PREM 19/164

MT

Part 7

SECRET

x97

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Public Expenditure and Cash Limits.

Rate Support Grant.

~~Draft~~ ~~White~~ White Paper on Expenditure Plans 1980-81.

ECONOMIC POLICY

Part 1: May 1979

Part 7: November 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~22-11-79~~							
~~26-11-79~~							
~~27.11.79~~							
~~7.12.79~~							
~~10.12.79~~							
~~12.12.79~~							
~~17-12-79~~							
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~~24.1.80~~							
~~25.1.80~~							
~~28.1.80~~							
Ends							

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PART 7 ends:-

M/S MAFF to M/S CSD 28.1.80

PART 8 begins:-

CST Office to Energy 30.1.80

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C (79) 60	10.12.1979
C (79) 61	10.12.1979
CC (79) 25th Conclusions, Minutes 6 and 7	13.12.1979
Limited Circulation Annex to CC (79) 25th	
Conclusions, Minute 6	13.12.1979
C (80) 3	21.01.1980
C (80) 4	22.01.1980
C (80) 7	22.01.1980
Limited Circulation Annex to CC (80) 3rd	
Conclusions, Minutes 6 and 7	24.01.1980

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 OM Wayland Date 2 March 2010

PREM Records Team

Econ Pol

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

Paul Channon Esq MP
Minister of State
Civil Service Department
Whitehall
LONDON SW1

28 January 1980

Dear Paul

AGRICULTURAL EXPENDITURE 1981/82 TO 1983/84

Thank you for your letter of 23 January.

You are, I think, under a misapprehension about our Urgent Work Authority proposals. These could not have been included in the options exercise.

We are, of course, looking to the ending of prior approval later this year to help us make the reduction of up to 400 staff in my Department through simplification of the Capital Grant Schemes to which we are committed. However, in the short term by making greater use of Urgent Work Authority under the present Schemes we shall in effect simply be postponing the detailed scrutiny of applications. There will be all the more work to do later when the claims come in. We certainly could not make continuing staff savings until the rules of the Schemes were altered to require less scrutiny.

My officials have already explained to yours that the work load on the Farm and Horticulture Development Scheme is mounting cumulatively as a result of the large numbers of development plans approved every year since 1976, each of which provides for a large number of separate items of investment to be phased over up to 6 years. The dip in applications in 1979, while most regrettable economically, should enable our staff to begin to catch up on some of the unacceptable time lags in paying grant that have appeared through undue pressure of work. Applications under the other grant schemes have continued broadly at the same rate as before. My officials will, of course, be glad to discuss this again at any time with yours.

I think we need to distinguish between the policy decisions on capital grant assistance dealt with in my correspondence with John Biffen and the procedural changes recommended in Sir Derek Rayner's report, about which I am in touch with him and hope to go to wider consultations immediately.

I am copying this letter as before.

Peter

PETER WALKER

1. MR WIDDUP

2. CHANCELLOR

Copies attached for:

Chief Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt

cc:
Mr Butler
Mr Slater

PUBLIC EXPENDITURE - OVERSEAS AID

This is a note for the meeting with the Prime Minister on 25 Janaury.

2. As requested we have prepared a table (Annex A) of the cost of the aid programme since 1971-72 in 1979 survey prices. This shows that the cuts now envisaged would still leave the aid programme above the levels of the early 1970s. If the ~~Chief Secretary's~~ proposals which have been challenged in Cabinet were accepted, by 1982-83 we would be virtually back to 1972-73 levels although the figures for the early 70s tended to jump about.

3. Because the previous Government planned on a continuously rising total, the Government inherited a very high level of commitment so that the scope for potential cuts is very much smaller than appears at first sight. The relevant figures are shown at Annex B.

4. A breakdown of the commitments for the future years is shown at Annex C in amounts and Annex D in percentages. These show how the multilateral components of the programme so far committed take a rising share. The scope for bilateral aid is correspondingly reduced. We have included the Aid Contingency Reserve among the commitments, calculated on the basis of the aid policy review. From the point of view of using the aid programme for foreign policy objectives, including industrial and commercial objectives, the Aid Contingency is of high importance since it is largely from here that the Government has scope to change its priorities and respond to changing world events both in the short term and in the longer term. In these tables any provision for ATCP for 1981-82 onwards would have to come out either of the line for Contingency Reserve or from the uncommitted line. Presumably the the Chancellor, in line with the aid policy review, would like to see ATCP maintained at least in real terms at £30m.

5. The scope for reductions beyond what the Chief Secretary agreed is therefore small. However there remain some scope. In 1980-81 the revaluation process could be used to impose a small real terms cut and no doubt one or two of the small components of the programme could be trimmed. The ODA might be successfully pressed to offer something further beyond the cuts agreed by the Chief Secretary and/nearer the original Treasury proposals (figures in Annex B). This would suggest something of the order of a further cut of:-

1980-81	1981-82	1982-83	1983-84
5	5	10	10

W.L.St.C.

W L ST CLAIR
25 January 1980

As Mr St Clair's note explains, the degree of existing commitments, including the important requirement to maintain adequate provision for future contingencies (of which many can already be foreseen, such as support for an independent Rhodesia, Turkey and Pakistan) leaves very little room for further reductions in the Aid Programme. It would I think be feasible in arithmetical terms to go rather further than the figures at the end of Mr St Clair's minute, to something like:-

1980-81	1981-82	1982-83	1983-84
5	10	15	20

The effect, however, would be to squeeze still further the amount available for bilateral aid, which as Annex C shows is already being subject to a severe squeeze.

MW

M WIDDUP
25/1/80

ANNEX A

OVERSEAS AID PROGRAMME

£m at 1979 Survey Prices

1971-72	651
1972-73	684
1973-74	629
1974-75	628
1975-76	699
1976-77	671
1977-78	718
1978-79	786
1979-80	790
1980-81	781*
1981-82	751*
1982-83	716*
1983-84	716*

*As the figures stood before the current exercise.

ANNEX B

/‾1979 survey prices_7

	1980-81	1981-82	1982-83	1983-84
Labour Government plans	896	951	1011	
Plans before recent exercise	781	751	716	716
/‾Treasury proposals for recent exercise	-10	-50	-50	-50_7
Cuts agreed by Chief Secretary	-	-19	-28	-28
Present figures	781	732	688	688
Of which, provision for contingency reserve*	50	90	110	130
Of which committed in other ways+	731++	606	501	451
Maximum potential scope for further cuts	Nil	36	77	107

*Treasury estimates worked out on the principles of the aid policy review. Calculated before the Chief Secretary's cuts and therefore a little too high but probably still correct to the nearest 10 on our assumptions.

+ODA figures based on a strict definition of 'commitment' but including a number of judgements.

++Including 30 ATCP. No decisions about ATCP for future years have been taken.

ANNEX C

£m at 1979 prices

	1980-81	1981-82	1982-83	1983-84
COMMITMENTS				
Multilateral				
World Bank, International Development Association (IDA) and Regional Development Banks	85	148	148	148
EEC Group	132	151	139	138
UN Group	8	7	6	6
Total Multilateral	225	306	293	292
Functional TC and Pensions	90	75	60	45
Bilateral	384	225	148	114
Contingency Reserve	80*	90	110	130
Total Commitments	779	696	611	581
UNCOMMITTED	2+	55	105	135
AID PROGRAMME (As agreed before recent exercise)	781	751	716	716

*~~Ex~~Including 30 ATCP

+The small difference from the figure of Nil in Annex B arises from rounding.

ANNEX D

percentages

	1980-81	1981-82	1982-83	1983-84
COMMITMENTS				
Multilateral	28.8	40.7	40.9	40.8
Functional TC and Pensions	11.5	10.0	8.4	6.3
Bilateral	49.2	30.0	20.7	15.9
Contingency Reserve	10.2	12.0	15.3	18.2
Total Commitments	99.7	92.7	85.3	81.2
UNCOMMITTED	.3	7.3	14.7	18.8
AID PROGRAMME (As agreed before recent exercise)	100	100	100	100

10 DOWNING STREET

(1) ~~Mr Turnbull~~ P

(2) P.A.

cc Housing: May 79: Policy 18

Spoke to Berrill - agreed that timing wrong. Better to consider this approach as part of 1980 Survey. TL 21/(

Qa.04413

SECRET

To: MR LANKESTER

From: SIR KENNETH BERRILL

Public Expenditure: Housing

The over-riding need to cut the PSBR faces Ministers with difficult choices. To achieve the targets required it may be necessary to consider policy changes which in other circumstances would be politically impracticable. If so, the CPRS believes that the greatest scope lies in the field of housing. In opposition the Government identified this as a major area where savings in public expenditure could be achieved and where the market should be given greater scope. This note sets out some of the considerations which the Prime Minister may wish to have re-examined.

2. Much has already been done. The housing budget was cut substantially in the Autumn and further cuts are now envisaged. The Housing Bill opens up the scope for market forces through council house sales and the introduction of shorthold. Substantial subsidies remain, however, and these distort the market and the demand for new investment. It is for consideration whether the Government should aim at setting a timetable - even if a long one - for eliminating indiscriminate subsidies and concentrating on those in need. The balance between subsidies to the public sector and the special tax reliefs for owner-occupiers would have to be examined.

3. The condition of British housing is good by international standards. There is a surplus of dwellings over households of over 1 million (5% of the total stock). The quality is better than that of a number of more prosperous countries. It can be argued that, in the post-war period, the UK gave a priority to housing which many of our competitors reserved for industry.

4. Paradoxically, housing problems are often perceived as getting worse. There are still many unfit and poor quality houses. Local housing shortages persist and waiting lists remain long. The young and mobile have difficulty in getting homes. We would argue that this is largely the consequence of market-distorting subsidies.

5. The Case Against Indiscriminate Subsidies

(i) The cost of subsidies is over £3bn a year (£1.8bn for local authority housing and £1.5bn for tax relief to owner-occupiers). Withdrawal over, say, 10 years would make a substantial contribution to the PSBR - even allowing for retention of rent and rate rebates for the protection of the poor. £3bn is equivalent to 4-5p off the standard rate.

(ii) At present demand is artificially stimulated. For example there is little inducement for people to move to smaller dwellings as families get older and children leave home. A move towards economic charging would reduce unnecessary investment. It would leave the market to determine the allocation of resources and would lead to a more efficient use of existing housing stock.

(iii) The excess demand causes high prices in the owner-occupied market, creating barriers for first-time buyers and windfall gains for existing owners. Where the price cannot rise, as in the public sector, rationing takes place by queuing.

(iv) The Government is not prepared to subsidise food, fuel and other necessities. Why should housing be treated differently?

(v) Withdrawal of subsidy would release resources for investment in productive investment; would remove one obstacle to mobility; and lead to manpower savings in local authorities and tax offices.

6. Any radical reform of housing finance would need to involve all ~~three~~ forms of housing tenure. The object should be to face each household with the true costs of the resources it pre-empts. Clearly this would mean higher rents for both the public and private tenant. But it would also mean higher costs for the owner-occupier. Would this be compatible with the Government's commitment to encourage owner-occupation?

7. In our view it would. Demand for home ownership is high because at a personal level there is no better investment that an individual can make. No other investment offers:-

(i) tax-free capital gains;

(ii) inflation proofing - over the past decade the rise in house prices has outstripped the RPI and comprehensively outperformed the Stock Exchange indices;

(iii) cheap finance through the building societies (even now a negative real interest rate);

(iv) an asset which conveys visible social status and which allows one to live rent free.

8. Moreover, gradual withdrawal of subsidies from all three sectors would not damage the relative attraction of owner-occupation. Nor, of course, would it necessarily leave individuals worse off since they are currently paying part of their housing costs through taxation.

9. In the case of the owner-occupier there is a problem of what constitutes the existing subsidy. From an economic point of view the best way to treat houses for tax would be to charge income tax on the rent which the owner would have had to pay to a landlord for the same house (Schedule A). But this would be difficult to administer and to justify presentationally.

It would therefore probably be necessary to fall back on the withdrawal of tax relief, though this is conceptually less satisfactory.

Distributional Effects

10. It is inevitable that any reform of the kind outlined above would make some people worse off and some better off. The obvious gainers would be those owner-occupiers who own their houses outright. They would benefit from general tax cuts while suffering no reduction in "subsidy". On the other hand new owner occupiers could suffer a marked fall in disposable income since the value of the tax relief they receive on the high outgoings of the early years of the mortgage would in most cases exceed the value of any general tax cut. So far as council tenants are concerned, some would be unaffected by the change since they would qualify for rent rebates. But council tenants as a whole would be worse off since they at present receive a greater subsidy per head than owner-occupiers, and would on average receive smaller tax cuts. The distribution effects should not be too severe if subsidies were withdrawn gradually.

Conclusion

11. The CPRS does not under-estimate the political sensitivity of housing subsidies. But we believe that it is the one area of policy which holds out some prospect of a substantial contribution to reducing the PSBR, while at the same time offering substantial longer-term benefits for the economy as a whole. If the Prime Minister agrees, she may feel that the Department of the Environment should be asked to review the possibilities quickly, in consultation with the Treasury and the CPRS. The groundwork has already been done over the past 3 or 4 years and the necessary material is readily available.

12. I am sending a copy of this minute to Sir Robert Armstrong.

KB

25 January 1980

Tim, this is an annex to the Chancellor's Cabinet briefing which the PM may find helpful for this afternoon

With the Compliments
of the
Chancellor of the Exchequer's
Private Secretary

Treasury Chambers,
Parliament Street,
S.W.1.

25/1/80

APPENDIX B

SECRET 17. Econ Pol.

P.

LOCAL AUTHORITY MANPOWER (OUTSTANDING ISSUE)

The tables circulated as background to C(80)3 show the implications for local authority current expenditure and manpower (excluding housing - see para 4 below) of the plans as they now stand (including reductions already agreed in the current exercise), compared with actual levels in 1978-79. Mr Heseltine's proposed cumulative 1% annual reduction in local authority current expenditure from 1981-82, secured through manpower savings, is regarded in C(80)3 as fully additional to the savings incorporated in the tables.

2. Given the limitations of central government's influence over local authorities (RSG, exhortation, guidance etc), it is doubtful whether such additional savings are in practice deliverable. Significant manpower reductions are already expected on all the main local authority services, except police (which is a priority area) and personal social services, where you have accepted modest increases for demographic reasons. If the whole of the extra reduction were taken on manpower costs, each 1% cut in expenditure would involve a manpower reduction of about 1¼%; to the extent that police and personal social services were protected, the cut in manpower on other services would need to be higher (about 1¾% on non-protected manpower for each 1% of total expenditure - ie an extra 5¼% reduction in numbers by 1983-84).

3. The savings so far agreed involve policy changes and pressure for efficiency savings in the various local authority programmes concerned (for examples, see footnotes to the manpower table), not simply pruning administrators. We suggest you take the line that additional savings can realistically be scored only if the responsible Ministers are prepared to accept the implications for their services (ie reduced services, if further efficiency improvements are not attainable) and to take action to deliver the savings. This of course applies to Mr Heseltine himself, who is responsible for local environmental services, where the

manpower reductions at present expected are much lower than on the other main non-protected programmes. He might therefore be pressed to deliver the full 1% cumulative reduction on this programme, whatever the outcome elsewhere.

4. The tables exclude housing because housing management and maintenance do not score in PES but are covered in the subsidy figures. We do not know the wages and salaries component. The housing subsidy savings already agreed assume a 2% efficiency cut in management and maintenance from 1981-82 (not cumulative). But if Mr Heseltine can offer manpower savings here, we should accept them.

5. It may be suggested that, because of the uncertainty about how and where savings will be achieved, the extra reductions should not be allocated to programmes, but be presented as a separate line in the White Paper. We would advise against this. It would leave no Minister with responsibility for delivering the savings (or for finding alternatives if in time they were seen to be unattainable) and would damage the general credibility of the published plans.

Efficiency and waste

6. The Prime Minister or Mr Heseltine may possibly refer to the Rayner/Berrill proposals for a Government campaign to improve efficiency and reduce waste in local government, which were circulated with her Private Secretary's letter of 18 January. The proposals include the mobilisation of public interest in the cost-effectiveness of local services; Government publication of a series of guides on value for money and on the management role of local councillors and officials; publication of data on comparative expenditure and manpower levels; and a greater emphasis in the work of district audit - and also possibly the Government Inspectorates - on value for money issues. Leaving aside their effectiveness, there must be a question mark over the local authority reaction to a number of these proposals, to the extent that they involve more detailed Government intervention in their affairs.

7. It will be important to have Mr Heseltine's considered views on the likely efficacy and practicability of the proposed initiative, bearing in mind that there is a good deal of overlap with the action he has already taken (eg through a number of the provisions of the Local Government Bill) to improve local accountability. Obviously Treasury Ministers will not wish to put a damper on any new proposals which may improve local authority efficiency. But, from the point of view of the immediate decisions needed on public expenditure, our advice is that it would not be justifiable to score any additional savings on local authority current expenditure on the basis of a possible campaign of the kind proposed.

SECRET

APPENDIX C

HOUSING

Outstanding Issues

Further housing cuts to be sought if local authority manpower reductions are insufficient

1. The paper records the original Treasury targets

300 500 500 600

A revised spread was agreed with Mr Heseltine

300 450 550 600

The latter is the baseline for further reductions.

2. You have still to decide whether you will accept private finance for housing associations towards Mr Heseltine's reductions. You said at the bilateral that if you rejected it you would not ask the Environment Secretary to make the £50m per year in savings in another way. If this can be regarded as subject to Cabinet discussion, the shortfall on the target is:-

					4 year total
Targets (revised spread)	300	450	550	600	1900
Savings agreed so far	225	364	415	420	1424
Gap	75	86	135	180	476

If Mr Heseltine is allowed to score private finance (or the equivalent is conceded) the savings to be sought are:-

25	36	85	130	276

Tactics

3. Avoid detailed debate about the size of the new housebuilding programme which is needed. We suggest that you should

(a) seek global cuts in local authority housing capital in general; without attribution to particular programmes;

(b) argue new housebuilding reductions on realism rather than merits;

(c) mount an attack on the council house improvement programme in particular (NB This is different from the improvement grants programme which is for the private sector).

Arguments

4. (a) The cuts agreed in local authority capital are less than half the options illustrated by the Treasury:

					4 year total
Illustrated by Treasury	228	357	454	492	1531
Accepted by DOE	108	180	220	230	738
Rejected by DOE	120	177	234	262	793

(b) None of the options rejected by DOE is inherently more difficult than what is having to be done on other programmes and on the whole they are a good deal easier: Examples follow:

(c) New housebuilding: possible further savings £200 million over 4 years. This means 30,000 approvals a year from 1981 only 5000 below the level to which approvals have already declined.

(d) Council house improvements; possible further savings £220 million over 4 years. There is still fat on this programm Has been expanded - not cut at all - since Government took office. Much of this expenditure has little or nothing to do with hardship. The houses are not unfit. Money mostly goes on things like new kitchens, central heating etc for council tenants. Politically popular but could be slashed without real pain. If this is councils' highest housing priority, - they prefer it to new housebuilding - there must be very little real housing need left. Baseline falls in later years, but further cuts would not bring hardship.

(e) Private sector improvement grants: could also be cut more - say £100m over 4 years: by concentrating on real need in terms of state of housing stock and individual means. Only a small proportion of these grants go to the poorest households and the worst houses.

5. All of this suggests that local authority housing capital can be cut by whatever is needed to make up your original targets, with or without the abatement for private finance.

HOUSING

AGREED SAVINGS THAT MAY BE CONTESTED

Insulation cuts

1. Energy Secretary may challenge the decision to cut domestic insulation schemes.

Amounts involved (public and private sector schemes combined)	25	25	25	25

Points

(a) Proposal merited on principle (higher fuel prices - people don't need further incentive) and realism (underspending).

(b) Environment Secretary chose these cuts from range of Treasury proposals. If Energy Secretary can persuade him to make them in other ways while still meeting the reductions agreed or sought for housing, so be it.

Cuts in housing affected by change in economic assumptions

2. The new economic assumptions are likely to increase the cost of housing subsidies in 1980-81 and to reduce them in 1982-83 and 1983-84. No Cabinet discussion is necessary. The precise figuring should be available later this week when DOE and Treasury officials will discuss urgently whether and if so how far the agreed housing totals should be adjusted, reporting to Ministers as necessary.

~~PRIME MINISTER~~ PM sees Econ Pol

PUBLIC EXPENDITURE - MEETING WITH TREASURY MINISTERS AND OFFICIALS

I suggest you might take the meeting in the following order.

First, discuss the "changing gear" paper. The essence of the paper is that we should take 3 per cent off retirement pensions, and all other social security benefits, public sector pensions, tax threshhold uprating, and public service pay. The argument is that it would be fairer and more defensible to hit everyone rather than individual groups.

You should note that the figures in paragraph 17 do not take credit for any reduction in public service pay. This is because the problems of achieving this look insurmountable - i.e. contrary to PRU agreement, row with unions, impression of incomes policy, and "bounce back" in 1981/82 if PRU were then to operate normally again. If there is to be a squeeze on the public sector pay bill, it would be easier to achieve this through a cash limit squeeze. (This would probably mean fewer civil servants, but the unions could in theory offer to accept a lower settlement than indicated by PRU in return for not losing so many jobs). Nor do the figures take credit for holding back the uprating of tax threshholds. (Worth £350 million).

Although the basic idea looks appealing, I think that it will be difficult to take decisions on it quickly enough. In particular, the cut back in public service pensions - though very desirable - is almost certainly a mine field. The Treasury and CSD would need to do a lot more work on this. But if public service pensions are not to be reduced, it does seem difficult to contemplate reducing retirement pensions. (Final decisions on public expenditure are needed by next Thursday if the White Paper is to be published before the Budget: I have checked whether this is really true, and the Treasury say it is).

/ If the concept

If the concept as a whole is not on, I fear we are back to looking at individual programmes. The main programmes you will want to go through are as follows:

Social Security

The package agreed between the Chancellor and Mr. Jenkin is at Flag A. Yesterday, you were thinking of a maximum reduction in the short term benefits of 5 per cent (including invalidity benefit?) and possibly a reduction in pensions in the sense that the uprating would not cover indirect tax increases in the Budget (say ¾ per cent). You were very unhappy about abolishing the death grant.

Defence

The private compromise agreed in the autumn was that the defence programme should increase by 3 per cent per year in cost terms, with any expenditure on Polaris replacement to come out of the contingency reserve. The Treasury were assuming that the cost of defence spending would go up faster than costs in the economy as a whole (i.e. the relative price effect would be positive), and therefore a 3 per cent increase in cost terms would mean a slightly lower increase in volume terms. On this basis, the Treasury were hoping for savings of £100 million per year.

The Treasury are no longer keen on this approach because they now think the relative price effect in the coming years will be negative. (This is mainly because they are now assuming that, with the gloomy economic prospect, public service pay - including armed forces' pay - will go up slower than prices.) They would therefore like to go either for a cash limit squeeze on defence. By limiting the defence cash limit to 14 per cent in 1980/81 we would save £250 milliom; they would then allow a 3 per cent increase in volume terms from 1980/81 onwards. In other words, defence would be asked to stand still for a year. Or, the 3 per cent volume increase would be based on this year's estimated outturn.
This would yield £100 million per year (and I would have thought would be easier to negotiate with Mr. Pym).

/Mr. Pym

Mr. Pym has so far only offered £25 million on 1980/81 and £50 million for each of the succeeding years - in return for an easy cash limit.

Housing

The Chancellor and Mr. Heseltine have so far agreed on savings of £225m in 1980/81 rising to £420m. Following the strong steer given in Cabinet yesterday, the Treasury think they can get the full savings they were originally proposing (i.e. £300m rising to £600m) by cutting back housing starts.

Education

The Treasury have so far only got about half what they were proposing. They had hoped to get an increase in parental contribution. They do not think this is worth pursuing. Instead, they are looking at savings from polytechnics. In addition, they would like a steer from you on whether to insist on further savings in primary and secondary education: many people of course believe that further savings are possible from improved efficiency - especially by cutting down on administration.

