the discussion on gas and electricity prices at Cabinet last week, and at E Committee on Tuesday. The Chancellor intends to announce the whole set of nationalised industry limits on 20 November, the day of the RSG 'Statutory Meeting', probably by way of a press notice or arranged PQ.

all in this folder ..... PL.

6. One final complication arises from the letter from the Nationalised Industries' Chairmen's Group, at Annex C. This raises a wide range of issues, beyond the scope of the present meeting. You will no doubt want them discussed, when Sir Keith Joseph reports on nationalised industry policy in general (probably now in December). Meanwhile, the immediate response to the chairmen is proposed in paragraphs 6 and 7 and need cause no problems.

7. But the immediate task for Cabinet is to agree specific figures for the cash limits of the nationalised industries listed in Annex A, plus gas and electricity. Our information is that only three of these are likely to be contested - rail, bus and airways - though coal, gas and electricity merit special confirmation because they result from agreements not reported in the paper. Detailed notes on all six are in paragraph 9 below. It should be possible to get agreement on the other cash limits "on the nod".

HANDLING

8. You will probably want to divide the discussion into two parts: a general discussion and then detailed consideration of the individual industries. As a general lead in you might invite the Chancellor to introduce his paper, and then seek comments from the Secretary of State for Industry (as de facto chairman of the unofficial group of Ministers on nationalised industry policy);

the Secretary of State for Employment (because of the implications for pay negotiations); the Secretary of State for Trade (consumers) and any others who wish to join in. But you will want to keep this part of the discussion short and avoid special pleading on particular cases. The issues which are likely to come up are:-

(i) the vulnerability of nationalised industry performance to extraneous factors: for example, the difference between a standard and a bad winter can mean £55 million to the electricity industry alone;

(ii) the inflexibility of their response. Because of constraints on redundancy agreements, closures, price increases and market response, the industries cannot react very quickly to any deterioration in their performance.

(iii) the special nature of their cash limits. Not all of your colleagues may fully appreciate that the nationalised industry 'cash limits' apply to their external financial needs only and are the net result of much larger gross numbers. The suggested change in nomenclature to "external financing limit" may help here. The consequence, of course, is that holding to these limits involves giving the industries freedom to adjust other factors, especially prices, if they are to stay within them; and that, even then, the task they face can be a good deal more demanding and uncertain of achievement than say that of a Government Department with a cash limit essentially related to gross expenditure.

(iv) Pay and other costs. Although there are considerable variations between industries, the Treasury have in most cases uprated the volume totals agreed in the summer by a standard figure of 17 per cent to cover both pay and prices. This is, of course, considerably above the 13 per cent agreed for the calculations of RSG. Indeed, it is even more generous, in one or two cases, than the industries themselves had assumed (but the industries were operating on much earlier information). You may want to probe a bit on the reasons for choosing these figures: but we know that the Chancellor has himself rounded them down from those discussed with Departments earlier. Whatever is decided, however, you will want to ensure that no figure as high as 17 per cent gains currency

outside the Cabinet room, especially as the RSG is based on a lower percentage. This bears on the proposal in paragraph 7 of the Chancellor's paper that the industries might be told the assumption underlying the limits. Of course the fact that the 17 per cent - where this applies - covers other costs as well as pay makes it hard to disentangle any specific pay assumption. But considerable care will be needed if unfortunate public conclusions are to be avoided.

9. After this general discussion, you will want to turn to the detail of the outstanding cases:-

(a) Coal As suggested above, I think you will want to ask Mr Howell for a progress report on the result of the negotiating meeting on 31 October. Does the Coal Board seriously believe that it can get by with a cash limit of £834 million (the figure he has now agreed with the Chief Secretary? You might glance at his exchange of letters with the Chancellor (Howell 25 October and Howe 30 October). The cash limit provides for an increase of 13.4 per cent in wage costs over the period, and any excess above this will have to be picked up in coal prices. Is it too early to ask what this means? If so, you should ask Mr Howell to let you have a report as soon as the picture becomes clear.

Any further increase in coke prices hits BSC (which can't put up its prices)

(b) British Rail Mr Fowler ~~has written~~ wrote to the Chancellor ~~today~~ on 24 Oct 1979 about this. The Treasury bid is for a limit of £705 million, and his proposal is a bid of £750 million. The Treasury figure assumes a pay increase of about 12 per cent, plus a further 2 per cent which is a hangover from an earlier settlement. It also takes a very favourable view of all the commercial risks. The Department of Transport argue that railway pay has fallen behind (8-10 per cent below the peak of 1975 in real terms) and is bound to catch up somewhat; and that the going rate is emerging at something like 17 per cent; but they rest their argument much more on the economic assumptions than on pay. They see no scope for economies in the first year either from closures (because of the long statutory process of consultation), or productivity (because of the slow pace at which agreements are negotiated with the unions). They are convinced, therefore, that a £705 million cash limit would in practice be breached. I believe the Chief Secretary may be prepared to concede something here, though it is not clear how much.

12 ⇒ £702.

20%

(c) National Bus Company Mr Fowler's letter also deal with this. The main point here is that the cuts in local authority expenditure, and in Department of Transport expenditure on TSG and new Bus Grant, have already reduced the NBC cash flow; that consumer resistance to further fare increases makes them self-defeating; and that the scope for productivity changes, again in the short term, is pretty limited. The consequence of the cash limit proposed by the Treasury (£77 million, against a Transport bid of £85 million) might be a substantial reduction in services. You will want to probe the realities here so that the political consequences can be weighed, not only in rural constituencies but generally.

(d) British Airways There is a gap of £15 million between the Treasury bid of £205 million and the Department of Trade bid of £220 million. The difference arises because the standard inflation factor of 17 per cent is not enough to cope with increased fuel costs and the fare cuts imposed by the CAA. The difference represents one new aircraft.
The Secretary of State will argue strongly that, given the impending privatisation of British Airways, it would be silly to make it change its programme in this way, thus damaging the prospects of a satisfactory sale. The £220 million limit proposed by Trade still puts a fairly realistic squeeze on pay and builds in a sizeable allowance for improvements in productivity.

(e) Electricity The Secretary of State for Energy (letter of 30 October to the Chancellor) proposes a cash limit of £187 million. The Chief Secretary is - I understand - prepared to accept this; indeed the Treasury thinks this limit is very tightly-drawn. (It leaves room only for about 12 per cent increase in wage costs, on top of increases already agreed.)
The Secretary of State for Scotland will be writing later today to propose limits of £73 million (South of Scotland Electricity Board) and £59 million (North of Scotland Hydro Board). These have already been agreed at official level with the Treasury.
All these limits are consistent with last week's decisions on electricity prices.

(f) Gas Agreement was reached this morning with the Gas Corporation on a limit of minus £400 million (ie, a repayment to the Exchequer). This is still subject to Ministerial approval, but I am told there will be an exchange of minutes between the Secretary of State for Energy and the Chief Secretary later today. This figure is £100 million better than the Corporation's original offer, and is regarded as very tight indeed.

CONCLUSIONS

10. Subject to the discussion, you might be able to reach the following conclusions:-

(a) to note the cash limits agreed for the coal industry;

(b) to approve the cash limits for gas, electricity (England and Wales) and electricity (Scotland) set out in the Secretary of State for Energy's minutes of 30 and 31 October, and the Secretary of State for Scotland's minute of 31 October;

(c) to endorse the other cash limits listed in Annex A to C(79) 48 [with any changes agreed during discussion];

(d) to agree that the cash limits should be published by the Chancellor of the Exchequer on 20 November [by way of an arranged PQ];

(e) to agree the general approach to proposals of the nationalised industries' chairmen's group suggested by the Chancellor of the Exchequer in paragraphs 6 and 7 of his paper, and the procedure for dealing with the chairmen, individually and collectively, suggested in paragraph 12 of his paper.

P Le CHEMINANT

Cabinet Office
31 October 1979

cc Paymaster General

Mr Whitmore

PRIME MINISTER

The Chief Secretary, Treasury, will take the lead in the presentation of the Public Expenditure White Paper tomorrow (Thursday 1 November). In addition to his statement in the House, he will hold a press conference, with the Financial Secretary (and give any consequential radio/TV news interviews). The Chancellor of the Exchequer is due to appear during the evening in the Thames "TV Eye" programme.

2. Other activities include:

i Press conferences by the Secretaries of State for the Environment, Education and Social Services;

ii Press notices from MAFF, FCO and the Overseas Development Administration;

iii Ministry of Transport will be issuing the departmental response to the Select Committee report on rural bus services and new bus grants;

iv The Secretary of State for Wales hopes to hold an informal Lobby and to give regional radio/TV interviews;

v The Scottish Office intend to issue a note drawing attention to the proposed publication of cash limits on RSG on 16 November;

vi All other Departments are briefed to handle questions from the press;

vii A Ministerial speaking note will be circulated by the PMG's office before the weekend;

viii FCO/COI have made all necessary arrangements to brief Posts abroad.

3. I also understand that the Chancellor of the Exchequer will be issuing a statement through Conservative Central Office.

4. I shall be discussing with the PMG this evening the necessary follow-up activity, including regional and local radio/TV current affairs programmes and the national weekend media.

NG

NEVILLE GAFFIN

31 October 1979

211 6402

41.

Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3HE

31 October 1979

Dear John

FLEXIBILITY BETWEEN FINANCIAL YEARS

Thank you for your letter of 18 October in response to mine of 8 October about the possibility of Sir Derek Rayner including nationalised industries in his study of the application of accounting conventions in Government business.

I agree that it is important not to undermine cash limits as a discipline on the industries. Nevertheless I believe that there is a danger that, if they are operated too rigidly, they can cause industries to pursue, as a result of short term factors, courses of action which could be undesirable in themselves and out of line with the thinking behind the industry's medium term financial objectives. I would not, myself, rule out the possibility of modifying the operation of cash limits in such a way as to ease some of the difficulties of the current system without sacrificing its advantages.

Since I wrote to you, we have received the Nationalised Industries' Chairmens' Group's paper on the Framework of Financial Discipline, also circulated as an Annex to your paper on cash limits - C(79)48. To some extent this paper makes the same sort of point. Provided I can be clear that this issue remains open for serious consideration in that context, and that the possibility of a constructive response to the Chairmen is not ruled out in advance, I am content not to press that the terms of reference of Sir Derek Rayner's study should be broadened to include the nationalised industries.

I am copying this to other Members of Cabinet, Sir Robert Armstrong and Sir Derek Rayner.

Yours ever

David

D A R Howell

2

Prime Minister
Mr Britten and
Mr Carlisle have
now reached
agreement.

1/11

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Mark Carlisle QC MP
Secretary of State
Department of Education
and Science
Elizabeth House
York Road
London SE1 7PH

31 October 1979

Dear Mark,

PUBLIC EXPENDITURE 1981-82 TO 1983-84: EDUCATION

Thank you for your letter of 30 October about the outstanding issues on the education programme for the later years. This morning you and I and the Financial Secretary discussed these matters and then asked our officials to work out a detailed proposal. I am glad to say that I can now accept the proposal which is set out below and I understand that it will also be acceptable to you.

The Treasury position is that, while we would question some of the arguments in paragraph 2 of your letter, we recognise that an operating margin of £130 million a year (with unit costs at the 1978-79 level) may not be adequate to cover the non-transitional costs which are likely to exist in 1981-82 to 1983-84, when pupil and teacher numbers are falling. Therefore it might be too difficult to achieve the whole of the reduction in current expenditure on schools which I proposed to Cabinet (in Annex G of C(79)42). At the same time it may be possible to slow down the increases in expenditure on non-advanced further education or (in 1983-84 only) on higher education which are shown in the run of figures in paragraph 3 of your letter, that is to substitute savings on those sub-programmes in place of part of the savings on schools. To ease the position generally, I am prepared to reduce the total savings which the Treasury were seeking on education by further sums of

£ million, 1979 SP

1981-82	1982-83	1983-84
40	30	30

leaving you to decide on their distribution between sub-programmes.

Thus, starting from Cmnd 7439 revalued, the position on the "further reductions" proposed in Annex G of C(79)42 is as follows:-

	£ million, 1979 SP		
	1981-82	1982-83	1983-84
Savings proposed in C(79)42	-125	-210	-295
Allowance on account of NAFE	40	70	75
Further allowance now offered	40	30	30
Reduced level of savings	-45	-110	-190
Savings from reducing Assisted Places Scheme	-34	- 40	- 31
Total "further reductions"	-79	-150	-221

With reference to paragraph 6 of your letter, I confirm that you are free to make any adjustments you wish within the total which is now agreed for your programme in each year.

I am sending copies of this letter to the Prime Minister, the other members of Cabinet including the Minister of Transport, and to Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

RT2 IC1 SHelf

10 DOWNING STREET

Prime Minister

There is a 3 month billing cycle - i.e. a third of electricity consumers get their bills in April, a third in May etc. The increase will go into the RPI as people get their bills. So if we increase in April, a third of it will show up in the April

30.10.79 RPI. 12

CONFIDENTIAL

PM saw revised version

Prime Minister 2

You may care to glance - I will return this to you for weekend reading.

Treasury Chambers, Parliament Street, SW1P 3AG

30 October 1979

T P Lankester Esq
10 Downing Street
LONDON SW1

Dear Tim,

PUBLIC EXPENDITURE WHITE PAPER 1980-81:
BRIEFING

I attach a copy of the briefing prepared for Treasury Ministers' use on publication of the White Paper on 1 November.

Brief B2 deals with the point about what the previous Government's plans might have meant in terms of the basic rate of income tax. Your letter of 26 October asked for a note about this.

Yours sincerely,
Alistair Pirie

A C PIRIE
Private Secretary

PUBLIC EXPENDITURE WHITE PAPER ON 1980-81

(Cmnd 7746)

- Briefing -

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13. Other public services.
14. Common services.
15. Northern Ireland.

A1. The planning total for 1980-81

A1(R)

Factual

1. After allowing for shortfall, the planning total for 1980-81 is expected to be about the same in volume terms as the expected outturn for the current year, which in turn is expected to be the same as in 1978-79. The figures (which are shown in more detail in table 1 of the White Paper) are shown below:

	1978-79	1979-80	1980-81
	69,766	69,797	69,829
(% change)	(+6.0)	(0.0)	(0.0)

2. The planning total comprises expenditure programmes, total borrowing by the nationalised industries, sales of assets and the contingency reserve. It differs from total public expenditure by excluding debt interest but including net overseas and market borrowing of nationalised industries and asset sales. It is the total that is used as a basis for decisions on the level of public expenditure.

Positive.

1. The Government has stablilised public expenditure next year as well as this year, in conformity with its economic strategy.

2. The figures belie talk of drastic cuts. They represent a considered decision not to have growth in the public sector before growth in the private sector.

Defensive

1. To increase public expenditure next year, when the prospects for output are poor, would have imposed an additional burden of taxation and borrowing which would have been quite inconsistent with the need to restore incentives and reduce inflation in the interests of future economic growth.

2. Substantial reductions have been made from the previous Government's plans (see brief A5). But the Government has not felt it necessary to reduce expenditure from current levels next year.

A2(R)

A2 THE CURRENT YEAR 1979-80

The projected outturn for the planning total for 1979-80 is £69,796 million the same level as the provisional outturn for 1978-79.

2. The White Paper figures for 1979-80 are early estimates of outturn. They incorporate all budgetary measures ie cuts in expenditure programmes, cash limits squeeze and sales of public sector assets. Other announced policy changes have also been included.

3. The allowance for shortfall is considerably less than in previous White Papers. The size of the expenditure measures is considered to reduce the general allowance for shortfall. It also takes account of likely changes in the working assumptions since they were made some months ago.

4. Apart from definitional changes in the White Paper, the estimate of the planning total for 1979-80 is consistent with the volume figures underlying the budget arithmetic (public expenditure is shown in outturn prices in table 7 of the FSBR). The main definitional changes is the gross presentation of child benefit and the inclusion in the planning total of nationalised industries short term borrowing and leasing (see Explanatory and Technical Note to the White Paper).

5. The composition of the 'special sales of assets' totalling around £1 billion was announced in a Treasury press notice on 16 October. It was as follows:

	£ million
BNOC advanced oil payment	400 - 500
Approximately 5% of BP shares	200 - 300
New town assets and other public land	100 - 150
Other assets including assets held by NEB	100 - 150

Positive

i. The planned volume of public expenditure in 1979-80 is our first step in stabilising public expenditure.

ii. The reductions from the inherited plans are necessary to bring government borrowing under control and so help in reducing the rate of growth of the money supply.

