

SECRET AND PERSONAL



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*From the Private Secretary*

4 October 1988

PUBLIC EXPENDITURE

I have not done a formal record of yesterday's discussion on public expenditure for circulation. However, you may find it helpful to have the enclosed copy of an internal note for the record I have done. I should be grateful if you would ensure no further copies of this are made, and that it is seen only by a strictly limited number of individuals.

Paul Gray

Miss Carys Evans,  
Chief Secretary's Office,  
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SECRET AND PERSONAL

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NOTE FOR THE RECORD

PUBLIC EXPENDITURE

The Prime Minister held a meeting this morning to discuss the state of play in the bilateral public expenditure negotiations. Those present were the Chancellor of the Exchequer, the Secretary of State for Energy, the Chief Secretary, Sir Robin Butler and Mr Richard Wilson (Cabinet Office).

Opening the discussion, the Chancellor reported considerable progress in the bilaterals, but explained that it seemed likely there would be a need for the Star Chamber to operate. As yet, however, it was unclear just which programmes the group would need to consider. The overall Survey outcome remained uncertain, but the present expectation was that it would be necessary to add around £1½ billion and £4 billion respectively to the existing public expenditure planning totals for 1989-90 and 1990-91. However, these additions would be after taking credit for a large increase of around £1¾ billion in estimated receipts from sales of council houses which were classified as negative public expenditure; so the underlying increase in gross public expenditure for 1989-90 was likely to be about £3¼ billion.

As regards the ratio of public expenditure to national income, the combination of faster than expected growth of GDP and restraint on public expenditure meant that the ratio for the current financial year would be substantially lower than previously planned, at around 40 per cent; this would be the lowest figure since the 1960s. Following the large reduction in the ratio over the last few years, it would now be difficult to obtain a substantial further decline, but it was expected that some continuing reduction would be achieved in the current negotiations in line with the Cabinet remit. The rate of decline would be moderated as a result of the removal of the negative EFLs of the water and electricity industries from the planning total as they were privatised; the presentation of this issue would need to be addressed. A



further requirement for achieving a continuing downward path in the public expenditure/GDP ratio would be to avoid substantial additions to the cash expenditure totals if it proved necessary to raise the inflation assumptions.

The Chief Secretary then reported on the state of play on the individual departmental programmes. He had now virtually finalised agreements on overseas aid, energy, education and science, Northern Ireland and Scottish electricity. He also expected to be able to reach bilateral settlements covering the programmes of the Home Office, the Lord Chancellor, the Office of Arts and Libraries, the Departments of Employment, Transport and Trade and Industry, the Ministry of Agriculture and the Foreign and Commonwealth Office Diplomatic wing.

But he faced more substantial difficulties in the case of Defence, Wales, Scotland, the Environment, Health and Social Security. There then followed discussion on each of these programmes.

#### Defence

The Chief Secretary reported that there was a very large gap in his negotiations with the Secretary of State. At the outset the Ministry of Defence had not surrendered the 2½ per cent cumulative annual savings identified at the Prime Minister's value for money seminar. They had now surrendered two-thirds of this figure in the first two years of the PES period but, after taking account of other bids, a large gap remained. The Chief Secretary was envisaging offering the Secretary of State approximately £1 billion extra over the three years of the survey period but this would still leave him some £1.4 billion below the Secretary of State's demands. He hoped it would not be necessary for this programme to go to the Star Chamber, but at present he could not see how that could be avoided.

In subsequent discussion it was noted that it was essential to cut out waste and ensure that the maximum value for money was

achieved within the Defence programme, but that it would be important to avoid any suggestion of a formal Defence Review.

#### Territorial Departments

The Chief Secretary explained that the additional housing receipts in England implied large negative consequential for Wales (and the other territorial departments) under the normal formula arrangements. The Secretary of State for Wales was insisting he could not accept this result. The Chief Secretary said that he thought he would need to make some offer to the Secretary of State, but one that was well short of his demands. The Prime Minister commented that the Chief Secretary should offer what seemed to him to be reasonable, against the background that levels of public expenditure provision in all the territorial departments were generally substantially higher than for comparable programmes in England.

#### Department of the Environment

The Chief Secretary reported that there was still a large difference between himself and the Secretary of State. The problem centred on whether the large increases in council house receipts, and consequent reduction in net provision, should be significantly offset by additions to gross expenditure plans. The Prime Minister expressed surprise at the extent of the difficulties with Mr. Ridley. She commented that any difficulty for the Secretary of State could be minimised by focusing the presentation of the outcome on gross expenditure.

#### Health

The Chief Secretary said that he had had lengthy meetings with the Secretary of State which had so far made little progress. Apart from the central difficulty of the large gap between the Secretary of State's aspirations and what the Chief Secretary felt able to offer him, there were a number of difficult



aspects to resolve. These included the question of whether to hold any money back in the PES settlement for announcement when the results of the NHS Review were published, how to deal with the provision for pay both for Review Body and other groups, and the consequences of a recent report by the Government Actuary's Department which had recommended a reduction in employers' pensions contributions equivalent to some £300 million. The Chief Secretary said that, although he had earlier hoped it would be possible to avoid bringing Health to the Star Chamber, this now looked to be an increasingly likely outcome.

### Social Security

The Chief Secretary reported that the two main outstanding issues were whether or not child benefit should be up-rated and the bid for overseas pensions. The Prime Minister suggested that the issue of child benefit might be handled by providing for no up-rating, but re-cycling a part of the resultant savings into additional family credit. The Chief Secretary said this was one possibility, but he understood that the Chief Whip foresaw major difficulties with Government backbenchers if child benefit was not to be up-rated. An alternative approach, which would yield broadly similar savings, would be to up-rate child benefit but to reduce the duration of payments of unemployment benefit, before claimants were switched to income support, from twelve months to six months. In discussion it was argued that this alternative proposal would itself involve major sensitivities, such as the impact on the less prosperous areas of the country, and the difficulties if the rate of decline in unemployment was to slow. The Prime Minister invited the Chief Secretary to consider carefully the respective merits of the alternatives, and to discuss them with the Chief Whip.

### Conclusion

The Prime Minister said it was essential to maintain the tightest possible grip on public expenditure during the

current PES round. The Chief Secretary should therefore continue to negotiate for tough settlements on all outstanding programmes. If it proved necessary for the Star Chamber to be convened, it seemed likely that the membership of the group could include the Lord President, the Secretary of State for Employment and the Minister of Agriculture, in addition to the Secretary of State for Energy and the Chief Secretary. Further consideration would need to be given to the appointment of another member of the group in the light of progress achieved in the Chief Secretary's continuing bilateral discussions. The Prime Minister saw great attraction in having the Secretary of State for Defence as a member if it was possible to settle his programme; if not, the leading candidate was the Secretary of State for Northern Ireland. Meantime, there would be no need to discuss at Cabinet on 6 October the possible establishment of the Star Chamber as this had already been approved by Cabinet in July.

PAUL GRAY

4 October 1988