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Prime Minister's Econ. Bd. ✓

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PRIME MINISTER

There is also an interesting note (Flag E) from Mr. Howell. His main point is that we must de-link public expenditure from the RPI - which means mainly social security.

The Economic Outlook and Public Expenditure
Brief for Ministerial Meeting, 9.00 am 7 December

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BACKGROUND

There are four papers for this meeting:

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- (i) The Chancellor's minute of 27th November, copied to those attending the meeting, covering a draft paper on 'the Economic Outlook', originally intended for Cabinet.
 - (ii) The Chancellor's paper on 'Pay and Price Provisions for the 1980-81 Cash Limits' which he sent to you at the end of last month (undated). He is recirculating this to the Ministers attending the meeting at your request; it is intended for Cabinet on 13th December.
 - (iii) The CPRS paper on 'the Economic Outlook' which, as you asked, was circulated with Mr. Lankester's letter of 3rd December to the Ministers attending the meeting.
 - (iv) A redrafted paper on 'the Economic Outlook and Public Expenditure' which is a condensed version of the first paper, extended with some paragraphs on public expenditure, suggesting postponement of the Public Expenditure White Paper and a fresh public expenditure cuts operation in the next month or two. The Chancellor proposes specific targets of £1 billion for 1980-81 and £2 billion reductions in the later years. If approved, this paper is intended for circulation to Cabinet for discussion on 13th December.
2. The CPRS paper ((iii) above) should serve as a brief on the substance of all this. I will not attempt to duplicate it. This note deals only with handling and procedure, and with a couple of points which were not covered by the CPRS.
 3. The object of this meeting is to secure the approval of a few key Ministers before the Chancellor launches his proposals on the full Cabinet. The balance of the group was intended to cover both the Chancellor's natural allies and some potential critics. It is already clear that Mr. Prior feels he

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has been outflanked (he and Mr. Jenkin are in a minority). He has told the Chancellor, during the NEDC briefing meeting, that he disagrees with the whole approach. This was before he had seen the Chancellor's detailed proposals either on cash limits or on further cuts. His line seems likely to be that forecasting is an inexact science; that the forecast £10 billion plus PSBR in 1980-81 may be an overstatement; that the outturn may be quite a bit better and that we should wait and see; that further public expenditure cuts will be damaging in themselves, and politically dangerous.

4. If the Ministerial Group on Friday agrees with the Chancellor, the next step will be for him to circulate his revised paper ((iv) above), with any further modifications to reflect the discussion, for discussion by Cabinet on 13th December. The Cash Limits paper ((ii) above) would be taken at the same time. Thereafter, you would establish a small 'star chamber' group of Ministers, rather on the lines of MISC II which met during the summer, to conduct the cuts operation and make recommendations to Cabinet. Final decisions would be needed some time before the Budget. The Group might need to start work early in January. I shall submit further advice about membership and mode of operation later.

5. There is a particular problem over the position of the Secretary of State for Defence. These papers have not been copied to him. He is away in Brussels, at a NATO meeting, on Monday, Tuesday and Wednesday of next week. The first he will hear of the cash limits proposal will be when he reads his Cabinet papers on Wednesday night. This, as Mr. Le Cheminant warned Mr. Lankester in an earlier note, may cause considerable difficulty for the Ministry of Defence because it implies a substantial squeeze on the volume of defence spending next year. In addition, the Chancellor wants to leave open the possibility of further cuts in the Defence programme. His new paper ((iv) above) deliberately does not mention this. The CPRS paper does. He had intended to speak privately to the Secretary of State for Defence before Cabinet. It is not now clear that there will be time for this. You may want a word with the Chancellor about the best way to handle the problem. Otherwise, there is a risk that the deal which the Chancellor struck with the Secretary of State following the previous Cabinet discussion will come unstuck.

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6. There is a further problem over cash limits, not brought out in the CPRS paper (which was circulated before the cash limits paper was available). It concerns only 1980-81. The Chancellor says that the PSBR for 1980-81 would 'exceed £10 billion'. The latest figure is, I understand, £10.3 billion. But this is on the assumption that cash limits are set to accommodate the expected rate of inflation (17 per cent) rather than the 14 per cent which the Chancellor suggests in his separate cash limits paper. If cash limits were, in fact, set at 14 per cent, and inflation turned out to be 17 per cent, there would thus be an automatic squeeze of £450 million even before any further cuts were explicitly sought. If Ministers were minded to endorse the Chancellor's target of £1 billion reduction in 1980-81 it would be important to establish whether the cash limit volume squeeze was included in this total, or additional to it. (We have asked the Treasury to ensure that the Chancellor is ready to deal with this point). In any case, there is no one-for-one relationship between a cut in the volume of public expenditure and a fall in the PSBR. Other factors, including shortfalls, complicate the calculation. The Chancellor's £1 billion is only a very rough indication of the scale of the problem - not a precise target.

HANDLING

7. I imagine you would want the Chancellor to introduce his paper, and you may then wish Sir Kenneth Berrill to say a word. The Chancellor may at some point wish to take a list of possible ways of meeting his target of £1 billion. Thereafter the discussion could be, as the CPRS suggest, structured round the series of questions listed in their paper. The point about cash limits arises on paragraph 13 of their paper, and you may want to bring it out clearly at that stage. The separate problems about Defence are best handled in a private word with the Chancellor.

CONCLUSIONS

8. The outcome of the meeting will, presumably, be agreement that the Chancellor should revise his paper - and possibly also his cash limits paper - in the light of discussion and circulate it to Cabinet at the beginning of next week. You may want to reserve a decision on the subsequent steps until you have heard the Cabinet discussion.

REA

(Robert Armstrong)

6th December, 1979



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