Defensive

i. Where will the unallocated shortfall in 1978-79 fall?
Too early to say. It is impossible to give estimates based on the information available for the first half of the year. Any estimate of shortfall is extremely tentative.

ii. Some underspending is to be expected where planning figures are used as a basis for control. Shortfall has been a feature of public expenditure in most of this decade. It is also found in other countries.

iii. To the extent that shortfall eases the task of getting government borrowing under control and reducing the rate of growth of mon ey supply, it is not unwelcome.

A3(2)

A3. PRIORITIES AND THE BALANCE BETWEEN PROGRAMMES

Factual

The Government's review of expenditure plans has not been conducted on the basis of arbitary cuts across the board. The expenditure plans reflect the Government's priorities as stated in the Conservative Manifesto. The following programmes are planned to increase between 1979-80 and 1980-81:

	per cent
Defence	+3.0
Law, order and protective services	+3.6
Health and Personal social services	+0.9
Social security	+1.2

The increases in other programmes are special cases. The 4.2 per cent increase in Industry, energy, trade and employment is more than accounted for by the once for all reduction achieved in 1979-80 by the Trustees Savings Banks taking over some £200 million of outstanding refinance. The 2.6 per cent rise in Overseas aid and other overseas services is more than accounted for by the increased provision for net contributions to the European Communities (and the European Investment Bank). The 1.4 per cent increases in Common Services is more than accounted for by the increased provision for civil service superannuation, which depends upon the number retiring and their length of service.

To achieve the required fall in public expenditure other programmes have to be restrained. The programmes planned to fall as follows:

	per cent
Roads and transport	-6.5
Housing	-5.6
Other environmental Services	-2.7
Education and science, arts and libraries	-4.3
Other public services	-1.3
Northern Ireland	-2.9

Positive

1. The planned increases in expenditure on defence and on law and order fulfill commitments given in the Conservative Party Manifesto.

2. The social security increase partly reflects this year's record uprating of pensions and other benefits.

Defensive

1. The reductions in planned expenditure in such programmes as education, housing and roads and transport are needed to curtail the growth in public expenditure. High standards of public services can only be achieved when there is the output growth to support them. Public expenditure needs to be stabilised to create the conditions for that growth.

2. Part of the problem arose from the high level of public sector pay settlements set in train by the previous Government. Mr Healey told the House on 25 January that wage increases of 15% in the 1978-79 pay round would add some £2 billion to central and local government costs over the level he had planned. That was the situation we inherited. Next year the impact will also be felt of the staged element of part awards.

Percentage Changes in Public Expenditure

1. per cent change between 1980-81 (plans) and 1978-79(provisional outturn)

2. per cent change between 1980-81(plans) and 1979-80 (expected outturn)

		(1) 1980-81 / 1978-79 per cent change	(2) 1980-81 / 1979-80 per cent change	1980-81 (plans) £ million
1.	Defence	7.4	3.0	8062
2.	Overseas aid and other overseas services			
	Overseas aid	-0.5	-1.0	782
	EEC Contribution	29.2	8.8	1000
	Other overseas services	2.3	-4.0	409
3.	Agriculture, fisheries food and forestry	10.8	0.7	993
4.	Industry, energy, trade and employment	-12.2	4.3	2870
5.	Government lending to NI's	29.9	-47.1	900
6.	Roads and transport	-2.2	-6.5	2914
7.	Housing	-2.8	-5.6	5078
8.	Other environmental services	-3.5	-2.7	3213
9.	Law, order and protective services	7.3	3.6	2542
10.	Education and science, arts and libraries	-3.4	-4.3	9246
11.	Health and personal social services	1.5	0.9	9194
12.	Social security	5.9	1.2	19289
13.	Other public services	2.5	-1.3	997
14.	Common services	3.8	1.4	1088
15.	Northern Ireland	-3.7	-2.9	2150
	TOTAL	2.0	-1.5	70729

A4(R)

A4 Capital and current expenditure, including construction

Factual

1. The plans for 1980-81 imply broadly constant capital expenditure compared with the current year. This, however, includes the £500 million fall in receipts from sales of assets. Excluding this, there is a fall of some £½ billion in capital expenditure.

2. Current expenditure is planned to increase by some £400 million in 1980-81 compared with the current year. (The overall increase in current and capital expenditure combined is broadly offset by the increase in unallocated shortfall between the two years, leaving only a slight increase in the planning total).

3. Compared with the previous Government's last White Paper (Cmnd 7439), both current and capital expenditure are planned to fall next year by over £2 billion. But the fall is proportionately much greater for capital expenditure (15 per cent) than for current expenditure (4 per cent).

4. Direct public expenditure on construction is planned to fall by some £300 million in 1980-81, from the expected outturn on the current year. Tentative figures for construction expenditure by the nationalised industries suggest an increase of £250 million in 1980-81, implying total public sector construction expenditure not substantially out of line with the current year's level. But the eventual outturn figures are likely to be depressed by shortfall.

Defensive.

1. The precise allocation of expenditure within the programme totals in the White Paper remains to be settled in a number of cases, and no breakdown of current and capital expenditure has been given in this White Paper (except for local authority expenditure). This information will be provided in the full White Paper on the later years, early in the new year.

2. In settling priorities within the total, the emphasis has been on the balance between expenditure programmes, which are shown in Table 2 of the White Paper. The balance between current and capital expenditure is for decision in the light of the needs of those programmes.

B1(R)

ECONOMIC BACKGROUND

1. Reasons for the cuts

The reductions in the previous government's plans as published in their January White Paper, Cmnd 7439 are necessary to bring government borrowing under firm control and so help in reducing the rate of growth of the money supply. Not only is the growth in the volume of expenditure between 1979-80 and 1980-81 planned by the previous government too high, but the situation has been made worse by the large increases in public sector pay awarded by the Clegg Commission. The expenditure reductions also demonstrate that we are serious in wanting to enlarge freedom of choice and restore incentives by reducing the role of the State. Extra resources for public spending must follow economic growth, not stifle that growth by trying vainly to anticipate it.

2. Cuts unjustifiable when the economy is heading for recession

No. The threat of a recession next year reflects the enfeebled state of our economy as well as an expected slowing of world activity. The "soft" option of postponing the sometimes painful measures needed to restore balance in our economy is no option at all. Unless we act now to clear the way for a stronger industrial sector then our underlying economic position will be even weaker.

3. How much unemployment will the cuts create?

The cuts in public spending should not be seen in isolation. They are part of an overall economic strategy to reduce inflation and to put the economy back on its feet so as to get output and employment growing again. This involves lower taxation, lower government borrowing and a progressive reduction in the money supply. There is no other way if sustainable growth and genuine jobs are to be created in the long term. The fact is that if we had continued on the public spending path the previous Government planned, the prospects for the economy would have got progressively worse.

4. What is the direct effect of the cuts in public spending on employment?

Public expenditure in 1980-81 is now planned to be about the same in real terms as in 1979-80. Some programmes will grow, some decline, but on balance there should not be a great change in public sector employment.

5. How will the private sector be able to take up unemployed public sector workers in a recession?

The principal economic objective of the Government is to reduce the rate of monetary growth and thereby the rate of inflation. The cuts in public spending play a crucial role by allowing interest rates to be lower than they would otherwise have been. Both this and the lower rate of inflation will stimulate an increase in economic activity and employment in the private sector in due course, whether or not the economy is in a recession.

6. How quickly will the switch of resources from the public to the private sector occur?

It is impossible to say. It will depend on a lot of things - confidence, industrial relations, for example. Most importantly it will depend on how expectations in the economy react to our policies. If wage negotiators quickly recognise the implications of our determination to reduce the rate of inflation, then the switch of resources will come about more quickly.

7. The expenditure decisions were taken without knowledge of the autumn forecast?

These decisions do not depend in any precise manner upon a particular forecast of the economy. The general lines of the outlook for 1980 have been apparent for some time - they were reflected in the forecasts published at the time of the Budget. And, of course, we keep abreast of developments in the economy as they occur. The general outlook for 1980 is also reflected in most of the outside forecasts. The expenditure plans have been decided in the light of the three central policy objectives mentioned in para 4 of the White Paper.

8. The White Paper's Economic Assumptions are out of date

The working assumptions - on unemployment and so on - underlying the White Paper were in fact made some months ago. They will be reviewed and if necessary revised for the White Paper on Expenditure to 1983-84. Come what may, government expenditure and revenues in 1980-81 will be consistent with achievement of our monetary target.

9. Are the 1980-81 public spending plans consistent with income tax cuts next year?

As the Chancellor said in his Budget speech, the income tax cuts we have already made represent only the first stage in the reduction in the burden of direct taxation that we are determined to make. How fast we can proceed will depend on development of the economy following the measures we have adopted so far. Obviously we must wait for the Chancellor's next Budget to see what is possible for 1980-81.

10. The White Paper (para 5) says the immediate prospects for output are poor. How poor?

The latest evidence points to a recession next year. World trade, which was already growing only slowly, is likely to be further reduced by higher oil prices and higher interest rates.

At home, inflation has not yet been brought under control. There are signs that consumer spending has slackened and investment is probably at ot near its cyclical peak.

11. Can you be more precise about the extent of the recession?

No. It is particularly difficult to make forecasts when the economy is at a turning point, as the UK and many other countries now appear to be. Most forecasters agree that output will fall over the next year, but there is much less agreement about the likely extent of the fall.

12. Do you expect unemployment to rise next year?

Unemployment is very difficult to forecast. Most people expect it to rise next year. For instance, both the National Institute and the London Business School have forecast unemployment to reach more than 1.6 million by the end of next year.

13. When do you expect unemployment to stop rising?

The sooner inflation is brought down, the sooner the economy can start expanding.

14. What is the latest forecast for this year's PSBR?

It is still too early to give an assessment of the PSBR for 1980-81.

15. What is the PSBR in 1980-81 that you are aiming at? Are these expenditure plans consistent with it?

This will be announced at the appropriate time. It will be consistent with the Government's policy of securing a progressive reduction of the growth of money supply.

16 What is the forecast of the Relative Price Effect in 1980-81?

This first White Paper does not show an estimate of public expenditure in cost terms (including the relative price effect). It will be given in the second public expenditure White Paper covering the later years.

B2(R)

8p INCREASE IN BASIC RATE — (this is mentioned in the text) of the White Paper).

Factual

8p on income tax raises about £4 billion of revenue in the first year. This is higher than the £3½ billion at 1979 survey prices in the White Paper, because some allowance has been made for the increase in prices between the survey and next year.

Positive

If monetary growth is to be kept under control without excessively high interest rates, it is necessary to tighten fiscal policy. This means that either public expenditure must be reduced from planned levels, or tax as raised. There is no other way.

Defensive

1. Since the ultimate objective of checking the growth of public expenditure is to control monetary growth, an alternative calculation would be to work out the increase in income tax that was equivalent in its impact on monetary growth (or perhaps the PSBR) to the reduction in expenditure. The figure of 8p would not be very different on the alternative basis.

2. The government's plans are for public expenditure in 1980-81 to be the same level as in 1979-80. The reduction in public expenditure of £3½ billion to which the increase of 8p in the basic rate might be the alternative is the difference between the previous government's plans for 1980-81 and the level of expenditure projected for 1979-80 and now planned for 1980-81.

3. The 8p increase in the basic rate cannot simply be added to the existing basic rate of 30p to give the basic rate that would be necessary in 1980-81. It is possible that the existing basic rate would anyway be changed in the Budget to take account of the government's objectives and the economic and financial situation at the time.

4. The increase in the basic rate is intended only to illustrate the broad order of magnitude. Other taxes might be increased instead, for example an increase in VAT on 1 April 1980 of 10 percentage points (or 7½ percentage points on 1 January 1980) would raise an equivalent amount of revenue. [If the increase in VAT were calculated so as to be equivalent in its impact on monetary growth to the reduction in public expenditure (see defensive point 1), much larger increases (of the order of 25 percentage points from 1 April 1980) would be required. Unlike with income tax it would not be possible to say that the increase necessary to have an equivalent monetary impact was much the same as the increase designed to raise a particular amount of revenue. It would be difficult to explain all this in public and it might therefore be best not to refer to a VAT increase.]

RPI EFFECTS

Factual

The total effect of the RPI of the changes in public expenditure plans for 1980-81 included in the White Paper might be rather under 1 per cent.

Central Government. The increase in Prescription charges to 70p will add 0.05 per cent to the RPI in April 1980. The reduction in passenger support grants to British Rail will add 0.02 per cent to the RPI during 1980-81.

Nationalised Industries. The external financing requirement for British Gas has been reduced. The resulting gas price increase will add 0.2 per cent to the RPI by the summer of 1980.

Local Authorities. It is for individual local authorities to settle the distribution of their expenditure. The assumed cut in school meals and milk might increase the RPI by 0.3 per cent, whether met by a cut in the quality of the service or by raising prices. It is envisaged that local passenger transport subsidies and new bus grants will be cut with an RPI effect of 0.15 per cent in 1980-81.

Summary Table	RPI Effect in 1980-81
Prescription charges	0.05
BR passenger support grants	0.1
Gas	0.2
School meals and milk	0.3
Local passenger transport subsidies and New bus grants	0.15

DEFENSIVE

The way to get inflation down is to control monetary growth and the tax burden. This requires restraint in public expenditure. Inflation will not be brought down simply by giving special priority to expenditure which has the immediate effect of depressing the RPI.

ECONOMIC ASSUMPTIONS

The major working assumptions used in the public expenditure White Papersare unemployment, earnings, prices and interest rates. A variety of price indices relating to specific items of expenditure are used.

2. The assumptions are used for costing various programmes in the White Paper - these include social security, housing subsidies, export and shipbuilding credit, overseas aid etc.

3. The working assumptions on the level of unemployment and growth in real earnings then used, were given in the last public expenditure White Paper Cmnd 7439. This was in response to a recommendation by the previous Expenditure Committee in their Eighth Report of the 1977-78 Session.

4. The unemployment and real earnings assumptions used are not shown in this White Paper. They were made some months ago. When the autumn forecast is complete, any working assumptions which seem to be outdated will be revised for the White Paper on expenditure to 1983-84.

5. The real earnings assumption is no longer of central importance by the social security programme - prices only uprating has been for 1980-81, reflecting the government's stated policy.

6. It would be inappropriate to publish all the working assumptions used in the White Paper. A major difficulty always is the risk that their status will be misunderstood. If they are thought to be forecasts they may influence expectations and hence events.

RATIOS OF PUBLIC EXPENDITURE TO GDP

Factual

i. The ratios of total public expenditure and general government expenditure on goods and services to GDP at market prices for the last three years as shown below.

Ratios of public expenditure to GDP at market prices[1]

	1976-77	1977-78	1978-79
		per cent	
Total public expenditure	44	40	42
General government expenditure on goods and services	25½	24½	23

(1) In order to have strict comparability with the GDP measure, these ratios use a different measure of public expenditure to that which is normally published. The total public expenditure on the White Paper basis is increased to include an allowance for the amortisation of capital assets required by the non-trading part of the Government sector.

Defensive

i. No expenditure ratios have been included in the White Paper. Ratios in future years will be affected by the growth of GDP, the relative movement of costs in the public sector and the actual growth of public expenditure. The calculation of the ratios will have to await the publication of an Industry Act.

ii. Substantial reductions in the previous Government's plans have been necessary in order to constrain the proportion of national income taken by the public sector. As a result public expenditure will be about the same in 1979-80 and 1980-81 as in 1978-79. But the prospect for GDP which we inherited is poor; and any decline in the economy would obviously increase the ratio next year.

C 1 (R)

LOCAL AUTHORITIES

FACTUAL 1. Local authorities in England and Wales have already been asked to cut current expenditure in 1980-81 by 5% below inherited plans. This implies a reduction of about 3½% on 1979-80 planned levels as shown in Table 3. But we asked them to make reductions in 1979-80 as soon as we took office. To the extent that they do this, the reduction needed in 1980-81 will be less than shown in the White Paper.

2. Local authority capital expenditure in 1980-81 is 9% lower than 1979-80 (estimated outturn) and 8% lower than 1978-79.

3. Total local authority current and capital:-4½%, 1980-81 on 1979-80; - 3%, 1980-81 on 1978-79.

4. Total public expenditure (Table 1): -0.2%, 1980-81 on 1979-80; -0.3%, 1980-81 on 1978-79.

POSITIVE 1. Local authority expenditure has been rising. June manpower levels were highest ever. Got to put brakes on.

2. We have given local authorities as much time to take action as possible and have asked them to rein back both this year and next. The aim is that by 1980-81 their current expenditure will be about 2% below 1978-79 levels.

DEFENSIVE 1. Not slashing cuts. Local authorities being asked to forego growth this year and next and make some limited economies besides.

