

Ref.A083/2947

PRIME MINISTER

Cabinet: Public Expenditure Survey 1983

BACKGROUND

At their meeting on 21 July the Cabinet agreed that the objective for the 1983 Public Expenditure Survey should be to hold to the published totals for 1984-85 and 1985-86; and that total spending should be held at the same real level in 1986-87. The figures were to include adequate planning reserves. Your summing up stressed the importance of adhering to the published expenditure planning totals, on which the Government had fought the last Election (CC(83) 24th Conclusions, Minute 5).

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2. The Chief Secretary, Treasury's minute of 18 October reports progress in his bilateral discussions with spending Ministers. Compared with the situation reported in July, the present situation is a good deal more satisfactory. In July, agreed changes and additional bids totalled £6.1 billion for 1984-85; £6.9 billion for 1985-86; and £7.0 billion for 1986-87. The corresponding figures are now £1.1 billion, £1.8 billion; and £2.5 billion: the figures for the two later years include additions to the planning reserves, proposed by the Chief Secretary himself, of £0.5 billion and £2.0 billion.

3. There is thus still some way to go before the objective of the Survey is achieved. The Chief Secretary has reached agreement with the spending Ministers concerned on most programmes; but there are outstanding differences as follows.

	1984-85	1985-86	£ million 1986-87
Defence	420	618	1462
FCO	76	123	152
MAFF	47	50	60
DES	130	136	220
Arts and Libraries	12	20	25
L A Current	-	335	415
Energy Industries	400	300	75
Total	<u>1085</u>	<u>1582</u>	<u>2409</u>

The above figures show the differences between the Departmental Ministers' and the Chief Secretary's proposals.

Acceptance of some departmental proposals would involve small consequential additions to the Scottish, Welsh and Northern Irish programmes; but there is no separate disagreement about these programmes.

4. The Chief Secretary says that it is unlikely that he will be able to reach agreement bilaterally with his colleagues in the areas of disagreement and suggests the establishment of a small group of Cabinet Ministers to consider the remaining issues.

MAIN ISSUES

5. Strictly speaking, there is no issue before the Cabinet. The Cabinet have already agreed the objectives for the 1983 Survey; and the Chief Secretary's procedural proposal is for you to decide. You have, of course, already decided to set up a Ministerial Group on Public Expenditure under the chairmanship of the Lord President; this decision has not yet been made known to your colleagues.

6. You will presumably wish to keep the discussion short. The main points to be conveyed to the Cabinet seem to be the following:

- U - expressions of gratitude for the progress that has been made;

- the need to resolve the outstanding issues within the published planning totals;
- your decision to establish the Ministerial Group on Public Expenditure;
- that final decisions will be taken when the Group reports back, in two weeks' time or so. (For your own information, we expect that three weeks will be required; but it would be undesirable to make this too clear now, in case that reduces the pressure on spending Ministers to make progress. Equally, of course, you will wish to avoid setting too firmly an unrealistic deadline).

7. On this basis, any attempt to discuss detailed questions on individual programmes should be discouraged: if they arise on disagreed programmes they will pre-empt the work of the new Ministerial Group; if they arise on agreed programmes they will be an attempt to undo the work that has already been completed (subject only to final approval by the Cabinet when the new Ministerial Group reports back and the 1983 Survey is settled). However, I attach at Annex A briefing on a number of points which may be raised.

The Size of the Reserve

8. There is also a more general point that may be raised. The published expenditure figures include a contingency reserve of £1.5 billion in 1983-84, and a 'provisional reserve' of £3.0 billion in each of 1984-85 and 1985-86. The Chief Secretary's proposals envisage a contingency reserve of £3.0 billion in 1984-85 and a 'provisional reserve' of £3.5 billion in 1985-86 and £5.0 billion in 1986-87. Some of your colleagues may argue that these figures are too high; and that Treasury Ministers are seeking, in effect, to depress expenditure programmes in order to allow room for tax reductions. They may quote the passage in the last Public Expenditure White Paper, which said, justifying this year's reserve of £1.5 billion, that the contingency

reserves of £2.5 billion in 1981-82 and £2.4 billion in 1982-83 'turned out to have been unnecessarily large'. They may also point out that if the contingency reserve for 1984-85 were set at £2.0 billion (£0.5 billion higher than in 1983-84), it would be possible to accommodate virtually all agreed changes and outstanding bids within the published total.

9. If so, the following points could be made.

(a) There are many uncertainties in public expenditure, especially in demand-determined programmes, which are included in the planning total even though increases in them are not charged to the contingency reserve.

Expenditure on them has to be financed. Experience in July this year showed the risks in leaving too small a reserve and thus reducing the Government's freedom of manoeuvre on public expenditure generally.

(b) More specifically, the Chief Secretary's figures assume that we shall get the full refunds we are seeking from the Community; there is also a high probability of substantial over-spending by local authorities in 1984-85; and the schemes of end-year flexibility which have been agreed may well add to expenditure.

