ECONOMIC POLICY
(Public Spending)
(Part 5)
PART 5 ends:-

C (79) 49  23/10/79

PART 6 begins:-

mk Transp to cadEx 24/10/79
### Cabinet / Cabinet Committee Documents

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The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB (CABINET OFFICE) CLASSES**

Signed [Signature]  
Date 24 October 2009  
PREM Records Team
Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Cmnd. 7439 January 1979
The Government’s Expenditure Plans 1979-80 to 1982-83

Cmnd. 7681 October 1979
Cash Limits 1978-79 Provisional Outturn (and 1977-78 Outturn)

Signed [Signature] Date 24 October 2009

PREM Records Team
NATIONALISED INDUSTRIES PAY

Background

A number of recent newspaper reports have suggested that the Government is attempting to lay down a pay norm for the nationalised industries. Those reports appear to originate from the letter sent out by Sir Keith Joseph (and other sponsoring Ministers), in accordance with the conclusions of E Committee (eighth meeting) in September about the setting of cash limits.

The nationalised industries cash limits have in the past been set at Budget time, after many if the industries have concluded or are near to concluding agreements on pay increases. This means that the cash limit has little effect in controlling pay. It was therefore agreed by E Committee in July that the industries cash limits for 1980-81 should be set early, in October or November, so as to exert pressure for responsible pay bargaining. It was further agreed in September that departments and the Treasury should begin discussion with the industries immediately and that this should be on the basis that the industries' pay bills would be expected to rise somewhat more slowly than prices generally, ie industries would be expected to achieve some reduction in their real unit labour costs.

Following this decision sponsoring Ministers wrote to their industries, on the basis of a draft prepared by the Treasury, setting out in general terms the basis for discussions about cash limits. The letter to the industries said that "in approaching the judgements about the appropriate allowance for increases in the pay bill, sponsoring departments will be starting from a general presumption - consistent with the Government's overall determination to counter inflationary pressures - that the real cost per unit of output should fall. In very broad terms, this means that each industry's pay bill (assuming constant output) should go up by less than the forecast increase in the retail prices index." No view was taken about the actual magnitude of the forecast increase in the RPI.

The suggestions in the press have been to the effect that these instructions amount to laying down a pay norm for the industries. This is not correct: the increase which can be provided for in the cash limit will vary from industry to industry according to the scope for greater productivity. Nor would it be possible to set cash limits without making some assumptions about each industry's pay bill.
NATIONALISED INDUSTRIES PAY

Supplementaries

Q. Has the Government laid down a pay norm for the nationalised industries?

A. No. The Government has decided to set nationalised industries cash limits earlier than usual so that they will exert some pressure for responsible pay bargaining. Setting these limits involves making an estimate for each industry of the future course of the industry's prices and costs, including wage costs. These will be different for each industry and there is no question of setting a norm. But the Government is determined that the industries' performance will be improved and it has therefore drawn their attention, in the context of setting cash limits, to the importance it attaches to securing reductions in real costs, including labour costs, per unit of output.

Q. Is the Government allowing the nationalised industries pay increases of 17 2/3%?

A. No. The Government has not laid down any such figure and suggestions to the contrary are mischievous and damaging. What the Government has done is to say that cash limits for nationalised industries should be set earlier than usual and that they should be set on the basis that the industries improve their performance and reduce their unit costs. The level of wage increases will vary from industry to industry according to their circumstances, and in particular their ability to increase their productivity.

Q. Why not wait and see what is the going rate in the private sector?

A. There are a number of important nationalised industry negotiations early in the pay round, (coal miners, postmen, gas manuals and steelworkers, and January settlement dates) and what happens here can set the pace for the private sector.

Q. Has the Government changed its mind?

A. No. The manifesto stressed the need for "a clearer financial discipline" for the nationalised industries and for higher productivity. Cash limits are an important element in the Government's strategy for imposing financial disciplines and increasing productivity. As the Chancellor said in the Budget speech, higher pay without higher productivity can lead only to higher inflation and unemployment.
I told you on the telephone that I had prepared two tables on public expenditure for the Prime Minister yesterday based on information in the draft Public Expenditure White Paper for the years 1978-79/1980-81 and for the earlier years provided by GÉ Division. I enclose copies of these tables.

The Prime Minister has asked that both tables should be circulated to Cabinet as background for the public expenditure discussion for Thursday. I would be grateful if the Chancellor or the Chief Secretary could therefore circulate them immediately, after the figures have been checked by your officials. (I spoke to Margaret Pearson about the figures for the earlier years yesterday: she was going to check the point that the programme figures for the years 1974-75/1977-78 do not match up exactly with the totals in line four of the second table. The figures for these earlier years in my table 1 were taken from a minute which Robin Butler sent me dated 25 July).

The Prime Minister has asked if you could send copies of these two tables also immediately to the Secretaries of State for Social Services and the Environment.

I am sending a copy of this letter and enclosures to Martin Vile (Cabinet Office).

M. A. Hall, Esq., M.V.O.,
H.M. Treasury.
Treasury Chambers, Parliament Street, SWIP 3AG

Rt Hon Humphrey Atkins MP
Secretary of State
Northern Ireland Office
Great George Street
LONDON SWIP 3AJ

23 October 1979

Dear Humphrey,

Thank you for your letter of 5 October about the Meat Industry Employment Scheme in Northern Ireland.

As you know, I regard this as an expensive and unsatisfactory way of dealing with the problem caused by the price differentials between the livestock markets in the North and South, and by our inability to prevent smuggling across the border. I urge you, therefore, to prepare the way now for bringing the scheme to an end from April next year. I shall certainly expect you to finance any expenditure on it beyond 31 March 1980 from within your own allocation.

In the meantime, I acknowledge the short-term difficulties you faced this year in accepting your share of the Budget cuts as well as financing a full year's MIES, and agree that the cost of the scheme from mid-July 1979 to 31 March 1980, up to a maximum of £10 million, may be met from the Contingency Reserve.

A copy of this letter goes to all members of the Cabinet and to Sir John Hunt.

JOHN BIFFEN
Ref. A0482

MR. LANKESTER

RSG and Cash Limits

Cabinet will this Thursday have to decide the cash limits for the Rate Support Grant. The Secretary of State for the Environment has asked if he may bring Mr. Tom King for this discussion. We do not encourage double-banking of this kind in either Cabinet or Ministerial Committees - a Minister in charge of a Department should be able to make his own case. On the other hand, Mr. King has attended E Committee discussions on the RSG (and, I gather, acquitted himself well) and has also been useful in the discussions in the Home Secretary's Group on the RSG.

I should be grateful if you would let me know the Prime Minister's wishes.

M. J. VILE

23rd October, 1979
PRIME MINISTER

I attach two tables on public expenditure as background for Questions. The programme figures in Table I are summarised in line 4 of Table II. But when talking about total public expenditure, you should focus on line 13 of Table II. There is some good ammunition here - which Ivor Fallon referred to in the Sunday Telegraph. In particular, the very big reduction in expenditure in 1977/78.

22 October 1979
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<td>+6.0</td>
<td>0.0</td>
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PRIME MINISTER  

You asked how much we would have to increase income tax or VAT in the absence of the public expenditure "cuts" for 1980/81.

The "cuts" on the plans inherited from Labour come to about £4 billion. (The precise amount will depend upon final decisions on gas and electricity pricing: the total will probably end up £2-300 million short of £4 billion.)

The £4 billion is at "1979 Survey Prices" - i.e. November 1978 prices. After allowing for inflation between then and 1980, the alternative of tax increases works out as follows:

- There would have to be a 9p increase on the basic income tax rate, or

- VAT would have to be increased to 26 per cent.

The additional revenue from a VAT increase in the first year is considerably less than in a full year. This explains partly why it has to be so large. (If one could have a Finance Bill in January with a VAT increase then, then the necessary increase to offset £4 billion of expenditure would be 8 per cent rather than 11 per cent.

The Treasury are doing some further work on these figures for the Chancellor's and the Chief Secretary's use at their Press Conference after the publication of the Public Expenditure White Paper. They will, for example, refine them further to show what would have to be the VAT increase to keep the money supply on target. To satisfy this objective, the VAT increase would have to be even higher than shown above. This is because - pound for pound - a
reduction in public expenditure is better for the money supply than a VAT increase. The reason for this is that public expenditure reductions have a more depressing effect on activity, and VAT increases - by raising prices - to some extent increase the demand for money.

I am sure you will not want to get into this kind of refinement. However, it would be a good thing if you were to use the same arithmetic as Treasury Ministers. If possible, therefore, it would be best to keep off this kind of comparison until the Chancellor and Mr. Biffen have considered the calculations themselves. Since the White Paper showing the £4 billion "cuts" will not be published until next week, you will probably want to avoid any reference (explicit or implicit) to the £4 billion. Until then, anyway.

T. P. LANKESTER

22 October 1979
Mr. Lamacker,

Public expenditure 1974-75 to 1977-78

Please find attached tables you requested via Miss Reyon. Apologies for manuscript.

L.R. Robbins

G.E.A. 3

22 October, 1979
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<td><strong>Total</strong></td>
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<td>53804.4</td>
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27 October, 1979
Public expenditure 1974-75 to 1977-78

£ million at 1979 survey prices

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<td>14. Percentage change on previous year</td>
<td>+0.3</td>
<td>-2.5</td>
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White Paper on Public Expenditure in 1980/81

The Prime Minister was grateful for the Chancellor's minute of 19 October on the above subject. She has noted the public expenditure effects of the various options for phasing in the electricity and domestic gas price increases as set out in the minute, and that the Chancellor would like a firm decision on one of the options by the end of this week so that it can be reflected in the forthcoming White Paper.

The Prime Minister has also read the draft of the White Paper which was enclosed with the minute. She has made a few drafting suggestions. Although I understand that the draft has already been printed up for circulation to Cabinet, the Chief Secretary will nonetheless wish to note these suggestions with a view to revising the draft in the light of Cabinet on Thursday. The Prime Minister's drafting changes are as follows:-

(i) paragraph 3, line 7 to read: "High Government borrowing has fuelled inflation, has denied the wealth-creating sectors some of the finance they need for expansion, and has led to high interest rates."

(ii) paragraph 4, line 3 to read: "First, to bring down the rate of inflation. This means that Government borrowing must be firmly controlled. It is a main determinant of monetary growth."

(iii) paragraph 5, line 3: delete "and likely to remain so for some time".

(iv) paragraph 8, line 3 to read: "It is rather to recognise that the only way in which that improvement can be secured is to earn the money and resources by higher output. But higher output can only come from lower taxes, lower interest rates and less Government borrowing, and better use of investment." Delete the rest of the paragraph.

/I am sending
I am sending a copy of this letter to Bill Burroughs (Department of Energy), Alistair Pirie (Chief Secretary's Office) and Martin Vile (Cabinet Office).

T. P. LANKESTER

A.M.W. Battishill, Esq.,
HM Treasury.
White Paper on Public Expenditure in 1980/81

Thank you for your letter of 19 October which I have shown the Prime Minister.

As I told you on the telephone, the Prime Minister would prefer to put off taking a decision on the date of publication of the White Paper until decisions have been taken on the outstanding question of electricity and gas pricing in 1980/81. I assume that this will be settled at Cabinet on Thursday, so a decision on timing of publication can be taken then.

The Prime Minister has noted that the Chief Secretary is opposed to the suggestion that there should be an oral statement. She has, however, not yet taken a firm view on this herself; it would seem appropriate for this to be considered in Cabinet as well.

I am sending a copy of this letter to John Stevens (Chancellor of the Duchy of Lancaster’s Office), Richard Prescott (Paymaster General’s Office), Murdo Maclean (Chief Whip’s Office) and Martin Vile (Cabinet Office).

T. P. LANKESTER
My Secretary of State has four points on which he would like to see changes to the current draft of the White Paper on Public Expenditure 1980/81.

i. On housing, officials have been in touch with yours about the reference to rents. I understand that the latest draft proposed by the Treasury still contains a reference to higher rent increases in 1980/81 than in recent years.

My Secretary of State considers it increasingly clear that whatever decisions are finally taken on rents are going to need exceptionally careful handling. He is certain that this White Paper is not the place to open up discussion and it would be helpful if now before the Draft comes before Cabinet, this direct reference to rents can be deleted.

ii. On construction my Secretary of State attaches great importance to the inclusion of a brief reference to the implication for the construction industry of the decisions for 1980/81.

On 16 October the Group of Eight called on the Secretary of State to make representations on matters concerning the construction component of public expenditure. Not unexpectedly they were anxious about the effect which our plans may hold for the industry and for civil engineering in particular. They have a point to make since half of the industry's demand comes from the public sector.

More specifically they left the Secretary of State in no doubt of the importance to them of the reference to construction in the Expenditure White Paper - both as a forecast of their future workload and as confirmation that the Government pays close regard to the health of the industry. The construction table which the Group of Eight persuaded the previous Government to include in the last White Paper was hailed as a major breakthrough for the industry. For the present Government to appear to be going back on this would invite massive political trouble.
It is for this reason that my Secretary of State regards it as essential that the forthcoming White Paper should contain a comment on the construction implications even though the actual figures may not have a favourable appearance from their point of view. My Secretary of State hopes that the Chief Secretary will realise that at a time when there can be little in the Government's revised public expenditure plans to help the industry, this is the least that can be done.

My Secretary of State therefore suggests the insertion of a single sentence on the following lines:

"Capital expenditure on construction in 1980/81 will be £6.250m."

This might perhaps be included at the end of para 12 of the text.

iii. On para 14 my Secretary of State would like to see a reference to the target reduction of 3% for local authority current expenditure which he announced at the time of the Budget. He suggests an additional sentence at the end of the paragraph as follows:

"For England and Wales the Secretary of State for the Environment asked authorities to reduce their expenditure to 3% below the level planned at the time of the 1978 Rate Support Grant Settlement."

iv. On para 12, sentence 2, the Secretary of State considers that it would be better to replace the phrase "the figures are necessarily tentative" with the alternative "the figures are only illustrative" which more accurately reflects the autonomy of local authorities.

Jeff Jacobs
Private Secretary
Treasury Chambers, Parliament Street, SW1P 3AG

T. P. Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1A 2AL

19 October 1979

Dear Tim,

WHITE PAPER ON PUBLIC EXPENDITURE IN 1980-81

On 13 October Cabinet agreed that there should be an early White Paper on public expenditure in 1980-81, and the Chief Secretary will shortly be circulating a draft to Cabinet. Meanwhile he has asked me to write to you to seek the Prime Minister’s concurrence in the date of publication.

The earliest practicable date for publication, if Cabinet agree to the draft, is Wednesday 31 October. The Prime Minister and the Chancellor and other colleagues are due to visit Bonn that day and, if the Prime Minister felt that publication could embarrass her in her discussions with Chancellor Schmidt on defence, publication could be held up until the following day. But the Chief Secretary considers it barely conceivable that the Germans could learn of, and digest, the contents of the White Paper in time to raise it with the Prime Minister on the day of publication, and Wednesday is a more convenient day than Thursday for press conferences (which the Chief Secretary and Financial Secretary would take). So unless the Prime Minister sees objection, the Chief Secretary would propose to publish on 31 October, at 11 am.

