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PRIME MINISTER

PUBLIC EXPENDITURE 1984-85

I promised you a note on the latest position on public expenditure and the Contingency Reserve for the current year.

2. You will have seen from the PSBR note that supply expenditure in April was about £400 million above the (unpublished) forecast. Some £250m of that is defence expenditure carried over, under the new arrangements, from March; and the remainder is payments (by ECGD for example) which are believed to have been brought forward from May. So there is no need to be too disturbed by the April figure - although we shall be watching the May figure closely.

3. With the new, tighter, arrangements for controlling the Contingency Reserve, the Treasury is now carrying out monthly monitoring not just of supply expenditure but of public expenditure as a whole. The Budget forecast assumed that there would be neither overspending nor underspending this year, but that Departments would spend right up to ceiling, including the whole of the Contingency Reserve. But this month's forecast, which has just been completed, is distinctly less favourable. It suggests that we might be as much as $\text{£}\frac{1}{2}$ billion over the top. Local authorities' budgets are now in, and imply that their overspending might be $\text{£}1.6$ billion - higher even than the overrun originally expected. Improved redundancy arrangements for miners and policing costs of the coal strike account for some $\text{£}170$ million. The overall nationalised industry position, including an estimate for the costs of oilburn and other related costs, is $\text{£}100$ million above forecast. About $\text{£}650$ million may be



taken up by a combination of health service and review body pay costs, plus end-year flexibility carry-over and launch aid. The prospects for our net EEC contribution this year have also worsened since the Public Expenditure White Paper and the Budget. And we must leave some room (although there is, on this arithmetic, precious little left) for genuine contingencies in the remaining 10 months of the year.

4. This all adds up to a worrying picture, particularly so early in the financial year. I do not wish to inform colleagues of the detailed position at this stage - not least because any leak would cause the markets to be even more unsettled than they are at the present time. But it is clear that we must be very restrictive indeed about any additional bids on the Reserve.

A handwritten signature in dark ink, appearing to be 'N.L.' with a small flourish below the 'L'.

N.L.

24 May 1984