(c) The figures for 1986-87 are based on increasing the 1985-86 figures by 3 per cent. This is tight. The Chief Secretary will argue that it would be premature to try to determine individual programmes in real terms for that year (for which there is anyway no published inflation assumption); that eventual decisions will have to take into account not only forecasts of inflation but demonstrated needs and proposals for savings and improvements in efficiency; and that the right course is to create a large reserve in order to cope with the inevitable uncertainties.

because not possible to set AEGs low enough without pushing rates up in "good" councils.

Announcements

10. It is common knowledge that the Cabinet are discussing public expenditure on 20 October. There are widespread and exaggerated reports of disagreements and failure to make progress. You will presumably wish to agree a line for use in response to press and other enquiries. I imagine that this should be low-key and have the aim of rebutting reports of extensive disagreement without going into details. The substance might be on the lines that the Cabinet has taken note on the substantial progress achieved in discussion so far towards the agreed objective of remaining within the published totals; and that final decisions will be taken over the coming weeks.

HANDLING

11. You will wish to ask the Chief Secretary, Treasury to open the discussion by reporting the current situation. You might then make the points outlined in paragraph 6 above, and suggest that the Cabinet should simply take note. Any of your colleagues may wish to speak, but you will probably not wish to encourage contributions, especially on points of detail. The discussion might be concluded by agreement on the line to be taken in public.

CONCLUSIONS

12. The conclusions need extend no further than:

- (i) taking note of the Chief Secretary's report, and your decisions on procedure;
- (ii) the line to be taken in public.

Lord President
Lord Privy Seal
Sir A. Hill for Ireland,
for London
Chairman of the Party
 19 October 1983

Lindsay Wilkinson
 ROBERT ARMSTRONG
 approved by Sir Robert Armstrong
 and signed in his absence.

Clara P. M.
P. M. 24



COMMUNICATION

Detailed points that might be raised in discussion.

Housing

The Chief Secretary and the Secretary of State for the Environment have agreed on reductions of about £½ billion a year. Some members of the Cabinet may suggest that this is wrong, in particular because it will entail a further reduction in capital rather than current spending. However, we understand that the figures represent an agreed view between the Secretary of State and the Chief Secretary of what local authorities are actually likely to spend. There is no point in inflating the figures with money that will not in fact be spent.

Local Authority current expenditure

2. The baseline for current expenditure by local authorities in England is as follows.

	£ million		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	<u>20,300</u>	<u>20,269</u>	<u>20,619</u>

There is no disagreement about the figure for 1984-85. But for 1985-86 the Secretary of State for the Environment has proposed an addition of £640 million (to give a total of £20,909 million); for 1986-87 he proposes £708 million (to give a total of £21,327 million). He regards these increases as necessary on grounds of realism, in the

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light of what local authorities are currently spending. The Chief Secretary regards these proposals as excessive. He is prepared to concede only £355 million in each of 1985-86, giving totals of £20,624 million and £20,974 million; he regards these as adequate in the light of existing public expenditure provision for spending by local authorities on individual services. (The figures differ from those shown in Annex A to the Chief Secretary's minute, because these include the Scottish and Welsh consequentials).

3. It would clearly be wrong to go into the substantive question at this stage. But there is a possible procedural difficulty. The Chief Secretary implies that the issues, if they cannot be resolved between himself and the Secretary of State for the Environment, should be considered by the new Ministerial Group. He does not want it to go to the Ministerial Sub-Committee on Local Authority Expenditure (E(LA)) because of its wider implications for the Public Expenditure Survey. Although it will probably be right to accept the Chief Secretary's approach, it does have the difficulty that the Secretary of State for the Environment may argue that Ministers with responsibilities for individual local authorities are at least as concerned as he is: his own part of the programme is indeed quite small. He may therefore say that neither he, nor the new Group, can unilaterally resolve the issues, particularly if doing so entails setting a figure which he will be bound to advise

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his colleagues is unrealistic. The best solution is undoubtedly for the Secretary of State and the Chief Secretary to continue to try to reach bilateral agreement. If they cannot, then the new Ministerial Group may be able to clarify the issues and facilitate an agreement; but it would be only prudent to recognise that any such agreement will be particularly liable to challenge in the Cabinet by one or more service Ministers.

Water charges

4. The section in Annex B to the Chief Secretary's minute dealing with nationalised industries draws attention to 'the water settlement which will require domestic charges to rise by at least 1½ per cent more than the RPI'. The 'water settlement' does not mean the pay settlement following the water strike, but the Secretary of State for the Environment's agreement with the Chief Secretary about the water industry's external financing limit (EFL). The assumption underlying the agreed EFL is for an average increase in water charges of 5 per cent, in line with inflation. The increase for industrial consumers will be less than 5 per cent, and that for domestic consumers about 6½ per cent. The difference arises principally from the continued gradual elimination of previous cross-subsidisation of the domestic consumer by industry. Holding domestic water charges down to 5 per cent would involve adding

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£30 million to the EFL in 1984-85; the effect would
be larger in later years.

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