I mentioned to the Chief Secretary the suggestion of an oral statement, but he would be opposed to it, particularly if it had to be on a Thursday. He considers that a more helpful way to present the White Paper is to give Members of Parliament an opportunity to study it properly and then to debate it. The plans in the White Paper relate after all to the next financial year, not to measures taking immediate effect on the day of publication. An
oral statement would also compel publication in the afternoon, which would be less convenient for press conferences and hence for getting the Government's line reflected in press comment in the next morning's newspapers.

I am sending a copy of this letter to the Private Secretaries to the Chancellor of the Duchy of Lancaster, the Paymaster General and the Chief Whip, to the Chief Press Secretary at No 10 and to Sir John Hunt.

Yours sincerely,

A C PIRIE
Private Secretary
WHITE PAPER ON PUBLIC EXPENDITURE 1980-81

I attach a draft of this White Paper, which John Biffen will be circulating to Cabinet in printed form early next week.

2. There is one immediate issue. The direct effect of the decisions taken at E Committee on electricity and gas pricing was to add some £400 million to the public expenditure totals for 1980-81. After allowing for other changes, we have had to add £350 million to the 1980-81 totals in the White Paper which causes them to show a small rise over 1979-80, instead of a decline as we had both hoped. The relevant figures are in line 13 of table 1 of the White Paper.

3. The figures include the price increases from April which were agreed at E Committee. But a decision to start the phased removal of under-pricing before the end of 1980-81, and preferably in October after the RPI rise will have passed its peak, would make a big difference to the figures. The provisional effects of various illustrative options are as follows:-

<table>
<thead>
<tr>
<th></th>
<th>Savings £ million at 1979 Survey prices</th>
<th>Direct RPI Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity and Domestic Gas 5%</td>
<td>125</td>
<td>+0.2</td>
</tr>
<tr>
<td>Electricity, 5%, Gas 10%</td>
<td>150</td>
<td>+0.3</td>
</tr>
<tr>
<td>Electricity and Gas 10%</td>
<td>250</td>
<td>+0.4</td>
</tr>
</tbody>
</table>
4. Removing under-pricing is of course also very important for the later years. Compared with raising prices no more than the increase in the RPI, the amounts at stake in David Howell's proposals rise to £700-800 million a year by 1983-84. He and John Biffen will be reporting on the options for phasing out under-pricing and their effects as soon as they can get figures good enough to base decisions on.

5. But the urgent aspect is 1980-81. I hope that we could aim to take a decision on one of the options in paragraph 3 by 26th October so that we can reflect it in the 1980-81 White Paper and in the cash limits to be published for the industries next month.

6. I am copying this minute to David Howell, John Biffen and Sir John Hunt.

[Approved by the Chancellor of the Exchequer and signed in his absence]
THE GOVERNMENT’S EXPENDITURE PLANS 1980-81

1. Public expenditure is at the heart of Britain’s present economic difficulties.

2. For a long time now the performance of the British economy has been deteriorating. Over the past five years output has grown less than half as fast as it did over the previous 20 years, and little over a third as fast as in other industrialised countries. Without the contribution of North Sea oil there would have been scarcely any growth in output or productivity at all. Inflation has been at record levels, and has acquired strong momentum.

3. Over the years public spending has been increased on assumptions about economic growth which have not been achieved. The inevitable result has been a growing burden of taxes and borrowing.

   - Increases in taxes have made inflationary pressures worse and reduced incentives.

   - High Government borrowing has fuelled inflation by making proper control of the money supply more difficult, and has denied the wealth-creating sectors some of the finance they need for expansion, and has led to high interest rates.

   - High inflation has increased the risks and uncertainty faced by both employer and employee and gravely damaged investment, production and jobs.

If this continued, our economy would be threatened with endemic inflation and economic decline.

4. In deciding their spending plans for 1980-81 the Government have had in mind three central objectives:
First, to bring down the rate of inflation. To achieve this it is essential to contain and reduce progressively the growth of the money supply. This means that Government borrowing must in turn be firmly controlled. It is a main determinant of monetary growth.

Second, to restore incentives. This means the Government must hold down and if possible reduce taxes, particularly on incomes.

Third, to plan for spending which is not only compatible with the necessary objectives for taxation and borrowing, but is also based on a realistic assessment of the prospects for economic growth.

5. The immediate prospects for output are poor both in this country and in the rest of the world. The growth of world trade is low and likely to remain so for some time. The recent increase in the oil price has made matters worse.

6. The Government's economic strategy must be to stabilise public spending for the time being. Unless this is done there can be no possibility of lower taxes, lower borrowing or lower interest rates.

7. For 1980-81 the previous Government's plans involved a level of expenditure which could not be sustained. Even leaving out of account the likely cost of "catching-up" pay settlements in the public services, their published plans were £4 billion higher than the spending now planned for 1979-80(1). To pay for this increase would have required sharply higher taxes or borrowing on a scale which, if possible at all, would mean higher interest rates or an excessive growth of the money supply and more inflation. Any of these would damage our growth prospects still further - and, in so doing, the prospects for higher spending on our public services in future.

8. To limit severely the resources devoted to our public services
for the time being is not to deny that many of them need improvement. It is rather to recognise the way in which that improvement can be secured, the only way is to earn the money and resources required first by higher output. Higher output can only come from better working of our market economy, lower taxes, lower interest rates and less Government borrowing. To plan more public expenditure before the required output is available to support it would ensure that in the event that growth of output does not take place. Higher public expenditure cannot any longer be allowed to precede, and thus prevent, growth in the private sector.

9. Total expenditure now planned for 1980-81 is shown in Table 1. The Government have provided for growth in some programmes, particularly defence, law and order, and social security (reflecting among other things this year's record pensions uprating). Within the total, reductions have therefore been made in other services. The plans for later years will be published in a later White Paper.

10. The figures in Table 1 for 1979-80 include the public expenditure reductions announced in the Budget. The outturn is still uncertain, particularly on local authority expenditure which the Government do not directly control. The present estimate is that the planning total of public expenditure will be about the same as in 1978-79.

Table 1 - Public Expenditure 1978-79 to 1980-81

[at end]

11. Figures for the main programmes are set out in Table 2. Brief comments on the individual programmes follow in paragraphs 16 to 42. Where appropriate, the Ministers concerned will be announcing further details.

Table 2 - Total Public Expenditure by Programme

[at end]
12. The broad breakdown of local authority current expenditure between services, incorporated in Table 2, is consistent with the pattern of individual programmes discussed in paragraphs 16 to 42, which reflect the Government's view of national priorities between and within services. However, the figures are necessarily tentative since it is for individual local authorities to decide the eventual distribution in the light of local needs and conditions. The breakdown which has been assumed is set out in Table 3 below. The planned levels for capital expenditure in 1980-81 are some 8 per cent lower than in 1978-79, or 9 per cent less than the outturn at present estimated for the current year.

| TABLE 3 - Public Expenditure by local authorities in Great Britain |
| [\text{at end}] |

13. The outturn of local authority current expenditure in 1979-80 cannot yet be estimated. The figures for current expenditure in 1979-80 therefore still reflect the levels of expenditure planned at the time of the Rate Support Grant settlement in November 1978. But local authorities have been asked to achieve economies which would result in a lower outturn for 1979-80.

Special sales of assets

14. As announced in the Budget speech, the Government is intending to raise £1 billion from sale of assets owned by the public sector in the current year, as a contribution to reducing the public sector borrowing requirement. Measures for raising this sum are in hand. The target for 1980-81 is £2 billion.

Civil service staff costs

15. The civil service staff costs included in the 1980-81 programme take account of the revised manpower levels flowing from the adjustment to the current year's cash limits and the changes in public expenditure programmes both in 1979-80 and 1980-81. They do not, however, allow for additional savings resulting from the review of the size of the cost of the civil service announced by the Minister of State, Civil Service Department, on 11 June; these will be announced in due course.
The individual programmes

Unless otherwise stated, all the expenditure figures in the following paragraphs are at constant, 1979 Survey prices.

Defence

16. The provision for the Defence Programme reflects the Government's determination to give priority to strengthening the nation's defences, within the framework of the NATO Alliance, and at the same time to achieve maximum value for money within the resources available.

Overseas aid and other overseas services

17. Overseas aid will be at about the same level in 1980-81 as in the current year. Similarly, the provision for other overseas services is planned to continue at much the present level (except that the current year includes contingent provision for UN peace-keeping operations, and once-for-all grants of military aid to two Commonwealth countries). In order to tailor activities to this level of expenditure, 23 overseas posts will be closed or reduced in size and other FCO services curtailed.

18. The provision for contributions to the European Communities and to the European Investment Bank rises from about £920 million in 1979-80 to about £1000 million in 1980-81, representing the full estimated net cost to the United Kingdom under present arrangements; it demonstrates the strength of the Government's case in pressing our Community partners to accept without delay a fundamental change in these arrangements.

Agriculture fisheries food and forestry

The provision made for

19. Expenditure on EEC-financed market support policies is forecast to increase by £84 million compared with 1979-80. In the rest of the programme there is a net reduction of £77 million as a result of sales of land and changes in various services and their uptake, partly offset by provision for some increase in expenditure on fisheries. (The forecasts for expenditure for 1979-80 are on which these comparisons are based, include payments due in 1978-79 but delayed by industrial action; if allowance is
made for these the £77 million reduction becomes £40 million. Similar delays affected other programmes, but not to the same extent.)

Trade, industry, energy and employment

20. Expenditure by the Department of Industry in 1980-81 on industrial support will be slightly below the level now planned for 1979-80. The policy changes announced by the Government on regional and selective assistance, and on the National Enterprise Board, affect both of these years but the full savings will be achieved after 1980-81.

21. Selective assistance by the Department of Energy to certain industries under Section 8 of the Industry Act 1972 and assistance to the nationalised industries, mainly coal, will continue to be provided. This programme also provides for the United Kingdom Atomic Energy Authority’s research and development work in the nuclear field and for the Department of Energy’s expenditure on energy conservation, research and development activities.

22. ECGD expenditure is expected to increase by £156 million which reflects the once-for-all reduction achieved in 1979-80 by the Trustee Savings Banks taking over some £200 million of outstanding refinance.

23. The abolition of the Price Commission, which is expected to save £3 million in 1979-80, should produce a full year’s saving of £7 million in 1980-81.

24. The provision for 1980-81 for measures operated by the Manpower Services Commission is held at the reduced level for 1979-80. No provision is made for the extension of the Small Firms Employment Subsidy, the Job Release Scheme, or the Temporary Short-Time Working Scheme which are due to close for applications in March 1980. The statutory short-time working scheme proposed by the previous Government has been dropped.

Nationalised industries

25. The public expenditure planning total includes the industries’
borrowing from all sources (line 9 of table 1 as well as Government lending in table 2). The level planned for 1980-81 represents a reduction of £35 million on the expected figure for the current year.

No allowance is made in these figures for the Government's plans for special sales of assets, the proceeds of which are included separately in line 10 of table 1 (see paragraph 14 above).

Roads and transport

26. The roads and transport programme will be reduced by some £200 million compared with 1979-80 and the reductions will be spread widely across the programme. It is the Government's intention that about half the total reduction should come from local transport expenditure, both capital and current. There will be a reduction in central government expenditure on the motorway and trunk roads programme from the level previously planned, but the level will remain slightly above the reduced volume of expenditure now planned for 1980-81 and there will be a switch within this programme to permit increased expenditure on motorway maintenance. Roughly half of the overall change will result from a reduction in central government subsidies to transport industries, the bulk of which will reflect changes in the arrangements for the funding of British Rail and National Freight Corporation pension schemes. There will also be small reductions in new bus grants, ports investment and transport research.

Housing

27. Public expenditure on housing is expected to increase between 1978-79 and 1979-80 by about £150 million. It will then fall in 1980-81 by about £300 million to about £5080 million. Capital expenditure will be broadly unchanged between 1978-79 and 1979-80 but will fall in 1980-81 by some £240 million. The reduction compared with 1978-79 reflects the expected decline in local authority new housebuilding which will result from a change in local authorities' priorities.
28. Current expenditure, chiefly subsidies to public sector housing, is expected to be £30 million higher in 1979-80 than in 1978-79, partly because interest rates have risen. A further increase of about £30 million is expected in 1980-81, although local authorities are expected to make higher rent increases than in recent years. Over a period of years the Government intend to reduce the level of housing subsidies, which at present costs taxpayers and ratepayers £1.5 billion – nearly a third of all public expenditure on housing. This will be assisted by the new subsidy system for England and Wales, which will start in 1981-82 and relate subsidies more directly to need.

Other environmental services

29. The amount included for 1980-81 for this miscellaneous group of services, mainly provided by local authorities, takes account of savings arising from the Government's decision to abolish the Community Land Scheme. Legislation will be introduced to enable local authorities to reduce their net expenditure on local environmental services by charging for planning applications and for the enforcement of building regulations. Capital investment on water and sewerage services is planned to continue at broadly the same level as in 1979-80. Expenditure on the Urban Programme will be at a higher level than is now expected in 1979-80. Capital expenditure on local environmental services is less than the prospective outturn for 1979-80. Expenditure on the Thames Barrier will increase by £28 million with a view to completing the project in 1982.

Law, order and protective services

30. Planned expenditure on this programme will increase to reflect the Government's decision to give priority to law and order. Total provision in 1980-81 will thus be £2,542 million, £23 million higher than the provision for that year in Cmd 7439 and £83 million higher than expected expenditure in 1979-80. This does
not however include any net expenditure which may arise from the recommendations of the Inquiry into the United Kingdom Prison Services or from the Royal Commission on Legal Services. Included in the total is provision for additional central government expenditure on court services and other legal services, including legal aid, and on prisons. In England and Wales expenditure on the police will be increased to allow an increase in strength to 115,500 officers by March 1981 with increases in supporting staff and services both locally and centrally. If this estimate for numbers of police officers is exceeded, further provision will be made from the contingency reserve. The planned expenditure will also enable local authorities to increase their provision for the probation and after-care service and magistrates’ courts; and, in the fire service, will enable existing standards of fire cover to be maintained. In Scotland, additions for these services will be made commensurate with the totals in England and Wales.

Education and science, arts and libraries

Education and science

31. The Government are committed to promoting higher standards of achievement. The number of pupils in schools will be falling but account has been taken, both in teaching and in non-teaching expenditure, of the inescapable diseconomies of smaller scale. The figures in the programme provide for the employment of some 505,000 teachers in 1980-81 (compared with about 526,000 in 1978-79), sufficient for the present level of induction and in-service training to be maintained. It will be necessary to step up the rate at which surplus school places are taken out of use. It should be possible to maintain expenditure on the under-fives at about the present level.

32. The Government expect expenditure savings of some £240 million to be made on school meals, milk and transport. Parliament will be asked to give local authorities greater discretion in the nature of and charges for these services.
33. Some modest expansion of non-advanced further education, especially vocational courses, should be possible to meet rising numbers aged 16 to 18. The resources available for home students in higher education will be about the same as in 1979-80. New overseas students or their sponsors will be expected in future to meet the full cost of their tuition.

