

*of Civil Service*  
*May 79* |

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PRIME MINISTER

Public Expenditure 1979-80: Cash Limits 1979-80 and  
Civil Service Manpower

The two Treasury papers - Public Expenditure: Scope for Cuts (C(79) 4) and Cash Limits (C(79) 5) - and the CSD paper on Civil Service Manpower (C(79) 7) represent essential building blocks for the Chancellor's Budget. For good order you will need to take them separately (and I am letting you have a brief on each) but they hang together and in some respects overlap. I do not know how far the Chancellor will be willing (or indeed at this stage able) to expose the broad arithmetic of his Budget. But it would no doubt help him, and focus the minds of Cabinet, if you felt able to give them a collective scene-setting introduction. This might take the following form:-

*see Civil Service - May 79*

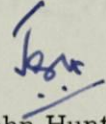
- (a) We have a dreadful inheritance. The previous Government budgeted for a 2 per cent increase in public expenditure this year in real terms and grossly underestimated, in their public expenditure plans, the prices they would have to pay for goods and the pay they would have to allow their employees. The built-in assumption for the price of goods was of an increase of  $8\frac{1}{2}$  per cent over last year - the RPI is already over 10 per cent up on a year ago and rising. Similarly they assumed that the earnings of their own employees would increase some 7 per cent over the year. The outcome is likely to be two or three times as much as this.
- (b) Moreover the last Government gave a good deal of currency to a public sector borrowing requirement this year of around  $\pounds 8\frac{1}{2}$  billion. Without action to increase the net yield of taxes and/or to cut public expenditure the outturn is likely to be a good deal higher than this. Thus the Chancellor will need to make up a good deal of ground simply to return to the previous Government's PSBR target on which confidence depends. The scope for cutting direct taxation therefore turns critically on making

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bigger savings in public expenditure or bigger increases in indirect taxation than those needed to restore the last Government's PSBR objective, let alone to improve on it.

(c) But our economic strategy depends critically on making a significant start in the reduction of direct taxation in this Budget. The Chancellor will therefore require all the help he can get from his colleagues in making immediate cuts in public expenditure. To the extent that these cuts are not forthcoming either indirect taxes will have to be increased further - with consequent upward pressure on the RPI - or the Government's ambitions for cuts in direct taxation will have to be restrained and our new strategy will be hamstrung before it starts.

2. If you felt like opening the discussion on these lines you could then invite the Chancellor to add any general comments. Thereafter you might take your colleagues successively through the three papers in the order: 1 public expenditure; 2 cash limits; 3 Civil Service manpower.

  
(John Hunt)

16th May, 1979

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PRIME MINISTER

Public Expenditure: Scope for Cuts  
(C(79) 4)

BACKGROUND

This paper by the Chief Secretary represents the first step in a longer term programme of cuts in public expenditure. Further proposals covering the arrangements for reviewing expenditure for 1980-83 will be before the Cabinet next week. And a full-scale review will take place after the Budget with a report back to Cabinet in the summer. The paper makes a mixture of proposals, some of which are for immediate decision and others for further discussion with spending Departments. Bilateral discussions are planned for next week and the Chief Secretary would then intend to bring his specific proposals for decision to Cabinet. Given the Budget timetable the most convenient date for a meeting of the Cabinet for this purpose is likely to be 31st May.

2. In addition to running through his own suggestions the Chief Secretary will put considerable emphasis on his proposal that Ministers in charge of spending Departments should consider urgently whether they can offer any further savings this year. He does not say how much he wants in further cuts but his present suggestions appear modest and of course it is by no means certain that Cabinet will adopt all of them. You may therefore feel that it would be worthwhile putting spending Ministers on their mettle by asking that all their suggestions for additional savings should be forwarded to the Chief Secretary by, say, Monday of next week with copies to you for information.

