

Growth 1 1/2 p.c. (higher than 1978)

Pay (yellow)

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May 1979
of the Prime Minister's
PRIME MINISTER

SECRET

79-80

1) HHS 98,000 3

I.R 81,000

D.E. 54,000

M.O.D. 248,000

PUBLIC EXPENDITURE

(C(79) 30 and 31)

35,000
16,000 R.D.F.
121,000
127,000
35,000

BACKGROUND

At Cabinet last week, you asked:

- (a) that the Chancellor should produce a paper on the economic background, showing what would happen if his objective of £6.5 billion reductions in 1980-81 were not met;
- (b) that a sub-Committee (MISC 11) should review some of the main spending programmes.

2. The first remit is discharged by C(79) 30.

3. The second remit is covered by the report of MISC 11, circulated by the Chancellor as C(79) 31. In the event, the Group was able to talk to nearly all the spending Ministers, and not just a limited range which you mentioned at Cabinet. The report shows that, while substantial progress has been made, the Chancellor is still £800 million short of his target. This is after taking account of very big concessions by the Secretary of State for Education. But Education, along with Housing and the Defence Budget, remain the principal areas of difficulty.

4. As background you may care to be reminded of the make-up of the £6½ billion cuts as set out in the earlier papers. It was:-

(1) Public Expenditure programmes other than the nationalised industries	4.75 →
(2) Nationalised Industries (net)	0.35
(3) Further cuts in Civil Service manpower	0.15
(4) Reduction in Contingency Reserve	0.75 -
(5) Sale of Assets	0.50 -
	6.5

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5. The Cabinet's present discussion is concerned with items (1) and (2) and the Chief Secretary will also seek decisions on (4) and (5). Item (3) - Civil Service manpower^wer - is for consideration after the recess (though the cuts in line 1 already imply substantial - if as yet unquantifiable - cuts in Civil Service manpower).

HANDLING

6. This is bound to be a long and difficult Cabinet and the sooner specific decisions can start to be made the better. I suggest therefore that you start straight off on C(79) 31 treating the Chancellor's "background" paper (C(79) 30) as background and only praying it in aid if any colleagues seek to reopen the tax and monetary strategies.

7. Accordingly I suggest that you begin by asking the Chancellor of the Exchequer to take the Cabinet item by item through C(79) 31. This is right both because he has chaired the "star chamber" group and because on this occasion it will probably be best for you to hold your own fire until you can see the shape of the final package which you will then need to throw your weight behind.

8. The Chancellor and the Chief Secretary will be seeking eight specific decisions:-

- (a) Agreement on the figures for changes to individual programmes listed in Annex B.
- (b) Agreement to the changes in nationalised industry borrowing listed in the earlier paper, C(79) 28 as modified by the MISC 11 report. (The cuts are set out in Table 3 on page 6 of C(79) 28 and the modifications on pages 14 and 15 of C(79) 31.)
- (c) Decisions on the form of an announcement next week: if it cannot be finally agreed before next Thursday's Cabinet, should the *Nard* text be circulated in correspondence in advance, for final settlement then? (You will remember that the Chancellor has toyed with the idea of presenting a White Paper to explain the economic setting in which the Government's decisions have to be placed - it is highly doubtful, however, if such a White Paper

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could be prepared and cleared in time for publication next week. Mr. ^{Walker} Walker has of course argued that it will help him in his operation with the local authorities to have his requests to them put in a wider frame - and he needs this soon.)

- (d) Whether any announcement should treat local authority current expenditure as a single block (the proposal in paragraph 7 of the MISC 11 report).
- (e) Agreement to go to consultation with the local authorities on years beyond 1980-81 during the summer.
- (f) Agreement that the 'end-year carry-over' arrangements should be examined at official level (a point left over from the Chief Secretary's paper at the last meeting).
- (g) Agreement on the target size of the Contingency Reserve for 1980-81 (necessary, to prevent Cabinet piling up too many imprecise forward commitments - e.g. on regional expenditure).
- (h) Agreement on the target for disposals in 1980-81 - necessary to give guidance to E(DD), which is considering the 1980-81 programme later on Thursday.

