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attachment in P's
Box 2/10



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Treasury Chambers, Parliament Street, SW1P 3AG

Barry Potter Esq
Private Secretary
10 Downing Street
London
SW1

2 October 1990

Dear Barry,

PUBLIC EXPENDITURE SURVEY: PROGRESS REPORT

... I attach a copy of the paper I agreed to send over tonight.

Yours

Jeremy

JEREMY HEYWOOD
Private Secretary

PUBLIC EXPENDITURE SURVEY : PROGRESS REPORT

Warned Cabinet last April and again in July that this Survey would be exceptionally difficult. Subsequent developments, including Gulf crisis, have made matters even worse.

2. Cabinet agreed that top priority must be to defeat inflation and maintain confidence in our economic policies. Intense pressure on demand-led programmes, on top of existing firm commitments, make large additions to planning total unavoidable. Cabinet remit was to eliminate or sharply reduce other bids, and offset any unavoidable increases by savings elsewhere.

The Bids

3. Total bids at time of Cabinet were £16¼/21¼/25½ billion, even higher than last year. Revised economic assumptions implied price level in 1991-92 nearly 5 per cent higher than expected at time of 1989 Autumn Statement. By September, total bids had risen to £17¼/22¼/28 billion (9/11¼/13¼ per cent increase on baseline).

4. Cabinet agreed that we could not afford to accommodate inflation. But bids include hard core of irresistible increases, amounting to roughly £8½ billion in 1991-92. These consist of:

- £3¼ billion additions to demand-led programmes - mainly social security (uprating and community charge benefit), but also housing subsidies, ECGD, agricultural market support and EC contributions;
- a further £2 billion of agreed, technical or other irresistible claims - 1989 review body awards, war widows, Jubilee Line, Budget measures, VAT on construction, etc.
- about £2¼ billion for the UK cost of the July AEF settlement

5. In September, faced discretionary bids of around £9 billion both to compensate for inflation, and to finance policy changes. Target was to reduce these bids, or offset them by savings, to £2-3 billion ie by about 75 per cent.

6. Extremely ambitious. In normal year, might aim to reduce bids by one third to one half. As well as insisting on much larger reductions in bids than in previous years, the Chief Secretary has also been looking for offsetting savings, and, where at all feasible, has been seeking settlements at baseline or below.

7. Even this very tough target would mean additions to programmes of at least £10½ billion. Assuming the Reserve is set at £3 billion (as this year), this would mean additions to planning total of at least £7½ billion rising to £10 billion in 1992-93.

8. Target may not be achievable at all, with or without Star Chamber, especially if economic assumptions have to be revised again.

Bilaterals

9. First round bilaterals on all main programmes. Second round meetings on many, and third round meetings on some.

(i) Nearly settled : DTI (fractionally below baseline), Northern Ireland, Department of Energy, Transport (including Rail);

(ii) Good progress : Social Security, Scotland, Wales and - though successful outcome still far from certain - Environment;

(iii) Difficult (but moving) : Employment, Health, FCO/ODA, MAFF

(iii) Very difficult : Defence, Education, Home Office.

There could be significant movement (and some settlements) before end of Party Conference, especially on programmes in second group.

Key outstanding issues

- (i) Transport : Should be possible to reach a settlement which accommodates the Jubilee Line and the East-West Crossrail, within an affordable transport package. BR and the roads programme would still show substantial real increase in investment between 1987-88 and 1993-94, although to a lesser extent than last year; and LT would gain considerably.
- (ii) Social Security : huge irresistible bids for economic assumptions, estimating changes and agreed policy changes (around £3 billion rising to £7 billion in 1993-94). Mr Newton has reduced his discretionary policy and administration bids. Chief Secretary seeking to offset them more than fully by policy savings. Key issues : treatment of child benefit and other unpledged benefits; cost of Child Support Agency; running costs.
- (iii) Environment : Unavoidable additions to cost of housing subsidies, due to higher interest rates. Mr Patten's top priority is "green" bids (associated with White Paper). He has offered useful concessions on his substantial bids for housing and other environmental services. But reduced local authority spending power from capital receipts makes him reluctant to go as far as Chief Secretary wants on central government support, despite very high capital spending by local authorities in recent years (and this year).
- (iv) Health : Bids still £2-2½ billion in 1991-92 for substantial real growth in hospital service, capital, NHS Review and a range of other initiatives. Chief Secretary seeking lowest politically realistic addition for service growth, with minimum concessions on capital and other

bids, and large reductions on baseline in drugs expenditure. Key issue : how much cushion to provide for hospital service, to ensure smooth introduction of reforms.