Aid

You said this programme should be looked at again. The bilateral programme is to be reduced by 40%, but this is apparently offset by rising multilateral aid. Lord Carrington has argued the political case against further reductions; you will want to ask just how firm our commitments to the existing programme are.

Health Charges

Mr. Jenkin has agreed an increase in prescription charges of £1 next autumn. Should we accept this?

/Child Benefit

Child Benefit

The question of whether we uprate by 50p or £1 was left unsettled yesterday. A 50p uprating would yield savings of £98 million in 1980/81 and about £250 million in later years. Why not have a lower uprating for third and subsequent children? This would be bitterly opposed by the poverty lobby but it could be justified on the grounds that the average cost of extra children must go down - sharing accommodation, clothes, etc.

Total Cuts

The so-called agreed package in the Chancellor's paper came to £500 million in 1980/81 and £1.4 billion in 1981/82. Presentationally, we could reach £1000 million in 1980/81 by an announced 3 per cent cash limit squeeze. A 3 per cent squeeze on central government expenditure would yield £675 million. But we could only take credit for this if we announced that this was what we were aiming for.

R.

25 January 1980

Tim Lankester
Original returned to S Holgate

PRIME MINISTER

DE-INDEXATION

Some general points for this afternoon's meeting. Indexation and de-indexation is a big and complex subject. In my view, the Treasury team under Douglas Wass is still extremely confused about it.

1. Any de-indexation (eg X-3) must not be permanent. We need to reduce the absolute figures for public expenditure purposes. But the principle of full indexation thereafter must be wrong. There is, in economic logic, an argument for saying that it could be linked thereafter to prices or pay, whichever is the lower - something no-one seems to have thought about. But we should avoid giving the impression that, having made this once-for-all change, we are committed to indexation thereafter.

2. It is fallacious to compare, from the point of view of social justice, the indexation of tax bands and allowances with the partial indexation of benefits. If (or when) benefits are taxable, then the beneficiaries will have the advantage of whatever indexation of taxes there may be. The comparison is between the gross pay of those not on benefits, to the extent that that is indexed, and the benefits themselves.

3. Following directly from 2 above, if Government takes the view that, in the end, aggregate pay increases and benefits must all come below the going rate of inflation, if inflation is to be cured, then Government must control what it can (eg benefits) and must exert pressures (monetary discipline through the market) on pay where it can't control directly. In the past, the bit that Government can control has in fact been the most inflationary, because it has been fully indexed. We've got it exactly the wrong way round.

4. Public sector pay. In principle, yes perhaps this should be partially indexed (we proposed this more than two years ago, because, again in the event, it will have to be, at least during the time that inflation is squeezed out of the system). However, we begin to get into deep water here and it can probably only be done when the thinking about indexation is much clearer, and in the context of a properly developed and sold stabilisation programme.

5. Public sector pensions. Not such big money. Raises issues of principle - can one really break contracts? Politically attractive because indexed pensions are unpopular. I suspect it will raise very big and complex questions, involving the private sector insurance industry and pension funds, in turn raising questions about their indexation of pensions, and whether or not there would be indexed gilts. In many ways, much more important to concentrate

on squeezing out inflation so that indexed pensions are not such a big issue. Beyond those comments, we have no view. The subject is big, deep water, not properly thought through yet.

The whole area of indexing and de-indexing is much more subtle and complex than it at first appears. It lies absolutely at the heart of stabilising the currency. We have to be very careful that we don't take measures which look on the face of it sensible, in a hurry, and then find that they have closed off any chance of getting the right answers in the longer-term. The Douglas Wass committee, on which I sit, has only just started in time. It should have been in action years ago.

JOHN HOSKYNS
25 January 1980

2

Prime Minister

TL 24/1

CHIEF SECRETARY TO THE TREASURY

PRIME MINISTER

Reprising reading MS

PUBLIC EXPENDITURE AND THE PSBR IN 1979-80

You may like to know the way actual expenditure has been developing in 1979-80 and its impact on the £8.3 billion PSBR forecast given in Geoffrey Howe's statement in the House on November 15. I am not covering revenue in this minute. It is important but less open to our control within the year.

2. The figure for central government supply expenditure which underlay the statement was £53 billion. We have now received the Spring Supplementary Estimates from departments. Coupled with our latest monitoring information, these suggest the expenditure outturn will add some £250 million to the PSBR. A significant part of this excess arises from increased payments of ECGD insurance claims as a result of developments in Zambia, Iran and Turkey. These payments are not subject to cash limits, being largely determined in amount by events outside the government's control.

3. There are indications that the Ministry of Defence are again in difficulty with their cash limit this year. I wrote to Francis Pym about this on December 19 and Treasury officials are in close contact with his. The threatened excess is of the order of £50 million, which would add correspondingly to the PSBR.

4. Indications are that local authorities expenditure will also add some £200 - £300 million to the November PSBR forecast. Monitoring information shows that their capital expenditure will be that much closer to their cash limits (i.e. less underspend) than previously expected. There is no suggestion that their cash limits will be breached.

5. The overall position on the nationalised industries is little changed since November. The Post Office billing backlog has been unwound faster than expected, but this is offset by the emergence of a possible overspend of some £$\frac{1}{4}$ billion on the Electricity Council's external financing limit. This was notified by the Council to the Department of Energy only on January 11. David Howell and I met the Chairmen of the Electricity Council and the CEGB on January 21 to emphasize the need for urgent remedial action. David Howell will be writing about their response very shortly.

He has done - see letter attached

WJB

JOHN BIFFEN
24 January 1980

S E C R E T

Prime Minister

cc J. Hoskyns
cc Cab Office

S.J. Pike Duty Clerk
for TPL 24.1.80

/6.

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

24th January 1980

Dear Tim,

"CHANGING GEAR"

As promised, I enclose a note by Treasury officials which the Prime Minister may like to discuss at her meeting tomorrow at 2.30 p.m. The Chancellor has not had time to study the note carefully, but thought that the Prime Minister would like the opportunity of studying it overnight.

I will be in touch with you early tomorrow with a list of officials for the meeting.

Yours ever,

MAH

(M.A. HALL)

T. Lankester, Esq.,
No.10, Downing Street

NOTE BY TREASURY OFFICIALS : ACROSS THE BOARD DEINDEXING

This note discusses as an alternative to the piecemeal deindexation of some social security benefits, the possibility of a one-off global deindexation exercise, whereby at the next opportunity all elements controllable by the Government which would usually increase in line with some index or another, formal or informal, should only be increased by something less than that index. The essence of this proposal is that it should be as broadly based as possible, so as not to seem to identify any particular programme or sector for such treatment; but that it should achieve substantial public expenditure (and PSBR) savings for the year 1981-82 (with spin off into 1980-81 and for 1982-83 onwards), while at the same time forming a new lower base from which normal indexation or increases would resume once the "change of gear" had taken place. The move would be represented as, and would indeed be, action by the Government across the board to get the system back on to a new plane which the economy can afford.

2. Individual areas which should come into this exercise are considered below. The assumption is made that current legislative constraints are irrelevant, and that where necessary (and in many cases it would be necessary) current legislation would be overruled through one single Act empowering the Government to make this "change of gear".

Social Security Benefits

3. The items in this programme (or associated with it) which are formally uprateable (notably retirement pensions, supplementary allowances and benefits, unemployment, sickness, etc benefits but not child benefit and benefits such as death grant and maternity grant) total around £16 billion. 3 per cent deindexing would therefore secure £480 million in a full year, or about £160 million in 1980-81. As an example of the effect it would have on beneficiaries, assuming an uprating otherwise of 15 per cent, the married couple pension now £37.30 per week would go up to £41.80 rather than £42.90 in November 1980, a cash difference of £1.10 per week.

4. Child benefit is not included here, because it is not formally or informally indexed, and the question of what increase on the current £4 per week that should be given next November is a separate one.

5. So far as contributory benefits go, in order to get the PSBR savings, either legislation would be needed to reduce the level of Treasury Supplement to the National Insurance Fund or the balance on the Fund would have to be allowed to grow, so that contribution rates to the Fund were not lowered.

Public Service Pensions

6. Under the Social Security Pensions Act 1975 price protection of public servic pensions (eg Civil Service, police and firemen) is integrated with the price protection provisions for the additional component of the new State scheme (which would fall into the exercise under paragraph 3 above). Public service pensions are increased each year in November on the basis of the price forecast used for additional components. No firm figures of the cost of public service pensions are readily available, but it is broadly estimated that the total in the current year will be of the order of £2 billion on the basis of this figure 3 per cent deindexation would save around £60 million.

7. It should be noted that there would be no way of deindexing public sector pensions (eg nationalised industry pensions), because these are matters of separate contracts.Therefore these would continue fully indexed alongside deindexed public service pensions.

Tax Thresholds

8. An increase in the main personal allowances (which set the tax thresholds) in the forthcoming Budget by 3 per cent less than that required by the statutory indexation provisions in the Finance Act 1977 would "save" around £300 million in 1980-81. Similarly, to restrict the increase in the other thresholds in the income tax system (lower rate and higher rates - which are not covered by the statutory indexation provisions) would "save" a further £45 million.

9. On the other hand, it must be questioned whether it makes sense to increase the real burden of taxation simply as a presentational adjunct to cuts in public expenditure which are, in themselves, designed partly to allow room for real reductions in direct taxation.

10. Moreover :

i. Deindexing the tax thresholds would impose, proportionately, a bigger burden ~~of~~ on those on low incomes than those on higher incomes. This could not be corrected by reduction in the basic rates.

ii. As much as possible should be done on the thresholds so as to improve incentives at the bottom end of the earnings ladder.

iii. Deindexing both thresholds <u>and</u> pensions would maintain the same proportionate "clear water". But failure to index the tax thresholds could reduce the "clear water" between the tax thresholds and the retirement pension, if that pension were to escape the full impact of deindexation.

iv. Failure to index would bring more people (around 200,000) into the tax net, and require more staff in the Inland Revenue.

11. Finally, if it were decided to deindex the personal allowances, careful consideration would need to be given to the extent to which there should be a similar reining back in the increases in the specific duties on the indirect tax side.

<u>Pay</u>

12. Another form of deindexation would be to try specifically to "deindex" pay, by announcing that the Government's policy on pay settlements in the public services would be that they should be 3 per cent below the level which would otherwise be indicated.

This would be very strongly opposed by the unions as being a direct and selective attack on their pay. Moreover, comparability, formal or informal, would ensure that the Government faced extreme difficulty in preventing a bounce-back on pay in 1981-82.

Problems

13. In a sense the problems speak for themselves. Action in many of the areas involved would be inconsistent with stated policy. But taken collectively, as part of a wider one-off exercise the problems associated with each individual area may be less. It would be essential to see the proposal as a package.

14. Nevertheless, this would not mean that exceptions could not be made in individual areas. However each exception of this kind built into the scheme would not only erode the savings that would arise, but also would reduce the benefits to be obtained from the all embracing nature of the exercise.

The future

15. The operation is conceived as one-off, with the normal rules etc. applying for future years from the new lowered base. In the wider context of deindexation, however, Ministers might wish to keep the door open to do a similar exercise sometime in the future. This would be for judgment, taking account of legislative and other constraints.

Rate of deindexation

16. This note assumes a 3 per cent deindexing. There is no magic about this. A lower rate would give lower savings, and a higher rate higher savings. A higher rate might be preferable, in that the problems are not greatly increased, and the additional savings could give scope for some exceptions (see paragraph 14).

Impact on current Public Expenditure operation

17. If this exercise were pursued on a broad front on the basis of 3 per cent the current public expenditure operation might look as follows :-

£ million 1979 Survey prices

	1980-81	1981-82
Savings as at Annex A to C(80)3	492	1363
Less Social Security items therein	(110)	(505)
Add Social Security items not covered in this paper (i.e.	50	110
Add Social Security savings above (para 4)	160	480
Public Service pension savings above (para 6)	30	60
	622	1508

Further savings are possible on other programmes now under discussion, including child benefit. The PSBR savings are not necessarily the same as these, notably in that these would reflect deindexing tax thresholds (if agreed) at about £350 million (para 8).

Further work and timing

18. More work would be needed to refine this preliminary note. This would take time. The implications of the new proposals will clearly not be ready in time for firm decisions, on the exact measures and the amounts of savings, to be taken at Cabinet next Thursday. This would preclude the publication of the full Public Expenditure White Paper before the Budget, though it might be possible to have a much more curtailed announcement in the Budget itself. The White Paper could then only be published several weeks after the Budget (since, inter alia, it would have to take into account the Budget forecasts), if at all. Such further delay could cause adverse speculation and criticism, which Ministers will want to consider.

General

19. While the broadest possible coverage would yield the greatest effect and lend greater credibility on presentation, such coverage carries with it the

the need to take some very difficult decisions. The conflict of objectives may be most apparent in the tax field, where deindexation would cut across the tax strategy, but it would also be acute in other areas eg pensions and defence. The key to these difficulties would lie in making this exercise as comprehensive as possible. Thus action on pensions would be more defensible against a background of similar action elsewhere; and in its turn could be the key to savings being obtained from other hitherto difficult areas. On the other hand if the cover is narrowed, not only are the savings (public expenditure and PSBR) reduced but the more emphasis would fall on individual items and the less acceptable the operation becomes. Where conflicts do arise it may be that the possibility of limited exceptions mentioned at paragraph 14 could be explored; or other measures found outside this exercise.

CONFIDENTIAL

Pub. Exp

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

24 January, 1980

Dear Mark

R
24/1

CASH LIMITS - C(79)60

You wrote to me on 12th December about my proposals for cash limits for 1980-81 which we considered in Cabinet on 13th December. You raised a number of points which I take in turn below.

As far as comparability awards are concerned, referred to in your paragraph 1(i) and (ii), we are agreed that realistic allowance must be made for these. Since you wrote, our officials have discussed what allowance would be appropriate. I attach an Annex setting out their proposals with which I am content. These figures carry no implications for the 1979-80 cash limits.

You also suggested parity of cash limit treatment with the universities and local authorities for those direct grant institutions with employees paid on university, Burnham and other local authority scales. This is clearly right and I understand our officials are in touch about the implications for the relevant 1980-81 cash limits.

As regards the Research Councils, I agree that we should make the same allowance for university pay increases in their cash limits as we propose for the universities themselves, and that this treatment should apply both to those of the Research Councils' staff who are paid on university pay scales and to that part of their research grants which is directly related to unversity pay.

You also mention your concern about how the new arrangements of the central Vote for civil servants pay increases might affect bodies such as the Research Councils. I understand that my officials have now written

/to yours

The Rt. Hon. Mark Carlisle, M.P.

CONFIDENTIAL

to yours explaining in more detail how these arrangements will operate in practice. I am satisfied that the Research Councils and similar bodies will not suffer any loss of responsibility for managing their own affairs.

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

(GEOFFREY HOWE)

ANNEX

ALLOWANCE TO BE MADE IN 1980-81 CASH LIMITS FOR UNIVERSITY PAY GROUPS COMPARABILITY AWARDS

University teachers	$11\frac{1}{4}$% from 1/4/80 and $11\frac{1}{4}$% from 1/9/80
University technicians	20% from 1/4/80 (to replace the interim award of 13%)
University clerical staff	10% from 1/1/80
University manual workers	3.7% from 1/4/80

24 JAN 1980

PRIME MINISTER

Meeting with the Chancellor

I imagine you will want to go over the public expenditure paper for Cabinet - including any further thoughts from the Chancellor on social security. I enclose in this folder the material which I gave you for this evening's meeting with him and Mr. Jenkin. One point which I have established is that the ERS could be abolished with effect from 1982 without any criticism that we were breaking the "contribution contract". ERS contributions in Year 1 are assumed to pay for ERS benefits in Years 2 and 3 - i.e., it is not a funded scheme like a pension.

I have mentioned to the Treasury that you are very doubtful about the Chancellor's capital taxation proposals - simply because we won't have the money to pay for them. They tell me that the Chancellor is also having second thoughts, and will almost certainly want to cut it down in size and scope. In any case, final decisions on the package are not needed for quite a while.

I also enclose Len Murray's letter to the Chancellor asking for a meeting to discuss steel and coal.

T. L.

23 January, 1980.

14

SECRET

Ref. A01205

PRIME MINISTER

Public Expenditure and the Economic Outlook

(C(80) 3, 4, 5, 6 and 7)

BACKGROUND

Cabinet agreed in December (CC(79) 25th Conclusions, Minute 6) to aim at further reductions in the planned levels of public expenditure of £1,000 million in 1980-81 and £2,000 million in each of the subsequent years. The Chancellor offered at the same time to circulate a paper about the wider economic strategy, and about the role of monetary policy and the consequent need to keep down public expenditure and the PSBR.

2. Since Christmas, there has been the usual series of bilateral and multilateral talks, in which the Chancellor has been supported by the Home Secretary. He reported the first results of these talks to you at your private talk on 17th January, and again in his minute of 21st January. Since then he has made further progress. The main outstanding points now relate to housing and local government manpower, to the Defence Budget (on which I have minuted you separately), to employment measures and to certain parts of the social security programme. In addition, he wants Cabinet to endorse some of the bilateral agreements he has reached with spending Ministers, because of their wider political implications, and to get sufficient backing from Cabinet to be able to agree some other issues with spending Ministers before next week's Cabinet.

3. Cabinet thus has five papers in front of it. The first is the general economic and monetary background (C(80) 4) which will be convenient to take first. The second main paper, C(80) 3, is the public expenditure one: discussion of the three supporting papers (on special employment measures; on social security uprating; and on housing) can be fitted in as the Cabinet works through the main paper.

LA. b.
N.I. b
V.A.T. in
oil borrowing

$17\frac{3}{4}\%$

→ Oil

PSBR 10 - 13

Credit Controls - Car

SECRET

HANDLING

I. Economic and Monetary background

4. You might ask the Chancellor to introduce this paper (C(80) 4): as noted above, it was commissioned by Cabinet. It calls for endorsement rather than decision, and it should not require prolonged discussion provided that all your colleagues accept the underlying premise that there is no acceptable alternative to the strategy to which the Government has set its hand.

5. The Chancellor concludes that there is no 'alchemist's stone' which would allow him to dispense with the present monetary restrictions. Cabinet may grumble, but is likely to endorse this conclusion. You might run briefly round the table: the Ministers most likely to want to join in are the Secretary of State for Employment and the Minister of Agriculture (still grumbling) and the Secretary of State for Industry and Secretary of State for Trade (broadly in support of the Chancellor). The Home Secretary might also be ready to support the Chancellor. But the Chancellor's paper deals with all the obvious escape routes which Cabinet talked about last time: the hope that oil would float us off the rocks; the expectation that the Government's policies will take effect more quickly than the Chancellor reckons; the hope that interest rates will begin to turn down of their own accord; the possibility of reimposing the 'corset' in some tighter form; hire purchase and direct credit controls as an alternative or supplement to interest rate policy; going back on the exchange control decision; monetary base control. You will need to give some of these arguments a run if they are raised, but you might guide the Cabinet, fairly briefly, to agree with the Chancellor that there is no real alternative to the strategy on which it is already embarked.

Mr Nott is in the Far-East
R.

II. Public Expenditure

6. You might start yourself by making five general points:

(i) Timing. It is essential that the Cabinet complete its discussion by next week. This is necessary both to give the Chancellor time to prepare his Budget, and to complete the printing of the Public Expenditure White Paper for publication ahead of the Budget.

(ii) There has already been a good deal of Press speculation. It is important to keep these discussions absolutely confidential until the decisions are announced. /̅NB: this may be before the publication date for the White Paper: see below. I suggest you do not get Cabinet involved in discussion of timing and presentation until they have taken the actual decisions._/

(iii) The economic outlook is, if anything, even more forbidding than it appeared in December. (Oil prices, Afghanistan/Iran, etc.)

(iv) Yet the agreed savings listed here (Annex A), together with some of the other possibles, still do not add up to the Chancellor's - and the Cabinet's - original target. To some extent the short-fall may be made good by a volume squeeze, if inflation runs ahead faster than cash limits. But this is an unsatisfactory way of keeping the PSBR down, and the use of cash limits as an ex ante volume squeeze is liable eventually to discredit the cash limit system. Clear decisions on volume would be better - and those in the Chancellor's paper are the only ones on offer at this stage.

(v) Inevitably, discussion will focus most on 1980-81. But the short-fall is almost as serious in later years. Cabinet has agreed to publish full five-year public expenditure figures. But it may well have to return to the levels for later years next summer, when it looks at the 1980 Survey. Ministers may therefore want now or later to identify those areas where they think there is scope for still further savings, so that detailed work can be done on them during the Survey period. Some such points may emerge in discussion today and next week.

7. You should then invite the Chancellor to introduce the discussion, which he will do briefly. He will have three objectives: to get Cabinet ratification of the agreed cuts listed in Annex A; to get a favourable decision on Child Benefit, the biggest unresolved issue which is ripe for Cabinet decision this week; and to get sufficient guidance from Cabinet on the other issues to be able to conduct further bilaterals between now and next week. To do this it is important that Cabinet should complete a first run through the complete list at the first meeting.

8. You should then take the Cabinet through the individual issues in the sequence listed in the paper, bringing in related topics at the appropriate point (as shown below). The agreed figures are all listed in Annex A to C(80) 3, which also shows in brackets the Chancellor's original bid, for comparison.

(a) Social Security including Child Benefit. (Paragraph 5 and Annex C; also C(80) 6).

The proposal to abolish Earnings Related Supplement is agreed with the Secretary of State for Social Services. But it means reopening a decision taken by Cabinet as recently as 25th October (CC(79) 18th Conclusions, Minute 4) when it was agreed that the Government should not go back on the contractually-earned right to ERS. This is, however, the biggest single social security saving available, and if it is not acceptable substantial new savings will have to be found elsewhere. In judging this issue colleagues will especially need the judgment of the Leader of the House and the Chief Whip.

Mr. Jenkin has also agreed to cut the real level of short-term benefits (unemployment, sickness, maternity and injury benefits, widow allowances and long-term invalid), uprating them by 10 per cent less than is needed to keep pace with prices. At this point you will want to draw colleagues' attention to Annex C of the Chancellor's paper which makes it clear that what is proposed is a 10 percentage point shortfall, not a 90 per cent uplift. This is a major cut in the real value of these benefits. The Chancellor sees this as a 'change of gear' which would permanently shift the regular uprating on to a trend line below the present one. (The discussion at Wednesday's E on the taxation of unemployment benefit will be relevant). The Chancellor may also propose later - but not at this meeting - a similar 'change of gear' in relation to the Defence Budget and the NATO commitment. Cabinet has of course already accepted the need, wherever possible, to 'de-index' benefits and public sector wages. The Chancellor's proposals are not quite this - being a substitute for tax - but have much the same effect.

There is a quite separate problem over long-term benefits, which erupted at Question Time last Thursday, and is now dealt with in a joint paper (C(80) 6) by the Chancellor and Mr. Jenkin to which Cabinet could now turn. The question is whether, given the Manifesto commitment to make good the 1978 shortfall (which has been done), the Government should also make good the shortfall on its own 1979 uprating. If so, when should this be announced? Both Ministers agree that there is no obligation to put right the 1979 'earnings' shortfall. If Cabinet agrees (as I think they must), in what terms should the announcement be made, and when? Is the formula in paragraph 8 sufficient?

The unresolved issue concerns Child Benefit. The Chancellor wants to carry the de-indexation principle still further (and it should be easier, in principle, to do so for Child Benefit, which is not yet formally indexed). The Secretary of State wants to uprate in line with prices, because of the effect on incentives if this is not done. Whatever is decided on Child Benefit, he wants to keep children's supplementary benefit on a full uprating basis, arguing that this has very little effect on the in-work/out of work incentive problems. As you know, a fuller report on incentives is in preparation, but will not be ready in time for these Cabinet discussions. However, its tentative conclusions would, I understand, probably support Mr. Jenkin's case on both counts. Against this, the Chancellor feels that he must get the Child Benefit decision in his favour: £85 billion is at stake next year.

