

Ref. A0426

PRIME MINISTER

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Also a 'personal'  
paper from  
Mr Wallace

Prime Minister

3  
There is a paper  
in his folder from  
Mr Heseltine which  
you have not seen  
yet.

Public Expenditure: Later Years

(C(79) 42)

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14/11

#### BACKGROUND

Cabinet on 13th September (CC(79) 15th Conclusions, Minute 6) broadly approved the Chancellor's proposals for expenditure reductions in the last three years of the PESC period, but remitted all the details to be sorted out in bilateral discussions with the Chief Secretary. I think it is fair to say that, in doing this, Cabinet did not formally accept any of the specific proposals, and as was to be expected, some of them have given rise to problems. These problems have to be resolved at the Cabinet meetings scheduled for 18th October and (to give time for any further bilateral negotiations) 1st November. The Lord President's paper on Civil Service Manpower will also be taken on 1st November. You have it in mind to have a preliminary talk with the Chancellor and the Chief Secretary before Cabinet, and I am submitting this brief in advance, with that in mind.

2. The introduction to the paper sets out very clearly the extent of the gap which still has to be bridged, even to avoid any increase in taxation during the period. It will of course be argued that this is a pessimistic forecast, and that it takes insufficient account of the dynamic effects of the Government's other economic policies. But that is for the future. The Chancellor's prudent line is that the Cabinet should not spend the increment until it has been earned. This may prompt demands for discussion of the macro-economic strategy, and (as I said in an earlier note to you before the weekend) you may feel that you have to concede this in principle. If you so decide, it might be prudent to say so at the beginning of the discussion. But, purely for timetable reasons, I see little chance of fitting in such a discussion before the Cabinet has to decide on the expenditure strategy. That timetable assumes the publication of a longer-term

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public expenditure White Paper, though in less detail than in previous years, before Christmas. This is not an absolute deadline, of course; but political pressures can be expected to mount if the publication is delayed much beyond that timescale.

3. But whatever the medium-term forecast says, it is already clear that the cuts proposed by the Chief Secretary are just about the minimum consistent with the Government's fiscal and monetary policies. The cuts already fall a bit short of the target tentatively endorsed by Cabinet in the summer. But, given the difficulties, in fact the Chief Secretary has done pretty well to secure all the savings noted in Annex B. He cannot really afford to lose any of the five remaining major issues identified in his paper. His position has already been weakened by the defeats on 1980-81 in the summer (we know, for example, that this has encouraged the Secretary of State for Education to try his luck again in Cabinet). Further losses will simply encourage other Cabinet Ministers to appeal against him to Cabinet on all sorts of expenditure issues. If he doesn't end up somewhere near the new target figure for the later years, you will face the danger of another cuts exercise next year, possibly in less propitious political circumstances. You may feel it is better to get all the difficult decisions out of the way, and on the public record now. Expenditure operations of this kind are always difficult for any Government. The extract attached at Annex 1 shows that it was no easier in the Seventeenth Century.

HANDLING

4. You may want the Chancellor of the Exchequer to set out very briefly the general background before calling on the Chief Secretary to introduce his paper. This will depend somewhat on what you decide to do about a general economic strategy discussion. You might then intervene yourself and speak on the lines of the first sentence of paragraph 3 above. When the Chief Secretary has spoken, I think you should move right in to a discussion of the detailed issues. You could start by seeking confirmation that all Ministers accept the savings listed in Annex B - but noting that the Chief Secretary reserves the right to come back and ask for more if he does not secure his major cuts. You can aim to make as much progress as possible at this meeting, covering all the

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points listed in the Chief Secretary's paper if time allows. There may be points remitted back for further study which can be swept up on 1st November.

5.(a) Defence. The base-line here is the Treasury one: the Secretary of State for Defence's suggestions constitute an additional bid. He has reinforced this in his minute to you of 12th October. He has, as you know, circulated a separate paper, OD(79) 30, which is specifically designed to strengthen his case. (paragraph 7 of that paper reads: 'it is essential that we settle a Defence Budget in the 1979 PESC in a way which plainly reflects both NATO guidelines and our earlier commitment to give Defence the priority it needs.'). We have not yet arranged for an OD discussion of this paper. Discussion in OD could only be expected to strengthen the Secretary of State for Defence's case. It is his colleagues in other Departments who would have to find countervailing savings if he won. So this is really a decision for Cabinet, and the OD discussion could only be indicative. The correct tactics here might be to allow the Secretary of State for Defence to outline his case, with the Chief Secretary's retort, and to see whether he gets any support from the rest of the Cabinet. Only if he does, need you ask OD to look at the paper, returning to the matter at the next Cabinet discussion on 1st November. Although it is wrapped up as a technical question of Budget conventions the real issue here is whether to devote a further £160 million in the final year to the Defence Budget. It is, however, true that methods of forward financial planning vary considerably among NATO countries. Some compensate fully for inflation, even if only after the event rather than in forward plans. Others plan in volume terms throughout. Figures declared to NATO are supposed to be based on real volume planning. Any move on their part would be noticed and might give cause for Alliance criticism. If Cabinet supports the Treasury, as they may well do, they should accept this risk. But Defence has had a very easy ride so far, and the Cabinet may feel that enough is enough. The Rayner presentation at the beginning of September has shown that there is plenty of room for economy within MOD's present programmes.

