



10 DOWNING STREET

Prime Minister

You saw the paper over
the weekend, but may wish
to have another quick look
tonight before tomorrow's
meeting.

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PRIME MINISTERPUBLIC EXPENDITURE

I have arranged two meetings over the next fortnight for you to consider the background to this year's public expenditure negotiations.

Next Wednesday, following your normal bilateral with the Chancellor, he will be joined by the Chief Secretary, Robin Butler and Richard Wilson for a half-hour talk about the general Public Expenditure Survey prospects. Then in the following week there will be a meeting, with the same cast plus Nicholas Ridley and Cecil Parkinson, to consider the more specific issue of prospects for the local authority settlement; this will be in preparation for the meetings of E(LF) on this subject which you will be chairing in June and early July.

A note from John Major for next Wednesday's general discussion is at flag A. I also attach at flag B a note you saw last week from Robin Butler concerning the chairmanship of the Star Chamber (though this is probably not an issue you will want to raise at this stage with the Chancellor and the Chief Secretary).

It is par for the course at this time of the year for the Treasury to say that the public expenditure round will be even tougher than in the past. That is broadly the drift of John Major's minute, though it is cast in commendably restrained terms.

Following experience in the last two years, there is a temptation to think that the Treasury is crying wolf. In both 1987 and 1988 they have been able, towards the end of the negotiations, to pull rabbits out of the hat to balance the books - notably in 1988 when, despite earlier forecasts of a likely £2 billion increase in the year one planning total, they managed to hold it constant.

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In fact, I think this will be a very tough Survey. The general prospects remind me very much of the 1985 Survey when, at the end of the day, we were obliged to add nearly £5 billion to the first year planning total. The favourable developments in 1987 and 1988 were virtually all due - either directly or indirectly - to the rapid growth of the economy. This year, if we are to get on top of inflation, we have got to ensure that economic growth is contained. And it is difficult to see any of the developments that came to the Treasury's aid last year on public spending - lower unemployment, extra housing receipts, lower agricultural support spending and improved nationalised industry performance - recurring this year.

So, if anything, I suspect the Chief Secretary is understating the difficulties. There is a very serious risk of the downward trend in the general Government expenditure/GDP ratio being reversed, and going back above 40%.

The key to containing the problem does not lie in identifying major new policy savings; after 10 years the politically acceptable ones have been exhausted. The approach will have to be of resisting to the maximum extent the very large additional bids that spending Ministers are sure to put forward.

PRG.

PAUL GRAY
12 May 1989

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