2. Local authorities have not been singled out. Government has taken decisions in terms of programmes and priorities. It has also had to take account of the recent high pay increases* Obviously Defence and Social Security mean that central government total of expenditure likely to fall less than other areas.

* including comparability in the public services.

3. Revised totals of LA capital expenditure reflect in large part greater realism on housing.

4. The Rate Support Grant settlement for 1980-81 will be compatible with White Paper plans.

5. Rates next year? Wait for the settlement announcement next month (November 20).

C2 SPECIAL SALES OF ASSETS

Factual

The broad composition of the 1 billion target for 1979-80 was announced on 16 October. The components are: approximately 5% of BP shares-200 million to 300 million; new town assets and other public sector land-100 million to 150 million; other assets including assets held by NEB-100 million to 150 million. No details of the ½ billion target for 1980/81 have yet been announced. The reason why the proceeds may, in some cases, not count as reductions in public expenditure is that they may take the form of additional revenue receipts.

Positive

These receipts from special sales of assets, which provide a useful contribution to the reduction of the public sector borrowing requirement, result from the Government's policy of reducing the public sector.

Defensive

Points on particular industries should be referred to the departments concerned.

C3

CIVIL SERVICE STAFF COSTS

Factual

The relevant cash limits this year ~~were~~ were initially set in accordance with the previous Administration's pay guidelines. This proved insufficient. The present Government therefore decided to revise the limits, but not to the full extent of the pay settlements reached. Accordingly the limits were set to achieve a reduction of 3% in manpower costs. There were a few exceptions, notably the Prison Service.

The lower manpower levels flowing from this action have been carried forward to 1980-81, and are reflected in the figures published in this White Paper.

A further review to secure reductions in the size and cost of the civil service was announced by the Minister of State, CSD, on 11 June. Decisions have not yet been taken. Any changes to 1980-81 figures on this account will be announced in due course.

Positive

Carry forward of the cash limits squeeze (about £100million) is evidence of the Government's determination to fulfil their Manifesto commitment to reduce waste, bureaucracy and overgovernment. This is just a start. The longer term review will carry the process further.

Defensive

This just adds to unemployment? No. It contributes to the reduction in public expenditure to which the Government are committed as a principal means of stimulating economic growth. It is only through the achievement of such growth that we can hope to reduce unemployment.

C4R

DEBT INTERES

Factual

i. Debt interest projections are shown in Table 1 of the White Paper on the definition used in the last three White Papers, namely including only those payments which represent a charge on taxation or borrowing. Total public sector payments to the private sector and overseas are also shown in the explanatory and technical notes.

ii. Debt interest is not included in expenditure control totals, because it is not amenable to the same controls as other expenditure.

iii. The debt interest projections in the White Paper are shown below:

	£ billion at 1979 survey prices		
	1978-79	1979-80	1980-81
Debt interest (as in public expenditure)	2.9	3.1	3.2
Changes from Cmnd 7439	+0.3	+0.4	+0.4
Total public sector debt interest payments	9.9	9.9	9.8
Changes from Cmnd 7439	+0.4	+0.7	+0.8

iv. Total public sector debt interest payments are assumed to fall slightly after 1979-80. The different trend in this series partly reflects the inclusion of public corporations' payments of interest to the private sector and overseas, which are expected to fall over the survey period.

v. It has not been the practice to disclose / the precise assumptions about interest rates and future borrowing used in the projections, for fear of misunderstanding of their status by markets.

Defensive

i. Debt interest in 1978-79 was £0.3 billion higher than expected in Cmnd 7439. This reflects higher than expected borrowing and interest rates in 1978-79, as well as a change in the CSO estimate of interest receipts. The projections for 1979-80 and 1980-81 have each been revised upwards by £0.4 billion, partly as a result of current high interest rates, and partly as a carry-over from last year's high figure.

C5

C5. WASTE AND EFFICIENCY

Factual

1. The plans for 1980-81 do not include a specific global reduction in respect of improved efficiency and reduced waste. However the cash limits for the current year were set to achieve a reduction of 3 per cent in manpower costs, and the resulting lower manpower levels have been carried forward to 1980-81 (see brief C3).

2. The reductions made in a number of programmes from the levels previously planned will act as a spur to economy in the provision of services.

3. Sir Derek Rayner's project has not yet reached a stage at which credit can be taken for savings in the public expenditure plans.

Positive.

The Government's policy of avoiding growth in public expenditure for the time being means that the emphasis in providing services will have to be on increased efficiency rather than increased expenditure.

Defensive.

Work on improving efficiency, notably Sir Derek Rayner's project, is continuing. This is all part of the Government's policy of containing public expenditure. The results will be reflected in public expenditure plans as decisions are taken.

Cash Limits

Now that the volume plans for 1980-81 have been decided, the government will be setting the cash limits.

> "The intention is that the industries should know the limits in good time, so that they can act as an effective constraint upon the growth of unit costs and as a stimulus to greater efficiency. To this end it is necessary that they should be agreed and announced before major pay settlements are reach, a number of which are negotiated around the time of the calendar year.

The provision to be made in cash limits for pay and price increases will be determined on a case by case basis taking account of particular circumstances. As in previous years, the cash limits on the rate support grant will be announced in November. Other public service cash limits will be published nearer the start of the financial year in accordance with the normal timetable. The general aim will be to publish cash limits in time for spending authorities to know the financial limits within which they have to work before the major pay settlements are reached.

This year the limits on the external financing requirement of the nationalised industries - which are treated as a form of cash limit - will also be published in November. In the past they have been published at budget time. The intention is that the industries should know the limits in good time and, in particular, before major pay settlements are reached. A number of these pay settlements are reached around the turn of the calendar year.

Cash Limits

A. Positive

i. Will the pay and price assumptions be published?

Yes. They will be published as in previous years.

ii. Will cash limits be set in advance of all pay awards?

This is the general intention. In this way cash limits will create framework for negotiations. There is a limit to the cash available to the government as to a private company.

B. Defensive

i. Wont the pay figure become a norm?

There will always be those who see a norm in every figure. The government is not setting norms. It is setting limits on the availability of cash. The size of settlements that can be financed will depend on the circumstances of each case and, in particular, on the extent to which productivity is improved.

ii. Are nationalised industries allowed 17½% pay rises?

No. This is a misconception. In considering the 1980-81 cash limits for the industries the government started from the presumption that these real labour costs per unit of output should fall in the coming year. Scope for each industry to achieve a reduction depends on the particular circumstances which of course vary widely. It involves looking at the increases in prices in the year ahead. The 17½% related to the increase in the RPI between November 1978 and November 1979. It has nothing to do with the likely increase in the year ahead. The budget forecast put that increase in the RPI at around 13-14% but later forecasts will be published in due course. It is in any case the government's view that pay negotiations should take account of the TPI rather than the RPI.

iii. Will the allowance for pay and prices be realistic?

The general aim will be to make a realistic allowance for pay and price increases subject to two objectives. First, the need

to exert downward pressure on the level of inflation. Second, planning public spending in a way compatible with the government's objectives for taxation, borrowing and the money supply.

iv. Will the assumptions be based on the Industry Act Forecast?

As I have said, the provision will be decided on a case by case basis. It will not necessarily be identical in all cases or directly related to particular Industry Act forecasts.

v. What if pay and prices rise more than allowed?

If spending authorities incur higher increases in costs than allowed for in the cash limits, we will expect them to achieve corresponding savings and it will not be possible to fulfill the full volume plans in this White Paper.

vi. Will the NHS cash limit be set ahead of this autumn's ancillaries settlement?

No. This is the only exception. It is not practicable to set the cash limit in time. The award is however generally closely linked to the local authority manuals and here the RSG cash limit will be fixed in advance.

vii. What about the Civil Service?

We have stated its intention of reconciling our general policy on cash limits with pay research. We shall be discussing with the Civil Service unions the way in which we intend to do this in 1980-81.

D2

EXPENDITURE PLANS FOR THE LATER YEARS

Factual

The expenditure plans for the later years will be published as usual early in the new year.

Positive.

The Government's expenditure plans for the next year have not been published so early since 1970 (publication of Cmnd 4515, October 1970). On that occasion also plans for the later years were published the following New Year (Cmnd 4578, January 1971).

Defensive

The plans for later years are not delayed. They will be available at the usual time.

E1

DEFENCE

The 1980-81 figure shows a 3% increase over the expected outturn in 1979-80, which itself shows a 4.2% increase over the outturn in 1978-79. The UK is thus meeting in full the NATO 3% target.

The expected outturn in 1979-80 reflects additions to the cash limit totalling £550 million which the Government have made this year.

Further questions should be referred to the Ministry of Defence.

E2A

FCO (OTHER)

Factual

Expenditure in 1980-81 at around £300 million will remain at much the same level as this year. This figure excludes once-for-all items in 1979-80 only. [For your own information those items are: £10 million contingent provision for a UN Peace Keeping Force in Namibia; and, £9 million being the balance of military training and equipment for Zambia and Tanzania approved by the previous government.]

Positive

Some reduction in FCO manpower will save about £2½ million next year by closure of 23 subordinate posts - as already announced by the Foreign Secretary. The BBC External Services provision is some £5 million more next year to cover the capital cost of new equipment to improve its audibility. The British Council have undertaken to save £3 million next year and are now considering with the FCO how this can best be achieved.

Defensive

We understand the BBC have agreed with the FCO that economies will be made in its vernacular broadcasts. But the World Service in English and vernacular broadcasts to Eastern Europe will not be affected.

E2B

OVERSEAS AID AND OTHER OVERSEAS SERVICES

PROGRAMME 2.7 CONTRIBUTIONS TO THE EUROPEAN COMMUNITIES (NET) AND TO THE EUROPEAN INVESTMENT BANK

Factual

The figures shown in table 2.2 of the White Paper are made up of three elements:

i. UK payments to the EEC Budget net of public sector receipts from it and excluding the UK share of expenditure allocated to other functional programmes;

ii. Contributions to the capital and reserves of the European Investment Bank;

iii. Receipts from the European Coal and Steel Community.

The figures for 1979-80 and 1980-81 are £917 million and £1000 million respectively, on the above definition. These estimates represent the full cost to the UK under the present arrangements and take account of refunds under Article 131 of the Treaty of Accession in respect of UK contributions in 1979, and under the Financial Mechanism in respect of UK contributions in 1980.

Positive

The Government is currently pressing our Community partners to accept a fundamental change in the arrangements which have led to the present unacceptable level of UK net contributions. The Commission has produced a paper on the existing arrangements for budget contributions by member states which confirms the UK view that the UK net contribution is inequitable. The Commission are working on proposals for solving the problem posed by the UK net contribution and will put forward proposals which will form the basis for a decision by the European Council on 29-30 November.

Defensive

If asked what level of net contribution the UK would accept:

> The Government has made it clear that the UK payments to, and receipts from, the Community Budget should be in broad balance.

If asked if the UK will refuse to pay what is considered to be an excessive contribution:

> This is speculation. We are negotiating with our Community partners, and have no reason to believe that a satisfactory solution will not be found at the Council meeting on 29-30 November. The Prime Minister has recently made it clear, in the House of Commons, that the UK would not act unlawfully in this matter.

If asked about the effect of the 1% VAT ceiling, applying to EEC Budget expenditure, on the UK net contribution:

> The constraint implied by the 1% VAT Ceiling is not expected to have any effect on the figures for 1980-82.

If asked why the figures for 1980-81 appear to assume complete failure of the Dublin European Council to agree any alleviation in our budgetary contributions:

> The Government hopes to negotiate a satisfactory solution to the present budgetary problem at Dublin, but clearly a range of more or less satisfactory outcomes are possible. The figures in the White Paper emphasise the scale of the problem; to show anything less would be entirely arbitrary and it would be wrong to base our expenditure plans on such an assumption.

E2C

Overseas aid

Factual

The Overseas Aid Programme will continue at about the same level as for the current year (1979-80 £790.1 million; 1980-81 £781.4 million).

Positive

The UK aid programme compares favourably, even allowing for the present economic restraints, with that of other countries.

The UK aid performance is above the average for the OECD countries.

The UK Aid Programme has for a number of years represented a greater proportion of our GNP than those of eg the USA, Japan, Germany.

Defensive

Aid expenditure can be a particularly burdensome form of public expenditure because of its balance of payments implications.

The constraints now imposed do no more than stabilise aid expenditure. This can no longer be protected from the effects of the acute economic difficulties facing the country.

Agriculture, fisheries, food and forestry

Factual:

The broad makeup of the totals in paragraph 19 of the White Paper is:

	1979-80	1980-81	£m
IBAP	398	482	+84
MAFF	348	298)	
DAFS	112	99)	
WOAD	44	37)	-77
Miscellaneous	20	20)	
Forestry Commission	64	57)	
	986	993	+ 7

Agricultural support expenditure is demand determined and notoriously subject to fluctuation e.g. weather, world prices and production levels. The forecasts for the IBAP (market regulation) fall very much in this category. The bulk of the Board's expenditure is covered by receipts from the Community.

Positive

Expenditure is stabilised at about the 1979-80 level which was nearly £100m up on 1978-79. Total provision on the programme is not therefore badly treated. Some increase is made for support for fisheries (restructuring and sea-protection), although actual aid will depend on new schemes being agreed.

Defensive

The details of the proposed reductions on the non-IBAP elements are for the Agricultural Ministers to explain. Briefly, after taking account of downward estimating changes, the bulk of the cuts fall on the support services.

E4A(2)

PROGRAMME 4: INDUSTRY, ENERGY, TRADE AND ECGD

FACTUAL

Within Programme 4 the totals are:-

	£ million	
	1979-80	1980-81
Industry	1035	995
Energy	301	312
Trade and ECGD	111	259

The increase in this programme is more than accounted for by ECGD (see defensive iv)

/ These provisions cover regional support; industrial innovation including nuclear R & D; general support for industry; grants for aerospace, shipbuilding and coal; export promotion; and ECGD expenditure on export credit refinancing and interest support costs. The main changes in 1980-81 affect RDGs. This was announced and debated in July.

POSITIVE

(i) The process of reducing expenditure on these programmes began in the Budget with savings in 1979-80 of the order of £230million.

(ii) Where possible precipitate and disruptive changes have been avoided.

(iii) The full effect of the measures announced on regional and selective assistance and the NEB will take effect in later years.

(iv) Regional policies will enable resources to be concentrated more effectively.

DEFENSIVE

(i) Selective industrial support will continue but with more emphasis on selectivity and against stiffer criteria, as announced by the Secretary of State.

(ii)Where areas have been downgraded for RDG purposes the changes are being phased.

(iii)The result of the BL ballot will be announced on Thursday 1 November morning. Whatever the outcome the Government will not take decisions until it has considered proposals from BL and NEB. In the meantime there is provisional allowance for some further financing of BL in 1980-81.

(iv)ECGD expenditure reflects a once-for-all reduction achieved in 1979-80 by the Trustee Savings Bank taking over some £200 million of outstanding refinance.

E4B

EMPLOYMENT AND TRAINING

Factual

a) The Programme 4 totals for both 1979/80 and 1980/81 includes just over £1,100m for the employment and training programme. [This represents a cut of over £500m on the last Government's plans for 1980/81.]

b) The Manpower Services Commission's programme (including the Youth Opportunities Programme) will continue at broadly ~~their~~ its present level.

c) There is no provision for the extension of the Department of Employment's temporary employment measures (which include the Job Release Scheme and the Small Firms Employment Subsidy) beyond 31 March 1980.

d) The last Government's proposed statutory scheme for short-time working compensation has been dropped.

Defensive

a) We have not made provision for the extension of the temporary employment measures beyond the end of the year because we have not yet decided whether or in what form they should continue. Those decisions will follow a full review of the measures in the next few months. [Provision could be made from the Contingency Reserve if we decide that the measures should be extended.]

b) Have the MSC been consulted? Suggest you take that up with the Secretary of State for Employment.

C5 NATIONALISED INDUSTRIES

Factu al

The figures for the Nationalised Industries are divided between Government lending in Table 2 and their borrowing from overseas and the market in line 9 of Table 1. Taking these two together gives their total borrowing and it is this which contributes to the planning total. Since the last White Paper, the coverage has been somewhat expanded to include the industries' net short-term borrowing and the capital value of leased assets. This borrowing total, together with grants to the industries, now coincides with the basis on which the industries' cash limits are set.

Positive

The Government is determined that the industries shall improve their efficiency and cash limits, which are an element in the framework of financial discipline, will be set accordingly. This, together with moves to more realistic pricing which will be necessary in some cases should lead to reductions in the figures, as can be seen in the planned level for 1980/81.