(b) Health (Annex A)

This is a convenient point at which to pick up the proposed reductions in the Health Service, which have been agreed with Mr. Jenkin. They are listed in Annex A as 'agreed' and described there. Mr. Prior complained last time that he had not realised prescription charges were to be increased. Is he content that they should be increased further this time? Does the Cabinet agree? What will be the effect on the RPI?

(c) European Community (paragraph 6).

At official level, there are signs that Departments feel their programmes are being cut unnecessarily, when there is a prospect of savings on the European Budget later in the year. If this argument emerges, you will probably want to ask Cabinet not to count its chickens. It is far from clear that we shall get the whole £1 billion reduction in the European Budget; even if we did, the Chancellor's strategy ideally requires even more savings than those Cabinet has agreed to find. The prospect of success in the EEC Budget negotiations is not an excuse for failing to take difficult decisions on domestic programmes.

(d) Cash Limits (paragraph 7)

Cabinet has already approved most cash limits for next year, building in a 14 per cent inflation assumption for central Government. The cash limits for the central Civil Service vote and for the defence budget, however, have yet to be agreed. If inflation were to continue next year at something like the present 17 per cent rate, there would be a quite sizeable volume squeeze implicit in these limits (yielding as much as £450 million); but, as the paper notes, obvious difficulties about publishing these. For the moment, Cabinet need only note the problems this would raise. Mr. Pym will probably keep quiet at this point, because these matters are under separate discussion; but such a squeeze (quite apart from any further squeeze on Armed Forces' pay) would make it even harder for him to maintain his 3 per cent volume growth rate. If anyone else challenges these assumptions, you should remind them that Cabinet has already decided the main cash limits and there is no going back on them.

(e) Local authority manpower (paragraphs 8-9 and C(80) 7).

As Annex A makes clear, Mr. Heseltine was asked to make much bigger cuts in the housing programme than he has in fact offered. The shortfall is £75 million in 1980-81 and £146 million, £85 million and £180 million in the subsequent years. His suggestion is that further economies in 'his' area could be found by further cumulative 1 per cent reductions in current expenditure on local authority services. But this is not in his gift. First it is not clear what base-line he proposes to apply this 1 per cent cut to: is it the figures which emerge from the Cabinet's decisions this month, or is it the earlier figures agreed by Cabinet but never announced? If the latter, local authorities will not know what they are supposed to be cutting. Next, how would he make it stick? The most he can do is to issue exhortation to local authorities, and to reduce the 'eligible expenditure' for RSG purposes. But local authorities would not necessarily reduce their expenditure correspondingly: they might choose to put up rates instead. Next, is such a percentage cut acceptable across the board, given the sizeable reductions already made in other local authority services? Finally, does it reflect the Government's own priorities? How could the present exemptions for the 'law and order services', and the relative protection of the Education budget, be continued? (The Chief Secretary has circulated some relevant figures as C(80) 7). All in all, this looks like a rather hastily-conceived gimmick, and the Chancellor will not wish to accept it. He will have some support for this line from the Secretary of State for Education. The Home Secretary will certainly oppose Mr. Heseltine's plan, and believes that more can be taken off the housing programme.

(f) Civil Service and other manpower cuts

The cuts listed in Annex A already take full account of the manpower reductions agreed by Cabinet before Christmas. The question is whether any further overall reduction should be made. Some Ministers may be disposed to argue that there is still plenty of administrative fat: and that the "Rayner" and similar exercises will sweat it off. They will want to take credit for these further savings. The Chancellor (and Mr. Channon, who you may wish to call at this point) will remind them that they were very reluctant indeed to come up with any further specific manpower savings last year. In addition, they are already being subject to an overall volume squeeze, of indeterminate size, through the operation of cash limits. It does not seem realistic to impose a further administrative 'super cut' across the board.

(g) Housing (paragraph 11)

Mr. Heseltine has agreed to reductions in the housing programme of £225 million in 1980-81, £364 million in 1981-82, £415 million in 1982-83 and £420 million in 1983-84 (listed in Annex A). But he is not prepared to say how this will be found. This presents some technical problems: how will the cuts be described in the White Paper? It leaves Government spokesmen a little exposed if they are asked to explain the figures. There is a general feeling in Cabinet (to which you have referred yourself) that Mr. Heseltine was too soft on council house rents last time. Can he be persuaded to firm up his proposals now? If so, he might be invited to discuss with the Chancellor between now and next week, and to come back with firm proposals. These should certainly include a statement of the effects on the RPI. The CPRS note that it might be possible to go further on housing subsidies than would otherwise be possible if the Government were prepared to consider a gradual elimination of housing subsidies, public and private.

(h) Defence (paragraph 12)

I have minuted you separately on this. For the moment, you need only take note simply that talks are continuing.

(i) Education (paragraph 13 and Annex A)

Although these cuts, largely in student grants and charges for nursery schools, have been agreed with the Education Ministers, they need ratification by Cabinet because of the political implications and the effect on the RPI (not quantified in the paper). You will note that the Home Secretary and other Ministers feel that there is scope for further reductions in the Education budget: does Cabinet wish the Chancellor to pursue these ideas bilaterally with Education Ministers before next week?

(j) Employment (paragraph 14, Annex A and C(80) 5)

The Secretary of State for Employment has accepted the reductions listed in Annex A, subject to consultation with the Manpower Services. They fall mainly on training. But he is not prepared to give up his additional bid for 'special employment measures' next year. These are described in his separate paper C(80) 5. They were the subject of preliminary discussion at E(EA) last week, but this was necessarily inconclusive because the Chief Secretary reserved his position. Mr. Prior's additional bids would amount to a maximum of £18 million in 1980-81, against which some receipts from the European Social Fund might be expected (figures in Annex 1 to his paper). The arguments are set out extensively in his paper. The decision is a straightforward one. In addition, a decision is needed on the taxation of the job release scheme allowance: the Chancellor wishes to tax it, in line with his proposals on short-term benefits. But because of existing undertakings, the payments would have to be correspondingly grossed up for tax, at a cost of £34 million, as well as incurring some additional administrative expenses. Mr. Prior proposes postponement of the tax decision for a further year. The sums involved are not large, and barely affect the PSBR at all. If the Cabinet does not decide the issue one way or the other this time, they might invite Mr. Prior to pursue the subject once again with the Chancellor, with a view to getting agreement before next week's discussions.

(k) Other agreed savings

At this point, you might ask Cabinet to confirm that the remaining savings listed in Annex A as 'agreed' can be taken as approved. The ones not so far discussed are those on page 2 of that Annex: Transport, FCO; Home Office; Energy; Legal Aid; and Export Credits. None of these seem to raise serious political problems which involve anyone beyond the spending Ministers concerned, who have already agreed to these cuts.

(l) Earnings rule

The CPRS note that, if it were desired to find additional savings for the later years, quite large provision is made (£35 million for 1982-83, rising to £125 million for 1983-84) for implementation of the Manifesto commitment to phase out the "ER" during this Parliament. It is arguable that deferring this commitment would be a good deal less painful than some of the measures already agreed. Indeed the objective of the commitment (to encourage retirement pensioners to go on working) may be open to question in present circumstances.

(m) Resulting figures

The results of these cuts, subject to any further bilateral discussions, are summarised in Annex B of C(80) 3. In his paper, the Chancellor proposes ~~that~~ publication in a Public Expenditure White Paper in March (just ahead of the Budget). But he is likely to suggest (next week, if not this) that, because of the risk of leaks, and the need to convince public opinion that the Government means business on public expenditure, he should announce the main decisions earlier than this, by way of a statement, Written Answer, or in some other form. All you need to do today, I suggest, is to get the Cabinet's agreement that, once final decisions have been taken, they should be announced between now and the Budget.

CONCLUSIONS

9. I think you might try to record agreement as follows:

(1) That Child Benefit should be uprated by /£1/, /50p/ in November 1980, with a premium of /£1/ for fourth and subsequent children.

(2) That Supplementary Benefit child allowance should be increased by /£1/ per week.

(3) That no decisions should be taken at this stage about the figures to be published for the United Kingdom contribution to the EEC Budget.

(4) That the possible implications of the 1980-81 cash limits for volume of public expenditure should be noted, without any final decisions this week.

(5) Either that the Secretary of State for the Environment should be asked to find further savings on his programmes in lieu of the suggested 1 per cent cut on manpower, and to agree them with the Chancellor;

or that the Chancellor, in consultation with the Secretary of State for the Environment and others concerned, should examine further the 1 per cent reduction and agree on how it should be applied and enforced.

(6) In addition /possibly/ that the Secretary of State for the Environment should agree with the Chancellor of the Exchequer further identifiable potential reductions (of £X million, to be specified if possible) in the housing programme, to be considered by Cabinet next week.

(7) That no further general squeeze other than that implied by cash limits, should be imposed on central government expenditure.

(8) That the Chancellor and the Secretary of State for Defence should continue their discussions of the Defence budget.

(9) That the Education programmes should be reduced as shown in Annex A to C(80) 3, and that the Secretary of State for Education should agree with the Chancellor on the scope for further savings.

(10) That the new Special Employment Measures proposed by the Secretary of State for Employment in C(80) 5 be turned down. /Or alternatively, remitted to the Chancellor and the Secretary of State for Employment for further bilateral discussion./

(11) That the remaining cuts noted in Annex A should be approved.

(12) To invite the Chancellor to pursue with the Ministers concerned any further potential savings identified in discussion.

RTA

(Robert Armstrong)

I am sorry that this brief is so long; but the discussion is liable to range widely over some difficult issues.

23rd January, 1980

SECRET

13

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

23 January 1980

Nick Sanders Esq
Private Secretary
10 Downing Street
LONDON
SW1

Dear Nick,

PUBLIC EXPENDITURE: SOCIAL SECURITY

I enclose some examples of how the proposals currently before Cabinet would affect benefits to typical families. My Secretary of State will be able to answer questions on the wider front of how various changes would affect public expenditure. If there are points on which you would like further briefing before the meeting arranged at 5.45 pm, please let me know.

Yours sincerely

D

D Brereton
Private Secretary

ENC.

SECRET

endo to DHSS
to NSS of 23/1

EFFECT OF AGREED SOCIAL SECURITY CHANGES, ON AVERAGE EARNERS

1. The two key changes are:

(i) put up sickness, invalidity, unemployment benefit 10% less than prices in November 1980.

(ii) abolish the Earnings Related Supplement (ERS) to unemployment and sickness benefits in January 1981.

2. Examples

A. Single man with average ERS of £11 to unemployment or sickness benefit.

(a) Now receives	£29.50
(b) With 15% uprating would in November get	£32.30
(c) With only 5% uprating will get	£30.45
(d) From January '81 with abolition of ERS gets	£19.45

B. Married couple, with average ERS of £11 to unemployment or sickness benefit.

(a) Now receives	£40.95
(b) With 15% uprating would get in November	£45.45
(c) With only 5% uprating will get	£42.45
(d) From January 1981 with abolition of ERS will get	£31.45

C. Married couple with two children, with average ERS £11 to unemployment or sickness benefit.

(a) Now receives	£52.35
(b) With 15% uprating and £2 child benefit increases would get in November	£57.35
(c) With only 5% uprating and £2 child benefit increase will get	£54.35
(d) From January 1981 with abolition of ERS will get	£43.35

Notes: 1. ERS lasts for a maximum of 6 months.
2. A person getting ERS when abolition occurred would continue to get it for that spell of sickness or unemployment, so he wouldn't have a cash cut.
3. Assumed throughout no entitlement to supp ben.

D. Married couple with two children, on long-term Invalidity Benefit

(a)	Now receives	£62.60
(b)	With 15% uprating would get in November (with £2 CB increase)	£70.75
(c)	With only 5% uprating will get (with £2 CB increase.	£66.70
(d)	From January 1981 will continue to get (ERS not having been in payment)	£66.70

SOCIAL SECURITY PROGRAMME 1980-81

	£m. at 1979 survey figures
Retirement pensions	9,058
Invalidity benefits	1,068
Old persons' pensions and war pensions	403
Supplementary pensions	768
Widows' pensions and industrial death benefits etc.	521
Supplementary allowances	1,685
Sickness and injury benefits and maternity allowances	867
Unemployment benefits	887
Child benefits	2,392
Family income supplements	32
Administration and miscellaneous services	727
+ balance to make TOTAL	19,289

CONFIDENTIAL

Minister of State

Civil Service Department
Whitehall London SW1A 2AZ
Telephone 01-273 3000

23 January 1980

The Rt Hon Peter Walker, MBE, MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
LONDON SW1A 2HH

P 23/1

Dear Peter

AGRICULTURAL EXPENDITURE 1981-82 to 1983-84

I have seen the exchange of correspondence between John Biffen and yourself on 9 and 14 January. I should like to make three comments.

First, I note that you are able to release the staff needed (which, I understand, is some 30-35) for your survey of marginal land by making wider use of urgent work authority under the existing Capital Grants Schemes. I am disappointed that you did not feel it possible to offer this saving as part of the recently conducted manpower cuts exercise, but given that Cabinet has now decided what your first target for firm savings should be, I am glad that you have found this way of providing the staff for your proposed survey of marginal land. I agree that use of the urgent work authority is preferable to abolition of the prior approval condition which is an integral part of the Rayner savings, to which I refer below.

Secondly, I note that the rate of applications under the existing Capital Grants Scheme is falling, and will continue to do so. I think it would be helpful if our officials could discuss the effect of this on your department's staffing requirements in the next Public Expenditure Survey.

Lastly, I should like to draw attention to the relationship between your proposals for savings in Capital Grants expenditure and the recommendations of your and Sir Derek Rayner's project on Capital Grants to farmers. I hope very much that the outcome of your current discussions with John Biffen will not damage the implementation of the administrative simplifications proposed in that report. These form the main source of the manpower savings to which you have agreed. Also, they stand in their own right as an important contribution to our attack on inefficiency and waste. No doubt you will be discussing the detail of the implementation of the Rayner project with Sir Derek when you send him the draft action plan on it.

I am copying this letter to the recipients of the earlier correspondence.

Yours Paul

PAUL CHANNON

CONFIDENTIAL

SECRET

12

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

22 January 1980

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1.

Dear Geoffrey.

In para. 8 of C(80)3 you refer to a proposal from Michael Heseltine that, as an alternative to reductions in the housing programme on top of those so far agreed, local authorities in England and Wales should be asked to make additional savings in current expenditure rising to £360m by 1983-84. Since half the current expenditure of local authorities goes on education, the effects on schools and colleges would be direct and severe. The proposal has not been discussed with me at any stage, and I cannot accept it.

The tables in C(80)7 show clearly the impact on education in particular of the decisions on local authority spending which we took last summer and autumn. Compared with 1978-79, they mean a cut of 8½ per cent in educational expenditure by 1983-84 (5½ per cent for all services) and of 12½ per cent in educational manpower (7½ per cent for all services), reductions which go well beyond anything you have asked us to contemplate in expenditure and manpower under the Government's own control. Teacher numbers are due to fall in line with pupil numbers and there will therefore be virtually no change over the period in the pupil teacher ratio. With the diseconomies of scale from falling rolls which John Biffen and Nigel Lawson acknowledged in October (though we disagreed about their extent), the cuts we have already approved make it very difficult for me to claim that we can maintain and improve the quality of education, as we promised in the Queen's Speech. Any further reductions of the kind suggested by Michael Heseltine would require us to abandon that promise.

We have already made cuts (including those which I have agreed with John Biffen in the present round) in the inherited plans for education of almost £3 billion over the 4 years 1980-84. As a result my programme as a whole for 1983-84 is nearly one tenth smaller than in 1978-79 when it was no greater than in 1973-74. This will mean cuts in provision for under 5's; big increases in charges for school meals and transport; the closure of 750,000 school places, including several hundred complete schools; hardly any growth in resources for home students in further or higher

/education

education, even though the relevant age-groups are rising and, as Finniston showed, we badly need more skilled manpower; a cut in the real value of students' grants; and a halving in the scope of the assisted places scheme. I can only defend these decisions on the basis that they enable us to protect standards in primary and secondary schools and thus fulfil our commitments.

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

Yours ever

Mark

MARK CARLISLE

Econ Pol

10

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

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

22 January 1980

R
23/1

Dear Mark,

PUBLIC EXPENDITURE 1981-82 to 1983-84: EDUCATION

Thank you for your letter of 16 January about the savings to be made on the education programme in the financial years 1981-82 to 1983-84. I, too, accepted the composition of the savings proposed by our officials.

With reference to your provisos, I agree first, that you may make adjustments between your programmes if that seems desirable in the light of more detailed consideration. No doubt your officials will keep in touch with mine about that.

On your second point, Patrick Jenkin is intending to make a saving of 10 per cent at the next uprating of unemployment, sickness, and invalidity benefits which, though relating to a different twelve-month period, is marginally higher than the saving which we envisage on student grants.

As to your last point, I shall be ready to consider your proposals on student grants for the next academic year in the light of both the public expenditure provision and the triennial review of the grants which, I understand, is now in progress. I doubt therefore if we need consider the shortfall on the 1979 uprating as a separate issue.

The paper to Cabinet for 24 January will include the further cuts on education on which we have agreed. I should mention however that the separate discussions with other Ministers have revealed a widespread belief that it should be possible to make larger savings from the education programme and, in particular, from the central area of primary and secondary schools. I think this is a matter which Cabinet should consider, and it is therefore referred to in the paper.

I am sending copies of this letter to all members of Cabinet and to Norman Fowler and Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

22 JAN 1980

Prime Minister

Econ Pol. 2

Mr Jenkin will be circulating a paper on the child benefit point.

~~Mr Whitmore~~

Mr Duguid

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

PRIME MINISTER

REVIEW OF PUBLIC EXPENDITURE

When the Cabinet discussed public expenditure on 13th December, the Chief Secretary and I were asked to agree further reductions with the Ministers concerned, and to report back to Cabinet by the end of January. It was also suggested that some of the issues might usefully be taken forward in a small group of Ministers.

2. We are about to circulate to Cabinet our report on the discussions which have taken place, for consideration on 24th January. We have achieved a substantial degree of agreement with colleagues on the reductions to be made. In this we have had valuable assistance from Willie Whitelaw, Keith Joseph and Jim Prior in discussing the difficult issues on social security and on housing.

3. The reductions so far achieved are not sufficient and some further possibilities are still being explored: we shall ask the Cabinet simply to note these on Thursday and shall hope to report again with the aim of completing the decisions on 31st January. But there is one substantial point on the social security programme on which we have got as far as we can in the ad hoc group of Ministers, and have not been able to reach agreement. It concerns the amount of the uprating

of child benefit this autumn and its consequences for the uprating of supplementary benefit children's rates. Substantial sums are at stake here, of the order of £100 million in 1980-81 and £200 million a year thereafter. Apart from seeking endorsement of the measures so far agreed with the Ministers concerned, this is the only substantial issue which we expect to have to ask Cabinet to decide on 24th January.

4. I am copying this minute to Willie Whitelaw, Keith Joseph, Jim Prior and Patrick Jenkin, and to Sir Robert Armstrong.

(G.H.)

21 January 1980

21 JAN 1960

Prime Minister

To note – especially implications for the budget.

TL

Original Energy Jan 80 re North Sea Oil Prices.

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

PRIME MINISTER

NORTH SEA OIL OUTPUT

The Department of Energy's latest estimates of North Sea oil show output rising somewhat more slowly over the next few years than the estimates made last autumn. Estimation of the oil flow is, inevitably, highly uncertain but, while the precise figures are debatable, there are quite strong reasons for revising down the earlier ones. There have been technical difficulties in bringing some of the newer fields into production, revised production profiles from the companies operating at Forties and Dunlin and the recently announced restriction on flaring.

2. The two estimates are compared in the table below:-

Total North Sea Oil Production* (m tonnes)

	1979	1980	1981	1982	1983	1984	1985
December 1979 Forecast	77	86	101	110	117	126	127
September 1979 Forecast	77	95	110	122	130	131	128

(* including Natural Gas Liquids)

Over the years to 1983 the reduction amounts to about 40m tonnes.

3. We are, of course, already considering the case for slowing down the oil flow in these years in order to spread the benefits

further into the future. These new output estimates show that the peak is a little further away than we thought. But there still is a peak and we shall need to consider the implications of it when we resume our discussion of depletion policy.

4. More immediately, however, the lower production forecasts would have important implications for the trade deficit and the tax flow from North Sea operations. In themselves they imply an addition of around £900 million to the visible trade deficit in 1980 (though, because of reduced earnings by foreign operators, the adverse effect on the current account will be somewhat less). Their effect on tax revenues from North Sea operations is likely to build up fairly slowly, but to reach very substantial amounts by 1983-84. In that year it could offset the addition to revenues expected to arise from the increase in the oil price since the autumn. In 1980-81 the reduction in North Sea tax revenues attributable to the lower output forecasts could be of the order of £200m and in 1981-82 £500m. The net effect on the PSBR would differ from this because of changes in other tax flows, and account would also need to be taken of the effects of the higher oil prices. These ramifications will be examined in the economic forecasts now being prepared; but if the new forecasts were fulfilled these reductions in the projected oil flow would in themselves add to the serious budgetary problems we face in 1980-81 and 1981-82.

5. Since these revisions are relevant to the discussion of public expenditure at Cabinet on January 24th, I am circulating this minute to all our Cabinet colleagues. David Howell rightly emphasizes that all the figures I have quoted are inevitably imprecise; and should ideally be expressed in ranges rather than in single figures. But he agrees with me about the importance of alerting colleagues to the main point.

G.H.

(G.H.)

January 1980

213

COVERING SECRET.

Econ Pol

MOD BA

Subject. cc Master Set
~~Econ Pol. Pt 7 Pub Expend.~~
Defence May 79 Budget
Econ Pol: Pt 3 Domestic Monetary Policy

~~10 DOWNING~~ STREET

From the Private Secretary

17 January, 1980.

As you know, the Chancellor called on the Prime Minister this morning. He first reported on the public expenditure bilaterals. He was still a long way short of reaching agreement on savings which would total £1,000 million in 1980/81. It would be necessary to obtain additional savings on the housing programme over and above what the Secretary of State for the Environment seemed willing to offer; he would probably have to press for the limitation of child benefit uprating to 50p - even though this would be difficult because of the associated need to limit the uprating of the child supplement on supplementary benefit; it would probably be necessary to look for further savings from the education programme, the aid programme, and also from defence. In the latter connection, the Secretary of State for Defence had written to the Chief Secretary saying that further savings were impossible, and he (the Chancellor) was intending to reply to the effect that defence could not be immune from the latest public expenditure exercise. However, he wanted to have the Prime Minister's view on whether he should proceed in this way.

The Prime Minister said that it would be right to look for savings on the defence programme, but procedurally it would be better if the Chancellor were to see Mr. Pym - rather than write to him. She also suggested that the Home Secretary might be invited to the meeting. As regards the possible scope for savings, the Prime Minister drew the Chancellor's attention to a letter from the editor of Jane's Fighting Ships (copy enclosed). She also referred the Chancellor to briefing which Sir Derek Rayner had provided her with before her recent visit to the Ministry of Defence. (I enclose a copy of the brief; but I should emphasise that this was prepared for the personal use of the Prime Minister, and the fact that you have a copy should not be revealed to the Ministry of Defence.)

Filed on Defence May 79 Defence Budget.

The Chancellor also reported briefly on the monetary situation. He was proposing to authorise the issue of a new tap stock the following day, in order to provide further funding

/ in

in February - which would be the last banking month before the Budget. He was also considering with the Governor the possibility of issuing some kind of indexed stock: there was a case for considering this because of the heavy burden which the current high cost of borrowing would impose on future generations. The Prime Minister took note.

T.L.

A.J. Wiggins, Esq.,
HM Treasury.