34. There will be no reduction in the provision for capital expenditure on school basic need but building programmes for school improvements, under-fives and further and higher education will be reduced by about half.

35. Provision for science at just over £300 million will be slightly less than in 1979-80.

Arts and libraries

36. Direct central government expenditure in support of museums, libraries and the live arts in 1980-81 should allow a continuation of activities at a level broadly comparable to what has been possible in the current year. Planned expenditure includes the contribution of the Office of Arts and Libraries to the £15.5 million to be provided for the new National Heritage Fund and for acceptance of works of art in lieu of tax. Local authority expenditure on libraries, museums and art galleries will fall to the extent that local authorities' provision for these services reflects the reductions in planned local authority expenditure in general.

Health and personal social services

37. The Government plans to maintain spending on the National Health Service in 1980-81 at the level proposed by the last Administration. However, the net cost will be reduced by increased recovery under the Road Traffic Act 1972 of the cost of treating the victims of road accidents, by increasing prescription charges to 70p from April 1980, by revising dental charges so as to maintain their 1979-80 level in real terms, and by limited changes.
in the welfare milk scheme. Gross expenditure will be about 3 per cent above the 1978-79 outturn. Measures which are being taken to eliminate waste and to simplify administration in the National Health Service will enable the available resources to be channelled more into direct patient care.

38. Spending on the local authority personal social services is likely to be reduced. The Government expect that savings will as far as possible be made by further increases in efficiency, by reducing or eliminating low priority provision, by developing policies designed to help people to help themselves and others, and by promoting collaboration with the voluntary sector. Where reductions in standards of provision prove necessary, authorities will be relied upon to implement these in ways which protect the most vulnerable. Authorities have also been asked to give priority as far as possible to those services for children which are concerned with the prevention and treatment of delinquency. Joint finance will continue at the level planned.

Social security

39. Expenditure on social security reflects the numbers who qualify for and claim the benefits, which are in turn influenced by the course of the economy and demographic variations. The figures reflect the Government’s intention to intensify efforts against fraud and abuse of the social security system.

Other public services

40. The principal expenditure in this programme is on revenue collection by Inland Revenue and Customs and Excise, and is mainly related to staff. In 1979-80 the programme included £26 million for the cost of the Parliamentary and European elections. For 1980-81 there are small increases for financial administration surveys (preparation for 1981 census).

Common services

41. The provision for civil service superannuation, which is £28 million higher than for 1979-80, assumes some increase in the
number of pensions in payment and their average level. Expenditure by the Property Services Agency on the Government office estate in the UK will be reduced by cuts in expenditure on major new works (mainly on new offices following the decision to reduce the dispersal of Government work from south-east England) and also by reductions in minor works, furniture, rent, maintenance and running costs.

Northern Ireland

42. The Northern Ireland total for 1980-81 reflects, among other changes, the consequences of decisions taken on public expenditure in 1979-80, including the application to Northern Ireland of measures such as the increase in health charges. Expenditure on law/order in Northern Ireland will rise to ensure that the necessary resources are available to combat terrorism.
## Public Expenditure 1978-79 to 1980-81

<table>
<thead>
<tr>
<th></th>
<th>Provisional outturn</th>
<th>Plans</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>1978-79</td>
<td>1979-80</td>
</tr>
<tr>
<td>1. Central Government</td>
<td>49887</td>
<td>52085</td>
</tr>
<tr>
<td>2. Local authorities</td>
<td>18421</td>
<td>16692</td>
</tr>
<tr>
<td>3. Certain public corporations</td>
<td>1012</td>
<td>1098</td>
</tr>
<tr>
<td>4. Expenditure on programmes</td>
<td>69320</td>
<td>71875</td>
</tr>
<tr>
<td>5. Contingency reserve</td>
<td>-</td>
<td>271(a)</td>
</tr>
<tr>
<td>6. Debt interest</td>
<td>2921</td>
<td>3100</td>
</tr>
<tr>
<td>7. Total public expenditure before shortfall and special sales of assets</td>
<td>72241</td>
<td>75246</td>
</tr>
<tr>
<td>8. Expenditure on programmes and contingency reserve (4 + 5)</td>
<td>69320</td>
<td>72146</td>
</tr>
<tr>
<td>9. Net overseas and market borrowing of nationalised industries (b)</td>
<td>446</td>
<td>-500</td>
</tr>
<tr>
<td>10. Special sales of assets (c)</td>
<td>-</td>
<td>-1000</td>
</tr>
<tr>
<td>11. Planning total(d)</td>
<td>-</td>
<td>70546</td>
</tr>
<tr>
<td>12. General allowance for shortfall</td>
<td>-</td>
<td>-750</td>
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<tr>
<td>13. Outturn (actual or projected)</td>
<td>69766</td>
<td>69796</td>
</tr>
<tr>
<td>14. Percentage change on previous year</td>
<td>+6.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

(a) Balance remaining at 19 October 1979 in the contingency reserve for the current year.

(b) Includes short-term borrowing and capital value of leased assets, which were not included in the planning totals in Cmdn 7439.

(c) See paragraph 14. The precise treatment of the sales in relation to public expenditure and the public sector borrowing requirement depends on the exact nature of the transactions.

(d) The planning total (line 11) differs from total public expenditure (line 7) by excluding debt interest (line 6) but including all net borrowing by the nationalised industries (ie including line 9 as well as Government lending to nationalised industries in line 1) and special sales of assets (line 10).
## Total Public Expenditure by Programme

**Table 2**

<table>
<thead>
<tr>
<th>Programme</th>
<th>£m at 1979 survey prices</th>
<th>1978-79</th>
<th>1979-80</th>
<th>1980-81</th>
</tr>
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<tr>
<td><strong>Provisional plans</strong></td>
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<td>Defence</td>
<td>7509</td>
<td>7824</td>
<td>8062</td>
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<td>Overseas aid and other overseas services</td>
<td>1961</td>
<td>2135</td>
<td>2191</td>
<td></td>
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<tr>
<td>Agriculture, fisheries, food and forestry</td>
<td>896</td>
<td>986</td>
<td>993</td>
<td></td>
</tr>
<tr>
<td>Industry, energy and employment</td>
<td>3267</td>
<td>2753</td>
<td>2870</td>
<td></td>
</tr>
<tr>
<td>Government lending to nationalised industries</td>
<td>693</td>
<td>1800</td>
<td>1000</td>
<td></td>
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<tr>
<td>Roads and transport</td>
<td>2980</td>
<td>3118</td>
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<td>Housing</td>
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<td>Other environmental services</td>
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<td>3303</td>
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<td>Law, order and protective services</td>
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<td>Education and science, arts and libraries</td>
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<td>Social Security</td>
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<td>19289</td>
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</tr>
<tr>
<td>Other public services</td>
<td>973</td>
<td>1010</td>
<td>997</td>
<td></td>
</tr>
<tr>
<td>Common services</td>
<td>1048</td>
<td>1073</td>
<td>1088</td>
<td></td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>2232</td>
<td>2215</td>
<td>2150</td>
<td></td>
</tr>
<tr>
<td><strong>Total programmes</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>(see table 1 line 4)</em></td>
<td></td>
<td>69320</td>
<td>71875</td>
<td>70829</td>
</tr>
</tbody>
</table>
Public Expenditure by local authorities in Great Britain (a)

Table 3

<table>
<thead>
<tr>
<th>Current Expenditure</th>
<th>£m at 1979 survey prices</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1978-79</td>
</tr>
<tr>
<td>Provisional outline</td>
<td></td>
</tr>
<tr>
<td>Education, libraries and arts</td>
<td>7664</td>
</tr>
<tr>
<td>Local environmental services</td>
<td>1902</td>
</tr>
<tr>
<td>Law, order and protective services</td>
<td>1764</td>
</tr>
<tr>
<td>Personal social services</td>
<td>1263</td>
</tr>
<tr>
<td>Transport</td>
<td>1182</td>
</tr>
<tr>
<td>Housing</td>
<td>539</td>
</tr>
<tr>
<td>Other programmes</td>
<td>226</td>
</tr>
<tr>
<td>Total (Current)</td>
<td>14540</td>
</tr>
</tbody>
</table>

| Capital Expenditure                                     |          |         |         |
|----------------------------------------------------------|--------------------------|
| Education, libraries and arts                          | 418      | 534     | 550     |
| Local environmental services                           | 640      | 620     | 615     |
| Law, order and protective services                     | 68       | 58      | 66      |
| Personal social services                               | 64       | 75      | 72      |
| Transport                                               | 507      | 643     | 549     |
| Housing                                                 | 1822     | 1865    | 1623    |
| Other programmes                                        | 4        | 7       | 9       |
| Total (Capital)                                         | 3584     | 3623    | 3284    |
| TOTAL (Capital + Current)                               | 18123    | 18389   | 17561   |

(a) The totals differ from those in line 2 of table 1, which cover the UK.
Explanatory and technical notes were included as Part 6 in the public expenditure White Paper published in January 1979 (Cmnd 7439). The following notes supplement that description.

The definition of public expenditure in this White Paper

In general, the same definitions are used in this White Paper as in Cmnd 7439 1.

2. A few changes in the definition of public expenditure have been made in this White Paper from that used in the last White Paper. The two principal changes are:

(a) Family benefits. The change from child tax allowances and family allowances (including child interim benefit payable during 1976-77) to child benefit was spread over a period of years, and during the transitional period the total for the social security programme included only the net Exchequer cost of the change; this treatment was reflected also in public expenditure totals. The gross cost of child benefit was shown in the main table for the social security programme together with tax revenue flowing from reductions in child tax allowances. Now that the transition to child benefit has been completed by the general withdrawal of child tax allowances, the social security programme and public expenditure totals include the gross cost of child benefit (up to 1976-77 family allowances including child interim benefit).

(b) Net overseas and market borrowing of nationalised industries. The definition has been broadened to include short-term borrowing and the capital value of leased assets. Net short-term borrowing is defined to include the industries' transactions in other public sector debt. The definition of the industries' external financing requirement used in the public expenditure planning total is thus now aligned with that used for their cash limits.

Main classification changes since Cmnd 7439

3. The following are the principal transfers between main programmes that have been made to reflect new arrangements:

(a) Expenditure on computer requirements supplied to central government departments by the Central Computer Agency and formerly included in the common services programme has been distributed to the appropriate functional programmes, reflecting the change to provision against repayment by the user department from 1 April 1980. The other programmes principally affected are defence; trade, industry, energy and employment; roads and transport; housing; other environmental services; law, order and protective services; health and personal social services; and other public services.

(b) Some further expenditure on the urban programme has been reallocated from other environmental services to housing, roads and transport, education, and health and personal social services.
(c) To improve functional control it has been decided to confine the programme for Northern Ireland to expenditure within the responsibility of the Secretary of State for Northern Ireland. Thus expenditure by the Ministry of Agriculture in that area is now classified to agriculture, fisheries, food and forestry, and expenditure on the court service to law, order and protective services.

The price basis of this White Paper

4. Except where otherwise stated, money figures in this White Paper are presented at constant prices (described as 1979 survey prices) to allow comparisons from one year to another of the quantity ('volume') of goods and services used, either directly or indirectly, by the programmes. For most expenditure on goods and services 1979 survey prices are used as they were in the autumn of 1978 (as most local authority current expenditure the date is, more precisely, November 1978). For most transfer payments, 1979 survey prices are assumed average prices of 1979-80.

5. The average increase from 1978 survey prices (the price basis of Cmd. 7439) to 1979 survey prices is 1\% per cent. The price basis for borrowing by industrialised industries has been changed from estimated prices for the financial year in which the White Paper is published to prices for the preceding financial year (1976-79 for this White Paper).

6. Total public sector interest payments, corresponding to the estimates in table 1, line 6, on the "public expenditure" definition of debt interest, are as follows:

<table>
<thead>
<tr>
<th></th>
<th>1978-79</th>
<th>1979-80</th>
<th>1980-81</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ million</td>
<td>9,900</td>
<td>9,900</td>
<td>9,800</td>
</tr>
</tbody>
</table>
CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

T P Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AL

19 October 1979

Dear Tim,

WHITE PAPER ON PUBLIC EXPENDITURE IN 1980-81

On 13 October Cabinet agreed that there should be an early White Paper on public expenditure in 1980-81, and the Chief Secretary will shortly be circulating a draft to Cabinet. Meanwhile he has asked me to write to you to seek the Prime Minister's concurrence in the date of publication.

The earliest practicable date for publication, if Cabinet agree the draft, is Wednesday 31 October. The Prime Minister and the Chancellor and other colleagues are due to visit Bonn that day and, if the Prime Minister felt that publication could embarrass her in her discussions with Chancellor Schmidt on defence, publication could be held up until the following day. But the Chief Secretary considers it barely conceivable that the Germans could learn of, and digest, the contents of the White Paper in time to raise it with the Prime Minister on the day of publication, and Wednesday is a more convenient day than Thursday for press conferences (which the Chief Secretary and Financial Secretary would take). So unless the Prime Minister sees objection, the Chief Secretary would propose to publish on 31 October, at 11 am.

I mentioned to the Chief Secretary the suggestion of an oral statement, but he would be opposed to it, particularly if it had to be on a Thursday. He considers that a more helpful way to present the White Paper is to give Members of Parliament an opportunity to study it properly and then to debate it. The plans in the White Paper relate after all to the next financial year, not to measures taking immediate effect on the day of publication. An
oral statement would also compel publication in the afternoon, which would be less convenient for press conferences and hence for getting the Government's line reflected in press comment in the next morning's newspapers.

I am sending a copy of this letter to the Private Secretaries to the Chancellor of the Duchy of Lancaster, the Paymaster General and the Chief Whip, to the Chief Press Secretary at No 10 and to Sir John Hunt.

Yours sincerely,

A C PIRIE

Private Secretary
18 October 1979

Sir Charles Villiers MC
Chairman
British Steel Corporation
33 Grosvenor Place
London SW1X 7JG

Dear Charles,

NATIONALISED INDUSTRIES’ CASH LIMITS AND PAY: BRITISH STEEL CORPORATION

As you will know, I wrote recently to the Chairmen of other nationalised industries for which I am responsible about their cash limits for the financial year 1980/81 and on pay settlements in the coming round. I explained that it was the Government’s intention that the cash limits should exert a downward pressure on the level of pay settlements although we were determined to avoid specifying any sort of pay norm.

Since my letters have now received wide publicity, I should explain that I did not write similarly to you since the position on BSC’s cash limit for 1980/81 is already much more advanced, as the result of the various discussions between us from June onwards. And, on pay, we have been well aware of BSC’s present objective, namely, a very modest if any central settlement. With any further pay increase to come from self-financing productivity agreements to be negotiated locally. So it was clear to me that BSC were already acting well within our policy and was keeping us informed of the position. I have every confidence that you will continue to keep the Department informed as your negotiations progress.