Defensive

The total for 1979-80 (1200 at survey prices) is considerably higher than the figure for borrowing at outturn prices published in the FSBR (812). This increase results from two factors. First, as recently announced by the Secretary of State for Industry, the Post Office's cash limit for the current year will have to be increased by some 400 million to take account of the recent strike of those involved in sending out telephone bills. This money will however be recovered early in the following financial year. The second factor is that the shortfall by other industries below their cash limits is now expected to be lower than the allowance included in the FSBR.

E 6

PROGRAMME 6: ROADS AND TRANSPORT

FACTUAL

The programme will be reduced by some £200 million compared with 1979-80, to total a little under £3,000 million. Spending by local authorities accounts for about half the programme and it is the Government's intention that the distribution of the reductions should follow this split. A large part of the reduction on the central government side will be from reductions in support for transport industries, primarily through changes in the funding arrangements for British Rail and National Freight Corporation pension schemes.

POSITIVE

At nearly £3,000 million the provision for the programme will remain large. It will enable investment on new and improved motorways and trunk roads to continue on a substantial scale - since the Government recognises that roads have an important part to play in economic recovery. By far the largest part of the reduction in central government support for transport industries is in a form (ie changes in British Rail and National Freight Corporation pension funding) which will not put pressure on fares. It will, of course, be for the local authorities themselves to decide how to allocate the reduction on their side; however, the reduction envisaged should enable them to maintain a high level of expenditure on road construction and maintenance while avoiding a sharp reduction in public transport subsidies.

DEFENSIVE

The programme has to contribute to the Government's public expenditure objectives. There will inevitably be some reduction in construction expenditure, but this will be small in relation to the total provision remaining and the effects on the construction industry should not be significant. Similarly the effects on fares and the Retail Price Index if local authorities reduce public transport subsidies should not be large. The changes in British Rail and National Freight Corporation pension funding arrangements (for which there will be provision in the forthcoming Transport Bill) will not affect the pensioners concerned.

Factual

Public expenditure of £5078 million in 1980-81, 3% less than in 1978-79, 5½% less than may be spent in 1979-80.

2. The expected outturn for 1979-80 is some 4½% below the Budget provision.

3. Last Government's programme for 1978-79 was underspent by 7%.

4. Current expenditure in 1980-81 £500 million higher than in 1974-75, capital £2,500 million (52%) lower.

Positive

1. Provision has been made for capital expenditure in 1980-81 some £280 million below the 1978-79 level to reflect the substantial drop in the level of local authority new housebuilding approvals - not an enforced cut.

2. Have inherited too heavy a burden of public housing subsidies: introducing new subsidy system in 1981-82, to help reduce it.

Defensive

1. Rents. Plans for 1980-81 assume authorities will make higher increases than in recent years. How much? There is not a simple answer. Depends on a number of things eg. repairs costs. In any event Housing Ministers will need to discuss the details with local authorities.

2. Capital programme more than halved compared with 1974-75

(a) Largely due to decline in new housebuilding before we took office.

(b) Mistake to equate level of public investment with progress in meeting housing needs. Much can be done better by private sector, and by making better use of existing housing stock.

3. Huge cut in inherited plans for 1980-81 (£1200 million, 19%) Inflated plans which would not have been realised, huge underspend last year (7%) and on inherited plans for this year (10%).

OTHER ENVIRONMENTAL SERVICES

Community Land

FACTUAL The Community Land Scheme will be abolished. Powers will be taken in the Local Government, Planning and Land Bill to wind up the scheme.

Urban Programme

FACTUAL Expenditure on the Urban Programme is continuing despite reductions; the amount included is still higher than expenditure in 1979-80. Procedures are being simplified and streamlined.

E 9

LAW ORDER AND PROTECTIVE SERVICES

Factual

1. The services in this programme include expenditure on Crown and magistrates courts, legal aid, prisons, probation and after-care, police, fire, civil defence and other community services. Planned expenditure will be £2542 million, £88 million higher than in 1979-80; local authority expenditure, mainly on police, should be approximately three quarters of the total.

Positive

2. The decision to increase planned expenditure on law and order services is in line with a Manifesto commitment to restore the respect for the rule of law and give the right priority to the fight against crime. We have accordingly increased the resources available, in particular to the police.

Defensive

3. The programme includes services other than those (administration of justice, police, prisons and probation and after-care) conventionally described as law and order. Expenditures not related directly to the Government's priority have either been cut back (eg grants to voluntary bodies) or held steady to maintain existing standards (eg fire services).

4. Additional provision will be made for police, should numbers exceed estimates within authorised establishments. This reflects the reality that police authorities are free to build up their numbers to authorised establishments and that, if recruitment is faster than expected, additional provision will be made from the Contingency Reserve.

5. The planned expenditure takes no account of the recommendations of either the Royal Commission on legal services or the Committee of Inquiry into the Prison Service (the May Committee; report due to be published on 31 October). The Government will be announcing its policy on these reports in due course.

Factual (a) About four fifths of this programme is local authority expenditure on education and libraries. That is, in turn, over half of local authority expenditure.

(b) The RSG settlement will be based on the planned expenditure - here as in other programmes.

(c) Expenditure on schools should fall with falling rolls quite apart from the expected savings on school meals, milk and transport.

(d) Planned expenditure includes the Office of Arts and Libraries' half share of the £15.5 million to be provided on the new National Heritage Fund and for acceptance of pre-eminent objects in lieu of tax.

Positive arguments

(i) For all its importance this programme is of lower priority than the other large programmes.

(ii) In seeking the necessary economies in schools the Government have turned first to the ancillary services - meals, milk and transport - rather than to teaching expenditure.

Defensive arguments

(i) Maintaining standards of achievement in basic skills - the Manifesto commitment - is not synonymous with keeping expenditure up.

(ii) Unit costs in schools have been rising for years - it cannot just go on and on.

(iii) There has been overprovision in the past for higher education - the number of students has been steady for four years now, despite a rising age group.

(iv) Overseas students must pay their fair share of the costs attributable to their education.

(v) Direct central Government support for museums, libraries and the live arts should allow a continuation of activities at about the same level as in 1979-80.

Questions of detail: on Education and Science to the Secretary of State

on Arts and Libraries to the Chancellor of the Duchy of Lancaster.

E 11(R)

HEALTH AND PERSONAL SOCIAL SERVICES (HPSS)

It is proposed to maintain spending in the health service at the level planned by the previous administration. This is in accordance with the Manifesto commitment. The net cost to the taxpayer of the HPSS programme is expected to be some 1 per cent higher in volume terms in 1980-81 than in 1979-80. To help meet the rising cost of the health programme, prescription charges are to be raised from 45p to 70p from April 1980 and it is intended that an increased proportion of the cost of treating the victims of road accidents will be recovered under the Road Traffic Act 1972. As a result, spending by health authorities is expected to be about 3 per cent higher in 1980-81 than in 1979-80.

POSITIVE

Although health authorities have had difficulty managing within their cash limits for 1979-80, the proposals in the White Paper should give them scope to improve and develop services in 1980-81. The effective growth in services for patients should be even greater since the measures which are being taken to eliminate inefficiency and waste, and to cut down bureaucracy in the NHS will enable the available resources to be channelled more into direct patient care.

DEFENSIVE

The Manifesto commitment did not apply to the personal social services, which cannot be exempted from the general cutback in local authority spending. Local authorities themselves will best be able to decided where to make savings, but it is expected that they will give priority to the protection of the most vulnerable members of society.

The proposed increase in prescription charges will mean that the charge will be only slightly higher in real terms than when it was reintroduced in 1971. Even at 70p it will represent only about one quarter of the average cost of a prescription. The recovery of NHS costs under the Road Traffic Act 1972 will be restored to about the same level in real terms as when the Act was passed.

SPLIT BETWEEN HEALTH AND PSS

	1978-79	1979-80	1980-81
Health (gross)	7909	7929	8165
Health(net of charges)	7716	7728	7904
Personal social services	1339	1381	1290
TOTAL HPSS	9055	9109	9194

E 12 (A)

SOCIAL SECURITY

This programme provides for the payment of cash benefits. Planned expenditure in 1980-81 will be £19,289 million - an increase of some £230 million over expenditure in the current year. This increase reflects the year-on-year change in the number of beneficiaries and it also includes the full-year effect of the restoration of the 1978 shortfall in the November 1979 uprating.

Positive

2. In addition to the provision for the full-year effect of the November 1979 uprating (including the restoration of the 1978 shortfall) planned expenditure also provides for the increase in the child benefit premium for single parent families and the recently-announced scheme for assistance with fuel costs. The planned 1980-81 expenditure also includes provision for the uprateable benefits expressed in terms of the available level of benefit in 1979-80, which assumes an uprating will be made to preserve that purchasing power. The size of the 1980 uprating will depend on the estimate of the movement of prices between November 1979 and November 1980 on which the uprating proposals will be based.

Defensive

3. Although the figures provide for an increase of 50p in the one-parent family premium from November 1979, there is no provision for further upratings of child benefit. The Secretary of State is required to review the rate of child benefit annually but there is no statutory obligation to uprate this benefit. No decision has yet been taken on the timing and the amount of the next uprating. The figures include provision to implement the Government's decision to continue the Christmas bonus on an annual basis. Account is taken of the Government's decision to alter the basis of future upratings of long-term benefits by price movement only rather than the better of price or earnings movements. The figures also allow for savings expected from intensified efforts against fraud and abuse of the social security system.

4. The increase in expenditure (of £845 million) between 1978-79 and the current year was primarily due to the full-year effect of the November 1978 increase of child benefit to £3 and the effect of the April 1979 increase of child benefit to £4.

5. This programme is affected by the working assumption on unemployment - see briefing on B.6 (Economic Assumptions).

"The record pension uprating"

The reference in paragraph 9 to "this years record pensions uprating," is to the 19.5% increase in pensions and other long term benefits which will take effect from November 1979. The increases (of £3.80 and £6.10 per week for single and married people respectively) are the biggest ever in cash terms, and take the value of the pension in both real and money terms to its highest ever. The total cost affects 4 months of 1979-80 but 12 months of 1980-81, and hence contributes to the rise in total social security spending between 1979-80 and 1980-81.

E 13

OTHER PUBLIC SERVICES

The only significant increase over Cmnd 7439 provision is £1.7m in the Office of Population Censuses and Surveys (OPCS) for preparatory work on the 1981 Census.

Any enquiries on CSD-controlled items should be referred to CSD.

COMMON SERVICES

(This programme covers capital and current expenditure: by the Property Services Agency on civil accommodation and accommodation services; by the Paymaster General's Office on civil service pensions etc; by the Central Office of Information on government information services; by Her Majesty's Stationery Office on stationery and printing; by the Treasury on rating of government property; and certain other miscellaneous common services, including legal services. Only the first two - PSA and civil service pensions are substantial enough to be likely to attract comment).

PROPERTY SERVICES AGENCY: GOVERNMENT OFFICE ACCOMMODATION ETC (UK)

The figure for 1980-81 of £327m represents a big reduction on the provisional outturn for 1978-79 (£357m) and follows the reduced provision of £334m in 1979-80.

This expenditure is closely aligned to the size and needs of the civil service and the reduced level reflects the Government's intention to reduce administration expenditure generally. A major feature in the 1980-81 reduction is the saving in major works achived by the Government's decisions on the dispersal programme. Other reductions, in major and minor new works, rents, furniture, maintenance, running costs and PSA administration anticipate a generally lower level of expenditure on central government administration.

Existing agreed accommodation standards will be maintained. For the time being it will be necessary , in the interests of achieving the required level of short term public expenditure savings, to curtail the planned programme of purchases and building to reduce the dependence on expensive leased accommodation.

CIVIL SERVICE SUPERANNUATION

The increase in 1980-81 is due almost entirely to the "retirement bulge". Entrants in the post-war reconstruction period are now reaching retirement age and the numbers retiring substantially exceed deaths of pensioners. As time passes, the average length of pensionable service increases; we therefore have both rather more pensions and slightly larger pensions.

E 15

NORTHERN IRELAND

Factual

1. The Northern Ireland programme includes elements of expenditure comparable to most GB programmes and thus the trend between 1979-80 and 1980-81 reflects that for those programmes in total rather than for any one particular programme.

2. N.I receives the same treatment in aggregate as do the comparable programmes in GB including its share of growth provided for in law and order and social security.

3. The Secretary of State does not have to follow exactly the GB pattern of expenditure (see 4 below) but is able to make dispositions as is appropriate for N.I.

4. Changes on items involving cash transactions (eg rents, school meals, prescription, social security benefits) will also be implemented in N.I.

Positive

1. Within the N.I programme total, expenditure on law and order is being increased.

2. By his ability to depart from the precise pattern of expenditure in GB the Secretary of State is to some extent able to tailor measures to meet the special needs of N.I.

Defensive

1. Given the Government's decision to effect some growth in eg defence and law and order within their overall objective of stabilising public spending, some programmes will inevitably show a decline. That in the N.I programme between 1979-80 and 1980-81 is not the largest (eg programmes 5, 6, 7 and 10).

2. In making his dispositions the Secretary of State attaches priority to avoiding affecting employment adversely and reductions such as in housing (a shift from the public to the private sector) and in education (demographic factors) are neutral in that respect.

CONFIDENTIAL

1.

Prime Minister.

Do you agree with X/ below ?
If you do, a short-ish meeting during the week should be enough. A meeting at the week-end 10/11 November would in any case be difficult : you have Remembrance Day engagements both days.

Ref. A0525

PRIME MINISTER

Public Expenditure

We have taken Public Expenditure to 1983-84 off the agenda for this week's Cabinet.

2. The Treasury are already thinking that publication will have to be postponed until about the middle of January. On this basis final Cabinet approval can readily wait until 8th November.

3. Both on housing and on education, there are signs that the Departmental Ministers concerned and the Treasury may be able to reach bilateral agreement within the next 24 hours or so. In order not to damage the prospects of this, I propose to hold back the promulgation of the decision to set up a small group under your chairmanship until tomorrow. I do not think we will lose anything by doing this. If they can settle those problems bilaterally, that will leave only the agriculture problem to resolve in the small group. If they cannot, then those problems will have to come to the small group as well. We have had draft Cabinet papers on rent options from the Secretary of State for the Environment and the Chief Secretary. I propose to sit on these until we hear the results of the bilaterals. If the bilaterals reach agreement, then the papers should not need to be circulated. If the bilaterals do not reach agreement, then the papers would be circulated, in the first instance to the small group.

4. You said that you would like to consider whether there was anything that could be done, short of dropping the last year from the published White Paper, to modify the basis on which the figures for the last two or three years of the PESC period are presented in the published White Paper. You have in mind that you might have a meeting with the Chancellor of the Exchequer and the Chief Secretary, together with senior Treasury officials, over the weekend, to look further at this.

5. You should know that we have two official studies already in train on various aspects of public expenditure. An interdepartmental group has been set up under Treasury chairmanship to consider ways of improving and modifying the

PESC process. We have also set up a small group, again under Treasury chairmanship and this time with Cabinet Office participation, to look at the problems of presenting public expenditure to Ministers for decision, and in particular at the problem of the gap between bilaterals and full Cabinet.

6. As regards the presentation of the White Paper on Public Expenditure to 1983-84, I understand that the Treasury are already considering ways of changing the presentation for the later years: the sort of idea they have in mind is more aggregation within the totals, so that for the later years the White Paper will include a rather smaller number of figures, though of course the figures themselves will be that much larger. There might be scope in this process for some degree of rounding, so as to get away from the spurious precision that surrounds the figures for later years on the traditional presentation.

7. So I think that we have a choice between three possible courses:

(a) To go ahead with the meeting with the Chancellor of the Exchequer and the Chief Secretary and senior Treasury officials this weekend.

(b) To invite the small group of officials which is already looking at the problems of presenting public expenditure decisions to Ministers to add to its remit possibilities for modifying the basis on which figures for later years are presented in this year's White Paper.

(c) Asking the Treasury to produce, as quickly as possible, a paper describing its proposals for presenting the figures for later years in the forthcoming White Paper. The Treasury are preoccupied over the next day or two with the publication of the White Paper on Public Expenditure to 1980-81, but they could produce a paper shortly after that is out of the way, and certainly in time for a meeting in the middle of next week or on the weekend of 10th November. That would be time enough for the purposes of publication of the White Paper in January.

