PREM 19/167

SECRET

Part 10

MT

Confidential filing

Public Expenditure and cash limits
Public expenditure White Paper.

ECONOMIC POLICY

Part 1: May 79
Part 10: July 80

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~9.7.80~~							
~~10.7.80~~							
~~14.7.80~~							
~~21.7.80~~							
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~~13.10.80~~							
~~15.10.80~~							
22.10.80							
Ends							

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PART 10 ends:-

JB Unwin to Ch/Ex

22-10-80

PART 11 begins:-

22-10-80

C(80) 58

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C (80) 38	3.7.80
C (80) 39	4.7.80
CC (80) 28th Conclusions, Minute 2	10.7.80
C (80) 44	18.7.80
C (80) 45	22.7.80
CC (80) 30th Conclusions, Minute 7	24.7.80
CC (80) 33, Minute 3	18.9.80
MISC 21 (80) 2	23.9.80
MISC 21 (80) 4	15.10.80
MISC 21 (80) 7	16.10.80

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 O Wayland Date 2 March 2010

PREM Records Team

TIM LANKESTER

Your Ref

with compliments

J B UNWIN

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Econ Pol.

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Ryrie
Mr Bailey
Mr Littler
Mr Middleton
Mr Battishill
Mr Bridgeman
Mr Cassell
Mr Evans
Mr Monck
Mrs Gilmore
Mrs Stamler
Mr Folger
Mr Ridley
Mr Cropper

CABINET ON 23 OCTOBER: THE ECONOMIC PROSPECT

The three papers by yourself and the Chief Secretary on the economic prospect, public expenditure, and pay and price factors for next year's cash limits are being circulated today as background to tomorrow's Cabinet. They will not be on the agenda but it was agreed at the meeting with the Prime Minister yesterday that you should make an oral statement relating to them.

2. Your objectives will be:-

(i) to secure Cabinet reaffirmation of the necessity of keeping as closely as possible to the public expenditure totals in Cmnd 7841, less the benefit from refunds of EC contributions;

(ii) accordingly, to secure acceptance in principle of the quantum of cuts proposed in the Chief Secretary's paper;

(iii) to set up immediate procedural arrangements for reaching as much agreement as possible with your spending colleagues prior to Cabinet on 30 October when the above papers and others will formally be considered.

3. The purpose of (iii) above is, of course, to meet the Prime Minister's wish that as much disagreement as possible should be cleared out of the way before Cabinet considers the issues collectively.

4. I attach accordingly:-

Flag A: Some speaking notes which might form the basis of your opening statement. These do not cover the procedural proposal for a "star Chamber" consisting of yourself, the Home Secretary and the Chief Secretary. I understand from Mr Lankester that the Prime Minister will want to put this forward herself provided you supply the cue. But it may be as well to raise this with the Prime Minister when you see her at 9 am tomorrow so that tactics are fully coordinated.

Flag B: An updated and more detailed note on the underlying arithmetic to replace that attached to my minute of 20 October on which you drew at yesterday's meeting. Although this is as reliable a guide to the magnitudes as we can at the present assess them, I do urge again caution in putting undue weight on specific figures. Among other things:-

(i) Our assessment of the economic prospects will change before the Budget, and some of the numbers correspondingly. We are not Budget making now.

(ii) When we come to the process of Budget making we shall need to pay particular attention to the implications of specific PSBR reducing measures for the money supply and interest rates. I have not attempted such an analysis in the present rough guide.

(iii) Many crucial decisions remain to be taken on the tax side. Not least, from the point of view of its effect on the PSBR, what is going to be possible on PPT.

5. Nevertheless, subject to these commonsense caveats, I hope this further analysis will help in focusing on the central problems we now face.

J B UNWIN
22 October 1980

SPEAKING NOTES: CABINET 23 OCTOBER

Encouraging signs that Government's strategy beginning to pay off. Picture on inflation particularly encouraging - both on pay and prices. Therefore more than ever vital to build on this by taking all steps necessary to maintain momentum and stick to financial strategy. Only sure way of getting inflation and interest rates down.

2. Always thought 1981-82 would be most difficult year. Said so in Budget and in presentation of MTFS. But, as my paper on economy shows, prospect even tighter than anticipated. This partly reflects effects of world recession, but also - very important - our own failure to control borrowing and spending as we had intended. In particular, on present outlook faced with very severe problems on PSBR (forecast at over £11 bn even assuming White Paper totals restored). Unless this reduced substantially, little prospect of any significant fall in interest rates. This damage inflation prospect and make prospect of easing of exchange rate more difficult.

3. Precise numbers (see my paper) not certain at this stage. But indicate right directions and orders of magnitude. All past experience shows we cannot afford to take risks. Key points to emerge are:-

(i) Absolutely vital to get back as closely as possible to what Cabinet agreed in July - ie Cmnd 7841 totals less benefit of EC refunds. This now harder than we thought in July as result of further excesses now revealed. CST's proposals designed to offset those excesses.

(ii) But even restoration of White Paper totals would do relatively little to reduce PSBR below present forecast. Rather, position is that if we fail to secure cuts of size proposed, we shall face prospect of PSBR even higher than that now forecast. Forecast not unreasonably assumed we would achieve public expenditure objective that Cabinet in July decided. Present prospect for PSBR is incompatible with interest rate and inflation objectives.

(iii) This means that in Budget I shall have to look for large tax increases (even greater to extent that room found for some relief to industry). Am considering possibilities (including N Sea) and will consult with colleagues concerned in due course. But further increase in real burden of personal taxation probably unavoidable (to add to increase in this year's Budget).

(iv) Stress again that above prospect, unattractive though it is, depends on accepting CST's proposals and holding close to White Paper totals. To extent that this not achieved, even greater weight will fall on tax side. Difficult to see how could avoid putting even greater tax burden on persons.

4. Recognise that to extent that worsened PSBR prospect reflects deeper than expected recession it would be perverse to cut back expenditure, or raise taxes, to restore early forecast of PSBR. Not proposing to do that. But serious deterioration in PSBR both this year and next only partially accounted for by revised view of course of economy. Indeed this year economy is moving much as expected in Budget, but PSBR is forecast to be about £2 billion more than expected. This reflects among other things higher public sector pay than allowed for, higher defence spending, and higher local authority spending and borrowing. Interest rates are thus now likely to have to remain higher than we had hoped.

5. Recognise concern about transitional effects of policies on industry. Accept further that any cuts in public expenditure work through to industry - those on transfer payments and pay indirectly, other cuts (not only on capital expenditure) more directly. This is regrettable. But overriding priority, and best way of helping industry in longer run, is to attack inflation by sticking to present financial strategy and getting interest rates down. This strongly endorsed recently by Pennock and Beckettwho in particular press case for more public expenditure cuts.

6. Therefore ask Cabinet to:-

(i) reaffirm July objective of keeping to Cmnd 7841 totals less EC contributions;

(ii) cooperate in securing quantum of cuts proposed by CST.

This is absolute minimum if to maintain credibility, secure progress on inflation and interest rates that is so vital, and avoid very damaging tax cuts in next Budget.

7. [Accordingly propose arrangements for taking this forward before Cabinet on 30 October. Cue for Prime Minister to speak on 'star chamber' proposals].

1981-82 £ billion

	expenditure effects (where relevant) 1980 Survey prices	PSBR cash terms
(4) Brought forward: PSBR resulting from full adoption of proposals in C(80)58		12.05
Other spending possibilities		
(5) social security savings, including consequential on public service pensions	- .2	-.3
(6) public service earnings increases of 6% instead of 9% assumed in forecast	- .6	-.4
(7) PSBR after all spending adjustments		11.35 (say)
possible discrete tax measures		
(8) North Sea package to yield revenue of 1 in 1981-82		-1.1
(9) ½% point increase in employee NIC		- .5
(10) change accounting date for VAT on imports		- .6
but (11) cost of corporation tax changes (with stocks index and credit restrictions)		+ .3
(12) PSBR after all spending adjustments and discrete tax measures		9.45

Memo items

... each 1% under-indexation of income tax structure (allowances and thresholds)	- .15
... each 1% under/over-indexation of specific duties (inc VED)	± .08

FLAG B

fiscal position 1981-82 £ bn

	expenditure effects (where relevant) 1980 Survey prices	PSBR cash terms
(1) PSBR in forecast (assumed Chief Secretary's July package for return to Cmnd 7841 would be achieved and that EC refunds would be a further bonus. But allowed for .5 excess spending (Survey prices) over Cmnd 7841 in demand-determined programmes and shortfall taken together)		11.25
(2) PSBR benefit of adhering to Cmnd 7841: adjustment arises because forecast foresaw higher spending in some areas than allowed for in Cmnd 7841	-.5	-.5
(3) excess over Cmnd7841 less EC refunds implied by CST proposals in C(80)58 (which provide for 2.3 at Survey prices for the nationalised industries - ie EFLs of 1.5, Reserve element of .8). Effects of the major C(80)58 spending items are:-	+1.1	+1.3

	expenditure, 1980 Survey prices	PSBR, cash
a) defence	-.5	-.6
b) 2% cut in cash-controlled programmes, excl defence	-.4	-.5
c) 1% cut in l.a. current	-.1	-.1
d) effects of revised economic assumptions and other changes on social security programme	+.2	+.3
e) probable increase in housing subsidies and export credit owing to revised economic assumptions, less cuts	+.4	+.5
f) increase in nationalised industries finance (incl Reserve provision)	+1.1	+1.4

(4) PSBR resulting from full adoption of proposals in C(80)58	12.05

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Ref. A03326

PRIME MINISTER

Cabinet: Public Expenditure

The three Cabinet memoranda by the Chancellor of the Exchequer and the Chief Secretary, Treasury, are being circulated this evening. Arrangements are in hand with the Treasury for the "enlarged bilaterals" between the Chancellor, the Home Secretary and the Chief Secretary on the one hand and certain individual spending Ministers on the other to be held in the period between this week's Cabinet and next week, though we shall not "go public" on these arrangements until after tomorrow's Cabinet, and subject to agreement at that Cabinet.

2. I suggest that the right place for inserting this subject into tomorrow's agenda is as an introduction to the last item, Civil Service Manpower, after the discussion of The Queen's Speech on the Opening of Parliament.

3. You might open the discussion on the last item by saying that, before you invite the Lord President to speak to his paper (C(80) 56), you would like to draw the attention of your colleagues to the three important Treasury papers which have been circulated for discussion next week, and you think that it would be helpful if, in preparation for that discussion, the Chancellor could say a preliminary word this morning about the economic prospects and their implications for policy, particularly on public expenditure and cash limits.

4. The object of the discussion will be to get a sufficient degree of reaffirmation of the economic strategy, and specifically of July's decision that public expenditure totals in 1981-82 and later years should be held within the figures set out in the March White Paper, so as to provide a framework for the "enlarged bilaterals" and for next week's discussion of the detailed proposals on public expenditure. You will therefore want to keep the discussion away from the detailed public expenditure proposals and on the strategy and the expenditure targets.

5. The advantage of coming to this subject relatively late in the agenda, but with one big item still to deal with, is that Ministers may be in a frame of mind not to pursue the subject at inordinate length on this occasion, and may be prepared to postpone a full discussion until next week. You could perhaps encourage this by intervening as soon as the Chancellor has said his piece, to say that Cabinet will of course be returning to a full discussion of this next week, but that in the meantime the Chancellor and the Chief Secretary, together with the Home Secretary, will during the next seven days be seeking to discuss with the spending Ministers most seriously affected the very difficult decisions that are called for. You would go on to urge Ministers each to go as far as possible, in this very difficult situation, in agreeing the reductions proposed by the Chief Secretary.

6. The Ministers concerned will include the Secretaries of State for Defence, Social Services, Education and Science, the Environment, and Scotland, and the Ministers of Agriculture and (probably) Transport. They may also need to include the Secretary of State for Employment, who will not readily accept the reductions in his special employment measures which the Treasury are proposing.

7. The ideal outcome would thus be

(i) provisional reaffirmation of the strategy, and in particular of the decision to stay within the public expenditure totals in the March White Paper;

(ii) agreement to continue discussion at next week's Cabinet;

(iii) endorsement for the "enlarged bilaterals".

8. But it may not go as smoothly as that. You may encounter expressions of dissent on two counts.

9. Some Ministers (e.g. the Secretary of State for Industry) may accept the strategy and the overall targets, but want to see the cuts decided and distributed so as to minimise the damage to industry. As we saw yesterday, the implications of this would be:

(a) not to make further cuts in capital programmes;

(b) not to make further cuts in defence equipment projects;

(c) to go as far as possible on public sector pay and numbers;

(d) to consider deeper reductions in transfer payments.

10. That makes obvious sense; the difficulty is to make up the numbers required on that basis. If this strand of thought did emerge in the discussion, you might sum up by saying that:

(a) if public expenditure is to be held within the totals in the March White Paper, we need reductions totalling the £1,850 million or so indicated in the Chief Secretary's paper;

(b) if capital programmes, or defence, are to be spared, in order not simply to push the squeeze on to industries already very vulnerable, then other current expenditure, especially transfer payments, will have to find more;

(c) in his "enlarged bilaterals" the Chancellor should take account of the effects of the proposed reductions on industry and employment and of the views expressed and should endeavour to see how the "mix" of the package of reductions can be adjusted to reflect them.

11. The dissent may go beyond that, to questioning whether the strategy continues to be valid in the present circumstances. The argument will be that industry is already under unprecedently heavy pressure with the combination of recession, high interest rates and the high exchange rate; that the recession is deeper and the levels of interest rates and the exchange rate are higher than was forecast or foreseen at the time when the strategy was decided upon; that industry is in no position to absorb the consequences of reductions of public expenditure proposed; and that we should therefore look either to more reliance on fiscal measures - increases in taxation - and less on public expenditure cuts or, more drastically, to a modification of the strategy: an easing of the pressures that the strategy is placing upon the economy and in particular upon industry, even at the cost of slowing down the rate at which inflation is being reduced.

12. If this line of thought were to emerge in discussion, you would have to judge whether it was sufficiently strongly and widely held to make it necessary to change the handling plan. It might be possible for you to say that that was something which the Cabinet would need to discuss when it took the papers next

week, but that in the meantime the Chancellor should go ahead with his "enlarged bilaterals", on the basis that the reductions would be needed if the strategy and the March public expenditure totals were to be adhered to, and the results of the "enlarged bilaterals" could be very relevant to next week's discussion. But you might judge that the disquiet was so profound and so wide in the Cabinet, that there was no point in pursuing the public expenditure proposals and holding the "enlarged bilaterals" until the major questions had been resolved. In that event you would presumably have to conclude that the Cabinet would be having a full discussion next week of the economic prospects and their implications for policy, and that further consideration of the Chief Secretary's public expenditure proposals would have to wait until after that discussion. But that is an outcome you will want to avoid if it is possible to do so.

RCA

ROBERT ARMSTRONG

22nd October, 1980

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Ref. A03308

PRIME MINISTER

Public Expenditure

Your meeting with Ministers this afternoon.

2. We need two things:

(1) Collective reaffirmation of determination to keep within the public expenditure targets for 1981-82 (and later years) as published in the March White Paper.

(2) Decisions on the distribution of reductions to bring the forecasts back to the targets.

Keeping within the targets

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

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

How to keep within the targets

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

(1) Agreement to all the specific cuts he has proposed (only about £150 million of which are agreed): about £1,100 million.

(2) A further 1 per cent reduction in local authority current expenditure next year, on top of the 2 per cent reduction already agreed: about £150 million.

(3) A 2 per cent cut in cash-controlled central Government programmes next year: about £600 million.

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

Handling

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

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

Conclusions

8. You will want the meeting to guide you and the Chancellor on:

(a) whether any further action should be taken in advance of Cabinet on 30th October;

(b) if so, whether it should include:

(i) an oral statement by you (or the Chancellor) in Cabinet this week;

(ii) a minute by you to all Cabinet Ministers;

(iii) bilaterals between the Chancellor and the Chief Secretary and certain spending Ministers, or

(iv) meetings between a small group of Ministers under the chairmanship of the Home Secretary or the Chancellor (essentially this group, but without you) and certain spending Ministers, with a view to softening them up for Cabinet on 30th October, and discovering what scope there might be for large reductions in particular programmes, if the Government were prepared to look at commitments again.

9. The spending Ministers to be worked on would have to include the Secretaries of State for Defence, Education and Science, Social Services, and Environment: they are the big spenders. They should also include Scotland, I think, and the Minister of Agriculture.

RTA

(Robert Armstrong)

21st October, 1980

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NOTE FOR THE RECORD

cc Sir Robert Armstrong

The Prime Minister held a meeting this afternoon to discuss public expenditure and nationalised industry finance. The Home Secretary, the Chancellor of the Exchequer, Chief Secretary, the Secretaries of State for Social Services, Industry and Trade, Sir Anthony Rawlinson, Sir Robert Armstrong, Mr. Ibbs, Mr. Hoskyns, Mr. Wolfson and Mr. Whitmore were present.

The following is a summary of the main points of the discussion.

The Chancellor said it was essential, for the attainment of the monetary strategy, to get the volume of spending in 1981/82 back to the planned levels of Command 7841, and also to achieve a reduction in the relative cost of public expenditure. In achieving the Chief Secretary's volume cuts, it was important to minimise the damage to private sector industry - though there was no way of insulating the latter altogether. The arithmetic he was working on was roughly as follows. The latest Treasury forecast suggested a PSBR of £11¼ billion: this was after allowing for the revalorisation of all taxes and it assumed that the planning total in Command 7841 was achieved. It thus assumed that all of the Chief Secretary's proposed cuts, or some variation on them to reach the same total, were achieved. He felt it would be necessary to provide about £½ billion of tax relief to industry, which would bring the PSBR to about £11¾ billion. He was considering the following revenue measures to reduce this figure: a temporary increase in VAT on imports (£½ billion), an increase in the national insurance contribution paid by employees (£½ billion), increased take from the North Sea (£½ billion), and less than full indexation of personal taxes (£½ billion). These measures might produce a PSBR of £9¾ billion, nearly 4 per cent of GDP. This was higher than the plan in this year's Red Book; so the achievement of the Chief Secretary's cuts was a minimum.

As for the cost of programmes, the key here was the pay assumption. He was proposing a figure of 6 per cent for the public services, which if anything was on the low side in terms of its attainability. The majority of the nationalised industries,

/after nudging

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after nudging by Treasury and sponsor Departments, were assuming 10 per cent or less, which again was the best which was likely to be achievable. The experience of the last year showed that there was no point in assuming cash limits for the nationalised industries that could not be achieved. The Prime Minister commented that there was an equal danger of being under-ambitious on the pay assumptions: she went along with the 6 per cent on public service pay, but was sceptical of the nationalised industries' assumptions. The Home Secretary, after explaining MISC 21's conclusions on the RSG grant percentage and distribution, said that the Committee were doubtful that a pay figure of less than 8 per cent could be achieved - though the option of 6 per cent was being put to Cabinet.

The Chief Secretary explained his preference for volume cuts achieved by reducing the programme figures, rather than by imposing a repetition of this year's cash limits squeeze. (There was no dissent.) He went on to say that, if industrial damage was to be minimised, much of the burden of the cuts would have to be concentrated on transfer payments.

Mr. Ibbs said he was very concerned about the consequences for industry of the Chief Secretary's proposals. Without a proper assessment of their impact, there was a risk that what was intended as a cure for industry would actually do harm. Mr. Nott argued that the Chancellor was trying to reduce inflation too fast and that the monetary strategy was too ambitious (though he would support the Chancellor in Cabinet). Sir Keith Joseph said he supported the need for further cuts, but he hoped they would be chosen as far as possible so as not to add further to the pressures on industry. Mr. Jenkin said he would like to know what the tax options were before final decisions were taken on expenditure. Sir Anthony Rawlinson said that it was a fantasy to believe that the necessary cuts could be achieved simply by reducing the pay and numbers in the public services: there had to be substantial other cuts which were bound to hit the private sector.

/On the specific

On the specific proposals in the Chief Secretary's paper, the following points were made:

(i) Defence

The Chief Secretary said that Mr. Pym was likely to offer some reduction, but nothing like the £500 million he was proposing. He did not believe that the Government could credibly achieve the further substantial overall cuts without significant economies from MOD. In any case, the argument no longer seemed to be about our commitments, but rather about what we could afford. Moreover, we were already spending more than our allies in relation to GDP, and we did not seem to be getting value for money. The Prime Minister commented that MOD must be made to obtain savings by improved efficiency - particularly in relation to their industrials. Sir Keith Joseph said he hoped defence would as far as possible be spared: Ministers should look at our NATO commitments, our security needs, the implications for the private sector, and at the possibility of cutting other programmes further (he mentioned further education). In addition, the floatation of British Aerospace shares had had to be deferred because of the Chief Secretary's proposals: this would lose the Treasury money and the Government a political prize.

(ii) Social Security

Mr. Jenkin said that the proposed 3 per cent cut in pensions was politically extremely difficult. It would cover all pensions: at the very least, the exclusion of, for example, war pensions, ought to be considered. Also, it would be worth considering alternative approaches so as to achieve the same saving - for example, full indexation up to "x" per cent on the RPI and partial indexation above that. The Chancellor suggested that, presentationally, we should not be talking about a pension "cut". The overall package might be presented as follows: pay up by 6 or 7 per cent, benefits by 8 or 9 per cent and the prices assumption for cash limits by 10 or 11 per cent. The Prime Minister said that, in view of the sensitivity of this proposal, it should not be mentioned in terms in the Chief Secretary's paper for Cabinet.

/(iii)

(iii) Health

Mr. Jenkin said that the real reduction proposed was about £200 million - because colleagues had turned down his proposal for a road accident scheme. The £200 million reduction would go against specific pledges in the Manifesto, and would - in his view - be even more difficult to present than a pension cut. Politically, increasing the tax on alcohol and/or tobacco, or increasing the "health stamp" would be a better option. The Prime Minister said that the Chancellor should discuss the "health stamp" alternative with Mr. Jenkin; he should also consider removing alcohol and tobacco from the social security uprating formula. This would remove one of the disadvantages of raising these indirect taxes, though there would still remain their RPI impact.

(iv) Scotland

Mr. Jenkin pointed out that the Scots were over-provided according to the Needs Assessment Study.

(v) Home Office

The Home Secretary said that he would find it easier to achieve the further £30 million cut (over and above the £10 million he had already agreed) if he had freedom to choose between local authority current expenditure and his cash controlled programmes: the £21 million cut in local authority current expenditure proposed by the Chief Secretary would involve asking the local authorities to reduce the number of policemen employed. The Chief Secretary said he should be able to go along with this.

On the nationalised industries, the Prime Minister said that somehow greater disciplines must be brought to bear on them. She suggested, for example, that the Government guarantee on NCB borrowing should be removed for any borrowing over the EFL. In relation to BGC's proposed EFL, she suggested that the decision to make BCG a co-financer of the gas gathering pipeline should be

/reconsidered

reconsidered: there was no reason why this project should not be financed wholly by the private sector.

The Chancellor said that the Government had to continue its attack on the monopoly practices of the nationalised industries; but Ministers should not deceive themselves that this would achieve all that much in the short run. EFL figures had to be realistic; otherwise, we would have a repetition of this year's experience.

Handling

The Prime Minister said that the Chancellor's paper on the economic prospect and the Chief Secretary's paper on public expenditure should be circulated in time for this week's Cabinet. There should be a second reading discussion on the general public expenditure position, and she would aim to get the re-endorsement of the planning totals in Command 7841. She did not wish there to be discussion at this week's Cabinet of the Chief Secretary's detailed proposals; but it would be helpful if Ministers had the Chief Secretary's paper by way of background. The paper should then provide the basis for further bilaterals between the Treasury and individual Ministers with a view to decisions being taken on individual programmes at Cabinet on 30 October. She asked the Chancellor to conduct these further bilaterals with the support of the Chief Secretary and the Home Secretary.

21 October 1980

cc Hoskyns
D Wolfson

CONFIDENTIAL

Qa 05155

To: MR LANKESTER

From: J R IBBS

Public Expenditure, EFLs, etc.

1. As the Prime Minister knows, I am convinced that a high exchange rate, and high interest rates which in part cause it, are a combined burden which important sectors of manufacturing industry cannot endure for long on top of the other difficulties they currently face.

2. The Chancellor is putting forward proposals which are intended to create conditions in which interest rates and hence the exchange rate can fall. As I understand it, these include:

(i) the public expenditure savings in the Chief Secretary's paper (£1.85 bn.);

(ii) the cuts in EFLs proposed in E(80)121;

(iii) further PSBR savings of £2½ bn., presumably from taxation.

However, it is not clear so far what the consequences of this package would be for industry and employment.

3. On the one hand these proposals should achieve a significant reduction in the PSBR, and therefore in interest rates and the exchange rate with consequent benefits to industry. But against this must be set the direct effects of a cutback in public programmes much of which will fall on investment and hence the manufacturing industry, together with the effects of a reduction in real personal disposable income which also will affect industry adversely. I believe it is essential that Ministers should have, before Cabinet on 30 October, a quantified assessment from the Chancellor of the likely net consequences for industry and employment of his proposals.

4. I do not know how reassuring such an assessment will be. However, if there is still a substantial risk of continuing serious damage to important sectors I believe the Chancellor should also provide, at least

for the Prime Minister's own guidance, and within the basic strategy of progressive reduction of monetary growth to 6 per cent in 1983/84, an assessment of the likely effects on industry of some slightly less stringent monetary target for 1981/82, say 10 per cent, which might for example give modest scope for reducing the impact of investment cuts at key points. My experience in industry has taught me that, when one is trying to judge highly complex situations in which reliable quantification is difficult, it is helpful to have an alternative proposition against which to make a comparison.

5. The MTFS envisaged that output would grow by an average of one per cent a year after 1980 but this growth is no longer in prospect and there is probably a more difficult world economic situation than was originally expected. Presumably these are the sort of potential changes which were envisaged when it was said in the MTFS that "the precise target rate of growth in the intervening years will be decided at the time". In view of the grave dangers facing some worthwhile parts of industry it appears prudent to have available some assessment of the scope that exists for mitigating serious difficulties at key points while remaining within the basic strategy.

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

JR

21 October 1980

DRAFT 20/10/80

PUBLIC EXPENDITURE

Memorandum by Chief Secretary, Treasury

Cabinet agreed on 10 July to keep public expenditure plans for 1981-82 and later years within the totals announced in the March White Paper (Cmnd 7841) less the benefit from refunds of EC contributions (CC(80) 28th conclusions). The separate paper now being circulated by the Chancellor (C(80)) shows the importance of sustaining that decision. Indeed, if it were practicable, it would be helpful to reduce public expenditure further in 1981-82.

2. But the prospects have deteriorated since July. We foresaw then that cuts in other programmes would be needed to offset increased provision for nationalised industries, then put £470 million* over what was provided in the March White Paper. Subsequent developments show very large prospective excesses over the March totals of the order of £2.7 billion in 1981-82, and more in later years. To offset these increases and get back to the March White Paper will now require larger and more difficult cuts in programmes, with serious difficulties, both practical and political.

3. The main reasons for the increases, set out in table 2 of Annex A, are:

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* This, and all other figures in this paper, are at late 1979 prices.

(i) The July increase would have allowed £1.2 bn for specific industries in 1981-82. The industries have now sought external financing limits totalling £2.5 bn. I propose in [E(80)] that their bids should be scaled down to £1.5 bn - £0.3 bn more than we allowed for in July. In addition increased provision of £0.3 billion is needed in the Reserve for next year, partly for the end-year flexibility scheme for nationalised industries. So £0.6 bn more is needed.

(ii) The changed prospects for unemployment, inflation and interest rates require increased provision of perhaps £0.7 billion in 1981-82, and more in later years, for benefits, housing subsidies and export credit subsidies.

(iii) In view of the recent discussion in E Committee, we need to allow something for the proposals put forward by the Industry and Employment Secretaries for "seed-corn" proposals for industry and measures concerning unemployment, particularly for young people. The original proposals amounted to £0.4 billion. I suggest that in present circumstances we can only allow for a net increase of £0.15 billion.

(iv) An additional £0.5 billion is needed in 1981-82 for a necessary increase in the Reserve together with a reduced estimate for shortfall.

(v) Certain other smaller items require a further £¼ billion.

4. To cover these changes action is needed on public service pay, and on expenditure programmes both by specific cuts as so far discussed in bilaterals with the Ministers concerned, and/by certain general cuts affecting a large number of programmes. The proposals in this paper need to be considered in conjunction with those in C(80) concerning cash limits.

(a) Public services pay

5. The Chancellor proposed in C(80) that the 1981-82 cash limits provide for a 6% increase in public services pay in the next pay round. Each 1% reduction in the pay settlements below 9% reduces the relative costs of the public sector below those allowed for in the Medium Term Financial Strategy by some £220 million and can justifiably be counted towards bridging the gap.

(b) Specific cuts

6. My proposals for specific cuts are in the first column of Table 3 in Annex A: the main ones are described in Annex B. They have been reduced in some cases to allow for the interaction with the general cuts described below. I have discussed them bilaterally with the Ministers directly concerned. So far I have secured agreement to £0.2 bn of the £1 bn proposed.

7. The political difficulties of many of the cuts are evident. But we can only obtain the amounts needed to secure both our economic strategy and our specific commitment on public expenditure by significant savings in the very large programmes as well as in smaller programmes. This means moving away from certain commitments made previously, notably in relation to health, defence, education and social security.

8. Defence is one particular difficulty. I respect the Defence Secretary's concern both about National security and about relations with our NATO allies. My proposal would mean that we had atleast stopped the decline in defence spending which occurred under our predecessors. But any significant increases now need to be deferred until later in our period of office.

9. Another key issue is social security. It accounts for a quarter of total public expenditure. The largest single element is retirement pensions. A step change here would not only give us a needed saving next year but put the programme on a more realistic basis for the future.

10. I propose that the increase in retirement pensions and other benefits in November 1981 should be abated to 3% less than the expected increase in the RPI. A similar abatement would apply to the increases in public service index-linked pensions. This would be in line with the fall in real earnings in the public service.

11. Legislation will be required. The way in which the cut should be expressed, and whether the legislation should give permanent enabling powers can be considered later.

(c) General cuts

12. On expenditure other than pay the Chancellor has proposed a cash limit factor of [12%].* This is within the realistic range of expectations, but towards the optimistic end of that range, so it may still imply some degree of cash limits squeeze, if inflation turns out higher. Rather than reduce the factor further to produce a deliberate major cash limits squeeze, I propose a general volume cut in all expenditures subject to cash limits (excluding local authority current expenditure) of 2% in 1981-82, carried forward into the later years. The effect will be similar to that produced this year and last by the cash limits squeeze. It is simpler and better than such a squeeze, because it enables programme managers to plan for it now, and the volume figures published in the White Paper to represent more nearly the Government's intentions.

13. In addition, I propose that we seek a further 1% cut in local authority current expenditure, in 1981-82, and in subsequent years, to be shared out proportionately among the relevant programmes. This involves re-opening the earlier decision, announced in August to local authorities, to stick to the 2% reduction between 1980-81 and 1981-82 shown in the

*The Chancellor is considering this further.

March White Paper. The extra reduction would be explained as required by the economic climate. It may not be implemented in full, especially in 1981-82, but we cannot exempt the local authorities from this further effort.

Total effect

14. Annex A, Table 3 shows the combined effects of the various reductions on the main programmes. The figures for later years are on the basis of carrying forward the policy measures involved in the specific cuts, and the absolute amounts of the general cuts.

