

Copy on: Defence, Budget.

PRIME MINISTER

c.c. Mr. Wolfson
Mr. Whitmore

Meeting with the Chancellor at 0930 on Thursday, 1 November

I don't know of anything in particular which the Chancellor wishes to raise with you tomorrow morning. He was to have discussed the Bray forecast (i.e., the forecast of the balance of payments, RPI, etc., which has to be published before the end of November), but the Chancellor is not yet ready with firm proposals - he will be minuting you over the weekend.

The Chancellor may want to have your reaction to his minute on defence expenditure, which Clive took to Bonn. I think the only issue now is how and when to reveal the deal which has been agreed between Treasury Ministers and Mr. Pym to Cabinet colleagues. But you don't need to decide this immediately.

You might just take the opportunity of discussing the papers for Cabinet. On vehicle excise duty, you might query the Chancellor's reasons for wanting VED to continue: my own feeling is that he exaggerates the advantages of so-called "fiscal flexibility". Of course, we need the money; but the unpopularity of raising petrol duty would be matched - in my view - by the popularity of abolishing VED. And of course, abolition would give us substantial staff savings, as well as being good for energy conservation.

Lord Soames' paper on "Further Action to Reduce the Size of the Civil Service" is difficult. I have provisionally asked Lord Soames to join you and the Chancellor at 0945 to discuss it.

Lord Soames' paper offers three choices for decision. Cabinet are likely to go for either.

(i) Announce savings of 6% plus vague promises of more to come.

Or

(iii) Announce savings of 6% as an interim measure with firm promises of more to come next Spring.

/ Option (i)

Option (i) is the more likely outcome I think, since (iii) presupposes the outcome of the MOD manpower studies and certain policy decisions (listed in Annex 4). If (i), there is the question of whether the present exercise which has been carried out separately from the public expenditure exercise should be carried forward as part and parcel of next year's public expenditure exercise.

There may have been advantage in looking at Civil Service staff as a separate exercise this year when the Government knew there was staff "fat" in programmes, and when a reduction in Civil Service staff was being sought - to some extent - for its own sake. But as soon as functions and policies have been looked at as a way of finding savings, there has been an untidy overlap with the public expenditure review. Taking into account the fact that CSD have not carried out the present exercise very well, there may well be a case for making the search for further staff savings under the umbrella of next year's expenditure review - with the Treasury taking overall responsibility. Under this formula, the CSD would assist the Treasury in identifying public expenditure savings (including staff cuts), rather than offer their own options. This is the way PESC should have been conducted in the past. In practice, CSD have contributed very little to previous PESCOs - which is one reason why we set up this year's quite separate exercise. What I am suggesting is an improved PESC next year with staff options being given greater attention than they have been in the past.

You don't need to reach a firm view on this question now, but you might like to mention it to the Chancellor and the Lord President as something which needs to be considered. We could ask that this question be covered in the review of PESC methods which Sir Robert Armstrong and the Treasury have set in hand. (There is of course also the wider question of the future of the Treasury and the CSD. There are some - including John Hunt - who think the public expenditure control function of the Treasury should be taken out of the Treasury and integrated with the staff

control function of the CSD to form a new "Department of Public Expenditure". Others think that the CSD should go back to the Treasury. In both cases, the present illogical division of control over expenditure programmes from control over staff - which are the main cost element in many programmes - would be ended.)

TL

31 October, 1979.