Yours sincerely,

[Signature]
Rt Hon David Howell MP  
Secretary of State  
Department of Energy  
Thames House South  
Millbank  
London SW1  

18 October 1979

Dear David,

FLEXIBILITY BETWEEN FINANCIAL YEARS

In your letter of October 8 you suggested it would be helpful if the nationalised industries could be included in Sir Derek Rayner's examination of the application of accounting conventions to government business. You said that there had been suggestions that some increased flexibility in their cash limits would be an aid to management.

It is clearly for Sir Derek to consider whether he wishes to include nationalised industries in his study. I must say that I would see difficulties in giving the industries further flexibility.

Keith Joseph and the Chancellor have both circulated papers to E Committee - E(79)6 & 35 - with accompanying notes pointing out that the external financing needs of the industries, being the balance between much larger revenue and expenditure flows, can on occasion increase in a way beyond the industry's control. The risk of any excess would call for every effort by an industry to stay within its limit but it is only realistic to accept that in these circumstances these limits cannot be as immutable as those in the public services.

I believe that to go beyond this would create a real risk of undermining such discipline as the cash limits exert on the industries. The industries themselves have a choice about their rate of investment spend, and may also be able to adjust their volume of output. And like any commercial company the industries can alter their external financing requirement by manipulating

1.
creditors, debtors and stocks in a way which is not open to government departments. Further flexibility could jeopardise our policy that cash limits should contribute an effective constraint on their operations, and in particular that they should exert pressure for responsible pay bargaining.

I am copying this letter to other members of the Cabinet, Sir John Hunt and Sir Derek Rayner.

Yours,

John Biffen
When the Chancellor called on the Prime Minister this morning, they discussed the Chancellor's minute of 17 October about the pay and price assumptions for the 1980/81 Rate Support Grant cash limit.

The Chancellor explained that, while the Treasury's forecast for the RPI from November 1979 to 1980/81 was for a 14½% increase, he was proposing a cash limit based on a price increase assumption of 13%. This would put a further small squeeze on local authority current spending, and would be helpful for the PSBR. As for the pay assumptions, these were set out in paragraph 7 of his minute. On the face of it, these might look on the high side; but it was hard to see how, realistically, lower figures could be used. The Prime Minister said that she fully supported the Chancellor on his price assumption - if anything, she felt it could be lower still. She was also concerned that the pay assumptions might even be on the high side.

Later, the Chancellor raised with the Prime Minister the question of the RSG percentage - whether it should be 61% as recommended by the majority in MISC 21 or some lower figure. The Chancellor said that, if the Prime Minister was willing to support a lower figure, he would like to propose in Cabinet a figure of 58% or somewhere in between. The Prime Minister said that she would indeed support the Chancellor if he were to put forward a lower figure to Cabinet, though she was by no means sure that Cabinet would be willing to endorse anything lower than 61%.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

J. P. LANKESTER

Tony Battishill, Esq.,
HM Treasury.
17 October 1979

G G H Walden Esq
Foreign and Commonwealth Office
Downing Street
LONDON
SW1

Dear Mr Walden,

1980-81 PUBLIC EXPENDITURE WHITE PAPER

Thank you for sending the Treasury a copy of your letter of 12 October to Michael Alexander.

Since the date of publication of the White Paper has not yet been made public, and should in any case be the subject of a Treasury announcement, we tried yesterday morning to have the reference to publication "at the end of October" removed from your draft Press Notice. However, we were advised that the Notice had already been issued under embargo, although your letter said that it was proposed to issue it today.

I am sure you will agree that the Notice should not have been issued without clearance from the Treasury. Perhaps you would ensure that, in future, any public announcement relating to matters of specific Treasury concern is not to be issued without prior clearance from us.

I am sending a copy of this letter to Michael Alexander at Number 10.

Yours sincerely,

A O'Flynn
Private Secretary
Meeting with the Chancellor – Thursday 18 October, 0845

I understand the Chancellor may want to discuss the following issues with you tomorrow morning:

i) RSG Cash Limit for 1980/81
There is a minute on this at Flag A. This proposes certain assumptions on pay and prices for working out the cash limit. The pay assumptions (in paragraph 7) consist of estimates of what will be the effect of the outstanding Clegg awards, an assumption of 14% in other settlements up to end July 1980, and 12½% for settlements for the following year. On prices, the Chancellor proposes 13% — rather less than the Treasury's forecast/assumption for price increases generally. The purpose of this is to put some additional squeeze on the local authorities. MISC 21 have decided (see minutes at Flag B) that the RSG percentage should be 61%, as against 58% proposed by the Treasury. This, if endorsed by Cabinet, will reduce pressure for rate increases; on the other hand, it will mean more public expenditure than the Treasury were counting on. In order to soften the public expenditure effect of a 61% grant, it would be wise to have a tight cash limit, and therefore the Chancellor's proposals on pay/price assumptions seem right. (If they are too tight, the local authorities will not believe the pay/price assumptions on which they are based; and will again put up the rates by an excessive amount.)

ii) TV Licences
The Chancellor has agreed the Home Secretary's proposals for TV licence increases, which the Home Secretary discussed with you. These call for a £9 increase for colour sets from November and a £2 increase for monochrome sets; and they are to last for 2 years. You made various suggestions
to the Home Secretary (record at Flag C) — such as that there should be no increase for monochrome sets if the monochrome licence falls largely on pensioners. I think it would be best to wait for a minute from the Home Secretary, in which he will no doubt cover your points, before taking any final decision.

(iii) **NEDC Membership**
You discussed this last time, and suggested that Sir Leslie Murphy should not be re-appointed and should be replaced by somebody from small businesses and that Mr. Shanks should be replaced by Daisy Hyams.

(iv) **Gas Prices**
The Chancellor will show you figures on the PSBR effect of delaying the gas and electricity price increases by one year — as suggested in E this afternoon.

(v) **Defence Expenditure**
There is a dispute between the Treasury and MOD about the interpretation of the 3% NATO commitment. The argument is continuing to range (as reflected in three minutes which are in the Cabinet folder). You told the Chancellor earlier that you would support him against Mr. Pym.

At last week's meeting with the Chancellor you asked for a note on additional demands for finance coming forward from the nationalised industries, Rolls Royce, British Leyland, etc. This is at Flag D. It shows that there are some substantial potential demands — in 1981/82 as much as £850 million — and this is on the assumption that the Chief Secretary's proposals to Cabinet for "cutting" expenditure are agreed, including the energy price increases. The note simply reinforces the importance of getting as much of the Chief Secretary's proposals on public expenditure through Cabinet as possible.

17 October 1979
PRIME MINISTER

1980-81 RATE SUPPORT GRANT CASH LIMIT
PAY AND PRICE ASSUMPTIONS

We face a difficult decision on the pay and price assumptions to be used in setting the cash limit on the 1980-81 Rate Support Grant (RSG). I would welcome the opportunity of discussing this with you at our meeting on 18th October. This minute outlines the issues.

2. The RSG is due to be announced on 16th November for Scotland and 20th November for England and Wales. It is planned that Cabinet should take the key decisions on the RSG, including the cash limit, on 25th October. I understand that the latest date for Cabinet's decisions, if the RSG is to be announced on the proposed dates, is 1st November.

3. The RSG cash limit will incorporate Cabinet's decision on local authority current expenditure and provide for pay and price increases during 1980-81. E Committee agreed - E(79)10th meeting - that provision for these increases should be "realistic, not extravagant".

4. The pay and price assumptions will become known when the RSG is announced. The assumptions are critical for the RSG and for public service cash limits generally. On the RSG, local authorities will tend to make larger rate increases if they do not think the pay and price assumptions are realistic.

/On cash limits generally,

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On cash limits generally, the decisions on the assumptions for the RSG cash limit will have a powerful influence on decisions which will be required later for other public service cash limits. More immediately the nationalised industries will have a grievance if their cash limits, which are also published in November, are inconsistent with the RSG.

5. A complicating factor is that no decision has yet been taken on the price forecasts we will publish in November in the Industry Act forecast.

6. It is simplest to consider the pay assumptions separately from prices. On pay there are three components - the outstanding comparability awards, settlements in the current pay round and settlements in the pay round starting on 1st August 1980.

7. All three are uncertain. Treasury officials consider the following a realistic assessment for increases in earnings from the due settlement dates:

   Outstanding comparability awards
   for teachers               - 15% - 20%
   for local authority APT &
   C Staff                   - 12%
   for craftsmen             - 10% - 12%

   New settlements in this pay
   round up to 31st July 1980 - 14%

   New settlements in the next
   pay round starting from
   1st August 1980           - 12½%

/8. On prices

CONFIDENTIAL
8. On prices their assessment is that the RPI will increase by about 14½% from November 1979, the RSG base date, to the average of 1980-81.

9. I would not propose to spell out the detailed figures above to the local authorities. What matters to them is the overall increase in costs for which we are providing, rather than its breakdown. If we used the figures above, they work out at an increase of 14.7 per cent for increases in local authority costs between 1979-80 and 1980-81 as a result of new pay awards and price increases, plus a further 6 per cent for outstanding comparability awards. I would give only these aggregate figures rather than the details in paragraphs 7 and 8, both in public and in the papers circulated to Cabinet, given their wide distribution, although I would ensure that the Ministers directly concerned with local authorities know how the figures are built up.

10. There are two immediate questions:—
   (a) is this assessment realistic?
   (b) whatever we think realistic, should cash limits be set using lower figures?

11. I would not argue with the realism of the assessment, and as a general principle I think that we must set cash limits on a reasonably realistic basis, as the E Committee decided. Unrealistic figures would quickly be shown up as such, and it could become impossible to avoid making many increases in cash limits, as happened this year. The local authorities would discount our assessment of inflation, and make higher increases in rates.

12. But I think we should round the figures down a bit. In any case 14.7 per cent looks unnecessarily precise.

/ For my part
For my part I would go for 13 per cent and put a further small squeeze on local authority current spending which I believe they could accept. This figure would look well presentationally as it would appear to be well below the current figure for the increase in earnings and in the R.p.i. And it would do something to make good the harm that has been done by the circulation by the press this week of the figure of 17½ per cent which they are treating as the going rate of public sector settlements.

13. I would welcome the opportunity to discuss these issues with you on Thursday.

(G.H.)
17th October 1979
BACKGROUND

Cabinet on 13th September (CC(79) 15th Conclusions, Minute 6) broadly approved the Chancellor's proposals for expenditure reductions in the last three years of the PESC period, but remitted all the details to be sorted out in bilateral discussions with the Chief Secretary. I think it is fair to say that, in doing this, Cabinet did not formally accept any of the specific proposals, and as was to be expected, some of them have given rise to problems. These problems have to be resolved at the Cabinet meetings scheduled for 18th October and (to give time for any further bilateral negotiations) 1st November. The Lord President's paper on Civil Service Manpower will also be taken on 1st November. You have it in mind to have a preliminary talk with the Chancellor and the Chief Secretary before Cabinet, and I am submitting this brief in advance, with that in mind.

2. The introduction to the paper sets out very clearly the extent of the gap which still has to be bridged, even to avoid any increase in taxation during the period. It will of course be argued that this is a pessimistic forecast, and that it takes insufficient account of the dynamic effects of the Government's other economic policies. But that is for the future. The Chancellor's prudent line is that the Cabinet should not spend the increment until it has been earned. This may prompt demands for discussion of the macro-economic strategy, and (as I said in an earlier note to you before the weekend) you may feel that you have to concede this in principle. If you so decide, it might be prudent to say so at the beginning of the discussion. But, purely for timetable reasons, I see little chance of fitting in such a discussion before the Cabinet has to decide on the expenditure strategy. That timetable assumes the publication of a longer-term
public expenditure White Paper, though in less detail than in previous years, before Christmas. This is not an absolute deadline, of course; but political pressures can be expected to mount if the publication is delayed much beyond that timescale.

3. But **whatever** the medium-term forecast says, it is already clear that the cuts proposed by the Chief Secretary are just about the minimum consistent with the Government’s fiscal and monetary policies. The cuts already fall a bit short of the target tentatively endorsed by Cabinet in the summer. But, given the difficulties, in fact the Chief Secretary has done pretty well to secure all the savings noted in Annex B. He cannot really afford to lose any of the five remaining major issues identified in his paper. His position has already been weakened by the defeats on 1980-81 in the summer (we know, for example, that this has encouraged the Secretary of State for Education to try his luck again in Cabinet). Further losses will simply encourage other Cabinet Ministers to appeal against him to Cabinet on all sorts of expenditure issues. If he doesn’t end up somewhere near the new target figure for the later years, you will face the danger of another cuts exercise next year, possibly in less propitious political circumstances. You may feel it is better to get all the difficult decisions out of the way, and on the public record now. Expenditure operations of this kind are always difficult for any Government. The extract attached at Annex 1 shows that it was no easier in the Seventeenth Century.

**HANDLING**

4. You may want the Chancellor of the Exchequer to set out very briefly the general background before calling on the Chief Secretary to introduce his paper. This will depend somewhat on what you decide to do about a general economic strategy discussion. You might then intervene yourself and speak on the lines of the first sentence of paragraph 3 above. When the Chief Secretary has spoken, I think you should move right in to a discussion of the detailed issues. You could start by seeking confirmation that all Ministers accept the savings listed in Annex B - but noting that the Chief Secretary reserves the right to come back and ask for more if he does not secure his major cuts. You can aim to make as much progress as possible at this meeting, covering all the
points listed in the Chief Secretary's paper if time allows. There may be points remitted back for further study which can be swept up on 1st November.

5.(a) Defence. The base-line here is the Treasury one: the Secretary of State for Defence's suggestions constitute an additional bid. He has reinforced this in his minute to you of 12th October. He has, as you know, circulated a separate paper, OD(79) 30, which is specifically designed to strengthen his case. (paragraph 7 of that paper reads: 'it is essential that we settle a Defence Budget in the 1979 PESC in a way which plainly reflects both NATO guidelines and our earlier commitment to give Defence the priority it needs.'). We have not yet arranged for an OD discussion of this paper. Discussion in OD could only be expected to strengthen the Secretary of State for Defence's case. It is his colleagues in other Departments who would have to find countervailing savings if he won. So this is really a decision for Cabinet, and the OD discussion could only be indicative. The correct tactics here might be to allow the Secretary of State for Defence to outline his case, with the Chief Secretary's retort, and to see whether he gets any support from the rest of the Cabinet. Only if he does, need you ask OD to look at the paper, returning to the matter at the next Cabinet discussion on 1st November. Although it is wrapped up as a technical question of Budget conventions the real issue here is whether to devote a further £160 million in the final year to the Defence Budget. It is, however, true that methods of forward financial planning vary considerably among NATO countries. Some compensate fully for inflation, even if only after the event rather than in forward plans. Others plan in volume terms throughout. Figures declared to NATO are supposed to be based on real volume planning. Any move on their part would be noticed and might give cause for Alliance criticism. If Cabinet supports the Treasury, as they may well do, they should accept this risk. But Defence has had a very easy ride so far, and the Cabinet may feel that enough is enough. The Rayner presentation at the beginning of September has shown that there is plenty of room for economy within MOD's present programmes.

