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Ref: A01278

SECRET

PRIME MINISTER

Public Expenditure
(C(80) 9)

BACKGROUND

In this paper, the Chancellor and the Chief Secretary report the results of the bilateral negotiations following your meeting with the Treasury on Friday. I believe that the Chancellor has kept you in touch with the progress he has made with the Secretary of State for Social Services and the Secretary of State for Defence.

2. In total the present position is that the Chancellor is still about £200 million short of his target in 1980-81, and about £250 million in 1981-82, even if all the savings listed in Annex A are agreed. For 1980-81 he has the 'volume squeeze' implied in the cash limits up his sleeve: every 1 per cent squeeze on volume saves roughly £200 million. He does not want, however, to make too much of this, for fear of prejudicing his agreement with the Secretary of State for Defence (whose civilian staffs and equipment are vulnerable: the agreement on pay relates only to uniformed personnel). The bigger the volume squeeze on which he has to rely to achieve his target, the more the Secretary of State for Defence is hurt. Assuming that Cabinet takes the decisions for which it is asked this time, the only outstanding items for 1980-81 will be Civil Service pay cash limits (coming to Cabinet in late February) and the size of the contingency reserve which the Chancellor wants to leave until nearer the Budget.

HANDLING

3. The Cabinet should go through the paper topic by topic. You can use Annex A as a checklist: the sequence of the lines in Annex A is the same as the paragraphs in the main paper.

(i) Social Security (see also Annex C).

The Treasury target is a reduction of about £200 million from 1981-82 onwards. There is no way of getting so large a saving in 1980-81 from these options. Two 'packages' are identified in

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Annex C, although combinations of parts of these could be devised. Two main decisions are needed:-

(a) whether to suspend the Christmas bonus: colleagues may feel that this is politically impossible, but there is £85 million at stake in 1981-82 (and £90 million in 1980-81, when we shall be particularly tight). The Christmas Bonus is not cost-effective, and the main problem (fuel bills) is being looked at elsewhere.

£4 - 50

(b) whether to go for 50p or 75p increase in child benefit. Despite its 'incentive' value, a £1 increase seems ruled out. We think Mr. Jenkin is prepared to accept 75p, but not to go as low as 50p (which the Chancellor of course would prefer). At 75p, it should not be necessary to add the sweetener of the £1 premium for fourth and subsequent children (which costs £20 million in 1981-82); in any case, the Home Secretary believes that, though this would help with incentives, it would be politically unpopular because it would give greatest benefit to large families, who are often black or Irish. Whatever the motives, it is an expensive extra. The question of a cut in the supplementary benefit child allowance arises. Whatever the increase in child benefit, the case for a cut will be weaker with a 50p increase. This is a 'subsistence level rate' and politically hard to cut.

In addition, there are three additional bids which Mr. Jenkin may try to persuade the Cabinet to agree: something for help with fuel bills (the Treasury will try to get away with £20 million, but there are likely to be more expensive proposals coming forward early in March); some minor improvements in FIS (where £5 million would be a sensible allocation, according to the Treasury); and something for one-parent families (where £2 or £3 million could make a really useful impact). The Treasury would prefer to leave these as claims on the contingency reserve, rather than have them agreed now.

(ii) Housing

The Secretary of State offers £270 million, and the Chancellor wants a further £122 million in 1980-81. The gap is narrower in later years. But, as on previous occasions, the Secretary of State has been reluctant to specify the savings he will find. I understand that the Chancellor is content with this rather open-ended promise but wants more money from Mr. Heseltine. He has, we think, the Home Secretary's backing in this. The potential savings are set out in paragraph 5 and would fall on new house building, improvements and on private sector housing. These bids have been substantially increased following your talk with the Treasury on Friday and, on the face of it, seem relatively painless.

(iii) DOE - other

The Chancellor has accepted the proposed savings in the 'DOE - other' programme. Part of this (£12 million - £24 million - £36 million) falls on 'local environmental services' (this means refuse collection, town halls, swimming pools, etc.). The Secretary of State can only deliver these savings (in 1981-82 and later years) by putting a squeeze on next year's RSG. In effect he is promising now to do that when the time comes. The rest falls on expenditure which he controls directly - either local authority capital expenditure, or his own Department's spending (including the Property Services Agency).