HANDLING

3. If you adopt my suggestion in the covering brief that you, and possibly the Chancellor, should make a scene-setting introduction to the three expenditure papers, you could probably tackle this paper by moving straight

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to the conclusions in paragraph 16 without further preliminary. The following check-list may be helpful:-

16(i) "The proposals listed in the Annex should be discussed with Ministers concerned, after which I should report back to Cabinet with my recommendations": You will want to establish at the outset that the specific proposals in the Annex are not a substitute for any squeeze arising from the operation of cash limits. They stand on their own. This said you will then want to run through the items in the Annex as follows:-

Annex, paragraph 1(a) Housing capital: You will want the views particularly of the Secretary of State for the Environment, the Secretary of State for Scotland, the Secretary of State for Wales and the Secretary of State for Northern Ireland. Unless they object in principle bilateral talks with the Treasury can go ahead after the meeting. The scope for savings is considerable.

Annex, paragraph 1(b) Local Authority Rents: The same Ministers are involved and may wish to speak. The Cabinet too may care to express a view on whether it prefers an increased rent guideline or a cut in the subsidy on "new capital costs element". The latter has the political merit of leaving specific decisions to local authorities.

Annex, paragraph 2(a) Prescription Charges: The Secretary of State for Social Services will wish to speak. The issue is highly charged politically and you may want to check on what, if anything, was said during the election campaign.

Annex, paragraph 2(b) Miscellaneous Health Charges: The Secretary of State for Social Services and the Chief Secretary should be asked what they have in mind - and perhaps to say why ophthalmic charges are to be excluded?

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Annex, paragraph 3(a) School Meal Charges: The schools meal service is very expensive - upwards of £400 million a year - and meals are heavily subsidised. Provided that the poorest children can be protected this proposal may be generally acceptable. You may also find it illuminative to ask about the current cost of providing subsidised or free meals to school teachers and other school helpers and to enquire into the justification for the present practice. Looking further ahead it could well prove that the school meals service is worth a close examination in terms of justification and value for money. It costs more than twice as much as the provision of books.

Annex, paragraph 3(b) Awards to 16-18 year olds: It is to be doubted whether any of your colleagues will wish to revive this proposal.

Annex, paragraph 4(a) Special Employment Measures: I understand the savings shown to be gross in that they do not take account of the increased Unemployment Benefit that would have to be paid if the Special Employment Measures were reduced or cut back. Cabinet will need an idea of the net savings.

Annex, paragraph 4(b) The MSC Programme: The same gross/net problem arises.

Annex, paragraph 5(a) The NEB: The Cabinet can be expected to look on the figure of savings here with some scepticism. However we understand that £50 million represents the uncommitted margin in the NEB's accounts. It implies a total moratorium on new investment and as such may be unrealistically high.

Annex, paragraph 5(b) Regional Support: Given that regional support is now running well in excess of £1 billion a year a £15 million saving looks very small. You will certainly want to ask what arrangements are being made to put in hand the

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"full review" referred to and when it is expected to be available. Even allowing for the need for a review colleagues may well question whether £15 million is all that can be expected this year. (The Department will argue that the time needed to process claims means that cuts in, say, Regional Development Grant would not show up as lower expenditure until next year.)

Annex, paragraph 5(c) Scottish and Welsh Development Agencies:

Again, £10 million looks small. Is it the best that can be done?

Annex, paragraph 6 Community Land Scheme: No problem.

Annex, paragraph 7 Aid: £20 million may be all, as the paper says, which can be found this year given existing commitments but a lot of attention will need to be concentrated on this area in the post-Budget expenditure review.

Annex, paragraph 8 British Rail Fares: This is the only suggestion in the Annex for raising nationalised industry prices above the level needed to keep within their cash limits. You will want to ask what prospects exist in other nationalised industries, e. g. gas and electricity, for a similar operation.

Annex, paragraph 9(a) BNOC: Colleagues will no doubt find this specific proposal acceptable. But as with nationalised industry prices under the previous item, the BNOC proposal is the only reference to nationalised industry capital spending. You will want to ask nationalised industry sponsor Ministers what opportunities may be open to them.

