



cc BS
B/UPS

CONFIDENTIAL

P 02049

PRIME MINISTER

M

Public Expenditure: Meeting at 9.30 am on Friday, 9 May

The Chancellor of the Exchequer and the Chief Secretary are coming to see you tomorrow morning to discuss public expenditure. The Lord President will also be present.

2. No specific decisions will be required. As I understand it, the Chancellor's main objectives are:-

(i) to give you a preliminary account of the (already very worrying) prospects for the forthcoming Survey, and to seek general guidance from you and the Lord President on how tough you think it will be possible to be in order to keep to the planning totals;

(ii) as a result, to register firmly with you the context in which other more immediate expenditure decisions will need to be taken (eg on local authority and territorial expenditure).

eg particularly police manpower

BACKGROUND

3. It is already clear that the Reserves in 1987-88 and 1988-89 (there is, of course, no figure for 1989-90, the new year in the coming Survey) will be under very great pressure. The figures for those two years in the January Public Expenditure White Paper were £6.3 billion and £8.0 billion respectively. The employment measures announced in the Budget reduced this to £6.0 billion and £7.9 billion.

4. The biggest single threat is local authority current expenditure. No new decisions have yet been taken. The figures in the White Paper simply repeated the 1986-87 cash figure. It is clear, however, that this will be substantially exceeded. Local authorities are

budgeting for a cash increase overall of some 8 per cent (4 per cent real), which would add up to £2.0 billion in 1986-87. The Chief Secretary will separately be proposing that in 1987-88 there should be a 2 per cent reduction on the 1986-87 outturn. Even this would add around £2.25 billion to the GB total in 1987-88. But it must be extremely doubtful whether this would be realistically attainable; even holding 1987-88 to the same level as the (inflated) 1986-87 outturn is likely to be very difficult. This would add around £3.5 billion in 1987-88 and £4.5 billion in 1988-89. The effect of this alone would be to reduce the Reserves in those two years to only some £2.5 billion and £3.5 billion respectively.

Other Spending Pressures

5. But that is only the start. It is already clear that there will be strong pressure on the Treasury to concede extra spending on the following programmes to:-

- Education and Science (teachers pay, universities etc - it seems inconceivable that the teachers' pay dispute can be settled satisfactorily without substantial expenditure over and above the £1.6 billion over 4 years already offered);
- Law and Order (especially legal aid);
- Housing and Construction (the Environment Secretary will no doubt take up again his last year's crusade on this, backed by external reports about the poor state of public sector housing);
- Health and Personal Social Services (especially the implications of the Review Body awards);
- European Community Budget (a substantial supplementary budget, which will increase our net contribution, albeit moderated by the Fontainebleau mechanism, seems inescapable;



CONFIDENTIAL

- Nationalised Industries (the current negotiations between the ESI and the NCB are bound to add to coal costs, although there could be some compensating reductions elsewhere as a result of lower oil prices (eg BSC and BR)).

6. In addition to all these there is the usual uncertainty of the social security programme. I have put it to the Treasury that the prospect of lower than forecast inflation should this year work to their advantage. They fear, however, that increased take up could more than offset this, and past experience suggests that, whatever happens to the economy, these figures invariably move in the wrong way from the public expenditure point of view.

Scope for offsetting savings

7. The Chancellor may want to outline to you his preliminary view of the possibilities. At official level, the Treasury think the cupboard is pretty bare. However, the following will presumably need to be considered:

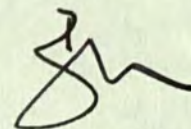
(i) Asset sales: I doubt whether there is much if any scope this time for increasing the planned programme which already provides for net receipts from asset sales of £4.2 billion and £4.1 billion in 1987-88 and 1988-89 respectively. The Treasury still believe that they can attain these figures, but there are inevitable uncertainties and it would be most imprudent, and tactically very unwise at this stage in the Survey exercise, to count on any further substantial relief this year from this quarter;

(ii) Territorial expenditure: you are due to hold a meeting on 22 May to discuss the report I have already put to you. Treasury Ministers will no doubt want to make a preemptive strike by urging you to take the toughest possible line on this. I think the only practical and realistic option will be to go for a population related adjustment in the Scottish base, which could save around £130 to 160 million in each of the Survey years;

(ii) Reductions in other programmes: the Treasury have not yet completed their assessment of the possibilities, but you may want to ask for the Chancellor's preliminary view. It is clear that little will be obtained without very tough decisions indeed, and you will want to judge how far you can expect your Ministerial colleagues to be read to accept these. I have no doubt that the Treasury will again set their sights on the defence programme, although the new Defence Secretary is said to be very worried about the 1986 long-term costings, and is likely to resist vigorously any attempts to cut his budget further. One possibility here must obviously be to translate into a quantified reduction in the overall defence budget the February E(A) decision that the Defence R&D programme should be constrained to the figures in the 1985 Costings.

HANDLING

7. You will want to ask the Chancellor and the Chief Secretary to run over the above ground and to give you their assessment of how serious the prospect is, and of what sort of decisions would be entailed in order to keep to the present planning totals. As noted above, no immediate decisions are required, but you may want to consider whether it would be helpful to take an early opportunity to issue a general injunction to Ministers to approach this year's Survey, and in particular their own additional bids, with the utmost stringency. A suitable opportunity for this might be Cabinet on 22 May. This would be before the deadline (end-May) for submission of bids to the Chief Secretary; and could be in the context of looking forward to the various issues that will need to be resolved between the spring or summer recesses, including the Cabinet public expenditure decision in July.



J B UNWIN

8 May 1986
Cabinet Office



COMMINGIOL

