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PRIME MINISTERCash Limits, RSG and Public Expenditure

We have put cash limits as the first item on the agenda (after the stock items) because the Chancellor of the Exchequer is very anxious to have decisions which he can announce later in the day, ahead of the CBI Conference. There may be problems on two points:-

- (a) If the Cabinet are willing to agree a percentage factor on pay for cash limits, they may be content that it should be announced very soon, before the CBI Conference. There may be greater reluctance to agree upon the prices factor, since the figure there interacts with the 2 per cent volume cut. There is deep suspicion of the Treasury, because, although the 11 per cent for prices is presented as a "low realistic" factor, spending Departments fear that the Treasury is looking for some volume squeeze out of that, on top of the 2 per cent volume reduction. It may be argued that the decision on the prices factor should not be taken until the public expenditure decisions have all been taken too. From the point of view of the CBI Conference it is presumably the pay factor that matters. Would the Chancellor be prepared to consider announcing the pay factor only at this stage? The prices factor will have to be disclosed when the RSG announcement is made; but that would at least see us through until the discussions on public expenditure reductions is complete.
- (b) Some colleagues may ask the Chancellor to postpone his announcement until Friday morning, to give time for preparatory warnings to staff associations and other preparations of that kind. I expect that the Chancellor will be reluctant to postpone even until Friday morning; but if there is pressure on this he might buy some goodwill by bowing to it. He would not lose anything from the point of view of the CBI Conference.

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2. After you have taken cash limit factors, you will wish to take the Rate Support Grant paper. Decisions on that are also urgently required for operational reasons. It is crucially important for the RSG decision that the 1 per cent cut in local authority current expenditure (including education) should be agreed. You may wish to confirm that all the Ministers concerned are agreeable. You will remember that the Cabinet agreed the cut in education, ^{on the understanding} ~~understand~~ that everybody else took their share.

3. If and when we come back to other public expenditure, I think that (for reasons I have explained in a separate minute) it would be premature to resume the discussion on defence. Both the Chancellor and the Secretary of State for Defence are content to leave over further Cabinet discussion until next week.

4. I understand that the Chancellor would like to take the other programmes in the following order:-

Scotland

Wales

Social Security

Education (the 2 per cent cut for cash limit programmes)

5. There is clearly going to be unfinished business which we ought to try to complete next week. There is other business to do on Thursday, 13th November, and I do not think that we can count on being able to complete the public expenditure business and the rest of the business in that meeting alone. I fear that you may have to call your colleagues for a meeting of Cabinet on the morning of Tuesday, 11th November.

(Robert Armstrong)

5th November 1980

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PRIME MINISTER

I have seen a copy of the Chancellor of the Exchequer's note of 4 November about the timetable for announcing decisions on public expenditure and other matters.

2. The Chancellor will probably be reluctant to contemplate anything that could be described as an Autumn Budget. But the case for a comprehensive announcement of decisions, not just the cash limits and the Rate Support Grant (which have to be announced in November anyway) but also on public expenditure reductions and on tax proposals, seems to me to become increasingly strong.
3. It is widely believed outside that the Cabinet is looking for reductions in public expenditure of the order of £2,000 million. What is actually achieved is likely to become as widely known as the objective. The further achievement falls short of the objective, the greater the damage to the credibility of the Government's strategy, the greater the fear of a very high PSBR next year, the more damage will be done to prospects and hopes of a fall in interest rates and of the exchange rate. Indeed, expectations could force both interest rates and the exchange rate still further up.
4. These effects could be much reduced, credibility maintained, and the prospect of reduced interest rates held out, if the Chancellor could demonstrate that by a combination of agreed cuts in public expenditure and specific changes in taxation he would be able to keep the PSBR next year down to the sort of level he has in mind (which seems to be somewhere about £9 to £9½ billion). That would also provide a framework for whatever monetary decisions - either on rates or on techniques - he wanted to announce.
5. You will remember that in 1968 Roy Jenkins announced public expenditure cuts in January but postponed his tax announcements until Budget time. He came to regret the postponement, because the expenditure decisions were not credible without the tax decisions, and there was a very difficult three month period between the two.



6. There is in any case something to be said, in terms of impact upon industry and markets, for getting all the agony out and over in one fell swoop, rather than paying it out in instalments. People then stop expecting more agony, and begin to look forward to the possibility of better things; and industry may then be more disposed to hold on to markets and accept lack of profitability for a little longer, because they see the prospect of improvement more clearly.

ReA

ROBERT ARMSTRONG

5 November 1980