15. Even these proposals taken together will still leave our planned spending in 1981-82 above what we decided in July by more than £0.2 billion, as is shown in Table 2. There is a corresponding excess in 1982-83, although the totals for that year and the one after are provisional: the economic assumptions may need to be changed before the Budget. The excess will be more if the cuts are not implemented in full or if the other assumptions, eg on public service pay are not validated.

16. For public presentation we can obtain some easement by taking advantage of the EC refund, ie by presenting our decision as holding public expenditure from 1981-82 onwards below the March White Paper provision, but not to the full extent of the gain from the EC refund. But this does not help the problem with the PSBR.

Announcement

17. We have first to reach decisions on the substance, but need to keep in mind what requires to be said and when.

18. Specific announcements will be needed in the next month or so of:

(i) Cash limits factors, as proposed in C(80);

(ii) The additional cut intended in local authority current expenditure, which is relevant to the Rates Support Grant settlement next month;

(iii) Some changes in other programmes where operationally necessary;

(iv) The public expenditure policy assumed in the Industry Act forecast.

19. It will be for consideration whether some announcement about our overall plans in general terms will be appropriate in the near future. Subject to that, the occasion for comprehensive and detailed announcement will be the next public expenditure White Paper, which I propose we publish again on Budget Day next March.

Conclusion

20. I invite the Cabinet's approval of the proposals set out in this paper.

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ANNEX A

TABLE 1

CHANGES COMPARED WITH MARCH PUBLIC EXPENDITURE WHITE PAPER

£m late 1979 prices

		1981-82	1982-83	1983-84
I	Total public expenditure Cmnd 7841 revalued			
	Total programmes excluding nationalised industries	75,606	74,351	74,330
	Nationalised industries' finance	754	167	-507
	Reserve	1,350	1,700	2,200
	Special sales of assets	-50	-50	-50
	Shortfall	-840	-840	-840
		76,820	75,328	75,133
	EC refunds	-680	-680	-680
II	Increases (see table 2)	+2,724	+3,056	+2,967
	Reductions proposed (see table 3)	-1,840	-2,117	-2,580
	Net changes in total public expenditure volume (a)	+884	+939	+387
III	Effect of reduced public service pay (b)	-650	-650	-650
	Net changes (a & b)	+234	+289	-263
IV	EC refunds (c)	-680	-680	-680
	Net changes (a & b & c)	-446	-391	-943

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TABLE 2

INCREASES COMPARED WITH MARCH PUBLIC EXPENDITURE WHITE PAPER (Cmnd 7841)

£ million late 1979 prices

	1981-82	1982-83	1983-84
Nationalised industries			
Anticipated in July	+470	+470	+470
Further increase for individual industries	+300	-	-
Increase in reserve (partly for end-year flexibility)	+300	+50	+50
	+1,070	+520	+520
Other programmes			
Revised economic prospects (unemployment benefits, export credit, housing subsidies) (1)	+700	+1,100	+850
Industrial support / Employment measures	+150	+185	+185
Reserve (not including provision for end-year flexibility for public services)	+350	+500	+250
Reduction in shortfall	+200	+340	+340
May CAP price-fixing	+40	+55	+60
Civil service manpower: extra redundancies	+64	+39	+47
Child benefit uprating by prices (proposed in C(80)40) (2)	+75	+250	+360
Changes agreed before July (incorporated in survey baseline)	+75	+67	+55
	+1,654	+2,535	+2,447
Total increases	+2,724	+3,056	+2,967

NOTES:

(1) Provisional Treasury estimates (including DHSS staff). Additions will be made to specific programmes in consultation with Departments.

(2) Reduction proposed in Table 3 (3% off all social security benefits) will partially offset this.

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TABLE 3

REDUCTIONS COMPARED WITH MARCH PUBLIC EXPENDITURE WHITE PAPER

DEPARTMENTS (excluding nationalised industries)	81-2 £m late 1979 prices				82-3	83-4
	Cuts already proposed (inc some agreed)	1% reduction in LA current expenditure	2% volume cuts in cash - controlled programmes	Total		
Defence	-317	-	-183	-500	-500	-500
DHSS (social security)						
- 3% off all benefits, less small bid	-162	-	-	-162	-498	-496
- child benefit: changed date of payment	-62	-	-	-62	-10	-15
Indexed public service pensions (3% off)	-10	-	-	-10	-30	-30
DHSS(health and PSS)	-	-12	-125	-137	-137	-137
DOE (housing)	-34	-1	-27	-62	-88	-83
(PSA)	-19	-	-8	-27	-23	-23
(other)	-62	-15	-18	-95	-89	-84
DES (gross)	-85	-61	-32	-178	-238	-243
Scotland (excl. DAFS)	-109	-17	-24	-150	-150	-150
MAFF/DAFS/WOAD	-26	-	-9	-35	-35	-35
OAL	-10	-2	-3	-15	-15	-15
Home Office	-10	-21	-9	-40	-40	-40
Transport	-15	-10	-17	-42	-42	-42
All other Departments: general cuts	-	-8	-118	-126	-126	-126
ECGD: shift to TSBs, less smallbid	-48	-	-	-48	+4	+4
Other changes						
EC unadjusted contribution: revision to forecast	-90	-	-	-90	-240	-490
Sales of assets (slippage from 80-81)	-100	-	-	-100	-	-
Other changes in C(80)40 and agreed in bilaterals	+39	-	-	+39	+140	-75
TOTAL	-1120	-147	-588	-1840	-2117	-2580

NOTES: (1) 2% volume cuts include savings resulting from reductions in civil service manpower proposed by Lord President (incl. 2½% manpower squeeze carried forward from 1980-81).

(2) "Formula" cuts for Scotland, Wales and N.Ireland are excluded and replaced by general cuts.

ANNEX B

IMPLICATIONS OF MAIN CUTS PROPOSED

1. Defence

As part of the specific cuts proposed in September, defence were asked for a contribution "of the order of £400 million a year". The additional 2% volume cut now proposed would mean for defence a further reduction of £205 million. Since a total cut of nearly £600 million is clearly not feasible, this has been scaled down in the table to £500 million. The Secretary of State for Defence will be concerned that cuts of that order, on top of previous cuts built into the baseline, would damage operational capability and defence industrial capacity.

2. Social Security

The proposal is to uprate all benefits (including retirement pensions) by 3 percentage points less than the Budget forecast of the rise in prices up to November 1981. Main legislation will be needed. This is a very difficult decision politically, when the Government has just legislated to align long term benefits with prices, and when the published forecast is not expected to show a fall in average real earnings on the same scale. Nevertheless this measure will produce savings of £170 million in 1981-82 and £510 million in later years, which are central elements in reducing the total. Even with these measures the social security programme - the largest public expenditure programme - is likely to rise over the period.

3. Education

Cabinet in July decided on cuts of £85 million next year, mainly in local authority current expenditure (on schools and further education) to achieve education's share of the 2% target reduction for local authorities. Since education is nearly half of local authority current spending, a further £61 million is needed towards the further 1% reduction; and a 2% reduction in other programmes (universities, science) would yield a further £32 million. These cuts carried forward,

with some further reductions, total (gross) £240 million a year for later years. The Secretary of State will be concerned about trebling the cut in his programme, when he regards what has already been agreed as putting at risk the Queen's Speech commitment to "maintain and improve" the quality of education.

4. Health

Following decisions not to pursue fully a number of proposals for additional charges which has been made (notably charging for accident treatment) the programme is already £100 million below current spending plans. A further £125 million (2 per cent) cut in volume would mean a total reduction of £225 million below present plans. Unless colleagues are prepared to reconsider charging on the necessary scale, gross NHS spending would have to be cut, not only below the planned level arguably implied in the Manifesto commitment but in fact below volume spending in the current year. Because of upward demographic pressures, this means an absolute reduction in level of service.

5. Scotland

The figures in the table show £109 million for specific cuts, plus £17 million for local authority current 1% and £24 million for the 2% on other programmes, giving a total of £150 million. The Secretary of State was originally asked for £150 million plus "formula cuts" and regarded this as poticially unacceptable. The equivalent figure is now £109 million since the £41 million for percentage cuts would take the place of "formula cuts". These cuts would mean that expenditure per capita in Scotland on comparable programmes would continue to be almost one-third higher than in England.

6. Home Office

The Home Secretary reluctantly accepted a cut of £10 million. The percentage cuts now proposed would mean a further cut of £30 million, mainly on local authority current spending (police, courts etc).

7. Environment

The proposal is for specific cuts of a further £50 million, including £10 million on PSA. The percentage cuts would be additional to these. The PSA contribution is likely to entail a reduction in departments' accommodation programmes and standards of service provided to them.

DRAFT CABINET PAPER 20/10/80

PAY AND PRICE FACTORS FOR THE 1981-82 CASH LIMITS AND VOTES

We need to decide now the inflation factors to be used in fixing cash limits for 1981-82. This is material to the RSG decision to be taken during the next month, and it will be useful to announce the factors generally in the near future.

2. These factors need to be considered at the same time as the volume programmes discussed in C(80) . It is the cash limits which will ultimately determine how much money is available for the cash controlled programmes next year. Whatever figures we decide, it is central to our policy that the resulting cash limits should be rigorously observed.

3. The cash limits cover much of central Government expenditure including defence, the hospital and community health service and universities. They also cover the rate support grant (RSG) and local authority capital expenditure. Altogether this amounts to over £40 billion at late 1979 prices.

A. Pay

4. On pay, cash limits cover numerous public service pay groups including the armed forces, doctors, nurses, NHS ancillaries, teachers, local authority manual workers and civil servants.

5. I propose that the 1981-82 cash limits and Votes should provide for a [6%] annual increase in earnings from due settlement dates in the current pay round.

6. The 1981-82 cash limits and Votes must also include provision for a number of settlements in the autumn of 1981. These fall in the next pay round. I propose that the provision for these settlements should be two percentage points below the figure we decide on for the current pay round (i.e. 4% if the proposal of 6% above is agreed). It should be made clear that this is a provisional figure.

7. There are two other points on the pay provision. First, settlements in the remainder of the current financial year. The 1980-81 cash limit provide 14% for these. This is too high. I propose that the 1981-82 cash limits should only finance settlements in the remainder of 1980-81 (i.e. those agreed between 1 October 1980 and 31 March 1981) only to the same extent as the provision for new settlements in the current round (as in para 4).

8. Second, staging. The general policy from now should be to avoid staging whenever possible. In future cash limits should be set so as to prevent financial advantage to employees from staging.

9. Certain public service awards were staged in 1979-80; non-industrial civil servants, for whom staging increases earnings

between 1980-81 and 1981-82 by about 2% in the absence of any further pay increase; teachers, for whom the comparable figure is about 4%; and university teachers (about 5%). [Passage to be added in the light of E Committee discussion.]

B. Prices

10. For 1979-80 we set cash limits in such a way as to produce a deliberate 'cash limit squeeze', that is, deliberately lower, we we acknowledged, than would provide in full for expected price increases.

11. Apart from the saving in expenditure, such a squeeze is a useful incentive to efficiency. But for 1981-82 there is a better way than a fresh major cash limit squeeze of consolidating and carrying forward the savings from last year's cash limits squeeze and renewing the stimulus to efficiency. This is the proposal in C(80) for a general cut of 2% in the volume plans for cash controlled central government expenditure (capital and current) and in local authority capital expenditure. A further general cut of 1% is also proposed in local authority current expenditure, to be reflected in the RSG.

12. Provided that these proposals are agreed, I propose that in cash limits and votes we provide for an increase in prices of [12%*] between 1980-81 and 1981-82. This is within the range of realistic expectation, but towards the optimistic end of the range. So it may still imply some degree of cash limit squeeze,

*The Chancellor is considering this further.

but this should not be significant unless the current economic assessment turns out to be significantly wrong.

13. This figure would apply to all expenditure other than pay. There appears to be no significant difference in the price prospects in the different areas of expenditure, so it is not necessary to use a range of different price factors as in the past.

14. This would be the provision made for price increases in the RSG.

C. Conclusions

15. I invite Cabinet to:-

a. consider whether the 1981-82 cash limits and votes should provide for a [6%] annual increase in earnings from due settlement dates in the current pay round and [4%] in the next pay round;

b. agree that the 1981-82 cash limits should only finance settlements in the remainder of 1980-81 to the extent of the figure agreed as a. above for the current pay round.

c. [conclusion on staging to be added]

d. agree that for expenditue other than pay the 1981-82 votes and cash limits should provide for a [12%] increase in prices between 1980-81 and 1981-82.

Original filed on ECON POL Part 3 Disposal of Public Sector Assets

Prime Minister. The background to the British Aerospace issue, on which Sir Keith Joseph wants a word next week.

MTP 17/X

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 October 1980

T. Lankester, Esq.,
No.10, Downing Street
S.W.1

Dear Tim,

PUBLIC EXPENDITURE AND THE BAE FLOTATION

As you know, Sir Keith Joseph saw the Chancellor this morning to discuss whether the Defence programme could be made exempt from the current public expenditure reductions, and be maintained at the Cmnd 7841 planned levels, in order at least partially to resolve current uncertainties about future MOD orders for British Aerospace which will otherwise preclude the privatisation of BAe next month. I understand that Sir Keith Joseph may intend to mention the matter to the Prime Minister tomorrow.

Sir Keith is not now coming in on Saturday. We will get him in next week. MTW 17x.

The Chancellor explained to Sir Keith Joseph this morning that the level of cuts in total public expenditure which, in his view and that of the Chief Secretary, are now required necessitates a substantial contribution from Defence. While regretting the delay to the privatisation of BAe, he saw no way in which an exemption for MOD could be contrived. At his request, I have subsequently sent to Sir Keith Joseph's office a copy of the attached note by officials which sets out some of the considerations underlying his view that some reductions on the Cmnd 7841 Defence figures are both essential and defensible within the Alliance.

It may be helpful to set out for your information some figures relevant to the arrangement which Sir Keith Joseph had in mind. As foreshadowed in the Chancellor's minute of 10 October to the Prime Minister, Treasury Ministers are now seeking a substantial reduction, at present set at £500 million pa, in the Defence PES figures throughout

/the Survey

the Survey period. To forego any Defence reductions might be to concede rather more than this, since it would be difficult to secure Cabinet agreement to the total public expenditure cuts sought if as significant a programme as Defence had been wholly exempted. On the other side of the equation, the proceeds from a sale in November of 50 per cent of the shares in BAe Ltd. are, on the DOI's estimate, likely to amount to rather less than £70 million; and, provided that no new launch aid proposals from the Company were accepted, the PSBR would additionally benefit to the tune of some £100 million in 1981-82 and £75 million in the following two years as a result of the Company's meeting its forecast capital requirements from within the private sector. The imbalance in these figures is obvious: moreover, it is not certain that a sale of shares next month could take place even if MOD were granted exemption from any Survey reduction, since their current cash limit problems would make it difficult for them to give a commitment to no cancellation of existing BAe orders. Various other uncertainties overhanging the plan for November flotation were mentioned in E(DL) on 14 October.

The picture should of course be much clearer in the New Year.

Yours ever,

Richard Tolkien

for

A.J. WIGGINS

NEED FOR CUTS IN PUBLIC EXPENDITURE: WHY DEFENCE CANNOT BE EXEMPT

It is vital to the Government's economic strategy that they should adhere to their commitment to contain public expenditure. It is fundamental to their approach that the size of the public sector should be rolled back. And added to this is a financial imperative to hold the PSBR in 1981-82 to a manageable level. It now appears necessary to find further savings of the order of £2 billion in order to achieve the objective, agreed in July, of holding to the Cmnd 7841 totals adjusted for the EC contribution.

2. The scope for savings on other programmes is severely limited: indeed there are some areas where increases are being sought. Defence represents a sixth of all Central Government expenditure. Total public expenditure programmes for 1981-82 were cut last year by £6.3 billion or 8.4%, while Defence was allowed an increase. Total spending was planned to decline by 0.6% in 1980-81 and 1.2% in 1981-82 while defence was to rise by more than 3% a year. The Cmnd 7841 figure for 1981-82 would now represent a 5.8% increase on the volume for 1980-81 which was implicit in the decision on the August cash limit increase. It has become impossible to reconcile this rate of growth with the progressive decline in output. Mr Pym accepted in the discussions on the cash limit that it was necessary to fall short of the NATO target in the short term in the interests of restoring the economic health which will sustain an enhanced defence effort in the future.

3. The UK's performance in relation to the NATO target will still compare favourably with many of our Allies. The target allows for derogation in the event of economic difficulties and many Allies have availed themselves of this with much less justification than the UK's current circumstances provide. (See the Annex attached, which reflects the position so far as we have been able to ascertain it in consultation with MOD.) The UK is still, along with the USA, well clear of the rest of the field in the share of national income it devotes to defence (about 5%) and that share will rise as the economy contracts over the next year or so. This compares with other European countries as follows:

	1979
Germany	3.3%
France	4.0%
Belgium	3.3%
Netherlands	3.3%
Italy	2.3%

4. It is up to NATO as a whole to respond to the threat to the Alliance. The UK is already carrying a disproportionately heavy share of the burden. Mr Pym recognises this, and is indeed understood to be preparing a paper for OD Committee on the possibility of more equitable burden sharing.

5. Politically, too, the success of the overall public expenditure strategy, which will require great sacrifices from other Ministers, demands a substantial contribution this time from the previously protected programmes. Mr Whitelaw has accepted a cut in the provision for law and order. The whole balance of the package would be distorted if there were no contribution from Defence, and it would not be feasible to re-allocate Defence's share to other programmes.

ANNEX

PERFORMANCE OF OTHER COUNTRIES IN RELATION TO THE NATO TARGET

The NATO target

In 1977 NATO Defence Ministers agreed (and the undertaking was endorsed by Heads of State and Government at the Washington Summit in May 1978) to aim at making avail resources which would allow for annual increases in Defence spending in the region of 3% in real terms, recognising that, for some individual countries, economic circumstances would affect what could be achieved. The agreement covered the period 1979-1984. In May 1979 Defence Ministers agreed to extend this objective up to 1986.

2. But it is a target, not a binding commitment, and there are several ways in which countries can justify deviating from it. It speaks of "increases in the region of 3%", and allows for derogation in the event of economic difficulties. In practice compliance has been very patchy, as the following notes show.

Belgium

The Belgians achieved a 4.5% real increase in 1979, but in 1980 their plans provided for a 3.3% fall in real defence spending. In mid-year they announced a package of emergency cuts designed to save 5% of the defence budget in the second half of the calendar year. These measures attracted severe criticism from NATO.

Canada

Canada had negative growth of 2.3% in 1979. The previous Government's plans for 1980 were for an increase of 4.7%, but the restrictive fiscal stance being adopted by the Trudeau Administration makes it likely that the increase will fall well short of 3%; and the prospects for future years are uncertain.

Denmark

Denmark's growth in 1979 was - 0.2% and a further slight decline is planned in 1980. They are now considering a freeze on defence spending at constant prices: the clearest possible departure from the NATO target.

France

France is not a signatory to the target, but in fact French defence spending has been increasing at 3% a year and is likely to continue to do so.

Germany

The Germans achieved 1.7% growth in 1979. Their initial budget for 1980 provided for real growth of only 1½%, but supplementary provision is likely to bring them near to 3%: the latest estimate is 2.8%.

Italy

Italy achieved 6.0% growth in 1979, but real defence spending is expected to decline by 2.8% in 1980.

Netherlands

The Netherlands achieved 3½% growth in 1979. Their plans for 1980 showed a real increase of 2.2% and growth of 1½% in 1981. However the planned 2.2% is unlikely to be achieved because inadequate provision has been made for inflation. The Defence Minister has stated that the country's "difficult financial position" will prevent it meeting the target this year.

Norway

Norway achieved 1.9% growth in 1979 and plans for 2.6% growth in 1980.

Portural, Turkey

It is accepted that these countries, in their particularly difficult circumstances, will be unable to achieve significant real growth of defence spending in the foreseeable future. Portugal is planning 2% growth in 1980 but negative growth after that.

United States

The USA achieved 3.1% growth in 1979. The budget for fiscal 1980 (ie. the year starting in October 1979) was intended to achieve 3.9% growth, although the President did not exempt the Defence Budget from cuts in supplementary provision in the course of the year, so the outturn may be rather lower. The President's budget for fiscal year 1981 provides for more than a 5% real increase in defence spending, and although this is as usual on a conservative assumption about inflation there seems little doubt that in the current mood the necessary supplementary provision will be granted to achieve most of that growth. The planned minimum growth in 1981 is 2.7%. The plans for future years show increases of more than 4% a year in real terms up to fiscal year 1985. The Presidential candidates are currently outbidding one another on further increases in defence spending - Mr Reagan has mentioned 10%.

CONFIDENTIAL

File

10 DOWNING STREET

From the Principal Private Secretary

SIR ROBERT ARMSTRONG

PUBLIC EXPENDITURE

The Prime Minister discussed with you this afternoon your minute A03270 of 17 October 1980 about the handling of the discussion of public expenditure in the coming weeks.

She agreed that we should have a meeting on Tuesday 21 October with the following Ministers present:-

Chancellor of the Exchequer
Chief Secretary
Home Secretary
Secretary of State for Industry
Secretary of State for Social Services
Secretary of State for Trade

She told you she would like you to be there as well; and she agreed that you should circulate to those attending the meeting advance copies of the two Treasury papers for the Cabinet. We will be in touch with Private Offices on Monday morning to fix a time for Tuesday's meeting.

The Prime Minister also said that she would like a preliminary meeting on Monday, 20 October, with the Chief Secretary Sir Anthony Rawlinson and you. This has now been arranged for 1530.

C. A. WHITMORE

17 October 1980

CONFIDENTIAL

Ref. A03270

MR. WHITMORE

Public Expenditure

I should like to discuss with the Prime Minister how we should handle the discussion of public expenditure in the next few weeks.

2. As the Prime Minister will remember, the Chancellor of the Exchequer warned his colleagues at E on 15th October that on present forecasts and policies the public sector borrowing requirement for 1981-82 looked like being something like £3 billion above the targets provided for in the last public expenditure White Paper; and that, if expenditure was to be brought back into line with the targets in order to create the possibility for some easing of interest rates, he would have to look not only at the revenue side of the account but also at further reductions in public expenditure, beyond those which the Chief Secretary has been discussing with colleagues. This warning has caused a certain amount of consternation among spending Ministers, who see this as being all too like a repetition of last year's public expenditure round, when cuts were agreed and then the Treasury came back for a second bite. Their consternation was increased by the size of the figure which the Chancellor mentioned.

3. I have a vivid recollection of the Prime Minister saying to me, at the end of the last Cabinet discussion in last year's round "We must never do it like this again".

4. I understand from the Treasury that the forecast for nationalised industry EFLs for 1981-82 is now running at £550 million more than was foreseen in July, when the excess was already £500 million. E Committee will be looking at this next Wednesday, and the Treasury will be proposing to claw back from the nationalised industries £250 million of the total excess of £1,050 million, leaving an excess of £800 million. They want to make additional provision for nationalised industries in the Contingency Reserve for 1981-82.

5. They are now also proposing reductions totalling £1,864 million (at Survey - late 1979 - prices; equivalent to about £2,500 million in 1981-82 cash terms) in other public expenditure programmes for 1981-82. This total is made up of three components:

(i) Just over £1,000 million from the reductions proposed by the Chief Secretary in his bilateral talks: this represents the total proposed by the Chief Secretary not the amounts actually so far agreed with colleagues. SS/DES/HO/DTrs/DOE/HSS

(ii) Requiring local authorities to reduce expenditure by an additional 1 per cent (3 per cent rather than 2 per cent) to produce £150 million.

1½

2½ (iii) A 2 per cent volume cut across the board in central government programmes (to yield about £650 million).

They would then propose to set cash limits at levels which did not imply a further volume squeeze, though obviously they would seek to set them at the low end of the range of realism.

6. I understand that the application of these cuts to the defence programme would involve a reduction of £600 million, but the Treasury have in fact shaded this down to £500 million. They would propose to do this by letting the Ministry of Defence off £100 million of the specific cuts proposed by the Chief Secretary, while maintaining the 2 per cent volume cut.

7. Principal Finance Officers of Departments will be informed this afternoon that the Chancellor is likely to make proposals on these lines to his colleagues.

8. If we go "cold" into all this at Cabinet on 30th October, without any previous preparation, that is likely to be a pretty unhappy meeting. We should consider what preliminary action could be undertaken to try to prevent that outcome.

9. The Chancellor himself would like to have a small preliminary meeting of Ministers under the Prime Minister's chairmanship. The Treasury have accepted that that meeting should be held as early as possible next week, in case it needs to be followed by further meetings or a series of bilaterals before the Cabinet discussion. The Chancellor will be in Brussels all Monday, but

I think that we should try to have the meeting on Tuesday, 21st October if at all possible. Advance copies of the two Treasury papers for Cabinet - one on the economic background, giving the economic justification for going for more reductions in public expenditure, and the other a paper by the Chief Secretary with the detailed proposals - will be available on Monday; the suggestion is that I should then circulate them at the Prime Minister's request to the Ministers invited to the small meeting. I have urged brevity upon the Treasury, who appear to have rather big ideas about the size of the economic paper.

10. As to who should be invited to the small meeting, apart from the Prime Minister, the Chancellor of the Exchequer and the Chief Secretary: I think that it would be important to have the Home Secretary there, because his is one of the shoulders on which colleagues will be weeping. I understand that he would welcome the opportunity to be present at such a meeting. I think that the Secretary of State for Industry should be invited. That is five people: we do not want to have many more than that. There is a strong case for inviting the Secretary of State for the Environment, both because of the local government element in the Treasury package and because he has more than once said in Cabinet that he would welcome a substantial reduction in public expenditure, if he thought that that might be the end of the story, in order to make room for increased industrial investment. There is a good case for including the Secretary of State for Social Services in this meeting: he has been extremely responsible in all discussions of public expenditure; and, if it were felt that there was something to be said - as I think there may be - for operating rather more selectively than by a 2 per cent general cut on all programmes, his would undoubtedly be one of the programmes to which it would be necessary to look for a substantial contribution. There is also a case for including the Secretary of State for Trade in the meeting, though more on general grounds than because he is a large spender.

RTA

(Robert Armstrong)

17th October, 1980

CONFIDENTIAL

Chancellor
CST
MST (C)
MST (L)
Sir A Rawlinson
Mr Ryrie
Mr Kemp
Mr Bridgeman
Miss MP Brown
Mr March
Mr Judd
Mr Gulvin
Mrs Woods
Mr Riley
Mr C Ward
Mr Ridley
Mr Cartland
Mr Kitcatt
Mr Bailey

Treasury Chambers, Parliament Street, SW1P 3AG

October 1980

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1

Dear Michael

Treasury would find it helpful if you could endorse x below. Agree?

TL 22/10

Mrs Diggle

LOCAL GOVERNMENT BORROWING

The escalation of local authority borrowing, both last year and this, has been giving Geoffrey Howe and me some cause for concern. The Local Authority Borrowing Requirement, already a substantial component of the PSBR, was responsible for most of the PSBR overshoot in 1979-80, and looks like accounting for a very significant part of the PSBR overrun now forecast for 1980-81. Our dramatic reversal of the Government's stance towards local authorities in the middle of last year must have contributed to the unforeseen increase in last year's LABR (which was more than double the June 1979 forecast); but there can be no such excuse this year.

Agreed MT

We should therefore like to find some more effective means of controlling the LABR. I understand that our officials have been over the ground together quickly, but it seems to me that some more directed work is now required as a matter of urgency. I therefore propose that we should put in hand a study of the means available to limit RSG support for loan charges associated with local authority debt in 1981-82.

What I have in mind is restriction of grant support for borrowing costs in such a way as to provide a real disincentive to excessive borrowing nex year. This might involve, at one extreme, ceasing paying grant on loan charges; and at the other, subjecting grant on loan charges to full cash limit discipline. Between these two extremes there are options such as paying grant only on old debt or only on a proportion of new debt. Even if a fully developed scheme could not be implemented until 1982-83, I very much hope that it will be possible to take some effective action in 1981-82.

I appreciate that your officials are already stretched in preparing the RSG settlement, especially with the introduction of unfamiliar distribution arrangements. Nevertheless, the Chancellor and I attach such importance to this work that I must ask you to endeavour to accommodate it in time for our conclusions to be incorporated in the RSG settlement.

To complete the picture, I should add that Treasury officials will also be considering the possibility of restricting local authorities' access to sources of loan finance, notably the PWLB. It is too early to say at this stage whether this approach will prove worthwhile, and in any case there may be virtue in a two-pronged attack on local authorities' propensity to borrow.

I am copying this letter to the Prime Minister and to George Younger and Nicholas Edwards in view of their local government responsibilities

Yours ever
Nigel

NIGEL LAWSON

MS NJS G see
NBPM MAP

PRIVY COUNCIL OFFICE
WHITEHALL LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

16 October 1980

Dear Michael

Thank you for your letter of 3 October about arrangements for the Debate on the Rate Support Grant Orders. I agree that we owe it to local authorities to give them as much advance warning as possible of the financial background against which they will have to fix the 1981/82 rates or precepts, and I shall do all I can to arrange the Debate at a time which is convenient for you. You will appreciate however that I cannot give specific guarantees at this stage.

I notice from your letter to Geoffrey Howe that you do not propose to make any announcements about the changes in the settlement date until the Local Government, Planning and Land Bill has passed through the Lords. There are, of course, a large number of Government amendments tabled to the Bill in the Lords. These will have to be considered in the Commons, and I think that it would help to avoid unnecessary criticism if you could defer your announcements until the Bill has completed all its stages in both Houses.

I am copying this letter to the recipients of yours.

Yours ever

Nick

The Rt Hon Michael Heseltine MP
Secretary of State
Department for the Environment

Ex Pd.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 October 1980

David Edmonds Esq
Private Secretary
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

Dear David,

THE RATE SUPPORT GRANT ORDERS

The Chancellor replied yesterday to your Secretary of State's letter of 3 October about the timetable for decisions leading up to this autumn's RSG settlement.

I should add one point to that letter. Such is the weight of the agenda for the 30 September it may not be possible to reach decisions on public expenditure programmes, including local authority current expenditure, before the following Cabinet a week later. I am sending copies of this letter to the Private Secretaries to the recipients of the Chancellor's letter.

Yours ever,

Richard Tolkien

R I TOLKIEN

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

13 October 1980

The Rt. Hon. Michael Heseltine, MP
Secretary of State for the Environment,
Department of the Environment,
2, Marsham Street,
LONDON. S.W.1.

Dear Michael

THE RATE SUPPORT GRANT ORDERS

Thank you for your letter of 3 October about the timetable for decisions leading up to this autumn's RSG settlement. As you know, I myself have felt for some time that it would be wrong to reach decisions on RSG in isolation from other public expenditure decisions. I am therefore content with your proposal that Cabinet should consider the settlement package on 30 October rather than 23 October as you originally suggested. I take note of what you say about the consequences for the timing of subsequent events, and do, of course, sympathise with your desire to get the RSG debate in before Christmas if possible. I agree with you that it would be sensible to await passage of the Local Government Bill before announcing the deferment of the settlement date.

Copies of this letter go to the recipients of yours.

GEOFFREY HOWE

4

Seen by PM
Copied to Dom. Monetary Policy

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

PUBLIC EXPENDITURE

This minute is to give you warning of further serious problems over our future public expenditure plans, especially for 1981-82. These will have to be brought out in the paper which John Biffen and I will be putting to the Cabinet planned at the end of the month. We urgently need to discuss the issues, both because of their intrinsic difficulty and because they are relevant to our discussion on Monday of monetary policy. Hence this interim note.

