

Ref. A087/2202

PRIME MINISTER

Economic Prospects and 1987 Public Expenditure Survey
(C(87) 13 and 14)

CONCLUSIONS

No conclusions need to be reached on the Chancellor's paper, (C(87) 13). The conclusions put forward by the Chief Secretary, which you will want the Cabinet to endorse, are in paragraph 12 of his paper, (C(87) 14).

Public Spending and National Income

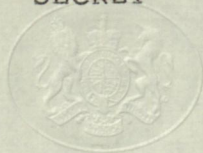
2. The figures in last year's White Paper are as follows:

	£ million		
	Cash	In real terms (1985-86 base year)	As percentage of GDP
1986-87	140.4	136.5	43.25
1987-88	148.6	139.3	42.75
1988-89	154.2	139.7	41.75
1989-90	161.5	142.1	41.25

The trend was therefore for an increase in public expenditure in real terms, but a fall as a percentage of GDP.

3. The Chief Secretary now suggests that:

- | The Government should reaffirm the Manifesto policy of ensuring that public expenditure takes a steadily smaller share of national income; and



- the level of public expenditure should be held as close as possible to the existing planning totals.

4. There are two important points about his formulation. First, it does not, as in previous years, propose the target of keeping within the existing planning totals. The Treasury believe that such a target would not be realistic. But spending Ministers and then the outside world will at once notice the change (there has already been press comment), and its presentation will require great care.

5. Secondly, the Chief Secretary's formula, by giving the planned reduction as a share of GDP as a target, would appear to reaffirm last year's figures by a different route. But this is not so. The forecast of GDP growth has increased since last year and therefore the fall in expenditure as a percentage of GDP shown in last year's plans would now be consistent with higher planning totals. They could be higher by £2 billion or more. Other Ministers may not be able to calculate the exact figure but will probably see the general point. Indeed, the Chancellor's own paper says (paragraph 9) that growth for 1987 is likely to be closer to 4 per cent than the 3 per cent predicted at Budget time.

6. The Chief Secretary intends that in calculating public expenditure as a proportion of GDP privatisation receipts should be ignored. Since they are treated as a deduction from public expenditure an increase in them would otherwise justify raising expenditure. The Chancellor or Chief Secretary will probably mention this.

7. Generally you may want to avoid much discussion of the targets. It is only too likely to reveal differences of approach and the scope for an increase in expenditure.

Effect on Bids

8. The Chief Secretary says that to secure the policy objective already described bids will have to be substantially cut back and difficult decisions faced in a number of areas.

9. The Chief Secretary's minute of 17 July to you, copied to other members of the Cabinet, gave a summary of the bids from the main Departments. The biggest were:

	£ million		
	1988-89	1989-90	1990-91
Defence	551	815	954
Overseas Aid	83	158	239
DTI	254	327	266
Employment	207	237	235
Housing	395	562	689
Other Environmental	134	148	144
Home Office	102	155	230
Education	558	688	783
Health	956	1384	2196
Social Security	1201	1545	2996

10. The total bids for 1988-89, allowing for territories, nationalised industries and local authorities amount to more than £7 billion, but this figure cannot easily be deduced from the papers and, especially given the risk of leaks, you may not want to reveal it.

11. The Chief Secretary will mention the main areas where he believes savings must be sought, in particular:

- policy changes on social security;

- savings from the employment programme as unemployment falls;
- re-examination of regional policy, to make it more selective;
- re-examination of territorial expenditure;
- scope for more transfers to private sector;
- scaling down of defence, health and education.

12. The risk of this at this stage is that it may provoke the Ministers concerned to defend their corners. You may therefore want to aim for general endorsement of the Chief Secretary's approach, but to avoid any lengthy discussion now on individual programmes which might prejudice the bilaterals and subsequent negotiations.

Running Costs

13. On running costs the Chief Secretary proposes:

- the general target that their share of public expenditure should not grow - implying an increase of 1 per cent a year in real terms;
- that Departments should propose 3 year management plans, for discussion in the bilaterals.

14. Some spending Ministers may argue that this is unrealistic. As the Chief Secretary says, it will mean scaling down the running cost bids for 1988-89 by more than half and looking for efficiency gains of 1.5 per cent a year when, it will be alleged, the scope for them has been exhausted. Again, you may wish to ensure that the discussion gives the Chief Secretary maximum flexibility for the bilaterals.

Nationalised Industries and Local Authorities

15. The Chief Secretary recommends that the external finance limits of the nationalised industries, except electricity, should be held to baseline and possibly below. This means rejecting bids totalling £0.9 billion in the first year. Again, sponsoring Ministers may argue that this is unrealistic but you may want to strengthen the Chief Secretary's hand in the bilaterals by endorsing his general approach.

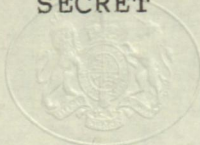
16. E(LA) under the Lord President has agreed on public expenditure and grants for local authorities for 1988-89. There seems no need for further discussion of this, although the Lord President can speak to it if necessary.

Future Discussions

17. The Chief Secretary recommends that he should now conduct bilaterals with his colleagues. This is of course the usual procedure. They should be complete by early October. It is not yet clear whether another Cabinet discussion will then be desirable, before outstanding programmes are referred to a Star Chamber. In case it is not, it would be useful, as last year, to have formal agreement now that a Star Chamber could be set up if necessary. You could therefore say now that you hoped that the Chief Secretary would be able to reach agreement with his colleagues on the basis proposed but that if this proved impossible you would at the appropriate time establish a small group under the Lord President of the Council to consider outstanding issues and make recommendations to the Cabinet.

Handling the Press

18. The press will certainly ask questions about the outcome of the Cabinet and it is usual to agree a form of words which your Press Office could use in briefing them after Cabinet. The



Treasury have suggested the following words which, if you agree, you could read out to Cabinet:

"The Cabinet had its usual July discussion of public expenditure today. It reaffirmed the policy that public expenditure should continue to take a declining share of national income, as set out in the last Public Expenditure White Paper. Within that constraint, the Chief Secretary will hold bilateral discussions in the autumn. In the light of these, the Government will review both the individual spending programmes and the planned totals for spending and will, as usual, announce decisions in the Autumn Statement in November."

You might also emphasise that other members of the Cabinet should adhere to this line, that bilaterals should be carried out in confidence, and that the media should be given no ground on which to base speculative stories of Ministerial disagreements.

HANDLING

19. You will wish to invite the Chancellor of the Exchequer to open the discussion by describing the current economic background and prospects and the Chief Secretary, Treasury to follow with a more detailed account of his proposals on public expenditure. All members of the Cabinet may wish to contribute to the subsequent discussion.

REA

ROBERT ARMSTRONG

22 July 1987