8. The advantage of course (b) or (c) is that it would give you and the Treasury Ministers something to bite on when you have your meeting. Course (c) would be likely to produce a paper and therefore a meeting earlier than course (b). I recommend therefore that we should ask the Treasury to prepare as soon as possible a note describing their own proposals for modifying the way in which

figures for the later years are presented in the forthcoming White Paper. On the basis of that note we could then consider whether you wanted to have a weekend meeting to go over the ground comprehensively, or whether it would be possible to arrive at conclusions on the basis of a shorter meeting in London during the week.

RtA

ROBERT ARMSTRONG

+ shorter meeting in London

30th October, 1979

Treasury Chambers, Parliament Street, SW1P 3AG

30th October 1979

T Lankester Esq
No 10 Downing Street
LONDON SW1

Prime Minister
Content?
Yes ok TL
30/10

Dear Tim,

WHITE PAPER ON PUBLIC EXPENDITURE 1980-81

The Opposition have now indicated that they want to press for a Parliamentary Statement on the publication of the 1980-81 public expenditure White Paper on Thursday, 1st November. I enclose a draft of the Chief Secretary's statement. I ask for comments not later than close on Wednesday, 31 October.

I am copying this letter to the Private Secretaries to other members of the Cabinet and to Sir John Hunt.

Yours sincerely,
Alistair Pirie

A C PIRIE

DRAFT PARLIAMENTARY STATEMENT

Mr Speaker, with permission I will make a statement about the White Paper, published today, on the Government's expenditure plans for 1980-81. Copies are available in the Vote Office.

The Government's strategy is to stabilise total public spending in volume terms. The outturn for last year, 1978-79, is now put at £69¾ billion at 1979 Survey prices. Estimates for the current year, 1979-80, are still speculative, but the outturn is not expected significantly to exceed last year's expenditure. We plan to hold the total for next year, 1980-81, at the same level.

Within the total planned for 1980-81, provision is made for growth in some programmes, offset by reductions in others. Provision for defence increases by 3 per cent in 1980-81 over the expected outturn in the current year, and provision for law and order increases by 3½ per cent. [~~Gross~~] expenditure on the National Health Service is maintained; whilst a rise in spending on social security partly reflects the recent pension uprating.

For local authorities, the plans provide for a reduction of 3 per cent in their capital and current expenditure over the two year period, 1978-79 to 1980-81. The provision for their current expenditure in 1980-81 is in line with the figures on which they have been consulted and is about 2 per cent less than in 1978-79. The allocation between services shown in the White Paper is tentative. It will be for the authorities themselves to decide the pattern of their current expenditure in the light of local needs and conditions.

X ? X I will check the need for "gross" which doesn't sound good.

MT

The plans also provide for a further programme of public sector asset sales aimed at a figure of some £½ billion in 1980-81 compared with £1 billion in 1979-80.

The Government consider that the plans in the White Paper take realistic account of the poor prospects for growth in the domestic and world economies, and of the need to bring government borrowing and the money supply under firm control without unacceptable consequences for taxation and interest rates. They will form the basis for setting the cash limits for 1980-81.

The Government's ~~general~~ intention is to publish the cash limits in time for spending authorities to take account of them in making major decisions affecting their costs in 1980-81, including the costs of pay settlements. We intend to exert a firm control on spending through the cash limits. Spending authorities must expect that, if they incur higher costs than provided for in the cash limits, it will not be possible to implement the full volume plans in this White Paper.

We aim to publish the cash limits on the rate support grants and the limits on the external financing requirements of the individual nationalised industries later this month. Other public service cash limits will be published nearer the start of the financial year.

The Government are also preparing provisional expenditure plans for the years up to 1983-84. These will be published in a subsequent White Paper.

CONFIDENTIAL

Prime Minister
I think Britton's formulation at X seems the best we can get away with.
Agree?
PR
30/10

PRIME MINISTER

Agreed out.

PUBLIC EXPENDITURE WHITE PAPER: DISCLOSURE OF UNEMPLOYMENT ASSUMPTIONS

Your Private Secretary wrote to mine on 26 October to confirm that the assumptions about unemployment used in preparing the figures should not be disclosed in the 1980-81 public expenditure White Paper.

2. We need however to decide how to respond to questions about what levels were assumed. My strong preference is to give the figures if I am asked a direct question about them in the House following the Statement on Thursday. I am sure that we would have to disclose them later on if pressed - as we are bound to be - in a Select Committee hearing, and I could not refuse the House on Thursday, knowing this.

3. To deny the House as a whole what I am prepared to give in due course to a Committee would be to set a damaging precedent for this Government's dealings with the House. I personally attach great importance to this.

4. In this case there is anyway a difficult history, culminating in Denis Healey's agreement last year to give the then figures to the Social Services and Employment Sub-Committee of the Expenditure Committee and the inclusion of unemployment assumptions in the last full White Paper last January (Cmnd 7439).

5. If asked I would give the two key numbers of 1.35 million for 1979-80 and 1.65 million for 1980-81 for the number of unemployed (excluding school leavers etc). I would say that the assumptions had been chosen some months ago; that the first looked to be on the high side, given the movement of unemployment so far this year; and that the second was a broad assumption and is under review. As it stands it happens to be not out of line with projections published in recent months by forecasting bodies such as the London Business School or the National Institute.

X

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6. In fact my Treasury colleagues and I believe that the House will generally be expecting a higher figure for unemployment in 1980-81.

7. It is perhaps worth recalling that details of the working assumptions were obtained by the Guardian and published on 10 October in a form that maximised the figures (by including the peak of school leavers etc due in July). As far as I am aware this had no harmful repercussions.

8. I hope therefore that you can accept this way of responding to pressure in the House.

9. Mr Lankester's letter asked whether it is essential for the Government Actuary's report to reveal the unemployment assumptions. It is. The Secretary of State must under statute lay before the House a copy of the Actuary's report at the same time as the draft Contributions Rerating Order. This report must, again under statute, give the Actuary's assessment of the effect of the Order on the National Insurance Fund. The unemployment assumption is, of course, critical to his assessment, and therefore must emerge.

10. The question of the assumption to be used by the Actuary will be dealt with in the Chancellor's minute about the Industry Act forecast and related matters.

* This with Treasury colleagues tomorrow

Acting

P.P. JOHN BIFFEN
30 October 1979

(approved by the Chief Secretary and signed in his absence)

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

Copy on: Nat Inds, Sept 79, Gas and Electricity pricing

CONFIDENTIAL
Rt Hon
Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3HE

30 October 1979

Dear Secretary

ELECTRICITY INDUSTRY CASH LIMIT 1980/81

E Committee decided on 17 October (E(79) 12th meeting) that it was reasonable to have a target of raising the price of electricity in real terms over a 3 or 4 year period in order to achieve full economic pricing, provided that the increase in April 1980 was not larger than that in the RPI. My minute to the Prime Minister of 24 October on electricity and gas pricing proposed that electricity increases of 17% in April 1980 and 5% in October 1980 should be sought as the first part of the implementation of this strategy. Cabinet agreed on 25 October. The effects of this decision on the industry's cash flow and financing requirements for 1980/81 were among the options set out in my minute under reference.

On the basis of the agreed price increases I propose a cash limit for the electricity supply industry in England and Wales for 1980/81 of £187m in out-turn prices (equivalent to £144m at survey prices). The key industry assumptions underlying this figure are as follows:

a) an average price increase for coal in line with the RPI in the Spring of 1980, followed by a 7½% increase in the Autumn; this is tantamount to a 3-4% real increase in March 1980; which is certainly within the bounds of possibility;

b) an increase in salaries and associated costs of 18%; 6% of this arises from this year's pay settlement, and next year's pay settlements are taken as in line with the industry'

general inflation assumption of 12%. I do not disagree with the industry's view that the assumption of a 12% pay settlement may prove to be over-optimistic;

c) unit requirements on the CEGB of 232 Twh, an increase of 0.9% on 1979-80 (whereas my Department's latest short-term forecast shows a fall).

This cash limit has been discussed with the industry, who acknowledge that they will have to trim expenditure below present expectations if they are to achieve it.

I invite you to agree to this cash limit.

I am sending a copy of this letter to the Chief Secretary and Cabinet members

Yours ever

D A R Howell

David

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VLB

10 DOWNING STREET

From the Private Secretary

30 October 1979

Dear George

Public Expenditure Cuts: B.B.C. External Services

The Prime Minister has seen the Lord Privy Seal's letter to her of 27 October on this subject. She agrees with the line of action proposed by the Lord Privy Seal.

The Prime Minister is, however, somewhat concerned about how the proposed approach will be received in the House of Commons. She has noted that there is a motion on the Order Paper. I am sure that you have the question of presentation in the House very much in mind.

I am sending copies of this letter to Tony Battishill (H.M. Treasury), John Chilcot (Home Office), Stuart Hampson (Department of Trade) and Michael Richardson (Lord Privy Seal's Office).

Yours ever

Richard Alexander

G. G. H. Walden, Esq.,
Foreign and Commonwealth Office.

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DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

30 October 1979

Rt Hon John Biffen Esq MP
HM Treasury
Parliament Street
London SW1.

Dear John.

On 25 October the Cabinet, on the basis that there was continuing provision for offsetting the diseconomies of reducing school rolls, were disposed to accept your figures for schools in C(79)42. But they asked us to discuss further this and other matters, and to try to reach agreement on revised figures, to be reported to them on 1 November (CC(79)18th Conclusions, Minute 4).

2. On schools, I think there was some uncertainty in Cabinet about the nature of the difference between us, which rises from £65m in 1981-82 to £175m in 1983-84; and I would welcome the chance of a talk with you before this week's Cabinet. Meanwhile I would summarise the difference as follows:-

   a. when pupil numbers are falling and the average salary of teachers is rising as the profession gets older, there has to be some increase in unit costs each year if standards are to be maintained;

   b. the figures for 1980-81 that we agreed in July made provision for these factors (and this week's White Paper specifically acknowledges the first of them); the £130m for higher unit costs is needed to maintain 1978-79 standards; but

   c. the process of falling rolls and salary drift continues and, if standards in the later years are not to drop below those of 1980-81 and 1978-79, the further inescapable increases in unit costs will have to be covered. Your figures do not do this.

3. Our officials have discussed the position on non-advanced further education (NAFE) and higher education (HE); and I can now propose that we should adopt my figures for NAFE in Annex G to C(79)42 and yours for HE, i.e

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	£m 1979 Survey Prices			
	1980-81	1981-82	1982-83	1983-84
NAFE	577	590	600	605
HE	1608	1604	1600	1626

4. The table at the beginning of Annex G gives the following provisional figures for the assisted places scheme:-

	£m 1979 Survey Prices			
	1980-81	1981-82	1982-83	1983-84
	-	40	55	55

I can now accept the following figures instead:-

-	6	15	24

5. These figures, which make a further useful contribution to the reductions you are seeking, reflect the provisional working out of a scheme on more modest lines from that which was canvassed while we were in opposition, but I am satisfied that it will be more appropriate in present economic circumstances.

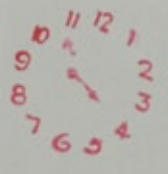
6. I hope that you will agree to the figures in paragraphs 3 and 4 above, and also confirm that, within the totals finally agreed for my programme, I am free to make any necessary adjustments between sub-programmes. I believe that we could defend those figures and the policies they imply, but only if we can also show that we are maintaining standards in schools. The continuing inclusion of a level £130m can be claimed to do this for 1980-81 but not for subsequent years.

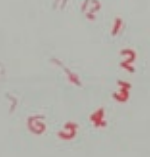
7. I am sending copies of this letter to the Prime Minister, the other members of the Cabinet, the Minister of Transport and Sir Robert Armstrong.

Yours ever

Mark

MARK CARLISLE





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Not seen
Prime Minister PA 31/x
To note.

Foreign and Commonwealth Office

London SW1A 2AH

29 October 1979

Dear Michael,

WHITE PAPER ON PUBLIC EXPENDITURE 1980/81

Cabinet has decided that, because the White Paper will contain no more than brief descriptions of the reductions in individual Departments' spending programmes, Departments could complement it, on or after publication day, with a press announcement giving details of their cuts. The FCO proposes to do this.

I enclose the text of a Press Notice which we propose to issue on the day the White Paper is published. The figures for overseas representation and for the BBC External Services reflect the proposals described in the Lord Privy Seal's letter of 27 October to the Prime Minister.

Copies of this letter go to Aidan O'Flynn at the Treasury and Richard Prescott in the Paymaster General's Office.

Yours ever

Paul

(P Lever)

M O'D B Alexander Esq
10 Downing Street

DSR 11

Registry No.

DRAFT PRESS RELEASE

Type 1 +

SECURITY CLASSIFICATION

Top Secret
Secret.
Confidential.
Restricted.
Unclassified.

To:-

From

Telephone No. Ext.

Department

PRIVACY MARKING

In Confidence

PRESS RELEASE (following publication of White Paper)

1. The White Paper on the Government's Expenditure Plans for 1980/81, published today, refers to economies which are to be made by the Foreign and Commonwealth Office. These economies will produce an annual saving in FCO expenditure (excluding that on Aid and related items) of £12 million as follows:

Overseas Representation - £5.8 million

2. In addition to the closure or pruning of consular posts abroad announced on 17 October, about 120 jobs are to be abolished in the FCO. Expenditure on building work and accommodation services overseas will be reduced or rephased.

British Council

3. The grant-in-aid paid by the FCO to the Council will be reduced by £3 million. In addition the contributions paid to the Council by the Overseas Development Administration will be reduced by £2.2 million.

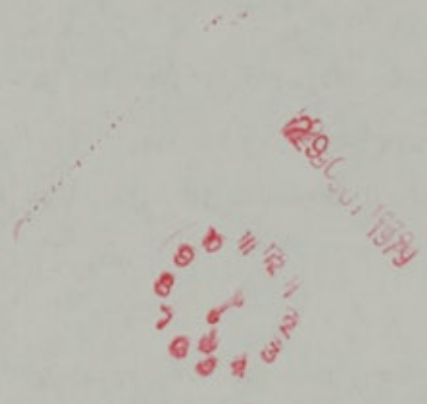
BBC External Services

4. The grant-in-aid paid by the FCO to the BBC for the operation of the External Services will be reduced by £2.7 million.

Other Overseas Expenditure

5. Cuts totalling £500,000 will be made in some miscellaneous items and grants-in-aid to various bodies.

Dd 0532000 800M 5/78 HMSO Bracknell



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Ref. A0517

PRIME MINISTER

Gas and Electricity Prices and Public Expenditure 1981-82 to 1983-84

(E(79) 61)

BACKGROUND

There have been two recent Cabinet or Committee decisions on gas and electricity prices:

(i) E Committee on 17th October (E(79) 13th Minutes, Item 2), which determined the principle of a return to economic pricing, but left the timetable open.

(ii) Cabinet on 25th October, in the context of the Public Expenditure White Paper (CC(79) 18th Conclusions, Minute 5) which decided on the timing of the second price increases for gas and electricity next year: 10 per cent for gas and 5 per cent for electricity, both in October.

2. This paper is about the speed of the return to economic pricing in the remaining years of the survey period. You will want to turn down any attempt at reopening the Cabinet decision: it was taken very rapidly, on the basis of rather thin documentation, but the main principle had already been accepted, and in the public expenditure context, a second increase next year seemed almost inevitable.

HANDLING

3. This is an agreed paper: you should invite the Secretary of State for Energy to introduce it, and then see whether the Chief Secretary, Treasury, wishes to add anything. To the extent that the paper deals with Scottish electricity prices, you will also want comments from the Secretary of State for Scotland (because the two Scottish Electricity Boards are, of course, independent of the English system) but, in general, the Cabinet decision should bind Scotland as well as the rest of the country. There may be some minor adaptation to local circumstances, but no more. The Secretary of State for Social Services has also sought an invitation for this item.

4. The issues which may arise seem to be these:

(a) Do we need to go public soon? The answer must be yes, for three reasons: in order to establish ~~treble~~ three-year financial targets for the gas and electricity industries; in order to give the right signals to consumers, and encourage gas consumers in particular to modify their consumption patterns, order new equipment, instal insulation, etc. (bearing in mind that next year's increases in gas prices will still leave that fuel as much the cheapest option for domestic consumers); and in order to get clear volume figures for the second Public Expenditure White Paper where the contribution which economic pricing can make to the expenditure/revenue situation is very substantial.

(b) Exact phasing of the return to economic pricing. The decision in E on 17th October turned on the idea that it might be slightly easier to start the return in October 1980 than in April 1980. Clearly, it is very difficult to forecast the trend of retail prices more than a year ahead. The Chancellor of the Exchequer will, I think, argue that the worst will be over by next autumn, and that a slow downward trend in the movement of the RPI should have set in. The paper demonstrates that, once the initial step has been taken, the RPI weight of the successive stages thereafter is small, compared with the size of the steps necessary simply to keep pace with costs. I understand that you are worried at the prospect of successive large gas price increases each April - always a bad month for the RPI: but to defer the April 1981 increase till October might cost, I am told, about £70 million on gas, and more on electricity.

