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PRIME MINISTER

Public Expenditure

**Economic Prospects: C(88)10**  
Memorandum by the Chancellor of the Exchequer.  
**1988 Public Expenditure Survey: C(88)11**  
Memorandum by the Chief Secretary, Treasury.

DECISIONS

No formal decisions are needed on the Chancellor's paper (C(88)10). But you will want the Cabinet to endorse the conclusions put forward by the Chief Secretary in paragraph 17 of his paper (C(88)11). The most important of these, conclusion (i), concerns the Government's objective for the public expenditure figures.

ISSUES

Economic prospects

2. You may prefer to avoid an extended discussion of the Chancellor's paper on economic prospects. The Treasury have provided a speaking note for you, attached.

3. Ministers may however note the following worrying features in the forecasts annexed to the paper:

i. GDP is forecast to grow at 4% in 1988 (3% in the Budget forecast), a rate which the Chancellor describes as unsustainable. The forecast for domestic demand is 6% (4% in the Budget).

ii. The forecast for the current balance is a deficit in 1988 of £9bn (£4bn in the Budget). Forecasts for both exports and imports have worsened since the Budget.

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iii. The RPI is forecast to be 51/2% higher in the last quarter of 1988 compared with the same quarter of 1987 (4% in the Budget forecast).

You will wish to deduce from this, as the Chancellor does, the need for a continuing prudent fiscal policy and restraint in public spending.

The objective for public expenditure

4. The Chief Secretary proposes the following objectives:

i. keep as close as possible to the existing planning totals;  
and

ii. ensure that the ratio of total public expenditure (excluding privatisation proceeds) to GDP continues to decline steadily over the three Survey years.

5. The ratios of general Government expenditure to GDP set out in the Public Expenditure White Paper in January were as follows:

1987-88	421/2%
1988-89	42%
1989-90	413/4%
1990-91	411/4%

6. There are two major points on the objective now proposed.

i. Because of unexpectedly high growth this year, the ratio of expenditure to GDP will be considerably lower in 1988-89 than shown in the White Paper: perhaps 40-40 1/2%. The Chief Secretary's formula is designed, without being too explicit, to take this low ratio as the starting-point for the future.

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ii. Even so, the formula still allows for some increase in public expenditure above the White Paper figures, although in 1989-90 it might be only about £1.5bn. If the White Paper figures were taken as the starting-point, the permissible increases would be very substantial.

7. Ministers will be interested to know what increases in expenditure would be consistent with the new objective. But you may wish to discourage any such speculation, and endorse the objective.

Effect on bids

8. The Chief Secretary's paper says only that bids would have to be cut back to meet the objective. The total of the bids taken together cannot be calculated from the summary which he circulated to members of the Cabinet on 7 July, although that does make it clear that they are very large. In fact the total is on latest calculations about £8 bn in 1989-90, £12 bn in 1990-91 and £15-17 bn in 1991-92. But you may prefer not to mention any such figures. Leaks about the size of the bids could be damaging.

9. The largest bids are as follows:

	1989-90	1990-91	1991-92
<b>DHSS:</b>			
Health and Personal Social Services	1866	2596	3482
Social Security	649	1249	2563
<b>DES</b>	632	843	976
<b>MOD</b>	298	934	1380
<b>DOE</b>			
Housing	524	602	936
Other Environment	418	351	310
<b>DTP</b>	393	456	605
<b>HO</b>	366	474	484
<b>DEm</b>	194	247	258

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The Chief Secretary does not go into detail but only asks Cabinet to note that bids must be cut back and difficult decisions taken. You will wish to endorse this.

#### Running costs

10. The Chief Secretary proposes that on running costs:

i. the objective should be to hold their share in running costs roughly constant. This will mean cuts from existing bids which, if accepted, would raise Civil Service manpower back above 600,000;

ii. Departments should continue to develop satisfactory management plans;

iii. for Departments with such plans, there should be a small modification of the running cost system to take more account of receipts. This is an area of contention with some Ministers.

11. You may wish to endorse these proposals, and in particular ask Ministers to give their personal attention to establishing satisfactory management plans.

#### Nationalised industries and local authorities

12. The Chief Secretary proposes that the aim for the nationalised industries should be to keep overall provision to baseline, or less. Again, you may wish to endorse this. Agreement on local authority provision for 1989-90 has of course already been reached, at a cost to the Reserve, without allowing for Scottish local authorities, of £1.5 bn.

#### Future discussions

13. The Chief Secretary recommends that he should now conduct bilaterals with his colleagues. This is of course the usual procedure. They should be complete by early October. It is not

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yet certain whether another Cabinet discussion will then be desirable, before outstanding programmes are referred to a Star Chamber, but it may well not be. In case it is not, it would be useful, as last year, to have formal agreement now that a Star Chamber could be set up if necessary. You may also wish to make it clear that you will want the Secretary of State for Energy to chair the Star Chamber, as rumoured in the press. You could therefore say now that you hoped that the Chief Secretary would be able to reach agreement with his colleagues on the basis proposed but that if this proved impossible you would at the appropriate time establish a small group under the Secretary of State for Energy to consider outstanding issues and make recommendations to the Cabinet.

#### Handling the Press

14. The press will certainly ask questions about the outcome of the Cabinet and it is usual to agree a form of words which your Press Office could use in briefing them after Cabinet. The Treasury have suggested the following words which, if you agree, you could read out to Cabinet:

"The Cabinet had its usual July discussion of public expenditure today. It agreed that public spending should be held as close as possible to the existing planning totals so that the share of public spending in national income should continue to decline steadily over the 3 Survey years. With this objective, the Chief Secretary will hold bilateral discussions in the Autumn. In the light of these, the Government will take decisions on individual programmes and the planning totals, and these will be announced, as usual, in the Autumn Statement in November."

15. You might also emphasise that other members of the Cabinet should adhere to this line, that bilaterals should be carried out in confidence, and that the media should be given no ground on which to base speculative stories of Ministerial disagreements.

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HANDLING

16. You will wish to invite the Chancellor of the Exchequer to open the discussion by describing the current economic background and prospects and the Chief Secretary, Treasury to follow with a more detailed account of his proposals on public expenditure. All members of the Cabinet may wish to contribute to the subsequent discussion.

RJW.

R T J WILSON  
Cabinet Office  
13 July 1988

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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.