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PRIME MINISTER

Public Expenditure 1979-80: Cash Limits 1979-80 and  
Civil Service Manpower

The two Treasury papers - Public Expenditure: Scope for Cuts (C(79) 4) and Cash Limits (C(79) 5) - and the CSD paper on Civil Service Manpower (C(79) 7) represent essential building blocks for the Chancellor's Budget. For good order you will need to take them separately (and I am letting you have a brief on each) but they hang together and in some respects overlap. I do not know how far the Chancellor will be willing (or indeed at this stage able) to expose the broad arithmetic of his Budget. But it would no doubt help him, and focus the minds of Cabinet, if you felt able to give them a collective scene-setting introduction. This might take the following form:-

- (a) We have a dreadful inheritance. The previous Government budgeted for a 2 per cent increase in public expenditure this year in real terms and grossly underestimated, in their public expenditure plans, the prices they would have to pay for goods and the pay they would have to allow their employees. The built-in assumption for the price of goods was of an increase of  $8\frac{1}{2}$  per cent over last year - the RPI is already over 10 per cent up on a year ago and rising. Similarly they assumed that the earnings of their own employees would increase some 7 per cent over the year. The outcome is likely to be two or three times as much as this.
- (b) Moreover the last Government gave a good deal of currency to a public sector borrowing requirement this year of around  $\pounds 8\frac{1}{2}$  billion. Without action to increase the net yield of taxes and/or to cut public expenditure the outturn is likely to be a good deal higher than this. Thus the Chancellor will need to make up a good deal of ground simply to return to the previous Government's PSBR target on which confidence depends. The scope for cutting direct taxation therefore turns critically on making

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bigger savings in public expenditure or bigger increases in indirect taxation than those needed to restore the last Government's PSBR objective, let alone to improve on it.

- (c) But our economic strategy depends critically on making a significant start in the reduction of direct taxation in this Budget. The Chancellor will therefore require all the help he can get from his colleagues in making immediate cuts in public expenditure. To the extent that these cuts are not forthcoming either indirect taxes will have to be increased further - with consequent upward pressure on the RPI - or the Government's ambitions for cuts in direct taxation will have to be restrained and our new strategy will be hamstrung before it starts.

2. If you felt like opening the discussion on these lines you could then invite the Chancellor to add any general comments. Thereafter you might take your colleagues successively through the three papers in the order: 1 public expenditure; 2 cash limits; 3 Civil Service manpower.

(John Hunt)

16th May, 1979