2. The main reasons why the prospects looks worse than in July are:

(i) Discussions with the nationalised industries about their external financial limits for next year show that their financial prospects have worsened further. Clearly we must do all we reasonably can to get the industries themselves to take measures to offset their increased bids. John Biffen has made some proposals to this end. We may have to insist on further cuts in investment. The position will not be clear for a few more days. At the moment we cannot be sure whether the increase in the provision for nationalised industries can be held to the £½ bn envisaged in July or will have to be increased, perhaps to £1 bn (at late 1979 prices).

/(ii). Meanwhile

(ii) Meanwhile changes in the prospects for unemployment, inflation and interest rates call for increased spending for unemployment and other social security benefits, housing subsidies and export credit subsidies. Other recent developments also point to further adverse changes.

3. In addition, Keith Joseph and Jim Prior are formulating proposals for industrial support and employment measures which could come to £0.4 bn.

4. In July we decided that public expenditure plans for 1981-82 and the subsequent years should be held within the totals published in our March White Paper, adjusted downwards for the EC settlement, which would make the planning total for 1981-82 about 1⅓ per cent lower in volume terms than the plans for the current year. I regard it as critical to the credibility of our public spending policies that we hold to this decision, keeping the figures within our own published planning totals.

5. It would be helpful if we could get it lower. For now there is a further reason for a tough line. The latest Treasury forecast points to a public sector borrowing requirement approaching £11 bn (in cash) in 1981-82, which would be incompatible with our objectives for reducing monetary growth and getting interest rates down. So we have to find ways of bringing it down. We can in theory, do so in 3 broad ways: higher taxes; reductions in the cost of given spending volumes; or lower expenditure volumes. In practice the cost is, of course, largely the pay element.

6. I am examining what contributions might come from the tax side, including further revenue from the North Sea, employees' national insurance contributions, and

/perhaps

perhaps not revalorising to the full extent the personal tax allowances. It is nether desirable nor easily conceivable to look to this source for a major contribution. Public expenditure must contribute in one way or another.

7. Pay is a critical element. Each 1 per cent more, or less, on public services pay is about £¼ bn on the PSBR. We are considering in E the provision to be made for public services pay next year. A draft paper is coming to you separately. All I need say here is that the lower we set that provision and - the real imperative - achieve pay settlements within it, the less the cuts in services forced upon us.

8. But we do have to consider cuts in services in any event - as we foresaw in July and as I indicated in my minute to Cabinet last month. If we were to close the gap by further reductions in volume the implications look like being as follows.

9. Even if there were no net increase on employment and industry measures, in order to achieve the target agreed in July we should probably need cuts of between £1¾ bn and £2¼ bn (at late 1979 prices) on programmes other than the nationalised industries. John Biffen and I will be considering further over the next few days what proposals we must make. I should say now that I have sympathy with what Michal Heseltine has been saying about spreading the cuts widely and doing enough to minimise the risk of having to come back yet again for more later.

10. We shall certainly need most of the £0.9 bn specific cuts which John Biffen has so far been discussing in bilaterla with our colleagues. But those discussions show that many of the proposals already on the table

/are

are difficult and will be strongly resisted. This has more important implications for how we might proceed now.

11. These are the kinds of proposals we shall have to consider if we are to do more on volume. I am looking at the possibility of trying for a further reduction in local authority current expenditure beyond what was announced in August. I am also considering adding to the specific cuts a general 2 per cent cut in all cash controlled programmes. This would in effect carry forward into next and subsequent years the benefit from the current year's cash limits squeeze, which in the plans so far was carried forward only in civil service numbers.

12. All of this involves political difficulties. In particular the further volume cuts would mean moving away from commitments made previously, for example in looking for significant savings in the very large programmes for health, defence and social security.

13. I fear cuts would be needed in gross spending on health, which we have hitherto sought to protect.

14. We would also have to look for a further contribution from defence, while respecting Francis Pym's concern both about national security and about relations with our NATO allies. I understand his wish to be able to say that we have at least stopped the decline in defence spending which occurred under our predecessors, even though I think significant increases may now need to be deferred until later in our period of office.

15. Social security accounts for a quarter of total public expenditure, and by far the largest single element within that is retirement pensions. I regard it as essential

/to effect a

to effect a step change here in the light of our exceptional problems, in order to put the programme on a more realistic basis. Such a change would only be defensible in a year when the increase in incomes generally has to fall behind that in prices, as has to happen next year. We should have to think extremely carefully about presentation in the light of our pledges. Were we to proceed the kind of change needed would be to abate the increase in retirement pensions and other benefits in November 1981 to, say, 3 per cent less than the expected increase in RPI. The same would apply to public service index-linked pensions.

16. This is a forbidding menu. But the overall arithmetic will persuade you, as it has pursuaded me, that we have to think in this kind of way. I hope we may have a chance of talking together about the central problems, quite briefly - perhaps on Sunday evening, at any rate separately from the meeting on Monday about monetary matters.

(G.H.)

10 October 1980

Chancellor: This needs to go across to No 10 by Thursday am: so would you please telephone approval to me.

Ben 8/10

1. MR MIDDLETON (copy to keep)
2. PRINCIPAL PRIVATE SECRETARY (2 copies)

MR pp J. Wiggins 9/10.

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Ryrie
Mr Britton
Mr Evans
Mr Monck
Mr Unwin
Mr Collinson
Mr Riley
Mr Ward
Mr Ridley
Mr Cardona
GECS

RT 8/10.

(You may find it convenient to hand this copy to the PM. I will send a copy to TL in any event.)

RT.

CGBR: PSBR FORECASTS FOR THE PRIME MINISTER

I attach the first of the regular notes to be sent to the Prime Minister giving the rolling three month forecast for the CGBR and the latest assessment of the PSBR for the current financial year.

2. The Chancellor referred to this, as in preparation, in para 3 of his note of 7 October to the Prime Minister headed "Money Supply, Interest Rates, the PSBR and the Exchange Rate".

3. It should reach the Prime Minister before the press notice on the CGBR in September is published at 2.30 pm on 9 October.

4. I attach also a draft letter of transmittal.

MPB

PATRICIA BROWN
8 October 1980

Private Secretary No 10.

The Chancellor has asked me to transmit to you this minute, with the message that

(a) this note raises a number of disquieting issues;

(b) he will be commenting on them briefly as soon as possible, probably in a P/S minute to Tim Lankester.

Adam Ridley 9 October

370/10

DRAFT LETTER TO:

Private Secretary
10 Downing Street
LONDON
SW1

SHORT-TERM PROSPECTS FOR THE CGBR AND PSBR

The Chancellor's minute of 7 October to the Prime Minister (Money Supply, Interest Rates, the PSBR and the Exchange Rate) noted (para 3) that the Treasury was preparing, in accordance with the agreed work programme, the first three month forward look at the CGBR and the forecast path on a quarterly basis for the PSBR over the rest of the financial year.

I am now enclosing this note.

THE PROFILES OF THE CENTRAL GOVERNMENT BORROWING REQUIREMENT (CGBR) AND PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) IN THE REMAINDER OF 1980-81: NOTE OF OCTOBER 1980

A. Outturn of the CGBR in September

The provisional estimate of the CGBR in September is £800 million. This will be published on 9 October. The outturn may later be increased a little by further information. The result is within the margin of error of a one month ahead forecast: the rolling forecast made at the beginning of the month had been £650 million. Tax receipts were nearly £400 million below forecast with shortfall on receipts from both Inland Revenue and Customs and Excise. In earlier months the tendency had been for the former to run above forecast. Net issues to finance departments' expenditure were some £300 million more than forecast. In the absence of special knowledge, some reaction from the relatively high August figure had been expected. No large special factor in the outturn has been identified. There were offsets elsewhere in the accounts, including an increase in departments' end-month balances. Table 1 compares the outturn with the figures forecast in Table 1 of last month's note.

2. The CGBR this September was much smaller (largely because of PRT receipts) than it had been a year ago. So the cumulative excess of the CGBR this year so far over the corresponding part of 1979-80 has fallen from £2.1 billion at the end of August to only £1.2 billion at the end of September. Table 2 summarises the figures and also the new forecasts for the remainder of the financial year.

3. The CGBR counterpart relevant to the money figures for banking September was £749 million (compared with £650 million forecast). The equivalent figure seasonally adjusted was £1,145 million.

B. Rolling forecast for CGBR in banking October

4. The banks' mid-month make-up day in October is 15 October. So the October banking month is 18 September-15 October. From 18-30 September the CGBR was £690 million and the current figure for the banking month as a whole is £830 million, in both cases before seasonal adjustment.

C. Rolling forecast for CGBR in October-December

5. The new working figures for the CGBR in the next three calendar months were compiled alongside work on the new forecasts for the PSBR as a whole (see next section). They are:

	£ million
October	100
November	1,800
December	1,300

As noted in the recent paper "Money Supply, Interest Rates, the PSBR and the Exchange Rate" such forecasts can deviate by around plus or minus £500 million for the first month and plus or minus £750 million for the third month.

6. The composition of the rolling forecast is summarised in Table 3. Receipts into the Consolidated and National Loans Fund are forecast to be relatively high in October: this is the quarterly peak for receipts of both VAT and advance corporation tax.

7. In total, expenditure from the Consolidated and National Loans Fund (including net lending) is more evenly spread over the quarter, though lending is forecast to be heaviest in October and debt interest payments are always large in November. Main borrowers which have signified intentions are the Electricity Council, the Steel Corporation. Relatively high net borrowing by local authorities from PWLB is usual in October.

D. PSBR in 1980-81

8. A fresh assessment of the PSBR is produced by the new economic forecasts. For the current financial year the figures by quarters, not seasonally adjusted, are as follows:

	£ billion		
	1979-80 outturn	1980-81	
April - June	3.3	4.9	Provisional outturn
July - September	3.8	3.0	Estimated and forecast
October - December	3.9	$3\frac{1}{4}$	Forecast
January - March	-1.2	$-\frac{1}{2}$	Forecast
Year	9.9	$10\frac{3}{4}$	

A minus sign denotes a net repayment.

9. The new forecast reflects a thorough reappraisal of all elements. A realistic margin or error, on each side of the new forecast for the year is some £2 billion: hence the forecast may best be expressed as a range £$8\frac{3}{4}$-$12\frac{3}{4}$ billion. The chance of going outside this range is assessed, subjectively, as one in five. The estimate of the error margin is derived from an analysis of the Industry Act forecasts published in the autumn of the years 1976-79: in 1976 and 1977, the year's PSBR was overestimated in the autumn forecast and in 1978 and 1979 it was underestimated (though by less). Even though much is already known about borrowing in the first half of the current financial year, there are still major uncertainties:

(i) Although the borrowing of the central government over the period April-September 1980 is known to within a small margin, there is less information about the borrowing of the rest of the public sector;

(ii) The need for borrowing arises because of an excess of expenditure over income, and that is the way forecasts of borrowing requirements are constructed. Knowledge of

expenditure and income for the period April-September is weaker than knowledge of what has been borrowed; and, for example, unexpectedly high borrowing thus far in the year may suggest either a continued extra excess of expenditure over income in the rest of the year; or only a temporary excess, with much lower borrowing in the second half of the year. In building up the new forecast some items have been interpreted one way and some the other;

(iii) Government income and expenditure flows for the rest of 1980-81 depend on the development of the economy - on output, inflation, unemployment etc. Errors in these forecasts for the next six months, and in the uncertain estimates for the July-September quarter, will contribute to errors in the PSBR forecasts.

10. The main elements in the net increase of £2¼ billion in the forecast PSBR since the Budget are:

Factors increasing the forecast PSBR	£ billion
Extra borrowing by local authorities	0.9
Extra borrowing by public corporations[1)]	0.7
Shortfall on VAT receipts	0.7
Shortfall on other Customs receipts	0.4
Shortfall on expected special sales of assets	0.2
Extra social security benefits because of higher unemployment	0.3
Increase in defence cash limit	0.2
Total	3.4

1) The latest forecast for public corporations' borrowing is £3.1 billion. The FSBR showed only £1.4 billion, but included a hidden allowance of about £1 billion.

Factors reducing the forecast PSBR	£ billion
Extra receipts from EC as a result of 30 May agreement[2]	0.4
Extra receipts of income tax and national insurance contributions	0.6
Total	1.0

2) This is the difference between the refunds forecast to result from the 30 May agreement and the refunds expected at FSBR time under the old financial mechanism. The latest forecast, unlike the figures being used in the public expenditure survey, assumes some slippage of cash refunds out of 1980-81 into the following year.

Total identified changes, net	+2.4
Others, net	-0.2
Total change in the forecast PSBR	+2.2

11. Outside forecasts for the PSBR in 1980-81, published in August or September, range from £9-11 billion.

TABLE 1

CENTRAL GOVERNMENT BORROWING REQUIREMENT

CGBR IN SEPTEMBER

	Forecast	Outturn	£ million Effect on CGBR
RECEIPTS			
Consolidated Fund			
Inland Revenue	3200	3050	-150
Customs and Excise	1730	1507	-223
Other	600	605	+5
National Loans Fund			
Interest etc receipts	300	618	+318
Total receipts	5830	5780	-50
EXPENDITURE			
Consolidated Fund			
Supply services and Contingencies Fund	5300	5603	-303
Other	250	244	+6
National Loans Fund			
Services of the national debt	800	884	-84
Net lending	280	335	-55
Total expenditure	6630	7066	-436
Other Funds and Accounts	+150	+486	+336
CGBR	650	800	-150

TABLE 2

Central Government Borrowing Requirement

£ billion

			Cumulative		
	1979-80	1980-81	1979-80	1980-81	Difference
April	1.3	0.9	1.3	0.9	-0.4
May	1.5	2.3	2.8	3.3	+0.4
June	1.0	1.3	3.8	4.6	+0.8
July	-	0.8	3.8	5.4	+1.5
August	1.1	1.6	4.9	7.0	+2.1
September	1.7	0.8	6.6	7.8	+1.1
October	0.1	(0.1)	6.7	(7.9)	(+1.2)
November	1.8	(1.8)	8.5	(9.7)	(+1.2)
December	1.6	(1.3)	10.2	(11.0)	(+0.8)
January	-2.5		7.7	..	..
February	0.4	(-1.3)	8.0	..	..
March	0.2		8.2	(9.7*)	(+1.5)

* Latest forecast

Note: Some rows may not cross add because of rounding. Each column is correctly rounded.

TABLE 3

CENTRAL GOVERNMENT BORROWING REQUIREMENT

£ million and %

	(1) April-September	(2) October forecast	(3) November forecast	(4) December forecast	(5) Year to end December	(6) % change of col (5) on year earlier	(7) Budget forecast for whole year % change
Receipts							
Consolidated Fund							
Inland Revenue	14,510	2,850	2,100	2,250	21,700	+20	+17
Customs and Excise	10,371	2,600	1,950	1,700	16,650	+34	+33
Other	3,746	700	750	750	5,900	+14	+5
National Loans Fund							
Interest etc receipts	1,971	400	300	300	2,590	-	+19
Total receipts	30,592	6,550	5,100	5,000	47,200	+22	+20
Expenditure							
Consolidated Fund							
Supply services	31,726	5,700	5,400	5,500	48,300	+24	+20
Other	1,535	250	250	250	2,250	-	+12
National Loans Fund							
Service of the national debt	4,788	350	1,200	450	6,850	+19	+19
Net lending	1,766	550	250	150	2,700	+12	+27
Total expenditure	39,825	6,850	7,100	6,350	60,100	+22	+20
Other Funds and Accounts	+1,465	+200	+200	+50	+1,900		(1,350) [1]
CGBR	-7,768	-100	-1,800	-1,300	-11,000		

[1] £ million.

TPM.2
Pub. Exp Pt 10

Econ Pol.

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

7 October 1980

Dear Michael,

PUBLIC EXPENDITURE: IMPLICATIONS FOR PSA

We discussed your letter of 26 September at the bilateral on 29 September. The wider issues we shall be pursuing in Cabinet. In the meantime one point on the implications for PSA, to which your letter of 18 September is also relevant.

As part of your proposals for meeting the savings asked for by the July Cabinet, you intend to reduce the PSA programme by £9 million in 1981-82 and £5 million in each of the following two years. I have asked my officials to discuss with yours the allocation of these savings. It is to be hoped that, difficult though it is, the bulk can be found from PSA's current expenditure on maintenance, rents and other services.

To the extent that you have to look there too, savings on the PSA's capital programme may involve some deferment on deletion of schemes related to departments' operational requirements. In that case the savings can only be assured if our colleagues collectively endorse the proposals, taking into account the implications for specific schemes.

I suggest that following the examination by officials you might write to colleagues in advance of the Cabinet discussion on 30 October, with a revision of the schedule originally attached to your letter of 18 September, indicating which schemes would fall if you make the cuts proposed.

For the Inland Revenue computerisation of PAYE E Committee are due to consider a revised scheme at the end of October. This would have the same implications for the PSA capital programme as the original scheme. Looking at the schedule attached to your letter

of 18 September I think that the computerisation of PAYE has a priority at least as high as other projects in the programme.

I am sending copies of this letter to other members of Cabinet and Sir Robert Armstrong.

Yrs

John Biffen

JOHN BIFFEN

2 MARSHAM STREET
LONDON SW1P 3EB

Pol

My ref: Econ

Your ref:

Mich

3 October 1980

Dear Chancellor of the Duchy,

DEBATE ON THE RATE SUPPORT GRANT ORDERS

You will see from the enclosed copy of my letter to Geoffrey Howe that we are faced with the unavoidable prospect of slippage in the rate support grant timetable this autumn.

It is in practice now certain, though I do not propose to announce this yet, that the date of the Rate Support Grant Settlement will have to be put back by one week from 21 to 28 November. This means a tight timetable if the Report on the 1981-82 RSG settlement (under the new block grant system) and the Reports and Increase Orders to update the 1979-80 and 1980-81 settlements (under the existing legislation) are to be tabled and debated before the House rises for the Christmas adjournment.

Last time, for various reasons, (including the withdrawal of the first Local Government Bill) it was not possible to hold the annual RSG debate until January 1980. This was criticised as unsatisfactory, especially for the local authorities who needed to know their exact entitlement before deciding on their 1980-81 rates or precepts, and I am anxious that the same does not happen again when we are in the throes of introducing block grant. Authorities are particularly concerned to hear for certain what their grant entitlements will be for 1981-82, and it would be helpful for them to know exactly where they stand before they enter their important rate-fixing cycle in January. For this reason I would be most grateful foryou assurance that a firm slot can be reserved in the Parliamentary timetable for the necessary debate on the floor of the House in the week beginning 14 December.

I am copying this to the Prime Minister, other members of MISC 21, the Chief Whip and to Sir Robert Armstrong.

Yours ever

Pp MICHAEL HESELTINE
(approved by the Secretary of State and signed in his absence)

Rt Hon Norman St John-Stevas MP

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

Dear Chancellor of the Exchequer,

3 October 1980

THE RATE SUPPORT GRANT ORDERS

VMJS 6/10

My Private Secretary wrote to yours on 21 August about the timetable for decisions leading up to this autumn's RSG settlement.

As you know, my preference has been for a settlement on 21 November, in view of the advantages this will bring in giving the earliest possible notification to authorities of their grant entitlements for 1981 - 82, with the influence this can have on their rating decisions, and in view of the better prospect of a debate on the RSG Orders before Christmas. Working back from this date would mean a final Cabinet decision on the RSG package on 23 October, following the second meeting of MISC 21 on 13 October.

However, it is now quite clear from the first meeting of MISC 21 on 25 September that we will not be able to prepare a paper in time for the meeting due on 13 October. We have more, not fewer, grant distribution options to exemplify and consider with colleagues. Bearing in mind that we shall be at Brighton for much of the previous week I fear I have no option but to call off the MISC 21 meeting arranged for 13 October and ask instead for a meeting in the week beginning 20 October. This of course makes it impracticable to consider the settlement package as a whole in Cabinet until 30 October. As you know, this means in practice that we must plan for a week's slippage in the RSG settlement date until 28 November to allow adequate time for essential computation and for checking all the calculation. I am, however, still hopeful that we could have the RSG debate in the week before the House rises for the Christmas recess; indeed I believe we must aim to do so if we are to maximise our influence over local authority budgeting and also to help reduce the embarrassment of having to delay the Settlement. I am writing separately to Norman St John-Stevas about this.

The RSG timetable is also, of course, subject to successful completion of the remaining stages of the Local Government, Planning and Land Bill, and I do not propose to make any announcements about changes in the settlement date until the Bill has been passed through its stages in the House of Lords.

I am copying this to the Prime Minister, other members of MISC 21 and Sir Robert Armstrong.

Yours ever
Michael

MICHAEL HESELTINE
(approved by the Secretary of State and signed in his absence)

Rt Hon Sir G Howe MP

SECRET

174
No 16 copy of 23 Ten 3

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

26 September 1980

Dear John

R. 26/9

Thank you for your letter of 19 September. We are, of course, discussing this on 29 September.

The already agreed expenditure reductions for DOE programmes over the planning period illustrate our particular problem. DOE is already contributing some £2½bn in expenditure reductions over the period 1978/79 to 1982/83. This is roughly equal to the reduction planned over that period for the whole of UK public expenditure. I have already contributed greatly more than a proportionate share to the public expenditure reductions we have so far made.

Following the July decisions, I have completed a further review of DOE programmes. I propose to achieve the further savings you required as follows:

	1981/82 £m	1982/83 £m	1983/84 £m
Housing	14	40	35
DOE (other)	42	36	31
PSA	9	5	5
	65	81	71

On the DOE (other) programmes the two major items are water investment and Local Environmental Services. On the former, I have now reduced the programme to a minimum barely consistent with maintaining the service and keeping pace with new developments of housing and industry. On the latter, expenditure is now declining in line with the reductions in total local authority expenditure, and should continue to do so over the period. But it would be unrealistic to think that we could impose a substantially faster decline.

The PSA has already taken severe cuts and is now down nearly to its minimum base-load of virtually fixed costs (rents of Government offices and other property, essential services to buildings and basic maintenance). There is very little left for new developments, although some of those have a very high priority with colleagues. I am nevertheless seeing what further reductions can be made in current expenditure. I am also proposing the deletion of expenditure on the Inland Revenue Computerisation of PAYE scheme (where there is no firm commitment) Numerous other

new starts on the list I sent you on 18 September will also have to be postponed. I hope to secure £9m in savings in this way.

The facts on housing are straightforward. On current spending, the savings I have already agreed and noted above imply that council rents will have to rise by an average of £2.95 per week in 1981/82. There will be equal rises in each of the following two years if the heavily depleted capital programme is not to be further reduced. This is a 37% increase on the present average of £8.10 per week. To impose another £50m cut on housing current would take the rent increase to £3.35 per week, or 42%. I imagine colleagues will share my misgivings about the impact of increases of this order on our counter-inflationary policy.

On the capital side, the programme is already planned to decline from £2715m in 1978 to £1508m in 1981/82 with a further decline thereafter. By 1983/84, housing capital investment in the public sector will be at the lowest level since the war. I cannot see how we can defend politically any further reductions. As it is, I fear that the decisions we have already taken are bound to lead to a steadily growing chorus of complaint about deteriorating housing conditions by the time of the next election.

On the local authority spending, I agree with you that there must be no question of revising upwards the July decisions on local authority current expenditure next year on which I have, as agreed, announced the overall figures. If an RSG settlement in November is not to be put in jeopardy we must also know the total planned capital expenditure by the end of September in order to work through the necessary calculations and exemplifications in time for the necessary decisions to be taken.

You have now asked me to find a further £50m a year for the next three years. This is the 5th time in the 16 month life of this Government that I have had to go through such an exercise and I feel I must express the anxiety I feel.

We saw the last Government coming back time and again with adjustments to its programmes at short notice. In the process it stretched the allegiance of its supporters ultimately past breaking point. One can ask for sacrifices promising an improvement in the long term and undoubtedly we have enjoyed much public support in our endeavours. But there comes a point when one's credibility is at risk if again and again one has to go back for yet more sacrifices.

I see that you are asking for approximately a further £½ billion expenditure cut from colleagues but it seems to me that that will not be sufficient for us to achieve the really significant reduction in interest rates that are necessary if we are to create a background against which the private sector can respond.

Of course a large round of public expenditure cuts would be controverial but it seems to me that it would be justified if we could combine it with a much better interest rate regime and a range of investment incentives for the private sector.

SECRET

Before I search for yet another trimming of my already much trimmed Department I would like to be assured that this time we really have brought to an end the public expenditure cuts that are necessary and upon which confidence in our policies depends.

I am copying to other members of the Cabinet and to Sir Robert Armstrong.

Yours ever

MICHAEL HESELTINE

Rt Hon W J Biffen MP
Chief Secretary
Treasury

3F

OW

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/16398/80

Your ref:

25 September 1980

Dear Peter

TIMING OF RSG SETTLEMENT

I am afraid that because of an oversight we did not circulate widely copies of our response to the Chancellor's letter of 8 August to my Secretary of State, in which he proposed that Cabinet decisions on the 1981/82 RSG settlement be deferred from 23 October to 30 October.

I enclose a copy of my letter of 21 August to the Chancellor's Private Secretary in the absence of our Ministers on leave. The Secretary of State has subsequently endorsed the views expressed in the second paragraph of that letter.

Copies go to the Private Secretaries to the Prime Minister, other members of the Cabinet, the Minister for Transport and Sir Robert Armstrong.

Yours sincerely

J JACOBS
Private Secretary

P A Shaw Esq

Prime Minister

To note that the Treasury are insisting that the Prior should find offsetting savings for the extra money to be made available to the Dock Labour Board. This will have to be resolved as part of the general public expenditure decisions.

TL

28/9

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon James Prior MP
Secretary of State
Department of Employment
Caxton House
Tothill Street
London SW1

22 September 1980

Dear Jim,

LOANS TO THE NATIONAL DOCK LABOUR BOARD (NDLB)

At the meeting held by the Prime Minister on 16 September it was agreed that your proposals for improving the severance terms for dockers at a cost of about £13 million should be accepted, but no decisions were taken on how this cost should be financed.

You are well aware of the difficult position we face this year on public expenditure and on the PSBR. The contingency reserve is under severe pressure and it is necessary to seek offsetting savings whenever additional expenditure is proposed. In the minute which I sent on 16 September I proposed that the cost of the measures we are taking to avert a dock strike should be met by further deferring the proposed increase in the Redundancy Fund rebate. Deferment until next April should save about £7 million of the £13 million required. I suggested that it might be possible to offset the remaining cost of the loan by reducing the level of compensation offered under the temporary short time working scheme. But you may prefer to make the necessary offsetting savings in other areas.

In your minute of 16 September to the Prime Minister you said that you would be quite unable to meet the costs involved from your existing programmes. Whilst I appreciate your difficulties, we have to face up to the problem of controlling public spending and, in present circumstances, it is imperative to seek offsetting savings for additional expenditure. I can see the attractions of giving some help to industry's cash flow by an early increase in the Redundancy Fund rebate. As far as industry is concerned, however, it stands to benefit much more from our success in

avoiding a dock strike than it would have done from an additional £7 million of redundancy money or additional compensation for short term working. I hope therefore that, bearing these considerations in mind, you will be able to offer the necessary offsetting savings.

I should, perhaps, add that I should also have to seek additional offsetting savings if you were to be presented with a request for further sums for the NDLB to finance any further increase in the level of severance payments. I am sure that you will have conveyed to NAPE the thought that, whilst we will look sympathetically on any request which they may make for a further increase in severance payments, there can be no question of automatic approval because of the public expenditure consequences.

I am copying this letter to the Prime Minister, Keith Joseph, George Younger, Nick Edwards, Norman Fowler and Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

SF

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/16398/80
Your ref:

CONFIDENTIAL

22 August 1980

Dear Martin

TIMING OF RSG SETTLEMENT

The Chancellor wrote to my Secretary of State on 8 August proposing that final Cabinet decisions on the 1981/82 rate support grant settlement be deferred until 30 October.

not enclosed - will request if required

In the absence of both the Secretary of State and Mr King on holiday I enclose "without prejudice" a note by DOE officials commenting on this proposal. You will see that they think a decision to defer would be premature, and could put unnecessarily at risk the completion of the RSG timetable before Christmas. They suggest that if it should prove necessary to defer decisions by a week this decision can be taken in the light of events in October.

We shall, of course, put the Chancellor's letter before the Secretary of State when he returns, and I will let you know his reactions as soon as possible.

Yours sincerely

J JACOBS
Private Secretary

M Hall Esq

Econ Pol

PMG NOTE 70/80

LOCAL AUTHORITY SPENDING

The Secretary of State for the Environment announced on 18 September the Government's conclusions on the revised budgets for current expenditure in 1980-81 which it asked local authorities to submit last June.

The original budgets submitted in April by local authorities in England and Wales showed a "raw" planned excess of 5.6% (£740m) over the Government's own plans. This indicated a final outturn 2-3% above target. The Government could not accept this. It therefore called for revised budgets.

These have been analysed. 444 authorities out of 457 have responded, covering over 99% of expenditure. The new budgets showed overall a reduction of £390m (3%). This still leaves a planned excess of £350m (2.6%).

Conservative authorities have made a much more responsible effort to cut expenditure than authorities under Labour or other control.

	No of authorities	% excess remaining
Conservative	233	1.5%
Labour	115	4.7%
Other	120	4.3%

Local government actual spending has in the past tended to be lower than budget plans. The Government believes there will be some further reductions in the remaining excess. But for two reasons it cannot be sure the excess will disappear:

(i) past budget overspending has been at a time of rising expenditure plans - it may be less easy to underspend when expenditure should fall, as at present;

(ii) the key to expenditure reduction is manpower reduction. Manpower costs make up 70% of current spending. The latest manpower figures are encouraging (about 29,000 or 1.4% in the year June 79 to June 80). But considerable further reductions would be needed in the rest of the financial year 1980-81 for local government generally to get on target.

The Government therefore believes it is still possible local authorities may overspend in 1980-81 by some £200m.

The Government has therefore taken 3 steps. Authorities may still be exempted from (i) and (ii) if they can achieve satisfactory revisions of their budgets before the laying of the Orders in November/December.

(i) The Government is acting specifically against a small number of authorities who have blatantly disregarded the need to reduce expenditure. They will have their rate support grant entitlements removed by between the equivalent of a 1p and a 5p rate, depending on the extent of their overspending, under the "transitional arrangements" provided for in the Local Government Bill. The authorities are:

Camden	Islington
Tower Hamlets	Lambeth
Hackney	Lewisham
Brent	Hammersmith and Fulham
Hounslow	Waltham Forest
Afan	Greenwich
Newcastle	Sheffield

(ii) it is adjusting 1981-82 Urban Programme grant to 3 of the above authorities who have made no effort whatsoever to reduce expenditure. These are the London Boroughs of Hackney, Islington and Lambeth. The Government believes that partnership should mean just that. Urban programme grant will therefore be withheld and made available to more responsible authorities;

(iii) finally, the Government is withholding £200m of additional rate support grant that would otherwise be due to be paid to authorities in the first Increase Order for 1980-81 to be announced in November. The Government appreciates that this makes no distinction between those who have made great efforts to reduce expenditure (especially Conservative authorities) and those who have not. But selective grant powers to distinguish between the prudent and the profligate authorities (except in the limited case of the transition arrangements) will not be available until next year, subject to the successful passage of the block grant provisions of the Local Government Bill.

The Government recognises the criticism of unfairness that will be made by responsible authorities to this across the board reduction in grant. But it was impossible to ignore the risk of overspending. The public expenditure targets are too important for that.

The reductions in grant will not themselves reduce overall levels of public expenditure. Only actual reductions in spending by local authorities will achieve that. But grant reductions will clearly influence levels of local authority expenditure, and help towards achievement of our target.