9. I suggest that you start by settling the local authority issue in paragraphs 6 - 9 of the MISC 11 report: this effects the handling of the subsequent discussion. The argument is that the Government cannot directly control local authority current expenditure. That being so, the best route might be 'globalise' the cuts, give guidance on exemption for law and order programmes, and leave the local authorities to sort out the rest. The Secretary of State for the Environment broadly favours this approach: the Secretary of State for Education is likely to oppose (see his letter of 10th July).

The point is an important one, which goes to the root of the Government/Local Authority relationship. If the Cabinet chooses this course, for next year only, its implications for longer-term control will need to be worked out in some

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detail. It also leads straight into the difficult question of control over rates. There is no absolute need for a decision on that difficult question at this stage. You might want to call for a further paper immediately after the recess, from the Chief Secretary and the Secretary of State for the Environment, on this point. If the decision is in favour of 'globalisation' it is not strictly necessary to go through the individual programmes with a local authority element: but Cabinet cannot very well accept a global figure without knowing approximately what it might mean for individual programmes and I think the better course is to go through the details.

10. In that case, you might use the MISC 11 report as a text, starting at paragraph 11. The figures are summarised in Annex B, but this does not deal with the nationalised industry totals, which are shown separately (unrevised) in C(79) 28, Table 3. You need to have both lists before you as you proceed.

I attach as an Annex notes on some points of difficulty which may arise.

11. The remaining points should take little time, but they need to be covered.

12. Local Authority consultations about subsequent years. The Chief Secretary will argue that early consultations are needed with the local authorities about the deeper cuts which will be needed in 1981-82 and subsequent years, and that these talks should begin immediately in order to prepare the ground for decisions which the Cabinet has to take in the autumn. The proposal is that illustrative cuts of $12\frac{1}{2}$ per cent in 1981-82 and of $17\frac{1}{2}$ per cent in 1982-83 should be explored. ^{Although} ~~However~~ the fact of such consultation must become public knowledge, it seems desirable that they should take place if Cabinet is to have a well-informed discussion in the autumn about the later years. It can be emphasised in the consultations that the figures are at this stage purely illustrative. But equally, the authorities must not be led to believe that the 1980-81 cuts are the end of the story.

13. Contingency Reserve. The Chief Secretary's earlier paper, C(79) 26, proposed in paragraph 13 that the Contingency Reserve for next year should be cut from £1,500 million to £750 million. This is a very large cut so long before the start of the year. It leaves a very small margin for error which

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may have to accommodate a further up-rating in child benefit in November 1980, as well as any 'over-runs' on pay beyond whatever cash limits are agreed for next year. Nevertheless, this cut seems inevitable if anything like the original target is to be maintained. You will want to make Cabinet sign up on the cut quite specifically, in order to maintain discipline on expenditure during the year as it proceeds.

14. Disposals. The target proposed is £500 million in 1980-81. It may well prove possible to do better than this. But it seems, particularly following the unsatisfactory discussion of BNOC earlier in the week, that it would be unwise to bet on this. E(DL) will be looking at the programme at its meeting next week.

15. Defence. It may be that before this point an agreement will have been reached on the Defence component. On the other hand there are signs of growing discontent among other Ministers about the privileged position of this programme. If this resentment surfaces frequently in the discussion you might suggest that the Cabinet take a second look at Defence at the end of the discussion.

16. Timing of Announcement. You will have seen the Chancellor's minute of 18th July which explores the options here. If there is to be a debate the Chief Whip thinks it might well mean extending the Sitting of the House into August. You will clearly not want to have a debate of this importance occurring while you are in Lusaka. But this imposes its own constraints on the timetable. If the debate must be next week you will have to fit in another meeting of the Cabinet early next week to agree the content of the announcement and this in turn means that Cabinet must reach virtually final conclusions on the cuts at the present meeting. Even if this proves practicable (which is a big assumption) you may still feel, that proceeding at this pace carries a high risk of muddle and of inadequately prepared public presentation. It is relevant that the principal operational reason for making this major announcement before the recess appears to be to give Mr. Heseltine a point of reference for his discussions during the recess with the local authority

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Associations. You might ask your colleagues whether they regard the present very difficult timing proposals as a sensible way of achieving this or whether there is some acceptable lower key alternative. Finally you will know that, if the business of the House for next week is to be rearranged, Parliament will expect to be told in the normal business statement tomorrow afternoon.