(b) Agriculture. Cabinet agreed at its last meeting, following the discussion on milk prices, to commission a rapid review of our whole agriculture policy. Sir Kenneth Berrill has this in hand. The full review will take at least two months. It may be possible to make an interim report in time for the resumed

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discussion on 1st November though my information is that this is in fact unlikely. You will in any case want to see whether there is any chance of agreement at this present meeting on the more limited question of capital grants, which is the Chief Secretary's main target. But the Minister of Agriculture is most unlikely to accept this and will press for a report from the Berrill Group first. In any event, however, decisions on the grants will have to be taken on 1st November.

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(c) DOE (Housing). It would be convenient to take the Secretary of State for the Environment's separate paper (C(79) 44) at this point. You might ask him to speak first, and then get the Chief Secretary to reply. At the time of submitting this brief I have not seen Mr. Heseltine's paper. But I understand he accepts the case for some increase in council house rents and sets out five possible paths for a return to more economic levels. His own preferred option (a return to the real level of rents in 1974, about 8.6 per cent of average earnings) would fall only about £50 million short of the Chief Secretary's target in 1981-82, but about £300 million short in 1983-84. I think you must press him for something more than this.

(d) Education. (See Mr. Carlisle's letter of 15th October). The three areas of disagreement are set out clearly in Annex G. Perhaps the unit cost figures are the most significant. They provide a partial political defence to the inevitable criticism of cuts in the Education programme. The education cuts proposed in the summer were politically controversial because they involved charges. These proposals escape that problem, but go into the heartland of education expenditure. Does the Cabinet prefer this course, or does it want to reconsider, for example, parental contributions? If the latter, you might remit this for further bilateral study.

(e) Social Security. The Secretary of State for Social Services is not himself resisting the abolition of earnings related supplement (ERS) but wants his colleagues' views. It is not clear whether this is merely an excuse for seeking to reopen the issue. You might therefore wish to make him show his hand by calling him to speak first. It would then be for others (e.g. the Secretary

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of State for Employment) to make the case for not abolishing ERS, and to suggest alternative savings. You will no doubt want views of the Leader of the House and the Chief Whip on the possibility of legislation.

(f) Consequential reductions: Scotland, Wales and Northern Ireland. The main point here is the Secretary of State for Wales' claim that the recent 'need study' justifies allocating a higher proportion of expenditure to Wales than the previous formula allows. The political argument for this, in its crudest terms, is pretty weak after the collapse of the devolution proposals in Wales. The case for 'equality of misery' is strong.

6. There are a number of other points, not all listed in the Chief Secretary's paper, which may be raised.

- (i) Employment. It is common ground that any fresh temporary employment measures should be a claim on the Contingency Reserve. But Ministers may also question the realism of the provision made for unemployment benefit. They will not, of course, have seen the full forecast, although the figures before the Cabinet assume unemployment rates of fairly high proportions.
- (ii) Nationalised industries. This brief is written before the E Committee discussions on 17th October about coal and gas. I shall let you have a supplementary note following that.
- (iii) Staff savings. When Cabinet resumes its discussion on 1st November, the Lord President's proposals will be available, and the realism of the 'broad allowance' made in line 8 of Annex D can then be assessed. At present it is impossible for Cabinet to take a view on this because the figure is rolled up with that for nationalised industries. (My information is that the figure is £50 million - £175 million - £250 million - £300 million in the four years; but this is in addition to the savings which have been scored against individual Departments. There is a danger of double-counting).
- (iv) Contingency Reserve. We understand privately that the Chief Secretary has refused to propose further cuts in the Contingency Reserve, which now stands (at 1979 Survey prices) at £2,197 million, £2,750 million and £2,750 million in the last three years. (This compares with

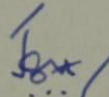
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£1, 527 million in 1980-81). I think you should support the Chief Secretary's refusal to go down any further. The number of unquantifiable extras is disturbing. There is bound to be further pressure for additional Defence expenditure; as Sir Kenneth Berrill has pointed out, there are large potential claims for Rolls-Royce and for BL; towards the end of the period, expenditure on the Nuclear programme may be building up (E is due to look at a paper on this on 23rd October); the Secretary of State for Employment's bid for employment measures is likely to be repeated in later years; etc. Particularly in the last years of a Parliament and in the run-up to a general election, it is unwise to leave oneself with nothing in hand.

- (v) Presentation. This is a point to be picked up again at the end of the resumed discussion. But Cabinet has already agreed that the White Paper for Later Years, while inevitable, should be in fairly general terms. You will want to make sure that the Cabinet has a chance to look at the text, and not just to note it formally. It could be very important for the presentation of the Government's overall strategy for the rest of this Parliament.

CONCLUSIONS

7. At this stage, you will want to record conclusions on any items which can be firmly agreed; to record instructions to the Chief Secretary to pursue any additional points with the Ministers concerned; and to agree to resume discussion on 1st November.

  
(John Hunt)

16th October, 1979