(iv) Education

The same RSG point applies to the additional savings offered by the Secretary of State for Education (£20 million in 1981-82 and subsequent years) and a further cut which the Chancellor wants amounting to £34 million at the end of the period. If Cabinet takes credit for these cuts now, it has to back Mr. Carlisle when he seeks to deliver them next year.

Mr Carlisle is unwilling to accept this - see letter in this folder.
TL

(v) Health

The main proposal is the increase of the prescription charge to £1. This has been agreed between the Chancellor and the Secretary of State for the Social Services, but there were considerable reservations about it in Cabinet last week. The figures actually allow for a slightly wider range of exemptions than those listed here (including war pensioners and family planning services). Cabinet will take the point that to widen the exemptions makes the in-work/out of work gap narrower.

(vi) Transport

No problem, apart from the general point that extra disposals must not be allowed to count as credit in the public expenditure exercise. The Chancellor is seriously short of his original target of £500 million disposals next year at present, and is looking around for further offerings. Ministers must not double count them.

(vii) Aid

The Foreign and Commonwealth Secretary fought hard, but made these token offerings. Probably not worth another row in Cabinet, since the Foreign and Commonwealth Secretary's support will be valuable elsewhere.

(viii) Employment

The Chancellor and the Secretary of State have agreed a package, including continuation of some - not all - of the Special Employment Measures. No special problems.

(ix) Defence

Paragraph 12 sets out the final position reached with the Secretary of State. It is entirely consistent with, though less detailed than, the exchange in correspondence which your office has been negotiating. The main features are:-

(a) agreed cuts of £62 million in 1980-81 and £10 million in 1981-82, with increases in the subsequent years;

(b) the same cash limits regime as for other programmes, implying a possible volume squeeze (which means that others cannot complain of preferential treatment);

(c) a special commitment to increase the cash limit on account of the AFPRB (which is unique, because it is the only pay increase to a cash-limited programme to which a Manifesto commitment applies). Even if AFPRB rates are 5 per cent above the 14 per cent norm, this is worth only 1 per cent on the Defence Budget;

(d) as a cosmetic face-saver, these figures are 'subject to review' during the year. Again, it can be argued that the international climate makes this a unique case;

(e) the figures can still plausibly be represented as consistent with the 3 per cent NATO commitment.

I suggest you steer the Cabinet towards accepting this deal with the minimum of discussion: it is liable to come unstuck if it is too closely inspected.

(x) Foreign and Commonwealth Office

Again, I would not advise you to press the Foreign and Commonwealth Secretary for more here; he was only persuaded to agree this with difficulty.

(xi) Cash Limits

This is for noting not for decision. The new forecast - which, when compared with the decision on cash limits already taken, will give a measure of the prospective volume squeeze - will be ready on 15th February. Treasury were thinking in terms of a reference to Cabinet on 21st February or 28th February. It is not clear why the Treasury are anxious to have this further discussion because it must carry some risk of reopening earlier decisions. You may care to ask the Chancellor what he has in mind. In addition CSD are preparing, as you know, a separate paper on cash limits for the Civil Service, and were planning to bring this to Cabinet also on 21st February; it cannot be left much later or the pay negotiations will have gone too far. The date can however be left open for a while.

On substance, the main point is the one I have already made: the more the Treasury takes credit for a volume squeeze through cash limits, the more this hits individual programmes, including those on which political commitments have been given. You yourself have recently reaffirmed the Government's intention not to cut the resources going to the health services; the Defence problem is familiar ground. There is also the point that the cash limit system was not intended for use as an instrument of ex ante volume squeeze, and its use for that purpose will put increasing strain upon it, and upon the readiness of colleagues to live with it.

(xii) Aggregate Expenditure

This is the opportunity for Cabinet to endorse the additional savings from the Home Secretary (mainly for morale-boosting purposes) and agreement to give the Secretary of State for Wales something more for closure areas.

