

SECRET AND PERSONAL - CMO



FROM: CHIEF SECRETARY

DATE: 8 May 1986

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B/WP

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PRIME MINISTER

PUBLIC EXPENDITURE: PROSPECTS FOR THE SURVEY

The Chancellor of the Exchequer and I are coming for a talk with you and the Lord President about the prospects for the 1986 Public Expenditure Survey. I hope that this will be useful in setting a general context for some specific decisions which have to be taken in the next few weeks.

2 I have not yet had colleagues' bids for the Survey, but the main outlines of the problem facing us are already clear. It is summed up in the attached table covering the first two years of the new Survey.

3 The biggest single problem is local authority current expenditure. The evidence from local authorities' budgets is that their current spending this year will be 8 per cent up on last year.

4 We are about to start discussion on the 1987-88 RSG settlement in E(LA). Kenneth Baker has proposed an addition to provision of £3.2 billion (£3.8 billion after taking account of the consequentials for the territories) - equivalent to a 1 per cent real increase on 1986-87 budgets. I will be proposing a 2 per cent real reduction, implying an addition to provision with consequentials of £2.8 billion.

5 But even with a tough settlement along the lines I am proposing we have to recognise that, on past experience, actual expenditure will exceed provision. We will do well to achieve a real terms standstill on this year's spending. That in itself would use £3½ billion of the Reserve for 1987-88 and £4½ billion for 1988-89 bringing down the Reserves in those two years to £2½ billion and £3½ billion. But Reserves at that level would be lower than prudent,

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especially in the light of pay pressures from local authority groups, which the employers, dominated by Labour controlled authorities, will have little inclination to withstand. There is every risk that pay pressures will push local authority spending still higher.

6 On top of that, there will be strong pressures for increases - which I hope will be modest - on central government education and law and order programmes; and we may see further upwards creep in the take-up of social security benefits. Developments in the European Community suggest that, even after holding the 1.4 per cent ceiling, our budget contribution will be higher than planned. In the nationalised industries, the fall in the oil price substantially worsens the position of coal, but should bring some offsetting improvement for steel and rail.

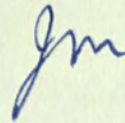
7 I will, of course, be looking toughly for savings on all Departments, but it would be unwise to count on achieving net reductions in the present provision for overseas aid, agriculture, trade and industry, employment, the nationalised industries, transport, housing and health.

8 The Chancellor feels, and I agree, that we should not attempt to resolve our difficulties in this Survey by further proceeds from sales of assets. The present target of £4½ billion a year is already substantial, although we expect to achieve it.

9 There are two programmes where I can see scope for substantial reductions: defence and territorial expenditure. On defence, a Cabinet committee has already decided on a reduction in R and D and considerable economies are being made on procurement and stockholding: the fall in the oil price also helps the defence programme. If the Exchequer were to have a share of these savings, it would be possible to reduce the programme by £1/3 billion in 1987-88 and £1/2 billion in 1988-89. We are soon to discuss the result of the exercise on territorial expenditure with you. I think that we could reasonably make an adjustment in the Scottish block to take account of the fall in population, in advance of undertaking a full needs assessment.

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10 I am copying this minute to the Lord President and the Chancellor of the Exchequer.

A handwritten signature in blue ink, consisting of the initials 'jm' in a cursive style.

JOHN MacGREGOR

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	<u>1987-88</u>	<u>1988-89</u>
Planning total	143.9	148.7
Reserves (after Budget measures)	6.0	7.9
Subtract further net increases (very speculative):-		
Social security	0.5	0.75
Nationalised industries	-	-
EC	0.1	0.1
Education/Law & Order	0.25	0.25
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Remaining Reserve	5.15	6.8
Add back cuts in-		
Defence	0.35	0.5
Territorial	0.15	0.15
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Remaining Reserve	5.65	7.45
Local authority current*		
England	2.4-3.2	3.2-4.2
Territorial	0.4-0.6	0.6-0.8
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Remaining Reserve	2.85-1.85	3.65-2.45

*On basis of prospective E(LA) bids.