And the £200m abatement of grant is not irreversible. When the Government has the figures for actual spending in 1980-81 it will be able to judge whether some or all of it could be restored next year when the final grant account for 1980-81 is settled.

Meanwhile, the withholding of grant provides the clearest possible incentive to local government to make the remaining reductions necessary to achieve the expenditure targets.

Moreover to the extent that local authorities cannot get on course in 1980-81 they will find it that much harder to meet the further reduction of 2% in 1981-81 which is a necessary element in the Government's drive to reduce public expenditure.

Paymaster General's Office
Privy Council Office
68 Whitehall
London SW1A 2AT

19 September 1980

2

Prime Minister
This warning that further public expenditure cuts will be needed is was, I think, inevitable.
TL
19/9

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

As I warned the Cabinet this morning, the public expenditure position is worse than we had previously expected. The task of achieving the objective of adhering to the net public expenditure totals for 1981-82 to 1983-84 published in Cmnd 7841, as modified by the European Community Settlement, now looks like being considerably harder than we thought at the time of the Cabinet discussion on 10 July. It was then agreed to consider some re-ordering of priorities in favour of employment and industrial support measures. But we shall only be able to make any move in this direction, within the agreed totals, if we can agree on significantly greater cuts in other programmes than the Chief Secretary proposed in July and is now in the course of discussing in bilaterals.

2. As I explained, part of the deterioration is in the position of the nationalised industries, notably steel. The Chief Secretary has already proposed that this should be matched by cuts of over £400 million in 1981-82 in nationalised industries' investments. But there is also the real risk that reassessment of the economy in the light of recent events will change the economic assumptions in a way which will add to future public expenditure. I want to reserve judgement, and quantification, until next month, but I think we must now work on the presumption that cuts beyond those which were proposed in July will be needed to fulfil the objective then set for the total of public expenditure. These cuts will obviously need to be greater to the extent that we decide to give greater priority to employment and industrial support.

/3.

3. The Chief Secretary will be in touch with the Ministers concerned about these further cuts, and discussing them in the course of his bilateral meetings in the coming weeks, reporting back to Cabinet towards the end of next month. Many will be politically difficult. But our colleagues should be aware of the prospect before we come to consider additional bids.

4. I am sending copies of this minute to other members of Cabinet, the Minister of Transport, and Sir Robert Armstrong.

R. I. Tolhurst (Private Secretary),
on behalf of,

(G.H.)

18 September 1980

CONFIDENTIAL

Econ Pol 2

Prime Minister

To note that the Treasury are asking that the RSG settlement should slip by a week to 28 Nov.

TL

8/8

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

8 August 1980

The Rt. Hon. Michael Heseltine, MP
Secretary of State for the Environment

Dear Michael

TIMING OF RSG SETTLEMENT

I have been giving careful consideration to the complex of decisions we shall have to take in the autumn on public spending and our economic strategy generally. One important piece of the jigsaw will be the decision on 1981-82 RSG - a final view on volume and a decision on the inflation factors to apply there and for all the other cash limits. But there are many other elements to be fitted in starting with monetary and other decisions within the framework of the medium-term financial strategy, flowing through to decisions on the kind of public borrowing figures that may be tolerable for 1981-82 and the implications of this for spending programmes generally.

To come straight to the point, I think it would be a mistake for us to make final decisions on RSG - or indeed any significant component of public spending - before the end of October. We really must leave ourselves adequate time, after our return from the Party Conference, to get 1980 PESC decisions right given that they will be absolutely crucial to the success of our strategy over this Parliament. Certainly the earliest Cabinet meeting to which John Biffen and I could put properly-considered proposals to Cabinet will be 30 October.

I understand that you have been thinking in terms of an announcement of the RSG settlement on 21 November, which given the difficulty of the exemplification exercise this year would imply Cabinet decision on RSG in the third week of October. I therefore write now to say that I think it would be very much in the general interest to postpone a Cabinet decision on RSG to 30 October. I realise that this may well mean slipping the settlement date correspondingly to 28 November, with some risk that the consequent

/compression

CONFIDENTIAL

compression of local authorities' budgeting process will lessen the impact of our RSG decision on their spending plans. But in my view the risks in that are outweighed by the overriding need to allow a sensible timetable for our own crucially important decisions on programmes generally.

I do hope you will be able to confirm that in the circumstances a one week delay will be tolerable.

I am sending copies of this letter to the Prime Minister, other members of Cabinet, the Minister of Transport and Sir Robert Armstrong.

GEOFFREY HOWE

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01 233 8224

CONFIDENTIAL

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

7 August 1980

Dear Chief Secretary

PUBLIC EXPENDITURE: END-YEAR FLEXIBILITY

You kindly sent me a copy of your minute to the Prime Minister on this subject, circulated for information.

I am grateful to you for pointing up my strong support for the proposed scheme and am glad to see that it has your support also. I firmly believe that the present "annuality rule" leads to inefficiencies in public expenditure as it induces Departments to rush to spend at the end of the financial year and penalises those who, in trying to avoid an overspend (especially in the difficult to control capital programmes), end up with an underspend. The proposed scheme will sensibly overcome these problems. I do hope, therefore, that your colleagues will feel able to agree to its introduction this year.

I am copying this to the recipients of your minute.

Yours sincerely

DEREK RAYNER

CONFIDENTIAL

RESTRICTED

From: THE PRIVATE SECRETARY

1

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

5 August 1980

M Alexander Esq
Private Secretary to the
Prime Minister
10 Downing Street
London
SW1

Prime Minister
Content provided the Chief Secretary is?

NIO Cold
PM content
MAP 6/8

TL 5/8

Dear Alexander

As you know, the Prime Minister has recently approved certain adjustments in the 1980-81 Public Expenditure programme for Northern Ireland, including the provision of £48m from the Contingency Reserve.

My Secretary of State wishes to announce this in the House of Commons tomorrow afternoon by way of a written answer. (An appropriate veiled reference to this has been included in the Prime Minister's briefing for her meeting with Northern Ireland Trade Unionists tomorrow morning.) I enclose the text of the answer which he proposes to give.

The substance of this answer is of course completely in line with the substance of the expenditure adjustments which have already been agreed with the Prime Minister and the Chief Secretary. If, therefore, I have not heard by 10am tomorrow (Wednesday) morning from you and the other recipients of this letter, I shall assume that there is no objection to this answer being given.

I am sending copies of this letter to the Private Secretaries to the Chief Secretary, the Secretaries of State for Industry, Scotland and Wales, the Paymaster General and the Chancellor of the Duchy of Lancaster.

George Fergusson

G D FERGUSSON

RESTRICTED

E.R.

Parliamentary Question (Written)

To ask the Secretary of State for Northern Ireland whether his review of Public Expenditure priorities is complete and if he will make a statement.

Answer

Yes Sir. As foreshadowed during the debate on the Appropriation (Northern Ireland) (No 2) Order 1980 on 18 July last, I intend to reallocate some £50m within the Northern Ireland public expenditure programme in the current financial year to take account of changed priorities and new demands. In addition, in the light of the review, the Government has decided to increase the resources available to the programme this year by £48m. These figures are at 1980 Survey Prices. The additional resources are being made available from the Contingency Reserve and are therefore within the overall planned total of public expenditure for the UK set by Cmnd 7841.

Of the £50m reallocated, the main reductions are £24m from Environmental Services and £10m each from Education and from Health and Social Services. This reallocation is equivalent to some 2% of total Northern Ireland resources. There will also be certain technical adjustments and some movement of resources within individual NI Departments.

Thanks to the reallocation and the extra resources, I shall be able to increase the money available for industrial assistance and energy by some £80m. That figure will include the cost in 1980-81 of additional assistance by way of repayable loan to enable the De Lorean DMC 12 project to be brought to market launch. The company has indicated that up to £14m will be needed for this purpose. The £80m also includes the cost of action needed to restrain the increase in electricity tariffs. In addition, I propose to increase the provision for Law, Order and Protective Services by some £10m.

I shall when appropriate be consulting the spending authorities on the action now necessary to re-shape expenditure plans. For cash limited services this will involve the conversion of the figures from

1980 Survey Prices into cash terms. An announcement about Class 15 and NID 1 cash limits will be made before the recess.

It follows that the absolute Moratorium on new commitments which I imposed on 30 June is now lifted. Departments and their spending agencies will be considering urgently to what extent, if any, new commitments can now be undertaken.

The changes will be reflected in Supplementary Estimates which will be presented for the approval of the House in due course.

CONFIDENTIAL

JCW VB

Econ Pol

10 DOWNING STREET

From the Private Secretary

1 August 1980

Dear Alistair,

Northern Ireland: Claim on the Contingency Reserve

The Prime Minister has considered the Chief Secretary's minute of 29 July, and, subject to any objections from colleagues, agrees with his proposals for a claim on the Contingency Reserve by the Northern Ireland Office.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet, the Minister of Transport and to David Wright (Cabinet Office).

Tim Lankester.

A.C. Pirie, Esq.,
Chief Secretary's Office.

VB

CONFIDENTIAL

Copied to
De Lorean file
Ireland: July 80

CONFIDENTIAL

Prime Minister to
Chief Secretary
The ~~Chancellor and~~
Mr Atkins have reached
agreement on a claim
on the Contingency Reserve
(£35m plus a possible £13m).
Agree subject to any
objections from colleagues?

PRIME MINISTER

NORTHERN IRELAND: CLAIM ON THE CONTINGENCY RESERVE

The Secretary of State for Northern Ireland wrote to me on 4 July making a claim on the Contingency Reserve because of particular resource problems he faces this year (I enclose a copy of his letter). Following detailed examination of the claim between our respective officials, I have discussed the position with Humphrey Atkins and this minute reports the outcome.

2. In his letter, the Secretary of State said that the difficulties arose mainly on the industrial development front and he quantified them "as of the order of £50 million". In fact, further consideration has revealed the gap between requirements and resources to be nearer £60 million. This of course represents a major claim and, as you know, the position on the Reserve this year is very tight and causes me considerable concern. In these circumstances it is essential that we take a rigorous approach to any proposal that involves additional expenditure on programmes.

3. The problem facing the Secretary of State before he put forward his claim involved sums considerably larger than the £60 million. But the bid has been held to that figure by some difficult decisions involving the elimination of demands totalling about £85 million and the reallocation of sums totalling about £50 million. By doing this he has gone a long way to close the gap foreseen this year between the resources available to him and the demands likely to be made on them. I am

CONFIDENTIAL

satisfied that there is no scope for the Secretary of State to make further major reductions but he has agreed to find a further £6 million.

4. In the light of our discussion, I am prepared to make available £35 million from the Reserve. This does not include finance for the De Lorean car project, which I deal with below.

5. The Secretary of State's claim includes additional finance of £19 million for the De Lorean car project which involves the creation of up to 2000 new jobs in West Belfast. The case for providing additional finance has been put to E(EA) Committee and I have agreed that this should depend on their decision. If the Committee decides that further funds should be made available to the project on merits, I have agreed with the Secretary of State that a further £13 million should be allowed this year as a separate claim on the Contingency Reserve.

6. Unless you or any of our colleagues wish the matter to be discussed in Cabinet, the Secretary of State would like to announce the addition to his programme and the necessary reallocations in the House before the Recess. In the announcement, the terms of which would be agreed in the usual way, he would say that he was receiving an addition to his allocation from the Reserve, in order to make it clear that this did not represent an increase in the overall total of public expenditure.

7. I take this opportunity to mention that any additional expenditure on the fishing industries in the UK will also be a charge on the Contingency Reserve. We are to discuss this in E Committee shortly.

8. I am copying this minute to other members of Cabinet, the Minister of Transport, and to Sir Robert Armstrong.

W J B

JOHN BIFFEN
29 July 1980

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

B

The Rt Hon John Biffen MP
Chief Secretary to Treasury
HM Treasury
Parliament Street
London SW1

4 July 1980

Dear John,

As you will have heard from your officials, problems are arising on the public expenditure front in Northern Ireland. This is mainly because additional funds are required to support much needed industrial investment, as cases resulting from the inward investment drive over the past couple of years move along the pipeline. This is essentially demand-determined expenditure which cannot be tightly controlled.

I have been over the ground in detail with my Ministerial colleagues and my officials in the light of developments since we settled the public expenditure levels for 1980-81 in Comnd 7841. I have sought to exploit to the absolute maximum the scope for meeting requirements, by reallocating £50.5m from within my existing resources. However, even after doing this and paring to the bone all claims on my resources I am still left with a gap of the order of £50m which I see no prospect of closing from the means at my disposal.

The rigorous action of excision and reallocation in which I have engaged carries with it very serious difficulties for us here in NI. It will involve us in virtually eliminating new capital starts for the remainder of the financial year, eroding standards in the classroom, departing from the commitment to maintain planned expenditure in the health service, substantially reducing our support for the agricultural industry, and could cost us something of the order of 5,000 jobs in the face of what is the worst unemployment problem of any region in the United Kingdom.

2/Contd...

Clearly this cannot be achieved without a very substantial public reaction which will not be helpful to my efforts to obtain movement on the political front. To go further would in my judgement be disastrous in political, social and economic terms. I am therefore asking my officials to pursue with yours a claim against the Contingency Reserve to permit expenditure to take place at the level which I regard as essential.

I thought I should warn you personally of this development. You will obviously want to consider the matter fully and carefully. In doing that, I know you will understand that the sooner decisions can be finally taken the better, since every week which goes by erodes our freedom of manoeuvre for reallocation. Moreover, before I undertake action on reallocation, I want to be sure that my overall approach has been agreed. I believe it is much better presentationally that I should make a single announcement which explains the position fully and puts the individual decisions in context than have a trickle of individual items, with the result that the negative aspects receive prominence and the positive are discounted or go entirely by default. Meanwhile, of course, the spending departments have been instructed not to enter into any new commitments in respect of capital or current expenditure which would restrict their ability to adjust their budgets and I have put out a holding statement in general terms explaining that a temporary standstill has been imposed until revised budgets are determined.

Yours ever

Humphrey

25 July 1980

Policy Unit

Original returned to J Hoskyns

PRIME MINISTER

IS PUBLIC EXPENDITURE SELF-INDEXING?

I attach a copy of a letter to Geoffrey, together with a paper we have prepared on this subject. This is only for information, as I understand that you have yourself suspected that there is a dangerously large amount of self-indexation in public expenditure.

It is not necessary to read the paper, which is inevitably long and rather detailed.

JOHN HOSKYNS

10 DOWNING STREET

25 July 1980

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

Dear Geoffrey,

IS PUBLIC EXPENDITURE SELF-INDEXING?
- And does it matter if it is?

You will remember that we referred, in the table of contents for the "Long Campaign" paper (now in the process of serialisation, as agreed!) to the "auto-indexing muddle". We have done some more thinking about this and have the suspicion - I wouldn't put it stronger than that - that public expenditure is effectively self-indexing to such an extent as to threaten quite seriously the achievement of the financial strategy.

Accordingly, we have tried to set down our thinking in the attached paper. I would stress that we don't pretend to know the answer to the questions posed by the paper; we are really not qualified to do that. The paper therefore simply raises the underlying questions and tries to explain why we are worried about them. If we are sounding a false alarm, then there is no harm done. If there is anything in what we say, then, with so much at stake, the problem needs further thought by those properly qualified to tackle it.

Indexation, whether as a policy or as a phenomenon, is a very elusive subject as we found working in Sir Douglas Wass' small group last winter. I think most of us got fairly confused at various stages during that exercise. It is this elusiveness which makes it such treacherous ground; hence our concern and hence the paper.

I am copying this letter, and the paper, to the Prime Minister, Keith Joseph, and also to Robin Ibbs.

Yours ever

John

JOHN HOSKYNS

CONFIDENTIAL

CONFIDENTIAL

21 July 1980
Policy Unit

IS PUBLIC EXPENDITURE SELF-INDEXING?
- And does it matter if it is?

1. INTRODUCTION

1.1 In earlier papers on public sector pay, we have emphasised the danger that the process of Transition from high to low inflation could end with further resources transferred from the private sector to the public, rather than vice versa.

1.2 We have a nagging suspicion that public expenditure may be to a large extent self-indexing so that, even if inflation is brought down, this switch of resources is extremely likely. A natural response to this suggestion may be to say that, given the will to set the right cash limits and stick to them, there cannot be a problem. But self-indexing could still take place despite the system of cash limits because:

(1) Only about two-thirds of all expenditure is cash-limited.

(2) Cash limits could in the event be set to accommodate full indexation in order to avoid the embarrassment of (3) below.

(3) Powerful economic and institutional forces could ensure that cash limits are exceeded (eg B.Telecoms).

2. ARE WE THINKING STRAIGHT ON PUBLIC EXPENDITURE DURING TRANSITION FROM HIGH TO LOW INFLATION?

2.1 It is Transition which makes self-indexation a potential problem

2.1.1 As we have stressed in earlier papers, Transition is different from Stable State. It poses distinctive problems, calling for different solutions, because it requires deceleration in the nominal increase of public expenditure as well as real cuts. With the present balance of the economy, we would still need to cut public expenditure and reduce the PSBR as a percentage of GDP, even if we had zero inflation. (Of course, there are, in the real world,

all sorts of aggravating causal links between high public expenditure, high PSBR and the rate of inflation. But they should not be allowed to obscure the crucial systemic difference between Transition and Stable State.)

2.1.2 If public expenditure lags in accommodating to the MTFS, while the private sector leads, then the private sector will be damaged in several ways:

- Higher PSBR with both interest rates and exchange rate higher; <u>or</u> PSBR on target, but higher taxes.

- Higher nationalised industry prices.

- Cuts in public sector capital spending.

- Public sector pay knock-on encouraging private sector to damage itself further with high settlements.

2.1.3 This passing of the bill from the public to the private sector deepens the private sector recession, so that a larger bill for unemployment is passed back to increase public expenditure and reduce revenues still further.

2.1.4 We have heard it argued that no problem arises, provided the PSBR target is met; and that buoyant tax revenues will ensure that this is the case. We may have misunderstood this argument, but it seems to us that, if our fears are correct, the public sector <u>will</u> lag behind the private in adjusting to the MTFS. One of two things can then happen: either the private sector is damaged, via the PSBR, by recession (as described in Section 2.1.2 above) because the monetary contraction prevents the hoped-for buoyancy; or the buoyancy is provided by monetary accommodation - so that in effect both sides of the PSBR equation are multiplied by some higher GDP deflator. In other words, the struggle against inflation is relaxed

2.2 <u>Are we clear who should bear the burden of monetary deceleration?</u>

2.2.1 The Government urges people to settle for pay increases which are well below the current inflation rate because, if they do not, transitional unemployment will be unnecessarily high. The

Government has accepted in principle that it must practise what it preaches as regards the Civil Service. But it is worth remembering that, only a few weeks ago, the Chancellor had to push hard to get this principle accepted. Although we have now established the right principle for the Civil Service, can we make it stick throughout the public services, with their 11-month pay round?

2.2.2 There is still an implicit suggestion in some of the public expenditure papers that inflation is something beyond Government's control, something which (even though it is caused by Governments) simply "happens" to the Government (just as it happens to, say, a medium-sized engineering company) making the fulfilment of its programmes unnecessarily difficult. It is a short step from that assumption to the further assumption that Government should therefore be free to adjust its own nominal spending to take account of inflation. Government is the only party to the whole economic process which can lead the way, by cutting its own spending and thus reducing the money supply without forcing the private sector into the vicious circle of high interest rates serviced by indexed revenues*. And yet it treats itself as the one party which can effectively escape from the effects of the inflation it has helped to cause. In doing so, it either perpetuates the inflation or increases the damage of Transition.

2.2.3 All this is obvious enough, and the simple answer is that we must cut public spending. But we need to dig a little deeper. About £34bn of the total public expenditure of £98bn (1980/81 cash) is formally indexed (transfer payments and defence) and there are other less firm commitments to index other large parts of public expenditure. What will be the result of this in the eventual pattern of public expenditure, as planned in the White Paper, at present expressed in constant prices? Will that pattern itself affect the chances of achieving the PSBR target? By how much more must we reduce the pay outturn for the public services in order to compensate?

2.3 Even if we are clear that "public expenditure must bear its share", what does that really mean?

2.3.1 What are the effects of selective indexation? The Public Expenditure White Paper shows all categories of expenditure in constant

* and secured on indexed debtors, to meet indexed pay awards!

prices. Does the real eventual distribution reflect any advantage in being indexed rather than un-indexed? How do the White Paper plans, expressed in constant prices, reflect the difference in outcome between public services pay settling at, say, 9%, and transfer payments being indexed on a forward-looking basis at, say, 16% for this year and with similar differentials for following years? (This raises further questions addressed in Section 3.1 and 3.3 below.)

2.3.2 What is to be learnt from past experience? Social security was effectively indexed on an ad hoc basis from the early Seventies until about 1975, and thereafter formally indexed. During that period, total social security expenditure rose significantly as a percentage of public expenditure. Is there a connection between the indexation and the increase? Did indexed transfer payments lead the way during the acceleration of inflation, just as we fear that it may trail behind during deceleration? Do we expect this to happen again over the period of the MTFS? Are the figures in constant prices adjusted to show that? (See also 3.1.1 below.)

2.3.3 If we believe that the MTFS will reduce inflation to negligible proportions, should there really be any fully-indexed exceptions to the rule? Should not everything within Government's control be de-indexed (or, to be precise, consistently and partially indexed) in line with our exhortations to the private sector and in line with the monetary deceleration to which the whole of the economy must in the end accommodate? After all, when we have no inflation, everyone enjoys a stable pound; there are no exceptions then. If we mean to end inflation, should we be so worried about protection of particular groups, as if inflation is going to continue for ever? Why, at this point of all points, are we about to commit ourselves to full indexation of child benefit, rather than a deliberate ad hoc increase if that is called for, followed by a partial indexation in line with MTFS and the monetary targets? Our thinking does seem confused. Either we wish to increase transfer payments by deliberately indexing them fully during Transition; or we are tacitly assuming that the rest of public expenditure, in aggregate, will in the event index itself fully in the same way - in which case, the whole question of the resulting damage to the private sector rears its ugly head.

.3.4 Is indexation (both as policy and as phenomenon) confusing our thinking about public expenditure cuts? Are we cutting in order to get the real cuts called for in the White Paper? Or to get the monetary deceleration called for by the MTFS? Are we cutting to get the desired switch of resources from the public to the private sector, or to avoid the perverse switch in the other direction caused by the sheer momentum of self-indexing behaviour within the system? The underlying problem is obvious the moment you bring together the White Paper and the PESC Report. For example, in 1981/2, our total expenditure is expected to be £73bn, instead of £74½bn in the current year (1979 survey prices) - a fall of 2%. But the GDP deflator and RPI are expected to rise by 12.1%, and 10% respectively, during the same period (Annexes H and M of 1980 PESC). Is it possible to do PESC in cash terms, even if this forces early disclosure of cash limits?

2.4 Where do we go next?

2.4.1 The questions asked so far either have simple answers which show that there is no real problem, or else they lift the veil off a deeper problem and expose further underlying questions. On the assumption that it is the latter, the next section looks at some of those underlying questions.

3. UNDERLYING QUESTIONS WE NEED TO ASK

3.1 How different are the processes of inflationary acceleration and deceleration?

3.1.1 Can self-indexing public expenditure be a problem when inflation is accelerating? Will it tend to make the acceleration faster? Perhaps it makes no difference because, by definition, inflation means that all prices, all pay, all expenditures, are rising in money terms and public expenditure is no different from anything else. In that situation, the social reason for ad hoc indexing is understandable, even though it may end up by helping to perpetuate the very process which made it necessary. Perhaps the problem only emerges when one faces deceleration, the Transition downwards, as we are now doing. If we look at social security spending as a percentage of total public expenditure, over the period of the Healey deceleration, we see that it rose from 21.1% in 1975/6 to

25.3% in 1978/9. Was this the result of indexation, or rising unemployment, or deliberate changes in programme volumes? In the Public Expenditure White Paper, the proportion is expected to rise from 26% in 1980/81 to 27.5% in 1983/84. Again, is this the result of the indexation process, or a planned increase in volume? Or both?

3.1.2 What is the effect of inflation coming down quicker or slower than anticipated in PESC? What is the relationship between the GDP Deflator/RPI paths in PESC and the monetary targets in MTFS? If faster, does that increase the squeeze on the private sector, or does the nominal increase in public expenditure simply grow more slowly, so that the effect as between the two sectors is neutral? If slower, does that ease the squeeze on the private sector (although obviously at great inflation cost in other ways) or does the public sector simply absorb the extra money in the system by indexing its own expenditures?

3.1.3 We should, however, be clear that even if inflation comes down in line with the MTFS, public expenditure could still trail the deceleration process, with greater consequent damage (through the processes described at Section 2.1.2).

3.1.4 Is it possible to calculate the impact of inflation falling by, say, 3 percentage points less each year than was assumed? Is it possible to work out the effect of zero average growth over the next three years? Just so that we know what we might be up against.

3.2 Dealing with the different bits and pieces

3.2.1 Once we are clear about the processes at work, then we can decide how to deal with the different parts of public expenditure.

3.2.2 Fully-indexed expenditure. This includes most transfer payments, defence spending, possibly health spending, police pay, and armed forces pay. How far are these indexed on a forward-looking basis? Does the relationship between the monetary targets, cash limits and inflation rate, make this a satisfactory basis? Is it indeed a self-fulfilling prophesy? What happens with such indexed expenditures if the inflation rate falls more, or less, slowly than

expected? Would a partial and backward-looking basis be better? Or even partial and backward-looking or forward-looking, whichever is the smaller? (This should not present any political problems, once people realise that the indexation process is part of the Transition to a stable currency, not a device for living with perpetual inflation, which is the way many people at present see it.)

3.2.3 Pay which is negotiated and "de-compared". In the light of this discussion, what sort of outturn are we aiming for? Do we really know what we're up against in trying to achieve such an outturn on a case-by-case "do the best you can" basis with dozens of different groups negotiating in a virtually unending succession over the 12-month period? What percentage is compatible with the MTFS after we have satisfied those parts of public expenditure which are formally or effectively indexed, or better-than-indexed? (This question was examined more fully in our paper of 18 July on "Public Sector Pay".)

3.2.4 The remainder. How far can we go in de-indexing other current expenditures? What is the effect of a defence budget which is fully-indexed and then increased in real terms by 3%? How far should we resist the easy solution of further cuts in the public sector's capital spending? Has any work been done to estimate the long-term costs - political and economic - from such cuts? How do we prevent monopoly, trade union-controlled nationalised industries - Coal, Gas, Rail, Post Office, Electricity - from acting like a home-grown (but at least recycled) mini-OPEC exacting special levies by way of prices, increased subsidies, broken EFLs and reduced investment leading to lower future value for money?

4. CONCLUSION

4.1 This paper suggests that the very way in which we are conditioned to think about public expenditure may contain some dangerous optical illusions. In particular, we may not yet appreciate just how large the cuts in public service pay will have to be. Our fear is that it will not be possible to get a pay outturn which is sufficiently low, and, because it is difficult to shed manpower

in the way that the private sector would have to do in such circumstances, the cash limits will be simply broken or expanded. The probability is therefore that the public sector will help itself to a greater proportion of the available cash in the system, passing the consequences, as already described, to the private sector.

4.2 All the thinking at present, from the original reluctance in some quarters to publish an MTFS at all, through to the present reluctance to publish early cash limits, suggests an implicit assumption that what must be endured by the private sector simply can't be endured by the public. Achieving the MTFS demands an approach to the public expenditure arithmetic which displays absolute commitment to results.

4.3 If we are roughly right in the foregoing analysis, perhaps we should consider turning the present process upside down: doing all the forecasting in cash terms, based on forecast inflation; forecasting cash limits, in exactly the same way as the MTFS; adjusting cash limits downwards only, if inflation turns out to be lower; but not upwards if inflation turns out to be higher.

FMP

10 DOWNING STREET

From the Private Secretary

23 July 1980

CASH LIMITS 1979-80

The Prime Minister has now had an opportunity to consider the Lord Advocate's minute of 11 July, and the Chief Secretary's recent minute commenting on it.

The Prime Minister has noted the circumstances which gave rise to the overspend of £160,000 on the Lord Advocate's cash limit for 1979-80, and that he has agreed to provide a token reduction of £25,000 in this year's cash limit by way of offset. She agrees with the Chief Secretary that it is essential to avoid undermining the principle of compensating for excess expenditure against cash limits, and that he should pursue the possibility of finding the remaining £135,000 with the Secretary of State for Scotland.

I am sending copies of this letter to Godfrey Robson (Scottish Office) and Alastair Pirie (Chief Secretary's Office).

T. P. LANKESTER

Miss M.K. Howat, M.B.E.,
Lord Advocate's Department.

GB

✓MAP

HOUSE OF COMMONS

Fifth Report from the

TREASURY AND CIVIL SERVICE COMMITTEE

1979-80

PROVISION FOR CIVIL SERVICE PAY INCREASES IN THE 1980-81 ESTIMATES

Together with the Proceedings of the Committee.

Ordered by the House of Commons to be printed 22nd July 1980

730

The Treasury and Civil Service Committee is appointed under S.O. No. 86A to examine the expenditure, administration and policy of the Treasury, the Civil Service Department, the Board of Inland Revenue, and the Board of Customs and Excise and associated public bodies, and similar matters within the responsibilities of the Secretary of State for Northern Ireland.

The Committee consists of a maximum of eleven members, of whom the quorum is three. Unless the House otherwise orders, all Members nominated to the Committee continue to be members of the Committee for the remainder of the Parliament.

The Committee has power:

(a) to send for persons, papers and records, to sit notwithstanding any adjournment of the House, to adjourn from place to place, and to report from time to time;

(b) to appoint persons with technical knowledge either to supply information which is not readily available or to elucidate matters of complexity within the Committee's order of reference.

The Committee has power to appoint one sub-committee and to report from time to time the minutes of evidence taken before it. The sub-committee has power to send for persons, papers and records, to sit notwithstanding any adjournment of the House, and to adjourn from place to place. It has a quorum of three.

MONDAY 26TH *NOVEMBER* 1979

The following were nominated as members of the Treasury and Civil Service Committee:

Mr Kenneth Baker
Mr Anthony Beaumont-Dark
Dr Jeremy Bray
Mr Edward du Cann
Mr Timothy Eggar
Mr Michael English
Mr Terence Higgins
Mr Robert Sheldon
Mr Richard Shepherd
Mr Richard Wainwright
Mr Ken Woolmer

Mr Edward du Cann was elected Chairman on 29 November 1979.

The Treasury and Civil Service Committee have agreed to the following report:

Provision for Civil Service Pay Increases in the 1980/81 Supply Estimates

1. In its First Report[1] the Treasury and Civil Service Committee expressed the view that the Government's proposals for the Civil Service Estimates did not provide a sufficiently effective means of Parliamentary control over increases in pay. Events since the publication of that report reinforce the Committee's view. The situation now causes concern.

2. The Committee therefore draws attention to four particular problems and makes various recommendations to help solve them:

a) The present splitting of provision for increases in civil service pay between the main departmental Estimates and the so-called "global" Estimate for pay increases causes confusion and obscure the true position.

b) The costs of high percentage increases in civil service pay are said by the Government to have been kept within the cash limits by either staging the award between years or by delaying the date in the year of award from which the increases are paid. These are dangerous devices for reasons explained below.

c) The cost of high percentage increases in civil service pay are also said to have been kept within considerably lower cash limits on pay because of reduction in numbers. When the Government is committed to reducing the size of the civil service anyway there is an obvious danger of double counting.

d) The present procedural arrangements for debating the Estimates on the floor of the House of Commons, including controversial Estimates such as those covering civil service pay which Members are now being asked to approve, are completely inadequate.

