Prime Minister
I am not enclosing all the letters referred to here since most of them are adequately summarised in John Hunt's annex.
TL.
30/5

3

Ref: A09671

SECRET

PRIME MINISTER

Public Expenditure Reductions 1979-80
(C(79) 13)

BACKGROUND

This paper contains Mr. Biffen's report back on the Public Expenditure cuts in the current year which are needed to support the Budget. You have already discussed it with the Chancellor and a number of changes have been made as a result. His paper identifies five points which are still outstanding. However, there is rather more beneath the surface. I attach as an Annex to this brief a table setting out the complete cuts which have been agreed.

HANDLING

2. You will want to ask Mr. Biffen to introduce his paper. Thereafter, I suggest it will be best to go through the list of cuts (using the updated figures at the end of this note, rather than those set out in the Annex to his paper, which contains his original bids and not the finally-agreed figures).

(a) Environment. (Mr. Heseltine's minute of 23rd May)
No problem. But note that Mr. Heseltine's total of £450 million actually includes £20 million to fall in Wales: you might ask Mr. Edwards to confirm that he accepts this. The Scottish and Northern Ireland shares and similar savings are shown separately.

(b) Industry. (Sir Keith Joseph's letter of 24th May)
The main savings here comes from a four-month moratorium on payment of Regional Development Grant. This is a post-dated cheque which will have to be honoured next year, and makes the problem of securing cuts then even bigger. But it helps with the Budget arithmetic this year. Note, that with the £10 million for the Scottish and Welsh Development Agencies (which Mr. Younger and Mr. Edwards should be asked to confirm) Sir Keith Joseph has actually provided £10 million more than he was asked for.

(c) Employment. (Mr. Prior's letter of 24th May)

Mr. Prior has also exceeded his target by £12 million. His contribution is a miscellany of more cuts, some of which will be disproportionately difficult in political terms.

(d) Energy. (No letter; this was all agreed at a bilateral meeting)

I think I should draw your attention to the price assumptions here. Ministers have already agreed, in the context of the abolition of the Price Commission, that an electricity price increase of 8 per cent and a gas price increase of about the same size, should go ahead in June. They may not have appreciated that a second electricity price increase will be needed later in the year. This is necessary, to absorb (a) the recent increases in oil prices, and (b) a second coal price increase in the autumn, which the previous Government approved in its last few weeks. The second electricity price increase would have been 7 per cent in October. As part of this package, it is now proposed to increase it to ~~11~~ 9 per cent. The October price increase will add about ~~0.3~~ 0.25 per cent to the RPI. It yields £90 million; but only £40 million of this comes from the domestic consumer. It is also now proposed to have a second gas price increase. Part of this will fall on industrial contracts as they fall due for renewal: this is normal and merely keeps gas prices in line with those for oil. Part will fall on 'commercial' - i.e. business premises - tariffs. But part will involve an increase in domestic tariffs from December, of about $8\frac{1}{2}$ per cent, yielding £12 million this year - though a good deal more next - and adding 0.2 per cent to the RPI. As you were originally opposed to the idea of a further gas price increase, you might like to question Mr. Howell about this part of his contribution. If either of these increases were postponed, it would be very difficult to find alternative savings elsewhere in the energy programme. They would probably have to fall on someone else's programme.

You agreed with the Chancellor that the RPI impact of the Budget should be confined to 3.6%. (VAT and petrol duty). These ~~four~~ increases will take it over 4%.

T.

Flag B and C

(e) Education. (Mr. Carlisle's letters of 24th and 29th May)

The original package here included £22 million from a further increase in school meal prices (+10p rather than +5p in the autumn). You asked that this should be reconsidered. Mr. Carlisle says that he can only find the extra £22 million by a series of minor cuts including £3 million from arts, and by cuts in capital programmes (£13 million). He is prepared to do this, but is worried about the reaction of local authorities. But I doubt if you will want to rule out another look at the school meal service in the longer-term, especially in the context of the major savings which Cabinet will be considering in the Public Expenditure Survey. The cost is very high indeed, in comparison with other educational expenditure; it serves no educational objective; the nutritional value is now arguable; the distributional effects are not particularly helpful to poorer families; and the case for a fundamental re-examination seems very strong.

Mr St. John Stevas is refusing to find this £3 million (Flag A). TL.

(f) Social Services.

At your request, the prescription charges proposal has been dropped for the time being. Again, you may want to make it clear that it is not ruled out in the longer-term.

(g) Foreign Office.