(b) Agriculture. Cabinet agreed at its last meeting, following the discussion on milk prices, to commission a rapid review of our whole agriculture policy. Sir Kenneth Berrill has this in hand. The full review will take at least two months. It may be possible to make an interim report in time for the resumed
discussion on 1st November though my information is that this is in fact unlikely. You will in any case want to see whether there is any chance of agreement at this present meeting on the more limited question of capital grants, which is the Chief Secretary's main target. But the Minister of Agriculture is most unlikely to accept this and will press for a report from the Berrill Group first. In any event, however, decisions on the grants will have to be taken on 1st November.

(c) DOE (Housing). It would be convenient to take the Secretary of State for the Environment's separate paper (C(79) 44) at this point. You might ask him to speak first, and then get the Chief Secretary to reply. At the time of submitting this brief I have not seen Mr. Heseltine's paper. But I understand he accepts the case for some increase in council house rents and sets out five possible paths for a return to more economic levels. His own preferred option (a return to the real level of rents in 1974, about 8.6 per cent of average earnings) would fall only about £50 million short of the Chief Secretary's target in 1981-82, but about £300 million short in 1983-84. I think you must press him for something more than this.

(d) Education. (See Mr. Carlisle's letter of 15th October). The three areas of disagreement are set out clearly in Annex G. Perhaps the unit cost figures are the most significant. They provide a partial political defence to the inevitable criticism of cuts in the Education programme. The education cuts proposed in the summer were politically controversial because they involved charges. These proposals escape that problem, but go into the heartland of education expenditure. Does the Cabinet prefer this course, or does it want to reconsider, for example, parental contributions? If the latter, you might remit this for further bilateral study.

(e) Social Security. The Secretary of State for Social Services is not himself resisting the abolition of earnings related supplement (ERS) but wants his colleagues' views. It is not clear whether this is merely an excuse for seeking to reopen the issue. You might therefore wish to make him show his hand by calling him to speak first. It would then be for others (e.g. the Secretary
of State for Employment) to make the case for not abolishing ERS, and to suggest alternative savings. You will no doubt want views of the Leader of the House and the Chief Whip on the possibility of legislation.

(f) Consequential reductions: Scotland, Wales and Northern Ireland. The main point here is the Secretary of State for Wales' claim that the recent 'need study' justifies allocating a higher proportion of expenditure to Wales than the previous formula allows. The political argument for this, in its crudest terms, is pretty weak after the collapse of the devolution proposals in Wales. The case for 'equality of misery' is strong.

6. There are a number of other points, not all listed in the Chief Secretary's paper, which may be raised.

(i) **Employment.** It is common ground that any fresh temporary employment measures should be a claim on the Contingency Reserve. But Ministers may also question the realism of the provision made for unemployment benefit. They will not, of course, have seen the full forecast, although the figures before the Cabinet assume unemployment rates of fairly high proportions.

(ii) **Nationalised industries.** This brief is written before the E Committee discussions on 17th October about coal and gas. I shall let you have a supplementary note following that.

(iii) **Staff savings.** When Cabinet resumes its discussion on 1st November, the Lord President's proposals will be available, and the realism of the 'broad allowance' made in line 8 of Annex D can then be assessed. At present it is impossible for Cabinet to take a view on this because the figure is rolled up with that for nationalised industries. (My information is that the figure is £50 million - £175 million - £250 million - £300 million in the four years; but this is in addition to the savings which have been scored against individual Departments. There is a danger of double-counting).

(iv) **Contingency Reserve.** We understand privately that the Chief Secretary has refused to propose further cuts in the Contingency Reserve, which now stands (at 1979 Survey prices) at £2,197 million, £2,750 million and £2,750 million in the last three years. (This compares with
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£1, 527 million in 1980-81). I think you should support the Chief Secretary's refusal to go down any further. The number of unquantifiable extras is disturbing. There is bound to be further pressure for additional Defence expenditure; as Sir Kenneth Berrill has pointed out, there are large potential claims for Rolls-Royce and for BL; towards the end of the period, expenditure on the Nuclear programme may be building up (E is due to look at a paper on this on 23rd October); the Secretary of State for Employment's bid for employment measures is likely to be repeated in later years; etc. Particularly in the last years of a Parliament and in the run-up to a general election, it is unwise to leave oneself with nothing in hand.

(v) Presentation. This is a point to be picked up again at the end of the resumed discussion. But Cabinet has already agreed that the White Paper for Later Years, while inevitable, should be in fairly general terms. You will want to make sure that the Cabinet has a chance to look at the text, and not just to note it formally. It could be very important for the presentation of the Government's overall strategy for the rest of this Parliament.

CONCLUSIONS

7. At this stage, you will want to record conclusions on any items which can be firmly agreed; to record instructions to the Chief Secretary to pursue any additional points with the Ministers concerned; and to agree to resume discussion on 1st November.

(John Hunt)

16th October, 1979
Treasury Chambers, Parliament Street, SW1P 3AG

16 October 1979

The Rt Hon Mark Carlisle MP
Secretary of State
Department of Education and Science
Elizabeth House
York Road
London SE1 7PH

Dear Mark,

PUBLIC EXPENDITURE AFTER 1980-81 - EDUCATION

Thank you for your letter of 15 October.

In response to your first six paragraphs I must say that the measurement of "cuts" against the previous Government's unrealistic "plans" is no more than an arithmetical exercise. Such measurement has no real meaning for us.

The important facts are that the numbers of pupils in primary and secondary schools are falling and will go on falling; that the relevant age groups for further and higher education are reaching their peak now and will similarly be falling in a year or two; and that in higher education there is also a declining participation rate which has meant that, despite an increasing age group, the numbers actually participating have been flat for four years now. In these circumstances I believe that my proposal to maintain the current level of entry to higher education is as much as could possibly be justified.

In the case of schools, as Annex G of my paper says quite clearly, I have allowed as much as £130 million a year to cope with the problems that you mention in paragraph 7 of your letter. The difference between us is that you are seeking to stabilise at 1980-81 levels instead of 1978-79 levels. The fact that by taking large cuts first on school meals, milk and transport, you have
secured a breathing space in which to overcome the momentum of the previously inexorable rise in unit costs before cutting it back is no doubt helpful to you. But it does not convert our Manifesto commitment into a commitment to go on expanding until 1980-81 and only stop at the levels reached then.

As for non-advanced further education, it would be misleading to think of this as if it consisted entirely of vocational courses for technicians, craftsmen and apprentices. As you will know, it is actually a varied collection of many different kinds of course, some of that kind and some not. My proposal is to reduce it, eventually, only about 3 per cent below its 1978-79 level.

I do not dispute that, like all of our colleagues, you have gone a long way towards what is required to meet our economic objectives. Unfortunately it is not quite far enough; we have to go all the way if those objectives are to be reached. What I have proposed on these three issues is no more severe than to stabilise the scale of provision at about the level at which it stood when we were writing the Manifesto. In the circumstances I believe that to be reasonable and I cannot believe that it would have any deleterious effect on the kind of standards we actually had in mind in the Manifesto - which, as we have repeatedly insisted, are not synonymous with levels of expenditure.

I am sending copies of this letter to the Prime Minister, other members of Cabinet including the Minister of Transport, and Sir John Hunt.

[Signature]

JOHN BIFFEN
Dear John,

Now that I have seen your further paper on public expenditure in 1981-84 (C(79)42) I think it right to repeat in writing some of the points that I made at our meeting on 27 September.

Our decisions on 1981-84 have to be taken in the light both of the trend in expenditure up to 1978-79 and of the decisions already taken on 1980-81.

Between 1973-74 and 1978-79 total public expenditure grew by about 10 per cent. Expenditure on education and science was unchanged, despite the rise in all pupil and student numbers except primary.

So much for the past. As for 1980-81, the Cabinet approved in July cuts of £3.4 billion in the inherited plans for public expenditure as a whole, of which £0.44 billion (one eighth) fell on education.

I turn now to the years after 1980-81. In C(79)35 the Chancellor and you proposed cuts in those later years which, by 1983-84, would leave total public expenditure about 10 per cent above the 1973-74 level. You also proposed that nearly one sixth of those cuts or well over £1 billion in the last year should fall on education, to leave it by then almost 10 per cent below 1973-74 and therefore similarly below 1978-79.

As a result of our meeting on 27 September and subsequent discussions between our officials I have accepted net cuts in the inherited plans for education and science rising from over £500m in 1981-82 to over £200m in 1983-84, leaving the programme in that year about 6 per cent smaller than in 1973-74. But you are seeking further cuts totalling nearly £300m by 1983-84 in three vital areas in which I have already accepted major reductions rising by then to £240m.
On schools, you are proposing in effect to cut unit costs both in primary and in secondary education below the reduced levels on which we have agreed for 1980-81 and therefore to allow nothing after that year either for diseconomies of scale as numbers decline (a point acknowledged in the draft White Paper on that year) or for salary drift as the teaching profession inexorably becomes older and more senior. I judge that this would mean a cut in real standards of provision of at least 5 per cent by 1983-84. The maintenance of buildings, already depressed, would suffer further; teaching groups would get bigger and more diverse in age and ability, with less provision for the least and most able; standards would be impaired in the basic subjects in primary and secondary schools, and the range of the curriculum reduced, particularly in science and modern languages; and it would be impossible to ensure an adequate supply of books and materials.

On non-advanced further education you are proposing in each year up to 1983-84 a sharp cut in the current level of provision. This is an area where the age groups are still rising and demand (for part-time and full-time vocational courses not provided in schools) is strong from those who wish to improve their qualifications. Your cuts would mean a reduction in the supply of technicians, craftsmen and apprentices, on which industry's ability to respond to changing needs largely depends.

Your proposals for higher education, by imposing a freeze in the number of new admissions at a time when the relevant age-groups are also still increasing, would be seen as a significant erosion of the chances of a place in a university or polytechnic for able school-leavers. This would make it harder to attract more high quality entrants into key professions such as engineering.

We all agreed in July that we must protect the core of the education service from serious damage. As the Prime Minister put it in a letter of 17 September to Sir Fred Dainton, the last Chairman of the University Grants Committee, "We intend to abide by our Manifesto commitment (reiterated in the Queen's Speech) to maintain educational standards both in schools and in higher education." The cuts proposed for the later years will make it increasingly difficult to justify that statement.

I am copying this letter to the Prime Minister, the other members of the Cabinet, the Minister of Transport and Sir John Hunt.

Yours ever,

Mark Carlisle
1980/81 PESC WHITE PAPER

In his minute PM/79/84 of 2 October, the Foreign and Commonwealth Secretary informed the Prime Minister of those subordinate posts which he proposed to close or substantially reduce. The Treasury have now agreed that, for operational reasons, the FCO may announce this list of posts in advance of the publication of the White Paper.

I enclose a copy of the Press Notice we propose to issue on 17 October. In addition, there is one post, Ibadan, which is also to be closed but which we shall not mention at this stage because of local political considerations.

(G G H Walden)

M O'D B Alexander Esq
10 Downing Street
Part of the savings which the Foreign and Commonwealth Office will be making in 1980/81 as a result of the Government's decision to reduce public expenditure will be found by closing or substantially reducing 23 posts abroad. The following posts will be closed:

- Adelaide
- Basle
- Calais
- Innsbruck
- Malmo
- Ostend
- Palermo
- Philadelphia
- Rotterdam
- St Louis
- Salvador (Brazil)
- Strasbourg (Consulate General)
- Tangier
- Trieste
- Winnipeg

The following will be reduced in size:

- Detroit
- Hanover
- Durban
- Gothenburg
- Madras.
A substantial saving in staff and other costs will be found by re-allocation of responsibilities among the following posts:

Los Angeles
San Francisco
Seattle

In certain places where posts are being closed, Honorary Consuls may be appointed. The financial details of these and other reductions the Foreign and Commonwealth Office will be making will be made available when a White Paper is published at the end of October.
PRIME MINISTER

PUBLIC EXPENDITURE 1981-82 TO 1983-84

This minute is to report progress on my discussions with the spending Ministers.

2. I hope that before Cabinet I will have provisionally settled the majority of figures at, or close to, the proposals in my paper considered by Cabinet on 12 September. But there will be five or six issues outstanding, each involving large amounts of money. In reaching provisional agreements with other Ministers, I have kept open the possibility of re-opening them if the outstanding issues cannot be resolved satisfactorily.

3. The figures, not yet final, are in the Annex. The gap to be settled at Cabinet arises on five Departments - defence, housing, education, social security and agriculture. The amounts and issues at stake are -

<table>
<thead>
<tr>
<th></th>
<th>1981-82</th>
<th>1982-83</th>
<th>1983-84</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defence (interpretation of NATO target)</td>
<td>54</td>
<td>103</td>
<td>160</td>
</tr>
<tr>
<td>Housing (mainly rents and new council house-building)</td>
<td>418</td>
<td>587</td>
<td>746</td>
</tr>
<tr>
<td>Education (current expenditure on schools non-advanced further education and higher education)</td>
<td>125</td>
<td>210</td>
<td>295</td>
</tr>
<tr>
<td>Social security (abolition of earnings-related supplement)</td>
<td>260</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>Agriculture (mainly capital grants)</td>
<td>70</td>
<td>93</td>
<td>90</td>
</tr>
<tr>
<td>Consequences of these changes for Scottish, Welsh and Northern Ireland programmes</td>
<td>110</td>
<td>150</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1037</td>
<td>1338</td>
<td>1686</td>
</tr>
</tbody>
</table>

SECRET
4. A substantial sum may also be at stake on finance for the nationalised industries: this will depend on decisions to be taken by E Committee on 17 October on coal and gas, and on the outcome of Keith Joseph's negotiations with the Post Office.

5. If the Cabinet accepts my proposals on these points, the total for the later years will be about £68 1/2 billion in each year - compared with about £70 billion in 1978-79 and £67 1/2 billion in 1977-78. If the decisions go the other way, the figures could be close to £70 billion in the first two years and above it again in 1983-84. (These figures must be treated with caution: if unemployment is higher than assumed, social security payments will rise. On the other hand, they take no credit for a successful outcome of negotiations on our EEC contribution).

6. The £1 1/2 billion at issue in 1983-84 is a significant sum in terms of achieving our monetary objectives without excessive interest rates. It represents about 3 pence on the basic rate of income tax. This has to be seen against our aim of getting the basic rate down to 25 pence over the lifetime of the Parliament.

7. This minute is for information only, but I thought that you would like advance notice of the issues to be raised in the paper I am to circulate later this week for discussion at Cabinet on 18 October.