(c) Electricity - special points. The only real problem is the speed of adjustment in Scotland, where prices have tended to fall a little short of those in England and Wales. I believe that the Secretary of State for Scotland does not disagree in principle with the changes proposed; but if he demurs, you might invite him to discuss the exact timing and speed of transition with the Chief Secretary, Treasury. It is common ground that electricity prices will have to rise by sufficient to cover movements in oil and coal prices (including the effects of increases in miners' pay).

(d) Gas. This has always been the main problem; but the Committee has accepted the principle of a return to economic pricing (related to a very wide range of 25-50 per cent underpricing). The Committee agreed to move over four years to the oil-related level, and the phasing proposed in this paper would achieve that. The separate question of gas profits, taxation, etc., is already the subject of internal work in the Department of Energy following the previous E discussion. But this is not due for completion until December, which may be too late for action in the 1980 Finance Bill. You might therefore wish to press for an earlier report, which should involve Treasury as well as Energy Ministers.

(e) Targets. The Secretary of State for Energy now proposes to set new targets for gas and electricity (and the Secretary of State for Scotland would presumably follow suit for his two Electricity Boards). You will note one minor point: the proposal is to set a target rate related to current cost operating profit as a percentage of revalued net assets. This assumes a move to inflation accounting which has not yet been universally accepted for the nationalised industries (though the gas industry's current accounting practices come very close to it). In fact, E(EA) is to take a paper on the whole question of current cost accounting for nationalised industries at its meeting on 7th November. You might make the Committee's decision on targets one of principle, leaving the exact expression of the target conditional on the outcome of the general discussion in E(EA).

(f) Cash limits. The majority of cash limits for the nationalised industries are for discussion at Cabinet on 1st November. The cash limit for coal has already been agreed bilaterally (and reported to you in Mr. Howell's minute of 29th October). This paper implies (paragraph 7) that the limits for gas and for electricity will not be agreed in time for Cabinet discussion on 1st November. This is because the Department of Energy have so far felt unable to talk to the gas industry about cash limits for next year until they were able to tell them the decisions on pricing. It will obviously be untidy if the gas and electricity cash limits cannot be settled on 1st November. You will want to press Mr. Howell on this and to find out how much delay the Chancellor is able to accept. If in the event firm

proposals cannot be brought to Cabinet on 1st November, the Secretary of State for Energy will need to agree these two limits with the Chief Secretary, and (because of their implications for pay) the Secretary of State for Employment, within whatever timescale the Chancellor is prepared to accept. The Secretary of State for Scotland should take similar action for his Boards. /Note: the reference to "late November" in the paper is misleading: it is still the intention to publish cash limits for all the nationalised industries on 20th November, the same day as the RSG announcement is made./

(g) 1981-82. The paper raises the question whether the increases for the year after next should be rather larger than average, so as to make good the shortfall on the gas industry's net repayments to the Exchequer and to help with the public expenditure bulge now foreseen for that year. (The reason for the shortfall is apparently the additional investment now needed to cope with increased demand rather than the reshaping of price increases.) The Chief Secretary may urge this course, basing himself on the figures in Annex B of the paper which show that, after allowing for Corporation Tax receipts, he will be £220 million light on his expected contribution from gas and electricity in 1981-82 though doing better than expected in subsequent years. If the Committee want, on this account, to look for a bigger contribution from the industries in 1981-82 the figures in paragraph 6 suggest that electricity prices will have to bear the adjustment - £220 million requires only an extra 5½ per cent on electricity prices but an extra 20 per cent on gas prices.

CONCLUSIONS

5. Subject to the discussion, I think the conclusions on this item might be:

(i) To agree to the profile of gas and electricity price increases suggested in E(79) 61 /or alternatively to agree that the profile should be adjusted to allow for increases in October rather than April from 1981 onwards, and that the effects should be reported to you/ /and, possibly, to agree to a further increase in electricity prices in 1981-82 to eliminate, or contribute towards eliminating, the shortfall in net revenue now foreseen for that year as against the Chief Secretary's earlier paper/.

(ii) To agree that the Secretaries of State for Energy and for Scotland should set financial targets related to these figures, and expressed in terms of current cost operating profit as a percentage of revalued net assets for both industries (subject to any points made by E(EA) on 7th November when they consider current cost accounting).

(iii) To invite the Secretary of State for Energy and the Secretary of State for Scotland, in consultation with the Chief Secretary, Treasury, and the Secretary of State for Employment, to establish cash limits for the gas and electricity industries for 1980-81 consistent with the decisions already taken about price increases in that year; to report these to Cabinet in time for the discussion on 1st November of the cash limits for other nationalised industries; or, if this course is not practicable, to establish them within whatever time frame meets the Chancellor of the Exchequer's convenience and report them to you for endorsement. /Note: you may in any case feel it necessary to tell Cabinet on 1st November of E's decisions on gas and electricity prices./

(iv) /if necessary/ To invite the Secretary of State for Energy, in consultation with the Chief Secretary, Treasury, to bring forward proposals before the end of the year for dealing with the presentation of problem caused by very high profits in the gas industry, and possible taxation methods of dealing with these, with a view to action in the 1980 Finance Bill.

(v) To agree that there should be an early announcement about the return to economic pricing for gas and electricity, and that the Secretary of State for Energy should clear the timing and the draft of such an announcement with the Chief Secretary, Treasury, and any other Ministers concerned, and with your office, as soon as possible.

RwA

ROBERT ARMSTRONG

29th October, 1979

Ref: A0514

MR. WHITMORE

We discussed the business for Cabinet this week with the Prime Minister earlier in the day.

We agreed that the discussion of Public Expenditure to 1983-84 should be postponed until next week. Before that discussion takes place, she proposed to hold a meeting of a smaller group of Ministers at which the outstanding issues could, if possible be resolved before they came back to Cabinet. It was agreed that the Prime Minister herself would take the chair at this meeting, which would be held early in the week beginning 5th November.

For attendance at that meeting I propose (apart from the Prime Minister herself): Home Secretary, Chancellor of the Exchequer, Secretary of State for Industry, Lord President, Minister of Agriculture, Fisheries and Food, Secretary of State for the Environment, Secretary of State for Trade, Secretary of State for Education and Science and the Chief Secretary.

The programmes at issue will be education, housing and agriculture. It seems better to have the departmental Ministers concerned in for the complete discussion as full members of the group rather than one by one. If they are taken one by one they will think they are being picked out and they are bound to stand out and reserve their position in Cabinet.

If the Prime Minister is content, we will promulgate these arrangements tomorrow.

We also discussed the handling of strikers and supplementary benefits. The Prime Minister said that before this came to Cabinet, she would like to take it at a smaller group of Ministers. I shall be making proposals to her tomorrow.

ROBERT ARMSTRONG

(Robert Armstrong)

29th October 1979

External Services file

Foreign and Commonwealth Office
27 October 1979

CONFIDENTIAL

Dear Private Secretary.

PUBLIC EXPENDITURE CUTS: BBC EXTERNAL SERVICES

Peter Carrington, who is in Oslo, has asked me to write to you about our proposals for reductions in the budget of the BBC External Services for 1980/81 and succeeding years. (Your Private Secretary wrote to Peter Carrington's on 2 October to enquire about progress in this field).

The proposals we are now putting forward reflect our view that the BBC's External Services are a very important instrument of foreign policy. First, we shall be keeping the BBC World Service in English (cost £2.4 million) intact. I do not think anyone doubts its immense value as a news carrier and in terms of promoting our interests abroad. In addition, subject to some economies, we shall be going ahead as soon as possible with a capital programme to improve audibility. The sum of £23.4 million is already included in the current Public Expenditure Survey Programme for this purpose. For defence and intelligence reasons we have also decided not to touch the monitoring services. The highly successful English by Radio services, which pay for themselves, have also been retained.

This leaves the vernacular services which are transmitted in more than thirty languages to all parts of the world. Not all are of equal importance to the national interest and we have therefore reviewed them, bearing in mind your wish that services to Eastern Europe should be maintained. We have also tried to preserve services to developing countries, particularly those which have a commercial interest for us.

Against this background, we consider that seven vernacular services could be cut without loss to our essential interests: these are the services to France (including French to Francophone Africa), Italy, Greece, Turkey, Spain (but not including Spanish to Latin America), Burma and Malta. As you will see, the bulk of these services are aimed at our allies in Western Europe, and we are, frankly, sceptical of their present value. As an example, the French service costs us something in the region of £650,000 a year, and of this only 45 minutes a day is also broadcast to Francophone African countries.

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CONFIDENTIAL

It is against this background that one should I think look at the considerations which Roy Jenkins recently put forward to you in a letter. At the other end of the scale, the Maltese service, which costs £11,000 a year, is on the air for only half an hour a week. The abolition of these vernacular services would leave 30 vernacular services unaffected, including most of those broadcasting to the developing world and all of those which broadcast to countries which do not allow free and open access to news and information. The savings to be gained would amount to £1.7 million a year.

We would propose to save a further £1 million per annum by adjustments to the Capital Expenditure programme, mentioned above, and by reductions in the BBC's Transcription Services, which are largely concerned with distributing recorded material overseas.

The total savings thus achieved would be £2.7 million. The original proposal from the Chief Secretary had been that the BBC External Services should be cut by £4 million. But Peter Carrington and I consider that, while it would not be right to exclude the External Services wholly from current efforts to reduce public expenditure, we should ease the burden of the BBC to the maximum extent. Peter therefore proposed, and the Chancellor agreed, to take a further £1 million of the cuts required of the BBC out of the aid budget instead. We had hoped, following a suggestion from Sir Michael Swann, that the BBC might themselves make internal savings of £1 million by rationalisation of their home and external services. But when it became clear from the BBC that this would not be workable in practice, we decided to take an additional £300,000 out of that part of the FCO vote which relates to overseas accommodation - thus reducing the total figure for the BBC to £2.7 million.

Peter Carrington and I believe that, unless you think the Chancellor should exempt the BBC from cuts altogether, this reduction in the Grant-in-Aid is not unreasonable. The total reduction strikes a reasonable balance between the reductions being made to the FCO Votes. It also bears very favourable comparison with what has been proposed, subject to the interdepartmental review, for the British Council. I believe our proposals will be defensible in Parliament and to our own supporters whose effort has been greatly stimulated by misleading reports of our intentions, largely emanating

/from

CONFIDENTIAL

from the BBC itself. And I do not think we should want it to appear that we can be pushed off our public expenditure economies by individual lobbies.

I am copying this letter to the Chancellor of the Exchequer, the Home Secretary and the Secretary of State for Trade.

Yours ever

Ian.

Ian Gilmour

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

26 January 1979

I have written to you separately confirming that the Prime Minister does not wish the unemployment assumptions underlying the social security expenditure figures to be published in the White Paper.

I also mentioned to you that the Prime Minister has now questioned the realism of the 1.65 million assumption for unemployment in 1980/81. She thinks that this may be unduly pessimistic. Although she appreciates that it is too late to change the social security expenditure figures, she wonders whether there is any scope for mentioning a lower figure if Ministers are pressed to reveal the assumptions underlying the expenditure figures. Alternatively, if it is possible to deduce the unemployment assumption from the expenditure figures, she wonders whether Ministers should not emphasise that the assumption is hypothetical and set on a relatively high level as a measure of insurance against under-provision. I understand that the Government Actuary will publish a report in the next few weeks which, on past form, would reveal the unemployment assumption. Is this absolutely essential?

I also confirmed that the Prime Minister is very content for there to be a sentence in the White Paper setting out the likely effect of income tax levels if the Government had continued with the expenditure plans inherited from the last administration. You promised to let me have a note by next Thursday explaining the basis of the figures. If Treasury Ministers are going to use other illustrations (for example, what levels of VAT would be necessary) in briefing the Press, it would be helpful if the note could cover these as well. It is clearly important that the Prime Minister should be using the same figures.

J. E. LANKESTER

A.C. Pirie, Esq.,
HM Treasury.

SECRET

vb

c. Cabinet
Department of Transport

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary 26 October 1979

The Prime Minister has considered the Chief Secretary's minute of yesterday in which he proposed that the unemployment assumptions underlying the social security expenditure figures should be published in the White Paper next week.

As I told you on the telephone, the Prime Minister has decided that the decision of Cabinet should stand, and that the unemployment assumptions should not be published in the White Paper.

I am sending copies of this letter to Private Secretaries to members of the Cabinet and to Martin Vile (Cabinet Office).

I. P. LANKESTER

A.C. Pirie, Esq.,
HM Treasury.

CONFIDENTIAL

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

25 October 1979

Dear Secretary of State,

1980-81 WHITE PAPER : RENTS

Cabinet this morning invited us to agree what if anything the White Paper should say about rents.

I have given the matter further thought in the light of the Cabinet discussion. In view of your objections, I am prepared to take the sentence out on the understanding that you accept that we should be ready to say, if there are any questions about the White Paper's implications for rents, that authorities are assumed to make higher rent increases than in recent years; and on the understanding that the publication of the White Paper does not preclude - in advance of our further report to Cabinet on rents next week - the possibility of a rent guideline higher than £1.50 for 1980-81 if this should be necessary to secure savings for the later years within the range agreed by Cabinet.

As to the later years, I understand that you are not yet in a position to let me have the revised proposals for subsidy savings which you outlined when we met last Monday. Since we must report to Cabinet early next week, we ought to have, during the course of tomorrow, something concrete to consider alongside the proposals which I made to you on Monday.

I am sending copies of this letter to the Prime Minister and the other members of the Cabinet.

Yours sincerely,
John Biffen

p.p. JOHN BIFFEN
[Approved by the Chief Secretary and signed in his absence]

CONFIDENTIAL

Prime Minister

1

Mr Biffen apparently fears that the assumption will be forced out of Ministers. However, Cabinet was clearly against the inclusion of this, whatever the precedent – and the minutes will record as such. Shall I say "No"?

PRIME MINISTER

I don't think we can go back on Cabinet decisions. Has this assumption been published elsewhere? PL 25/10

UNEMPLOYMENT ASSUMPTIONS IN THE PUBLIC EXPENDITURE WHITE PAPER

It was proposed at Cabinet today that the unemployment assumptions shown in the social security paragraph of the draft White Paper should be deleted. I have now had a further look into the background to this, and if you agree I think we should still include them.

2. The assumptions used for unemployment and real earnings were given in the last public expenditure White Paper (Cmnd 7439). The Expenditure Committee, in its Eighth Report in Session 1977-78, had recommended that Parliament should in future be given the assumptions about future levels of unemployment and the expected growth in real earnings on which the social security expenditure figures are based. The previous Government said (Cmnd 7382) that this would be done in the next White Paper.

3. As this precedent already exists, I feel we should give the unemployment assumptions in the White Paper next week. We are justified in not providing a real earnings assumption as this is no longer of central importance to the social security programme, now that prices-only uprating is used. But if we fail to provide the unemployment assumptions we would be being less helpful to Parliament than Denis Healey was prepared to be.

4. I should be grateful for your agreement therefore that the unemployment assumptions should be included in paragraph 39 of the White Paper.

5. I am copying this letter to other members of the Cabinet and to Sir John Hunt.

WJB

JOHN BIFFEN

25.10.79

Mr [illegible]

Treasury Chambers, Parliament Street, SW1P 3AG PS/[illegible]

Rt Hon Michael Heseltine MP
Secretary of State
Department of Environment
2 Marsham Street
LONDON
SW1P 3EB

24 October 1979

Dear Secretary of State

PUBLIC EXPENDITURE WHITE PAPER 1980-81

Your Private Secretary wrote to mine on 19 October mentioning four points on which you would like to see changes in the current draft of the White Paper on Public Expenditure 1980-81.

The first point related to the reference to rents. I certainly agree that rents need careful presentation, but believe it will be helpful rather than the reverse to say in the White Paper that local authorities are expected to make higher rent increases than in recent years. The expenditure plans are based on that assumption and I think it is better to say so openly. For the White Paper to be silent on rents would give the unfortunate impression that the Government is defensive and apologetic about the need for rent increases. Questions about rents may well be asked by the Press when the White Paper is published and I think that there is therefore nothing to be lost and something to be gained by retaining the present reference in the White Paper, which does not prevent you reserving the details of the rent assumptions for later discussion with the local authorities.