Reductions agreed	£m 1979 Survey prices 80-81	81-82	82-83	83-84	Comments
DHSS - Social security	110	505	415	415	Abolish ERS from 1.4.81 + de-index sickness, unemployment and invali dity benefits.
DHSS - Health	30	120	125	80	Incr. prescription charg to £1, + reduce exemp- tions to 50% except for the poorest.
DOE - Housing	150	250	250	300	Method not determined.
DES - Education	16	42	55	64	Mainly student grants; also charges for under- fives + other items.
D/Employment	35	30	30	30	Mainly MSC.
M/Transport	-	35	40	40	Mainly local authoritie
FCO - Overseas aid	-	19	28	28	
Home Office	-	16	24	28	Mainly fire service.
Energy) Lord Chancellor) FCO - other)	24	18	11	9	Probable - some lette not yet received.
Export credit + home shipbuilding	8	39	84	126	Change in fixed-rate lending scheme
Consequentials - Scotland, Wales, N. Ireland	43	107	109	112	
Total agreed	416	1181	1171	1232	
Reductions not yet agreed					
DHSS - Social security					
child benefit	85	210	215	225	Uprate by 50p instead of £1, plus large family premium
supplementary benefit in respect of children	10	25	25	25	Similar de-indexing to preserve in work/out of work gap.
DOE - Housing	150	250	250	300)	To be discussed 17 January evening
- Other (incl. PSA)	-	40	50	50)	
Consequentials - Scotland, Wales, N. Ireland	32	65	67	78	
Total not yet agreed	277	590	607	678	
Reductions for consideration					
Defence	340	285	245	200	1-year moratorium on NATO commitment.
Total if all above agreed	-1033	-2056	-2023	-2110	
Increase due to revised economic assumptions	+100	+450	+300	+200	Approximate - mostly social security

Subject on: Defence: The Defence Budget: May 79

Econ Pol
Pub Expend

PRIME MINISTER

MEETING WITH THE CHANCELLOR

I am told that the Chancellor will wish to discuss the following:-

(i) The monetary situation

Money supply figures for December are to be published tomorrow. We were told last week that sterling M3 grew by 0.4 per cent largely because of a big reduction in lending to the private sector. The CGBR remained high. After the heavy gilt sales last week, the Bank are in something of a dilemma. They want to continue the funding programme in order to get M3 firmly within the target range; but the recent heavy sales have put severe pressure on the reserve asset position of the banks - and this is tending to push short-term interest rates up. The Chancellor will, I believe, want to discuss his plans for funding. You might like to ask him about the prospects for getting interest rates down. The latest building society figures suggest that, if interest rates do not fall soon, the rate of mortgage lending will have to fall significantly.

(ii) Public expenditure

The Chancellor will want to report on his bilaterals - in particular, his meeting with Mr. Heseltine today; he may also be able to say how close he is to reaching the £1,000 million target. There is, in addition, the problem of defence expenditure. Mr. Pym's letter in this folder indicates that he is not willing to provide any further savings. Our view is that it would be pointless for Mr. Biffen or the Chancellor to reply to this letter in writing; if the Chancellor is to get anything - he should not give up trying - he should have a meeting with Mr. Pym. (One argument for seeking at least some savings from defence is that we have let defence off lightly on cash limits: we agreed that they should be negotiated with the Treasury in the

/light of

light of further indications of the likely level of defence pay. On the other hand, as I need hardly remind you, Mr. Pym was most reluctant to agree even the compromise formula which was arrived at in November: this was that defence expenditure over the coming years should grow at 3 per cent per annum in cost terms subject to further provision from the contingency reserve for Polaris replacement).

?2

16 January 1980

SECRET

8. Econ Pol.

15

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

R 16/1

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Parliament Street
London SW1

16 January 1980

Dear John,

I understand that after our meeting yesterday our officials discussed the composition of the savings we agreed should be made in the financial years 1981/82 to 1983/84. I am happy to endorse the savings on the scale agreed between our officials in the four areas concerned, subject to two provisos. Firstly, I should have freedom to make adjustments between the programmes in the light of more detailed consideration. Secondly, the reduction in the real value of student grants would only be politically acceptable in the context of similar decisions on short-term security benefits announced at the same time, and should not prejudice the case for making good in 1980 the amount by which the uprating of grants fell short of the RPI in 1979.

Copies of this letter go to each member of the Cabinet, Norman Fowler and to Sir Robert Armstrong.

Yours ever

Mark

MARK CARLISLE

SECRET

16 JAN 1960

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

14 January 1980

AGRICULTURAL EXPENDITURE 1981-82 TO 1983-84

Thank you for your letter of 9 January. I was surprised that you should have been disappointed by my proposals to cut public expenditure in the agricultural sector. They are designed to bring about the full saving agreed by Cabinet while still maintaining some semblance of the agricultural policy in our Manifesto. The much larger cuts that you propose would admittedly save more - much more than Cabinet decided: but at the expense of further damage to our agricultural production and still more to the credibility of our agricultural policies. I therefore accept your invitation to meet next week to discuss the issues outstanding between us.

Meanwhile it may be helpful to comment on the points you make.

Capital Grants This is, as you say, the major issue to be resolved. I do not agree at all with your interpretation of the Cabinet decision. Cabinet decided to reduce planned expenditure on the capital grants schemes by £35-40m. It said nothing about the means by which this was to be done, except that they were to be selective.

Your proposal would mean that expenditure would fall, not by £35-40m, but by £45-50m. In this year's public expenditure exercise, reductions in requirements have previously been treated as the savings they are, both for my own and for other Departments. Contrary to what you say, there is no real doubt that the rate of application under the capital grants schemes will fall. The trend is already clear: the number of grant applications under the Farm and Horticulture Development Scheme in January - November 1979 was lower by over a third than in 1978; and in November itself was less than half that of November 1978. The clear prospect of a further decline in real farm income - already lower than in the worst year of the Labour Government - in 1980 and 1981 makes it certain that new investment will fall away. This, combined with the time lag between investment decisions and grant expenditure, means that we can be sure of a resulting saving on capital grants in 1983-84, and it would be quite wrong to ignore it.

/The pattern of grant rates ...

The pattern of grant rates which you propose, with reductions in 20 rates of grant out of 27, seems designed to depress investment yet further in every sector and on every class of farm. By doing so it would help to depress one of the very few sectors of our economy which is capable of contributing to economic growth in the immediate future. And it would wholly contradict our policy of giving British agriculture the means to compete on more equal terms with its Community competitors. I must therefore ask you to think again about this before we meet.

Aid for Marketing I shall be making policy proposals shortly. They will however be general in character, since my intention is to provide for possible aid to projects which will in time be suggested by the five marketing advisers who have volunteered their time and expertise to help me. I believe that small sums here could reap major dividends (as expenditure on marketing has done for our European competitors). I hope you will agree when we meet that the relatively small sums needed should be set aside, within the total agricultural programme, for expenditure in the marketing area.

Agricultural Research I note what you say and will discuss it with my agricultural colleagues before we meet. You are proposing that I should make much larger cuts than you have sought from Mark Carlisle, who shares with me responsibility for funding the Agricultural Research Council; and larger cuts here would damage the competitiveness of British agriculture in the years to come.

Marginal Land I am glad to see that you do not object in principle to a survey of marginal land. The best way to release the necessary staff immediately would, as you say, be to make a wider use of urgent work authority under the existing capital grants schemes. The later abolition of the prior approval condition would then follow when these schemes are replaced in the summer.

As for the need for the survey, the fact is that we are committed to doing better than the last administration, and we certainly cannot claim that the situation of the marginal land farmer has improved since they initiated work on this. But I would in no way commit us to decisions about assistance at this stage. The survey will not be completed until 1981, and I would make it clear that decisions about assistance and how to finance it would have to be taken in the light of the economic and financial circumstances obtaining then. I suspect that by then the savings on capital grants will be so large that it will be easy to finance any necessary help for marginal land within the existing PES programme.

I am sending copies of this letter to the Prime Minister, the other Agriculture Ministers, the Minister of State at the Civil Service Department and Sir Robert Armstrong.

Yours ever

PETER WALKER

CONFIDENTIAL

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

PRIME MINISTER has seen MJS

PRIME MINISTER'S QUESTIONS: PUBLIC EXPENDITURE

Public expenditure will no doubt be raised during your Question time this week and you will be asked about the £2 billion figure for 1980-81 first referred to by Samuel Brittan in an article in the Financial Times the week before last and raised with you by Brian Walden in your "Weekend World" Interview. You said in the interview that you would be "quite pleased" with such a further reduction.

2. The Treasury are providing you with the normal briefing for Questions but I think it is important to stress to the House, as you did in the interview, that £1 billion of the £2 billion figure is what we pay over to the EEC, and that the outcome of the EEC negotiations will be determined by a separate timetable from the rest of the public expenditure operation. Otherwise there is a danger that expectations will grow of a further "package" amounting to £2 billion in 1980-81 and that there will be corresponding disappointment when, as is inevitable if the EEC discussions have not been completed, the outcome of our current public expenditure operation is substantially less than that for 1980-81. As you know, the target of further cuts which I proposed to the Cabinet for 1980-81 was £1 billion and part of this may come from a squeeze on expenditure through the cash limits which is unlikely to be apparent this side of the Budget.

(G.H.)

January, 1980

CONFIDENTIAL

CONFIDENTIAL

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1. Mr Whitmore
2. Prime Minister

Original on Defence May 79
The Defence Budget.

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

14/1

Econ Pol: Public expend.

CONFIDENTIAL

MO 8/2/12

11thJanuary 1980

Prime Minister.

I mentioned this to you this morning.

Treasury officials have drafted a tough reply, but I have suggested to the Chancellor - and he has agreed - that you and he should discuss this when you meet on Thursday morning and that in the meantime no answer should be sent.

AHW 15/1

Dear John,

PUBLIC EXPENDITURE

In the light of the Prime Minister's minute of 14th December I have considered very carefully whether I can offer any further reductions in the defence budget.

I have to tell you that I cannot. The economic objectives towards which the Government is working have always had my complete support, and I fully accept that no programme can claim privileged exemption from the present search for further savings. But the figures to which I am now working are, as you know, very substantially below the bids I considered necessary. The cash limit is really hurting this year - despite the help I was given earlier. For next year I am faced with one which will be very tight and which seems only too likely to exert a further squeeze even on the reduced volume figure I had to accept last autumn. You are already aware of the difficulties of financing the defence programme in the following years. I am striving to eliminate waste. But all the savings I make will be needed to improve the effectiveness of the forces.

/ Indeed ...

The Rt Hon John Biffen MP

CONFIDENTIAL

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Indeed, I have had to consider, given particularly the recent changes in the world scene, whether to ask for an increase in my planned budget. I have concluded that in the light of the current economic situation it would be wrong for me to do that. But I believe that what we should be considering is whether the Government is doing enough for defence rather than whether we should spend less. I believe that to renege on the 3% increase for 1980/81 or to show a lower rate of increase than we have already agreed upon for the later years would perplex our Allies and supporters, as well as affect the morale of the Armed Forces, in a way which could be seriously damaging to the Government's standing both at home and internationally. The credibility of our commitment to defence is something which we must not put at risk.

I am sending copies of this letter to the Prime Minister, the Chancellor, and Sir Robert Armstrong.

Yours ever

Francis

Francis Pym

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Minister of State
Ministry of Agriculture
Fisheries and Food
Whitehall Place
LONDON SW1A 2HH

Rvh

9 January 1980

Dear Peter,

AGRICULTURAL EXPENDITURE 1981-82 to 1983-84

Thank you for your letter of 20 December (attached) which you amplified in your letter of 3 January (attached) about capital grants. I am also replying to your letter of 20 December to Nigel Lawson which seeks to link the announcement of changes in capital grants to a survey of marginal land.

As I think you already know, I was very disappointed by your general response to my letter of 17 December which made a number of substantial concessions to you and, I had hoped, outlined a reasonable compromise on the basis of which officials could reach agreement on details. I will not now go back on my offer to withdraw the proposed savings on less favoured areas and sheep and potato guarantees and to move a long way towards your position on Agricultural Research without seeking additional alternative savings elsewhere in your programme. But I am not prepared to consider further concessions at a time when Departments generally are being asked to make new savings in addition to what has been agreed in the earlier stages of the survey.

Against this background I have the following views on the detailed matters you have raised.

Aid for Marketing. I note that you will be making policy proposals shortly. These will require careful consideration and I cannot promise that decisions can be reached in time for the expenditure consequences to be considered in this year's survey which is now about to be completed.

Agricultural Research. I have moved a long way to try to reach a compromise on this issue. If you consider that the £2.5m which separates us is of major importance from the point of view of research policy I will not insist that you make this saving here. But I must insist that you make up this loss elsewhere in your programme, possibly by making a marginally different change in capital grants.

<u>Marginal Land</u>. I note that the survey you are proposing would not be completed until 1981 and that you are not seeking authority to introduce a scheme but only to relax the rules applying to capital grants, to release staff to carry out the work. I understand that in discussion between officials it has been suggested that the immediate staff saving could be achieved by a wider use of urgent work authority which would allow the final removal of the prior approval rule to take place in the context of the other changes proposed by Sir Derek Rayner and after farmers have had a chance to familiarise themselves with the other changes in the capital grants schemes. At first sight this seems to me a more satisfactory way of proceeding but I should be interested in your views and those of the Civil Service Department.

A prior question, however, is whether a survey is needed at all. I can, of course, understand that there is a sense of grievance among farmers who are on the wrong side of the hill line. This grievance may well have been intensified by the special increase in hill allowances which we made this year and may, therefore, decline if, as we envisage, the allowances revert to this previous level. But I am not aware of any commitment to introduce a scheme to meet this grievance, and would need to be convinced that the expenditure involved would be worthwhile. Also, of course, it goes without saying that if a scheme was to be introduced the cost would have to be met from within the agricultural programme.

<u>Capital Grants</u>. This is, of course, the major issue to be resolved. I made clear in my letter of 17 December that I should expect the measures to be introduced to achieve the target saving of £35-£40m in 1983-84 to cover the whole of that saving. I am strongly opposed to regarding predictions that, even without any action on our part, expenditure in that year will be below the baseline on which we have been working as a partial substitute for policy changes. There are three main reasons why I hold this view. Firstly, I am sure that when we discussed the issue in Cabinet we were thinking of the policy changes which would be needed to achieve the savings I originally proposed. No account was taken of savings which might arise spontaneously. Secondly, it seems to me entirely reasonable that if spontaneous savings can be firmly predicted they should count towards the further package of savings which we have now agreed to be necessary rather than used as partial substitutes for policy changes and to finance new expenditure. Thirdly, on a purely practical level, I see great difficulty in relying on a forecast made now about farmers' investment intentions in 1983-84. If, therefore, you cannot agree to surrendering the estimating savings now in addition to making policy changes of the order envisaged in Cabinet, I should prefer to reduce the baseline only by the amount which can be confidently predicted to result from the policy changes. Estimating savings can then be taken account of in successive surveys when we are surer of them.

Apart from the fact that the policy change you are proposing will not yield the full saving agreed in Cabinet, I am somewhat concerned about its effect on the schemes themselves. I recognise that the new limits on the quantity of assistance going to individual farms are a means of securing the extra selectivity which we agreed to be desirable. But they increase the bureaucratic complexity of the schemes and thus run directly counter to the recommendations of Sir Derek Rayner. And arbitrary differences between the effective rate of grant applicable to large and to small projects increases the distortion to farmers investment planning thus reducing what value to the nation the schemes provide. We may, of course, have to suffer these disadvantages if the Commission proposals on which they are modelled are accepted in Brussels but I am somewhat reluctant to anticipate them.

I understand that without commitment my officials tabled an alternative schedule of grant rates and that yours are carrying out detailed costings of it. This schedule involves a greater degree of selectivity than Sir Derek Rayner's proposals, but avoids the complexity of new investment aid limits. If in the light of the detailed costings or of the need to make additional savings, for example to cover the deficit on research, further cuts were needed this could be achieved by excluding certain items from grants.

Naturally, however, my main concern remains that whatever policy changes are made should achieve the full savings target. I hope that, in the light of this letter, you will be able to accept this in which case the details can perhaps be agreed between officials. If, however, you still have reservations then we should meet quickly in order to discuss them so that the Chancellor can report the outcome to the Prime Minister as envisaged in the conclusions of Cabinet on 6 December, before the final Cabinet discussion on this year's survey on 24 January.

I am sending copies of this letter to the Prime Minister, the other Agriculture Ministers, the Minister of State at the Civil Service Department and Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

ANNEX

CURRENT AND PROPOSED RATES OF CAPITAL GRANT (% OF APPROVED COST)

Item of Investment	Current Rate	MAFF Proposed Rate	30% Cut	Treasury Compromise to be Costed	Rayner
1. Buildings					
a) Basic Rates					
i) Dairy & Cattle	30	25	21	20	20
ii) Horticulture	25	25	17.5	20	20
iii) Other	20	25	14	20	20
In Less Favoured Areas (LFAs)					
iv) Dairy etc	30	30	21	25	25
v) Other	20	30	14	25	25
b) EEC Rates					
i) Dairy & Cattle	40	35	28	30	30
ii) Horticulture	30	35	21	30	30
iii) Other	25	35	17.5	30	30
In LFAs					
iv) Dairy etc	40	40	28	35	35
v) Other	30	40	21	35	35
2. Land Improvements, fencing etc					
a) Basic Rates					
i) Lowland Farms	20	25	14	20	20
ii) Horticulture	25	25	17.5	20	20
iii) LFAs	50	50	35	35	30
b) EEC Rates					
i) Lowland farms	25	35	17.5	30	30
ii) Horticulture	30	35	21	30	30
iii) LFAs	50	50	35	40	35

CURRENT AND PROPOSED RATES OF CAPITAL GRANT (% OF APPROVED COST)   cont'd

Item of Investment	Current Rate	MAFF Proposed Rate	30% Cut	Compromise to be Costed	Rayner
3. Field Drainage					
a) Basic Rates					
i) Lowland	50	40	35	40	20
ii) LFAs	70	70	49	60	25
b) EEC Rates					
i) Lowland	60	45	42	45	30
ii) LFAs	70	70	49	60	35
4. Other Items					
a) Basic Rates					
i) Dairy & Grassland equipment	20	nil	14	nil	20
ii) Horticultural equipment	15	15	10.5	10	20
b) EEC Rates					
i) Dairy etc equipment lowland	20	10	14	5	25
LFAs	25	15	17.5	10	35
ii) Horticultural equipment	20	20	14	15	20
iii) All Other Items					
Lowland	10	10	7	5	30
LFAs	15	15	10.5	10	35

We shall need more than this. MT

1. ~~Mr Alexander~~ 2

2. Prime Minister

BF (to Robba) ~~16/1/80~~ 18/1/80

FCS/80/9

CHIEF SECRETARY TO THE TREASURY

Public Expenditure: FCO (Non-Aid) Programmes

1. As requested by the Prime Minister in her minute of 14 December 1979 I have carried out an examination of FCO expenditure programmes other than Aid which we are dealing with separately.

2. The reductions imposed on the Diplomatic Service by the first round of cuts and Christopher Soames'manpower exercise lead me to the conclusion that further cuts would result in a reduction of activities to a level I am unwilling to contemplate. When the cuts already agreed take full effect the FCO and our posts abroad will be tautly stretched: further reductions could seriously damage our ability to protect and maintain our interests.

3. I shall shortly be writing to colleagues both to propose ways in which the economies already required of the BBC External Services for 1981/82 to 1983/84 could be effected and also to bring the interdepartmental review of the British Council to an agreed conclusion.

4. There is scope for a small cut in the provision of our subscriptions to international organisations about which Ian Gilmour wrote to Geoffrey Howe on 29 November 1979. For the years 1981/82 to 1983/84 I offer the following savings:

1981/82	1982/83	1983/84
£m	£m	£m
1.5	1.5	.6

If this is agreed I suggest our officials have an early meeting to work out the details.

5. I am sending a copy of this minute to the Prime Minister.

C

(CARRINGTON)

Foreign and Commonwealth Office

8 January 1980

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

C O N F I D E N T I A L

Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

TL 10/1

3 January 1980

Dear John,

CAPITAL GRANTS

I have been considering with our agricultural colleagues how we can best make the savings in expenditure on capital grants agreed by Cabinet on 6 December.

You will recall that we agreed in Cabinet that in achieving the savings greater stress should be placed on increased selectivity rather than on reducing rates of grant. We have concluded that the best way of making reductions selectively is to restrict the total amount of assistance going to individual enterprises. This will concentrate assistance where it is most needed, on the small and medium-sized farm, while effecting considerable savings because of the very large amounts of assistance hitherto available to big enterprises, particularly under the Farm and Horticulture Development Scheme.

We therefore propose that the limit for assistance to development plans under the EEC Farm Modernisation Directive should be 180,000 units of account for any one farm business; and that a comparable limit of 15,000 ua of grant in any 2-year period to any one business should be applied under the Farm Capital Grant Scheme and Horticulture Capital Grant Scheme, taken together. (We would of course have to review these cut-offs from time to time to reflect the decline in the value of money; but unless we automatically indexed them we would always be a bit behind the game, and this would provide an additional, if unquantifiable, saving.)

In order to pave the way for the streamlined scheme recommended by Sir Derek Rayner we propose to iron out the differentials introduced in 1976 in favour of dairy buildings and equipment. But with selectivity in mind we propose to retain the present rates of grant for land improvements and drainage in Less Favoured Areas, to continue to give preferential rates (though less than at present) for lowland drainage and to continue to assist horticultural plant and machinery under the national aids. The present and proposed future rates of grant are set out in the enclosure to this letter.

/We have already experienced .....

We have already experienced a sharp reduction in applications under the Farm and Horticulture Development Scheme during the current year, which will have their effect throughout the PES period. As I said in my letter of 20 December, the savings we can confidently foresee as a result should be counted towards the total decided by Cabinet, just as any forecast increases in demand would have implied the need for additional savings to offset them. If we do not do this, we shall bemaking an actual saving substantially greater than Cabinet decided, and one which I do not think could be defended in the context of our general agricultural policies.

Account also has to be taken of the transition to a Rayner-type streamlined scheme. We do not intend to adopt the Rayner suggestions which would have extended the range of investments eligible for grant, so there will not be an increase in liability on this account; but we might expect a more streamlined scheme to attract a few cases where at present the farmer does not want to go through our cumbersome procedures, and more streamlined treatment of claims may produce a once-only increase in 1980/81. We have made allowances for both these factors.

On these assumptions we would expect departures from the 1979 PES forecasts to be of the following order for the United Kingdom:

Estimated Savings in £m at 1979 Survey Prices

	1980/81	1981/82	1982/83	1983/84
Revised Grant Rates	(+2.3)	(+0.1)	1.4	2.4
Financial Cut off	9.2	16.1	21.5	25.9
Reduction in applications	11.0	11.0	11.0	11.0
Transitional - not more than	(+5)			
Extra volume, (1%)	(+1.6)	(+1.6)	(+1.6)	(+1.6)
Aid to marketing	(+0.5)	(+1.0)	(+1.5)	(+2.0)
Net	10.8	24.4	30.8	35.7

You will note that I have included in these figures provision for new assistance for marketing. As you know, I look upon our marketing performance as a major weakness of British agriculture. I am convinced that a modest scheme of assistance in this field will pay good dividends to the national interest in improving our performance in both the home and export markets. I shall be seeking policy approval of the scheme and legislative cover for the expenditure as soon as practicable.

Finally, I have just heard that the latest FHDS figures indicate a sharp drop in investment. This is likely to produce substantial savings in 1980/81 in addition to the £11m shown in the above table, and we are calculating just what these are likely to be. For the moment, I would only put it to you that this falling-off in investment intentions shows both that the cuts we make should neither be nor appear to be unnecessarily drastic, so as not to damage confidence yet further; and that the likelihood is that we shall in any case make savings greater than the figures in the table suggest, simply as a result of a decline in farmers' own investment plans.

I am sending copies of this letter to George Younger, Nick Edwards and Humphrey Atkins.