We now consider each of these four points in more detail:

a) Splitting provision between two Estimates

3. This year, provision for increases in civil service pay was in two parts. First, the main departmental Estimates covered those increases that had been agreed by the time the Estimates were prepared in February. Secondly a new "global" Estimate provided for further increases, the detailed distribution of which was to be determined following the annual pay negotiations. The Government has not yet decided whether to continue these arrangements next year but the confusion that is inherent in having two sets of Estimates for the same expenditure is exacerbated by the fact that increases in the total pay bill include both increases promised, or partially implemented, in previous years, and increases which flow from this year's pay negotiations.

1 Provision for Civil Service Pay Increases in the 1980-81 Estimates, HC (1979-80)371

4. In our First Report we made specific criticism of the Government's proposals and made it clear we did not regard them as an adequate procedure for future years. There are problems related to the timing of the pay negotiations and the timing of Parliamentary presentation and consideration of the Estimates. It is still for consideration whether having all pay increases included in the departmental Estimates or all of them in a single 'global' Estimate which is subsequently divided between departments is preferable. Later this year we intend investigating the present unsatisfactory form of the Estimates. This Estimate for civil service pay increases is an illustration of the unsatisfactory form in which the Estimates are currently presented to Parliament. Splitting the pay increases in any one year between the departmental Estimates and the 'global' Estimate obscures the true position and thus undermines effective control.

b) Staging and delaying of awards

5. The full extent of the danger of staging awards did not become evident until we took evidence from the Chancellor of the Exchequer.[1] It then emerged clearly that, while the 'global' pay increase Estimate was 14% the actual increase in central government pay this year was expected to be 25%.[2]

6.. We were told that this was due to a substantial extent to "Clegg-type" staged increases. But this is not the whole story. At present it is possible for any pay increase to be negotiated within the year's cash limit with (or by) a promise of a further staged increase the following year and even the year after. The following year the cost of this commitment appears in the departmental Estimate not in the 'global' Estimate covering increases following from that year's pay negotiations.

7. We have also been told that substantial increases in civil service pay have been brought within the 1980-81 cash limits by delaying the date from which the increases were to be paid. This is a most dangerous device. Like staging from year to year it has particular implications for the control of government expenditure in the subsequent year since it raises the base for future pay negotiations. To take a simple example, the situation next year is very different if an individual group is given an increase of 14% this year paid from the due date as against say a 500% increase (on an annualised basis well within the cash limit for 1980-81) on the last day of the pay year.

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1 Second Report (1979-80) HC 584
2 See footnote to table in paragraph 10

8. This places further obstacles in the way of effective Parliamentary control and enables the government of the day to buy peace in the immediate future at the cost of creating greater problems later on. We therefore recommend that the Treasury should immediately examine ways in which this major loop hole can best be closed. As a first step the Government should avoid any further staged pay settlements in the public service sector. Cash limits must be both realistic and effective. At the time they were introduced it was not possible to foresee all eventualities and in fact they have no effect in controlling the succeeding year's Estimates. A more sophisticated system is needed for the future.

(c) Civil Service Pay Increases and Numbers

(i) Reduction in Numbers

9. In our First Report we recognised that the proposed 'global' pay increase estimate gave the Treasury and the Civil Service Department too much scope for making adjustments in cash limits between individual departments after the results of the central pay negotiations were known and we therefore asked for detailed departmental allocations to be published with the Estimates showing the extent of pay increases broken down by main categories. We have now been given some but not all of this information. In particular, the extent of offsetting staff reductions in each department has not been given in the Revised Estimates or elsewhere. We cannot therefore judge how far cash limits have resulted in staff cuts in any one Departments. This illustrates the need for this and for the other Estimates to show changes both in price and volume terms, another point we are now considering in relation to the form of the Estimates.

10. Moreover, the estimates now presented to the House of Commons give no idea what the actual increases in pay are for particular groups. We have been given some information we think it right to bring to the attention of the House.

Group	Approx.Staff Numbers	Average increase of rates of pay in 1980-81 over final stage of 1979-80 pay award[1]
Administration Group (up to and including Principal) and consequentials	365,000	18.3%
Professional and Technology Group and consequentials (amounts determined by the Government)	54,000	18.4%
Inland Revenue Tax and Valuation Grades	49,000	18.0%
Secretaries and Typists	27,000	20.1%
Messengers and Paper-Keepers	11,000	20.9%
Data Processing Grades	9,000	20.5%

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1 The overall average level of increase, based on pay research, was 18.75% for non-industrials. This was held within the cash limit of 14% as follows:

Average increase in pay rates :	18.75%
Reduced by delay in payment of award to 7 May 1980 to :	17.00%
Cost further reduced by man-power squeeze, including effect of employer's national insurance contribution, not being a fixed proportion of pay, to :	14.00%

The impact for the first time for a full year of the staged increases in civil service pay awarded in 1979-80, together with comparable rises in other parts of the Central Government sector, took the rise in the total pay bill for Central Government to 25%, the figure quoted in paragraph 5 above.

ii) Double Counting

11.There is the further danger of double counting during the present period when large scale reductions in civil service manpower are being made in any case and hence it must be doubtful whether credit ought to be taken for any particular cuts to justify any given pay settlement. Looked at another way the reduction in the size of the civil service made by the Government does not mean that the consequent saving in civil service pay should then be given to the remaining civil servants. In normal times it may be right that cuts in numbers should provide the offset to high pay, but in present circumstances we do not believe it is legitimate to claim that increases in pay will be within cash limits because numbers have been reduced.

d) Procedure

i) Debate on the 1980-81 Revised Estimate for Civil Service Increase in Remuneration

12.At present there is no effective Parliamentary procedure whereby backbench Members of the House of Commons (including Select Committees) can ensure a debate on controversial Estimates. Yet the matter is of vital importance for the whole of government economic policy. Public service pay is equivalent to some 50% of the expenditure covered by cash limits. If it is not effectively controlled the PSBR and control of the money supply and of inflation are jeopardized. We recommend that the government should, with the appropriate replacement of Opposition time, ensure the House of Commons has an opportunity to debate the Civil Service Pay Estimates on an appropriate supply day.

ii) Debate on Estimates generally

13.At present it is possible for a backbench Member to table a Notice of Objection to ensure a separate vote on a given Class of Estimates[1] but this will not enable the Member to get a debate on the Estimate to which he objects although he can draw attention to it in his Notice of Objection. The Estimates are usually taken 'on the nod' without any debate at all because they nearly always come under a guillotine[2] or a motion requiring the votes upon them to be taken immediately. Where individual Estimates are put down they are usually used as a vehicle for the Opposition to debate the general policies of the Department concerned rather than to scrutinise the actual amount of money involved[3]. A motion by a Member concerning an Estimate will not be debated unless the Estimate is put down for consideration by the Government at the request of the Opposition - a very rare occurrence.

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1 Standing Order 10(10)
2 Standing Order 10(11)
3 For example, 3 August 1976; 2 May 1977

14. Since a Procedure Committee, although promised, has still not been established in this Session of Parliament and the general question of Estimates is our concern we believe it right that this Committee should meanwhile make a recommendation. In addition to our specific recommendations that the present pay increase Estimate should be debated we therefore recommend that in future the House should, again without prejudice to the Opposition's entitlement to Supply Days, always have adequate opportunity to debate the Estimates as a whole. If, as has been the case, Defence Estimates can be debated, Civil Estimates should also be debated.

PROCEEDINGS OF THE COMMITTEE RELATING TO THE CONSIDERATION OF THE REPORT

TUESDAY 22nd JULY 1980

Members present:

Mr. Edward du Cann, in the Chair

Mr. Kenneth Baker
Dr. Jeremy Bray
Mr. Michael English
Mr. Robert Sheldon
Mr. Richard Shepherd
Mr. Richard Wainwright

Draft Report, proposed by the Chairman, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 8 read and agreed to.

Paragraphs 9,10 and 11 read, amended, and agreed to.

Paragraphs 12 and 14 read and agreed to.

Ordered, That this be the Fifth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

THIS SHOULD READ 10% TO BE ON TARGET FOR 620,000

Department	1 4 79	1 4 80	Net savings/growth under current plans (as from 1 4 80) -	%	+	%	New savings proposed	as % of S I P 1 4 80	%	TOTALS since 1.4.80	(+) = more to come.
Defence (incl ROFs)	247,660	239,780	12,800	5.3			17,200	7.2		12.5	
FCO & ODA	12,078	11,564	278	2.4			400	3.5		5.9	
Agriculture	13,956	13,758	604	4.4			150	1.1		5.5	
Industry	9,514	9,143	1,223	13.4			330	3.6		17.0	
Energy	1,267	1,263	103	8.2			Under Review	-		8.2 (+)	
Trade/ECGD/OFT	7,308	7,198	238	3.3			560	5.9		9.2	
Employment	23,300	20,689			4,952	(+24.0)	1,650	8.0		(+16.0)	
MSC	25,332	25,142	3,001	11.9			Under Review	-		11.9 (+)	
Transport	13,908	13,633	2,205	16.2			Under Review	-		16.2 (+)	
Environment	12,358	11,654	935	8.0			3,850	8.1		16.1	
PSA	40,095	36,626	2,951								
Home Office	33,490	34,095			1,723	(+5.1)	140	0.4		(+4.7)	
LCD	10,211	10,011			590	(+5.9)	350	3.5		(+2.4)	
Land Registry	5,531	5,898	143	2.4			100	1.2		3.6	
DHSS	98,369	96,209			3,933	(+4.1)	8,700	9.1		5.0	
Chancellor's departments	126,869	118,568	4,074	3.4			7,000	6.0		9.4	
DES	3,749	2,596	177	6.8			100	3.9		10.7	
OAL		1,150	21	1.8			NIL	NIL		1.8	
CSD	5,043	5,083	299	5.9			260	8.0 excl.CISCO		11.0	
COI	1,182	1,210	106	8.8			88	7.5		16.3	
HMSO	6,689	6,236	371	5.9			469	7.5		13.4	
Scottish Office	11,119	10,950	700	6.4			Under Review	-		6.4 (+)	
Welsh Office	2,607	2,481	163	6.6			30	1.1		7.7 (+)	
Northern Ireland Office	216	220	3	1.3			17	7.7		9.0	
Paymaster General	873	924	-	0.0			35	3.8		3.8	
Other	20,000	19,000	700		500		200				
GRAND TOTAL	732,000	705,000		-20,000			40,000 (approx)	5.9		8.8	

THIS SHOULD READ 10% TO BE ON TARGET FOR 620,000.

(+) = more to come in 1.4.80

	1 4 79	1 4 80	Net savings/growth under current plans (as from 1 4 80) -		+	New savings proposed	as % of S I P 1 4 80	To
cl ROFs) 24 12/36.	247,660	239,780	12,800	5.3		17,200	7.2	12.5
	12,078	11,564	278	2.4		400	3.5	5.9
	13,956	13,758	604	4.4		150	1.1	5.5
	9,514	9,143	1,223	13.4		330	3.6	17.0
	1,267	1,263	103	8.2		Under Review	-	8.2 (+)
DFT	7,308	7,198	238	3.3		560	5.9	9.2
	23,300	20,689			4,952 (+24.0)	1,650	8.0	(+16.0)
	25,332	25,142	3,001	11.9		Under Review	-	11.9 (+)
	13,908	13,633	2,205	16.2		Under Review	-	16.2 (+)
	12,358	11,654	935	8.0		3,850	8.1	16.1
	40,095	36,626	2,951					(+ 4.7)
	33,490	34,095			1,723 (+5.1)	140	0.4	(+ 24)
	10,211	10,011			590 (+5.9)	350	3.5	
ry	5,531	5,898	143	2.4		100	1.2	3.6
13 6/19.	98,369	96,209			3,933 (+4.1)	8,700	9.1	5.0
s departments	126,869	118,568	4,074	3.4		7,000	6.0	9.4
	3,749	2,596	177	6.8		100	3.9	10.7
		1,150	21	1.8		NIL	NIL	1.8
	5,043	5,083	299	5.9		260	8.0 excl.CISCO	11.0
	1,182	1,210	106	8.8		88	7.5	16.3
	6,689	6,236	371	5.9		469	7.5	13.4
fice	11,119	10,950	700	6.4		Under Review	-	6.4 (+)
e	2,607	2,481	163	6.6		30	1.1	7.7 (+)
Land Office	216	220	3	1.3		17	7.7	9.0
eneral	873	924	-	0.0		35	3.8	3.8
	20,000	19,000	700		500	200		
	732,000	705,000		-20,000		40,000 (approx)	5.9	8.8

Ref. A02704

PRIME MINISTER

Public Expenditure 1981-82: Local Authorities

(C(80) 44 and 45)

BACKGROUND

The Chief Secretary, Treasury recommends in C(80) 44 that the Government should announce before the Recess that the provision for the total of local authority current expenditure in 1981-82, in England and Wales and in Scotland, should be 2 per cent below the Government's planned total for 1980-81. This reduction is in line with the assumption in the last Public Expenditure White Paper, Cmnd 7841. It is necessary to announce the total now in order to influence the local authorities in the planning of their budgets over the next few weeks.

2. Although the local authorities themselves decide on the allocation of this total among the various services, the Government has to form its own view of the service totals preparatory to more detailed work on the Rate Support Grant and, in due course, for publication. The Chief Secretary's proposals for the service totals for England and Wales are listed in column 4 of his Annex 1 (not Annex 2 as his paper says). They give rise to the two problems described in paragraph 7 of his paper.

3. First, it currently looks as though the provision for local environmental services in England could be overspent by about £80 million in 1981-82. The Chief Secretary's table makes no allowance for this possibility. It may well be that the local authorities can be persuaded to come back into line, and this would turn in part on the current discussions of their 1980-81 expenditure. If there is still a prospect in September of overspending on this service, it will be necessary to choose between further cuts on other local authority services - very difficult, as the Chief Secretary points out - or to look for savings elsewhere in the Secretary of State for the Environment's programme. For the moment no decisions are necessary.

4. Secondly, there is a major dispute over the education programme. The Chief Secretary is seeking additional savings of £87 million gross on the total of Department of Education programmes. £37 million of this is to cover the loss of savings on school transport, leaving a net reduction of £50 million. The most the Secretary of State for Education will offer is £20 to £25 million, mainly from provision for polytechnics and universities and from local authority capital expenditure. The dispute is over the difference of £62 million which the Chief Secretary argues should be found from economies in schools which would reduce local authority current expenditure. If this saving were not made the total reduction on local authority current expenditure in 1981-82, by comparison with 1980-81, would be only 1.6 per cent. It would then be necessary to look for savings from other local authority services in order to reach the target of 2 per cent.

5. The Secretary of State for Education puts his case in C(80) 45. He argues that if the cuts were made it would be impossible for the Government to honour the commitment in The Queen's Speech that 'the quality of education will be maintained and improved'. He rejects the Chief Secretary's argument that in present economic circumstances it is reasonable to concentrate on 'basic skills', as in the Manifesto, rather than 'quality'. His main arguments are in his paragraphs 3 and 4.

6. The Chief Secretary further proposes the 1981-82 totals for capital expenditure listed in column 3 of his Annex 2. It is possible that the Secretary of State for Trade will bid for a greater increase than that already offered for local airports capital expenditure.

7. The Chief Secretary proposes a reduction of £65 million in the provision for housing in England in 1981-82. This total cut is acceptable to the Secretary of State for the Environment, though he may wish to find some of it from his other programmes.

HANDLING

8. After the Chief Secretary has introduced his paper you might suggest that before turning to the major dispute over education the Cabinet should first deal with the other proposals on which the Chief Secretary generally appears to have reached agreement with his colleagues.

9. Dealing first with the services other than education you might:-

(i) Invite the Secretary of State for the Environment to give his general comments and to deal in particular with the Chief Secretary's proposals for local and environmental services (his paragraph 7(i)) and housing (paragraph 10).

(ii) It should not be necessary to discuss those services on which there is agreement, but you might give other Ministers an opportunity to raise any points they wish. The Secretary of State for Trade may wish to ask for higher provision for local airports capital expenditure than the Chief Secretary was willing to accept in the bilaterals (see paragraph 9(i)).

10. Turning to the education programme you might then invite the Secretary of State for Education to speak to his paper C(80) 45 and the Chief Secretary to reply. The main questions are:-

(i) Does the Cabinet accept the Chief Secretary's view that The Queen's Speech commitment on the quality of education need not rule out some savings on the schools, or indeed elsewhere in the education programme?

It is worth noting that a reduction of £62 million on total schools expenditure of £3,922 million is equivalent to only 1.6 per cent.

(ii) If the reduction is not accepted, where else can the savings be found if the Government's overall public expenditure objectives are to be maintained?

CONCLUSIONS

11. In the light of the discussion, and with reference to paragraph 13 of the Chief Secretary's paper, you will wish to record conclusions on:-

(i) Whether it should be announced that the Government's view is that the total of local authorities' current expenditure relevant for RSG purposes for 1981-82 should be 2 per cent less than the corresponding planned total for 1980-81.

(ii) Whether for purposes of calculating the RSG distribution in England and Wales the totals for individual services should, except for education, be as in Annex 1 column 4 subject to further review in September.

(iii) Whether the total for the education programme in 1981-82 in England should be reduced by £50 million net.

(iv) Whether the totals for local authority capital expenditure should be as listed in column 3 of Annex 2.

(v) Whether the proposed reduction of £65 million from the Secretary of State for the Environment's programmes in 1981-82 is acceptable.

(vi) Failing agreement on any of these proposals where else the savings should be made.

RTA

(Robert Armstrong)

23rd July, 1980

Ref. A02708

PRIME MINISTER

Public Expenditure: Provision for Juvenile Offenders

BACKGROUND

In his minute to you of 22nd July the Home Secretary reports that the Home and Social Affairs Committee has approved proposals to give the courts powers to make orders placing juveniles in residential care or subjecting them to 'intermediate treatment'.

2. The Secretary of State for Social Services is unable to find offsetting savings for this purpose - the failure to approve the proposals for charging for road accidents has already placed him under serious pressure. H Committee therefore invite the Cabinet to agree tomorrow to additional bids of:-

(£ million)

	1982-83	1983-84	After 3 or 4 years
England	5	7	10
Wales	0.3	0.4	0.6

3. They wish this decision to be taken in advance of the main public expenditure discussions for 1982-83 and onwards so that a White Paper can be published before the Party Conference in the autumn. There is a commitment to these proposals in the Manifesto.

HANDLING

4. After the Home Secretary has explained the proposal the Chief Secretary, Treasury, will wish to comment on these additional bids. There are four possibilities for dealing with them:-

(i) To defer a decision until the bilaterals are completed and the main decisions are taken - but nothing could then be said in the White Paper on juvenile offenders.

(ii) To refuse the additional bid - but this would reverse a Manifesto commitment.

(iii) To agree, but to insist that the Ministers concerned, mainly the Secretary of State for Social Services, should specify offsetting savings now - in theory the right approach but probably impossible to deliver in practice.

(iv) To concede the additional bids now - but recognising that in practice this will prove to be at the expense of other programmes, or the contingency reserve, since the public expenditure totals are now fixed.

CONCLUSIONS

5. In the light of the discussion you will wish to record a decision on which of the four options noted above is approved.

RTA

(Robert Armstrong)

23rd July, 1980

Prime Minister

No need for you to get involved in this little dispute except to agree that the Chief Secretary should pursue Mr. Younger for £135,000 to make good last year's overspend.

Agree?

TL 22/7

Yes MT

PRIME MINISTER

CASH LIMITS 1979-80

Flag A

The Lord Advocate has copied to me his minute to you of 11 July.

2. Since he did not receive a copy of my minute of 3 July, to which he refers, I should perhaps begin by emphasising that the purpose of that minute was to report the facts and not to attribute blame. The circumstances which gave rise to the overspend of £160,000 on the Lord Advocate's cash limit for 1979-80 and the question of what action should be taken have been fully explored in correspondence (which has included the Secretary of State for Scotland and the Minister of State, CSD) and at a meeting between the Lord Advocate and myself on 24 June. In these discussions we have also taken note of the difficulties which have arisen from the historical arrangement under which the Lord Advocate's Accounting Officer - the Queen's and Lord Treasurer's Remembrancer - is not a member of his staff. (Nor, incidentally, is the QLTR a Treasury official any more than the Lord Lyon who is also borne on the Treasury Vote). We are agreed that this division of responsibilities is highly undesirable and plans are in hand for a reorganisation which will remove this anomaly, we hope from 1981-82 onwards.

3. To my mind however that is not the central issue. What we have been seeking is a solution which preserves the discipline of cash limits, that is so vital to our economic strategy, and at the same time recognises the difficulties which the Lord Advocate would face if the full amount of his overspend were deducted from this year's cash limit, as has been done in the case of other overspending departments. At our meeting, the Lord Advocate argued powerfully that full deduction would have an adverse effect upon law and order in Scotland. I believe that the compromise we reached - for a token reduction of £25,000 -

represents a reasonable solution, and that it is most important that we now abide by it.

4. I have written to the Secretary of State for Scotland to ask whether he could find the remaining £135,000 from Scottish Votes under his control in view of the political importance of maintaining law and order in Scotland and the need to avoid undermining the principle of compensating for excess expenditure against cash limits. If you agree, I will pursue this possibility with him and report the outcome to you separately.

MT

5. I am sending copies of this minute to the Lord Advocate and the Secretary of State for Scotland.

WJB

22.7.80?

JOHN BIFFEN

BV

CONFIDENTIAL

10

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Parliament Street
LONDON
SW1

22 July 1980

R 22/7

Dear John.

Thank you for sending me a copy of your minute of 8 July to the Prime Minister about end-year flexibility.

Like you, I support the proposed scheme; but, also like you, I have some doubts about our ability to introduce it this year if it would have the impact on total spending next year which you expect. I am, however, puzzled by the statement in paragraph 13 of the note by the Treasury that "it would be unwise to assume that the whole of the amount carried forward into the year [ie 1981-82 if the scheme were introduced this year] will be matched by extra underspending". Since the present general allowance for shortfall next year is only just over 1 per cent of total planned expenditure, a low figure even by comparison with this year let alone earlier years, it seems to me likely that any sums carried forward into 1981-82 under the scheme will be fully matched by sums similarly carried forward into 1982-83.

In short, as I implied in paragraph 3 of my letter to you of 8 July, I doubt whether we need to retain the contingency reserve for 1981-82 at its present level simply to accommodate the introduction of the new scheme this year.

I am sending copies of this letter to the Prime Minister, the other members of the Cabinet, Norman Fowler, Sir Robert Armstrong and Sir Derek Rayner.

Yours ever

Mark

MARK CARLISLE

CONFIDENTIAL

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000 22 July 1980

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment

Dear Michael

At Cabinet on 10 July I was asked to put round a paper on the options for further measures of industrial support. This reflected the concern of yourself (amongst others) that we should be as inventive as the situation allows about the means of stimulating economic renewal at a time of recession.

I shall be considering this carefully. I know that you have put forward a number of suggestions which we have not felt able to adopt. But I think the record of our first year of office is quite respectable. We have had a generally favourable reaction to the enterprise elements in the 1980 Budget, especially the Venture Captial scheme, the small workshops scheme and Enterprise Zones. And work is in hand on measures which would maintain this thrust. While we certainly need to keep up the momentum, I do not think we need to be shamefaced about progress so far.

The overall expenditure constraint is of course severe, but I do not intend to rule out proposals to stimulate enterprise simply on financial grounds: there may be a case for some rearrangement of priorities for expenditure. Ideas which do not involve substantial expenditure will naturally be easier to accommodate and if you have further suggestions I should of course be glad to have them.

I am copying this to the Prime Minister, the Secretary of State for Industry and Sir Robert Armstrong.

Yours

GEOFFREY HOWE

With the Compliments

of the

Secretary of State

Scottish Office,
Dover House,
Whitehall,
London, S.W.1 A 2AU

Econ Pol

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

MBM

Pm 17

CONFIDENTIAL

The Rt Hon William Whitelaw CH MP
Secretary of State for the Home Dept
Home Office
Queen Anne's Gate
LONDON SW1

21 July 1980

Dear Secretary of State,

We agreed at Cabinet on 10 July that I should let you know if I could find the resources of additional civil defence measures from within my existing programmes. The additional costs in Scotland would be:

	£m at 1980 Survey Prices		
	1981-82	1982-83	1983-84
Civil defence			
Minimum requirement	1.7	2.1	2.1
Additional requirement for optimum provision	0.6	0.9	1.0

As you know, John Biffen has proposed that there should be a very substantial reduction in Scottish expenditure in addition to the reductions which all other Departments are facing. I cannot agree to the full amount he has requested but I am prepared to make a significant reduction. It will be extremely difficult to accommodate in my programmes and I have not yet decided where the cuts might fall once the size of the reduction has been settled, but I am sure you will understand that it is placing me in an extremely serious situation. In the circumstances I have no option at this stage but to say that I cannot undertake to find even the modest sums that our new civil defence measures will require.

As you know I am a strong supporter of what you wish to do for Civil Defence and it distresses me not to be able to help as I would certainly have done in more normal circumstances.

I am sending copies of this letter to the Prime Minister, the other members of the Cabinet, the Minister of Transport and to Sir Robert Armstrong.

Yours sincerely

J.S. Wilson

(Approved by the Secretary of State
and signed in his absence)

Can Pd 2

Prime Minister

The Treasury are giving Mr Pym the option of an immediate deduction from this year's cash limit for last year's overspend or wrapping this up in the decision on the much bigger question of the forecast overspend for this year. No need for you to take a view at this stage. Also, the Treasury are going ahead with the PAC idea.

CHIEF SECRETARY TO THE TREASURY

PRIME MINISTER

No.

CASH LIMITS

Play A I must respond to the Defence Secretary's minute of 8 July.

TL. 14/7

2. Let us first be clear about terms. There is no question of excluding the possibility of an agreed policy decision to increase a cash limit during the year. Obviously in present circumstances there must be a strong presumption against such increases, and grounds for considering them need to be compelling. But where a spending Minister believes an increase necessary and justified, it can be proposed. If Treasury Ministers and the spending Ministers are unable to reach agreement, the matter may have to be resolved collectively.

Play B 3. My minute of 3 July was concerned with overspending of cash limits where no policy decision to increase has been agreed in this way.

4. Here I am sure that we must maintain the general policy of deducting the amount of any overspend in one year from the cash limit for the next. I am glad to see that the Defence Secretary does not object to this in principle.

5. I recognise the problems of the defence cash limit this year. The facts are currently being sorted out by officials. When this has been done I expect to be discussing the problems with the Defence Secretary. I wrote to him (with a copy to you) on 9 July. It remains my view that a deduction in respect of the overspend last year should be agreed now. I should prefer that it also be

Play C

announced now, but if the Secretary of State prefers to include it in a later, more comprehensive announcement when we have settled the outcome of the wider review of this year's cash limit now in progress, I would go along with that.

6. The proposal that the PAC might investigate overspends (in the sense just discussed) where they involve a Supplementary Estimate, as well as those involving an Excess Vote (which the PAC already customarily investigate), should affect only a very few cases. It will be for the PAC themselves to decide whether to take up the idea, but if they do, it will be a minor, but appropriate and useful, reinforcement of the discipline of cash limits and of our commitment to proper control of expenditure.

7. The proposal has been the subject of correspondence between officials. Some initial criticisms were based in part on misunderstanding. In particular the C & AG has now agreed after discussion, that this is a proper area for the PAC.

8. The paper for the PAC has been amended to take account so far as possible of the comments made. I am sorry that the Defence Secretary still has reservations, but I have no doubt that the proposal is sensible and right. Since it is relevant to the PAC hearing on 16 July mentioned in my earlier minute, I have authorised the Treasury to put in the paper, and discuss it then with the PAC.

9. I am sending copies of this minute to members of the Cabinet and to the Minister of Transport, and to Sir Robert Armstrong.

W. J. B.

JOHN BIFFEN
14 July 1980

Original in G/R

cc. RGO

MKT 11/7

10 DOWNING STREET

THE PRIME MINISTER

14 July, 1980.

Dear Mr. Greet,

Thank you for your letter of 4 July, informing me of the resolution on public expenditure cuts passed by the Methodist Conference in Sheffield.

Of course, like all my colleagues, I share your concern at the need to make savings in public expenditure, especially at a time of world economic recession. I can assure you that we regret the need for temporary sacrifices in living standards and keep a very close eye on the effects of reductions in spending. Indeed, we have made substantial reallocations of spending priorities in order to concentrate more resources on those in greatest need, rather than spreading them thinly over a wider area.

But I must ask you to consider which is likely, in the long run, to have the more disastrous effects on the lives of those in need - a continuing very high rate of inflation, with permanently high levels of unemployment, or a policy designed to reduce inflation to acceptable levels and restore the ability of British industry to create wealth and new jobs.

I have no doubt that persistent inflation is the worst enemy of the poor, the old and the disadvantaged. If we can conquer that - as we can, through our present policies and by no other means - the temporary sacrifices will have been worthwhile.

/We can

We can then look forward not only to a lasting recovery in our industry, but, also to improving our social services, as other countries have been able to do.

Finally, we can see no way, at a time of world recession, in which the huge increases in energy prices can be absorbed by our economy without some temporary fall in real living standards. Our aim is to ensure that the sacrifices do not fall to be borne disproportionately by those least able to bear them.

Yours sincerely,

(SGD) MT

The Reverend Dr. K.G. Greet

A

PRIME MINISTER

Avoid comments for Treasury T.L.

CASH LIMITS 1979-80

I did not receive a copy of the Chief Secretary's minute to you of 3rd July, but as I am concerned with one of the Votes on which there has been a breach of the cash limit and since you have recorded that you are very disturbed by these breaches, I feel I should record my position.

The overspend amounts to about £160,000. The main but not the only reason for this, so far as I have been able to discover, is an inadequate flow of information to the Crown Office in Edinburgh from the office of the Accounting Officer responsible for this Vote. He is an official of the Treasury, not of my Department and I must say I thought that this would ensure that I was kept right on financial matters. However it has proved an unsatisfactory arrangement which I hope will be brought to an end before the beginning of the next financial year.

In these circumstances, as I have explained to the Chief Secretary, I do not think it is equitable to expect me to bear the countervailing cut in the present year, if only because the Accounting Officer concerned is not in my Department. But quite apart from questions of equity, I see no way in which such a cut can be implemented without serious damage to the public prosecution function in Scotland for which I am responsible through the Crown Office. The prosecution services are feeling the full effect of last year's increase in police manpower. From the beginning of January this year up to the end of June, the number of reports sent to Procurators Fiscal by police forces increased by 16% over the corresponding period last year. There is no way in which we can cope with this increase and take a punitive cut without letting go unprosecuted a number of cases where, in the public interest, proceedings should be taken. By abandoning all training in the present year I have offered to find £25,000 towards the total. The Chief Secretary has suggested that the Secretary of State for Scotland should find the rest, but I frankly see no reason why he, rather than any other Minister, should provide the countervailing savings for a totally separate Department.

I fully support the use of cash limits to impose financial and managerial discipline and no one could be more disturbed than I was when I came to know of this breach, but I agree with

the Secretary of State for Defence that the consequences need to be related to the circumstances. In the peculiar circumstances of this case I doubt if the cash limit system would be weakened by an acknowledgement that, for reasons which will be perfectly well understood and accepted, the Treasury has not insisted on full "reimbursement".

I am copying this to the Secretary of State for Scotland and the Chief Secretary.

Jm.