The Foreign Secretary (Lord Carrington's minute of 24th May) refuses to find the last £10 million. You may feel it necessary to overrule him on this: once one Department secures an exemption, it becomes very much more difficult to hold the others.

Flag D

At Flag E is a note setting how much of the aid programme is contractually committed. TL.

(h) Transport.

We do not yet know how Mr. Fowler proposes to find £25 million savings, which will fall partly on British Rail fares and partly on the road programmes.

(i) Trade. There was already £5 million to score from the abolition of the Price Commission: the extra £25 million re-finance of export credit (ironically from the Co-operative Bank) can be credited here as well.

(j) Scotland.

No problem, provided Mr. Younger confirms that he accepts his share of the cuts.

(k) Northern Ireland.

Mr. Atkins has registered a potential claim on the Contingency Reserve here (for his Meat Industry Employment Scheme) but you will want to do no more than note it at this stage. It cannot yet be quantified.

(l) Defence.

The additional resources for the Defence Budget this year have been put at £100 million, as claimed by Mr. Pym. It is not clear exactly how this figure is built up, but Cabinet obviously wishes to make an exception for the Defence Budget. Nevertheless it would be worth checking whether this additional sum can actually be fully spent in the financial year. It would be a pity to over provide.

See also Mr Pym's minute at Flag F

(m) Disposals.

The main contribution comes from the sale of 16 per cent of BP, yielding about £600 million. This would bring the Government Holding down from the present 51 per cent to about 35 per cent, of which some 20 per cent (actually held by the Bank of England) is the subject of the outstanding claim from Burmah which may take another two years to settle. Another £500 million comes from sale of Oil and Gas assets by BGC and BNOC. Although the paper says that no legislation will be needed, that is true only if the two Corporations agree. Sir Denis Rooke is at present holding out, and there is likely to be a fight. Moreover, the Government has no statutory power to compel either Corporation to divest itself of assets. You may want to ask Mr. Howell for an up-to-date report on this. You may also want to ask Sir Keith Joseph what the NEB disposals will involve: does he propose to keep the stake in INMOS for the time being, pending a review of Government involvement in microelectronics?

See Mr Howell's letter at Flag G

3. If all the savings claimed by the Chief Secretary can be confirmed, you will end up with a total of £2470 million - a substantial contribution to the Budget arithmetic.

CONCLUSIONS

4. You might aim to secure Cabinet approval to the proposals put forward by the Chief Secretary, and in particular to record the outcome on the five points listed in his paper: prescription charges, school meals, regional development grants, aid, and Northern Ireland. Of these, the only issue likely to be contested is aid.

JBH

John Hunt

30th May 1979

PUBLIC EXPEN DITURE CUTS 1979-80

Position at 29.5.79

			£m
Environment			
	Community Land	50	
	Urban Programme	7	
	Water Authorities(E)	55	
	PSA	25	
	Housing	313	
(of which, 20 falls in Wales)		450	450
Industry			
	Industrial Support /NEB	55	
	RDG - 4 month moratorium	145	
	B Aerospace	5	
	Post Office	5	
	British Steel	15	
		225	225
	Scottish & Welsh Devt Agencies	10	10
Employment			
	TOPS	24	
	Training incl ITBs	9.5	
	STEP	42	
	YOP	25	
	Community Industry	1	
	Employment Services	6.5	
	MSC Marketing	10	
	Emp Devt Scheme	10	
	Small Firms Emp Subsidy	29	
	Temporary Short-Time Wkg Scheme	18	
	Short-Time Wkg - Textiles	5	
		172	172
Energy			
	BNOC - reduced farm-ins	40	
	Energy Research	2	
	Increased prices -		
	- Electricity	90	
	- Gas - Ind & non-domestic	56	
	- Gas - Domestic	12	
		200	200

		£m
Education		
16-18 year olds	10	
Miscellaneous education	11	
Science budget	4	
Recurrant grant to univ. & c.	6	
Education building	5	
Other(to be specified)	22	
	58	58
Social Services		
Increased waiting days	40	40
(Prescription charges proposal dropped)		
Foreign Office		
Mainly aid	50	50
(Foreign Secretary objects)		
Transport		
BR Fares and roads	25	25
Trade		
Abolition of Price Comm & c.	5	
Refinance of export credit	25	
	30	30
Scotland		
Proportionate share	75	75
N Ireland		
Proportionate share	35	35
		1,370
Subtract extra for Defence		- 100
	Total cuts	1,270
Disposal of Assets		
BP(16%)	600	
BGC - BNOC	500	
NEB & c.	100	
	1,200	1,200
	Total for Budget arithmetic	2,470