

PRIME MINISTERHANDLING OF PUBLIC EXPENDITURE AT CABINET: MEETING WITH THE CHANCELLOR AND THE CHIEF SECRETARY

The purpose of the meeting is to discuss the handling of the regular Cabinet discussion on public expenditure, scheduled for 14 July.

The Treasury have sent in a background paper (Flag A). This is less forthcoming than I would have hoped, but it provides a starting point for the discussion. You may also like to have to hand the earlier internal Treasury note at Flag B (sent to me privately) which summarises the size of the departmental bids.

You will not be discussing tomorrow the Chancellor's economic prospects paper for the same Cabinet. The Treasury are still finalising the June economic forecast, which we should have available towards the end of next week. But whatever it shows in detail, it is already clear that a crucial element in the strategy must be the tightest possible public expenditure all round.

The Prospects

The Annex to the Treasury paper at Flag A shows what would happen if all the departmental bids were conceded. That is not particularly helpful, as we need to focus on what is actually likely to happen. On this the Chancellor has not revealed his hand. But I have obtained some further information unofficially from the Treasury, both on their views about the prospects and on the sort of formula for the July Cabinet the Chancellor will put forward. (Please protect my sources!).

The table attached summarises the figures given at Budget time for the existing public spending totals, both in cash terms and as a proportion of GDP. Points to note are:

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- Even if there is some over-run in cash terms on the 1988/89 public spending total, it is almost certain to come out as a smaller proportion of GDP than the current 41¹/₄ per cent. This is because GDP growth - both the real and the inflation elements - will be higher than forecast. I would guess that the proportion might fall to 40¹/₂ per cent or slightly less.
 - That means that the existing planned GDP proportion for 1989/90 - the first year of the ^{new} ~~first~~ survey - is higher (40³/₄ per cent) than the likely out-turn for this year. So to maintain the steady downward path we must end up with a reduced figure for 1989/90.
 - Based on what I have gleaned from the Treasury and my own rough assessment of the likely outcome for departmental bids, I would guess the cash public spending totals for 1989/90 and 1990/91 might at the end of this survey have to be raised by, say, £2 billion and £3¹/₂ billion respectively. Given the carry through effect of higher GDP in 1988/89, that should be consistent with continuing reductions in the GDP proportion below the new 40¹/₂ per cent figure for 1988/89 - hopefully breaching the 40 per cent mark in either 1989/90 or 1990/91.
 - But even to achieve that outcome, it will be necessary to take a very tough line on the "discretionary" bids for programmes like education and transport. *And defence - NB you meeting with the Defence Chiefs.*

Handling

Against that background, the key issue is what remit should ~~a~~ Cabinet set for the Chief Secretary's bilateral negotiations?

I also attach to this minute the formula that I think the Chancellor will put to you. (Again, I should be grateful if you would not reveal you have seen this!) It is similar to the formula adopted last year:

- "keep as close as possible to existing planning totals" is virtually identical;
- "ensure that the ratio of total public expenditure to GDP continues to decline steadily over the three Survey years" differs from last year's specific reference to "^{the path} in the previous year's White Paper". This is because, as explained above, we need to achieve ^{lower} GDP proportions for the Survey years than are currently set out in the plans.

You will want to consider the Chancellor's proposed approach. One question is whether it would be credible to go back to the 1986 approach of "working within the existing planning totals". That would set a tougher framework for the negotiations. As such, it ^{has} ~~is~~ a great attraction but, regrettably, I doubt if it is credible. Principal Finance Officers in Departments are sufficiently familiar with the way the Survey arithmetic works to be able to brief their Ministers that this outcome cannot be achieved, and that could lead to a much more difficult Cabinet discussion than broadly following the 1987 precedent.

Next Steps

Subject to the outcome of the discussion, you will want to press the Chancellor and the Chief Secretary to let you see, during the course of next week, a draft of the Public Expenditure Paper for Cabinet along with the separate material on the wider economic prospects.

Robin Butler has already told the Chancellor about your decision on the "Chairmanship of the Star Chamber". But you may want to mention this tomorrow.

PRCG.

PAUL GRAY

28 June 1988

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	<u>General Government</u> <u>Expenditure (excluding</u> <u>privatisation)</u>	<u>% of</u> <u>GDP</u>	<u>Possible Effects</u> <u>of Higher GDP</u>
1987-1988	176.4	41 ³ / ₄	
1988-1989	187.9	41 ¹ / ₄	40 ¹ / ₂ 40
1989-1990	197.9	40 ³ / ₄	
1990-1991	206.8	<u>40</u>	
1991-1992	215.0		

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JULY CABINET REMITS1986

The Cabinet agreed that "the Chief Secretary, Treasury, should hold bilateral discussions with colleagues, working within the existing published planning totals for 1987-88 and 1988-89, and within a new planning total of £153 billion set for 1989-90."

1987

"The Chief Secretary, Treasury, said that the Government's objective, based on its Manifesto commitment, must be to ensure not only that the level of public expenditure should be held as close as possible to the existing planning totals, but also that its share of national income, without allowing for privatisation proceeds, should not exceed the path in the previous year's White Paper."

"The Prime Minister, summing up the discussion, said that the Cabinet endorsed the proposals by the Chief Secretary, Treasury ... Meanwhile, in reply to questions, she would explain that the Cabinet ... had reaffirmed the policy that public expenditure should continue to take a declining share of national income, as set out in the last Public Expenditure White Paper ..."

1988*(possible proposal)*

We must keep as close as possible to the existing planning totals, and ensure that the ratio of total public expenditure (excluding privatisation proceeds) to GDP continues to decline steadily over the three Survey years.