PETER WALKER

CURRENT AND PROPOSED RATES OF CAPITAL GRANT (% OF APPROVED COST)

Item of Investment	Current Rate	Proposed Rate
1. Buildings		
a. Basic Rates		
i Dairy and Cattle	30	25
ii Horticulture	25	25
iii Other	20	25
In Less Favoured Areas (LFAs)		
iv Dairy etc	30	30
v Other	20	30
b. EEC Rates		
i Dairy and Cattle	40	35
ii Horticulture	30	35
iii Other	25	35
In LFAs		
iv Dairy etc	40	40
Other	30	40
2. Land Improvements, fencing etc		
a. Basic Rates		
i Lowland farms	20	25
ii Horticulture	25	25
iii LFAs	50	50
b. EEC Rates		
i Lowland farms	25	35
ii Horticulture	30	35
iii LFAs	50	50
3. Field drainage		
a. Basic Rates		
i Lowland	50	40
ii LFAs	70	70
b. EEC Rates		
i Lowland	60	45
ii LFAs	70	70
4. Other items		
a. Basic Rates		
i Dairy and grassland equipment	20	nil
ii Horticultural equipment	15	15
b. EEC Rates		
i Dairy etc equipment lowland	20	10
LFAs	25	15
ii Horticultural equipment	20	20
iii All other items		
Lowland	10	10
LFAs	15	15

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

Nigel Lawson Esq MP
Financial Secretary
Treasury
Parliament Street
London SW1

P
W71

20 December 1979

Dear Nigel.

As you know, our predecessors started a desk survey of marginal land outside the hill areas to try to establish without commitment whether any of it could qualify under the Less Favoured Areas Directive. I have now seen the results and Nicholas Edwards and I agree that in England and to some extent at least in Wales the land will have to be walked. In Scotland the problem is not acute. In Northern Ireland where pressure for extension has been considerable for some time, the survey is complete and DANI are confident that they can meet the EEC criteria for extension; but I am sure that the United Kingdom must act as one on this.

We are committed to doing better than the last administration. The problem is that the marginal areas, especially in England, are not simply extensions of the hill but detached, irregular and scattered. Until we have identified their boundaries by field inspection we cannot assess their economic and agricultural performance or the possible cost of grant aid.

In Wales the difficulty is rather that of being able to demonstrate to the two competitively vocal farming Unions that we are genuinely seeking a solution to the marginal land problem. Whilst our recent decision to provide more help for the designated Less Favoured Areas was absolutely right and was very well received, it has also pointed up the relative paucity of the aid for farmers on similarly poor land just outside the LFA. Their plight has been further emphasised by the Milk Marketing Board's ceasing last summer to collect milk in churns thus forcing an estimated 500 or more Welsh farmers out of dairying. Many of these will have been on marginal land and dairying has been their only way of getting a reasonable living from their few acres.

The ADAS officers who would have to walk the land in England and Wales are hard-pressed as a result of staff shortages and the ban on recruitment. To find the 30 to 50 man-years required it is essential to relieve them of some other function quickly. We

/are therefore ...

are therefore proposing to cut out most of the work at present undertaken on prior approval under the existing capital grant schemes by authorising a start of work at the farmer's risk where this will not prejudice verification at claim stage. If you agree in principle to our anticipating part of the Rayner recommendations in this way our officials will be happy to discuss details with yours. The ADAS time released could then be used for the inspection of marginal areas in 1980 and 1981.

If you agree, I plan to announce the survey of marginal land, the modification of prior approval, and the new rates of capital grant required by Cabinet's decision last week (about which I am writing to you separately) when the House resumes next month. I shall of course clear with you the draft statement, which will make it plain that the survey cannot be completed until 1981, and that decisions about assistance and how it could be financed will need to be taken in the light of the economic and financial circumstances at that time.

I am copying this letter to the Secretaries of State for Scotland, Wales and Northern Ireland.

Peter

PETER WALKER

Econ Pol 7

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

S E C R E T

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

20 December 1979

Dear John,

Rupp

PUBLIC EXPENDITURE 1981-82 TO 1983-84

Thank you for your letter of 17 December, in which you helpfully set out your view of the cuts that should be made in my programme following our talk in September and the Cabinet's decision on capital grants on 6 December. I will comment on each of your points in turn.

Capital Grants

I am writing to you separately with detailed proposals for revising capital grant rates and making selective cuts, in accordance with the Cabinet's decision. I propose to make the greater part of the saving by introducing a limit on the amount of investment on any one farm that can qualify for aid under the EEC scheme, and by applying corresponding limits to the amount of grant payable to any one farm under the national schemes. This means that the bigger farmers will bear the main brunt of the cuts, with the small and medium-sized farmers still being given encouragement to improve their efficiency. My proposals will result in savings within the range of £35-40m decided by Cabinet for 1983-84, and in substantial savings in the intervening years; but the latter may not of course follow precisely the year by year pattern that would be given by an across-the-board cut in grant rates.

I must however take issue with you when you argue that the reductions in take-up of grants that can now be firmly foreseen on the basis of the recent trend in applications, the effect of high interest rates and the certainty of lower real incomes for farmers in the next year or two, when projects qualifying for grant in 1983-84 will be planned or started, should not be counted towards the saving. I am quite sure that if the trend had been the other way and the demand for grants expected to increase, you would have insisted that my proposals for expenditure

/should nonetheless be .....

should nonetheless be kept within the provision agreed by Cabinet. In the same way, I hope you will accept that I should not be asked to reduce expenditure by more than the £35-40m decided by Cabinet. Your interpretation would mean a far bigger cut and one which frankly I could not defend in the context of our declared agricultural policies. My officials will of course give all the details of our estimates to yours; I am sure they will be able to agree on the facts of likely future expenditure.

Less Favoured Areas and Sheep and Potato Guarantees

I am grateful to you for agreeing to withdraw the savings you had originally proposed on these items, pending next autumn's review of rates of aid in less favoured areas, and decisions on EEC regimes for sheep and potatoes.

Research and Advisory Services

I am afraid I still see great difficulty in the extent of the cuts you propose for research and advice. I am fully prepared to match the 3% cut which DES are making in this field. But I do not think it would be right to go further. Virtually all the research in my programme is applied and contributes directly to improving efficiency and productivity, and keeping us up with, or in front of, our foreign competitors. The Agricultural Research Council is moreover financed in roughly equal proportions by DES and my Department. To apply different rates of cut to the two proportions would suggest either that we set a higher value on pure than on applied research, which in this field I am quite sure would be wrong; or that the Secretary of State for Education and Science set a higher value on agricultural research than I did. I hope therefore that you will agree that while I should match the DES cut in full, I should not be asked to exceed it.

Measures Agreed in September

Your letter states correctly, of course, the measures we agreed in September.

Sea Fisheries Protection

I note what you say about sea fisheries protection. My officials are in touch with the Ministry of Defence on the question whether the Defence budget could make a larger contribution to the cost of the vessels which that Department wishes to use for fisheries protection. We shall have to consider the outcome, when we have it, and we may then need to seek the views of our colleagues.

I am sending copies of this letter to the Prime Minister, the Secretaries of State for Defence, Scotland, Wales and Northern Ireland and Sir Robert Armstrong.

Peter

PETER WALKER

CONFIDENTIAL

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000

Direct Dialling 01-233 8633

12

11/1

J M Grant
MAFF
Whitehall Place
London SW1

18 December 1979

Dear John,

MAIN ESTIMATES & CASH LIMITS 1980-81:
PROVISION FOR FUTURE PAY AND PRICE INCREASES

Following Cabinet's discussion on December 13 I am writing to set out in detail the factors which will be used in making provision for future pay and price increases in the 1980-81 Main Estimates and cash limits. Details of the procedure are set out in 'Standing Instructions for the Preparation of Submission of Supply Estimates'.

2. On current expenditure provision will be made for a 14% increase in costs between 1979-80 and 1980-81. This single factor will cover both new pay awards (ie those after the survey base date other than outstanding comparability awards) and price increases. It will be applied as follows. The element for price increases on non-pay current expenditure will be calculated using the values in the attached table. On pay, provision will be made for the staged payment of past awards and for outstanding comparability awards. The element for other pay awards will be calculated as a 14% annual increase in earnings from due settlement dates.

3. The attached table also sets out the values of the price factors to be used on capital expenditure.

4. This information in this letter should be used only in the context of the 1980-81 Main Estimates and cash limits. It should not be communicated outside departments without the specific agreement of the Treasury. The calculations will be undertaken using the Treasury computer.

5. I am copying this letter to those on the attached list.

Yours sincerely,

Steve Robson

S A ROBSON

PM

Econ Pol 6

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Minister of Agriculture
Fisheries and Food
Ministry of Agriculture
Fisheries and Food
Whitehall Place
London SW1A 2HH

17 December 1979

Dear Peter,

17/12

PUBLIC EXPENDITURE 1981-82 - 1983-84

In Cabinet on 6 December we reached broad agreement on the cuts to be made in capital grants and we reached conclusions on a number of other items at our bilateral discussion in September. I am now writing to set out the conclusions of these discussions for your programme as I see them, and to propose figures for the items left unresolved in September and not discussed in Cabinet on 6 December. If these proposals are acceptable to you I will not make proposals for further reductions in your programme in the further review of public expenditure which we are now undertaking, although naturally any further savings you can yourself identify in response to the Prime Minister's minute of 14 December will be welcome.

Capital Grants

Cabinet agreed that the cuts in provision should be £35-£40 million in 1983-84 with consequential cuts in earlier years. You have separately agreed that the cut in rates would be implemented in January 1980. This result could be achieved by a 30% cut in rates, as shown in paragraph 60 of the report by Sir Kenneth Berrill which would make for the following changes across the whole of the PES period.

£m

1980-81	1981-82	1982-83	1983-84
- 13	- 25	- 33	- 39

It was agreed, however, that the change might be made in a more selective way, e.g. by cutting certain items out of grant altogether. In designing a package of measures to achieve these figures I should be prepared to accept that it could have a minor impact on the precise figure to be achieved in each year, provided that this did not affect the general trend across the period. If you have any later and more secure information on changes in demand for grants than was available when the figures in Sir Kenneth Berrill's report were agreed between officials I would wish the savings this would involve to be regarded as additional to these figures, not substitutes for any part of the changes in rates or coverage.

Less Favoured Areas and Sheep and Potato Guarantees

The rates of aid in less favoured areas are to be reviewed in the autumn of 1980 and the ending of the guarantee schemes is conditional on the entry into force of EEC regimes. I am prepared in the meantime to withdraw the savings I proposed on these items in the years 1981-82 - 1983-84 and not to ask you to make good the loss elsewhere in your programme, provided that the other proposals in this letter are acceptable to you.

Research and Advisory Services

I originally proposed the following savings:

1981-82	1982-83	1983-84 £m
- 7	- 10	- 10

In the light of the discussions between officials of the cuts that would be needed here to keep the change on this programme in line with the average of the changes in other programmes I would be prepared to agree to cuts of £4.5m in each year.

Measures Agreed in September

These were set out in your letter of 3 October.

			£m
	1981-82	1982-83	1983-84
End Beef Premium	-2	-2	-2
Consequential MLC Savings	-2	-2	-2
MAFF Salaries	-2	-2	-2
Minor Options	-2	-3	-7

I have not covered in this letter the question of sea fisheries protection. Meanwhile I see no prospect of my being able to increase the offer of £17m across the whole PES period which I have already made. But officials are still discussing the various options within this figure and we shall have to consider their report when it is completed.

2.

Including the increase I have offered on sea fisheries protection the net effect of the changes agreed so far and of the proposals in this letter on your programmes would be:

£m

1981-82	1982-83	1983-84
- 30.5	- 40.5	- 82.5

I am sending copies of this letter to the Prime Minister, the Secretaries of State for Scotland, Wales and Northern Ireland and Sir Robert Armstrong.

John Biffen

JOHN BIFFEN

CONFIDENTIAL

SUBJECT

10 DOWNING STREET

THE PRIME MINISTER

Personal Minute
No. M18/79

MEMBERS OF THE CABINET

We agreed yesterday to make further reductions in the expenditure plans as they now stand. The proposals which the Chancellor of the Exchequer and the Chief Secretary will now put to the Ministers concerned will concentrate first, as was said yesterday, on the large programmes and major decisions from which substantial savings can be obtained.

Smaller programmes too can make some further contribution to the savings we need. Now is the time for a critical re-examination of options that have so far seemed too difficult.

I ask all Ministers, whether or not they receive an immediate specific request from the Chancellor and Chief Secretary, to examine their programmes once again and to let the Chief Secretary know by the end of the second week of January what further savings they can make, toward the objectives on which we have agreed.

I am sending a copy of this minute to Sir Robert Armstrong.

Margaret Thatcher

14 December 1979

CONFIDENTIAL

CONFIDENTIAL

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

14th December 1979

Thro late

TL 14/12

Dear Tim,

PUBLIC EXPENDITURE

..... I enclose a draft minute for the Prime Minister to send to members of the Cabinet.

There is a related matter which the Chancellor has asked me to raise. Following the reports of the Prime Minister's remarks to the 1922 Committee last night and the interpretation put on them, the Chancellor and the Chief Secretary see no advantage, and some disadvantage, in delaying an announcement that the next public expenditure White Paper is not now expected to be published until March. It will be widely inferred that the White Paper cannot be published at the turn of the year as previously envisaged if the Government are having a further look at the plans, and the Chancellor considers that it would be better to tell the House this immediately rather than have it extracted. The Chief Secretary has told the House that they would be informed as soon as a decision on the date of publication is reached. Unless we have already announced the deferment, it is likely that the question would be pressed at Prime Minister's Question Time on Tuesday.

Unless the Prime Minister sees objection, therefore, the Chancellor would propose to have an inspired question put down today for answer on Monday.

Yours ever,
Martin

M.A. HALL
Private Secretary

T P Lankester Esq.

Please type for PM's signature

DRAFT MINUTE FROM THE PRIME MINISTER

MEMBERS OF THE CABINET

PUBLIC EXPENDITURE

We agreed yesterday to make further reductions in the expenditure plans as they now stand. The proposals which the Chancellor of the Exchequer and the Chief Secretary will now put to the Ministers concerned will concentrate, as was said yesterday, on the large programmes and major decisions from which substantial savings can be obtained.

2. Some Ministers concerned with smaller programmes said yesterday that they too could make some further contribution to the savings we need. Now is the time for a critical re-examination of options that have so far seemed too difficult.

3. I ask all Ministers, whether or not they receive a specific request from the Chancellor and Chief Secretary, to examine their programmes once again in a constructive spirit and to let the Chief Secretary know by the end of the second week of January of any further savings they can make, however small their programmes, toward the objectives on which we have agreed.

4. I am sending a copy of this minute to Sir Robert Armstrong.

153/12

1. SIR ANTHONY RAWLINSON
2. CHANCELLOR OF THE EXCHEQUER

cc COGPEC
GECS

Copies attached for:-

Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Mr. Ridley
Mr. Cardona

R. X
13/2

FURTHER REDUCTIONS IN PUBLIC EXPENDITURE: PROCEDURE

This is a brief for your discussion with the Prime Minister Thursday ~~tomorrow~~. It is about the procedure for negotiating further specific reductions in expenditure, on the assumption that Cabinet agree to your proposal on Thursday to seek reductions of the order of £1 billion in 1980-81 and £2 billion in the later years. A separate note from Mr. Bailey sets out the specific reductions in a draft minute to the Prime Minister.

Timetable

2. It is envisaged that the next steps are:-

(i) At Cabinet you would be given a remit to discuss and agree with the Ministers concerned proposals to reduce expenditure in 1980-81 and the subsequent years.

(ii) There would be an inspired Parliamentary Question about the expected date of the next White Paper to be answered next Monday: the answer would say that the Government are continuing to give consideration to some of the policy issues raised by the expenditure plans and that the White Paper is now expected to be published in March.

(iii) Following the Cabinet, Treasury Ministers would send to each of the spending Ministers concerned a letter setting out specific proposals.

(iv) Discussion should be undertaken about the proposals at Ministerial or official level, depending on the importance of the issues raised, during the first half of January;

(v) A report should be made to Cabinet, if possible for discussion on 24 January and not later than 31 January: the timetable cannot be allowed to slip beyond this date because some of the reductions will affect the 1980-81 Estimates which need to be published during February and March, and because of the timetable for the White Paper.

(vi) The White Paper would be published in March slightly ahead of the Budget: the reasons why we recommend that the White Paper should be published before the Budget will be explained in a separate submission being prepared by the Central Unit.

Discussions with spending Ministers

3. Should the discussions of specific reductions be undertaken in a small group or bilaterally between Treasury Ministers and the spending Ministers?

4. Whichever course or combination of courses is chosen, it is highly desirable that the Prime Minister should indicate on Thursday her wish that the discussions should be conclusive and not lead to further and repetitive discussion in full Cabinet.

5. The intention is to proceed selectively pursuing matters only where the amounts involved are significant.

6. Even within this category, except where the amounts are large or the policy issues very controversial, the natural and adequate way to proceed is bilaterally.

7. For defence you have already minuted the Prime Minister proposing separate discussions with Mr. Pym, in which she would be involved. It remains our recommendation that this is the best way forward on this programme.

8. For other programmes, like social security and housing, there are some advantages in proceeding by way of a group. Major and difficult issues are at stake and more than one spending Minister is involved. The chance of avoiding further controversy in Cabinet is greatly enhanced if the support of a nucleus of influential members of the Cabinet is obtained in a smaller group.

9. On the other hand the Prime Minister referred at last Friday's meeting to bilateral discussions, and there may be some general distaste for a "star chamber". A way forward might be not to set up any new MISC. group but to get a remit from Cabinet formulated so as to enable Treasury Ministers to bring in others where they think this advantageous.

10. Such an arrangement would certainly be appropriate for discussion of Mr. Jenkin's programmes. The group might include yourself, the Chief Secretary, Mr. Jenkin, Mr. Prior (who has to be carried on the social security proposals), Mr. Atkins (who has interests in the Northern Ireland angle), and a "neutral" Minister like Mr. Whitelaw or Sir Keith Joseph. Mr. Younger and Mr. Edwards would need to be brought in on the health proposals as they affect Scotland and Wales.

11. For housing, a slightly different group is indicated. It would need to include, in addition to the Chief Secretary and yourself, Mr. Heseltine, Mr. Younger and Mr. Edwards, and it might again include Mr. Whitelaw or Sir Keith Joseph.

12. We recommend that at such meetings the Ministers concerned should be supported by their officials.

<u>Discussion with the Prime Minister</u>

13. We recommend that you discuss these issues with the Prime Minister tomorrow, taking her over the main stages in the timetable in paragraph 2, mentioning specifically the intention to announce on Monday deferment of the White Paper.

F.E.R.B.

F E R BUTLER
11 DECEMBER 1979

11/12

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Econ Pol. 7

Seen by PM

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

Chancellor of the Exchequer
The Rt Hon Sir Geoffrey Howe QC MP
Treasury
Parliament Street
London SW1

12. December 1979

Dear Geoffrey.

CASH LIMITS - C(79)60

In general I agree with the proposals in your paper, but I thought I ought to let you know that I do have several reservations about their application to the universities, direct grant and voluntary colleges and Research Councils:-

i. Following discussion in E Committee John Biffen, in his letter of 24 October, agreed that I should tell the universities
".... that the 1980-81 cash limit will contain a realistic allowance for pay, including the cost of any Clegg award, when it is set"
and I have done so; I believe your proposed 15-20 per cent allowance for the increased cost of academic (and academic-related) pay following a Clegg award does not fully meet that commitment, and that at least 20-25 per cent would be the realistic figure.

ii. Provision should also be made for comparability awards to other university staff (technicians, clericals and manuals);

iii. Whatever figures are finally agreed under i. and ii. should apply also to those employed by the direct grant institutions who are paid on the same scales. Similarly others in those institutions paid on Burnham or other local authority scales will receive whatever comparability payments are awarded to those groups, for which we have made allowance in the RSG cash limit. The cash limits on other Votes for 1980-81 should cover both these factors, whatever we decide about the effects on cash limits for 1979-80 of the APTC settlement following John Biffen's letter of 10 December to Jim Prior;

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iv. Some of the staff of the Research Councils are also paid on university scales. It is important that the Councils' cash limits should allow both for this and for the substantial part of their research grants that is related to university salaries.

2. I think it will be helpful if, before the figures for the various Votes involved are finally settled, our officials can work out what is needed to make realistic provision taking account of the above points, on the basis that all cash limits affected by comparability awards are treated alike. Otherwise the universities and other institutions affected would be subject to larger cuts than we intend.. In my judgement this would lead to serious anomalies.

3. Finally, I should reserve my position on the way in which our decision to have a single Vote for the civil service will affect other Votes which cover staff paid on the same scales. We do not want to derogate from the responsibility of e.g. the Research Councils to manage their affairs in the most effective way within a fixed total.

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

Yours ever

Mark

MARK CARLISLE

c4 M. Vile
p. 6 clearance

4

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

PRIME MINISTER

PUBLIC EXPENDITURE - MAJOR REDUCTIONS

Before our talk tomorrow morning, you may wish to have this note on the proposed reductions in public expenditure needed to achieve the target (£1 billion in 1980-81, £2 billion in 1981-82 and later years) which I hope Cabinet will endorse on Thursday. To secure these savings, as I said in my paper, we need fundamental new decisions on major programmes. In particular we need to agree that earlier commitments to protect certain programmes (defence, social security) can no longer be sustained. I attach a table showing the cuts I propose, and my comments on the main programmes are as follows:-

(i) Defence

I have sent you a separate minute on the possibilities here, suggesting a meeting with Francis Pym to take this forward. We should recognise that defence will also be required to take a sizeable share of the squeeze likely to result in 1980-81 from the 14 per cent level of cash limits proposed in my other Cabinet paper.

(ii) Social Security

This is where the most important and difficult decisions are needed. On child benefit, I think we must go for something less than full uprating next year, despite the impact on incentives; we could meet this by some re-shaping, and holding back short-term benefits will help - so I have assumed half the increase that would correspond to full uprating. Less than full price uprating of short-term benefits (unemployment, sickness and short-term supplementary benefits) could be achieved through an amendment to the Social Security Bill to break the link with prices; the figures assume £2 a week less on most benefits (2 per cent less on supplementary benefits), but more could be saved if we decided to give little or no cash increase next year. The other main saving, from abolition of earnings-related supplement, has already been discussed more than once; in my view it is time to take this step. Clearly I should wish Patrick Jenkin to join me in considering the best shape for the whole of this package.

(iii) Environment

Michael Heseltine's programmes must be the next largest source of savings. We should assume some further decline in housebuilding by local authorities and housing associations, and some cut-back in improvement; also on current subsidies we should aim to bring rents up to 10 per cent of earnings by 1983-84, and reduce the rate of option mortgage subsidy to 25 per cent. There is some doubt whether the present assumed savings from council house sales will materialise, but in my view we should start by seeking the gross savings shown.

(iv) Health

Given our commitment to maintain existing (volume) plans for gross NHS spending, we have to look to charges. The least unattractive proposal which we can suggest is a £2 charge for each visit to a GP (on the same lines as charged for dental services now, and with the same wide exemptions as for prescription charges); this would need to be negotiated with the BMA, and would need primary legislation, but it would yield £140 million a year. The small balance would come less painfully from annual increases in prescription charges in line with prices after next year.

(v) Education

We have had earlier arguments with Mark Carlisle about the contribution from his programme, and I do not think it can be exempted from this round. The figures shown could be achieved by charging for under-fives, increasing the parental contribution to student grants, and postponing the assisted places scheme - but he may himself have better suggestions.

(vi) Public service superannuation

If we are not going to break the link with prices for state pensioners, it is questionable whether we ought to seek to do so for the wide range of public service pensioners (civil service, armed forces, NHS staff, police, teachers, judges, MPs, etc.). It would be a complex legislative operation, and not all the saving shown would count as public expenditure. I think we both agree that it would be better to save on this front by ensuring that the value of index-linked pensions is more fully taken into account in public service pay comparisons.

