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Ref. A09566

PRIME MINISTER

Cash Limits

(C(79) 5)

BACKGROUND

Cash limits are the keystone of your structure for controlling public expenditure but the limits you have inherited are outdated and based on self-evidently false assumptions about prices and pay movements. The Chancellor obviously needs new cash limits on which to base his Budget. And, self-evidently, to be effective those limits must be credible. In addition, therefore, to obtaining the decisions of your colleagues on the specific proposals in the Chief Secretary's paper you will want to ensure that Departmental Ministers are committed to, and fully accept, the impact of the decisions on their own programmes and are prepared to live with the consequences. It would be fatal for Ministers to take brave decisions now, only to run away from them later. This does not mean that there can be no flexibility later: no Government can afford to tie its hands absolutely for 12 months ahead. It does mean that Ministers with foreseeable problems had better identify them now because hereafter only the very strongest arguments can hope to prevail in making claims on what, on the Chancellor's proposals, will be a relatively small contingency fund.

HANDLING

2. You will want to ask the Chief Secretary, Treasury, to introduce his paper. Thereafter you may find it convenient to work through the specific conclusions in paragraph 16 of C(79) 5 which, for convenience, are set out, with comments, below:-

(i) "We should not adjust the published cash limits to cover higher price increases": The Chief Secretary himself qualifies this conclusion in paragraph 4 of his paper where he suggests that for expenditure other than on pay "it should be possible to absorb a squeeze up to 4 or 5 per cent". The implication is that if prices go up by more than 12 or 13 per cent cash limits can be reopened. This qualification is worth recording in the minutes. On the specific proposal your colleagues will need to indicate:-

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(a) Whether they are prepared to absorb a 4-5 per cent squeeze, if necessary, on their budgets (preferably on a "speak now or forever hold your peace" basis).

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(b) Whether there are any specific exceptions which need to be noted for later consideration. The Ministry of Defence, among others, is likely to want to put up a marker here.

(c) Whether they are prepared to accept that this potential squeeze on their spending is quite separate and distinct from the specific cuts discussed on the previous paper (without clarity there could be endless arguments later).

(ii) "We should be prepared to adjust the cash limits on the RSG to cover the Government's share of local authority settlements, noting that I am bringing forward in the context of the Budget a proposal for economies in local authority current expenditure and for cutting back proposed increase in the RSG accordingly": This particular proposal is important not least in the context of teachers' pay - and later of the pay settlement for local authority "white-collar workers". It has the merit of avoiding the RSG complications which would arise if the Government adopted a variety of different stances on individual local authority pay settlements this year as to the amount it was prepared to cover by RSG. In other words it greatly simplifies the RSG operation. On the other hand it would remove the possibility, to which some of your colleagues attached importance in the discussion on teachers' pay last Monday, of imposing direct cuts on the education budget as a counterpart to the teachers settlement.

(iii) "We should adjust the cash limit on universities and the National Health Service on the basis notified to them by the previous Government": It is to be doubted whether any of your colleagues will seek to challenge this conclusion.

(iv) "The cash limits on fringe bodies should be treated in the same way as those on Civil Service manpower, on which the Lord President is circulating proposals": Again no particular problems are likely to arise.

(v) "We should tell the nationalised industries that we expect them to observe the published cash limits on their external financing requirements and will support them in taking the necessary action including price increases": It is here that the Chief Secretary's proposals may be criticised as a generalisation. The circumstances of individual nationalised industries vary very widely and, for some of them, their financing requirements in the coming year are very uncertain. Thus there are at least three nationalised industries - coal, steel and shipbuilding - where powerful arguments may be advanced in the course of the year for additional public finance based on longer-term calculations of the national interest, i.e. the need to preserve capacity through a slump in demand, or on calculation of the social and political acceptability of abrupt programmes of closures and reduced employment. Depending on how colleagues react it may be necessary to put up a marker here. At the same time some of your colleagues may object to the Chief Secretary's proposal that the nationalised industries should have carte blanche for price increases. These colleagues will argue that savings should come through increased efficiency. They may well be right but the complexity of the problems involved, and crude operational necessity, may mean that the Chief Secretary's course should be followed at least for the coming year.

CONCLUSIONS

3. The conclusions reached by Cabinet on these issues will be of considerable operational importance for Departments and you will need to record as clear a statement of the Cabinet's view on each as is possible in the light of discussion.

John

JOHN HUNT

16th May, 1979