

SECRET

PRIME MINISTER

Public Expenditure - Resumed Cabinet Discussion

BACKGROUND

Since Cabinet yesterday MISC 11 has considered the DOE and Northern Ireland programmes. The results are reported in the Chancellor's minute to you of today. There is also a further minute from the Secretary of State for Education.

See Flag B

2. The savings achieved so far, including the agreement now reached with DOE, amount to £2,118 million. If all the remaining cuts proposed by MISC 11 are accepted the total on Departmental programmes would be a cut of £3,687 million. This compares with the original target of £4,810 million and £4,011 million which the Chancellor was seeking at Cabinet yesterday.

3. You made it clear on Thursday that the Cabinet would have to reach final decisions on Monday about 1980-81, and you also made it clear that you would not want any general announcement, still less a debate, before the Recess. This leaves open questions about disclosure to local authorities and nationalised industries, to which I return below.

HANDLING

4. You might start by noting the agreement which has been reached with DOE, which followed some fairly intensive horse trading. (Any attempt by Mr. Heseltine to reopen that agreement should be resisted.) You might then turn to Education, and work through the remaining programmes, continuing the process started on Thursday. Once again I attach as an Annex notes on the individual programmes; in some cases these have been slightly revised since Thursday's meeting to take account of new developments.

But see his his proposal (Flag E) to abolish high rate relief on mortgages  
R.

5. Having reached the end of the programmes at Annex you might pick up the remaining outstanding points from the Chief Secretary's paper (C(79) 26).

They are:-

SECRET

- (a) The size of the Contingency Reserve. The Chief Secretary suggests a reduction of £750 million, leaving another £750 million in the Reserve. As you know, this is a very small balance to keep in hand, so long before the beginning of the financial year. It will require great restraint on the part of spending Ministers. It will be important to maintain the rule that Treasury Ministers have the right of appeal to Cabinet over any claim on the Contingency Reserve which a Cabinet Committee is disposed to allow against their wishes (paragraph 8 of Questions of Procedure for Ministers). You might like to say this. It helps to have it on the record.
- (b) Disposals. Cabinet might approve the target of disposals of £500 million in 1980-81, noting that it may be possible to do better than this. E(DL) will be looking at the programme for that year on Thursday, under the Chancellor's chairmanship. They need a clear instruction.
- (c) Civil Service. The Chief Secretary's original arithmetic included £150 million for the Civil Service reductions, which Cabinet will be considering in September. It is possible that these will, in the event, be a little bigger. But the savings agreed on individual programmes already assume, in several cases, quite substantial staff cuts, in addition to the £150 million; and it would be unwise to reckon on very much more. I suggest you get Cabinet to note the £150 million provisionally, pending the resumed discussion in September. That will at least set a floor to the difficult decisions which will then have to be taken.
- (d) End-year Flexibility. There should be no problem in agreeing, as the Chief Secretary proposed, to a study of this proposal, provided that there is absolutely no commitment made at this stage. (This is potentially dangerous idea, from the point of view of controlling the PSBR in any one year.)

SECRET

6. In addition there is one general point left over from the MISC 11 report about globalisation. In paragraphs 6 - 9 of the MISC 11 report 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 18<sup>th</sup> July). The point is an important one, which goes to the root of the Government's/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 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.

Plus D

7. That leaves the question of an announcement. If there is to be no general statement, and no debate, then something must be said to the local authorities (and also to the nationalised industries). I understand that the Chancellor is considering something on the lines of Option 1(a) in his minute to you of 18th July; a formula on these lines, though not perfect, seems the best way of proceeding. It might mean a Parliamentary row after the Recess. It would certainly become public knowledge (some of the Cabinet discussions are already leaking). But it is operationally essential to say something to the local authorities now. This would also allow provisional discussion to take place about the level of reductions in later years. These form the basis for Cabinet's resumed discussion of public expenditure in the autumn. Something similar needs to be said to the nationalised industries, although a danger of a leak from that resource is rather less.