(vii) Other programmes (overseas aid, employment, transport, fire, personal social services - and Scottish, Welsh, Northern Irish consequentials). The cuts in all these programmes, though smaller, will all be painful, going beyond what we have already decided, but we need to find savings wherever possible.

(viii) Taxation

The links between cuts in public expenditure, and reductions in tax allowances, are close in some areas -

e.g. age allowance with state pensions, mortgage interest relief with council rents, VAT on children's clothes with child benefit. I hope we can make some PSBR savings in these areas, but they need to be considered in the Budget context and put into effect in the Finance Bill. They do not help to meet the criticism that we have not done enough to restrain public spending. The same applies to increases in NI contributions; the main need here is to prevent benefit savings feeding through into lower contributions, by reducing the Exchequer contribution (as assumed in the table).

2. I hope you will agree that Cabinet on Thursday should identify the first five programmes above as the main targets for reductions in spending, with whatever help we can get from the other areas mentioned. The total figures shown barely reach our target for 1981-82, and fall short in 1980-81; but they include nothing for defence (or EEC), and in 1980-81 we are likely to get some further volume reduction assuming that we hold to the cash limits proposed, plus perhaps a bit from the contingency reserve (depending partly on the child benefit decision). We have to recognise that we are unlikely to get all the savings shown, but in the light of last Friday's discussion (which has led me to drop de-indexation of long-term benefits, and hospital charges) I do not see much chance of adding to the list.

3. I hope we may have a chance, before Cabinet, to discuss the best procedure - as between colleagues - for carrying forward this whole exercise. I would propose to start by letting each spending Minister know individually what contribution we want from him.

(G.H.)

12 December 1979

12 DEC 1979

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Major Reductions £m 1979 Survey prices

	80-81	81-82	82-83	83-84	Comment
Defence					Under separate discussion
Social security					
Child benefit	100	300	300	300	) Assumes (a) savings carried
Short-term benefits (de-indexing - say)	70	230	230	230	) forward into later years) (b) NI Fund savings reduce
Abolish ERS	100	260	260	260	) Exchequer contribution,) not employer or employee
Uprating date (put back 3 weeks)	30	50	50	50	) contributions.)
Environment					
Housing	300	500	500	600	) Cuts in housebuilding,) improvements and insulation
Other (incl. PSA)	-	40	50	50	) schemes, and (from 1981-82)) higher rents, cut in option) mortgage subsidy.
Health	-	150	155	160	£2 charge for visits to GP, and index prescription charges.
Education	-	75	115	125	
Public service pensions	20	40	40	40	Break index link and uprate 2% less than prices.
Overseas aid	-	50	50	50	
Employment	35	30	30	30	MSC savings (including ITBs
Transport	20	50	50	50	Further cuts in roads prog.
Home Office	-	15	20	30	Reduce fire cover.
Personal social services	-	20	40	60	Remove proposed 2% growth.
Consequentials (Scotland, Wales, NI)	65	190	205	230	
Total	740	2000	2095	2265	

Copied to :-
Strategy : Pt 4

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Ref. A0939

PRIME MINISTER

Pay and Price Provisions for the 1980-81 Cash Limits

(C(79) 60)

BACKGROUND

You discussed this paper with the Chancellor of the Exchequer and others at your meeting on Friday. The Chancellor has now circulated it in a slightly amended form. The main difference is the omission of any indication of the 'volume squeeze' on different programmes.

2. There are two issues here: the effect of these proposals on the volume of public expenditure next year; and their impact on pay negotiations.

Effect on the volume of public expenditure

3. Cabinet will be discussing, later on this Agenda, the Chancellor's proposal to re-open the expenditure totals for next year. He is asking for a total reduction of £1 billion. On certain assumptions, the 'volume squeeze' implied in this paper on cash limits could add a further £450 million to this reduction. This would be true if the overall rate of inflation were 17 per cent (as the current forecasts suggest) and the Chancellor's proposals for a 14 per cent allowance in cash limits were accepted. The squeeze would be particularly tight on the Defence Budget, for two reasons:

(i) Experience shows that the rate of increase in defence goods and services is rather faster than that in the economy as a whole (the "sophistication factor"): this is compounded by the fact that goods which would be classified as 'capital' in other programmes, for which the Chancellor proposes to allow between 15 and 16 per cent, are treated as current expenditure on the Defence Budget, and get only 14 per cent.

(ii) The Government is committed to pay whatever increases are recommended by the Armed Forces Pay Review Body (AFPRB) whose report should be implemented on 1st April. This year's report is a straight up-dating one: but recent trends in pay settlements in the private sector suggest that the AFPRB will recommend something nearer 17 per cent than 14 per cent; this would put a further squeeze on the Defence Budget. The Secretary of State for Defence, who believed that he had done a satisfactory private deal with the Chancellor over the size of the Defence Budget, involving provision for the nuclear deterrent, will react adversely to this (see my separate note).

4. There are two ways of easing the Defence dilemma. It has already been agreed that a decision on the uplift factor to arrive at Civil Service pay cash limits for 1980-81 should be deferred until next February so that account can be taken in setting it of the indications which will be then available of the likely outcome of PRU. This arrangement will cover the Civil Service staff in Defence as well as civil servants more generally. A similar operation could be conducted for armed forces' pay relating in their case to the likely outcome of the AFPRB report. The alternative would be to set a higher number now - say 17 per cent - for armed forces' pay only, based on the best guess which can be made of the AFPRB results.

5. Similarly it would be possible, if Cabinet agreed, to set a higher price assumption for Defence expenditure on equipment - say 15 or 16 per cent - on the "capital goods" analogy referred to above. This could be continued with or calculated separately from the armed forces pay factor.

6. The impact of the squeeze on other programmes is smaller: but in the case of the Health Service could be as much as £85 million. Mr. Jenkin is prepared to consider some cuts there, but might argue that the cash limits squeeze involves double-counting. Other spending Ministers, who are affected to a rather smaller extent, might argue the same. To this, the Chancellor will reply that the proposals give a little more leeway than the cash limit applied to local authorities: but this was (as his paper admits) because the local authorities have the alternative of taking the strain of the rates, or of running down cash balances. All in all, Ministers will argue that the Cabinet decided the appropriate volume of public expenditure in the summer. If that has to be reopened, it should be done openly (in the way suggested by the Chancellor in the next paper) and not through the back-door.

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Public sector pay

7. One additional reason for settling cash limits at this stage is to put some pressure on public sector pay.

8. Ministers have already agreed the treatment of the nationalised industries and the local authorities. The approach appears to have worked, in the case of the NCB. It may not work so well with the BSC, where other factors have intruded. Negotiations in the local authorities continue: but our latest information is that there is a reasonable chance of a settlement at, or around, the 13 per cent provision built into cash limits for the RSG.

9. The picture in the Health Service is less clear: the negotiators will probably defer a settlement until they see how the local authority talks go. A cash limit for the water industry is being separately negotiated. In the past, the water workers have set the tone for local authority negotiations (and have of course considerable industrial muscle). This year, however, they seem to be biding their time, and there is a good chance that the local authority settlements would be reached without the risk of blackmail from the water workers.

10. It has already been agreed to leave over the cash limit for Civil Service until February. First indications are that the PRU evidence will point to something like 17 per cent. There is a margin for negotiation built in to the system, but even so a 14 per cent limit would be likely to impose a very considerable further volume squeeze.

11. The Government has no option on the armed forces - see above. The other two Review Body Groups (Doctors and Top Salaries) are, fortunately, small in numbers, and can be accommodated within cash limits without too much trouble.

12. Special provision has been made for the outstanding 'Clegg' awards for university teachers and nurses. That leaves the police (who are not subject to cash limits at all) and the fire service (who can probably be fitted into the Home Office overall total) and a few smaller groups like the Atomic Energy Authority (who settled earlier in the year at a figure which it may be difficult to accommodate within the proposed limits).

13. The picture thus seems reasonably containable: but Ministers have had no comprehensive account of the way these different negotiations fit together, and of the pattern which is emerging. You might wish to ask the Chancellor to produce one for a later meeting.

HANDLING

14. You will wish the Chancellor to introduce his paper, and perhaps to ask the Chief Secretary to supplement it. You might then call for comments from some of the big spending Ministers: Social Services; Defence; Environment; Education and Science; Industry; Energy. You might suggest that Ministers distinguish between the effect on the volume of expenditure and the effect on pay negotiations (though there is of course an inter-play between the two). The Chancellor suggests no alternative to his stark 14 per cent: and I think this is what the Cabinet will eventually settle for. But compromise positions may be necessary. Those open to you include:

(i) an extra ½ per cent or so on the inflation allowance all round;

(ii) special provision for the services most affected; notably the Defence Budget and the Health Service. It may be that in the special case of defence the Cabinet may be prepared to indicate a willingness to compromise on the lines suggested in paragraphs 4and 5 above. There is less scope for compromise in Health. Details would best be left to be settled bilaterally between the Chancellor and the Ministers concerned.

(iii) A procedural device: either postponement of publication of the estimates and cash limits (which would inevitably arouse Parliamentary curiosity if not criticism); or some additional overall and unallocated contingency margin which could be publicly identified at the time. Provided that this was not allocated to individual programmes, and remained clearly under the control of the Chancellor and the Cabinet, this need not be too damaging to confidence, though, as compared with the discipline of cash limits clearly set and announced in advance, these expedients are very much second-best.

Cash limit'

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CONCLUSIONS

15. The outcome of the meeting will be either:

(i) to approve the pay and price provisions proposed by the Chancellor in Annex A to his paper /with any modifications agreed in discussion/;

or

(ii) to invite the Chancellor to discuss with spending Ministers modified cash limits to apply to their particular programmes /in which case you will want to identify the Ministers concerned/;

or

(iii) to invite the Chancellor to consider further procedural modifications of his approach (e.g. a new unallocated contingency margin - see paragraph 14(iii) above) and to bring fresh proposals to the Cabinet at a subsequent meeting;

and possibly

(iv) to invite the Chancellor to bring before the Cabinet a comprehensive paper on progress in public sector pay negotiations in the light of cash limits already set or shortly to be announced.

RtA

(Robert Armstrong)

12th December, 1979

Ref: A0937

Copied to :-
Strategy : Pt 4

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PRIME MINISTER

The Economic Outlook and Public Expenditure
(C(79) 61)

BACKGROUND

The Chancellor of the Exchequer has now circulated the paper which he discussed informally with you and others on Friday. At that meeting there was general support for the Chancellor's proposals, although Mr. Prior (who left before the end) is not wholly reconciled, and can be expected, I think, to voice his reservations in Cabinet. The Chancellor has not yet had the separate talks with Mr. Pym (who only gets back on Wednesday night) and Mr. Heseltine envisaged last Friday. Nor have any further approaches been made, so far as I know, to other members of the Cabinet. But the Chancellor's intentions have been well-trailed in the Press, and his move will come as no surprise. His paper contains the £1 billion target for 1980-81 and a £2 billion target for later years. But, at your request, it does not contain detailed proposals for individual programmes.

HANDLING

2. I imagine you will want the Chancellor to introduce his paper briefly. You might thereafter like to take advantage of Friday's softening-up meeting by inviting some of the participants to speak. A possible sequence would be: Sir Keith Joseph or Mr. Nott (broadly allies); Mr. Prior (likely to be opposed); Mr. Jenkin or Mr. Whitelaw (supporters again). But after that, you will want to throw the discussion open, and give most members of Cabinet a chance to join in.

3. To judge by Friday's discussion, these are the points which may come up:-

(i) The uncertainty of forecasting the PSBR. This is not an argument for inaction because the penalties of guessing wrong are too high. Most commentators now believe - with the Chancellor - that the

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PSBR is likely to be unacceptably high next year, and are expecting corrective action. It will be easier to compensate later for overkill now, than to fail to do enough now and have to cut expenditure or increase taxes by more later.

(ii) In a depression, the Government will still be able to finance a PSBR of this kind at reasonable interest rates, and/or without adding to the money supply. The same arguments hold: the Government cannot afford to take a risk. Although there are some slight signs that the rise in interest rates is working through to bank lending, the Government borrowing requirement remains disturbingly high.

(iii) In a recession, the appropriate response is to allow the PSBR to increase somewhat. This argument would be stronger if the PSBR was not already uncomfortably high. But the Chancellor has to finance the real PSBR, and not some hypothetical constant-employment PSBR, in the markets.

(iv) If the PSBR must be reduced, the answer is to increase taxation not to cut expenditure. The scope for increasing direct taxation is severely limited, particularly if the Chancellor decides not to reverse the 'Rooker-Wise' amendments and increases would in any case be quite contrary to the Government's broad strategy Because of the big VAT increases this year, there is no scope here - though the yield will rise with inflation. Petrol, alcohol and tobacco are the traditional remedies. A respectable case can be made for an increase in petrol duty, on energy saving grounds; the duties on alcohol and tobacco ought at least to keep pace with inflation. But all indirect taxation - particularly on beer and tobacco - affects the RPI, and it may seem odd to seek to counter inflation by deliberately - and again - increasing consumer prices. Other remedies - PRT, NIS, or increased Employee Contributions, are worth considering. But all except PRT feed through to industrial costs.

(v) If expenditure must take the strain, we should take credit for a reduction in the EEC Budget. Mr. Walker is bound to revert to this point but the only sensible answer is 'not until we are sure of it'.

(vi) The Defence Budget should take its share. I have sent you a separate minute about the minefields in this area, through which you will need to step very carefully. You will need to bear in mind that the Cabinet does not yet know of the earlier deal between the Chancellor and the Secretary of State for Defence.

(vii) Law and Order. Mr. Whitelaw has offered to find his share somewhere - possibly on the Fire Service. You may wish to ask him if that can be done without unacceptable damage to standards of fire cover. Cabinet will probably accept that the main Law and Order programme must be preserved.

(viii) Social Security. The discussion on Friday of 'indexation' will help here - and there may be a little more to come when E has come to conclusions on the taxation of social security benefits. The Secretary of State for Social Services will, I think, argue on the latter point that the right course is to wait until benefits can be taxed. He will probably resist any attempt to cobble together an interim scheme for reduction of benefits meanwhile. Any action on indexation of course will require further and contentious legislation.

(ix) Costs of Administration. The Cabinet's most recent discussion of Civil Service numbers was disappointing, and some may wish to reopen the question. The separate proposals on cash limits in C(79) 60 will impose their own general squeeze. Cabinet has decided against another general manpower exercise. Further pressure on this front is best brought to bear in the course of public expenditure reviews, and the right course is probably to pursue extra savings case-by-case, in the course of bilaterals with spending Ministers. You might invite the Chancellor to associate CSD Ministers with his studies where appropriate (leaving it to the CSD to suggest the appropriate cases).

(x) Offsets. Mr. Heseltine made it clear, in an earlier discussion, that he would be more inclined to offer further savings in the housing and rents programme, if some part of the proceeds were recycled to 'accelerator' proposals. The discussion in E on Wednesday will have illuminated this problem. It seems unlikely that the two Heseltine schemes would work, and the Chancellor has grave reservations about finding room for any sweetners of this kind at all. In the event, therefore, Mr. Heseltine may have to be told rather than asked to find more. He will be the less likely to be co-operative if he foresees the prospect of losing part of the Local Government Bill.

(xi) Procedure hereafter. You were anxious to avoid any further negotiation in full Cabinet. Friday's meeting was not keen on reviving the idea of a 'star chamber' group on the lines of MISC 11 in the summer. I believe that on this occasion it is preferable for the discussions to be conducted bilaterally, extended as necessary on the lines I suggested in my earlier minute. You yourself should keep out of that stage of the exercise, so as to preserve your own freedom of action until final decisions come to be taken in Cabinet.

(xii) Public Expenditure White Paper. If Cabinet approves these proposals, the publication of the 'later years' White Paper will have to be postponed from January until nearer the Budget. The discussion in Cabinet provisionally planned for 20th December would be correspondingly set back.

CONCLUSIONS

4. If the discussion goes the way you want, the conclusions might be:-

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(i) To recognise that the prospects for the PSBR next year and in subsequent years require further savings of the broad order of £1 billion in 1980-81 and of £2 billion a year in 1981-82 and subsequent years - without any final commitment to exact numbers at this stage.

(ii) To invite the Chancellor of the Exchequer and the Chief Secretary to open discussions with spending Ministers and to bring proposals, and options, to the Cabinet in January.

(iii) To agree to postponement of the Public Expenditure White Paper until March.

RA

(Robert Armstrong)

12th December, 1979

1/

Prime Minister.

Yes

X| seems right for most programmes. Agree?

I see very clearly the arguments for adding either Sir Keith Joseph or Mr Nott to the meetings on the social security and DOE programmes in order to strengthen the hand of the Chancellor and Chief Secretary. But you will wish to consider whether to do so will not look a little like loading the membership of the groups against the spending Ministers and encourage them to take the matter back to Cabinet.

Ref. A0916

MR. WHITMORE

I understand that, when the Chancellor of the Exchequer sees the Prime Minister tomorrow, he will want to discuss with her how to follow up the decisions which the Cabinet will be asked to take on Thursday on the reopening of public expenditure.

2. The Treasury had been thinking in terms of having a small "star chamber" group to pursue the matter. At their meeting last Friday, however, the Prime Minister and her colleagues were thinking more in terms of bilaterals. I believe that in the circumstances this was right. If we were thinking in terms of a general review of all programmes, then a "star chamber" group might be the best way of dealing with it. The Chancellor is proposing, however, that attention should be concentrated on relatively few programmes. If the Cabinet accepts this approach, then it seems to make sense for the subsequent discussions to be between the Treasury and the Departmental Ministers concerned. The Prime Minister will no doubt want to urge colleagues to reach agreement, so that matters do not have to be referred back to Cabinet.

3. There are two fronts on which the Treasury think that the discussion will have to be "extended bilateral".

4. The proposals in the social security field will of course have to be discussed between the Chancellor of the Exchequer, the Chief Secretary and the Secretary of State for Social Services; but the Secretary of State for Employment has a direct interest, and should be included in the discussions. It is for consideration, I think, whether to suggest that one Minister not directly concerned should be added to the group, to reinforce the Treasury team; presumably the Secretary of State for Industry or the Secretary of State for Trade.

5. As to the proposal in the field of the Department of the Environment, the Treasury's experience of bilaterals with the Secretary of State has not been very happy, because the Secretary of State has tended to insist on taking everything back to Cabinet. For his "bilaterals" the cast should in any case include not only

the two Treasury Ministers and the Secretary of State for the Environment but also the Secretaries of State for Scotland and Wales. Again, it is for consideration whether to add one other Minister not directly concerned; and again the same two - Industry and Trade - suggest themselves.

RA

(Robert Armstrong)

11th December, 1979

SECRET

Copy also filed Econ Pol (Strat) Pt 4

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MINUTES OF A MEETING AT 10 DOWNING STREET AT 9.00 AM ON 7 DECEMBER 1979

Present: Prime Minister
Home Secretary
Chancellor of the Exchequer
Secretary of State for Industry
Secretary of State for Employment
Secretary of State for Social Services
Secretary of State for Trade
Secretary of State for Energy
Chief Secretary, Treasury
Sir Robert Armstrong
Sir Kenneth Berrill
Mr P Le Cheminant, Cabinet Office
Mr P Mountfield, Cabinet Office

THE ECONOMIC OUTLOOK AND PUBLIC EXPENDITURE

The meeting considered a draft memorandum by the Chancellor of the Exchequer on the Economic Outlook and Public Expenditure, a further draft memorandum by the Chancellor of the Exchequer on Pay and Price Provisions for the 1980-81 Cash Limits, and a paper by the CPRS on the Economic Outlook.

THE CHANCELLOR OF THE EXCHEQUER said that, in his judgement, it was now necessary to reopen the Cabinet's previous decisions on Public Expenditure, and to seek savings of at least £1 billion in 1980-81 and of £2 billion in each year thereafter. He invited the Group to endorse this conclusion before he circulated his paper to Cabinet. All advisers in the Treasury agreed that there was no feasible alternative. He began from the imperative of maintaining the present monetary discipline. The position was worse than had seemed in the Autumn. Oil prices had risen, pay settlements had been higher than expected, we had still to secure a reduction in our contribution to the EEC budget, and the Cabinet had not agreed on public expenditure cuts on the scale he had proposed. The long term objective of a prosperous and vigorous economy would be at risk if as a result of a failure to take the necessary decisions on public expenditure high interest rates were maintained and taxes had to be increased in the next two years. The Parliamentary Party and outside commentators alike expected a further reduction in public expenditure, and it would be damaging to confidence if it were not achieved.

SECRET

In discussion the following points were made -

a. It was argued on the one hand that the Government's monetary targets could not be achieved at reasonable interest rates without a reduction in the public sector borrowing requirement (PSBR) at least in real terms. If increased taxes were to be avoided, this meant that public expenditure had to be reduced. Against this, it was argued that the PSBR was a residual difference between two very large figures both subject to wide margins of error. Its forecasting was necessarily inexact, as were its effects on the money supply. Moreover, in a recession private sector demands would be declining, and it should be possible to finance the Government financing requirement at acceptable interest rates. It was too early to evaluate the impact of the most recent set of measures. There were cogent political and social, as well as economic, grounds for avoiding a further round of public expenditure cuts. It would be better to wait for the Budget. If further fiscal action was then thought necessary, consideration should be given to increases in some indirect taxes: there were, in any case, good social arguments for increasing the tax on tobacco and on drink, and sound energy arguments for increasing petrol tax, though all these would increase the Retail Price Index (RPI).

b. The economy paid a high price for the national obsession with the need to keep pace with the RPI. There was a good case for allowing some increases, notably the increase in world oil prices, to be passed on directly to the community, which could not be insulated from world trends. It might be possible to present the RPI in a way which distinguished these movements from others. Too much public expenditure was already related, directly or indirectly, to movements in the RPI. Many social security benefits, along with public sector pensions, were directly indexed. Indirectly, increases in prices led automatically to pressure on public sector pay, and therefore on public expenditure, and indeed on pay in the rest of the economy. There was a strong case for breaking out of this RPI trap. This would involve breaking the statutory and non-statutory protection of benefits, where this could be done without retreating from Manifesto commitments.

c. The social security programmes would have to make a substantial contribution to any future expenditure cuts. There was, however, a case for looking at rates of contribution as well as rates of benefit. These proposals could not be separated from those on the taxation of short term benefits which were shortly to be considered by E Committee. A considered approach on those lines was preferable to any immediate cut in general benefits. In any case, unless the structure of the National Insurance Fund - which was supposed to be maintained in broad balance - was changed the impact in any increase in contributions on the PSBR would be small. Moreover, increased contributions merely drove up unit costs for employers and tended to reduce employment or drive up prices.

d. Economies would have to be sought in other areas of public expenditure as well as social security programmes. While the armed forces proper must clearly be exempt, there might be a case for looking again at the Defence 'tail'. The Law and Order programmes were too small to make any significant contribution, and in present circumstances it would be wrong to make any major reductions. But there were other Home Office services, like the Fire Services, which could be re-examined. A major contribution would also have to come from housing and rents, and it might be necessary to look again at tax relief for mortgages. It would also be desirable, within the overall constraints of a reasonable PSBR, to leave room for a package of incentives for small firms and for the encouragement of investment generally as well as to leave room for other contingencies, including British Leyland. Apart from cash limits, where the Chancellor's proposals would involve an overall 'squeeze', it would be wrong to seek further across-the-board reductions. The search should concentrate on specific policy changes. Discussions to this end would be better carried out bilaterally, between Treasury and spending Ministers, than in full Cabinet, provided that sufficient political endorsement could be found for the overall target.

e. More dramatic solutions might be considered. For example, it had several times been proposed that the standard rate of income tax should be brought down to a low figure, say 15 per cent, to be financed largely by the abolition of personal allowances. Schemes of this kind deserved further study. Alternatively, income tax could be abolished altogether and replaced by a modified poll tax on the lines of the National Insurance Surcharge, collected direct from employers. The developing oil situation also provided a further major potential source of revenue. A steep increase in petrol taxation, could be entirely justified on energy saving grounds and rising oil prices gave scope for further increases in Petroleum Revenue Tax (PRT) which would not affect the RPI.