CONCLUSIONS

17. The conclusions might therefore be as follows:-

- (i) To agree that the economic prospects described in C(79) 30 require reductions on the published expenditure plans for 1980-81 of at least £5.7 billion.
- (ii) To agree that, if necessary in order to maintain an acceptable PSBR total, the Chancellor should be authorised to explore other ways of offsetting the failure to secure adequate public expenditure cuts by increases in indirect taxation. [In order that the Cabinet cannot say later that they did not know.]
- (iii) To note the individual figures agreed for Departmental programmes, listed in Annex B to C(79) 31 [with any changes agreed during the meeting].
- (iv) To agree the cuts in nationalised industry financing listed in C(79) 28, Table 3 modified by C(79) 31 [together with any amendments agreed during the meeting].
- (v) To decide the timetable and arrangements for the announcement and any subsequent White Paper.
- (vi) To invite the Chief Secretary to circulate the text of any announcement for clearance at a Cabinet next week.
- (vii) [Possibly] to agree that the cuts in local authority expenditure should be treated as a global total, without itemisation, and that local authorities be free to choose where the cuts should fall.
- (viii) [Possibly] to invite the Chief Secretary and the Secretary of State for the Environment to bring forward proposals in the autumn for controlling the level of local authority rates.

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- (ix) To invite the Secretary of State for the Environment and the Secretaries of State for Scotland and Wales to open consultations with the local authorities about the reductions of 12½ per cent in public expenditure in 1981-82 and of 17½ per cent in 1982-83.
- (x) To invite the Chief Secretary to arrange for officials to study the problem of end-year carry-over, and to report back to the Cabinet.
- (xi) To agree the Contingency Reserve for 1980-81 should be reduced by £750 million.
- (xii) To agree that the disposals programme for 1980-81 should be designed to produce savings of at least £500 million.

M.H.

JH

(John Hunt)

18th July, 1979

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ANNEX

Notes on Individual Programmes

Defence

The argument hitherto has been about the NATO commitment. You may find it useful to have the exact text by you: it is attached as an appendix. But it has become clear that the Secretary of State for Defence's real worry is domestic: he does not wish to show a figure for 1980-81 lower than that planned by the Labour Government. His bid, but not the MISC 11 recommendation, would achieve this. He will also seek special treatment over cash limits for next year: given the tightness of the Contingency Reserve, he may be reluctant to agree to this. The level of cash limits will have to be determined in the autumn, in the light of a further look at the Chancellor's 'Option A' as commissioned at E yesterday.

Aid and FCO expenditure

2. The FCO proposals are accepted (they mean some cut in the level of representation overseas and in BBC and British Council standards) but MISC 11 wants a further £8 million off aid.

Agriculture

3. MISC 11 wanted cuts in capital grants, but there is a review in progress as part of the Rayner exercise. Mr. Walker offered some land disposals in lieu, but the Scottish and Welsh Ministers could not necessarily follow suit. MISC 11 suggest taking credit for a review of capital grants, and treating the land disposals as an uncovenanted extra.

4. There is a separate problem about the Defence food stockpile, on which Mr. Walker wrote to you on 6th July. He believes that, because this stockpile is held for Defence and Civil Defence purposes, the cost of rebuilding it should not be a charge to his programme and should fall on the Contingency Reserve. There are several other similar cases: the strategic oil pipeline system is one such. You might well insist that he sticks by the present rules, for 1980-81, although you could concede that a review of the rules should be made for subsequent years before Ministers take decisions about them. This would mean him absorbing an extra £14 million.

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Forestry

5. No problems. It is important to avoid double counting potential savings in the public expenditure cuts and in the disposals exercise.