MACKAY OF CLASHFERN
11th July 1980

Tragic note handed to the Chancellor 10/7

DEFENCE EXPENDITURE

Two objectives of Government policy are now in conflict: adherence to the NATO commitment, as interpreted by MOD, to 3% real increases in defence spending; and the need to hold cash limits, keep the borrowing requirement under control, and restrain future public expenditure plans. Defence accounts for 11 per cent of total public expenditure.

The NATO target

2. The Allies are asked to "aim at average annual increases in defence expenditure in the region of 3% in real terms". Only the UK, US and Italy did so in 1979, and only the UK, US, Germany, Netherlands, Norway and Canada have announced plans to do so over the period to 1983.

The UK interpretation of the target

3. We penalise ourselves by interpreting the target in volume, not cost terms. Few of the Allies do so. We thus take no credit for the major increases in forces' pay made in fulfilment of the commitment in the Manifesto (which was silent on the target). And since their primary concern is with the overall volume total, MOD have insufficient incentive to economise in administrative and support services and concentrate on front-line forces.

Implications for cash limits

4. Defence argue that it is insufficient to aim at the target: we must be able each year to demonstrate retrospectively that we hit it. But this year's cash limits were intended to impose some volume squeeze, and it is important for the CGBR that they be held. Officials are now reviewing MOD's current spending, and Defence are likely to bid for an addition of some £350 million to ensure 3% volume growth over the year (after the deduction - on which we must insist - of some £60 million to compensate for the overspend on the 1979-80 cash limit).

Implications for future expenditure plans

5. Defence expenditure was exempt from detailed scrutiny in the 1979 Survey. In view of the NATO target, it was accepted that we would plan

/ for

for 3% annual growth, and the debate centred on the baseline. The figures eventually agreed, and published in the White Papers, provided for a 3.6% increase in 1980-81, and 3% increases thereafter. (See attached table.) In the 1980 Survey documents the Chief Secretary has not challenged the 3% volume target, but has pointed out that annual average 3% growth over this year and the next three now calls for figures rather lower than those in the White Paper, because the 1979-80 volume outturn was lower than expected. Defence are in fact now asking for some £140 million in each of the three years 1981-82 to 1983-84 over and above what would be required to comply with the target, as they interpret it, and on the basis used in the White Papers. (See attached table.)

The case for a review

6. The importance of holding down public expenditure necessitates a review of our attitude to the target. NATO specifically accepted, when it was first adopted, that there would be derogations in difficult economic circumstances: the prospect of a 2½% decline in our GDP this year is highly relevant. The Defence White Paper pointed out that "we shall not feel obliged to adhere slavishly to a particular growth path, nor shall we consider it a failure of policy if we modify our spending plans in either direction from year to year as new information becomes available".

Options

7. Savings greater than those proposed by the Chief Secretary could be achieved if we were to come into line with the majority interpretation of the NATO target, or to conclude that our present circumstances necessitate a one-year derogation from it. Various courses are possible, depending on how far we decide to hold the cash limits this year. No increase in them would mean no volume growth, although we might still plan for 3% in future years.

Timing

8. It would be wrong to choose between the options until the current review of the MOD 1980-81 cash limit is complete, and bilateral discussions with other spending departments have established the likely feasibility of the Chief Secretary's Survey proposals. The proposal

/ in respect

in respect of defence is seen at this stage only as a marker. But it would be damaging in both the cash limits and Survey contexts, and to the search for economy, if Cabinet were now to accept that the MOD interpretation of the NATO target was sacrosanct. The case for demonstrating, in both plans and outturn, constant 3% volume growth in the defence programme does not necessarily take precedence over the Government's wider policy concerns and commitments.

Conclusions

(i) Current financial and economic prospects necessitate a review of our current interpretation of the NATO target, and the re-assertion of the primacy of cash control over expenditure in the current year;

(ii) public statements should be so framed as to impale us no further on the hook of our current interpretation of the NATO target; and

(iii) decisions on future levels of defence expenditure should be deferred until later in the Survey.

DEFENCE PROGRAMME+

	1979-80	1980-81	1981-82	1982-83	1983-84
£ million at 1979 Survey prices					
The inherited plans (Cmnd 7439)	7917	8177	8219	8227	8227
(% increase over previous year)	5.9	3.3	0.5	0.1	0.0
June, 1979 Budget	+100				
July Cabinet decision		-115			
Revised estimate of outturn	-193				
Cmnd 7746 (November, 1979)	7824	8062			
(% increase over previous year)	4.2	3.0			
January 1980 Cabinet decisions		-65	+21	+263	+513
Revised estimate of outturn	-101				
Cmnd 7841 (March, 1980)	7723	7997	8240	8490	8740
(% increase over previous year)	2.9	3.6	3.0	3.0	3.0
£ million at 1980 Survey prices					
Cmnd 7841 revalued*	9288	9615	9941	10236	10540
(% increase over previous year)	2.9	3.5	3.4	3.0	3.0
Revised estimate/Cash Limits squeeze	-49	-175			
Estimating changes			+2	+5	+3
Survey baseline: Mr Pym's position	9239	9440ø	9943	10241	10543
(% increase over previous year)	2.4	2.2	5.3	3.0	3.0
Chief Secretary's proposals			-139	-141	-143
	9239	9440ø	9804	10100	10400
(% increase over previous year)	2.4	2.2	3.9ø	3.0	3.0

+ The Defence Budget figures, to which the 3% strictly applies, are £3 or 4 million more in each year.
* and with some minor classification changes.
ø The estimate of outturn in 1980-81 is uncertain: the Chief Secretary's proposal ignores the current year and bases 1981-82 on a 3% compound increase over 1979-80.

PRIME MINISTER

CONFIDENTIAL

MEETING WITH THE CHANCELLOR AT 0900
THURSDAY 10 JULY

The Chancellor will want to go over the public expenditure papers for Cabinet. But he also wishes to discuss the particular problems of defence (though, as you know, Mr. Pym will not be attending Cabinet).

There are three issues:-

(i) The £60 million over-spend in 1979/80, which the Treasury want to claw back by reducing this year's cash limit correspondingly. If they do not, so they argue, it will be patently unfair to other Departments who have over-spent and whose cash limits for this year are being reduced; and it will under-mine the cash limit system.

(ii) The over-spend for this year which MOD are now forecasting. This apparently amounts to £550 million in total, of which about £400 million is due to inflation being higher than the cash limit assumed and £150 million due to an excess on volume. Mr. Pym is prepared to take corrective action to eliminate the volume over-spend, but is arguing for an extra £400 million to compensate him for the inflation element - relying on the review clause which was agreed when the cash limit was set.

(iii) The volume cuts proposed by the Treasury amounting to £135 million in 1981/82 rising to £143 million in 1983/84. The Treasury argue for this on the grounds that it would maintain a volume growth rate of 3 per cent based on the 1979/80 out-turn, and ~~that~~ has some compensation for the higher projected cost of the defence programme relative to costs in the economy as a whole. (Expressed in terms of cost, the defence programme is expected to be £280 million more expensive in 1981/82 than the volume figures implied).

CONFIDENTIAL /Only

Only the third issue is immediately relevant to tomorrow's Cabinet, and - particularly without Mr. Pym being present, it will not be possible to take a decision on it. But the Chancellor will want to reach decisions on the other two issues as soon as possible. For as Clive has explained, it is going to be very difficult - if not impossible - to pull this year's spending back by £550 million (or if you add the £60 million reduction for last year's over-spend, by £610 million). The sooner a decision is taken the greater will be the possibility of reining the programme back to the cash limit. But of course, Mr. Pym is going to resist this very strongly.

You clearly won't be able to reach a decision on the cash limit problem tomorrow; presumably you will have to have a meeting with Mr. Pym and the Chancellor separately or together when all the facts are known.

P.

P.S. See further papers which have just come in, in this folder.

But I have told the Chancellor's office that you don't want to spend too much time on the details of this tomorrow.

9 July 1980

Ref. A02591

PRIME MINISTER

Public Expenditure 1981-82 to 1983-84

(C(80) 38, 39 and 40)

BACKGROUND

The main paper, and the basis for discussion, is the Chief Secretary's memorandum, C(80) 40. The other two papers, C(80) 38 (the Red Book with the details of Departments' programmes) and C(80) 39 (the summary of the main issues by Treasury officials) can be treated as background.

① Objective

2. The Chief Secretary invites the Cabinet to confirm that the objective should be to keep to the net totals for 1981-82 to 1983-84 published in the last White Paper, Cmnd 7841, as reduced by the European Community (EC) savings. The aim of keeping within existing overall totals - though with some switching to reflect current priorities - was broadly endorsed by the Cabinet last week in the discussion of the economic strategy.

3. This proposition may lead to two different threads of comment and argument:

(i) Some colleagues, notably the Secretary of State for Northern Ireland, may wish to argue that EC receipts to particular programmes should be additional to, rather than in place of, existing expenditure. There is no need for this detailed "additionality" point to be discussed at Cabinet. The Chancellor of the Exchequer is planning to bring a paper on the general problem of accommodating the new EC receipts to E Committee next week and points about particular programmes can be pursued then. (See postscript to this brief).

(ii) The other thread may be an attempt to suggest that the EC settlement eases the general financial problem and that, rather than devote the whole of our gains to reducing the PSBR, some should be used to increase the general level of Government spending. You will

remember that, last year, Mr. Walker argued strongly in the public expenditure discussions then that credit should be taken in advance for the EC settlement. If this line of argument is developed, you will no doubt want to defend the Treasury position. The considerable "downside" risks - particularly in the nationalised industries - provide adequate justification, if justification is needed, for a cautious approach.

4. Assuming that the Cabinet accept the broad thrust of the Chief Secretary's argument on total spending, it will need to take a view, so far as it can at this stage, on the specific net reductions and additions shown in Annex A to C(80) 40. The additions cater for some unavoidable increases, in demand led programmes, but also include proposals to deal with the industrial and social problems created by the recession. In particular, you will see that he has responded to the concerns expressed in Cabinet last week by allowing for increases in the provision for special employment measures and for youth employment, though with some reductions in provision elsewhere for the Manpower Services Commission. His proposals also assume that it will be necessary, for prudence, to drop the assumption that nationalised industries' expenditure as a whole will fall short of programmes by £470 million. After today's discussion in E this is unlikely to be challenged.

5. As to procedure, the Chief Secretary proposes that any Minister who wishes to discuss with him the net reductions and additions shown in the table should ask for a bilateral meeting. He would come back to Cabinet in the autumn with final proposals in the light of these discussions and of other developments. In the meantime there is no need for Cabinet to discuss individual programmes in detail.

6. The Chief Secretary further proposes that the Cabinet should decide later this month on local authorities' current expenditure in 1981-82 with a view to a statement before the Recess. This timing is needed to give local authorities warning of the expenditure reductions expected of them before they get too far down the road of working out their budgets for next year. The Chief Secretary therefore wants authority to start urgent bilateral discussions with each local

authority Minister, with a view to putting proposals to Cabinet at the meeting on 24th July, before the meeting of the Local Authorities' Consultative Council on 28th July. This is a separate operation from that Mr. Heseltine is conducting on the 1980-81 budgets, though Mr. Heseltine's options for action will be relevant to deciding how the 1981-82 figures can be enforced.

7. You will also wish to note that the Chief Secretary has carried forward for each Department, other than Defence, the $2\frac{1}{2}$ per cent manpower squeeze made this year, but has not taken account of the further savings which will arise from the decision to reduce Civil Service numbers to 630,000 by 1983-84. He will consider this further in the light of the report on manpower savings which the Lord President of the Council will be putting to the Cabinet on 24th July. In the meantime I understand that a provisional estimate is that savings from this source might rise from £30 million in 1981-82 to £100 million in 1983-84 but that these savings might to some extent double count with those in the option cuts tabled by the Chief Secretary.

8. Apart from local authority current expenditure in 1981-82, and decisions on the overall public expenditure ceilings, no other detailed decisions need be taken before the Recess. It will however be necessary to take decisions in September on local authority capital expenditure for 1981-82; to start work on the 1981-82 cash limits and the External Financing Limits for the nationalised industries; and to reach agreement on the figures for the later years which will be incorporated in due course in the next Public Expenditure White Paper.

HANDLING

9. You might open the meeting by explaining that the objective is to agree on the four proposals listed in paragraph 25 of the Chief Secretary's paper. It is not the intention to start detailed discussions of individual Departmental programmes. These should be discussed, if Ministers so wish, bilaterally with the Chief Secretary. The Cabinet will discuss the outcome and any outstanding problems in the autumn.

10. You might then invite the Chief Secretary to introduce his paper and give the Chancellor of the Exchequer an opportunity to make supplementary remarks if he wishes. You might then seek agreement to the four points listed in the Chief Secretary's paragraph 25. Point 25(i) - agreement to stick to the totals

in Cmnd 7841 as reduced by the EC budget settlement - is the critical one. Given this, the rest is a question of changes at the margin - though in some cases, e.g. Education and Scotland, nonetheless difficult for that. Point 25(ii) - the detailed proposals - does not have to be settled now. It would nevertheless be helpful to the Chief Secretary to have an indication how far his suggestions command assent and, on the areas of likely dispute, what is the general feeling of Cabinet colleagues. You may therefore like to run quickly through paragraphs 13 to 23 to get a first reaction and to discover which spending Ministers will accept the proposals without demur. You might also like to end with a request to Ministers whose programmes are not specifically dealt with in the text to confirm whether they are prepared to accept the proposals affecting them set out in Annex A. Points 25(iii) and (iv) are procedural and need cause no difficulty.

CONCLUSIONS

11. In the light of the discussion you will wish to record conclusions:-

(i) Confirming that the objective is to keep to the net totals published in the last White Paper, as reduced by the EC settlement.

(ii) Recording any specific agreements to the Chief Secretary's detailed proposals and inviting Ministers who so wish to discuss bilaterally with the Chief Secretary the net reductions and additions shown in Annex A of his paper;

(iii) Inviting the Chief Secretary to have urgent bilateral discussions with the local authority Ministers with a view to bringing proposals to Cabinet on 24th July on local authorities' current expenditure in 1981-82.

(iv) Inviting the Chief Secretary to report further to the Cabinet after the Recess with final proposals on the remaining programmes.

(Robert Armstrong)

(approved by Sir R Armstrong and signed on his behalf)

9th July, 1980

Postscript. I have now seen Mr. Alexander's letter of 7th July to the Private Secretary to the Secretary of State for Northern Ireland which records that you have reiterated that there can be no additional expenditure as a result of the Article 235 arrangements.

2 PP's

PRIME MINISTER

PUBLIC EXPENDITURE SURVEY 1980: SCOTLAND

In his minute to you of 8 July the Secretary of State for Scotland objects to my proposal that £150 million per year be taken off public expenditure in Scotland as part of the reductions that are necessary to keep total public expenditure to Cmnd 7841 levels while accommodating the increased expenditure resulting from the recession.

2. I recognise of course that it will be difficult for the Secretary of State to implement my proposal. But there are no easy decisions open to us on public expenditure. Reductions in programmes have to be made, and even after making allowances for the inevitable limitations of any study of comparative need, it must be acknowledged that the Needs Assessment Study (NAS) shows that Scotland has a larger share of public expenditure than is justified by its needs. Under my proposals the disparity would largely remain, both because the proposed reduction is so much less than the NAS indicates and because there is no proposal to transfer the sum elsewhere. If the equivalent reduction is sought from other programmes the disparity will be larger.

3. At a meeting on 1 May, to which the Secretary of State refers, our colleagues most concerned agreed that there could be no question of a major redistribution by PES transfer to bring each country's share into line with the implications of the Needs Assessment Study. But we also agreed that should further reductions in expenditure be required, it would be legitimate to take the

results of the NAS into account as a factor relevant to the distribution of any such reductions. This is what my proposal does.

4. The Secretary of State foresees presentational difficulties because my proposal does not involve redistribution. On 1 May he argued, and we accepted, that obvious redistribution from Scotland to England and Wales would aggravate the political difficulties of making reductions in Scotland. There is, moreover, an element of redistribution, as I have pointed out. Without this reduction in Scottish public expenditure, the only alternative will be to seek additional reductions in other Ministers' programmes, including possibly some of those not touched by the present proposals.

5. As for the population formula, it is true that the use of this formula was described in the lobby note issued by the Secretary of State when Cmnd 7841 was published. But the fact that the formula was used in the last Survey and is normally used to translate marginal changes in comparable programmes into reductions on the Scottish block does not preclude an additional change to the Scottish baseline such as I have proposed, where there is justification for it.

6. I do not expect to resolve this issue in Cabinet tomorrow. It can be discussed further by the Secretary of State and me bilaterally.

7. I am copying this minute to the other members of Cabinet, the Chief Whip, the Minister of Transport and Sir Robert Armstrong.

W. J. B.

JOHN BIFFEN
9 July 1980

Original filed Euro Pol (Budget) Pt 9

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 July 1980

M.O'D.B. Alexander, Esq.,
No.10, Downing Street

Dear Michael,

PRESENTATION IN THE PUBLIC EXPENDITURE SURVEY OF THE UK CONTRIBUTION TO THE COMMUNITY BUDGET

This letter and its enclosures amplify the figures and explanations in my letter of 2 July about the UK contribution to the Community Budget.

The material falls into two parts, and is summarised in the two tables attached.

Table 1 is concerned with PESC figures. It starts with the last published figures in Cmnd 7841 for our net contribution. It then revises these figures to take account of all developments since publication, other than the refunds under the 30 May Agreement. Finally it applies those refunds. The main feature of this table is the effect of the time lag on our refunds, even though it assumes that we secure an advance payment of £135 million (300 meua at 1979 outturn prices) before the end of 1980. (We shall not know what advance we will get in 1980 until after the German elections.)

Table II reconciles the familiar Commission figures for our net contribution after the 30 May agreement with the PESC figures at the foot of Table I. It shows how the figures in the 30 May Agreement, which describe the intended outcome in respect of the years 1980 and 1981, need to be adjusted in order to show the expected cash flow in 1980 and 1981.

The main features of Table II are first, the effect of the lag in refunds as in Table I; secondly, that our estimates

/of our

of our net contributions are higher than those made by the Commission; and thirdly, that our contribution to the unallocated Budget is added back. The higher estimates of our net contribution take account both of a higher estimate of Community expenditure and a forecast of higher UK VAT contributions (in mua) attributable to the strong exchange rate, though these extra VAT contributions will be payable in arrears (line 7).

Most of these points will be familiar to the Prime Minister. The reporting telegram sent by Sir M. Butler following the 30 May Foreign Affairs Council (Telno 2654 of 30 May) recorded the Council decision, paragraphs 5 and 6 of which set out the general arrangements that had been agreed about the timing of payments. The Chancellor's minute of 12th May, before the Council, reminded the Prime Minister that the Commission's definition of our net contribution excluded the UK's share of the unallocated Budget (para.10) and he called attention to the presentational problems this might cause. The Annex to that minute set out the Treasury's latest forecasts of our unabated contribution for 1980 and 1981, which, at that stage, were significantly higher than the Commission's. (The latest figures which underlie the Public Expenditure Survey are in fact a little lower than we were then forecasting.)

in folder 10/7/80

Our total refund in respect of the two years 1980 and 1981 was quoted in the 30 May Agreement as the equivalent of £1570 million. The counterpart in Table I of this figure is the sum of the refunds shown against the three calendar years 1980, 1981, 1982:-

£ million
135
495
145
663
1438

We expect the £1570 million refund to be increased by the triggering of the risk sharing formula to give a cash refund of £1780 million. When converted to 1980 Survey prices (1979 outturn prices) this £1780 million becomes £1438 million. Lagged payments are smaller payments in PESC terms.

I should like to make two other points. First, while the present estimates reflect our most up-to-date assessment, it is virtually certain that they will change in the light of subsequent developments and information, before we come to publish the next Public Expenditure White Paper.

/Secondly,

Secondly, my earlier letter may have given the impression that the new estimates relating to the UK net contribution to the Community Budget were in the Public Expenditure Survey Report itself. I am sorry if it did. They are not in the Report, but underly the figures in the paper by Treasury officials on the "main issues" C(80)39.

I am sorry that all this is so complicated, but there is no other public expenditure programme so beset with complexities. This one involves change from an attributable basis and calendar years to a cash flow basis and financial years; a currency conversion; forecasts of total Community expenditure and timing of payments, that is guesses at decision-taking in a 10 Member international organisation; and estimates of imports and consumption not only in the UK but in the 8 (shortly 9) partner countries.

I am sending copies of this letter to George Walden (FCO) and David Wright (Cabinet Office)

Yours ever

John Wiggins

A.J. WIGGINS

TABLE 1 OLD AND NEW FIGURES ON PESC BASIS: CASH FLOW £m at 1980 Survey Prices (=1979 Outturn

	FINANCIAL YEARS			CALENDAR YEARS		
	1980/81	1981/2	1982/3	1980	1981	1982
1. NET CONTRIBUTIONS Cmnd 7841 (tables 2.2.1 and 2.2.2)	1061	1200	1350	1057	1150	1300
2. REVISIONS TO Cmnd 7841 FIGURES BEFORE 30 MAY REFUNDS (minus means reduction in our net contribution)						
Revised Own Resources Estimates*	-65	+151		-74	+121	+268
"Carry Forwards" from 1979 Budget/UK share	-50			-50		
Higher CAP receipts, including 30 May Agricultural Package	-97	-122		-90	-116	-138
Other receipts changes	-8	+2		-13	+8	-15
Downward revisions to contributions and receipts to stay within the 1% VAT limit						-102
Refund allowed for under unadjusted financial mechanism	+129	+201			+172	+210
TOTAL OF REVISIONS	-91	+232	n.a.	-227	+185	+223
REVISED NET CONTRIBUTIONS BEFORE REFUNDS UNDER 30 MAY AGREEMENT	970	1432	n.a.	830	1335	1625
3. EFFECT OF REFUNDS						
Net Refunds Paid in Respect of 1980	535	122		135	495	
Net Refunds Paid in Respect of 1981		605	203		145	663
Net Refunds Paid in Respect of 1982						[160]ø
NET CONTRIBUTIONS: CASH FLOW (on the same basis as tables 2.2.1 and 2.2.2)	435	705	n.a.	695	695	700

*Including effect of stronger exchange rate upon timing of UK VAT contributions; and our share of extra CAP costs following the agricultural price settlement.

WORKING ASSUMPTIONS:

2 COMMISSION FORECAST FOR UK NET CONTRIBUTIONS CONVERTED TO PESC CASH FLOW BASIS

		1980	1981	1982
A.	CONTRIBUTIONS IN MUA IN RESPECT OF:-			
1.	UK Net Contribution after 30 May Agreement as forecast by the Commission	609	730	[885]ø
B.	CONTRIBUTIONS IN RESPECT OF THESE YEARS IN £m AT 1980 SURVEY PRICES	(=1979 outturn prices)		
2.	Line 1 in £m at 1979 outturn prices	329	362	418
3.	Contributions to Unallocated Budget (Lome etc)	+81	+87	+95
4.	Extra UK Net Contributions expected under risk sharing formula*.	+13	+74	+61
5.	Total Net Contribution in respect of the named years	423	523	574
C.	YEAR TO YEAR REALLOCATIONS (WITH PRICE BASIS ADJUSTMENTS) TO REACH CASH FLOW FIGURES			
6.	Refunds in respect of 1980 paid later	+539	-495‡	
	Refunds in respect of 1981 paid later		+697	-663
	Refunds in respect of 1982 paid later			+757
7.	Adjustments for lagged payment of higher UK VAT contributions due to stronger exchange rate	-134	-30	+131
8.	"Carry Forwards" from 1979 Budget (UK share)	-50		
9.	Article 131 refund in respect of 1979	-83		
10.	Downward revision of Contributions and Receipts to stay within the 1 percent VAT limit			-102
11.	FIGURES FOR PROGRAMME 2.7 (table 2.2.1 basis)	695	695	700

ø Working Assumption.

*Mainly reflects larger Budget estimates than Commission have used but also reflects the effect of the stronger exchange rate in raising our VAT contributions in mua even though the extra payments are delayed to the next year.

‡ Differences in price bases mean that £495m at 1979 prices received in 1981, is the equivalent of £539m at 1979 prices in 1980.

SECRET

2

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3 (Direct Dialling)
01-218 9000 (Switchboard)

MO 8/2/12

9th July 1980

Dear Clive,

I enclose a personal letter to the Prime Minister from my Secretary of State which he is anxious that she should see before tomorrow's meeting of the Cabinet. His letter is relevant to his minute to the Prime Minister of today concerning the Chief Secretary's paper, C(80)40.

Yours ever,
Brian

(B M NORBURY)

C A Whitmore Esq

SECRET

✓ Defence Budget

MO 8/2/12

PRIME MINISTER

PUBLIC EXPENDITURE 1981/82 - 1983/84

I shall, as you know, be unable to attend Cabinet tomorrow. Had I been there, I would have been obliged to say that I cannot accept paragraph 14 of the Chief Secretary's paper, C(80)40.

2. We have only this week discussed in the Defence and Overseas Policy Committee (OD) ways of reshaping the defence programme to bring it into line with the last Public Expenditure White Paper (Cmnd 7841). Even taking account of the major economies in administration which I intend to secure, I have had to propose very considerable reductions in defence plans. The total reductions which I have made amount to £396M in 1981/82, £504M in 1982/83 and £568M in 1983/84.

3. The advice of the Chiefs of Staff has been made clear to OD. These reductions have no military justification. They act to lessen our security over the next few years at a time of mounting dangers and they bring us to the very edge of a crisis in our defence contribution to NATO. The reductions falling on British industry (90% of equipment bought by my Ministry is made in the UK) will cause serious difficulties, particularly in present economic conditions, for a number of firms both large and small.

4. I accepted these reductions in last year's Public Expenditure survey in the interests of our economic recovery. Our Allies were concerned that we were reducing expenditure below the plans left us by our predecessors but they accepted our good faith in our commitment to the Alliance and our determination to achieve the 3% real increases set out in our published PESC plans. Unrealistic cash limits frustrated our purpose last year when we underspent in volume terms (we achieved only a 2½% increase in our real defence effort, and even then there was a small overspend in cash as a result of the failure of Iranian orders). The Chief Secretary now

proposes that instead of making good this shortfall we should use it as a lower platform from which to calculate our 3% commitment. This is a transparent ploy which will fool no-one: we could not, as the Chief Secretary suggests, maintain that we are still meeting our obligations. We would not be believed, either by our friends abroad, or by the public and party at home. Neither will the lesson be lost on the Russians.

5. Our commitment as a Government to defence has become a vital anchor at a time of uncertainty and difficulty within the Atlantic Alliance. The cuts proposed by the Chief Secretary would take us over the safe limits of change.

6. At home I do not believe that further cuts in defence expenditure would be understood. The implications for industry would be very serious and we could see the disappearance of well-known names such as the Scott Lithgow and Cammell Laird shipyards as well as put in jeopardy the future viability of major elements of the aerospace and helicopter programmes. On the brink of a major recession it would be folly to inflict on industry damage of this magnitude.

7. I understand the reasons which have led the Chief Secretary to examine critically the public expenditure totals published in Cmnd 7841, but, as I made clear at OD yesterday, I believe that all the arguments point to sticking to our defence plans.

8. I am sending copies of this minute to our Cabinet colleagues, the Minister of Transport and the Chief Whip; and to Sir Robert Armstrong.

Ministry of Defence

9th July 1980

PM Seen

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Francis Pym MC MP
Secretary of State
Ministry of Defence
Main Building
Whitehall
London SW1A 2HB

9 July 1980

Dear Francis

DEFENCE CASH LIMIT 1980/81

Thank you for your letter of 27 June.

Our officials are now carrying out a joint examination of the reasons for the upsurge in your spending this year. I am sure this should be completed quickly, and if possible a report submitted before the end of the month so that we can consider together what if any adjustment should be made to your cash limit.

I have to say however that any adjustment going beyond those elements we have already discussed would raise formidable difficulties for me. It is essential to uphold, and be seen to uphold, the principle that the Government contains its expenditure within the cash limits announced in the Budget. Any increase in your (or any other) cash limit would increase the PSBR and CGBR, with consequential effect on interest rates, unless it were matched by a corresponding reduction elsewhere in the spending plans, which at present I see no practicable way of achieving, or by an increase in taxation which would be highly damaging and would simply transfer the problem to the private sector. However, we need not cross that bridge until the report by officials is available.

We must however settle now, at least in principle, the issue of a deduction from the 1980/81 cash limit to compensate for the 1979/80 overspend. I note the objections you have raised to this course, but I cannot accept them. Our allies made no complaint when a similar deduction was made last year. The deferred Iranian receipts were but one small part of your total receipts which are always liable to fluctuate in either direction

during the course of a year. And whereas the forecast overspend of £60.2 million is provisional, it is the figure provided by your Department, and by far the largest, in absolute terms, of last year's overspends which are shortly to be announced.

The principle of deduction is important to our general stance on cash limits. It is essential to prevent a Department spending more over the two years than intended in cash terms. Failure to make the deduction would call in question the credibility of the cash limit system, to which we are as a Government firmly committed. The rules apply, and must be seen to apply, to all Departments. The fact that the proposed deduction is not greater than the amount of the overspend, eg to take account of inflation, could itself be a cause for criticism in some eyes.

In the light of these wider considerations, I hope that you will now accept in principle that the overspend should be deducted from this year's cash limit. The adjustment could be announced, with the other changes listed in my letter of 18 June, either immediately (which I should prefer) or when the review now in progress has been completed.

I am sending copies of this letter to the Prime Minister, Members of OD and Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

cc Defence Expenditure

Prime Minister
With the defence cash limit issue outstanding, I doubt whether you will want to respond on the point in para 3. As for the point in para 4, I think we should await the Treasury's comments.

MO 8/2/12

PM seen

TL.

PRIME MINISTER

CASH LIMITS 1979/80

Flag A

The Chief Secretary minuted you on 3rd July, seeking agreement to the publication of a White Paper giving the provisional out-turn against cash limits in 1979/80. I have no objection to this.

TL. 9/7

2. There are, however, two particular points in his minute on which I must comment.

3. The first is the statement that any overspend should result in a corresponding deduction in the following year, in order to avoid a higher total of spending over a longer period than we collectively planned. In so far as my Department is concerned, even with an estimated overspend of some £60m in 1979/80 we shall have achieved a volume increase in defence expenditure of only 2½% over the previous year, significantly less than the 3% increase which we collectively planned. A corresponding cut as a penalty in the current year would simply ensure that we fell short of our planned target again by a similar amount. I believe in cash control of expenditure, on the basis of taut but realistic limits which do not create unmanageable problems for Departments. Likewise I do not object in principle to the concept of a 'fine', particularly as I understand that the Treasury are now prepared to contemplate a matching arrangement for carrying forward underspends. But any fine needs to be related to the circumstances.

But the same argument would apply to other programmes

TL.

There is a paper in the cabinet folder

TL.

4. Second, the Chief Secretary floats in his minute the possibility that the Treasury might discuss with the PAC the possibility of the Committee investigating any breach of a cash limit, whether or not it formally involves an Excess Vote. This proposition involves

a considerable extension of the PAC role and could bring the Committee into conflict with the Departmental Committees. It would also seem likely to result in a PAC examination of issues which we ought to have settled among ourselves. I am told that there was some considerable criticism of the Treasury proposal when it was circulated at official level, not least from the C&AG himself. I think we need to look hard at this on the basis of a proper assessment of the pros and cons.

5. I am copying this minute to other members of Cabinet, to The Minister of Transport and to Sir Robert Armstrong.

FP

Ministry of Defence

8th July 1980

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

Prime Minister

PUBLIC EXPENDITURE SURVEY 1980: SCOTLAND

1. In C(80)40, the Chief Secretary proposes that my programmes (excluding agriculture and fisheries) should be reduced by £150m a year over the next three years. This reduction would be additional to those flowing from his specific proposals on health, education, etc. I was given no warning, formal or informal, of this proposal which purports to reflect the outcome of a meeting of Ministers on 1 May held to consider the Needs Assessment Study completed last year.

