

Original on:

Econ Pol:

Public Expenditure

SECRET

MR. CARTLEDGE

✓ *GM*

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NOTE FOR THE RECORD

The Prime Minister held a meeting with Treasury Ministers and senior Treasury officials at 1630 today. Attached is a list of those who were present.

The Prime Minister said that she was dissatisfied with the two papers - C(79)4 and 5 - which the Treasury had put forward for Cabinet on public expenditure. The Treasury approach, as set out in these papers, was not nearly tough enough. The Budget arithmetic would require substantially greater cuts than the Treasury had put forward if the twin objectives of getting the PSBR down and substantially reducing income tax without raising indirect taxes unduly were to be met. In her view, the Chancellor should be aiming to reduce the PSBR to £7.5 billion in 1979/80 - rather less than the £8 billion which he was apparently thinking of. As for indirect taxes, she was extremely perturbed at the prospect of having to increase VAT to 15%. This would mean a sudden jump in the RPI of at least 3%. The result could be catastrophic for the next pay round, and she would far rather find the necessary savings for the direct cuts by a smaller increase in indirect taxes and larger public expenditure cuts. Within the cuts proposed by the Treasury, too much involved increases in charges - which would also show up on the RPI. The Treasury's method of trying to obtain cuts also seemed unsatisfactory: instead of proposing cuts in specific items, which individual Ministers would be bound to argue against, it would have been better to have proposed overall amounts by which Departments would have to find cuts - leaving it to them to find cuts in particular items. The Prime Ministers said that she was sure that there was enormous waste in most departments. Although the proposed squeeze on cash limits would get rid of some of this, the broader approach to the cutting exercise which she would have preferred would have forced departments to look further at the waste problem.

/The Prime Minister

SECRET

SECRET

-2-

The Prime Minister went on to say that she thought the sale of assets could provide a significant contribution to getting the PSBR down - though it would only find favour with the markets if the rest of the Budget package was right. It would be necessary to press ahead with early legislation to achieve the desired sales. If it was not possible to provide for this in the Finance Bill, then consideration should be given to preparing an Omnibus Bill covering different types of assets which the Government intended to sell off.

More generally, the Prime Minister said that it was essential to get the overall strategy right from the start. This must involve large public expenditure cuts this year leading on to more substantial reductions in later years; a lower growth in the money supply (she would favour a new target for M3 in the range of 7 to 10% rather than 7 to 11% which the Chancellor was presently considering); and lower interest rates.

The following conclusions were reached on the conclusions in C(79)4, and it was agreed that the Prime Minister, the Chancellor and the Chief Secretary would try to get agreement in Cabinet on these lines:-

- (a) On i, if Ministers failed to agree the cuts proposed for their Departments in the annex, they should undertake to find cuts from within their programmes of at least equal amounts - and these should be positively identified.
- (b) The RSG should be reduced by £300m., not £200m.
- (c) On iii, the aim should be to raise at least £1,000m from selling assets.

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SECRET

SECRET

-3-

- (d) Conclusions iv and v on the Contingency Reserves should be accepted, but it should be made clearer what these meant - i.e. the Contingency Reserve will be cut, it will then be held, and the reduced figure will only be drawn against with the authority of Cabinet.
- (e) Ministers should be asked to find additional savings of £400m in 1979/80.

Likewise, the following conclusions were reached on C(79)5:-

- (a) Ministers should endorse conclusion i. - i.e. the published cash limits should not be adjusted to cover higher price increases. (Sir Anthony Rawlinson had said earlier that if VAT were not increased to 15%, then there might well be a case for reducing the published cash limits.)
- (b) On ii, there should be no automatic adjustment of the cash limits of the RSG to cover the Government share of local authority settlements. However, if the £300m in the RSG noted above were achieved, there would be a stronger case for upward adjustment on account of pay settlements (the Prime Minister made it clear that she was still not convinced that the Government should agree to increase the RSG to cover its share of the teachers' settlement).
- (c) Conclusion iii on the adjustment of the cash limit for universities and the National Health Service should be accepted.

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SECRET

SECRET

-4-

- (d) On iv, fringe bodies would have to be treated very strictly - and this meant at least following the cuts in staff costs which the Prime Minister proposed for the Civil Service.
- (e) The conclusion on the nationalised industries should be accepted.

Other Points

The Prime Minister said that she was not convinced there was so little scope for cutting the aid programme for 1979/80. She did not believe that so much was contractually committed as the Treasury paper implied. She asked that a paper should be prepared spelling out precisely the UK's existing aid commitments.

The Prime Minister said that the paper by the Secretary of State for Employment on pay - ^{C(79)6} ~~sec 45.6~~ - should not be taken in Cabinet tomorrow. The paper was thoroughly deficient on content, and it would be quite wrong for Cabinet to take it without an accompanying paper by the Treasury who were in the lead on pay. She suggested that the Treasury produce a paper which should then be taken - along with Mr. Prior's paper - in E Committee.

L.P. LANKESTER

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16 May 1979

cc Sir John Hunt
Mr. Stowe
Mr. Wolfson
Mr. Ryder
Mr. Hoskyns
Mr. Cartledge

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Prime Minister

Chancellor of the Exchequer

Chief Secretary

Financial Secretary

Minister of State (Mr. Rees)

Sir Douglas Wass

Sir Anthony Rawlinson

Sir Lawrence Airey

Mr. Ken Couzens

Sir Fred Atkinson

Sir John Hunt

Mr. Ken Stowe

Mr. David Wolfson

Mr. Tim Lankester

SECRET

PRIME MINISTER

The following will be at this meeting:

The Chancellor

Mr. Biffen

Mr. Lawson

Mr. Rees

Sir Douglas Wass

Sir Anthony Rawlinson (Second Permanent Secretary in
charge of public expenditure)

Sir Lawrence Airey (in charge of the domestic economic sector)

Mr. Ken Couzens (in charge of the overseas sector)

Sir Fred Atkinson (Chief Economic Adviser and Head of the
Government Economic Service)

Sir John Hunt

Lord Cockfield has cried off because he is representing
the Government in the Debate in the Lords.

12.

16 May 1979