THE PRIME MINISTER, summing up the discussion, said that the Ministers present broadly supported the Chancellor's approach to public expenditure. He should now circulate his paper to Cabinet, for discussion next week, without at this stage indicating any firm figures for reductions. He should meanwhile discuss his proposals with some of the Ministers most directly affected. He should also circulate his paper on Cash Limits in the form at which it had been sent to her. He should circulate to Ministers present a note about the possibility of a 15 per cent standard rate of income tax with no personal allowances. He should arrange for a wide-ranging study to be made, by the Treasury and the CPRS, of the scope for 'de-indexation', covering wage bargaining, social security benefits, direct and indirect taxation, public sector pensions and the effect of world oil prices on the retail price index. This paper should be sent to her in the first instance.

The Meeting -

Took note, with approval, of the Prime Minister's summing up of their discussion, and invited the Chancellor of the Exchequer to be guided accordingly.

11 December 1979

Econ Pol.

THE SOCIAL SECURITY ALLOCATION

PESC PROGRAMME 1979-80

		£m
1.	Total Programme	19,100
	Less CTA element of Child Benefit say,	1,500
		17,600
	Less Contributions from Employers and Employees	10,100
		7,500
	Less Interest on NI Fund	500
2.	Net Balance of which:-	7,000
	(a) Supp Ben	2,300
	(b) Non-Contributory Disability Benefits	800
	(c) Child Benefits (non CTA element)	1,300
	(d) Treasury supplement element of Insurance Benefits	2,300

E & OE

1/4 ?

MAJOR REDUCTIONS

£m 1979 survey prices

	80-81	81-82	82-83	83-84	Comment
Defence	..	..	..	..	Under separate discussion.
Overseas aid	-	50	50	50	
EEC contribution	..	..	..	..	Under separate discussion.
Employment	35	30	30	30	Savings on MSC including grants to Industrial Training Boards (assuming no extension of temporary employment measures).
Transport	20	50	50	50	Further cuts in road programme.
Environemnt:					
Housing	300	500	500	600	Cuts in housebuilding, improvements and insulation schemes; from 1981-82 higher rents and cut in option mortgage subsidy also.
Other, incl. PSA	-	40	50	50	
Home Office	-	15	20	30	Reduce fire cover.
Education	-	75	115	125	Further cuts in programme, including charges.
Health	-	220	225	225	Indexation of prescription charges, and charges for GP visits, hospital stays.
Personal social services	-	20	40	60	Remove 2% growth proposed.
Social security ≁	600	1350	1350	1350	See attached sheet.

MAJOR REDUCTIONS

£m 1979 survey prices

	80-81	81-82	82-83	83-84	Comment
Public services superannuation*	20	40	40	40*	Break index-link and up-rate by 2% less than prices as for social security pensions. Covers Civil Servants; armed forces; doctors, nurses and other NHS staff; police, fire service, teachers and other local authority employees; judges and MPs.
Consequentials:					
Scotland) Wales) Northern Ireland excl. social security)	60	175	190	215	
Northern Ireland - social security	15	35	35	35	
TOTAL	1050	2600	2695	2860	

≠ Saving to the PSBR depends on reducing benefits but <u>not</u> reducing insurance contributions. It is assumed that Exchequer contribution to the national insurance fund would be reduced to prevent fund going into surplus.

* Because of way in which these pensions are scored, some would not count as public expenditure savings but would contribute to PSBR savings.

SOCIAL SECURITY PROGRAMME

Subject	Proposal	Value of proposal 1981-82
Child benefit	Uprate by less than prices in both November 1980 and November 1981, and possibly skew to big families.	400
Unemployment, Sickness and Invalidity benefits	"Tax" - ie hold back on November 1980 uprating, to the extent of (say) £2pw. Justified as precursor of taxing proper which has been objective of Governments for many years.	200
Supplementary benefits	Uprate by (say) 2 per cent less than prices in November 1980.	50
Retirement benefits	Uprate by (say) 2 per cent less than prices in November 1980.	200
	Means test to reduce "universality" <u>or</u> Tax more heavily (eg reduce age allowance) for same reason.	200
Earnings Related Supplement	Abolish <u>or</u> "Tax" - reduce by (say) 20per cent in lieu of taxation.	260
Uprating date	Put back uprating date to end November.	50
	(say)	£ 1350 m

For 1980-81 these proposals are valued at £600 million. For 1982-83 and 1983-84 it is assumed that amounts similar to those for 1981-82 (£1350m) will also be realised consequential on these proposals. (All figures 1979 prices).

Extract from the Financial Times dated Friday December 7, 1979.

Public sector borrowing

From Professor P. Minford

Sir,—There has been discussion in your columns of the effect on the public sector borrowing requirements (PSBR) of "fiscal stabilisers." I do not wish to revive this discussion, but I do wish to comment on the figures now being bandied about for the 1980-81 PSBR. These range from £8bn to £11½bn or a PSBR percentage (of gross domestic product at factor cost) from about 4.2 per cent to 6.1 per cent, as compared with the Chancellor's expected out-turn this year of £8.3bn (5.0 per cent.)

Appeal is being made to "stabilisers" as a reason for a PSBR at the upper end of the range. As I feared, the theoretical arguments I and others advanced on this issue are being used to unlatch the stable door by those who have no desire to control the PSBR in the longer term. There is also a dangerous misunderstanding of the distinction between automatic (or passive) and premeditated (or activist) stabilisation. The former only dampens unexpected shocks; the latter deliberately aims for a PSBR target in the light of forecasts. It is the latter that particularly concerns me here.

I believe, and have consistently argued, that there is need for the greatest caution in the practical use of activist stabilisation.

The full employment level of output is uncertain and governments have repeatedly been over-optimistic about its level; today, the vacancies and imports indicators suggest we are probably rather above this level, which makes current talk of oncoming "recession" quite misleading. If the PSBR percentage is allowed to rise, past experience shows that, whatever the reason it went up, it is politically difficult to reduce; therefore its rise will undermine the credibility of the Government's long-run commitment to reduce the PSBR. Even in a period of slow growth, the control of the money supply is made more difficult by a high PSBR, which increases the supply of financial assets generally, so puts upward pressure on the demand for money as one of these assets, and so implies higher interest rates or other pressures to achieve given monetary targets.

For these practical reasons, it seems to me that it would be most unwise of ministers to let the target for the PSBR percentage rise in 1980-81. They would be wise instead to cut it to about 4 per cent (about £7½bn).

This target should be calculated on the basis of the consensus GDP forecast. If after this budget target there are unforeseen developments in 1980-81, the out-turn can be allowed to vary within perhaps ±£½bn (about ¼ per cent of GDP) of this target—this being the automatic stabiliser element —just as an error band is tolerated for the money supply out-turn.

With such a policy, backed up by a published commitment to progressive further reductions in both PSBR percentage and the money supply growth rate, the Government will be able to regain the initiative in the war against inflation; if however it lets itself be talked into raising the PSBR percentage in 1980-81, I fear that a financial crisis will ensue, which will either play into the hands of those who desire a return to controls of all sorts or else will precipitate emergency "cuts" at short notice, the worst sort.

Professor Patrick Minford,
*University of Liverpool,
Eleanor Rathbone Building,
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Econ Pol, Pt 4
Strategy

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Ref. A0879

PRIME MINISTER

The Economic Outlook and Public Expenditure
Brief for Ministerial Meeting, 9.00 am 7 December

BACKGROUND

There are four papers for this meeting:

(i) The Chancellor's minute of 27th November, copied to those attending the meeting, covering a draft paper on 'the Economic Outlook', originally intended for Cabinet.

(ii) The Chancellor's paper on 'Pay and Price Provisions for the 1980-81 Cash Limits' which he sent to you at the end of last month (undated). He is recirculating this to the Ministers attending the meeting at your request; it is intended for Cabinet on 13th December.

(iii) The CPRS paper on 'the Economic Outlook' which, as you asked, was circulated with Mr. Lankester's letter of 3rd December to the Ministers attending the meeting.

(iv) A redrafted paper on 'the Economic Outlook and Public Expenditure' which is a condensed version of the first paper, extended with some paragraphs on public expenditure, suggesting postponement of the Public Expenditure White Paper and a fresh public expenditure cuts operation in the next month or two. The Chancellor proposes specific targets of £1 billion for 1980-81 and £2 billion reductions in the later years. If approved, this paper is intended for circulation to Cabinet for discussion on 13th December.

2. The CPRS paper ((iii) above) should serve as a brief on the substance of all this. I will not attempt to duplicate it. This note deals only with handling and procedure, and with a couple of points which were not covered by the CPRS.

3. The object of this meeting is to secure the approval of a few key Ministers before the Chancellor launches his proposals on the full Cabinet. The balance of the group was intended to cover both the Chancellor's natural allies and some potential critics. It is already clear that Mr. Prior feels he

has been outflanked (he and Mr. Jenkin are in a minority). He has told the Chancellor, during the NEDC briefing meeting, that he disagrees with the whole approach. This was before he had seen the Chancellor's detailed proposals either on cash limits or on further cuts. His line seems likely to be that forecasting is an inexact science; that the forecast £10 billion plus PSBR in 1980-81 may be an overstatement; that the outturn may be quite a bit better and that we should wait and see; that further public expenditure cuts will be damaging in themselves, and politically dangerous.

4. If the Ministerial Group on Friday agrees with the Chancellor, the next step will be for him to circulate his revised paper ((iv) above), with any further modifications to reflect the discussion, for discussion by Cabinet on 13th December. The Cash Limits paper ((ii) above) would be taken at the same time. Thereafter, you would establish a small 'star chamber' group of Ministers, rather on the lines of MISC 11 which met during the summer, to conduct the cuts operation and make recommendations to Cabinet. Final decisions would be needed some time before the Budget. The Group might need to start work early in January. I shall submit further advice about membership and mode of operation later.

5. There is a particular problem over the position of the Secretary of State for Defence. These papers have not been copied to him. He is away in Brussels, at a NATO meeting, on Monday, Tuesday and Wednesday of next week. The first he will hear of the cash limits proposal will be when he reads his Cabinet papers on Wednesday night. This, as Mr. Le Cheminant warned Mr. Lankester in an earlier note, may cause considerable difficulty for the Ministry of Defence because it implies a substantial squeeze on the volume of defence spending next year. In addition, the Chancellor wants to leave open the possibility of further cuts in the Defence programme. His new paper ((iv) above) deliberately does not mention this. The CPRS paper does. He had intended to speak privately to the Secretary of State for Defence before Cabinet. It is not now clear that there will be time for this. You may want a word with the Chancellor about the best way to handle the problem. Otherwise, there is a risk that the deal which the Chancellor struck with the Secretary of State following the previous Cabinet discussion will come unstuck.

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6. There is a further problem over cash limits, not brought out in the CPRS paper (which was circulated before the cash limits paper was available). It concerns only 1980-81. The Chancellor says that the PSBR for 1980-81 would 'exceed £10 billion'. The latest figure is, I understand, £10.3 billion. But this is on the assumption that cash limits are set to accommodate the expected rate of inflation (17 per cent) rather than the 14 per cent which the Chancellor suggests in his separate cash limits paper. If cash limits were, in fact, set at 14 per cent, and inflation turned out to be 17 per cent, there would thus be an automatic squeeze of £450 million even before any further cuts were explicitly sought. If Ministers were minded to endorse the Chancellor's target of £1 billion reduction in 1980-81 it would be important to establish whether the cash limit volume squeeze was included in this total, or additional to it. (We have asked the Treasury to ensure that the Chancellor is ready to deal with this point). In any case, there is no one-for-one relationship between a cut in the volume of public expenditure and a fall in the PSBR. Other factors, including shortfall, complicate the calculation. The Chancellor's £1 billion is only a very rough indication of the scale of the problem - not a precise target.

HANDLING

7. I imagine you would want the Chancellor to introduce his paper, and you may then wish Sir Kenneth Berrill to say a word. The Chancellor may at some point wish to take a list of possible ways of meeting his target of £1 billion. Thereafter the discussion could be, as the CPRS suggest, structured round the series of questions listed in their paper. The point about cash limits arises on paragraph 13 of their paper, and you may want to bring it out clearly at that stage. The separate problems about Defence are best handled in a private word with the Chancellor.

CONCLUSIONS

8. The outcome of the meeting will, presumably, be agreement that the Chancellor should revise his paper - and possibly also his cash limits paper - in the light of discussion and circulate it to Cabinet at the beginning of next week. You may want to reserve a decision on the subsequent steps until you have heard the Cabinet discussion.

ROBERT ARMSTRONG

(Robert Armstrong)

6th December, 1979

6/12/79

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Econ Pol, Pt4
Strategy

THE ECONOMIC OUTLOOK AND PUBLIC EXPENDITURE

Memorandum by the Chancellor of the Exchequer

Introduction

I have been taking stock of the economic situation. The general strategy remains the only feasible one but the difficulties we face are greater than we had any reason to expect. I consider that we need to look again at our public expenditure plans and it was evident at our 15 November discussion that many members of the Cabinet share this view. It is imperative to get our policies properly established in our first year of office.

Recent Developments

2. Three developments cause particular concern:-

(i) With strong wage inflationary pressures, poor trading, productivity and competitiveness performance and the unpromising outlook for world trade following the further large increases in oil prices, the economy is inevitably moving into a recession from which there could well be only a slow recovery;

(ii) despite the action I took in the Budget, underlying monetary growth has been much higher than expected;

(iii) inflationary expectations, and hence pay pressures, remain high and intractable.

3. This outlook was reflected in the recent Industry Act forecast which brought out in particular the deteriorating prospects for output and for reducing the rate of inflation next year; and some of the assumptions underlying that forecast (eg on earnings and interest rates) could be over optimistic. Recent non-government forecasts, such as that prepared by the London Business School, point in very much the same direction.

Action so far

4. The measures taken in the Budget established our credibility from the start by signalling our resolve to maintain strict

monetary control backed by fiscal policies consistent with it. And the further measures of 15 November were dictated by the necessity of maintaining those policies in the face of the disappointing monetary and PSBR developments. The initial reaction in the markets was favourable and we have secured substantial gilt sales to help fund this year's PSBR. I hope that the other effects of the changes will now come through so that money supply growth comes into the target range, without even higher interest rates than those which we have had no alternative but to accept. But this will depend on a number of factors some of which we can influence - particularly the market's assessment of our determination to carry through our policies - and others which we cannot, eg developments overseas.

Future action

5. The overriding priority is to reduce inflation, as a necessary condition of resumed and sustainable growth. In parallel with this we must secure a major improvement in the supply side of the economy. To these ends our policies must embrace the following:-

(i) progressive reduction of the rate of growth of the money supply at tolerable interest rates;

(ii) further reductions in the burdens of income tax and capital taxation;

(iii) substantial reductions in the inherited public expenditure plans and in the size and role of the public sector generally.

6. No compromise is possible on (i). Otherwise the credibility of any government's strategy on inflation would be destroyed. Nor can we compromise on our objective of restoring incentives by reducing taxation. Our weakness on the supply side is still acute and we urgently need to take further measures to remedy this. The single most important contribution we can make is to reduce taxation at all income levels. But, with the worsening economic prospects, and the difficulty evident from Dublin of getting an acceptable reduction in our EEC contributions,

there is now little prospect of attaining our inflation and tax objectives on the basis of the public expenditure plans agreed so far by Cabinet.

7. Disappointment with the 1980-81 White Paper (whose plans were some £2 bn higher than the target the Chief Secretary and I set) contributed to the unsettled market conditions that necessitated the 15 November measures. Many in the markets were hoping for an unequivocal reduction in the volume of expenditure and the PSBR for 1980-81.

8. For the period immediately after 1980-81 a similar situation is in prospect. The Chief Secretary and I warned the Cabinet in September that even with the reductions we proposed it would be hard to hold the PSBR in the later years to around its present proportion of GDP without some real increase in taxation. In the event the plans agreed by the Cabinet are more than £1 bn higher for most of the years concerned; and the economic prospect has worsened, as reflected in government and independent forecasts. Thus on any prudent assessment of the economic outlook the present expenditure plans seem incompatible with slower money supply growth unless we have even higher interest rates or higher taxes, or both.

9. Chronic structural weaknesses in the economy - low productivity growth and poor trading performance as well as the tendency to higher inflation - appear to have intensified in recent years. These problems cannot be overcome quickly and given also the worsened prospects for the world economy after the further rise in oil prices the medium term prospects for GDP growth are now poor. It is against this background that the Treasury's medium term analysis has been carried out. It suggests that the policy conflicts are likely to be most acute in the next two years. For example, to bring inflation down well into single figures by 1983 entails getting monetary

growth in that year down to 7% (and the PSBR to 2½% of GDP, which should allow interest rates to fall). On present expenditure plans this would require tax increases equivalent to around 5p on the basic rate of income tax by 1981-82. There would be no prospect of any real reduction in personal taxes from today's levels before 1983.

10. Two key conclusions emerge. First, however difficult the short-term, the centre piece of our anti-inflation strategy - progressive reduction in monetary growth - remains the only feasible one. But second, stabilisation of our expenditure plans at their presentlevels is not enough. (And, depending on the treatment of debt interest, it is arguable whether we have even done that.) Unless we reduce plans further we shall not be able to avoid serious damage to our taxation objectives and the risk of even higher interest rates than those we have now. This is also becoming increasingly clear to the financial markets and without changes there is a serious risk of a series of tensions in the markets, of which that last month was only a first example. Most important, it is also becoming clear to our supporters in Parliament that further action on public expenditure is needed.

Public Expenditure and the Second White Paper

11. I conclude that our public expenditure plans need to be reduced. It is difficult to say with confidence precisely what further reductions would be required to meet our monetary and tax objectives. On the Treasury's projections, the PSBR for 1980-81 would on present expenditure plans exceed £10 billion, and rise to around £13 bn in 1981-82, or over 5% of GDP compared with the 4¼% expected this year. A PSBR at this level would be a major blow to confidence and it seems very unlikely that we could finance it without still higher rates of interest.

12. Our room for manoeuvre in 1980-81 is restricted. We have published our plans and they are being acted on by spending authorities. For example, it would be difficult now to ask local authorities to make further reductions in their current expenditure. But we need to hold the cash limits and to make whatever further savings we can. One important decision for 1980-81 not yet taken concerns the uprating of child benefit. There is also the question of further savings on housing investment. In all we ought to be looking for a total volume reduction of the order of £1 billion.

13. In 1981-82 a reduction of the order of £2 bn appears to be needed. If the total is not to rise again we must carry this reduction forward to the two subsequent years.

14. We can only make reductions of this order by fundamental new decisions on the major programmes. The social security programme, which constitutes over a quarter of public expenditure, will need to be a major source of the further savings.

Second White Paper

15. If the above is accepted it points to postponing the White Paper hitherto scheduled for January. We do not want to publish figures we are subsequently going to revise; and to do so would make the revisions more difficult to achieve. Any economic projections published with the figures would also reveal the inconsistencies I have described; but equally refusal to publish supporting economic material would lead observers to conclude themselves that the figures did not add up. We certainly would not publish any convincing or viable financial plan incorporating the present expenditure figures. So I conclude that we should postpone the White Paper.

16. The decision to postpone implies that we shall achieve the necessary reductions. To delay the White Paper and then publish plans that were still too high would be the worst of all worlds.

17. Nor could we let the uncertainty run on too long. We need to publish the White Paper not later than the Budget and preferably in March. This will require an intensive operation which we should aim to complete by the end of January.

Conclusion

18. I recognise the difficulty of the decision I am asking the Cabinet to make, and of the subsequent decisions necessary to implement it. But without this decision it will become widely apparent that our policies are inconsistent and that our expenditure plans are incompatible with our monetary and taxation objectives; and that there is a serious risk that even more painful measures would become unavoidable.

19. I therefore propose that:-

(i) we undertake an exercise, which we should aim to complete by the end of January, to identify savings of £1 bn in 1980-81 and £2 bn a year in 1981-82 and subsequent years;

and (ii) we postpone the next Public Expenditure White Paper and aim to publish it in March.

Original in C/Cons

CC DOE
William Owen
Fred Mulley
Roy Mason

BK

10 DOWNING STREET

CF to nde

THE PRIME MINISTER

6 December 1979

Dear Councillor [illegible],

Thank you for your letter of 28 November.

I note that you criticise our plans for public expenditure by comparing them with the plans of the Labour Government. However, these plans were quite unrealistic and would have had to be cut whichever Government was in power. What we have done is to stabilise the level of public expenditure over the three years 1978/79 to 1980/81. This was essential. The country simply cannot afford continued growth in public expenditure at a time when there is no growth in the economy. We should be living in a fool's paradise if we pretended otherwise.

We have asked local authorities to achieve a phased reduction in current expenditure of 2½% over two years. This will bring the volume of expenditure back to the 1977/78 level. The scale of reductions is rather less than the 2% in one year which the Labour Government required in 1976. We are also introducing measures which will give authorities the flexibility they need to concentrate their resources on the priority areas. This is

This is scarcely the "attack on compassion" which you suggest.

I am afraid there is a misunderstanding about some of the figures you mentioned in the rate support grant settlement. The figure of £18.5 bn you mention is one estimate of what relevant expenditure might be at outturn prices. The settlement figures of £15.7 bn is of course at current (November 1979) prices. Relevant expenditure at outturn prices will inevitably be higher, and as usual we will pay additional grant to local authorities in respect of pay and price changes subject to cash limits. These are compatible with year-on-year price rises affecting local authorities of 13%, plus an allowance for outstanding comparability awards; they are fair and realistic. We have not repeated the mistakes of the Labour Government, whose quite implausible pay and price assumptions last year created such grave problems for local government.

The rate support grant settlement we announced on 16 November combines stability in distribution with a sensible approach to the problem of inflation. We now look to local authorities to play their part in the battle against inflation by negotiating moderate pay settlements, reducing costs and increasing efficiency so as to eliminate all unnecessary expenditure, and increasing rates by not a penny more than is absolutely necessary.

Yours sincerely

Margaret Thatcher

Councillor Roy Thwaites

CONFIDENTIAL & PERSONAL

Top Copy
Econ Pol, Pt 4
Strategy

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

6th December, 1979

Dear Tim,

THE ECONOMIC OUTLOOK, PUBLIC EXPENDITURE AND CASH LIMITS

On 27th November the Chancellor minuted the Prime Minister, with copies to other members of a small group of Ministers, with a draft Cabinet paper on the economic outlook, to be discussed at the group's meeting on 7th December. He indicated that a further Cabinet paper would be prepared on re-opening public expenditure.

The Chancellor has now decided that it would be better to combine discussion of the outlook, general economic policy and the implications for public expenditure in a single paper for Cabinet, a draft of which I now enclose for discussion by Ministers on Friday. Also enclosed for discussion at that meeting, as requested by the Prime Minister, is a draft Cabinet paper on 1980-81 cash limits.

Copies of this letter and of the enclosures go to John Chilcot (Home Office), Ian Ellison (Department of Industry), Ian Fair (Department of Employment), Don Brereton (Department of Health and Social Security), Stuart Hampson (Department of Trade), Bill Burroughs (Department of Energy) and Martin Vile (Cabinet Office).

Yours ever,

Tony Battishill

A. M. W. BATTISHILL

T. Lankester, Esq.,

CONFIDENTIAL & PERSONAL

PAY AND PRICE PROVISIONS FOR THE 1980-81 CASH LIMITS

DRAFT MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

The 1980-81 cash limits on the rate support grant (RSG) and the external financing limits on the nationalised industries were announced on November 16th. We now need to take decisions on the pay and price provisions in the Main Estimates for 1980-81 and in the other remaining cash limits.