8. I am copying this minute to Sir John Hunt.

WJB

JOHN BIFFEN
9 October 1979
<table>
<thead>
<tr>
<th></th>
<th>£m 1979 Survey prices</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>1981-82</td>
</tr>
<tr>
<td>The inherited plans</td>
<td>75977</td>
</tr>
<tr>
<td>Total proposed to Cabinet</td>
<td>68647</td>
</tr>
<tr>
<td>on 13 September</td>
<td></td>
</tr>
<tr>
<td>Reductions proposed to Cabinet</td>
<td>7330</td>
</tr>
<tr>
<td>on 13 September</td>
<td></td>
</tr>
<tr>
<td>of which:-</td>
<td></td>
</tr>
<tr>
<td>Reductions proposed for major</td>
<td>5658</td>
</tr>
<tr>
<td>spending Departments</td>
<td></td>
</tr>
<tr>
<td>Reductions provisionally agreed</td>
<td>4288</td>
</tr>
<tr>
<td>by major spending Departments*</td>
<td></td>
</tr>
<tr>
<td>Proposals conceded by the</td>
<td>333</td>
</tr>
<tr>
<td>Treasury</td>
<td></td>
</tr>
<tr>
<td>Amount still at stake:</td>
<td>927</td>
</tr>
<tr>
<td>5 Departmental issues</td>
<td></td>
</tr>
<tr>
<td>Consequential further reduc-</td>
<td>110</td>
</tr>
<tr>
<td>tions in Scotland, Wales and</td>
<td></td>
</tr>
<tr>
<td>Northern Ireland</td>
<td></td>
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*assuming agreement in certain bilaterals not yet completed, and net of further increases sought by Defence.
Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9th October, 1979

Dear Mr. Tin,

In your letter of 4th October you said that the Prime Minister would like to have a summary note setting out the additional demands for finance coming forward from nationalised industries, Rolls Royce and British Leyland. I enclose a note about these. It draws attention to the direct effects of the exchange rate on some of the individual industries' finances, but does not attempt to assess the savings in public expenditure attributable to the effect of a strong pound on prices and hence in due course on pay.

Yours sincerely,

M. A. HALL

T. Lankester, Esq.,
FINANCE FOR NATIONALISED INDUSTRIES, ROLLS ROYCE & BRITISH LEYLAND

Size & Nature of the Problem

1. The problem is that these bodies want more finance than envisaged in Treasury Ministers' public expenditure proposals in C(79)35 & 37. The actual and potential additional bids now foreseen by the nationalised industries, Rolls Royce and BL could together add up to about £350 million in 1980/81, £850 million in 1981/82 and £250 million in 1982/83. Table 1 shows how these totals are made up. Table 2 gives details on the nationalised industry component (see bottom line). It shows the large reductions proposed by Treasury Ministers, transforming the nationalised industries as a whole from net consumers into net providers of cash. Notes on individual industries are annexed.

2. The additional bids are large but need to be set against the size of these enormous businesses, which together invest over £4 billion a year and have a turnover of the order of £40 billion. The financing figures, which enter into public expenditure and cash limits, are the difference between much larger flows of revenue and expenditure and are inherently unstable. They are heavily influenced by factors other than decisions by their managements or the Government, such as macro-economic changes (notably the exchange rate, growth and inflation), strikes etc and even the weather. This instability affects the profitable industries, like the Post Office, electricity and gas, as well as those with chronic problems like coal, rail (and buses), steel, shipbuilding and BL.

3. The figures proposed by Treasury Ministers are at risk in two ways. First the outlook for the pound, UK competitiveness, inflation and growth, tends to reduce the industries' output and profits or increase their losses. Secondly the policy of using a squeeze on external finance to promote rapid changes in efficiency or to exert pressure on pay bargaining is bound to increase the risk of excesses because it does not provide for contingencies. The figures shown in Table 1 do not allow for the impact of changes in the economic climate next year. But it will clearly be extremely difficult - and may not be possible - to make the July decisions on nationalised industries' financing stick during the current discussions about cash limits for 1980/81. Ministers will in the end have to strike a difficult balance between realism and stringency.

The Scope for Policy Decisions

4. The Government can deal with some of these threats by policy decisions on specific industries. These often involve closures or de-manning (steel, shipbuilding, coal, rail) or raising prices (gas and electricity). The former have to be negotiated, often at some cost in redundancy payments, and the latter are politically difficult, but both make industrial and economic sense. In cases where de-manning cannot be achieved rapidly, a financial squeeze may in practice
bite on investment; investment cuts may increase current costs or risk shortages. It is, however, difficult to avoid this if financing limits are to be firmly enforced and public expenditure reliably curtailed.

5. So far as nationalised industries are concerned, policy decisions coming to E Committee on 17 October on gas and coal could eliminate much of the excess on energy. Most of the remainder depends on the outcome of the Secretary of State for Industry's discussions with the Post Office.

6. It may prove possible to reduce the Rolls Royce bid either by revising the estimates or by policy decisions scaling down the business. On BL some increased provision may well be unavoidable despite substantial retrenchment.

Conclusion

7. If more finance has to be provided for these bodies without increasing aggregate public expenditure, it will have to be found from the contingency reserves proposed by Treasury Ministers (£750 million in 1980/81, £1,500 million in 1981/82, £2,000 million in 1982/83, and £2,500 million in 1983/84). The possible requirements mentioned in this note would take a substantial proportion of these reserves, especially in 1980/81 and 1981/82, and leave very little in hand. There is, however, scope for reducing the bids by policy decisions, some of which will reach Ministers this month.
TABLE 1

Actual or Potential Demands for Funding in excess of Treasury Ministers' Proposals in C(79) 35 and C(79) 37

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nationalised industries*</td>
<td>100</td>
<td>500</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>BL</td>
<td>50</td>
<td>150</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rolls Royce</td>
<td>200</td>
<td>200</td>
<td>150</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>350</td>
<td>850</td>
<td>250</td>
<td>50</td>
</tr>
</tbody>
</table>

* see bottom line of Table 2

TABLE 2

Nationalised Industry Borrowing (including Coal bids for more grants)

<table>
<thead>
<tr>
<th></th>
<th>1981/82</th>
<th>1982/83</th>
<th>1983/84</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cmd 7439</td>
<td>700</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>plus: additional bids in July</td>
<td>+350</td>
<td>+450</td>
<td>+450</td>
</tr>
<tr>
<td>TOTAL bid</td>
<td>1050</td>
<td>1150</td>
<td>1150</td>
</tr>
<tr>
<td>less GST's option cuts</td>
<td>-1100</td>
<td>-1400</td>
<td>-1700</td>
</tr>
<tr>
<td>Treasury Ministers' proposal in C(79) 37</td>
<td>-50</td>
<td>-250</td>
<td>-550</td>
</tr>
<tr>
<td>Excess currently foreseen over C(79) 37:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Post Office</td>
<td>280</td>
<td>180</td>
<td>195</td>
</tr>
<tr>
<td>Energy industries</td>
<td>240</td>
<td>140</td>
<td>85</td>
</tr>
<tr>
<td>TOTAL excess on these industries</td>
<td>520</td>
<td>320</td>
<td>280</td>
</tr>
<tr>
<td>Net effect of above excess on total nationalised industry financing after deducting shortfall</td>
<td>+500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(as in line 1 of Table 1)</td>
<td></td>
<td></td>
<td>+100</td>
</tr>
</tbody>
</table>

* The figures at X above are likely demand for extra money on the assumption the Chief Secretary's proposals for cutting expenditure are agreed (re: C(79) 35 onwards).
NOTES ON INDIVIDUAL INDUSTRIES

1. Nationalised Industries

Steel. There is no disagreement at present about the figures. External financing is being reduced rapidly from £700 million in 1979/80 to £450 million in 1980/81 and zero in 1982/83. This is based on a financial target of getting into the black in 1980/81, compared with a loss of £330 million in 1978/79. The cost/price squeeze makes a profit in 1980/81 unlikely and, given heavy redundancy costs if closures are achieved, the cash limit will mean a reduction in investment.

Rail. There is no disagreement on figures (a subsidy of about £2½ billion and total finance of about £600 million). But unless manpower can be reduced, real unit labour costs may rise and prolonged limitation of investment means that the railway and signalling network is being run down, although some of the passenger rolling-stock is being modernised. The economic outlook suggests that keeping within present figures would require cuts in services or further increases in fares.

Coal. The industry will make a loss (before grants) of £250 million this year despite two price increases and buoyant demand. A joint paper by the Secretary of State and the Chief Secretary is to be taken by E Committee on 17 October. This should resolve a disagreement worth £250 million over the next 4 years.

Gas. Savings from proper pricing were the largest element in the proposed cuts. The case for this has been strengthened by the surge of demand caused by the price and shortage of oil and by the extra investment the industry is now proposing. E Committee will discuss the Secretary of State's proposals on 17 October.

Electricity. Boards are having difficulty in financing their investment without exceeding Treasury Ministers' proposals. The problem will be reduced but may not be eliminated by a move to economic pricing, which would be eased if the Secretary of State's proposals for gas are accepted. For both industries our decisions should shortly lead to medium-term financial targets which have not been set for almost a decade.

Post Office. This year's cash limit is bound to be broken, though some offsetting action is being taken (see the Secretary of State for Industry's letter to the Chancellor of 24 September). The reasons are the billing strike on the telecommunications side and the size of the pay award on the postal side. The first is an inevitable hazard: we do not want cash limits to inhibit resistance to unreasonable
pay demands. The second is something that we should not allow to happen again. The excess in the later years stems partly from higher investment and partly from lower profits than had been expected. The Secretary of State for Industry has undertaken to minimise this excess as far as possible, particularly in 1981/82.

2. **British Leyland**

The strength of sterling represents a major element in BL’s current problems. About 45% of BL’s revenue comes from exports. At an exchange rate of, say, £2.15 BL have estimated a decline of 8% in competitiveness as compared with the last Corporate Plan, giving reduced profits of £60 million a year. Loss of home sales, because imported cars are relatively cheaper, is on top of that. The Department of Industry have reported separately on the current discussions with the unions on Sir Michael Edwards’ retraining proposals. The new Corporate Plan is due to be formally put to the Government next month. Even with the further closures proposed, it seems likely that HMG will be asked to find something of the order of £200 million, on top of existing provision, over the next two years.

3. **Rolls Royce**

Recent increases in the expected volume of sales of big engines for civil aircraft, the strengthening of the pound against the dollar, and an increase in the difference between UK and US rates of inflation, have increased Rolls Royce forecast cash requirements over the period to 1983. The Company estimate that their external financing needs have risen from the £350 million which the previous Government, earlier this year, agreed to find, to about £1 billion. Of the extra £650 million, about £200 million might be needed in each of 1980 and 1981, and the balance over the next 2 or 3 years. These figures are uncertain: they may, and in the NEB’s view do, over-state the requirements, and some scaling-down of Rolls Royce business may be possible. There is of course no commitment as yet to provide more than the original £350 million.
PRIME MINISTER

You asked about the report in today's Sun that the Government is considering reducing the RSG percentage from 61% to 56%.

This is false. The current position is that DOE are submitting a paper to MISC 21 which proposes that the RSG percentage should continue at 61%. The Treasury, however, are suggesting it should be 58%.

The local authorities have been asked by DOE to spend 5% less than was provided for in the last public expenditure White Paper. If they complied with this request, the 61% RSG proposed by DOE would involve rate increases of between 15 and 25%. With the Treasury proposal of a 58% RSG, rates would go up between 25 and 40%. But the Treasury are presumably hoping that their proposal would persuade local authorities to economise rather more; hence, the rate increases consequent upon a 58% RSG could be less than 25 to 40%. By contrast, the Sun this morning was talking of rates increasing by as much as 60%.

You also asked about the "Jobs for golden handshake boys" story in the Mail this morning. The facts are as follows. Mr. Heseltine suggested at a meeting with the Staff Side that in order to take some of their activities out of Government some PSA employees should retire early and set up as consultants to the PSA. The Government would encourage them to do this by guaranteeing them a certain amount of work for the first year or two. The idea is Mr. Heseltine's own.

DOE say that Mr. Heseltine threw this out as simply an idea for discussion: it is not a firm proposal in any way. Mr. Heseltine is in touch with Lord Soames about it, and if the idea does develop into a firm proposal, we will be informed.

/On the face
On the face of it, this idea seems pretty half-baked. If the Government is to guarantee retired civil servants work, this seems little different from actually keeping them on the Civil Service pay-roll. Inevitably, there has been further criticism in the Evening News - their main editorial.

8 October 1979
CONFIDENTIAL

10 Downing Street

From the Private Secretary 8 October 1979

Dear Mr. [Name with Initials]

Pay and RSG: The Next Steps

The Prime Minister was grateful for Sir John Hunt's minute of 5 October on the above subject. She has noted the various points in the minute, including the tight timetable for the setting of the RSG and the related cash limit; she proposes to discuss the Treasury forecast with the Chancellor as soon as possible after this week's Party Conference; and she is content to postpone her meeting with Sir Derek Rayner and the local authority Ministers until early in December.

Yours sincerely,

[Signature]

Martin Vile, Esq.,
Cabinet Office
Rt Hon John Biffen MP
Chief Secretary to the Treasury
Parliament Street
London
SWIP 3HE

FLEXIBILITY BETWEEN FINANCIAL YEARS

I have seen your minute of 11 September to the Prime Minister reporting Departments' response to Treasury officials' scheme for carrying over up to 5% of allocated expenditure from one year to the next. You suggest deferring the proposal until Sir Derek Rayner's examination of the application of accounting conventions in government business is complete.

In discussion with nationalised industry chairmen I have detected some concern at what they regard as the rigidity of the cash-limits system as applied to trading organisations and it has been suggested that some increased flexibility would be an aid to management. I understand that George Younger has had similar comments made to him by the Scottish Generating Boards. I think it would, therefore, be helpful if the nationalised industries could be included in Sir Derek's terms of reference.

I am copying this to other members of the Cabinet, Sir John Hunt, and Sir Derek Rayner.

D A R Howell
Pay and RSG: The Next Steps

Following the discussion in E on Tuesday, you may like to know about our follow-up talks with the Treasury, DOE and other Departments, and about the timetable we have provisionally arranged.

2. There are three external constraints. First, the local authorities need to make a start on next year's rating. For this, they need decisions, confirmed by Parliament in an affirmative resolution before Christmas, about the size of the Rate Support Grant for 1980-81. The key dates for this purpose are the 'statutory meetings' with the local authorities, which are 16th November (Scotland) and 20th November (England and Wales). Because of the lead-time, this requires Cabinet decisions by 25th October.

3. Second, the local authority pay negotiations for the manuals group begin on 20th October, and the settlement date is, nominally, 4th November. In practice, the local authorities will not settle until they know the size of the Rate Support Grant, but they will come under increasing pressure from the unions from 4th November onwards.

4. Third, the Chancellor is required to publish the 'Industry Act' forecast before the end of November.

5. The position has been greatly simplified by the decision at E to go for a single cash limit for the Rate Support Grant next year. The Prime Minister asked us how this would work. Two separate figures will be announced in November. The first will be the Rate Support Grant for 1980-81 which Parliament will be asked to approve in December. This will be in November 1979 prices and will be expressed both in cash terms and as a percentage of relevant expenditure. It will also reveal the distribution formula which determines how much individual authorities get. It will take account of pay increases agreed up to November this year, but not beyond. Second will be
the cash limit for 1980-81 incorporating the Government's assumptions about pay and price movements next year. This, coupled with the agreed RSG percentage figure, effectively puts the upper ceiling on the amount of any increase order in November 1980. The 1980 increase order can be for a sum smaller than that derived from the total cash limit, but it cannot exceed that without the Government being seen to retreat. It is therefore important that, as agreed, the cash limit should be 'realistic but not extravagant'. It is the cash limit figure which will be taken seriously by local authorities, in setting their rate demands and in pay negotiations with the unions.