2. In fact, as the note of that meeting records, there was general agreement that it would be very difficult politically to alter relative shares by re-distributing existing public expenditure allocations, particularly since any such re-distribution would have to be made public. We did, however, agree that it would be legitimate to take account of the results of the Needs Assessment Study as a relevant factor in taking decisions on the distribution of increases or reductions in public expenditure plans. In taking this decision the Ministers concerned were all aware that the great bulk of my expenditure is, in total, adjusted in proportion to changes in the total of comparable programmes in England and Wales. The formula by which this is done was made public with Treasury agreement at the same time as the last Public Expenditure White Paper; and, as it happens, I was questioned in detail about this by the Scottish Select Committee yesterday.

3. The needs Assessment Study was part of the ill-fated devolution proposals which assumed an arm's length relationship between the UK Government and a Scottish Assembly. Many of us, in resisting the Assembly, argued that Scotland would do less well financially if it had one. The Chief Secretary's proposal totally undermines this argument - and this on the basis of a Study which the Chief Secretary himself acknowledges was not intended to determine relative levels of public expenditure. As you said in the House last week it is right that public expenditure per head in Scotland is greater by a considerable amount than in England and Wales.

4. A few key figures will show what the Chief Secretary's proposal would mean. He excludes agriculture and fisheries: in the light of our manifesto commitments I must also exclude health and law and order from my calculations. Present plans for the rest of my programmes provide for cuts of nearly 11½% between this year and 1984. The Chief Secretary's proposal would put this up to almost 18%. This is, quite simply, impracticable.

5. We need not imagine that any changes in public expenditure shares can be made by stealth. Public knowledge of the formula and the close interest shown by the Scottish Select Committee and the Scottish press will see to that. What is proposed is not re-distribution: it is, and will be seen as, a scheme to balance the national books by forcing Scotland to take debilitating medicine not prescribed for any other part of the UK. I need hardly explain to you what a disaster any move of this sort would be for our whole political position in Scotland. To do it within 18 months of the referendum and at a time of the highest unemployment since the war would be very hard to justify. My own credibility if I were to agree to such a proposal would be gravely weakened both with public opinion and our own Party supporters.

6. I shall of course be prepared to argue my case in Cabinet, but I think it right to make my position clear to you beforehand. I should not have been put in the position of having to challenge in Cabinet a proposal of such importance to me when I have had no previous warning of it and when it is in conflict with an earlier Ministerial agreement.

7. I am copying this minute to other members of the Cabinet, the Chief Whip, the Minister of Transport and Sir Robert Armstrong.

G.Y.

8 JULY 1980

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury
Parliament Street
LONDON SW1P 3HE

8 July 1980

Dear Chief Secretary,

In case I am not able to attend Cabinet on Thursday I thought it would be helpful if I recorded my reactions to your proposals in C(80)40 so far as their effect on education is concerned. I concentrate, as you do, on 1981-82.

2. Your proposals would mean substantial further reductions in the education programme over and above those we agreed earlier this year, were the maximum possible that could be made without reducing the quality of the service. I would like to explain why I do not consider that we should make the further reductions.

i. Your figure of £87m, including the savings to offset the school transport loss, is a good deal more than the total shown in the PESC Report for the three items that you identify in paragraph 18, namely capital expenditure, higher education (including the consequential savings on student awards) and a reduction in the school leaving age. To reach your total it would therefore be necessary for local authorities to make further cuts in schools expenditure. But there is evidence both in the report by our officials which I circulated on 4 July and in the report which is about to go to the Consultative Council from the Expenditure Steering Group - Education that additional resources are needed there if the quality of education is to be maintained. We have already approved big savings on school meals, under 5s, educational building, science and provision for overseas students. Our friends in the local authority world are clear that any further economies must fall on the core of provision in the schools.

ii. A cut in capital expenditure would fall essentially on the private construction industry and only serve to reinforce the criticisms from the industry to which the Treasury refer in paragraph 23 of the "main issues" paper (C(80)39).

iii. A further cut in higher education, where expenditure and unit costs are already planned to fall, would require a reduction in quality or numbers or both. If it depressed quality, it would mean going back on all that we have said about the support of excellence. If it meant fewer students, at a time when the relevant age groups are increasing, it would mean both diminished opportunities for some of our ablest young people and an impairment of the national capability for producing the highly qualified scientists and engineers that industry needs. A better way to make savings (though not, given the time lag before repayments could begin, in the lifetime of this Parliament) may be through the partial replacement of grants to students by loans. As you know, I have asked my officials to report to me on this by the end of 1980.

iv. Your proposals on the school leaving age is to allow pupils whose 16th birthday falls between 1 September and 31 January to leave at the end of the previous summer term, when some of them would be under 15½. This would be a serious retreat after the advance we made in raising the age to 16 in 1973; it might mean that up to one fifth of all pupils would fail to complete the full secondary course; it would certainly add to unemployment among young people; and it would require controversial legislation to be enacted very early in the 1980-81 Session - all for £10m (less the cost of extra social security benefits). My colleagues here and I have considered very recently this proposal and are clear that it should be rejected on policy grounds.

3. I think I am right in saying that, when allowance is made for further cuts in the civil service and the impact on the contingency reserve of your proposals on child benefit and special employment measures (paragraphs 10 and 11 of your paper), the net saving of £115m on Cmnd 7841 shown at the end of Annex A becomes about £250m. This would leave room for a significant reduction in the further savings you are seeking in my programme and others.

I am sending copies of this letter to the Prime Minister, the other member of the Cabinet, Norman Fowler, Michael Jopling and Sir Robert Armstrong.

Yours faithfully

IA Shaw

MARK CARLISLE
Approved by the Secretary of State
and signed in his absence

Econ Pol
PM o.

PRIME MINISTER

PUBLIC EXPENDITURE: END-YEAR FLEXIBILITY

In my Cabinet paper on Public Expenditure (C(80)40), I refer in paragraph 10 to the need for a large contingency reserve to provide, among other things, for some flexibility in end-year expenditure. This minute and the attached note explain what is envisaged. It is for information at this stage: I am not asking for an immediate decision.

The Treasury have been preparing a scheme, described in the attached note, to provide within limits for unspent allocations at the end of each year of certain types of expenditure - mainly capital and procurement programmes - to be carried forward and added to programmes in the following year. This would reduce the incentive, about which Sir Derek Rayner has been concerned, to wasteful end-year spending when unspent funds are "lost" to Departments at the end of each year.

The scheme in the attached note has been discussed with Sir Derek Rayner. He has said that it meets his concerns about "annuality" and has his strong support.

The scheme applies to underspending, not overspending. I am sure, and again Sir Derek Rayner agrees, that we must continue to treat cash limits as firm limits. However the scheme does help Departments which have to aim below the limits in order to avoid the risk of overspending, since underspent amounts can be carried forward.

A scheme which allows quite large sums of money to be added at the end of one year to the programme in the following year raises problems for control of public expenditure and the PSBR. To ensure that such additions are provided for in the plans, a larger contingency reserve becomes necessary, from which the sums would be provided.

You ought to know that we have also been discussing with the nationalised industries chairmen a scheme of a rather different kind for end-year flexibility for them in managing their external financing limits. This is part of work not yet completed but it will also impose a requirement on the contingency reserve. Together the two schemes involve earmarking about £600 million in the 1981-82 contingency reserve (at 1980 Survey prices).

This is a large sum. It is to be expected that the scheme in the attached note would cause Departments to underspend slightly more, because they would not be so anxious to spend their full allocations before the year-end. This might justify our adding another £100 million or so to the contingency reserve without actual expenditure turning out any higher. Even so, £600 million is a large sum to earmark in a reserve now standing at £1250 million for 1981-82, especially when the economic and industrial situation may throw up other contingencies.

I do not therefore propose an immediate decision to introduce the scheme described in the attached note. It will not be too late to introduce it this year if we decide in a few months time, when we can see whether a contingency reserve of the necessary size is available and when we may be clearer about possible threats to our expenditure plans for 1981-82. The delay will also allow us to take account of a report which the PAC are preparing on end-year flexibility.

I favour the scheme, and hope that we will be able to decide in due course to introduce it this year. To this end, I hope the

Cabinet will agree with the recommendation in my paper on Public Expenditure not to reduce the contingency reserve now provided in the plans for next year.

I am copying this minute to other members of the Cabinet, the Minister of Transport, Sir Robert Armstrong and Sir Derek Rayner.

W. J. B.

JOHN BIFFEN
8 July 1980

PUBLIC EXPENDITURE: FLEXIBILITY BETWEEN FINANCIAL YEARS

The purpose of this paper is to set out the general arguments for and against a scheme of carry-over between financial years of unspent funds in cash limits. It also described the scheme currently under consideration.

2. General arguments. There has for some time been interest in arrangements for flexibility between financial years, and there has been discussion from time to time of schemes of various types. The Public Accounts Committee have been interested in it, and have recently held hearings on the subject: their report is awaited. The White Paper on the introduction of cash limits in 1976 (Cmnd. 6440) envisaged that cash limits would point up the case for some arrangements for flexibility. It said:-

> "For certain services, such as the roads and hospital building programmes, where the timing of expenditure on existing projects cannot be precisely controlled, some arrangements are needed to allow a limited amount of flexibility between successive financial years and between current and capital expenditure. The extent to which such arrangements are required will be decided in the light of experience".

3. Ministers considered in 1979 the possibility of introducing a scheme for end-year flexibility but the scheme then envisaged was not at that time supported by Departments. The Chief Secretary proposed that consideration should be deferred. He did not rule out introducing a scheme for carry-over into 1981-82 and said that this was a decision for this summer.

4. There are two main arguments in favour of carry-over:-

(i) Some expenditure, particularly on capital programmes, cannot be regulated within narrow limits at short notice. To ensure that uncontrollable factors do not carry spending over the limits, it is necessary to aim below the limits and this causes allocations to be significantly underspent in most years.

(ii) In the absence of provision for carrying forward underspending, the annual limits encourage Departments to spend in March on items of low priority because unspent allocations are 'lost'.

5. Two important considerations are:-

(i) For purposes of managing the PSBR, safeguards are required against annual public expenditure totals being exceeded.

(ii) So far as possible the incentive should be retained for Departments to refine and sharpen the systems for monitoring and managing expenditure. Such incentive is now provided by the prohibition against exceeding cash limits coupled with Departments' own desire to make the maximum use of the money allocated to them. But the nature of certain programmes is that no amount of incentive can produce precisely accurate management.

6. A scheme of end-year flexibility could take the form of both allowing underspent amounts to be carried forward to the following year and of allowing cash limits to be overspent with a corresponding deduction from the following year, or of allowing only one of these two.

7. The scheme recommended is one which would allow, within defined limits, underspent amounts to be carried forward and added to the same cash limit in the following year, but which would not allow cash limits to be overspent. A scheme which condoned the overspending of cash limits would be contrary to the Government's policy that cash limits are strict limits, not targets.

8. Many of the arguments in favour of flexibility would be met by a scheme which allowed underspent amounts to be carried forward. The amounts carried forward would be known early enough in the following year for firm limits to be set for that year. Such a scheme would reduce the incentive to spend money wastefully to prevent its being lost. It would also make more tolerable aiming off in order to keep within the cash limit, because a consequent underspending is not lost.

9. Coverage. The scheme is intended to provide flexibility in those programmes where progress and cash flow cannot be managed with precision. In the main this means capital expenditure and certain procurement programmes. Departments have provided details of the expenditure they wish to see treated as eligible.

10. Limits. To contain the potential additions to subsequent years' expenditure, there should be an upper limit to the amount of carry-over. It is proposed that this should be 5% of the eligible expenditure in each cash limit. It should also be an object of policy to avoid large numbers of Supplementary Estimates for relatively trifling amounts. It is therefore proposed that there should be a lower limit of 1% of the eligible expenditure in each cash limit.

11. Contingency reserve. Funds carried over into a year would be charged against the contingency reserve for that year. In this way the scheme does not add to the planned public expenditure totals and to the planned PSBR.

12. It would be necessary to provide a reserve large enough to carry this cost. The amount of expenditure Departments wish to be covered by the scheme amounts to £8000-10,000 million, of which 5% is £400-500 million. It is unlikely that the full amount would be carried forward in any one year. This suggests that, to accommodate the scheme, the contingency reserve would need to be some £300 million at 1980 Survey prices higher than it otherwise would be. Ministers would need to decide in the context of the public expenditure Survey discussions whether this can be accommodated within acceptable public expenditure totals.

13. One consideration is that the scheme could be expected to result in somewhat higher shortfall than would otherwise have occurred, because Departments would be under less pressure to use up available funds at the end of the year. But some of this shortfall would have happened anyway, and it would be unwise to assume that the whole of the amount carried forward into the year will be matched by extra underspending. If it is assumed that the amount carried forward into 1981-82 is £300 million and that underspending is £100-150 million higher as a result of the scheme than it would otherwise have been, it follows that the scheme would increase

expenditure in 1981-82 by £150-200 million net (all figures at 1980 Survey prices). This should be allowed for in making the plans for 1981-82 and subsequent years.

14. Mechanics. The sums carried over would be calculated from provisional statements of outturn in time to take provision in Summer Supplementary Estimates. Further adjustments would not subsequently be made if outturn turned out to be slightly different from what had been expected. The amounts eligible for carry-over to the following year would be calculated as a percentage of the totals for the current year thus produced.

15. The scheme contains a presumption that Parliamentary authority would be given to a Supplementary Estimate. This aspect has been brought to the attention of the PAC.

16. Overspending. Overspending would continue to be regarded as a serious matter for detailed investigation and the control total for the following year reduced on that account.

17. Recommendation. It is recommended that Ministers consider in this year's Survey the proposition that the scheme be introduced in the current year. This would mean that the amounts underspent this year within the eligible categories would be added to the corresponding cash limits in 1981-82 and debited to the contingency reserve for that year. If it was decided that a contingency reserve of adequate size to cover this extra requirement could not be provided in 1981-82, the possibility could be retained of looking at this again next year, in the hope that the contingency reserve for 1982-83 might be less tight.

FILE

VLB

7 July 1980

Cash Limits in 1979/80

The Prime Minister has read the Chief Secretary's minute of 3 July and the draft White Paper on cash limit outturns for 1979-80 which he enclosed with it. The Prime Minister is content with the draft, but she has asked me to say that she is very disturbed by the number of cases of overspend which it reports.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet, to Tony Mayer (Department of Transport) and David Wright (Cabinet Office).

T P LANKESTER

A. C. Pirie, Esq.,
Chief Secretary's Office.

VLB

Prime Minister

The attached draft is straight-forward, though the increase in over-spends which it reveals is disturbing. Shall we say you are content with the draft, but disturbed by the number of over-spends?

PRIME MINISTER

CASH LIMITS IN 1979-80

Yes pm.

We are due to publish around the end of this month the usual White Paper showing the provisional outturn of expenditure against cash limits in 1979-80. A draft is attached, following the strictly factual format of the corresponding White Paper which we published last year. I send it to you and Cabinet colleagues for formal approval for publication. If anyone wishes to comment, I should be glad to hear by 10 July.

2. The vast majority of cash limits were once again correctly observed in 1979-80. In aggregate there was as usual some underspending. Central Government cash limits were underspent in total by about £325m, equivalent to under 1%. Underspending in previous years was rather larger: 1.5% in 1978-79, 2.6% in 1977-78 and 2.6% in 1976-77.

3. But there was a disturbing increase in the number of cases of overspend. The number of breaches of cash limits was two in 1976-77, two in 1977-78, four in 1978-79. Last year there were no less than twelve. The amounts were in most cases not significant, but the increase in number is worrying and does not accord well with the importance which, as a Government, we attached to cash limits in controlling expenditure.

4. This matter was mentioned at Cabinet today. I take the further opportunity of this minute to remind colleagues in charge of spending departments of our collective commitment to cash limits as an effective control on expenditure. Subject in one or two cases to specific agreements to review, we must adhere strictly to the cash limits which have been set, on which the Budget was based. This will undoubtedly cause difficulties in many areas this year, but the strategic need is imperative.

5. I am sure also that we must continue to operate the policy, which we have been applying so far, that in what we all hope will continue to be the few cases where a cash limit is overspent, there should not only be a thorough investigation to identify and correct any weaknesses in control, but also a corresponding deduction in the following year. Only in this way can we ensure that inadvertent overspending in a particular year does not result in a higher total of spending over a longer period than we collectively planned.

6. The fact of the twelve breaches of cash limits will become public when the Public Accounts Committee take evidence from the Treasury on 16 July about the outturn of cash limits in 1979-80. It is on that occasion rather than on the subsequent publication of this White Paper that there may be press interest. The Treasury intend to discuss with the PAC at that meeting the possibility of the Committee investigating where they think fit any breach of a cash limit, whether or not it formally involves an Excess Vote.

7. I am sending copies of this minute and of the White Paper to other members of the Cabinet, to the Minister of Transport and to Sir Robert Armstrong.

Adrian

P.P. JOHN BIFFEN
3 July 1980

[Approved by the Chief Secretary
and signed in his absence]

CASH LIMITS

1979-80 PROVISIONAL OUTTURN

(AND 1978-79 OUTTURN)

This White Paper gives the provisional outturn of cash limits on Government spending in 1979-80, and revised figures for 1978-79.

2. The Cash Limits set by the Government for 1979-80 were published in June 1979 in the White Paper 'Cash Limits 1979-80' (Cmnd 7604). Changes subsequently made are shown in Table 1 below.

3. Tables 2 and 3 give provisional figures for the outturn against the limits. The figures may be subject to some adjustment when final accounts are available. The estimated outturn to the External Financing limits on nationalised industries in 1979-80 was given in Table 17 of the Financial Statement and Budget Report 1980-81.

4. Table 4 gives the final outturn figures for central Government cash blocks in 1978-79. The figures for Local Authority cash blocks in 1978-79 shown in Table 5 are still subject to revision. Cash Limits for 1978-79 were published in the White Paper 'Cash Limits on Public Expenditure' (Cmnd 7161) and the provisional outturn figures, together with changes made to the limits during the year, in the White Paper 'Cash Limits 1978-79 Provisional Outturn' (Cmnd 7681).

CHANGES TO CASH LIMITS IN 1979-80

TABLE 1

THE FOLLOWING CHANGES WERE ANNOUNCED DURING 1979-80 TO THE CASH LIMITS PUBLISHED IN CMND 7604 EXCLUDING TOKEN INCREASES

Class and Vote/ Block Number (1)	Department	£ million(2)	Purpose of Change
CENTRAL GOVERNMENT ASSIMILATED BLOCKS			
I, 1	Ministry of Defence	+ 121.8 † + 9.9 ø	
I, 2	Ministry of Defence	+ 34.3 † + 35.0 ø	
I, 4	Department of the Environment (Property Services Agency)	- 10.0 † + 18.9 ø	
I, 5	Ministry of Defence	- 6.1 †	
II 1*	Foreign and Commonwealth Office	- 3.8	Reduction due to the strength of sterling and increased receipts from passports: announced on 15 February 1980.
II 3	Foreign and Commonwealth Office	- 2.1	Correction of error in Cmnd 7604: announced on 15 February 1980.
II 4	Foreign and Commonwealth Office	- 0.1	Correction of error in Cmnd 7604: announced on 15 February 1980.
II 5	Foreign and Commonwealth Office	- 3.5	Reduction following deferment of a payment into 1980/81: announced on 15 February 1980.
III 5	Ministry of Agriculture Fisheries and Food	+ 14.5	Increased expenditure on the maintenance of strategic reserves of food: announced on 16 November 1979.
IV 8	Department of Energy	+ 146.2	Grants to National Coal Board: announced on 6 February 1980.

† Increased provision to meet increased cost of VAT, Petroleum duty and the industrial pay award less a deduction equivalent to the cash limit overspend in 1978-79 announced on 16 November 1979

ø Increase taken in Spring Supplementary Estimates because the previously announced cash limit was expected to be overspent.

Class and Vote/ Block Number(1)	Department	£ million(2)	Purpose of Change
IV 14	Friendly Societies Registry	+ 0.1	Increased cost of the inspection of Grays Building Society: announced on 18 December 1979.
IV 16	Department of Employment	+ 12.0	Increase in expenditure on special temporary employment programme offset by transfers from IV, 19, W04 and SEPD 2: announced on 23 November 1979.
IV 19	Department of Employment	- 10.7	Transfer to IV, 16: announced on 23 November 1979.
VIII 4	Department of the Environment	+ 0.4	Increase in grant-in-aid of the Nature Conservancy Council to permit an exceptional land purchase offset by transfer from DOE/LA6: announced on 8 February 1980.
VIII 6	Department of the Environment	- 5.8	Transfer of expenditure for accommodation services of museums and galleries to PSA Vote XIV, 1: announced on 22 November 1979.
VIII 7*	Department of the Environment	- 0.3	Transfer of expenditure for the administration expenses of museums and galleries to PSA Vote XIV 2: announced on 8 February 1980.
X 4	Department of Education and Science	+ 31.9	Increased provison for forecast cost of pay settlements: announced on 28 November 1979.
X 6	Department of Education and Science	+ 0.2	Increased provision for cost of pay settlements: announced on 13 February 1980.
X 13	Department of Education and Science	+ 0.7	Increased provision for cost of pay settlements: announced on 13 February 1980.

Class and Vote/ Block Number(1)	Department	£ million(2)	Purpose of Change
X 16	Department of Education and Science	+ 0.3	Increased provision to meet cost of pay settlements: announced on 13 February 1980.
X 18	Department of Education and Science	+ 0.1	Increased provision to meet cost of pay settlements: announced on 13 February 1980.
X 20	Office of Arts and Libraries	+ 0.05	Increase to meet administrative expenses and London weighting award offset by decrease in X,26: announced on 26 February 1980.
X 26	Office of Arts and Libraries	- 0.1	Transfer to X,20 and X,27: announced on 26 February 1980.
X 27	Office of Arts and Libraries	+ 0.05	Increased provision to meet cost of pay settlements offset by decrease in X,27: announced on 26 February 1980.
XI 1	Department of Health and Social Security	+ 141.7	Increased provision to meet the cost of pay settlements in the National Health Service: announced on 29 November 1979.
		+ 111.8	Increased provision to meet the cost of pay settlements in the National Health Service including a transfer from DOE/LA6: announced on 29 January 1980.
XIII 3*	Privy Council Office	+ 0.1	Increased provision to cover salary costs and other expenditure: announced on 27 November 1979.
XIII 12*	Department for National Savings	+ 1.9	Recompense to savers for payments delayed by industrial action: announced on 26 November 1979.
		+ 0.9	Recompense to savers for payments delayed by industrial action: announced on 24 January 1980.

Class and Vote/ Block Number(1)	Department	£ million(2)	Purpose of Change
XIV 1	Department of the Environment	+ 5.8	Transfer from VIII, 6: announced on 22 November 1979.
XIV 2*	Department of the Environment (Property Services Agency)	+ 0.4	Transfer from VIII 7 and increased provision to meet cost of industrial pay settlement: announced on 8 February 1980.
XIV 3	Her Majesty's Stationery Office	+ 7.5	Increased provision to meet substantial increases in prices of purchases by HMSO: announced on 21 November 1979.
XV 2	Northern Ireland Office	+ 2.9	Additional provision for police pay: announced on 11 February 1980.
XVII 1	Department of the Environment	+ 230.0	Increase in Rate Support and National Parks supplementary Grants: announced on 16 November 1979.
XVII 14	Department of Transport	+ 2.0	Increase in Transport Supplementary Grant to meet cost of pay awards: announced on 16 November 1979.
OTHER CENTRAL GOVERNMENT BLOCKS			
HO 1*	Home Office	+ 6.1	Increased provision to meet the cost of the pay award for prison officers arising from the "May" inquiry: announced on 27 November 1979.
		+ 2.0	Increased expenditure arising from the need to make payments retrospectively of tax compensation on rent allowances paid to prison staff: announced on 14 February 1980.
HO 2	Home Office	+ 1.0	Increase in financial assistance to local authorities for education costs of Vietnamese refugees: announced on 15 November 1979.

Class and Vote/ Block Number(1)	Department	£ million(2)	Purpose of Change
SO 2	Scottish Office	+ 32.8	Increase in Rate Support Grant: announced on 19 November 1979.
DAFS 1	Department of Agriculture and Fisheries for Scotland	+ 0.9	Increased provision to meet pay settlement for staff of research and agricultural colleges: announcedon 27 November 1979.
SDD1	Scottish Development Department	+ 0.5	Increased grant to Shipping Owners to reduce fares in services to Orkney and Shetland: announced on 25 July 1979.
		+ 4.5	Increase taken in Spring Supplementary Estimate for Class VI, 1 because the previously announced cash limit was expected to be overspent.
SEPD 2	Scottish Economic Planning Department	- 0.8	Transfer to IV, 19: announced on 23 November 1979.
SED 1	Scottish Education Department	+ 0.9	Increase for the purchase of a building for the Scottish Council for Educational Technology and pay awards: announced 27 November 1979.
SHHD 1	Scottish Home and Health Department	+ 8.8	Increased provision to meet the cost of pay settlements in the National Health Service: announced on 27 November 1979.
		+ 18.1	Increased provision to meet the cost of pay settlements in the National Health Service announced on 13 February 1980.
SHHD 2*	Scottish Home and Health Department	+ 0.8	Increased provision to meet the cost of prison governors and officers pay: announced on 13 February 1980.
		+ 1.2	Increase taken in Spring Supplementary Estimate for Class IX, 8 because the previously announced cash limit was expected to be overspent.
SRO 1*	Scottish Record Office	- 0.2	Correction of error in Cmnd 7604: announced 13 February 1980.
QLTR1*	Queen's and Lord Treasurer's Remembrancer	+ 0.1	Increase taken in Spring Supplementary Estimate for Class IX, 14 because the previously announced cash limit was expected to be overspent.

Class and Vote/ Block Number (1)	Department	£ million(2)	Purpose of Change
WO 2	Welsh Office	+ 0.1	Increase for grant to National Eisteddfod: announced on 21 November 1979.
		- 1.3	Correction of error in Cmnd 7604: announced on 21 November 1979.
		+ 16.3	Increased provision to meet the cost of pay settlements in the National Health Service and a greater number of awards under the vaccine damage payments scheme: announced on 30 January 1980.
WO 3	Welsh Office	+ 4.1	Additional provision for special factories in Cardiff and Ebbw Vale: announced on 27 July 1979.
WO 4	Welsh Office	- 0.5	Transfer to Class IV, 16: announced on 23 November 1979.
CAPITAL BLOCKS FOR LOCAL AUTHORITIES			
DES/LA 1	Department of Education and Science	- 33.0	Reduction in the education building programme for 1979/80: announced on 28 November 1979.
DOE/LA 2	Department of the Environment	- 10.0	Reduction as part of the savings of £320m in the setting of the 1979/80 Rate Support grant: announced on 21 March 1980.
DOE/LA 6	Department of the Environment	- 0.5	Transfer to VIII, 4: announced on 8 February 1980.
		- 0.5	Transfer to XI, 1 for a project of the Camden and Islington area health authority: announced on 21 March 1980.

Class and Vote/ Block Number(1)	Department	£ million(2)	Purpose of Change
SO/LA 1	Scottish Office	- 0.3	Decreases to compensate for not fully reducing the RSG increase order 1979/80 in respect of comparability awards for manual workers: announced on 13 February 1980.
SO/LA 4	Scottish Office	- 1.2	
WO/LA 1	Welsh Office	- 1.5	Deduction of 1978/79 overspend: announced on 25 January 1980.
		- 0.2	Deduction in respect of special loan sanction to cover the costs of work to remedy the effects of subsidence at Rhymney Valley: announced on 25 January 1980.

Notes:

(1) Central responsibility for expenditure control is exercised by the Treasury and Civil Service Department depending on the nature of the expenditure concerned. The blocks controlled by the Civil Service Department are indicated by an asterisk.

(2) With one exception figures rounded to nearest £0.1m.

