

CONFIDENTIAL

P.0169

MR LANKESTER

cc: Mr Vile

Prime Minister

On reflection, I can see no point in having a row in Cabinet on 6 Decemb^r on cash limits, and another row about public expenditure volumes on 13 Decemb^r. The two are inevitably linked, and I suggest we take both on 13 Decemb^r (see X on page 3 below). You

PAY AND PRICE PROVISIONS FOR 1980-81 CASH LIMITS

might also discuss the cash limit proposals at the "Ince Group" meeting next Friday. seeks her

Flag A

The Chancellor's minute to the Prime Minister on 29 November agreement to the circulation of a Cabinet paper on cash limits for 1980-81 for all the outstanding elements in public expenditure except Civil Service pay (it has already been decided to make a global provision for Civil Service pay next February. The amount of this provision does not need to be decided until then). The cash limits the Chancellor now proposes are based on an assumed increase of 14 per cent for pay and prices taken together. The Chancellor acknowledges that such limits would mean a volume squeeze of £400 to £450 million, of which £140 million would fall on Defence and £85 million on the NHS. He warns however that, on the latest indications, the actual size of the volume squeeze "will almost certainly be more than this."

Agree?

IL
30/11

2. It is clear that a discussion of proposals of this kind at Cabinet this Thursday could lead to very severe difficulties. In particular:-

|| (a) Mr Pym may well argue that they involve reneging on the private agreement he already has with the Chancellor on Defence expenditure. ||

(b) Mr Jenkin may argue that the NHS squeeze means a departure from election commitments, and

(c) Most spending Ministers could argue that cash limits as restrictive as this depart unacceptably from the principle on which the RSG cash limits were set - namely by "making realistic, not extravagant, allowances for the likely movement in wages during the year" (E(79) 10th meeting).

CONFIDENTIAL

3. Part of the problem will arise from timing factors. On present plans the Cabinet is due to discuss the general economic outlook (though it doesn't yet know this) on 13 December when the Chancellor will be proposing the re-opening of volume expenditure figures, including those for 1980-81 (an exercise in which we understand he is not contemplating asking for a further contribution from Defence beyond that implicit in the cash limit decision).

This timing sequence would not have mattered had the Chancellor's cash limit proposals been non-controversial. But in the event he is asking for substantial cuts in expenditure before he has displayed, and the Cabinet has discussed, the economic outlook underlying his proposals. In the circumstances there would be much to be said for delaying the cash limit discussion either to coincide with, or to succeed, the general discussion and the decisions to look for further cuts which are its most likely outcome.

4. The pay and price assumptions for Defence cause particular difficulty because:-

(a) The pay of the Armed Forces is, to all intents and purposes, outside the Government's control. The Armed Forces' Pay Review Body will produce its updating report in the Spring and, given past commitments, the Government will have little option but to implement it. No one can yet be sure but it seems most unlikely that the AFPRB will recommend a pay updating as low as 14 per cent (they have an elaborate system of taking account of movements in private sector pay) and the percentage could well be significantly higher than 14 per cent.

(b) There is a long-standing tendency for the price of military equipment to increase faster than the general movement of prices in the economy.

5. The pay of the National Health Service presents a lesser problem because their settlement dates are, in many cases, imminent and negotiations will therefore, to a considerable extent, be conditioned by cash limits already set for 1979-80 - besides having more scope for negotiation because, unlike the Armed Forces, they will not be subject to binding awards this time round.

6. It is also relevant that the other main group on the law and order front - the Police - are not subject to cash limits.

CONFIDENTIAL

7. If the Prime Minister agrees that discussion of a paper on the lines suggested by the Chancellor of the Exchequer this Thursday would be likely to cause unacceptable difficulty, there are two course open:-

(a) The Chancellor could be persuaded, perhaps, to leave the pay assumption for the Armed Forces, like that for the Civil Service, to be determined nearer the time that the new pay scales come into effect. This might cause difficulty over the Defence White Paper due to be published early in the New Year but the possibility is worth exploring.

X | (b) The discussion of the cash limits paper as a whole could be deferred until either 13 December - when it could be taken along with the general discussion on economic prospects (the Treasury is constrained by its time-table for production of Estimates but could we believe wear this much delay) or could be postponed until 20 December (on the grounds of overcrowding of the 13 December agenda) though the Treasury might resist this as incompatible with their Estimates time-table.

8. In the circumstances the Prime Minister may feel that it would be desirable to have a discussion of tactical handling with the Chancellor before authorising the circulation of his paper.



P Le CHEMINANT

Cabinet Office
30 November 1979