Industry

6. The Secretary of State, as expected, has been very co-operative. It was of course easier for him as most of the decisions had already been taken in the context of this year's Budget and the additional cuts needed in 1980-81 were correspondingly smaller. It may still be necessary to seek further savings in the industry and employment areas to make good any shortfall elsewhere. Nevertheless he deserves congratulations. However, it is worth noting that one of the additional cuts involves calling in Industry Act loans: he will have to watch the effect on corporate liquidity next year. But there is no other way of securing the desired reductions.

Trade

7. Agreed.

Energy

8. No reductions sought: it is proposed that the additional bids for R and D should remain a very potential charge on the Contingency Reserve. You might use this opportunity to remind the Secretary of State for Energy that he must bring forward his proposals on the nuclear programme soon after the Recess. As you know, they have taken a very long time to produce.

Transport

9. Agreed.

Home Office

10. The Home Secretary is the only Minister who has managed to go into the discussions faced with a request for cuts, and to emerge with agreement on increases. He too deserves congratulations, of an ironic kind. But there is not much room for varying this recommendation.

Environment

11. The absolute sums at issue look very large, but the rate of growth in this programme is fairly low. You will recall the earlier argument with the Secretary of State about the validity of the 'Opposition cuts' which he claims he has never

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accepted. The political problem for Cabinet is whether it can face rent increases on the scale which these cuts would demand. The issue is posed in paragraph 32(b).

2 Action would be needed to prevent local authorities avoiding these rent increases by raising their rates. MISC II propose that the rent increases, and all the other changes suggested by the Chief Secretary, should be agreed (noting that legislation would be required) and that the additional bids should be dropped.

Education and Science

12. The Secretary of State for Education has gone a long way to meet the Chief Secretary's demands. There are obvious political traps here. Ministers at MISC II felt that Cabinet would be reluctant to endorse all their recommendations. That on maintenance grants is particularly contentious, and will effect the key group of the Government's own supporters (as well as a good many Ministers and MPs). It is worth noting that, if students are regarded as dependent children, although over 18, then the maintenance grant was a substitute for child tax allowances, and to withdraw it now would be seen as cheating. The other cuts, school meals and milk, school transport, and stand-still in educational standards, will be deeply unpopular, but Mr. Carlisle is prepared to defend them. Lady Young made the additional political point that some of the cuts bear heavily on women in work.

Arts

13. The Chancellor of the Duchy will fight for his programmes: the major issue is whether to postpone the start of the British Library. He claims he never agreed to do this, despite what is said in paragraph 36.

Social Security

14. These proposals are virtually agreed, if Cabinet will accept them. The only difference is over the last £15 million which depends on progress with the legislative programme.

Scottish Office

15. No separate issue: this will follow whatever is decided for the other programmes. The Secretary of State is however unhappy about the scale of the total operation, and will say so.

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Welsh Office

16. There is a difference of view here: MISC 11 recommends that the Welsh Office should find all but the last £2 million of the proposed cuts. The Secretary of State resists strongly, and wishes also to register a claim on attenuated Contingency Reserve for coal mine closures, etc.

Coal

17. No clear decision was reached on this at E on Tuesday. The Secretary of State originally wanted an extra £55 million; he is now prepared to offer a cut of £25 million instead, but with conditions. MISC 11 wants a £30 million cut without conditions. This would probably fall on investment but might require a small price increase, but the OPEC rise should leave headroom for it.

Scottish Electricity

18. £5 million at stake. You might press for it.

British Aerospace

19. This should be agreed without difficulty. £120m

Post Office

20. The problem here is that Post Office target is expressed in terms of a return on capital employed. The accountants, using inflation accounting, have redefined the capital base. If the fixed target is maintained, the surplus therefore comes down and the borrowing is increased. The remedy is to increase the target as a percentage of the reduced capital base. There are other elements in the shortfall too, which may require small additions to the next round of price increases. Cabinet will have to accept these if the cuts proposed here are agreed.

Other nationalised industries

21. All the other proposals have been agreed. Cabinet should note that these include the higher option for gas prices.

Minor programmes

22. We know of no contentious points.