Table 2

CASH LIMITS 1979-80 : PROVISIONAL OUTTURN

CENTRAL GOVERNMENT BLOCKS

A. Central Government Assimilated Blocks

Class and Vote number[1]		Accounting Department	Description of expenditure	£ thousand Cash Limit	Provisional Outturn
1	1	Ministry of Defence	Pay etc of the armed forces and civilians, stores, supplies and miscellaneous services	3,956,119[3]	3,942,241
1	2	Ministry of Defence	Defence procurement	3,805,644[3]	3,813,644
1	4	Department of the Environment (Property Services Agency)	Defence accommodation services, etc	528,000[3]	534,277
1	5	Ministry of Defence	Dockyard services	327,627	323,627
11	1*	Foreign and Commonwealth Office	Overseas representation: diplomatic and consular services	145,831	132,500
11	2	Department of the Environment (Property Services Agency)	Overseas representation: accommodation services	31,661	30,820
11	3	Foreign and Commonwealth Office	British Broadcasting Corporation: external services	42,176	42,176
11	4	Foreign and Commonwealth Office	British Council	28,924	28,924
11	5	Foreign and Commonwealth Office	Foreign and Commonwealth services	16,999	16,127
11	8	Cabinet Office	Secret service	40,000	39,840
11	10	Foreign & Commonwealth Office (Overseas Development Administration	Overseas aid	804,303	781,551
11	11*	Foreign & Commonwealth Office (Overseas Development Administration)	Overseas aid administration	15,175	14,077
111	5	Ministry of Agriculture, Fisheries and Food	Other agricultural and food services	76,584	74,512
111	7*	Intervention Board for Agricultural Produce	Central administration	8,621	7,485
111	8	Ministry of Agriculture, Fisheries and Food	Support for the fishing industry	17,235	16,266
111	9	Forestry Commission	Forestry	47,428	43,667
111	10*	Ministry of Agriculture, Fisheries and Food	Departmental administration	101,366	98,749
IV	2	Department of Industry	Miscellaneous support services	30,080	30,164
IV	4	Department of Trade	Pay, general administrative expenses, export promotion and trade cooperation, tourism, regulation of trading practices and other support services	80,248	68,284
IV	7	Department of Industry	Scientific and technological assistance	137,817	140,000
IV	8	Department of Energy	Industrial support	199,255	196,350
IV	9	Department of Energy	Scientific and technological assistance, nuclear energy	148,801	147,456
IV	11*	Export Credits Guarantee Department	Central services	13,721	12,936

Class and Vote number[1]		Accounting Department	Description of expenditure	Cash Limit	Provisional Outturn
				£ thousand	
IV	13	Department of Prices and Consumer Protection/Department of Trade	Pay, general administrative expenses and consumer protection	20,671	18,699
IV	14*	Friendly Societies Registry	Pay and general administrative expenses	739	709
IV	15*	Office of Fair Trading	Pay and general administrative expenses	2,633	2,403
IV	16	Department of Employment	Labour market services	123,834	118,275
IV	18*	Department of Employment	Advisory, Conciliation and Arbitration Service	11,807	10,451
IV	19	Department of Employment	Manpower Services Commission	524,188	522,910
IV	22*	Department of Employment	Departmental administration	74,442	63,842
IV	23*	Department of Industry	Central and miscellaneous services	35,862	34,599
IV	24*	Department of Energy	Administration and miscellaneous services	9,270	9,013
IV	25	Department of Employment	Health and Safety Commission	55,757	55,729
VI	3	Department of Transport	Roads etc, England	450,542	454,546
VI	4	Department of Transport	Transport services	89,809	87,079
VI	6	Department of Trade	Shipping and civil aviation services	53,861	49,313
VI	7*	Department of Transport	Central and miscellaneous services	30,979	27,016
VIII	4	Department of the Environment	Central environmental services etc	69,549	69,138
VIII	6	Department of the Environment	Royal palaces, royal parks, historic buildings and ancient monuments	41,598	42,091
VIII	7*	Department of the Environment	Central administration and environmental research	101,435	93,631
IX	1*	Lord Chancellor's Department	Administration of justice: England and Wales	33,884	30,960
IX	13*	Treasury Solicitor	Pay and general administrative expenses	6,019	5,844
X	4	Department of Education and Science	Universities etc	872,730	870,793
X	6	Department of Education and Science	Educational services	75,918	74,862
X	9	Office of Arts and Libraries	Libraries, England	32,405	29,679
X	11*	Department of Education and Science	Central administration services	22,810	22,211
X	11A	Office of Arts & Libraries	Office of Arts & Libraries	1	0
X	12	Department of Education and Science	Agricultural Research Council	29,501	29,501
X	13	Department of Education and Science	Medical Research Council	57,263	57,263

Class and Vote number(1)		Accounting Department	Description of expenditure	£ thousand Cash Limit	Provisional Outturn
X	14	Department of Education and Science	Natural Environment Research Council	36,605	36,605
X	15	Department of Education and Science	Science Research Council	175,594	175,593
X	16	Department of Education and Science	Social Science Research Council	16,765	16,765
X	17	Trustees of the British Museum (Natural History)	British Museum (Natural History)	5,835	5,824
X	18	Department of Education and Science	Other science etc	2,989	2,988
X	19	Trustees of the British Museum	British Museum	8,237	7,835
X	20	Office of Arts and Libraries	Science Museum	4,559	4,552
X	21	Office of Arts and Libraries	Victoria and Albert Museum	6,994	6,886
X	22	Trustees of the Imperial War Museum	Imperial War Museum	2,694	2,677
X	23	Trustees of the National Gallery	National Gallery	4,487	4,457
X	24	Trustees of the National Maritime Museum	National Maritime Museum	2,784	2,627
X	25	Trustees of the National Portrait Gallery	National Portrait Gallery	1,228	1,218
X	26	Trustees of the Tate Gallery	Tate Gallery	3,528	3,331
X	27	Trustees of the Wallace Collection	Wallace Collection	479	430
X	30	Office of Arts and Libraries	Arts Council and other grants	71,782	71,493
XI	1	Department of Health and Social Security	Health and personal social services, England	5,351,281	5,253,400
XII	4*	Department of Health and Social Security	Administration and miscellaneous services	357,164	348,389
XIII	3*	Privy Council Office	Pay and general administrative expenses	376	364
XIII	4*	Treasury	Pay and general administrative expenses	14,599	13,800
XIII	5*	Customs and Excise	Pay, general administrative expenses and capital expenditure	190,804	181,910
XIII	6*	Board of Inland Revenue	Pay and general administrative expenses	439,508	422,665
XIII	7*	Department of Transport	Driver and vehicle licensing	49,313	47,565
XIII	9*	Exchequer and Audit Department	Pay and general administrative expenses	5,216	4,745
XIII	10*	National Debt Office	Pay and general administrative expenses	1	0
XIII	11*	Public Works Loan Commission	Pay and general administrative expenses	1	0

Class and Vote number (1)		Accounting Department	Description of expenditure	£ thousand Cash Limit	Provisional Outturn
XIII	12*	Department for National Savings	Pay and general administrative expenses	43,725	42,280
XIII	15	Civil Service Department	Central management of the Civil Service	26,131	26,090
XIII	16*	Public Record Office	Pay and general administrative expenses	2,198	2,064
XIII	18*	Office of Population Censuses and Surveys	Pay and general administrative expenses	12,271	11,381
XIII	20*	Land Registry	Pay, general administrative expenses and capital expenditure	33,551	32,300
XIII	22*	Charity Commission	Pay and general administrative expenses	2,279	2,084
XIII	23*	Ordnance Survey	Pay, general administrative expenses and capital expenditure	14,349	11,143
XIII	24*	Cabinet Office	Pay and general administrative expenses	5,333	5,225
XIII	28*	Parliamentary Commissioner and Health Service Commissioners	Pay and general administrative expenses	941	797
XIII	29*	Public Trustee	Pay and general administrative expenses	2	0
XIV	1	Department of the Environment (Property Services Agency)	Office and general accommodation services	385,802	379,168
XIV	2*	Department of the Environment (Property Services Agency)	Administration and miscellaneous services	181,200	181,505
XIV	3	Stationery Office	Stationery and printing	114,319	113,209
XIV	4	Civil Service Department	Computers and telecommunications	58,277	57,279
XIV	5	Central Office of Information	Publicity and departmental administration	36,314	33,676
XIV	8*	Government Actuary's Department	Pay and general administrative expenses	381	355
XIV	9	Civil Service Department	Civil Service catering services	1,175	1,148
XIV	10*	Paymaster General's Office	Pay and general administrative expenses	5,487	5,284
XV	2	Northern Ireland Office	Law, order and protective services	241,330	240,700
XV	3*	Northern Ireland Court Service	Administration of justice: Northern Ireland	3,779	3,735
XV	4*	Northern Ireland Office	Central and miscellaneous services	4,187	3,820
XVII	1	Department of the Environment	Rate support grant and supplementary grants to local authorities (2)	7,786,400	7,786,400
XVII	10*	Crown Estate Office	Pay and administrative expenses	925	896
XVII	14	Department of Transport	Transport supplementary grants: England and Wales (2)	350,800	350,800
TOTAL				29,495,101	29,223,688

B. Other Central Government Blocks

Department	Block Number (1)	Description of Expenditure	£ thousand Cash Limit	Provisional Outturn
Bank of England	BOE 1	Financial management	64,500	64,050
Home Office	HO 1*	Pay and general administrative expenses	315,867	312,800
	HO 2	Law, order and protective services	154,908	146,800
SCOTLAND				
Scottish Office	SO 1*	Pay and general administrative expenses	59,514	49,855
	SO 2	Rate support grant for local authorities in Scotland (2)	1,170,300	1,170,300
Department of Agriculture and Fisheries for Scotland	DAFS 1	Agricultural services and fisheries support	38,900	37,776
Scottish Courts Administration	SCA 1*	Pay and general administrative expenses	4,881	4,657
Scottish Development Department	SDD 1	Motorways, trunk roads and other environmental services	98,243 (3)	96,381
Scottish Economic Planning Department	SEPD 1	Regional and industrial development	80,019	80,019
	SEPD 2	Manpower Services Commission	59,377	53,244
Scottish Education Department	SED 1	Education, libraries and arts	60,394	59,285
	SED 2	Social work	8,922	6,521
National Library of Scotland	SED 3	National Library of Scotland	1,471	1,419
National Galleries of Scotland	SED 4	National Galleries of Scotland	1,540	1,516
National Museum of Antiquities of Scotland	SED 5	National Museum of Antiquities of Scotland	555	548
Scottish Home and Health Department	SHHD 1	Health	840,650	834,650
	SHHD 2*	Law, order and protective services (central support and other services)	36,029 (3)	35,000
Department of the Registers of Scotland	DRS 1*	Pay and general administrative expenses	2	0
Registrar General's Office, Scotland	RGO(S)1*	Pay and general administrative expenses	1,723	1,588
Scottish Record Office	SRO 1*	Pay and general administrative expenses	583	558
Queen's and Lord Treasurer's Remembrancer	QLTR 1*	Pay and general administrative expenses	4,099 (3)	5,078

Department	Block Number (1)	Description of Expenditure	£ thousand Cash Limit	Provisional Outturn
WALES				
Welsh Office	WO 1*	Pay and general administrative expenses	19,013	17,704
	WO 2	Health and personal social services, roads, education, libraries, arts, other environmental services and agriculture	458,300	450,716
	WO 3	Regional and industrial development	58,015	57,674
	WO 4	Manpower Services Commission	34,450	31,021
NORTHERN IRELAND				
Northern Ireland Departments	NID 1	Services analogous to GB services covered by cash limits(5)	1,319,100	[1,320,426]
TOTAL			4,892,255	[4,839,568]
TOTAL CENTRAL GOVERNMENT BLOCKS			34,387,356	[34,065,255]

Notes

(1) Central responsibility for expenditure control is exercised by the Treasury and the Civil Service Department, depending on the nature of the expenditure concerned. The blocks controlled by the Civil Service Department are marked by an asterisk.

(2) The cash limits on rate support grants and on National Parks and transport supplementary grants apply to increase orders for 1979-80. The figures given here for XVII 1 and XVII 14 represent the limits on amounts disbursed in 1979-80, ie the amounts provided in second increase orders for 1978-79 and in main and first increase orders for 1979-80. XVII 1 covers both rate support grant and National Parks Supplementary grants; XVII 14 covers transport supplementary grants. The figures given here for S02, the Scottish rate support grant limit, represent the limit on the amount disbursed in 1979-80 in respect of 1979-80, ie the main and first increase orders for 1979-80; a second increase order of £5.3 million in respect of 1978-79 was also disbursed in 1979-80.

(3) The cash limit figures here quoted include extra provision granted by Parliament in Supplementary Estimates because the previously announced cash limits were expected to be overspent.

Table 3

CASH LIMITS 1979-80 : PROVISIONAL OUTTURN
CAPITAL BLOCKS FOR LOCAL AUTHORITIES
AND CERTAIN OTHER BODIES(1)

Department	Block number	Description of Block	£ million Cash Limit	Provisional Outturn
EXPENDITURE CONTROLLED				
Department of Employment	DEM/LA1	Capital expenditure on employment services	2.8	0.8
Department of the Environment	DOE/LA2	Capital expenditure by local authorities and new towns on new house building, land, improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by the local authorities, and other housing investment (other than that included in DOE/LA1)	2748.2	2681.0
	DOE/LA4	Capital expenditure on reclamation of derelict land and coast protection work	32.1	30.0
	DOE/LA5	Gross expenditure on the community land scheme	22.3	22.3
	DOE/LA6	Urban Programme : expenditure by local authorities	172.55	132.9
	DOE/NT1	New towns' industrial and commercial investment	37.6	37.6
Home Office	HO/LA1	Capital expenditure on police courts and probation	20.6	12.8
Scottish Office	SO/LA1	Capital expenditure by local authorities on roads and transport, water and sewerage, general services, urban programme, police and social work, school buildings, further education and teacher training	341.7	338.6
	SO/LA2	Capital expenditure by local authorities, new towns, and the Scottish Special Housing Association on new house building, land, improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by local authorities, other housing investment and new towns industrial and commercial investment	374.6	379.9
	SO/LA4	Gross expenditure on the community land scheme	1.5	0.9

Department	Block number	Description of Block	£ million Cash Limit	Provisional Outturn
Welsh Office	WO/LA1	Capital expenditure by local authorities on new house building, land and improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by the Housing Corporation and by local authorities, and other housing investment (other than that included in DOE/LA1) : capital expenditure by new towns on new house building, land and improvements, acquisition of existing dwellings, roads and industrial and commercial investment; capital receipts from sales of land and dwellings and associated gross lending	153.3	144.0
	WO/CL1	Gross expenditure on the community land scheme	9.5	7.3
TOTAL EXPENDITURE CONTROLLED BLOCKS			3,916.75	3788.1
STARTS/APPROVAL CONTROLLED				
Department of Education and Science	DES/LA1	Value of building projects started in 1979-80 under the aegis of the Department of Education and Science, local authorities, and other public bodies and the universities, for schools, further education and teacher training and higher education (England) and for universities (Great Britain)	201.6	200.4
Department of the Environment	DOE/LA3	Value of housing associations projects approved by the Housing Corporation	526.5	525.0
Department of Health and Social Security	DHSS/LA1	Value of capital projects for personal social services approved by the Department of Health and Social Security	57.4	47.3
Scottish Office	SO/LA3	Value of housing associations' projects approved by the Housing Corporation	76.6	76.6
Welsh Office	WO/LA2	Value of building projects started in 1979-80 under the aegis of the Welsh Office and local authorities in Wales for schools, further education and teacher training, and higher education	17.2	16.3
	WO/LA3	Value of capital projects for personal social services approved by the Welsh Office	2.6	2.4
TOTAL STARTS/APPROVAL CONTROLLED BLOCKS			881.9	868.0

Department	Block number	Description of Block	£ million Cash Limit	Provisional Outturn
BORROWING CONTROLLED				
Department of the Environment	DOE/LA1	Borrowing allocations made for capital expenditure within the locally determined sector in England and Wales	100.0	100.0
Department of the Environment and Welsh Office	RWA1	External financing requirements of the regional water authorities in England and Wales	354.0	338.2
Department of Transport	DTP/LA1	Key sector loan sanctions for capital expenditure on roads and other transport in England and Wales	126.6	126.0
TOTAL BORROWING CONTROLLED BLOCKS			580.6	564.2

Notes

(1) The other bodies referred to include water authorities, new towns, the Land Authority for Wales, the Housing Corporation, the Scottish Special Housing Association and certain educational bodies; these are indicated in the description of the blocks.

CASH LIMITS 1978-79 : OUTTURN

CENTRAL GOVERNMENT BLOCKS

Table 4

Department	Block(1) Number	Description of Block	£ million Cash Limit	Outturn
Ministry of Agriculture, Fisheries and Food	MAFF1*	Pay and general administrative expenses	91.8	87.7
	MAFF2	Agricultural and food services and fisheries support	65.4	55.8
Intervention Board for Agricultural Produce	IBAP1*	Pay and general administrative expenses	6.5	6.4
Bank of England	BOE1	Financial management	61.5	55.2
Cabinet Office	CO1*	Pay and general administrative expenses	4.7	4.7
Central Office of Information	COI1*	Pay and general administrative expenses	8.0	7.6
	COI2	Home publicity	17.5	15.9
Charity Commission	CC1*	Pay and general administrative expenses	1.9	1.7
Civil Service Department	CSD1	Central management of the Civil Service	23.7	22.2
	CSD2	Computers and telecommunications	63.7	51.3
	CSD3	Civil Service catering	1.2	0.9
Crown Estate Office	CEO1*	Pay and general administrative expenses	0.8	0.8
Customs and Excise	CE1*	Pay, general administrative expenses and capital expenditure	167.0	162.8
Ministry of Defence	MOD1	Defence Budget, less forces pensions and certain PSA staff costs	6,880.0	6954.1
Department of Education and Science	DES1*	Pay and general administrative expenses	19.6	18.7
	DES2	Current and some capital expenditure on schools, further education, teacher training, youth services and educational research	74.4	60.3
	DES3	Current and some capital expenditure on universities	720.3	715.1
	DES4	Libraries, museums, galleries and the arts	111.3	105.4
	DES5	Science Budget - Research Councils	284.0	281.1

£ million

Department	Block Number	Description of Block	Cash Limit	Outturn
Department of Employment	DEM1*	Pay and general administrative expenses	125.5	110.4
	DEM2	Manpower Services Commission	594.7	507.8
	DEM3	Health and Safety Commission	50.5	46.5
	DEM4	Other employment services	59.2	51.3
Department of Energy	DEN1*	Pay and general administrative expenses	9.5	9.3
	DEN2	Nuclear energy	139.8	137.6
	DEN3	Research and development and industrial sponsorship	75.0	61.7
Department of the Environment	DOE1*	Pay and general administrative expenses	93.0	85.9
	DOE2	Various central and miscellaneous services	133.5	128.3
	DOE3*	Property Services Agency : Pay and general administrative expenses	151.9	147.9
	DOE4	Office and general accommodation services	365.4	334.5
	DOE5	Overseas representation : accommodation services	29.3	28.3
	DOE6	Rate support grant and National Parks supplementary grants for local authorites in England and Wales (2)	7,058.8	7,058.8
Exchequer and Audit Department	EA1*	Pay and general administrative expenses	5.0	4.7
Export Credits Guarantee Department	ECGD1*	Pay and general administrative expenses	11.9	10.9
Office of Fair Trading	OFT1*	Pay and general administrative expenses	2.1	1.9
Foreign and Commonwealth Office	FCO1*	Pay and general administrative expenses	147.5	142.2
	FCO2	Overseas representation, overseas information and external relations	22.4	19.1
	FCO3	British Council	25.8	25.7
	FCO4	Overseas information : broadcasting	36.5	36.5
Forestry Commission	FC1*	Pay and general administrative expenses	43.1	40.7
	FC2	Forestry	30.4	24.0
Friendly Societies' Registry	FSR1*	Pay and general administrative expenses	0.7	0.7
Government Actuary's Department	GAD1*	Pay and general administrative expenses	0.4	0.4

Department	Block Number	Description of Block	£ million Cash Limit	Outturn
Department of Health and Social Security	DHSS1*	Pay and general administrative expenses	585.0	581.0
	DHSS2	Health and personal social services	4,944.7	4,887.5
Home Office	HO1*	Pay and general administrative expenses	268.4	260.7
	HO2	Law, order and protective services	132.5	122.1
Department of Industry	DI1*	Pay and general administrative expenses	59.3	58.4
	DI2	Regional and industrial policy and research and development	129.7	116.1
Board of Inland Revenue	IR1*	Pay and general administrative expenses	400.2	386.9
Land Registry	LR1*	Pay and general administrative expenses	25.6	25.4
Lord Chancellor's Department	LCD1*	Pay and general administrative expenses	18.5	17.6
	LCD2	Administration of legal aid fund and judges' salaries	20.0	18.9
National Debt Office	NDO1*	Pay and general administrative expenses	0.3	0.3
Department for National Savings	DNS1*	Pay and general administrative expenses	36.4	34.9
Ordnance Survey	OS1*	Pay, general administrative expenses and capital expenditure	23.7	22.5
Ministry of Overseas Development	ODM1*	Pay and general administrative expenses	13.6	11.8
	ODM2	Aid Programme	716.3	722.7
Parliamentary Commissioner and Health Service Commissioner	PCHC1*	Pay and general administrative expenses	0.8	0.7
Paymaster General's Office	PMGO1*	Pay and general administrative expenses	5.0	4.6
Office of Population Censuses and Surveys	OPCS1*	Pay and general administrative expenses	11.6	10.7
Department of Prices and Consumer Protection	DPCP1*	Pay and general administrative expenses	3.5	3.2
	DPCP2	Consumer protection	18.0	16.4
Privy Council Office	PCO1*	Pay and general administrative expenses	0.3	0.3
Public Record Office	PRO1*	Pay and general administrative expenses	1.9	1.6

Department	Block Number	Description of Block	£ million Cash Limit	Outturn
Public Trustee Office	PTO1*	Pay and general administrative expenses	2.0	1.9
Public Works Loan Commission	PWLC1*	Pay and general administrative expenses	0.2	0.2
Stationery Office	HMSO1*	Pay and general administrative expenses, office machinery	70.4	69.3
	HMSO2	Stationery and printing	36.9	36.4
Department of Trade	DOT1*	Pay and general administrative expenses	47.7	45.4
	DOT2	Civil aviation and shipping, export promotion and trade cooperation, tourism, regulation of trading practices and consumer protection, and other support services	47.3	34.2
Department of Transport	DTP1*	Pay and general administrative expenses	91.3	87.6
	DTP2	Motorways and trunk roads, new bus grants, etc.	477.9	437.5
	DTP3	Grants to transport undertakings and transport research,	32.4	23.8
	DTP4	Transport supplementary grant (2)	297.1	297.1
Treasury	HMT1*	Pay and general administrative expenses	15.4	14.0
	HMT2	Secret Service	34.5	33.4
Treasury Solicitor	TS1*	Pay and general administrative expenses	5.0	4.8
SCOTLAND				
Scottish Office	SO1*	Pay and general administrative expenses	65.8	62.4
	SO2	Rate support grant for local authorities in Scotland (2)	1,035.4	1,035.4
Department of Agriculture and Fisheries for Scotland	DAFS1*	Agricultural services and fisheries support	33.7	28.6
Scottish Courts Administration	SCA1*	Pay and general administrative expenses	4.2	4.0
Scottish Development Department	SDD1	Motorways, trunk roads and other environmental services	83.4	82.1
Scottish Economic Planning Department	SEPD1	Regional and industrial development	86.3	65.9

Department	Block Number	Description of Block	£ million Cash Limit	Outturn
Scottish Education Department	SED1	Schools, teacher training, educational research, further education, youth services, sport, social work, libraries, galleries, museums and other arts	65.2	58.6
Scottish Home and Health Department	SHHD1	Health	705.3	701.7
	SHHD2	Law, order and protective services	13.6	11.7
Department of the Registers of Scotland	DRS1*	Pay and general administrative expenses	2.1	2.1
Registrar General's Office, Scotland	RGO(S)1*	Pay and general administrative expenses	1.9	1.7
Scottish Record Office	SRO1*	Pay and general administrative expenses	0.5	0.5
Queen's and Lord Treasurer's Remembrancer	QLTR1*	Pay and general administrative expenses	4.1	4.0
WALES				
Welsh Office	WO1*	Pay and general administrative expenses	18.4	14.8
	WO2	Health and personal social services, roads, education, libraries, arts and other environmental services	388.3	381.9
	WO6	Regional and industrial development	54.0	43.4
NORTHERN IRELAND				
Northern Ireland Office	NIO1*	Pay and general administrative expenses	42.3	41.1
	NIO2	Law, order and protective services, grant to the Police Authority for Northern Ireland, and accommodation	111.9	111.1
Northern Ireland Departments	NID1	Services analogous to GB services covered by cash limits	1,147.3	1,135.3
TOTAL			30,252.3	29,799.0

Notes

(1) Central responsibility for expenditure control is exercised by the Treasury and the Civil Service Department, depending on the nature of the expenditure concerned. The blocks controlled by the Civil Service Department are indicated by an asterisk.

(2) The cash limits on rate support grants and on National Parks and transport supplementary grants apply to increase orders for 1978-79. The figures given here for XVII,1, XVII,14 and SO2 represent the limits on amounts disbursed in 1978-79, ie the amounts provided in main and first increase orders for 1978-79. XVII,1 covers both rate support grant and National Parks Supplementary grants; XVII,14 covers transport supplementary grant; SO2 covers the Scottish rate support grant.

CASH LIMITS 1978-79 : OUTTURN

CAPITAL BLOCKS FOR LOCAL AUTHORITIES AND CERTAIN OTHER BODIES (1)

Table 5

Department	Block Number	Description of Block	Cash Limit (£ million)	Outturn (£ million)
EXPENDITURE CONTROLLED				
ENGLAND				
Department of Employment	DEM/LA1	Capital expenditure on employment services	1.0	0.5
Department of the Environment	DOE/LA2	Capital expenditure by local authorities and new towns on new housebuilding, land and improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by the local authorities and other housing investment (other than that included in DOE/LA1)	2,659.6	2,348.9
	DOE/LA4	Capital expenditure on reclamation of derelict land and coast protection work	33.1	27.8
	DOE/LA5	Gross expenditure on the community land scheme	74.7	31.5
	DOE/LA6	Urban Programme : Capital expenditure by local authorities	90.0	54.5
	DOE/NT1	New towns' industrial and commercial investment	62.8	62.5
Home Office	HO/LA1	Capital expenditure on police, courts and probation	33.4	18.3
SCOTLAND				
Scottish Office	SO/LA1	Roads and transport, water and sewerage, general services, urban programme, police and social work	267.6	240.0

Department	Block Number	Description of Block	£ million Cash Limit	Outturn
Scottish Office	SO /LA2	Capital expenditure by local authorities, new towns, and the Scottish Special Housing Association on new housebuilding, land and improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by local authorities, other housing investment and new towns industrial and commercial investment	345.8	320.4
	SO/LA4	Capital expenditure by local authorities on school building, further education and teacher training	55.6	54.7
	SO/LA5	Gross expenditure on the community land scheme	6.8	1.1
WALES				
Welsh Office	WO/LA1	Capital expenditure by local authorities on new housebuilding, land and improvements, acquisition of existing dwellings, lending (gross) to private persons for house purchase and improvement, improvement grants to the private sector, slum clearance, finance for housing associations for projects approved by local authorities, and other housing investment (other than that included in DOE/LA1)	104.6	105.7
	WO/LA2	Finance for housing associations for projects approved by the Housing Corporation	30.7	22.3
	WO/LAW1	Gross expenditure on the community land scheme by the Land Authority for Wales	7.7	5.1
	WO/NT1	New towns' industrial and commercial investment. Capital expenditure by new towns on new housebuilding, land and improvements, acquisition of existing dwellings.	7.3	5.2
TOTAL EXPENDITURE CONTROLLED BLOCKS			3,780.7	3,298.5

Department	Block Number	Description of Block	£ million Cash Limit	Outturn
STARTS/APPROVAL CONTROLLED				
ENGLAND				
Department of Education and Science	DES/LA1	Value of building projects started in 1978-79 under the aegis of the Department of Education and Science, local authorities, other public bodies and the unversities, for schools, further education and teacher training, and higher education (England) and for universities (Great Britain)	253.8	250.4
Department of the Environment	DOE/LA3	Value of housing associations' projects approved by the Housing Corporation	403.1	402.7
Department of Health and Social Security	DHSS/LA1	Value of capital projects for personal social services approved by the Department of Health and Social Security	41.6	38.3
SCOTLAND				
Scottish Office	SO/LA3	Value of housing associations' projects approved by the Housing Corporation	66.1	66.1
WALES				
Welsh Office	WO/LA3	Value of building projects started in 1978-79 under the aegis of the Welsh Office and local authorities in Wales for schools, further education and teacher training, and higher education	13.2	13.2
	WO/LA4	Value of capital projects for personal social services approved by the Welsh Office	4.7	4.7
TOTAL STARTS/APPROVAL CONTROLLED BLOCKS			782.5	775.4

Department	Block Number	Description	£ million Cash Limit	Outturn
BORROWING CONTROLLED				
ENGLAND				
Department of the Environment	DOE/LA1	Borrowing allocations made for capital expenditure within the locally determined sector in England and Wales	169.0	169.0
	DOE/WA1	Net Borrowing by Regional Water Authorities	269.0	215.8
Department of Transport	DTP/LA1	Key sector loan sanctions for capital expenditure on roads and other transport in England and Wales	115.0	115.0
WALES				
Welsh Office	WO/WA1	Net Borrowing by the Welsh National Water Development Authority	20.0	25.1
TOTAL BORROWING CONTROLLED BLOCKS			573.0	524.9

(1)The other bodies referred to include water authorities, new towns, the Land Authority for Wales, the Housing Corporation, the Scottish Special Housing Association and certain educational bodies; these are indicated in the descriptions of blocks.

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We must discuss. I just can't accept these interpretations. (2)

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Prime Minister.
This is particularly very difficult. The figures I have ringed in paragraph 6 compare with those in the first sentence of paragraph 3. As you will see, they are broadly double! This will need some very convincing explanations if we are not to be attacked for selling for more less on the budget than we claimed at the time.

T.P. Lankester, Esq.,
No.10, Downing Street

2nd July 1980

Prime Minister
The figures in para 6 (particularly the calendar year figures) look less good than those which have been used publicly. The reasons are set out in para 4: I have asked for a more detailed explanation of the extent to which each factor affects the figures. The analysis in this letter will not, of course, become public for many months but the presentation will need careful consideration.

4/7

Dear Tim,

PRESENTATION IN THE PUBLIC EXPENDITURE SURVEY OF THE UK CONTRIBUTION TO THE COMMUNITY BUDGET

1. The Public Expenditure Survey (PES) will be circulated to Cabinet later this week, and will show the benefits of the 30 May agreement concerning the UK contribution to the Community Budget. The Chancellor thought that the Prime Minister might like to have a note about the effects of the agreement on the figures in the survey.

The 30 May Agreement

2. The 30 May agreement specified a UK net contribution of 609 MEUA in 1980 and 730 MEUA in 1981, subject to a sliding scale formula if the estimates on which those net contributions were based should change. For the third year, 1982, it was agreed that the UK net contribution would either be determined by the general review of Budget arrangements commissioned by the Council of Ministers, or there would be a solution "along the lines of the 1980/81 solution".

3. In constant 1980 survey prices, the sterling equivalents of the figures quoted in paragraph 2 for the UK net contribution in 1980 and 1981 are £328 million and £362 million respectively. The price base for the 1980 survey is the 1979 price level, and the conversion factors between the EUA figures and the 1980 survey price figures in sterling quoted above take into account forecast exchange rate changes between the pound and the EUA, and also the forecast changes in prices between 1979 and 1980 and 1981 respectively.

/The Public

* i.e. in the table attached to the Chief Secretary's paper on 'Main Issues': C(80)39 Pt 2

The Public Expenditure Survey *

4. The figures in the Public Expenditure Survey differ significantly from those in the previous paragraph. There are four important differences in coverage between the Commission figures used in the Budget negotiations, and appearing in the 30 May agreement, and those in the survey. These are as follows:-

(a) Some VAT contributions in respect of 1980 will not in practice be paid until 1981. The Commission attribute these to 1980; but in the survey they are attributed to 1981.

(b) The PES figures include refunds paid in 1980 in respect of 1979 under the terms of Article 131 of the Treaty of Accession. These are excluded from the Commission figures for 1980.

(c) The PES figures include the UK's contribution to the unallocated Budget - chiefly Community aid - whereas the Commission figures related only to the allocated Budget.

(d) The PES figures include our best estimates of the effect of the risk-sharing formulae in the 30 May agreement. These provide for the UK to take specified portions of the increases in our net contribution over the basic estimates. We think it likely that these provisions will operate.

5. A further difference arises because the 30 May agreement concerned the net contribution that the UK would make in respect of individual calendar years, but it provided that the refunds would be paid from the following year's Community Budget, except insofar as advance payments were agreed by the Council of Ministers. The PES, on the other hand, attributes financial flows to the years in which they actually occur.

6. The following table gives the figures that will appear in the survey and also shows the reduction in the figures compared with Cmnd 7841, the last published White Paper. The table is on the same basis as tables 2.2.1 and 2.2.2 of Cmnd 7841 and includes Community expenditure on aid, attributed to the aid programme. It contains the stylised assumption that our net contribution in 1982 (when our gross contribution is assumed to be contrained by the maintenance of the 1 per cent VAT ceiling) remains at about the same level as in 1981. This is intended to be a neutral assumption.

/UK

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UK contributions to and receipts from the Community Budget
(at 1980 survey prices) £ million

Calendar years	Gross Contribution	Receipts	Net Contribution	Savings over Cmnd 7841
1980	1715	1020	695	362
1981	2385	1690	695	455
1982	2550	1850	700	600
Financial years				
80/81	1885	1450	435	626
81/82	2475	1770	705	495
82/83	2550	1850	700	650

These are the figures in the survey.

It will be seen that the differences in coverage and timing explained earlier result in a much larger net contribution for 1980 and 1981 than the figures in paragraph 3.

7. The 1980 figure in the above table will be higher if we do not receive an advance of our 1980 refund of 300 MEUA by the end of this year. Nevertheless, our expectation that the bulk of our refund in respect of 1980 will be received in the first quarter of 1981 means that, as the table shows, the published figure for the financial year 1980/81 will be closer to the figures that were announced after the 30 May agreement; and the figure for the financial year will not be affected if we do not receive an advance payment.

8. The Chancellor intends that the reasons for the differences between the figures in the 30 May agreement and those in the survey will be fully explained in the Public Expenditure White Paper when that is eventually published.

9. I am copying this letter to George Walden and David Wright.

Yours

John

A.J. WIGGINS

PART 9 ends:-

S/S Environment to Home Sec 2.7.80

PART 10 begins:-

Home to TL 2.7.80.