Plus C

CONCLUSIONS

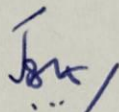
8. You will wish to record fairly precise conclusions at the end of these protracted discussions. They might be as follows:-

SECRET

- (i) To note the figures agreed for each individual programme listed in Annex D of C(79) 31 with any further changes agreed during this meeting;
- (ii) to note that the Chancellor will discuss separately with the Secretary of State for Northern Ireland the exact figure for the Northern Ireland programmes as a consequence of this;
- (iii) to agree the cuts in nationalised industry financing listed in C(79) 28, Table 3, as modified by C(79) 31 with any amendments agreed during the meeting; for the avoidance of doubt it might also be as well to refer specifically to the higher gas price;
- (iv) to agree that no announcement should be made before the Recess, but that an indication should be given to the local authorities of the cuts involved, on the lines of Option 1(a) set out in the Chancellor's minute to you of 18th July;
- (v) to agree that the Departmental Ministers concerned may make similar statements to the nationalised industries;
- (vi) possibly to agree that the cuts in local authority expenditure should be treated as a global total, without itemisation, and that the local authorities be free to choose where the cuts should fall;
- (vii) 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;
- (viii) to invite the Chief Secretary to arrange for officials to study the problems of end-year carry over, and to report back to Cabinet;
- (ix) to agree the Contingency Reserve for 1980-81 should be reduced by £750 million;
- (x) to agree that the disposals programme for 1980-81 should be designed to produce savings of at least £500 million;

SECRET

- (xi) to note that, given the shortfall on the Chancellor of the Exchequer's original target, the Chancellor may have to consider alternative ways of maintaining the acceptable PSBR total, not excluding further increases in indirect taxation [this is in order that Cabinet cannot say later that they did not know].

  
(John Hunt)

20th July, 1979

SECRET

EDUCATION AND SCIENCE

FlasA  
The Secretary of State has written to you, following Thursday's Cabinet, spelling out the political difficulties he sees in the package agreed by MISC 11. That package amounted to £517 million. The derogation now proposed by Mr. Carlisle amount to £130 million, leaving a net reduction of only £387 million. He suggest leaving out the £30 million unspecified cut; reducing the cut on under-fives from £70 million to £20 million (thus eliminating the £4 per week charge, which you thought unworkable); dropping the £40 million saving on school transport, which the Chief Whip thought would not get through the House; and reducing the £30 million on further education to £20 million, by dropping a £20 million proposal for increased parental contribution, but offering an additional £10 million on other parts of this block in exchange. You said at Cabinet last week that MISC 11 had perhaps gone too far: you may now feel that Mr. Carlisle has swung the balance too far in the opposite direction. A possible compromise would be to ask him to find at least the unspecified cuts of £30 million, giving him discretion to apply this anyway he likes in the Education Budget; this would bring the total net savings to £417 million.

ARTS

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 of the MISC 11 report.

SOCIAL SECURITY

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

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 told MISC 11 that he would argue the point at Cabinet. Having heard the discussion on Thursday he may now be less 'inclined' to do so.

SECRET

WELSH OFFICE

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 expenditure to offset the effects of coal mine closures, etc.

COAL

No clear decision was reached on this at E on 17th July. 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

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

BRITISH AEROSPACE

This should be agreed without difficulty.

POST OFFICE

Sir Keith Joseph warned Cabinet last week that the Post Office borrowing requirement had just been recalculated and showed a sizeable increase. The problem has been eliminated. As a result, the cut for the Post Office is now back to -£50 million. This involves increases in the domestic telephone bill of rather more than the 10 per cent originally planned from 1st January next. But there has been no significant increase in telephone prices since 1975.

OTHER NATIONALISED INDUSTRIES

All the other proposals in the original paper (C(79) 28, Table 3) had been agreed in earlier discussion. This included the higher option on gas prices, which yields £260 million in the 1980-81, involving a 5 per cent increase in real terms in gas prices from 1st April 1980, on top of anything needed to keep pace with inflation. (The additional effect on the RPI,

SECRET

compared with keeping pace with inflation, is only 0.08 per cent). Cabinet should perhaps endorse this proposal specifically. (The Chancellor has written to you separately about the public presentation of these increases.) But the nationalised industry figures as a whole have been recalculated, taking account of the changes on the Post Office noted above, and the overall result is now a reduction of [£300 million] instead of the £350 million originally proposed.

#### MINOR PROGRAMMES

We know of no other contentious points, save on the Northern Ireland programme, which the Chancellor has undertaken to discuss separately after the meeting with Mr. Atkins.

20th July, 1979