A. Expenditure concerned

2. These are the limits on central government expenditure and on local authority capital expenditure. They cover over £25 billion (at 1979 survey prices). The main areas of central government expenditure include defence, the hospital and community health service and the universities. The limits cover numerous pay groups principally the armed forces, doctors, nurses, NHS ancillaries and university staff.

3. At this stage, we can leave on one side civil service pay: a global provision for the civil service pay settlement is to be made in a single Vote which need not be decided until February.

B. Provision

4. I propose that provision should be made for a 14 per cent increase between 1979-80 and 1980-81 in current costs covering both new pay awards and other current expenditure. This differs from past practice when a separate factor was used for pay and two other factors for the remainder of current expenditure but it follows the approach we agreed for the RSG. The advantage of the RSG approach is that it avoids publishing

an explicit figure for pay which could become a starting point for negotiations.

5. I propose continuing past practice of using separate price factors for capital expenditure. Separate provision would be made for the outstanding comparability awards for the university teachers and for nurses. All the proposed factors are shown in Annex A.

6. These factors are based on the Industry Act forecast which showed a 14 per cent increase in the retail price index (RPI) between the fourth quarter of 1979 and the fourth quarter of 1980. They are also broadly in line with the figures supplied to the Government Actuary; these showed the same increase in the RPI and a 14 per cent increase in earnings between 1979-80 and 1980-81 for the economy as a whole (see Annex B).

7. As part of the RSG settlement, the local authorities were given a figure of 13 per cent for increases in the costs of their current expenditure generally. This cash limit represents a maximum contribution from the Central Government. We can justify the slightly higher figure of 14 per cent for Central Government cash limits on the grounds that for each Central Government service the cash limit is an absolute constraint whereas local authorities have greater flexibility and, in the last resort, their own balances to fall back on if inflation turns out higher than expected.

C. Implications for public expenditure plans

8. We cannot, consistently with our own published forecasts, make a higher provision than now proposed. And it is essential, in our first full year, to hold expenditure within the cash limits we set.

9. The effect of the cash limits on services will depend both on inflation generally and on public service pay settlements. If these costs increase faster than provided for, the cash limit will be bound to result in further reductions in the volume of expenditure. The size of these will depend on the mix of different types of expenditure on each service.

10. Any forecasts of inflation are inevitably subject to a wide margin of error, but it would be unrealistic if my colleagues do not allow for the possibility that the cash limits will require some further reduction in the volume of the services for which they are responsible in 1980-81. All spending authorities must manage their resources throughout the financial year in such a way that they keep within the cash limits even if costs rise faster than provided.

Conclusion

11. I invite the Cabinet to agree the pay and price provision proposed in Annex A.

ANNEX A

Provisions proposed for 1980-81 cash limits (based on the Industry Act forecast)

		% increase 1980-81 on 1979-80
i)	New pay awards and price increases on current expenditure *	14.0
ii)	Capital Expenditure:-	
	Construction	
	- Housing	15.8
	- roads	16.4
	- other	15.5
	Land	15.0
	Other capital expenditure	15.9

iii) Outstanding comparability awards

a) nurses in the range 20-25 per cent annual increase in earnings. This assumption will be replaced by the actual figure if the Clegg Report is available in time.

b) university teachers in the range 15 - 20 per cent annual increase in earnings.

* Apart from the global provision for civil service pay which will be settled later.

ANNEX B

Published figures

a. Assumptions given by the government to the Government Actuary for use in his report on the National Insurance Fund:

- Economy wide increase in earnings (including outstanding public sector comparability) of 14 per cent between 1979-80 and 1980-81

- RPI increase 14 per cent 1979 (Q4) to 1980 (Q4).

b. Industry Act Forecast:

- No earnings figure. Refers to "a progressive reduction in the rate of settlements over the coming year" by implication from the underlying increase of 15-16 per cent mentioned for this year.

- RPI increase 14 per cent 1979 (Q4) to 1980 (Q4).

c. RSG cash limit:

- increase in costs of 13 per cent between 1979-80 and 1980-81.

Top Copy Econ Pol, Pt 4, Strategy

These items not discussed. For record of Mtg - see Master Set.

PRIME MINISTER

MEETING WITH THE CHANCELLOR

I understand that the Chancellor will want to raise the following points:

(i) He will have with him draft papers for Cabinet on the economic outlook and public expenditure, and on the pay and price assumptions for cash limits. The paper on the economic outlook and public expenditure apparently covers the same economic ground as the draft which he sent round last week, but it includes proposals on the reopening of the public expenditure decisions as well. I imagine the pay and prices paper will simply repeat the proposals which you saw over the weekend, but which you said you would like discussed by the "inner group" on Friday morning. If you are agreeable, the Chancellor will circulate the drafts of these two papers to the "inner group" after the meeting.

(ii) The Chancellor has some inkling of the November money supply figures, and will be reporting on them. Apparently, the overall figures are likely to be reasonable; the bank lending figures continue at a high level but other factors (presumably including sales of gilts) have offset this.

(iii) The Chancellor will report on today's NEDC meeting, which - as I told you - did not go off too badly. He will also report on his efforts to persuade Len Murray to attend the January meeting. I understand that Murray is proving hard to get - partly because he does not want to break into his holiday, and partly because, if he did come, it would appear to his trade union colleagues that he thought they could not manage without him. (In this connection, Mr. Basnett told me at this evening's party that, as far as he was concerned, this morning's meeting was totally unproductive. He said that the TUC would not walk out of any of the major bodies such as

/NEDC,

NEDC, MSC, etc.; but he still could not rule out their walking out of some of the less important ones. Mr. Basnett went on to say - for what it is worth - that he was very concerned that there seemed to be no attempt by the Government to reach any kind of consensus with the trade unions. Ministers did not even seem interested in talking. Finally, he said that he and his colleagues would welcome an initiative from you to meet them before too long.)

(iv) The Chancellor is bothered about the FCO's posture on EMS - in particular, the recent statement by Lord Carrington in Brussels. I quote:

> "Fourth is the need for greater monetary stability. The British Government's present domestic policies will I hope convince you of the importance we attach to this objective. The European Monetary System is an important and welcome step, and Britain fully supports this initiative. We are not yet full members of the EMS, but that reflects only present economic realities, not a lack of will. We intend to join the exchange rate mechanism as soon as conditions permit and in particular as soon as the implications for sterling of being a petro currency are clear."

I believe the Chancellor would like your support for pulling the FCO into line - i.e. not being quite so bullish about EMS.

(v) He may want to mention the right of entry review, which is coming up in Cabinet. (There is a note on this in the Cabinet folder.)

S J Pike Duty Clerk

pp TPL

5 December 1979

10 DOWNING STREET

Caroline

Tom: OK for Chancellor. Cl. 3/12

It seems that CH was not invited. If JB doesn't come, he must.

R.

1445

CONFIDENTIAL

file LG

10 DOWNING STREET

From the Private Secretary

B/F 6-12-79 for mtg

3 December 1979

PAY AND PRICE PROVISIONS FOR 1980-81
CASH LIMITS

The Prime Minister has now considered the Chancellor's minute which he sent last week on the above subject.

The Prime Minister has now agreed - as you know - that Cabinet should consider public expenditure volumes once again on 13 December. Since the Chancellor's proposals for cash limits for 1980/81 have important implications for the volumes, she would like his paper on cash limits to be considered on 13 December as well. She has also asked that his paper on this subject should not be circulated until after the meeting which has been arranged for 0900 hours on Friday morning, 7 December; she would like that meeting to look at the Chancellor's proposals for pay and price provisions along with the other papers which are being circulated.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

T. P. LANKESTER

M. A. Hall, Esq., M.V.O.,
H.M. Treasury.

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GB

Prime Minister

On reflection, I can see no point in having a row in Cabinet on 6 December on cash limits, and another row about public expenditure volumes on 13 December. The two are inevitably linked, and I suggest we take both on 13 December (see x on page 3 below). You might also discuss the cash limit proposals at the "Inner Group" meeting next Friday. Agree?

1

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P.0169

MR LANKESTER

Agreed also

cc: Mr Vile

PAY AND PRICE PROVISIONS FOR 1980-81 CASH LIMITS

Flag A

The Chancellor's minute to the Prime Minister on 29 November seeks her agreement to the circulation of a Cabinet paper on cash limits for 1980-81 for all the outstanding elements in public expenditure except Civil Service pay (it has already been decided to make a global provision for Civil Service pay next February. The amount of this provision does not need to be decided until then). The cash limits the Chancellor now proposes are based on an assumed increase of 14 per cent for pay and prices taken together. The Chancellor acknowledges that such limits would mean a volume squeeze of £400 to £450 million, of which £140 million would fall on Defence and £85 million on the NHS. He warns however that, on the latest indications, the actual size of the volume squeeze "will almost certainly be more than this."

TL 30/11

2. It is clear that a discussion of proposals of this kind at Cabinet this Thursday could lead to very severe difficulties. In particular:-

(a) Mr Pym may well argue that they involve reneging on the private agreement he already has with the Chancellor on Defence expenditure.

(b) Mr Jenkin may argue that the NHS squeeze means a departure from election commitments, and

(c) Most spending Ministers could argue that cash limits as restrictive as this depart unacceptably from the principle on which the RSG cash limits were set - namely by "making realistic, not extravagant, allowances for the likely movement in wages during the year" (E(79) 10th meeting).

3. Part of the problem will arise from timing factors. On present plans the Cabinet is due to discuss the general economic outlook (though it doesn't yet know this) on 13 December when the Chancellor will be proposing the re-opening of volume expenditure figures, including those for 1980-81 (an exercise in which we understand he is not contemplating asking for a further contribution from Defence beyond that implicit in the cash limit decision). This timing sequence would not have mattered had the Chancellor's cash limit proposals been non-controversial. But in the event he is asking for substantial cuts in expenditure before he has displayed, and the Cabinet has discussed, the economic outlook underlying his proposals. In the circumstances there would be much to be said for delaying the cash limit discussion either to coincide with, or to succeed, the general discussion and the decisions to look for further cuts which are its most likely outcome.

4. The pay and price assumptions for Defence cause particular difficulty because:-

(a) The pay of the Armed Forces is, to all intents and purposes, outside the Government's control. The Armed Forces' Pay Review Body will produce its updating report in the Spring and, given past commitments, the Government will have little option but to implement it. No one can yet be sure but it seems most unlikely that the AFPRB will recommend a pay updating as low as 14 per cent (they have an elaborate system of taking account of movements in private sector pay) and the percentage could well be significantly higher than 14 per cent.

(b) There is a long-standing tendency for the price of milit ary equipment to increase faster than the general movement of prices in the economy.

5. The pay of the National Health Service presents a lesser problem because their settlement dates are, in many cases, imminent and negotiations will therefore, to a considerable extent, be conditioned by cash limits already set for 1979-80 - besides having more scope for negotiation because, unlike the Armed Forces, they will not be subject to binding awards this time round.

6. It is also relevant that the other main group on the law and order front - the Police - are not subject to cash limits.

7. If the Prime Minister agrees that discussion of a paper on the lines suggested by the Chancellor of the Exchequer this Thursday would be likely to cause unacceptable difficulty, there are two course open:-

(a) The Chancellor could be persuaded, perhaps, to leave the pay assumption for the Armed Forces, like that for the Civil Service, to be determined nearer the time that the new pay scales come into effect. This might cause difficulty over the Defence White Paper due to be published early in the New Year but the possibility is worth exploring.

X

(b) The discussion of the cash limits paper as a whole could be deferred until either 13 December - when it could be taken along with the general discussion on economic prospects (the Treasury is constrained by its time-table for production of Estimates but could we believe wear this much delay) or could be postponed until 20 December (on the grounds of overcrowding of the 13 December agenda) though the Treasury might resist this as incompatible with their Estimates time-table.

8. In the circumstances the Prime Minister may feel that it would be desirable to have a discussion of tactical handling with the Chancellor before authorising the circulation of his paper.

P Le CHEMINANT

Cabinet Office
30 November 1979

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Top Copy
Econ Pol, PE4
Strategy.

Ad 29.11.79

cc Mr Wolfson
Mr Duguid

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

Prime Minister

These proposals will cause trouble in Cabinet because of the likely volume squeeze (see para 9)
But higher figures would make the Chancellor's PSBR problems almost impossible
I think he should circulate his paper as proposed.

Agree? TL 29/11

PRIME MINISTER

PAY AND PRICE PROVISIONS FOR THE
1980-81 CASH LIMITS

The 1980-81 cash limits on the rate support grant (RSG) and on nationalised industries were announced on 16th November. We now need to take further decisions on the pay and price provisions for the remaining cash limits.

2. These are the limits on central government expenditure and on local authority capital expenditure. The provision should be approved by Cabinet and is on the agenda for 6th December. I shall be circulating a paper for that but I wished to inform you first what I have in mind to propose.

3. This is a major decision on public expenditure in 1980-81. The cash limits involved cover over £25 billion (at 1979 survey prices).

4. The main areas covered by central government expenditure are defence, health and universities, and the pay groups they cover, including the armed forces, doctors, dentists, nurses, and ancillaries, and university staff. We can leave civil service pay on one side for the time being since we have decided to make a global provision in a single vote which does not need to be decided until February.

/5. For the RSG

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5. For the RSG we provided for a 13 per cent increase in costs (in this case all current, not capital) between 1979-80 and 1980-81 arising from new pay awards and from price increases. It would be desirable to follow the same approach here and use a single figure for cost increases on current expenditure.

6. This differs from past practice when a separate figure has been used for pay and two price factors used for the remainder of current expenditure. The advantage of the unified figure as for the RSG is that it avoids publishing an explicit figure for pay which could quickly become a starting point for negotiations. With prices expected to rise faster than pay, a single figure is likely to bear down more heavily in those areas with a relatively high proportion of current expenditure other than pay - notably defence. I think this has to be accepted in present circumstances.

7. I propose to continue past practice of using separate price factors for capital expenditure.

8. The provisions which I suggest are set out in the Annex. They are in line with the Industry Act forecast and the Government Actuary's Report, and should not cause surprise. The provision of 14 per cent for increases in current expenditure arising from prices and new pay awards is slightly higher than the 13 per cent used in RSG; but the 13 per cent for the RSG was part of a package in which we maintained the RSG grant percentage at 61 per cent; and unlike local authorities, the Central Government services generally have no other sources of finance to fall back on.

9. Even so, these provisions are almost certainly less than the increases in pay and prices which will actually occur. So they imply a squeeze of the volume programmes

/previously agreed.

previously agreed. On the basis of the Treasury's economic forecast, prepared two months ago now, the squeeze might be some £400-450 million (at 1979 survey prices), of which £140 million would fall on defence and £85 million on the NHS. On latest indications the actual squeeze will almost certainly be more.

10. Since our recently published plans for 1980-81 now look high in relation to our PSBR and tax objectives, some squeeze is welcome. But some of our colleagues will find difficulty with it, and I do not advocate attempting a larger squeeze by this route. If in the end widespread increases had to be made in cash limits in our first full year, it would seriously damage the cash limit system. I think that the figures I am suggesting strike the most appropriate balance.

11. If you agree, I will circulate a paper to Cabinet accordingly.

12. I am copying this to Sir Robert Armstrong.

(G.H.)

29 November, 1979

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ANNEX

A. Published figures

a. Government actuary

- Economy wide increase in earnings (including outstanding public sector comparability) of 14% between 1979-80 and 1980-81.

- RPI increase 14% 1979 (Q4) to 1980 (Q4).

b. Industry Act

- no earnings figure. Refers to "a progressive reduction in the rate of settlements over the coming year" by implications from the underlying increase of 15-16% mentioned for this year.

- RPI increase 14% 1979 (Q4) to 1980 (Q4).

c. RSG cash limit

- increase in costs of 13% between 1979-80 and 1980-81.

B. Provisions proposed for 1980-81 cash limits (consistent with Industry Act forecast)

	% increase 1980-81 on 1979-80
i) New pay awards and price increases on current expenditure	14.0
ii) Capital Expenditure:-	
Construction	
- Housing	15.8
- roads	16.4
- other	15.5
Land	15.0
Other capital expenditure	15.9

iii) Outstanding comparability awards

a) nurses in the range 20-25% annual increase in earnings. This assumption will be replaced by the actual figure if the Clegg Report is available in time.

b) university teachers in the range 15-20% annual increase in earnings.

Econ Pol

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

27 November 1979

Dear Chief Secretary

1979-80 CASH LIMITS AND OUTSTANDING PAY SETTLEMENTS

Thank you for sending me a copy of your letter of 22 November to Patrick Jenkin.

I agree that it would be right to make these cash limit adjustments now. I would hope however that it would be possible to give general and overall figures as we have done in the RSG settlement. And while I can see that it may not be realistic to look for offsetting savings in these areas in the remainder of the financial year, I would hope that we would have the scope for improvements in productivity and efficiency very much in mind for 1980-81.

Copies of this go to those who had copies of yours.

Yours sincerely

MICHAEL HESELTINE

(Approved by the Secretary of State and signed in his absence)

The Rt Hon John Biffen MP

JT

CONFIDENTIAL

Econ Pol.

DEPARTMENT OF EDUCATION AND SCIENCE
ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH
TELEPHONE 01-928 9222
FROM THE SECRETARY OF STATE

The Rt Hon John Biffen MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON SW1

27 November 1979

Dear John,

1979-80 CASH LIMITS AND OUTSTANDING PAY SETTLEMENTS

I endorse the adjustment proposed for universities in your letter of 22 November. From my point of view, I need early agreement on this because of the increasing anxiety about lack of progress on pay negotiations, particularly for university dons and technicians.

I agree that we should not specify any percentage in the annoucement. This will be facilitated in my case by putting the amount of cash involved together with a number of other small adjustments which also follow the RSG or earlier established precedents and about which our officials are in touch.

I am copying this letter to the Prime Minister and to the Secretaries of State for Social Services, Industry, Employment, Environment, Scotland, Wales and Northern Ireland, and to Sir Robert Armstrong.

Yours ever
Mark

MARK CARLISLE

CONFIDENTIAL

27 NOV 1979

28 NOV 1979

cc Euro Pol (Cap) Pt 2. 1

Prime Minister.

Do you agree to have agriculture on the agenda for Cabinet on 6th December in view of all the difficulties about setting up a smaller meeting? Or shall we try to squeeze in an ad hoc meeting for an hour at 1500 on 5th December (see my note below)?

The Chancellor wants to discuss with you the handling of this issue before it comes to Ministers collectively. He is worried about the farmers' lobby in Cabinet. He may mention it at tomorrow's breakfast. 26xi

Ref: A0747

1. Agreed with the Prime Minister that we should fix the meeting for 1445 on Wed 5 December.
2. CA. 27xi

CONFIDENTIAL

MR. WHITMORE

Public Expenditure: Agriculture

You told me that the Prime Minister had suggested that discussion of expenditure on agriculture might be taken in E before going to Cabinet, since it did not seem appropriate for an essentially bilateral matter to be settled in Cabinet.

2. The timing considerations are as follows. The Report of Sir Kenneth Berrill's interdepartmental group will be completed by the end of this week. The three major issues it will highlight are the level of cash grants for farmers; the green pound; and the price of liquid milk. If the rate of cash grant for 1981-82 is to be changed, this must be embodied in an Order passed before Christmas. This is also the only question which needs to be decided before the public expenditure White Paper covering the later years can be finalised. It may be that the need for such a White Paper and its timing will be re-opened when the small group of Ministers meet under the Prime Minister's chairmanship to consider public expenditure plans in the light of the present economic outlook. But this group is not due to meet until 5th December. The Treasury had previously regarded 6th December as the latest Cabinet at which decisions would need to be taken for the White Paper. On the green pound, the Ministry of Agriculture consider that there is a strong case for a further devaluation. If this is agreed by Ministers, Mr. Walker will probably wish to distance the timing of the devaluation as much as possible from Community discussions of the next price fixing. This points to his obtaining Council agreement at the Agriculture Council on 10th December. There is no similar deadline as regard the liquid milk price, although Mr. Walker will be pressing for an early decision here as well.

3. All this points if possible to keeping agriculture on the agenda for Cabinet for 6th December. A meeting of E is scheduled for the Tuesday morning, 4th December. Unfortunately, Mr. Walker has to be in Brussels on

3rd and 4th December for a Fisheries Council and would not be able to return for that E meeting. The option of the Prime Minister taking a small meeting of e.g. the Minister of Agriculture, the Chief Secretary, the Lord Privy Seal, the Secretary of State for Trade and Sir Kenneth Berrill on the day before Cabinet does not look very promising from the Prime Minister's diary point of view.

You have the memorial service for Betty Harvie Anderson followed by the Press Gallery lunch. You could, however, do a meeting at 15.00 for an hour.

4. The conclusion seems to be that only by taking agriculture at Cabinet on 6th December can we keep open the options with regard both to the public expenditure White Paper and the Agriculture Council on 10th December. I would be grateful if you could let me know if the Prime Minister is content in the circumstances to proceed on that basis.

5. If the Prime Minister's diary permits, she may find it helpful to have a talk with Sir Kenneth Berrill in advance of Cabinet.

MJV

(M. J. Vile)

26th November 1979

AJ

CONFIDENTIAL

Econ Pol

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

R

27/11

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

26 November 1979

Dear John,

1979-80 CASH LIMITS AND OUTSTANDING PAY SETTLEMENTS

Thank you for your letter of 22 November proposing adjustments to health cash limits to provide realistically for the cost of settlements with ancillaries, ambulancemen, ambulance officers and maintenance staffs, and covering also adjustments for the universities.

For my part I am prepared to accept the approach proposed in your letter, and to agree the amount of the increase for health. There are obvious tactical advantages in avoiding revealing the percentage assumption at this stage, and my officials have already agreed with yours the text of a suitably arranged Parliamentary answer to be made tomorrow.

I am sending copies of this letter to the recipients of yours.

Yours ever

Patrick

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	The Government's Expenditure Plans 1980-81
HMSO	November 1979

Signed A Wayland Date 2 March 2010

PREM Records Team

Econ Pol

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Patrick Jenkin MP
Secretary of State
Department of Health
and Social Security
Alexander Fleming House
Elephant & Castle
London SE1 8BY

22 November 1979

Dear Secretary of State,

1979-80 CASH LIMITS AND OUTSTANDING PAY SETTLEMENTS

We agreed at Cabinet on October 25 - CC(79)18th - that the rate support grant (RSG) cash limit for 1979-80 should now be adjusted to cover, inter alia, the outstanding pay award this autumn for the manuals. This is in line with our general approach that public sector pay negotiations should take place within the financial framework of cash limits.

The other major outstanding pay settlements in the current financial year are the NHS ancillaries and ambulancemen and certain university employees. At present the relevant cash limits provide for a 5% increase in earnings for these awards. It would be appropriate to follow the approach on the RSG and make the outstanding adjustments to the relevant cash limits before these settlements are reached.

Bearing in mind that the health authorities and universities have no other source of finance and that they can hardly be expected to achieve further offsetting savings in the remainder of this financial year, I propose that the adjustment of their cash limits should be calculated on a basis sufficient to cover settlements this autumn giving an annual increase in the wage bill of up to 14%. In announcing the adjustment, however, we should avoid quoting a percentage and simply announce the money sum which we are adding to the limits. The increase to the cash limits for the universities on this account would be £23.603 million and for the English health programme £27.280 million. A similar adjustment would be made for the health programmes in Scotland and in Wales.

I hope we can agree this quickly so that the adjustments can be swept up in the cash limit changes to be announced before the Winter Supplementary Estimates are published on 28 November. Could you let me know by close tomorrow, Friday 23 November, whether you have any objection to proceeding on the basis I have proposed.

I am copying this letter to the Prime Minister, and to the Secretaries of State for Education and Science, Industry, Employment, Environment, Scotland, Wales and Northern Ireland, and to Sir Robert Armstrong.

Yours sincerely
A. Line

pp JOHN BIFFEN
[Approved by the Chief Secretary
and signed in his absence]

PART 6 ends:-

CAW ~~to~~ RTA 19.11.79

PART 7 begins:-

Ch. Sec HMT to S/S DHSS 22.11.79