6. It may be possible, within the total cash limit, to tailor the distribution of the November 1980 increase order, so as to penalise the most extravagant authorities. This could be done as part of the transitional arrangements to the new unitary grant system and will be considered in MISC 21 (under the Home Secretary) shortly. (The remainder of the unitary grant proposals are likely to be approved, either in correspondence or by H, well before the Cabinet discussions on 25th October: so that problem disappears.) Provided sufficient progress has been made with the transitional arrangements it should be possible to foreshadow at least the principle of penalising the extravagant in this November's RSG negotiations. Given the decision to go for a single cash limit next year this aspect of the arrangements will be very important presentationally.

7. In terms of work this means that, in addition to the transitional arrangements, MISC 21 has got to consider two quite difficult political issues: the RSG percentage, and the distribution formula. On the first at least, there is likely to be disagreement with the Treasury. There is a general political consensus on the second, but the details remain to be sorted out.

8. MISC 21 has also to consider how to translate the Cabinet's 'volume' decision in July into a cash limit. The 'pay and price' assumptions used to do this are absolutely crucial. The Chancellor will not have a chance to form a view on this until he sees the Treasury forecast on 8th October - just before the Party Conference. He is not likely to reach a final decision until he gets
back on 15th October. His decisions on the forecast, of course, go a lot wider than the immediate RSG question. But, because of the Industry Act deadline, he has got to bring forward proposals about publication of the forecast to Cabinet on 25th October. This will be the same meeting which considers the Rate Support Grant (and also, incidentally, the question of cash limits for the nationalised industries).

9. In constructing the forecast as it affects RSG the Treasury ought to take account of two quite separate elements: the as yet unknown outcome of the various comparability studies now under way (especially Clegg on Teachers and the local authority/union study of the APTC grades) and the uprating of these pay scales for 1980. On the first we have asked them to consult with the other Departments: Education, Environment, etc. to get as clear an indication as they can about the likely outcome. This would meet the substance of the point Mr. Carlisle made at E on Tuesday. The second depends more closely on the general economic forecasts for next year. There may also be some very informal soundings of the local authorities too: but that is for Ministers to do privately. The object would be to reach a 'realistic' estimate of the likely movement in pay in the public sector on which decisions can be based.

10. MISC 21 will have to start its work before the Chancellor's views on the forecast are known. They will meet first on 15th October. They will meet again on 22nd October, by which time they should know the Chancellor's view on the assumptions to be built in for pay and price movements. They will then make recommendations, which I hope will be unanimous, to Cabinet for 25th October.

11. This is a very tight timetable. It could come badly unstuck if the Chancellor does not like the forecast; or if the forecast points to the need for further reductions in public expenditure next year; or if the Cabinet does not believe that the resulting cash limits can be sold to the local authorities or imposed on the unions. We shall have to face up to these problems as and when they arise. Meanwhile the Prime Minister might like to know that this is the provisional game plan. I think it would be useful if she were to discuss with the Chancellor of the Exchequer, immediately after the Party Conference, his
ideas about the forecast generally and about public sector pay in particular. Ideally, this should be somewhere between 15th and 22nd October, so that MISC 21 can take account of any points she wishes to put in at that stage.

12. By way of postscript, I think that all this activity on the local authority front points to some postponement of the 'Rayner' initiatives as they affect local authorities which did not actually get discussed when Sir Derek Rayner and I saw the Prime Minister later on Tuesday. My own provisional view is that, given Sir Derek Rayner’s absence through most of November, the Prime Minister should aim at a meeting with him and with the local authority Ministers early in December. By then we shall have some feel for the local authority financial position next year, and be better able to judge how to launch a fresh drive on 'efficiency' in that area.

(John Hunt)

5th October, 1979
When we discussed public expenditure reductions this year on 24 May and subsequently in Cabinet on 31 May (CC(79) 2nd Conclusions), it was noted that, depending on circumstances later in the year, I might wish to make a claim on the Contingency Reserve in respect of the Meat Industry Employment Scheme, the need for which is of course peculiar to Northern Ireland.

Since then, the July 5% devaluation in the green pound has cleared up one of the major uncertainties about the probable cost of continuing the scheme to the end of March 1980 and has reduced its cost considerably. My officials have been in touch with yours about the Scheme and, based largely upon the advice of the latter about sterling levels, it has been agreed that a realistic estimate of the cost of the scheme for the current year at 1979 Survey prices would be about £15 million. In accordance with my earlier hopes, I now expect to be able to fund the scheme until mid-July 1979 (£5 million). It is clear, however, that I cannot cover the balance, estimated at £10 million, by offsetting savings from other services for which I am responsible. In these circumstances I hope that you can give your support to my request that up to £10 million of the Contingency Reserve may be used to enable this scheme to continue to the end of the current financial year.

I do not intend to make any announcement about the Scheme at present, but will arrange for my officials to clear with yours the terms of any such announcement, if I decide to say something at a later date. In due course I will have to consider the future of the Scheme beyond 31 March 1980. A further significant Green Pound devaluation as soon as possible would of course be most helpful to me in this connection since it would substantially help to reduce the potential future cost of the scheme.

I am copying to all members of the Cabinet and Sir John Hunt.
5 October 1979

CASH LIMITS 1978–79 PROVISIONAL OUTTURN

Provisional figures for the outturn of the cash limits on central and local government expenditure and finance in 1978–79 are published today in a White Paper, 'Cash Limits 1978–79 Provisional Outturn' (Cmdn 7641).

Table 1 of the White Paper lists the changes made to cash limits during the year. The cost of those changes which involved a net increase in public expenditure programmes was met from the contingency reserve provided within the public expenditure plans.

The provisional outturns are within the limits with the exception of two central and two local authority blocks. The reasons for these excesses are being examined by the Treasury and the relevant departments.

Tables 2 and 3 of the White Paper show that in total cash limits were underspent in 1978–79 by rather less than in earlier years. They show that taken as a whole expenditure on blocks directly controlled by central government at just under £30 billion reached 98.4% of the limits compared with 97.4% in 1977–78. The outturn on blocks covering the capital expenditure of local authorities and other bodies was over £4.5 billion, representing 89% of the limits, about the same proportion as last year.

In the majority of cases the control related to the amount spent, but for local authority capital expenditure some of the limits related to borrowing or to the value of projects started or approved and cannot be simply related to the underlying expenditure. On cash limits related
to the amount spent, expenditure was 97% of the limits. Common reasons for underspending were employment of fewer staff than forecast and slippage of capital work.

PRESS OFFICE
H M TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-233 3415

Notes to Editors

The cash limits for 1978-79 were set out in the White Paper 'Cash Limits 1978-79' (Cmd 7161). Provisional outturn figures for the nationalised industries cash limits in 1978-79 were published in the 'Financial Statement and Budget Report 1979-80' on Budget day. Provisional figures for the outturn against central government and local government cash limits in 1977-78 were published in a similar White Paper in July 1978 (Cmd 7295).

Questions on specific cash limits should be addressed to the departments concerned.
I am writing to let you know the Government's intentions on the setting of cash limits for next year and their implications for pay bargaining in the nationalised industries.

As you know, the Government's aim is to reduce the burden of financing the public sector and to cut inflation. We believe that the system of cash limits in the public sector has a key role to play in achieving this aim. We have accordingly decided that the cash limits for all the nationalised industries should be set this autumn, before any major pay settlements in the industries have been concluded. This, I am afraid, sets a tight timetable for our discussions with you.

The Government's explicit intention is that the cash limits so set should exert a downward pressure on the level of pay settlements. However, as you know, we are determined to avoid specifying any sort of pay norm.

If the cash limits are to be credible and realistic they will need to be founded on a considered view of each industry's prospects for next year, and so will need to reflect forecasts of prices, costs (including pay costs), output and investment. The fact that the cash limits will depend to an important extent on judgements about the appropriate allowance for increases in the pay bill was clearly recognised at the meeting we had with the Nationalised Industries Chairmen's Group on 23 July.

In approaching the judgments about the appropriate allowances for increases in the pay bill, sponsoring departments will be starting from a general presumption - consistent with the Government's overall determination to counter inflationary pressures - that real costs per unit of output should fall. In very broad terms this means that each industry's pay bill (in terms of unit labour costs) should go up by less than the forecast increase in the retail prices index. The extent of the reduction in real unit costs will need to be explored in discussions between the sponsoring departments and the industries; the margin - which is bound to vary markedly from industry to industry - will need to reflect the specific circumstances of each of them, and take into account factors like performance...
aims where these already exist or are proposed. The discussions will need to cover as well assumptions about increases in costs other than pay, and about prices, output and investment.

The Government's intention is to publish the cash limits some time in November and this implies firm decisions by late October. I suggest therefore that officials from the Departments of Industry and Treasury should start discussions with yours as soon as possible.

The cash limits, once set in this way, will present a considerable challenge to the industries. In this situation, we attach particular importance to effective monitoring of each industry's performance, so that action necessary to avert a threatened breach in a cash limit can be taken at the earliest possible moment. The existing monthly and quarterly returns provide a part of the necessary framework for this monitoring, and are usefully complemented by the cash flow forecasts that you send us when you need to draw more long-term finance. It will also be important for returns to be made expeditiously. Furthermore, as experience during the current year has shown, the pressure of pay negotiations may constitute a particularly dangerous threat to the cash limits, and the Government have therefore concluded that the industries should be asked to consult their sponsoring departments before entering into commitments in any major pay negotiations. (including those involving productivity bargaining).

In asking the industries to keep sponsor departments informed in this way of the progress of pay negotiations, the Government are not seeking to make judgments about the appropriate pay levels for particular industrial groups. Our objective is to secure essential information about developments which could lead to breaches in cash limits, whether in the industry directly involved or in other nationalized industries where in the past pay settlements in one industry have - however unjustifiably - had repercussions in another. The fact that the pay bill element in costs will have been identified in the course of the construction of the cash limit figures should help considerably in judging the implications of particular pay offers. I must emphasise that it will be up to the industries concerned to put forward proposals for any action necessary to accommodate pay settlements that would raise the pay bill above the level contemplated at the time the cash limits were set; the Government's concern is only to ensure that such action as is necessary to avert a breach in the cash limits is taken as quickly as possible.

We recognise that our decisions will not be easy for the industries to implement. Detailed discussions of the trading and financial prospects of each industry will need to be completed in a very short time. But there is no room for delay if the cash limits are to serve the purpose the Government intend, and we therefore look for the support of the Chairmen as an essential element in our plan of action to squeeze out inflation.

I am writing in similar terms to Chairmen of the other industries for which I am responsible.
When the Chancellor and the Prime Minister met this morning, the Chancellor said that he was concerned about demands that might be coming forward from public sector corporations for additional funding. The Prime Minister said that she would like to have a summary note setting out what these additional demands might be, and I would be grateful if you could send me such a note before the weekend.

T. P. LANKESTER

M.A. Hall, Esq.,
H.M. Treasury.
iv. The Chancellor said that he was very concerned at the prospect that public sector corporations would be putting in demands for additional funding: for example, the Post Office, British Steel and British Leyland. The Prime Minister asked for a note on this (which I have commissioned from the Treasury).
Public Expenditure Cuts: 1980/81

1. To help towards achieving expenditure reductions in 1980/81, I undertook to find savings of £2.5 m in the costs of our overseas representation.

2. I intend to find some of this saving by reducing the number of staff here in the Foreign and Commonwealth Office; but the greater part of the savings, amounting to some £1.8 m, will have to be found from the closure of and reductions in our posts overseas, where most of the expenditure falls. To this end I propose to close or substantially reduce the 24 subordinate Posts listed in the attached annex.

3. Closures and reductions on this scale - affecting about 10% of the total number of Posts that we maintain worldwide - will mean a reduction, in some cases marked, in our ability to provide consular services to British citizens and there will be an effect on our export promotion services to British businessmen. As far as our relations with other governments are concerned, I do not expect that in the majority of cases they will be unduly concerned. In some cases we may be able to soften the political blow by establishing an honorary consulate.

4. I am considering separately with the Treasury when the closures and reductions can be announced. I propose to instruct Heads of Mission in advance of publication to inform, in confidence, host governments of our intentions.

5. I am copying this minute to the Chancellor of the Exchequer, the Secretaries of State for Trade and Industry and to the Lord President. A copy also goes to the Paymaster General in view of his interest in publicity; and one to Sir John Hunt.

(CARRINGTON)

Foreign and Commonwealth Office

2 October 1979
SUBORDINATE POSTS PROPOSED FOR CLOSURE

Adelaide
Basle
Calais
Durban*
Gothenburg*
Ibadan
Innsbruck
Madras*
Malmo
Ostend
Palermo
Philadelphia
Rotterdam
St. Louis
Salvador (Brazil)
Strasbourg (Consulate General)
Tangier
Trieste
Winnipeg

SUBORDINATE POSTS WHERE STAFF REDUCTIONS ARE PROPOSED

Los Angeles
San Francisco
Seattle
Detroit
Hanover

Footnotes

* Posts where we are prepared to consider the retention of a few salaried staff.

Honorary consulates (at a cost of £500 each) might be established when a clear need for a very limited presence exists in some other places.

CONFIDENTIAL
I am writing to let you know the Government's intentions on the setting of cash limits for next year and their implications for pay bargaining in the nationalised industries.

Of course our aim is to introduce a substantial private sector shareholding into British Aerospace during 1980/81: and once that has taken place cash limits will no longer be applied. However, it seems necessary to establish a cash limit for 1980/81 as a contingency measure in case flotation should be delayed.

As you know, the Government's aim is to reduce the burden of financing the public sector and to cut inflation. We believe that the system of cash limits in the public sector has a key role to play in achieving these aims. We have accordingly decided that the cash limits for all the nationalised industries should be set this autumn, before any major pay settlements in the industries have been concluded. This, I am afraid, sets a tight timetable for our discussions with you.

The Government's explicit intention is that the cash limits so set should exert a downward pressure on the level of pay settlements. However, as you know, we are determined to avoid specifying any sort of pay norm.

If the cash limits are to be credible and realistic they will need to be founded on a considered view of each industry's prospects for next year, and so will need to reflect forecasts of prices, costs (including pay costs), output and investment and the need for adequate profits. The fact that the cash limits will depend to an important extent on judgements about the appropriate allowance for increases in the pay bill was clearly recognised at the meeting we had with the Nationalised Industries Chairmen's Group on 23 July.

In approaching the judgements about the appropriate allowance for increases in the pay bill, sponsoring departments will be starting from a general presumption - consistent with the Government's overall determination to counter inflationary pressures -
that real costs per unit of output should fall. In very broad terms, this means that each industry's pay bill (in terms of unit labour costs) should go up by less than the forecast increase in the retail prices index. The extent of the reduction in real unit costs will need to be explored in discussions between the sponsoring departments and the industries; the margin - which is bound to vary markedly from industry to industry - will need to reflect the specific circumstances of each of them, and take into account factors like performance aims where these already exist or are proposed. The discussions will need to cover as well assumptions about increases in costs other than pay, about prices, output and investment and about demand, the market and profits.

