

9(A-F)

PRIME MINISTER

MEETING ON PUBLIC EXPENDITURE: MONDAY 3 OCTOBER

You are meeting the Chancellor, Chief Secretary, Mr Parkinson, Sir Robin Butler and Richard Wilson to consider the state of play in the PES negotiations.

Agenda

I suggest the issues you need to cover are:

1. the position reached on the main programmes;
2. the likely overall outcome;
3. membership of the Star Chamber;
4. likely timetable for the Autumn Statement;
5. whether, and at what point, you might be prepared to see any individual spending Ministers;
6. handling of 6 October Cabinet.

1. The Position Reached

① | Although I pressed the Chancellor's office to provide a summary paper for the meeting, he declined to do so. I have, however, been keeping closely in touch with the Treasury and the picture is broadly as follows. You will presumably want to start by inviting the Chief Secretary to describe the position he has reached rather than revealing what you already know.

As the Chancellor reported to you yesterday, it seems pretty clear that four programmes will need to go to the Star Chamber:

B

- (i) Defence: a major issue here is whether or not the defence programme can be allowed to fall below 4 per cent of GDP. This is of considerable symbolic significance. But you will want to bear in mind that it is a moving target. The important thing is to ensure that the absolute level of the budget is adequate for our ~~different~~^{defence} needs, and that maximum value for money is being obtained from it.
- (ii) Social Security: the main outstanding issues are child benefit and overseas pensions.
- (iii) Wales: I have already reported to you on the difficulties of the negotiations with Mr Walker. The main point at issue is a complex one. For most programmes, the money Wales (and Scotland and Northern Ireland) gets is determined by a formula linked to provision for England. This year, estimated receipts for the English housing programme have gone up a lot; this counts as negative public spending, and so Wales should get a negative adjustment on the usual formula. The effect is about £100 million in Wales. Mr Walker says he won't be able to generate extra housing receipts on that scale and so will be penalised. There is something in his point. But by all accounts, he is refusing to negotiate sensibly - or indeed at all.
- (iv) Scotland: there is a similar issue about housing consequential. But the Treasury are also once again pressing for a negative "population adjustment", and Mr Rifkind is still arguing about Dounreay costs.

Other programmes still outstanding but where there is a reasonable prospect of bilateral settlements with the Chief Secretary are:

- a. Health: you will recall the Chancellor did have hopes for some kind of provisional settlement on health pending the review. You also both saw attraction in having Kenneth Clarke on the Star Chamber. But I gather the latest

C

bilateral meeting today did not go well, and the prospects of a settlement receded.

- b. Environment: the main problem is on the housing receipts. The Treasury are trying to claw nearly all these back and not allow significant extra gross expenditure, whereas Mr Ridley wants to boost his budget. There is still apparently a gap of some £400 million, so here again a settlement is proving more difficult than expected. But on past form, Mr Ridley will not want to go to the Star Chamber.

- c. FCO: the aid budget is settled but £20 million is still being argued about for the diplomatic wing. Treasury and FCO must clearly sort this out bilaterally.

- d. Employment: not yet settled but good progress being achieved. So ought to be capable of bilateral resolution.

- e. Transport: the Chief Secretary made an offer which Mr Channon is considering. Given the extent of his aspirations, this may be difficult to settle.

- f. MAFF: settled except for the R&D part of the programme, which may need to go to E(ST) on 19 October for resolution.

Rather surprisingly, education has been settled. Home Office and DTI are nearly sorted out.

2. Likely Overall Position

A couple of weeks ago, the Chancellor mentioned the possibility of a £2 billion addition to the planning total for 1989/90; this was very close to the June/July estimates. If anything, the latest forecast is a bit better - perhaps £1.5 billion - but, given the number of unsettled programmes, that is still very uncertain. It also depends heavily on what

inflation assumption is adopted for 1989/90. (Please do not reveal the £1.5 billion figure.)

Major attention will focus not just on the absolute levels of the planning total but on the public expenditure/GDP ratios. Because of higher real growth and inflation this year, the ratio for 1988/89 will be well below the earlier forecast - probably 40 per cent rather than 42 per cent. For 1989/90 the earlier figure was 41³/₄ per cent; it now looks likely to be 39³/₄ per cent. The main problem with the new ratio figures is that the continued downward path will be very slow - partly because of the additions to the planning total (which will be larger in the later years than in 1989/90) and partly because the inflation and money GDP assumptions from the last MTFs now look too low. If in the event inflation turned out to be higher, that would improve the public expenditure/GDP ratios.

But even if in the Autumn Statement the profile for the ratios over the planning period shows only a very slight further decline, there will be a good presentational story:

- (i) the level of the ratio now some two points lower than previously estimated, and poised to fall below 40%;
- (ii) ratio now the lowest achieved for twenty years;
- (iii) public expenditure continuing to fall as a proportion of national income.

3. Star Chamber Membership

Ideally there should be six members. But in some years we have got by with five.

Messrs. Parkinson, Major and Wakeham are already settled as members. So we need two or three more.

The four leading candidates identified in your earlier talk

with the Chancellor were Messrs. Clarke, MacGregor, Fowler and Ridley. None of these have yet settled their own programmes.

- (i) The only real problem with Mr. Macgregor is the R&D programme which, as noted above, is to be resolved at E(ST). As long as he is prepared to commit himself to accept E(ST)'s verdict I think Mr. MacGregor could become a Star Chamber member.
- (ii) The chances of having Mr. Clarke on the Star Chamber have receded.
- (iii) On present prospects it looks as if Mr. Fowler's programme should be settled, so he could join the group.
- (iv) The position with Mr. Ridley is rather uncertain.

This suggests membership could be taken up to five by adding Messrs. MacGregor and Fowler. You will want to discuss whether a sixth member is needed: and if so, whether the Chief Secretary's priority should be to settle with Mr. Clarke or Mr. Ridley.

4. Timetable

The Chancellor is currently planning to have the Autumn Statement on Tuesday 15 November, which means the final Cabinet discussion on Thursday 10 November. That would give three and a half weeks for the Star Chamber to do its work, assuming it starts immediately after the Party Conference on Monday 17 October. One possible point to consider at Monday's meeting is whether there is too much room in this timetable and it might be worth considering whether the Autumn Statement should be moved forward to 8 November and the Cabinet discussion to 3 November. Possible timings for your visit to Poland are a relevant consideration here.

F

5. Possible meetings between you and spending Ministers

As you know, Mr. Walker is making noises about wanting to see you. I would advise strongly against this at least until he has submitted to Star Chamber examination.

The same probably goes for the other Ministers likely to come to the Star Chamber, although you may want to have in mind the possibility of a talk ^{later} with Mr. Younger.

6. 6 October Cabinet

The July Cabinet conclusions provided for setting up the Star Chamber. Do you want:

(a) to confirm this orally on 6 October?

(b) have no mention at the 6 October Cabinet, and confirm the Star Chamber establishment by an exchange in writing by your responding to a progress report minute from the Chief Secretary?

In any event you will want to stress at 6 October Cabinet the need for caution in Party Conference speeches over references to public expenditure.

RRCC.

PAUL GRAY

30 September 1988