

PRIME MINISTER

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PUBLIC SPENDING: HOW TO HOLD THE BASELINE

Cabinet has agreed total public spending of £139 billion for 1986-87. This total already allows for increased spending on programmes financed by increased asset sales and a lower Contingency Reserve. If the Treasury is forced to give any more ground between now and the Autumn Statement, it will jeopardise the scope for tax cuts in the 1986 Budget. Yet the Chancellor's view (rightly) is that his next Budget is the crucial one for achieving tax cuts before the next Election.

How can the Total be Delivered?

The record of past spending rounds is dismal. Each year Ministers fight a war of attrition, using bilaterals as the focus for press leaks and back-bench campaigns. As a result, the underlying totals reached in the Autumn are consistently higher than those agreed at the July Cabinet and have to be generously fudged. Given the mood this year, there is a real risk of further drift.

There are two possible ways of avoiding a repetition of this:

- a tougher régime in bilaterals and Star Chamber; or
- a new shock tactic.

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Tougher Bilaterals

A problem with the bilaterals is that too much is given away too soon, so that by the time the Star Chamber convenes the baseline is already lost, unless a swingeing cut can be made into a pliant Minister's programme. This year, bilaterals should concede nothing (not even the "irresistible" bids) unless it is clear that the overall baseline will be met. Extra bids need to be matched by reductions elsewhere. If the Star Chamber cannot resolve this, the reconciliation of the bids and the baseline would come to Cabinet.

A New Shock Tactic

*I think this is naive. Department will immediately dispute their allocation and under this scheme Star Chamber is immediately engaged as Cabinet could not handle disputes on many fronts.*

John Redwood's note of 13 June outlined an alternative approach. You could disorientate spending departments by making a sudden change in the rules for 1986-87.

The Treasury could produce a set of departmental totals adding up to the expenditure baseline and reflecting the Chequers landscaping discussions. These would need to be sensible numbers allowing, for example, Norman Fowler to uprate pensions fully in line with inflation. A Cabinet Meeting would, before the Summer holidays, then be asked to fine-tune the Treasury package. To minimise the risk of adverse publicity flowing from a failure to agree, the meeting would be billed merely as a more detailed

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landscaping exercise following Chequers and the agreement on the baseline.

If Cabinet were able to agree on a revised Treasury package for departmental totals, you could then announce that there was no need for bilaterals dragging on through the Summer and Autumn. Instead, each Minister would be asked to make suitable arrangements to deliver his total, as agreed by Cabinet, without any further interference from Treasury. The prospect of a reshuffle may concentrate minds.

If any Minister claimed that he was unable to deliver his total, he would be subjected to a new form of Star Chamber, playing very much the rôle of a receiver in a bankrupt business. It would review all of the department's programmes, with a view to making offsetting savings. Ministers would not want either to be "declared bankrupt" or to lose their new-found departmental autonomy to the Star Chamber receiver.

The trick is to change attitudes. Currently, Ministers are treated rather like council tenants - they occupy their house but are allowed to make no structural changes without Treasury permission. They behave like council tenants too: they can see it would be a good idea to install loft insulation (and politically sensible as well) but unless the

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Treasury pay up, they won't do it. If, however, they are allowed to buy their council house, then their attitudes change overnight: in goes the loft insulation (they find a way, even though their income hasn't increased) and up goes the sign saying "council keep out". Ministers might pay quite a high price for such a buy-out.

Concluding Remarks

Some degree of change is already in the air, with the Chequers "landscaping" meeting, and now the reporting session of Cabinet, in the midst of the spending round.

We have outlined two options. The tougher, bilaterals route, is less radical; the shock tactic is very much more so, and would change the expenditure rules substantially. Neither is a substitute for fundamental policy reviews, which alone can make major savings and shift the baseline itself. But we believe that it is necessary to adopt one of them, in order to deliver the baseline. The existing arrangements are too tolerant. They leave a residue of "irresistible" bids, without finding room to accommodate them.

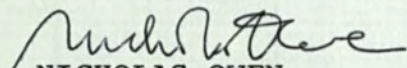
The shock tactic is one which you could only use once; the new system of landscaping and block grants could continue. The Chancellor may not relish the risk of changing a system which restrains, even if it does not

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contain, expenditure. He may also fear a loss of Treasury control. The downside is that if a Cabinet dominated by spenders could not agree in July, expenditure restraint would suffer a setback. At least Star Chamber is chosen to give a majority for cuts.

You may wish to discuss these, or alternative ideas next week.

  
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