Annex, paragraph 9(b) Energy Research: Given the importance of developing our energy supplies, it looks a little odd to single out energy research for a moratorium on new contracts. Is this sensible in itself? And what scope exists for other savings in research expenditure by Government Departments as a whole?

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16(ii) "A reduction in the Rate Support Grant to Local Authorities of £200 million should be made on the lines proposed in paragraphs 7-9":

This proposal links across to the Cash Limits paper (C(79) 5, paragraph 16(ii)). The essence of the proposal is that the Government should give a blanket RSG cover for all local authority pay settlements affecting public expenditure this year and then make a single and specific deduction of £200 million (England and Wales) and £25 million (Scotland). This is a relatively simple and tidy procedure and avoids the complication of detailed negotiation on RSG for each and every pay settlement in the local authority field. Some of your colleagues may regret it for just this reason. On the other hand its simplicity has many attractions. The Chief Secretary might be asked to explain his proposal and the 'territorial' and education Ministers to comment. You might then seek to determine whether the Cabinet:-

- (a) is prepared to adopt the recommended course;
- (b) considers £225 million as an adequate offset. (It may be wholly out of scale - in the sense of being too small - in comparison with the savings being sought from central Government. The Chief Secretary could be asked to re-examine the number with this consideration in mind.)

16(iii) "There should be a detailed review of the scope for selling assets (paragraph 10) with the intention of raising some £750 to £1000 million in the current year": Strictly speaking the sale of assets is not equivalent in its monetary effects to a cut in public expenditure. But there is unlikely to be any other way in which the Budget arithmetic can be made to balance and it is unlikely that the monetary theorists or the markets will jib. To make the Budget figures come out right, sales must be for cash, not on extended credit terms.

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16(iv) "We should take a decision on the cut in the Contingency Reserve in the light of what we decide on the relevant Social Security proposals": The Social Security proposals concerned are not yet to hand and it may be that a final decision on the Contingency Reserve will have to be deferred until the Cabinet meeting on 31st May. There is no doubt that a cut in the reserve can represent a meaningful cut in public expenditure but only if later spending decisions can be held within the reduced total. The credibility of a cut in the reserve is therefore a question of outsiders' judgments on the Government's strength of purpose. The Chancellor can probably get away with it this year but the Government will need to win its spurs if a repeat performance is to succeed next year.

16(v) "The Contingency Reserve should be used as an operational instrument to ensure that any decisions to add to expenditure are contained within the planned total as proposed in paragraph 12": Paragraph 12 - with its proposal that major claims on the reserve, or other claims which Treasury Ministers are not themselves prepared to accept should be referred to the Cabinet for a decision reflects hard experience. It is a necessary part of the process of maintaining discipline on public expenditure and endorsement at this stage by the Cabinet, clearly recorded in the minutes, would be helpful in the future.

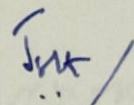
16(vi) "Ministers in charge of spending Departments should consider urgently whether they can offer any further savings in 1979-80": I have touched on this point earlier in this brief. The underlying reality is that spending Ministers are the best placed to know where their expenditures can be cut. But of course they all tend to operate their own private Contingency Reserve. You are more likely to get sensible offers from them at this early stage of the life of the Government than you will later on when they have become more identified with their Department and its clients. A strong push now could be rewarding.



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CONCLUSIONS

4. You will want to record specific conclusions on each of the individual recommendations in paragraph 16 of C(79) 4, together with a general steer on each of the separate items in the Annex to that paper. You will in addition wish to invite each of the Departmental Ministers concerned with the expenditures in the Annex to undertake urgent bilateral discussions with the Chief Secretary, Treasury, and to invite all Ministers to put proposals for further savings to the Chief Secretary by next Monday with their proposals copied to you for information.

  
John Hunt

16th May 1979