On construction, I would not have thought it unduly difficult to explain the omission of a reference to the industry from a very summary White Paper of this kind. In any case the figures are still very uncertain, as my officials have explained to yours. For this reason it would be unwise to attempt comparisons of construction expenditure in successive years, which could be falsified by revisions to figures. What the White Paper could say at the end of what is now paragraph 11 is:

"Capital expenditure on construction, including expenditure by the nationalised industries, is likely to be rather less than £7 billion in each of the years shown".

(The Treasury's figure for 1980-81 is £6851 million rather than £6250 million).

I would not have wished to include such a sentence; but if you see advantage in it I would not press my objections.

Your third proposal was to add a reference to your call to local authorities in England and Wales to reduce their expenditure in the current year to 3% below the level planned at the time of the 1978 RSG settlement. Subject to any views that the Secretary of State for Scotland and other Ministers may express, I would not be opposed to an addition of this kind and suggest that it be made by extending the last sentence of what is now paragraph 13 to read:

"But local authorities have been asked to achieve economies which would result in a lower outturn for 1979-80; for England and Wales the Secretary of State for the Environment asked authorities to reduce their expenditure to 3% below the previously planned level."

Finally, you proposed an amendment to the second sentence of what is now paragraph 12. I would prefer not to disturb the balance reached in the present text and could not agree to do so without giving other Ministers concerned with local authority services the opportunity to comment.

Yours sincerely

R. Wells

pp JOHN BIFFEN
(Approved by the Chief Secretary and signed in his absence)

Rub
Sep

Mr. Lankester.

I attach an amended copy of the table produced for you yesterday. It affects programme 2 in 1977-78. The figures in Miss Persons tables attached to her minute "White Paper on 1980-81 : No 10 Briefing" of 23 October are correct and I send this only for your information. Sorry for the slip.

L.R. Robbins
(GEN.3)
24/10/1979

Public expenditure - programmes 2 and 7

£ million at 1979 survey prices

PROGRAMME	1974-75	1975-76	1976-77	1977-78
2. Overseas aid and other overseas services				
Overseas aid	628·4	698·7	670·9	718·0 ~~785·4~~
Overseas aid administration	10·1	12·6	11·5	12·0 –
EEC contributions	-13·0	15·8	281·4	631·9
Other	689·0	398·9	381·8	474·5 ~~407·1~~ –
TOTAL	1,314·5	1,126·0	1,345·6	1,836·4
7. Housing				
Capital	4,828·8	3,894·8	3,653·2	3,007·6
Current	2,312·3	2,397·8	2,599·5	2,499·1
TOTAL	7,141·1	6,292·6	6,252·7	5,506·7

23 October 1979

L.P. - 1292
1204
HPSS.

10 DOWNING STREET

PRIME MINISTER

The impact of the White Paper will be conditioned by its announcement of the increase in presciption charges to 70p from April (para 37) and the estimate of unemployment in 1980-81 as 1·65 million (para 39). Despite these, I very much support the Leade of the House (his letter attached) in arguing for an oral statement. We should come out fighting, not hide from the enemy! MS

PRIME MINISTER

WHITE PAPER ON PUBLIC EXPENDITURE IN 1980/81

I have seen the Chief Secretary's paper C(79) 46 and also a copy of your Private Secretary's letter of 22 October.

My own view is that we ought on this occasion to make an oral statement when the White Paper is published. Although it has previously been the practice not to make a statement on publication but to wait for the debate, there are special features this year which would make a statement very desirable. There will be a very strong demand for one in the House; we are already departing from the usual practice by publishing our plans for the coming year separately from our plans for the later years of the survey period; and a statement should help us to get a proper balance in the subsequent reporting. In particular, we shall be able to demonstrate both that we have adjusted the priorities for public expenditure as we promised in the Manifesto, and that we have still provided for increased expenditure on health and personal social services and social security (and for only modest reductions on the other social services) contrary to the belief which our critics are trying to foster in the country. I know that points of this kind will be made in today's debate but I think it will be important to emphasise them again with the published figures.

On timing, I would favour publication (and an oral statement) on Thursday, 1 November.

Contd...

I am copying this minute to the Chief Secretary, the Paymaster General and the Chief Whip, and to Sir John Hunt.

NStJS.

N. St.J.S.
24 October 1979

Ref: A0498

CONFIDENTIAL

PRIME MINISTER

Prime Minister — put in back-up

This item was put off from the last meeting of Cabinet - except that the coal cash limit has been agreed bilaterally.

Nationalised Industries' Cash Limits
(C(79) 48 - and letters of 24th October from Mr. Howell and Mr. Fowler)
(with 10 Ans 5)

31/10

BACKGROUND

At its last discussion of cash limits, E Committee endorsed the general approach to the nationalised industries. The main components were:

(i) to make allowances for the differing circumstances of each industry;

(ii) to note that their cash limits (which apply to external finance only) are the residuals of very much larger figures, and correspondingly volatile;

(iii) to agree, nevertheless, to use cash limits to put pressure on pay;

(iv) to start from the assumption that increases in wage costs (not necessarily increases for individuals) should be somewhat less than the predicted increase in the RPI - how much less, to be settled case by case.

At the same meeting, E decided on the general line on the Rate Support Grant cash limit; this is now the subject of a separate paper for this Cabinet.

2. This paper is also relevant to the Public Expenditure White Paper for 1980-81, which is also on the Agenda. Any decisions taken by Cabinet which involve increasing the cash limits beyond the numbers proposed by the Treasury represent volume increases which have to be reflected in the White Paper. The point is made in the brief on that White Paper.

3. The main urgency is to get decisions on the cash limit for the NCB. The negotiating meeting is, as you know, on 30th October. But the Chancellor hopes to get decisions on all the cash limits listed here (save for gas and electricity, which will have to be picked up next week at E) and to announce the whole lot on 20th November, the day of the RSG 'statutory meeting', probably by way of a Press notice or arranged Parliamentary Question. As the Chancellor points out (paragraph 13) broad consistency between the treatment of the two is important.

4. One final complication arises from the letter from the Nationalised Industries' Chairmen's Group, at Annex C. This raises a wide range of issues, beyond the scope of the present meeting. You will no doubt want them discussed, when Sir Keith Joseph reports on nationalised industry policy in general (probably now in December). Meanwhile, the immediate response to the chairmen is proposed in paragraphs 6 and 7.

5. But the immediate problem for Cabinet is to agree specific figures for the cash limits listed in Annex A. Our information is that only four of these are likely to be contested: coal, rail, bus and airways. Detailed notes on these four are below. It should be possible to get agreement on the other cash limits "on the nod".

HANDLING

6. You might invite the Chancellor to introduce his paper, and then seek general comments from the Secretary of State for Industry (as de factor chairman of the unofficial group of Ministers on nationalised industry policy); the Secretary of State for Employment (because of the implications for pay negotiations); the Secretary of State for Trade (consumers) and any others who wish to join in. But you will want to keep this part of the discussion short and avoid special pleading on particular cases. The key issues which are likely to come up are:-

(i) the vulnerability of nationalised industry performance to extraneous factors: for example, the difference between a standard and a bad winter can mean £55 million to the electricity industry alone;

(ii) the inflexibility of their response. Because of constraints on redundancy agreements, closures, price increases, market response, and above all improved productivity, the industries cannot react very quickly to any deterioration in their performance which threatens their cash limit;

(iii) special nature of their cash limit. Not all of your colleagues may fully appreciate that the nationalised industry 'cash limits' apply to their external financial needs only: and that holding to these limits involves giving the industries freedom to adjust other factors including prices if they are to stay within them. The suggested change in nomenclature to "external financing limit" may help here though, in the last resort the cash limit may have to give;

(iv) Pay. The starting point was, as E agreed, increases in wage costs somewhat less than the movement of the RPI. In fact, the Treasury have moved quite away off this target, and not just to reflect the different considerations applying to each industry. In most cases (though the Chancellor's paper does not say this) the figures have been uprated from the volume totals agreed in the summer by a standard figure of 17 per cent. This is, of course, not consistent with the 14.6 per cent starting point for the RSG proposals. It is even more generous, in one or two cases, than the industries themselves had assumed (but the industries were operating on much earlier information). You may want to probe a bit on the reasons for choosing these figures: but we know that the Chancellor has himself rounded them down from those discussed with Departments earlier. Whatever is decided, however, you will want to ensure that no figure as high as 17 per cent gains currency outside the Cabinet room especially if the RSG is based on a lower percentage. This bears on the proposal in paragraph 7 of the Chancellor's paper that the industries might be told the assumption underlying the limits.

(v) other costs. The 17 per cent covers other costs as well as pay. This makes it harder still to disentangle this specific pay assumption.

7. After this general discussion, you will want to turn to the detail of the disputed cases:-

(a) Coal. The Treasury bid is for a cash limit of £810 million, and the Energy bid is for £834 million. There is in fact a reasonable explanation for this difference, but I don't think you should delay Cabinet on it. (Mr. Howell's minute of 24th October sets out the argument: it concerns the method used for getting from survey prices to current prices). It is better to concentrate on the gap of £24 million, and the implications this has. It is common ground that there is little or no scope, in the short term, for dramatic improvements in productivity or for more rapid closures, in time to produce any effect during 1980-81. The E Committee decision on coal strategy generally was that the burden of adjustment should fall on prices. It is very difficult to be precise, and you should not rely too much on what follows. But very roughly, the £810 million proposed by the Treasury is consistent with 15 per cent increase in wages; it could be made consistent with a higher wage outcome if prices were allowed to rise higher. The £834 million proposed by Energy is said to be consistent with 17-17½ per cent increase on wages, on the assumption that the NCB can pass on its increased costs to the CEGB. This is allowed for in the CEGB calculations which underly the electricity price increases now proposed (increases in line with the RPI in April, and a further 5 per cent next autumn). Both calculations assume that coal remains competitive with oil. However, the latest unofficial information from the NCB is that the wage settlement may turn out to be about 20 per cent. This would add roughly £55 million to NCB's costs. To recover this involves a further coal price increase of 3 per cent, which in turn adds about 1½ per cent to electricity prices (provided that the agreement between the NCB and the CEGB to stabilise prices can be ignored). The Department of Energy reckon that the £24 million gap between their

figure and the Treasury's would have to be recovered in prices - nearly another $1\frac{1}{2}$ per cent on prices, or $\frac{3}{4}$ per cent on electricity prices. These figures are inevitably pretty broad, as are the assumptions about the likely wage outcome. You also need to bear in mind the timetable. The next negotiating meeting with the miners is on Tuesday, 30th October. If Cabinet reaches a decision on Thursday, it can be communicated to the NCB that afternoon. But if Cabinet fails to agree, or if it agrees on a figure which the NCB does not accept, then there has to be time for further consultation. You will want to emphasise that, whatever happens, a firm cash limit must be agreed and in place, and accepted by the NCB, before 30th October. They cannot be allowed to negotiate, and maybe reach an agreement, without clear guidance on the available finance.

Letter in this folder

(b) British Rail. Mr. Fowler has written to the Chancellor today about this. The Treasury bid is for a limit of £705 million, and his proposal is a bid of £750 million. The Treasury figure assumes a pay increase of about 12 per cent, plus a further 2 per cent which is a hangover from an earlier settlement. It also takes a very favourable view of all the commercial risks. The Department of Transport argue that railway pay has fallen behind (8-10 per cent below the peak of 1975 in real terms) and is bound to catch up somewhat; and that the going rate is emerging at something like 17 per cent; but they rest their argument much more on the economic assumptions than on pay. They see no scope for economies in the first year either from closures (because of the long statutory process of consultation), or productivity (because of the slow pace at which agreements are negotiated with the unions). They are convinced, therefore, that a £705 million cash limit would in practice be breached. I believe the Chief Secretary may be prepared to concede something here, though it is not clear how much.

(c) National Bus Company. Mr. Fowler's letter also deals with this. The main point here is that the cuts in local authority expenditure, and in Department of Transport expenditure on TSG and new Bus Grant, have already reduced the NBC cash flow; that consumer resistance to further fare increases makes them self-defeating; and that the scope for productivity changes, again in the short term, is pretty limited. The consequence of the cash limit proposed by the Treasury (£77 million, against a Transport bid of £85 million) might be a massive reduction in services. You will want to probe the realities here so that the political consequences can be weighed, not only in rural constituencies but generally.

(d) British Airways. There is a gap of £15 million between the Treasury bid of £205 million and the Department of Trade bid of £220 million. The difference arises because the standard inflation factor of 17 per cent is not enough to cope with increased fuel costs and the fare cuts imposed by the CAA. The difference represents one new aircraft. The Secretary of State will argue strongly that, given the impending privatisation of British Airways, it would be silly to make it change its programme in this way, thus damaging the prospects of a satisfactory sale. The £220 million limit proposed by Trade still puts a fairly realistic squeeze on pay and builds in a sizeable allowance for improvements in productivity.

CONCLUSIONS

8. Subject to the discussion, you might be able to reach the following conclusions:-

(a) To endorse the cash limits listed in Annex A to C(79) 48 /with any changes agreed during discussion/.

(b) /If necessary/ to invite the Secretary of State for Energy and the Chancellor of the Exchequer to agree between them on the cash limit for coal, and to communicate it to the NCB before the negotiating meeting on 30th October.

(c) To note that the cash limit for gas and electricity will be settled either bilaterally between the Chief Secretary and the Secretary of State for Energy or, if necessary, at E Committee next Tuesday, 30th October in time for the results to be taken into account at Cabinet next week.

(d) To agree that the cash limits should be published by the Chancellor of the Exchequer on 20th November / by way of an arranged Parliamentary Question/.

(e) To agree the general approach to the Nationalised Industries' Chairmen's Group suggested by the Chancellor of the Exchequer in paragraphs 6 - 7 of his paper and the procedure suggested in paragraph 12 for a reply.

pp

(John Hunt)

24th October 1979

SECRET

Ref. A0494

PRIME MINISTER

Public Expenditure to 1983-84

(C(79) 42, 44 and 49)

I submitted a full brief on this for last week's Cabinet. But it may help simply to recapitulate the position reached on the various items. You have asked for some additional background information to be circulated (C(79) 48).

(a) Defence. As you agreed over the weekend, discussion on this item will not be resumed this week. You will probably not want to say anything to Cabinet about events since the previous discussion.

(b) Agriculture. Sir Kenneth Berrill and his group of officials will produce an interim report for discussion on 1st November. However, the Treasury have now suggested that it would be premature to try to reach decisions then on the outstanding agriculture points. They now say, contrary to their earlier advice, that it is not absolutely crucial to get final decisions on 1st November, but that if decisions are not taken then the White Paper will probably slip until after Christmas. The Treasury would not regard such an outcome as disastrous though the longer the delay before publication the greater the risk of existing agreements coming unstuck. Given that we hope to get everything else buttoned up on 1st November it would be a pity to have to leave over such a major item as agricultural support unless this is absolutely unavoidable. If the point is raised you will want to do no more than say that the plan is to reach final agreement on the whole package on 1st November.

(c) DOE/Housing. The Secretary of State for the Environment and the Chief Secretary met on Monday but failed to reach agreement on the rent increase which would meet the Cabinet instructions ('somewhere between Option C and Option D' but with a ceiling of £2 per week increase

every year'.). I think, unless there are further developments, that you will have to leave this over till next week. But you might ask the Chief Secretary for a progress report.

(d) Education.

(e) Social Security. On these two items, there is nothing to add to my earlier brief.

(John Hunt)

24th October, 1979

Ref: A0491

CONFIDENTIAL

PRIME MINISTER

Rate Support Grant
(C(79) 47)

BACKGROUND

This is the last year of the present Rate Support Grant system. The new Unitary Grant (which H Committee will formally ratify on Wednesday) will come into operation from 1981-82 onwards. Transitional arrangements will operate at the end of 1980-81.

2. Cabinet approved in the summer the volume of local authority expenditure for 1980-81. E Committee approved in October (E(79) 10th Meeting, Item 1) after two false starts, the general approach to pay and cash limits, including the Rate Support Grant.

3. There are now three main objectives:-

(i) To hold the level of rates at a reasonable level, and if possible to reduce the level of local authority expenditure.

(ii) To put some pressure on public sector pay.

(iii) But, despite this, to avoid the breakdown of the system or any confrontation with the authorities/unions.

4. The timetable is tight. The RSG percentage for Scotland has to be announced on 16th November and that for England and Wales on 20th November. It is the Chancellor's present intention to announce cash limits for the nationalised industries on 20th November as well.

5. You established MISC 21 under the Home Secretary's chairmanship to process the RSG for next year. This paper is his report. The key to the paper is in Annex D, which shows, for various combinations of inflation assumption and of RSG percentage, the total volume of Rate Support Grant for the year, and the likely effect on rate demands. All this is on the assumption of a constant distribution formula (the Group has not been able to find anything better). Various other related proposals are set out clearly in the paper, but do not need discussion.

