

SECRET



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12 July 1988

Paul Gray Esq
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Dear Paul,

PUBLIC EXPENDITURE CABINET

... I enclose a speaking note for the Prime Minister for Thursday's Cabinet, which she may wish to discuss with the Chancellor at tomorrow's bilateral.

I am copying this letter to Richard Wilson (Cabinet Office).

Yours,

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MOIRA WALLACE
Private Secretary

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(A-B)

SPEAKING NOTE FOR THE PRIME MINISTER

1. The Chancellor's paper describes the success of our policies - in particular, eight years of steady growth which is now producing an upsurge in investment. That investment is the foundation of growth to come; it is built on business confidence, high profitability, and financial stability. If we stick to the policies that have yielded these results, steady growth will continue.

2. But if we lose our grip now, the economy could take a very much worse course. The current account deficit can be financed, but only so long as we retain the confidence of the markets - especially the foreign exchange markets. And inflation has to be kept in check - both by tightening monetary conditions as and when necessary and by keeping firm control of public expenditure.

3. To sustain confidence we must stick very close to the planning totals, and demonstrate that we will continue to keep growth of public spending below that of the economy. If we do not, we will be seen to have abandoned our pledge to reduce the burden of taxation, and to have built our expenditure plans on incautious economic projections. We would be risking expenditure cuts later in the Parliament. This is the trap that Governments fell into in the 1960s and 1970s.

4. We simply cannot afford bids on anything like the scale proposed by spending Ministers. The bids must be cut back, and substantial savings found. This will mean difficult decisions. But our strength has been not ducking difficult decisions. There must be a thorough review of the options across the whole range of spending, not just within bids, but within baselines as well.