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Ref. A03308

PRIME MINISTER

Public Expenditure

Your meeting with Ministers this afternoon.

2. We need two things:
 - (1) Collective reaffirmation of determination to keep within the public expenditure targets for 1981-82 (and later years) as published in the March White Paper.
 - (2) Decisions on the distribution of reductions to bring the forecasts back to the targets.

Keeping within the targets

3. Ministers reaffirmed their determination to keep within the targets in July. Since then, however, the cuts required to achieve this have become even more painful, because of the effects of recession (unemployment benefits, etc.) and the requirements of the nationalised industries. Any further cuts are bound to reduce demand upon private sector industry, though the distribution of that reduction among industries will depend on the nature of the cuts. Some Ministers will argue that it would be better to bring the PSBR and £M3 back within the MTF5 ranges by means of increasing revenue from taxation on the personal sector: income tax, the National Insurance (or Health) charge on employees, or increases in the taxes on alcohol, tobacco and petrol. They may argue that it would be better to find the money from those who are in employment and can afford it rather than from those who are on Social Security and can't. Others will argue that increasing personal taxation (at any rate direct taxation) makes no political or economic sense, and that, painful though the reductions in public expenditure will be, they are consistent with the Government's longer-term aims for the balance between the private and public sectors, and the necessity to make them is in that sense welcome.

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4. You will want to make sure that this group of Ministers agrees that the March targets should be reaffirmed. If they do, you will want to discuss with them how to handle this in Cabinet.

How to keep within the targets

5. The Chief Secretary's paper defines the total sum now required in 1981-82 (about £1,850 million), and proposes to get it by:

- (1) Agreement to all the specific cuts he has proposed (only about £150 million of which are agreed): about £1,100 million.
- (2) A further 1 per cent reduction in local authority current expenditure next year, on top of the 2 per cent reduction already agreed: about £150 million.
- (3) A 2 per cent cut in cash-controlled central Government programmes next year: about £600 million.

6. You will wish to discuss with the group whether this is the right mix, or whether other possibilities should be considered. You are worried about the effects of cuts in capital programmes and in defence equipment programmes on vulnerable industries. If there is to be a general cut, should it be a $2\frac{1}{2}$ per cent cut on cash-controlled current expenditure, rather than a 2 per cent cut on all cash-controlled expenditure? Is it right to confine the cuts to cash-controlled expenditure? Is there a case for seeking to raise more money by means of reducing the size of the prospective increases in social security benefits (on the argument that, when wage-earners are being expected to settle for pay increases well below the going rate, it is not unreasonable that increases in social security benefits should be likewise trimmed)? Are the local authorities able, or should they be required, to do better than another 1 per cent on their current expenditure?

Handling

7. At present we are due to go "cold" into both aspects of the subject at Cabinet on 30th October. We need to discuss this afternoon whether there should before then be a curtain-raiser, which might be a prelude to bilateral activity between now and then; such a curtain-raiser might take the form of circulating the Treasury papers tomorrow, and you (or the Chancellor) making

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a brief statement at Cabinet on Thursday, or conceivably of your circulating a minute of your own tomorrow or on Thursday. The statement (or minute) could say that, if we are to stay within the March targets, we have to reduce public expenditure programmes in 1981-82 by the order of £2 billion; that this will call for very painful decisions by the Cabinet, which will involve postponing or renegeing on commitments; and that you have asked the Chancellor (or a group of Ministers chaired by the Home Secretary) to discuss some of the possibilities with certain Ministers in advance of the Cabinet meeting on 30th October.

Conclusions

8. You will want the meeting to guide you and the Chancellor on:
- (a) whether any further action should be taken in advance of Cabinet on 30th October;
 - (b) if so, whether it should include:
 - (i) an oral statement by you (or the Chancellor) in Cabinet this week;
 - (ii) a minute by you to all Cabinet Ministers;
 - (iii) bilaterals between the Chancellor and the Chief Secretary and certain spending Ministers, or
 - (iv) meetings between a small group of Ministers under the chairmanship of the Home Secretary or the Chancellor (essentially this group, but without you) and certain spending Ministers, with a view to softening them up for Cabinet on 30th October, and discovering what scope there might be for large reductions in particular programmes, if the Government were prepared to look at commitments again.
9. The spending Ministers to be worked on would have to include the Secretaries of State for Defence, Education and Science, Social Services, and Environment: they are the big spenders. They should also include Scotland, I think, and the Minister of Agriculture.

RA

(Robert Armstrong)

21st October, 1980