The Government's intention is to publish the cash limits sometime in November and this implies firm decisions by late October. I suggest therefore that officials from the Department of Industry and Treasury should start discussions with yours as soon as possible.

The cash limits, once set in this way, will present a considerable challenge to the industries. In this situation, we attach particular importance to effective monitoring of each industry's performance, so that action necessary to avert a threatened breach in a cash limit can be taken at the earliest possible moment. The existing monthly and quarterly returns provide a part of the necessary framework for this monitoring, but this framework will in some cases need to be buttressed by a forecast of the time-profile of the cash flow through the year with which the subsequent outturns can be compared. It will also be necessary for returns to be speeded up in the case of those industries which do not at present meet the deadlines. Furthermore, as experience during the current year has shown, the pressure of pay negotiations may constitute a particularly dangerous threat to the cash limits, and the Government have therefore concluded that the industries should be asked to consult their sponsoring departments before entering into commitments in any major pay negotiations (including those involving productivity bargaining).

In asking the industries to keep sponsoring departments informed in this way of the progress of pay negotiations, the Government are not seeking to make judgements about the appropriate pay levels for particular industrial groups. Our objective is to secure essential information about developments which could lead to breaches in cash limits, whether in the industry directly involved or in other nationalised industries where in the past pay settlements in the first industry have - however unjustifiably - had repercussions. The fact that the pay bill element in costs will have been identified in the course of the construction of the cash limit figures should help considerably in judging the implications of particular pay offers. I must emphasise that it will be up to the industries concerned to put forward proposals...
for any action necessary to accommodate pay settlements that would raise the pay bill above the level contemplated at the time the cash limits were set; the Government's concern is only to ensure that such action as is necessary to avert a breach in the cash limits is taken as quickly as possible.

We recognise that our decisions will not be easy for the industries to implement. Detailed discussions of the trading and financial prospects of each industry will need to be completed in a very short time. But there is no room for delay if the cash limits are to serve the purpose the Government intend, and we therefore look for the support of the Chairmen as an essential element in our plan of action to squeeze out inflation.

I am writing in similar terms to Chairmen of the other industries for which I am responsible.

[Signature]
Following our discussions recently, which I look forward to resuming with you shortly, on this year's cash limit I am now writing to let you know the Government's intentions on the setting of cash limits for next year and their implications for pay bargaining in the nationalised industries.

As you know, the Government's aim is to reduce the burden of financing the public sector and to cut inflation. We believe that the system of cash limits in the public sector has a key role to play in achieving these aims. We have accordingly decided that the cash limits for all the nationalised industries should be set this autumn, before any major pay settlements in the industries have been concluded. This, I am afraid, sets a tight timetable for our discussions with you.

The Government's explicit intention is that the cash limits so set should exert a downward pressure on the level of pay settlements. As you know, we are determined to avoid specifying any sort of pay norm. If the cash limits are to be credible and realistic they will need to be founded on a considered view of each industry's prospects for next year, and so will need to reflect forecasts of prices, costs (including pay costs), output and investment and the need for adequate profits. The fact that the cash limits will depend to an important extent on judgments about the appropriate allowance for increases in the pay bill was clearly recognised at the meeting we had with you and your colleagues on 23 July.

In approaching the judgments about the appropriate allowance for increases in the pay bill, sponsoring departments will be starting from a general presumption - consistent with the Government's overall determination to counter inflationary pressures - that real costs per unit of output should fall. In very broad terms, this means that each industry's pay bill (in terms of unit labour costs) should go up by less than the forecast increase in the retail prices index. The extent of the reduction in real unit costs will need to be explored in discussions between the sponsoring departments and the industries; the margin - which is bound to vary markedly from industry to industry - will need to reflect the specific circumstances...
of each of them, and take into account factors like performance aims where these already exist or are proposed. The discussions will need to cover as well as assumptions about increases in costs other than pay, about prices, output and investment, and about demand, the market and profits.

The Government's intention is to publish the cash limits some time in November and this implies firm decisions by late October. I suggest therefore that officials from the Department of Industry and Treasury should start discussions with yours as soon as possible with a view to you and me meeting in about ten days' time.

The cash limits, once set in this way, will present a considerable challenge to the industries. In this situation, we attach particular importance to effective monitoring of each industry's performance, so that action necessary to avert a threatened breach in a cash limit can be taken at the earliest possible moment. The existing monthly and quarterly returns provide a part of the necessary framework for this monitoring, but this framework will in some cases need to be buttressed by a forecast of the time-profile of the cash flow through the year with which the subsequent outturns can be compared. It will also be necessary for returns to be speeded up in the case of those industries which do not at present meet the deadlines. Furthermore, as experience during the current year has shown, the pressure of pay negotiations may constitute a particularly dangerous threat to the cash limits, and the Government have therefore concluded that the industries should be asked to consult their sponsoring departments before entering into commitments in any major pay negotiations (including those involving productivity bargaining).

In asking the industries to keep sponsor departments informed in this way of the progress of pay negotiations, the Government are not seeking to make judgments about the appropriate pay levels for particular industrial groups. Our objective is to secure essential information about developments which could lead to breaches in cash limits, whether in the industry directly involved or in other nationalised industries where in the past pay settlements in the first industry have - however unjustifiably - had repercussions. The fact that the pay bill element in costs will have been identified in the course of the construction of the cash limit figures should help considerably in judging the implications of particular pay offers. I must emphasise that it will be up to the industries concerned to put forward proposals for any action necessary to accommodate pay settlements that would raise the pay bill above the level contemplated at the time the cash limits were set; the Government's concern is only to ensure that such action as is necessary to avert a breach in the cash limits is taken as quickly as possible.

We recognise that our decisions will not be easy for the industries to implement. Detailed discussions of the trading and financial prospects of each industry will need to be completed in a very...
short time. But there is no room for delay if the cash limits are to serve the purpose the Government intend, and we therefore look for the support of the Chairmen as an essential element in our plan of action to squeeze out inflation.

We are also writing to the Chairmen of other nationalised industries.

Leon

Kem
CONFIDENTIAL

Ref. A0339

PRIME MINISTER

Cash Limits and the Rate Support Grant
(E(79) 46)

BACKGROUND

When the Chief Secretary's proposals on Pay and Cash Limits for 1980-81 were discussed in E a fortnight ago, there was some confusion about the way his 'sliding scale' for the Rate Support Grant would work. You asked him to prepare a further note within two weeks setting out alternative options, including cash limits on the expenditure of individual authorities. There has been very little time, and the paper (which was only finished on Friday) is still a bit thin on detail, but it sets out the options clearly enough.

2. These proposals are still confined to 1980-81, though they would set a pattern for future years. The DOE proposals for a new unitary grant (to replace RSG in later years) are under separate study in H (which will make proposals to Cabinet next month for inclusion in the new Local Government Bill). The relevant bits are summarised in the Annex to the paper. There is a link, because the recommended option iii. in the paper (a single cash limit) would be much more effective if the Unitary Grant were adopted and could be made to apply retrospectively to 1980-81 at the time of the November 1980 Increase Order.

3. The 1980-81 RSG Settlement itself is being looked at in MISC 21, under the Home Secretary. It meets first on 15th October. The first 'statutory meeting' with the Local Authorities is in Scotland on 18th November; about three weeks are needed to prepare the material for this after the Cabinet decisions. MISC 21 is concerned with a wide range of issues: the grant percentage and the distribution formula, as well as the problem of disciplining pay negotiations. It needs a steer from this Committee if its work is not to be nugatory. Alternatively, if E Committee can't reach a final decision at this meeting you could ask MISC 21 to sort out the details, provided E sets out an order of preference. But this is very definitely a second-best solution.
4. The Increase Order for 1979-80 is also relevant, because the way it is applied will give local authorities their first real clue to the Government's determination. E decided in September to cut back the current year's RSG, so as to make the local authorities foot part of the bill for the Clegg awards. It was left to the Chancellor and the Secretary of State for the Environment to agree on quantum and method. They have agreed (see Chancellor's minute of 21st September) to cut by £20 million, or about 45 per cent of the extra, unprovided cost of Clegg; but not to announce this until the time of the Increase Order in late November, when it will be wrapped up with a number of other changes. There is a real risk that this will blur the edges of the Government's message, unless it is specially emphasised at the time. (Important, because the recommended option iii assumes that the Government's determination will be well understood.)

5. This timetable is relevant to the problems in the present paper. It might be possible to set back the RSG meetings a bit - at some risk of a row with the local authorities, who need to get on with their rating. But the real deadline is set by the pay negotiations for local authority manuals which begin in late November. If the Government is to influence these, the RSG picture has got to be clear to the negotiators (and their paymaster, the individual authorities) some time earlier. Indeed it can be said that the immediate and overriding aim is to get a new RSG system in time to put some effective discipline on local authority pay negotiations this winter.

6. The ideal outcome would be for colleagues to agree now in principle on a particular approach to RSG. Failing complete agreement however you might get the Committee to establish an order of preference between the three options, and leave MISC 21 to sort out the details. (Sir Kenneth Berrill's minute of 28th September proposes more work at official level; if undertaken this would have to be completed in time to be considered by MISC 21 on 15th October). You will also want to know if the work on unitary grant being considered in H is likely to be ready for announcement in principle before this year's RSG negotiations. This is likely to be the case but option iii is likely to be the more acceptable if the unitary grant can be guaranteed.
HANDLING

7. This is the Chief Secretary's paper and you should invite him to introduce it. But the work was done jointly in the Treasury and DOE. Mr. King (in Mr. Heseltine's absence) should therefore speak second. After that, the choice is between a detailed look at options, or a series of general statements. The interested Ministers are Scotland (directly responsible); and Wales, then the sponsors: Home Secretary, Education, Social Services; then the honest brokers: Industry and Trade. You might want Sir Kenneth Berrill to join in at some point. But general statements will take a long time, and you may prefer to plunge straight into the detail.

(a) Objectives. You might restate the overall objective, if you have not done so earlier.

(b) Cash Limits on individual authorities (option i).

I know you favoured this course last time. But the arguments against it are very strong, both generally, and as a means of operating on pay. There is a point of principle: should central government interfere so deeply in local autonomy? There are several practical problems: the degree of remoteness from pay negotiations; the mass of detail and consequent administrative effort; the Clay Cross confrontation risk; the need for additional and very troublesome legislation to be added to the Local Government Bill; and finally the lack of any effective sanction, short of Commissioners. The indirect sanction via the grant mechanism is much less liable to challenge because the Government's rights as paymaster can't be disputed. There is one additional point which I want to stress very hard. There is no chance of working out and agreeing individual cash limits for all authorities in time to put pressure on the key local authority manuals' pay negotiations. I agree very much with Sir Kenneth Berrill that this option should not be pursued.
(c) **Sliding scale related to pay** (option ii - first variant). The Chief Secretary rules this out because it involves setting a norm. Sir Kenneth Berrill (in his minute to Mr. Lankester of 28th September) challenges this assumption, and suggests that the only 'norm' would be the weighted average of all local authority settlements. In fact the scheme is even further away from a norm because so much of next year's pay increases will come from the wide range of different comparability settlements. In any case, the Committee has already accepted that in the case of the Civil Service and the National Health Service, it will not be practicable to disguise the average pay assumption. (This was the conclusion of the Chancellor's paper E(79) 34, paragraph 5). This variant may seem to come closest to the intention of the 'Option A' route to cash limits and could have a significant overall influence on pay. Conversely however it involves very little differentiation between authorities who would broadly be applying nationally settled pay increases.

(d) **Sliding scale related to rates.** This was the proposal considered last time round (see Annex to E(79) 34). It was rejected then for the reasons set out clearly in the present paper: rough and ready; no protection for 'good' authorities who deferred rate rises this year; and with the risk of penalising twice those authorities who will lose out on this year's redistribution towards shire counties. Sir Kenneth Berrill says (28th September) that more refined formulae might ameliorate these defects. But I understand that Treasury and DOE looked for such refinement and failed. Without this however the variant is probably not a runner.

(e) **A single cash limit** (option iii). This is the Chief Secretary's preferred option, and I understand DOE officials also favour it. We do not yet know Mr. Heseltine's view. Sir Kenneth Berrill sees it as a fall back and suggests that if adopted, it should be strengthened by importing some features of the new unitary grant. This is indeed the DOE intention (see paragraph 24 of note by officials) but depends on the
CONFIDENTIAL

H decision on unitary grant: I believe H is likely to accept unitary grant so the condition would be met. However this method is less direct in its impact on pay negotiations than a sliding scale related to pay; the paper says (paragraph 23) that the message would be clearer if the Government took a tough line on paying for this year's pay increases. As explained above, the decision is not particularly tough (it is an exaggeration to refer to 'ad hoc penal measures'), and the presentation could be dangerously fuzzy. If the Committee goes for option iii you might therefore urge

(i) that H confirms its preference for the unitary grant principle (not necessarily all the details) and that a statement of intent be made before this year's RSG settlement is reached;

(ii) that the Secretary of State for the Environment presents the 1979-80 decision in a very tough manner to be agreed with you and the Chancellor.

But before going firmly for option iii the Committee should be invited to look again at option ii in its 'pay' variant, which may offer a better route this time round.

CONCLUSIONS

8. There are two ways of ending the discussion: either a clear decision in favour of one or other option, with any necessary conditions; or an indication of preference, coupled with a request to MiSC 21 to frame detailed recommendations on the 1980-81 settlement on two (or more) alternative bases. The first is obviously preferable. The conclusions will require a rather precise summing up. These notes may help.

A. Clear decisions.

The choices are:

1. To impose specific cash limits on individual authorities (option i). In this (unlikely) case, H Committee should be asked to consider the detailed legislation that would be needed; and the local authorities should be told that this year's RSG settlement would be postponed.
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2. To adopt a sliding scale related to pay (option ii, first variant). In that case, Mr. King should be invited to put the necessary legislative proposals to H; and MISC 21 should be asked to consider several different sliding scales incorporating different tapers and average pay rates, and to put recommendations to Cabinet on 25th October;

3. To adopt a sliding scale related to rates (option ii, second variant). The remit to Mr. King would be as in 2. MISC 21 should be asked to consider several different sliding scales, based upon but not explicitly related to various possible average pay outcomes, and to make recommendations to Cabinet on 25th October.

4. To set a single cash limit in November for the 1980-81 RSG as set out in paragraph 21 (option iii). In that case H should be invited to look favourably at the principle of a unitary grant, for introduction retrospectively in November 1980 for the 1980-81 settlement Increase Order and with an announcement in principle before this year's RSG settlement. The Secretary of State for the Environment might be invited to agree with you and the Chancellor the best way of reinforcing this in presenting the 1979-80 increase order this November.

B. No clear decision

In this case, the Committee might invite MISC 21 to frame alternative sets of proposals for Cabinet, in order of preference; probably 'sliding scale related to pay' first; 'single cash limit' second; and 'sliding scale related to rates' third; discarding 'individual cash limits' at least for 1980-81.

(John Hunt)

1st October, 1979
PART 4 ends:

Ben H 28/9/79

PART 5 begins:

Hunt to Lin AO339 1.10.79
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