(xiii) Contingency Reserve

The Chancellor is keeping this card up his sleeve. If Cabinet takes a clear decision on child benefits now, the pressures on the contingency reserve for 1980-81 will be somewhat reduced. On the other hand, there are a number of new bids. The obvious ones include additional requirements for the nationalised industries e.g. Steel and Electricity - these are not technically claims on the contingency reserve, but affect the overall PSBR forecast, and thus the amount the Chancellor can afford to allocate to the contingency reserve - and a few small ones like fuel assistance to the poor (if not agreed) as a programme increase). The present provision is £750 million, but the Chancellor may well decide later to increase this to a more realistic level. If he does so, this will offset some of the savings, unless the cash limit squeeze is sufficiently strong to provide the necessary money.

(xiv) Announcement

The Chancellor's paper does not deal with the question of an announcement. If Cabinet has taken a series of clear decisions, the Chancellor may well press for permission to make an early announcement, in view of mounting Press speculation. He would aim to set out the main details of the cuts, reserving the small print until the Public Expenditure White Paper comes out near or on Budget Day. The problem about an interim announcement, whether by way of statement or arranged PQ, is that it will give rise to a pressure for an additional day's debate, on which the Leader of the House will have views. But there is obviously some tactical advantage in an early statement. On the other hand there is also some advantage in deferring publication of the difficult changes e.g. in Child Benefit rate until Budget Day when they can be presented in a fuller context. This year, the usual practice of publishing a White Paper without specific provision for uprating is not available. You will want to ask how far an early announcement will have to reveal the more contentious items.

CONCLUSIONS

4. I suggest that you should aim to record conclusions on each of the individual programme changes listed above, to note the position on cash limits and the contingency reserve, to decide the question of an announcement, and to invite the Chancellor to bring forward the text of the Public Expenditure White Paper to the Cabinet as soon as it is available.

RTA

(Robert Armstrong)

30th January, 1980

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Qa 04416

To: MR LANKESTER

From: SIR KENNETH BERRILL

Public Expenditure: C(80)9

On 13 December 1979 (CC(79)25th Conclusions, Minute 6) the Cabinet agreed on the necessity for further reductions in public expenditure of the order of £1bn in 1980-81 and £2bn in each of the subsequent years of the Survey.

2. The Chancellor's proposals in C(80)9, if fully endorsed, would meet this target for the last two years of the Survey, but would fall short by nearly £200m in 1980-81 and nearly £250m in 1981-82.

3. The Prime Minister may feel that this is an acceptable outcome bearing in mind:-

(i) that it takes no account of any reduction in the UK contribution to the Community Budget;

(ii) that for 1980-81, it takes no credit for the volume squeeze expected to result from cash limits already agreed;

(iii) that for the later years the Government will have very much larger savings to present (£6½bn for 1981-82 and over £9bn for 1982-83) since the last published figures were the plans of the previous Government ie no credit has yet been taken for the cuts made last Autumn.

4. If, however, the Prime Minister felt that the Cabinet should at least consider additional options which would help to make good the shortfall in the first two years, the CPRS suggests two further possibilities.

(1) Cancellation of the Heysham and Torness AGRs

Given the prospect of low economic growth, there is little risk that cancellation would affect the security of future electricity supplies. Substitute power station orders would probably not be required for at least two more years, by which time it might be possible to go for PWRs. The case for continuing with the AGR programme is now almost entirely that of providing work for the admittedly hard-pressed and strategically important power plant manufacturers.

The main contracts have not yet been placed. Contracts for the nuclear island, the turbogenerators and for major site-works will be placed this Spring. Each station will cost well over £1bn to complete.

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Allowing for cancellation charges, the CPRS estimates that net savings could be, say, £100m in 1980-81 and £200m or more in each of the following two years.

(2) Education

The Chancellor has already asked the Secretary of State for Education to consider a further cumulative 1% reduction in the provision for non-teaching staff in the education services. The CPRS believes that such a reduction could also be applied for, say, two years to teaching staff without significantly altering the teacher/pupil ratio or undermining the Government's commitment to maintain the quality of the education service. It might involve some redundancies but this would not necessarily be a bad thing, given the mixed calibre of the intake during the peak period of the 'sixties. The additional savings might be £30-£40m in 1980-81 and £60-£80m a year thereafter.

5. If these options were adopted, in addition to all those proposed by the Chancellor, it would be possible to come very close to the £1bn target for 1980-81 (indeed the remaining gap could probably be closed by a small reduction in the contingency reserve); and the target for the later years would be fully met.

6. I am sending a copy of this minute to Sir Robert Armstrong.

KB

30 January 1980