- (v) Employment : Target requires cuts in the baseline as a whole. Mr Howard is resisting proposals for better value-for-money and savings in existing programmes, particularly ET (where the aim should be to return to the original purpose of concentrating on the long-term unemployed). Chief Secretary ready to consider changes in TEC funding arrangements to meet representations from industry about the need to maintain their budgets. Key issue : how to get more practical benefit from large sums already spent eg cutting out non-priority groups, eliminating old programmes and overlaps.
- (vi) Home Office : Large irresistible bids for police pay plus large discretionary bids for police capital and manpower, plus huge number of across the board increases on minor items. Chief Secretary seeking cuts in prison building programme to absorb likely surplus of prison places, and sharp reductions in discretionary bids. Key issue : police vehicles plant and equipment; prisons.
- (vii) Education : Mr MacGregor is bidding for larger percentage addition to baseline than any other major department; only small reductions offered so far. Pressure from increased student numbers in higher education. Key issues: cost of additional students and scope for improved efficiency in higher education; central government support for schools building and maintenance, after exceptionally high spending by local authorities this year and last;
- (viii) FCO/Aid : There are mounting pressures for extra resources for Eastern Europe and Gulf war. Chief Secretary is seeking offsets, arguing that dividing line between traditional aid budget and Eastern Europe/aid to front line states has become untenable.

- (ix) Defence : Extremely difficult. Department were initially reluctant to honour agreed ceiling announced in July (existing PEWP plans plus war widows). Chief Secretary seeking cash savings, starting low but rising to £2 billion in year 3, consistent with Options exercise and Prime Minister's 2½ per cent efficiency target. Mr King argues that benefits of Options cuts more than offset by inflation, and persistent failure to align plans with cash provision. Efficiency improvements needed to get back to agreed ceiling. Gulf costs highly uncertain and will be considered separately. Key issue : efficiency.

Star Chamber

10. Arrangements for Star Chamber now need to be put in hand. Chief Secretary to minute Prime Minister before Party Conference, copied to colleagues, picking up reference to possible need for Star Chamber in July Cabinet minutes. No need to identify Departments likely to be referred.

11. At this stage, possible referrals are:

Defence
Education
Employment
Home Office
Health
MAFF
Aid

12. Membership of Star Chamber will depend on progress in negotiations this week. In addition to Sir Geoffrey Howe and Mr Lamont it could be drawn from three or four of the following:

Mr Wakeham *
Mr Clarke
Mr Parkinson *

Mr MacGregor

Mr Lilley*

Mr Howard

* programme settled or near settlement.

13. Star Chamber would need to start work on 15 October and complete by end-October. As in past years, Treasury will propose remit.

Possible Survey outcome

14. Additions to next year's planning total since last Autumn Statement likely to be at least $\pounds 7\frac{1}{2}/10$ billion. Last year, we added roughly $\pounds 5\frac{1}{2}/6\frac{1}{2}$ billion to public spending.

15. On provisional projections for money GDP (which could move either way) GGE/GDP ratio is likely to rise in 1991-92, and to decline only very slightly thereafter, to a level no lower (and possibly higher) than the estimated 1990-91 outturn. In all years, the GGE ratios would be above those published in the 1989 Autumn Statement.

16. In any event, the Survey outcome will need very careful presentation. We could offer some reassurance by:

- drawing attention to the scale of the unavoidable increases in demand-led programmes (though this has the presentational disadvantage of spotlighting the inflation performance);
- doing our utmost to keep additions to the planning total below $\pounds 10$ billion. This will require some tough settlements. It will be more difficult if the inflation assumptions have to be increased;
- demonstrating convincingly that the GGE/GDP ratios are on a declining trend after 1991-92. Our ability to do this will depend on securing significant savings in Defence, particularly in 1993-94.

Date of Autumn Statement

17. The Oral Statement needs to be no later than 15 November, (to leave a week before electricity privatisation on 21 November). Whether an earlier date is possible will depend on progress in negotiations, and whether time needed for Star Chamber. In any event, the Oral Statement cannot be before 8 November, since Parliament will be in recess.