

CONFIDENTIAL

- 1. MR EDWARDS *ADCE*
- 2. CHIEF SECRETARY

FROM: R FELLGETT *RF*

Date: 6 July 1988

cc: PS/Chancellor *←*
 Sir Peter Middleton
 Mr Anson
 Mr Potter
 Mr Turnbull

Ch
Word with CST
this afternoon?
yes
AA

1989-90 RSG SETTLEMENT

Further to my submission of last night, we understand that following the Chancellor's meeting yesterday, departments are due to be told on Monday, in advance of the 14th July Cabinet, that the GDP deflator for 1989-90 is to be raised from 4% to 4.5%. You will wish to consider whether, for the same reasons, you ought to mention this change at some suitable point in the E(LA) meeting. *this evening* The problem is, clearly, that if you do not do so, there will be accusations of bad faith from colleagues next week, and it may be difficult to agree forms of words for the RSG statements tomorrow. If you do decide to mention the change, Mr Edwards would be grateful for authority to brief a senior official in both DOE and Cabinet Office in advance of E(LA) this evening.

2. In our view, the early change in the deflator reinforces the arguments in paragraph 11 of my submission for accepting a compromise ^{on expenditure provision} higher than option 2, perhaps between options 1 and 2. The danger is that the Government would ultimately be unable to sustain provision which implied real-terms cuts for many local authority services and would have to increase it. There are particular dangers that we would come under pressure to increase provision when substantial policy issues are settled with local authority expenditure implications - perhaps most

significantly, when Ministers decide in the autumn on the remit to the Interim Advisory Committee on teachers pay for 1989-90. If provision has to be raised, we will face intense pressure to raise grant (which is set in law, and defended publicly as a matter of practical politics, in the light of provision).

3. The broad arithmetic is as follows. A 10% increase in police pay expenditure seems unavoidable (8% for pay rises and about 2% for manpower increases already agreed). It will be difficult to settle on a teachers' pay increase below 5%, and there will be pressures to concede some real terms increase in Personal Social Services provision in view of demographic pressures and the attention focused on this area by Cleveland and similar cases. As the table below shows, provision option 2 would leave at best only about a 2.4% increase in cash terms (ie a 2% reduction in real terms), compared to local authority budgets for 1988-89, for all other local authority services on average. Some may have to get substantially less.

	1988-89 budgets	1989-90 provision option 2	£m
Police	2,700	2,970	10%
Teachers	7,000	7,350	5%
PSS	3,000	3,150	5%
Rest	15,170	15,530	2.4%
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	27,870	29,000	

4. We therefore conclude that there is a real risk of provision and AEG being re-opened later in the year if we do not now agree a figure higher than option 2 and perhaps somewhere between options 1 and 2 in Mr Ridley's paper. You will wish to bear this in mind. I understand from Mr Turnbull that the consequent claim on the Reserve of between £1.2 billion and £1.5 billion in 1989-90 would be awkward for the Survey arithmetic, but could be accommodated.

Robert Fellgett

R FELLGETT



OK ✓

Ch

I gather CST feels he should tell the Leagues this evening that the deflator for 1989-90 is being upped to $4\frac{1}{2}\%$, and more to a ^{correspondingly} revised option 2 for provision (ie $4\frac{1}{2}\%$ up on 1988-89 budget). He feels that if he doesn't, they will feel v aggrieved on Monday, and this ~~might~~ might cause them to raise difficulties at the public expenditure cabinet.

If you are content with this, CST sees no need to come over for a word. OK?

over

[I think this is probably right. So long as we are not tied to the grant percentage, higher provision does not automatically mean more grant. Potentially difficulties are (a) presentation of even higher increase (b) still lower grant percentage leading to pressure for more grant and (c) ~~provision~~ cannot adjust reserves by less than £ 1/2 bn so extra provision may raise planning totals (though won't necessarily). But real problems over settling RSE on Wednesday on one \rightarrow DP assumption & then upping it the following Monday. Only real alternative would be to go back to 4% of AA

assumption for RES, with consequent diffs in October