HANDLING

6. You should ask the Home Secretary to introduce his paper. You might then call in turn on the Secretary of State for the Environment and the Chief Secretary (or the Chancellor, if he wishes to speak instead). You might then call for general comments from three Ministers not involved: the Secretaries of State for Employment, Industry and Trade. Then you might go back to the main actors: the Secretaries of State for Scotland (who has his own separate RSG to follow the pattern established by Cabinet) and Wales (who is directly affected by these proposals); and the Secretaries of State for Education and for Social Services and the Minister of Transport, all of whom have an interest in the end product. (The Transport Supplementary Grant itself is not affected by these proposals and is the subject of separate correspondence).

7. The end-product of the discussion will be a single figure: probably one of those in the table in Annex D. But to arrive at this figure there are three main variables within the Government's control:-

(i) The RSG percentage itself: this usually goes by 1 per cent steps, but in Scotland, ½ per cent steps are common. A compromised solution this year may involve one.

(ii) The Distribution Formula. DOE have tried hard to find a way of altering the formula, so as to give further benefit to the Shire counties. They have failed. (One more route is being explored before the meeting: but it seems likely to penalise the outer-London boroughs, rather than the 'true' metropolitan authorities and is probably not a starter.) That means that the only way of helping the Shires is to go for a high RSG percentage. This is a politically difficult choice but there is no easy way out.

(iii) The Inflation Assumption. Together with the decisions already taken on the volume of expenditure, this determines the level of eligible expenditure to which the RSG percentage is applied.

8. The Cabinet has to balance these three. If it is agreed that the distribution formula cannot easily be varied, then it is a trade-off between the other two, and Annex D shows the range of choice, with a broad indication of the likely effect on rate increases next year. (It is important to emphasise

the broadness of this indication: there will always be some maverick authorities who fall well above or below the figures shown). Broadly speaking, Treasurers are much more likely to play safe and budget for big rate increases if the decisions lie in the top left-hand corner of the table: and to be fairly relaxed about decisions in the bottom right-hand corner. The main arguments are:-

(a) The RSG Percentage. On the one hand the need to contain Central Government expenditure; and the wish to reduce Central Government financing, at the margin, of any increase in local authority expenditure. (The Chief Secretary may ask why rate increases should be limited to 15 per cent when the general inflation in local authority costs is over 20 per cent?.) And, on the other hand, the need to maintain the credibility of the cash limit system and avoid it falling apart in the Government's hands; and the need (stressed particularly by Mr. Younger) to be reasonably consistent in our approach to the local authorities, and not to impose yet another volume cut on them by the back-door, after the successful negotiations of the summer cuts. It is also necessary to watch the consequences on the Shire counties.

(b) The Distribution Formula. As noted above, there is not much chance of varying this in a way which would help the Shire counties.

(c) Inflation Assumption. The argument here concerns the realism of the Chancellor's figure of 14.6 per cent, which I understand he discussed with you at the weekend. It is, as you know, only one of a series of forecasts produced by the model. It is probably the most favourable to the Chancellor's present case. Colleagues know, if only from recent Press speculation, that there are other possible outcomes. It is an amalgam of pay and of price movements next year. It was argued in MISC 21 that the more significant figure might be the current rate of price inflation, because it is this which influences union pay demands over the next few months (particularly for the manuals and the teachers). Moreover, the figure has to be reasonably consistent with that used for the nationalised industries

cash limits (which seems to be settling down at about 15 per cent: see the other paper on the Agenda) and with whatever the Government publishes by way of an "Industry Act" forecast later in the autumn. Ministers will also want to watch the implications for the NHS settlement, because while local authorities can, in the last resort, meet an 'excessive' settlement for their manuals by further increases in rates, there is no such safety valve for the NHS. No cash limit for the NHS will have been set at the time the local authority manual negotiations begin. (It may be necessary to set one in December/ January, ahead of the rest of Central Government cash limits.) But the cash limits for both local authorities and the NHS will have to be reasonably consistent with one another and the unions will play both sets of negotiations together.

9. In the end, there will have to be a political judgment about the trade-off between the inflation assumption and the RSG percentage, leading you to identify a particular figure in the table on page 2 of Annex D. You should identify this by reference both to the inflation assumption and to the RSG percentage; the exact figures will have to be recalculated slightly after the meeting to take account of some minor variables. A possible compromise, at which the Home Secretary may hint in introducing his paper, might be to combine a 14 per cent inflation assumption with a 60.5 per cent RSG percentage. This has three advantages:-

(a) It stabilises the proportion of grant going to the Shires overall (though 33 individual authorities out of 47 lose out).

(b) It meets the Chancellor's wish to get the percentage down a bit and thus the Government's share of any marginal addition to expenditure.

(c) It builds in an inflation assumption which is roughly consistent with that for nationalised industries (15 per cent) while still applying a gentle squeeze.

10. There should be no difficulty over the remaining points listed in the paper, all of which have been agreed in the course of discussion by MISC 21.

CONCLUSIONS

11. You should record Cabinet approval for all the agreed recommendations of MISC 21 (that is, those numbered (i), (ii) and (v) in paragraph 14 of the report) and agreement on the RSG percentage and the inflation assumption which determines the cash limit for 1980-81 (paragraphs (iii) and (iv)). You should also record the Cabinet's agreement that the figures should be published on 16th and 20th November, and that the Secretary of State for the Environment (and for Scotland) should agree the terms of the announcement with you and with the Chancellor of the Exchequer before that.

(John Hunt)

24th October 1979

Ref: A0489

CONFIDENTIAL

PRIME MINISTER

White Paper on Public Expenditure in 1980-81
(C(79) 46 and Mr. Howell's minute of 24th October)

BACKGROUND

The Chancellor of the Exchequer sent you a draft of this White Paper at the weekend, and you made some comments (Mr. Lankester's letter of 22nd October). The Chief Secretary also consulted you about the timing (his private secretary's letter of 19th October, and Mr. Lankester's reply of 22nd October). The drafting changes are not incorporated in this version, which had already gone to the printers, but will be picked up later.

2. Although Cabinet took the main decisions on 1980-81 in the summer, there is still some tidying-up to do. The main outstanding points are:-

(a) The Presentation of the Economic Background. This is now much easier, with the decision to postpone publication of the forecast until later. But the introductory paragraphs still require some care. The changes which you have suggested should do the trick, but there may be other nuances which other Ministers wish to add.

(b) Nationalised Industries. The present draft of the White Paper assumes that gas and electricity prices will rise in April in line with general inflation. E agreed that there should be a move towards economic pricing, probably involving increases in real terms later in the year. The timing and size were left to be settled between the Chief Secretary and the Secretary of State for Energy. The latter now reports (in his minute of 24th October to you, circulated to Cabinet) that they have agreed to recommend increases of 5 per cent for electricity and 10 per cent for gas in the autumn of 1980, on top of the April increases. This yields about £170 million in the financial year 1980-81. This is the central one of the three options which the Chancellor proposed to you in his minute of 19th October. You agreed then (Mr. Lankester's letter of 22nd October) that a

decision on this issue should be taken at Cabinet this week. It is a little hard on Ministers who did not hear the E discussion. But you should have no difficulty in convincing them that there is a good economic case for putting up gas and electricity prices in this way. The help it gives in the public expenditure context is clear. If the Cabinet agrees, the revised figure can be incorporated in the White Paper (net of any other changes which may be agreed on other nationalised industries cash limits). The consequences, for the 1980-81 cash limit, and for the profile of price increases in later years, can then be sorted out either bilaterally or at E, probably on 30th October (before the final Cabinet discussion on public expenditure on 1st November).

(c) Stationery Office. There should be no problem over the minor increase in this provision. From next year, HMSO will be on a full repayment basis, and Departments will have to justify their own demands upon it.

(d) Housing and Construction. At the very last minute, the Secretary of State for theEnvironment demanded some changes to the text (his private secretary's letter of 19th October) which are still the subject of dispute. The main difficulty arises on the reference to Council House rents (paragraph 28). Cabinet decided in July (CC(79) 10th and 11th Conclusions, following recommendations from MISC 11) that Council House rents should go up next year. There is no argument about the decision. But the Secretary of State wants to announce it in his own way, at a time of his own choosing (probably 20th November when he presents the RSG decisions). Every Minister could deploy arguments like that, and the result would be no White Paper at all. You might like, therefore, to support the Chief Secretary. Mr. Heseltine is also pressing for a special reference to the construction industry (which seems harmless) and to the 3 per cent target reduction for the current year (which Treasury officials

recommend accepting). His amendment (iv) (to paragraph 12 of the present text), however, goes to the heart of the earlier argument about 'globalisation', which he lost in Cabinet. He wants to say that the figures are 'only illustrative' not 'necessarily tentative'. That could be read to mean that the Government is giving local authorities no real indication of priorities between programmes - and thus failing to protect education etc. Before accepting this amendment you should see whether the Education and Social Service Secretaries are content.

(e) Timing of Publication. The Chief Secretary's covering note accurately reflects your own worries about timing. I understand from the Treasury that, if publication is delayed from 31st October, 1st November will not be very satisfactory (as it is never easy to get good press coverage for a major economic statement on a Thursday) and that some date the following week would be better. But you will want to know what the Leader of the House thinks about this.

HANDLING

3. You might invite the Chief Secretary to introduce his draft briefly; and then to take each of the points listed above in turn. (I doubt if the Stationery Office point needs comment).

CONCLUSIONS

4. You should be able to record approval for the text of the White Paper, subject to any drafting changes needed to reflect the decisions on gas and electricity, and on housing. You need also to record a decision on the timing on publication.

(John Hunt)

24th October 1979

Ccalls 2

PRIME MINISTER

Much as expected
MJS
22/10

WEDNESDAY 24 OCTOBER 1979

Notice of Motion: Mr. James Callaghan
Mr. Foot
Mr. Hattersley
Mr. Orme
Mr. Booth
Mr. Kinnock

Amendment to please

The Government's Damaging Expenditure Cuts

"That this House condemns Her Majesty's Government for its savage cuts in funds for the sick, the aged, the disabled, the young, the homeless, the badly housed and other dependents upon the support of the community; it further condemns the Government's assault on the caring society which is compounded by its failure to assist local authorities in dealing with inflation and their obligations under pay awards, and deplores Her Majesty's Government's reduction of the Rate Support Grant which will lead to substantial rate increases and reductions in essential services, and further calls on Her Majesty's Government to restore the drastic cuts they made in the National Health Service."

CONFIDENTIAL

Copy on Nat Ind 79.
Gas and Electricity pricing policy

PRIME MINISTER

PUBLIC EXPENDITURE IN 1980/81 AND GAS AND ELECTRICITY PRICES

E Committee on 17 October decided that price increases next April for electricity and domestic gas should not exceed the RPI increase over the previous 12 months, but invited the Chief Secretary and myself to propose alternative phasing for price increases over/3 to 4 year period which would achieve a correction of under-pricing comparable with that which I had proposed. The Chancellor minuted you on 19 October drawing attention to the public expenditure consequences of this decision and suggested that these could be considerably eased if a start was made on the correction of under-pricing before the end of 1980/81 but after the RPI rise should have passed its peak. A decision on this is needed before the public expenditure figures in the White Paper can be settled.

As E Committee asked, the Chief Secretary and I will be bringing forward to the Committee as soon as possible proposals for a rephasing of price increases over the whole 3 to 4 year period projected for financial targets. In view of Thursday's Cabinet discussion of the Public Expenditure White Paper and of cash limits, however, he and I have now agreed on our recommendations for 1980/81.

We propose a 3 or 4 year programme designed to remove under-pricing. For domestic gas prices, we propose an autumn 1980 increase of 10% to follow on the April increase - a deferment of the 10% real increase I originally recommended should be introduced in April. We assume this would be in October (though we cannot dictate this to the industries). Thereafter, we propose annual real price increases, in April, of 10%, which in money terms would be additional to whatever price increase was necessary to keep pace with the RPI, for the next 2 years. A weaker alternative would be to spread the correction of under-pricing over 4 years rather than 3, with a 7½% increase in autumn 1980, and real increases of the same amount each April in the 3 succeeding years. This would however leave us with a larger public expenditure gap than the first option. Any lower level of real increase would further exacerbate our public expenditure problems as well as prolonging the present serious

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imbalance between industrial and domestic gas prices.

For electricity, we propose a further increase of about 5% in the autumn of 1980 to follow the April RPI increase. This would have the effect of correcting underpricing by broadly the same amount which I originally proposed, ie 2½% in 1980/81, though in public expenditure terms it would leave a larger shortfall. A second price increase of much less than 5% would do little to correct underpricing and would probably not be regarded as worthwhile by the industry. Thereafter, a similar rate of progress towards full economic pricing could be achieved as under my original proposals - approximately 1% pa correction of under-pricing from 1981/82 onwards. As an alternative, we are also examining a faster rate of progress, involving a 2% correction of under-pricing in 1981/82. These real price increases would be additional to whatever increase was necessary to keep up with the electricity industry's costs, which mainly because of likely coal and oil prices, will probably rise somewhat faster than the rate of general inflation.

In our report back to E Committee, we will deal with the impact of these proposals on public expenditure subsequent to 1980/81. The table below shows the public expenditure impact of our proposals in 1980/81. The first column shows that there will still be a marked shortfall as compared with what we had planned to achieve in July; the second column shows the extent to which that shortfall would be increased if we do not adopt the pricing proposals recommended.

£M	Shortfall against public expenditure figures for gas and electricity (excl Scotland) agreed by Ministers in July	Savings compared with latest Draft White Paper figures (no real price increases in 1980)
Gas: Preferred option (10% autumn 1980)	230	50
Electricity: (5% autumn 1980)	170	110

(3)

I understand that Scottish Office officials have advised that if, as might well be the case, the Scottish Electricity Boards follow the same pricing path in 1980 as the industry in England and Wales, the comparable figures for shortfall and savings would be £20M and roughly £10M. On that assumption, adoption of the preferred option for gas and electricity would produce combined savings of £170M, with a direct RPI impact of .3%. If you agree with these pricing proposals, we recommend that they be reflected in the 1980/81 Public Expenditure White Paper, and also in the cash limits for the industries.

I am copying this minute to other members of the Cabinet and Sir John Hunt.

DH.

Secretary of State for Energy
24 October 1979

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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Parliament Street
LONDON
SW1

24th October 1979

Dear Geoffrey.

I have just seen your memorandum on Nationalised Industry Cash Limits C(79)48. We are to be asked, I understand, to reach decisions on the figures tomorrow. As the Agenda will be a full one it may be useful for me to record my views in advance.

I earlier accepted as you will know a cut of £24 million in the PES provisions for financing British Railways in 1980-81. This was on the basis that the reduced provisions would be translated to outturn prices in a realistic way. I am bound to say that the figures in the memoramdum fall very far short of this.

On the key assumption about pay, the proposed figure would only allow a settlement next April of about 12% (a 2% commitment will run through from this year's settlement). Moreover, as your own paper brings out, the Board's assumptions about performance of the economy next year are markedly more optimistic than the Treasury's latest forecasts. This alone could worsen their financial position by over £50 million.

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No private sector business would plan its finances on such a basis. In my judgement, the lowest realistic limit we could contemplate would be £750 million, and even that would be running matters very fine if the latest economic forecasts prove correct. If we hold them to the figure you are proposing they would, I believe, have no option but to raise fares again in mid-year, by a similar amount to the increases of almost 20% which they are making in January. And even then there would be a serious risk of the limit being breached. To force up fares by up to 40% while holding gas and electricity prices to the RPI would be paradoxical.

Although the figures are smaller, your proposal for the National Bus Company raises the same problems. Their finances are already subject to a tight squeeze from likely reductions in local authority revenue support (following our own squeeze on local authority expenditure), the faster phasing out of new bus grant, and the further £2 million reduction we agreed in July. Their pay settlement will have to reflect the general level of settlements in the industry. Their only hope would be to raise fares twice in the year, in each case by about 15%. At that level the traffic loss would be likely to be so severe that extensive withdrawals of services would be forced, and the effect would be most marked in the rural areas. I consider £85 million would be the lowest realistic limit compared with your proposal of £77 million.

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Copies of this letter go to the Prime Minister, other members of the Cabinet and Sir John Hunt.

Yours ever.

NORMAN FOWLER

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PART 5 ends:-

C(79) 49 23/10/79

PART 6 begins:-

M/S Transp to Chd/Ex 24/10/79

END

Filmed at the National Archives (TNA) in London

February 2010