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Mtg 17/5/89 1700FROM: CHIEF SECRETARY
DATE: 12 May 1989cc FRB
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PRIME MINISTER

1989 SURVEY

We are to discuss next week the prospects for the 1989 public expenditure Survey.

2. Public expenditure restraint has been a key instrument of our economic strategy over the past ten years. We have held the growth of public spending below that of money GDP, in order to eliminate the borrowing requirement and to make room for reductions in the tax burden. Since 1982-83, the ratio of government spending to GDP has fallen by 7 percentage points, bringing it, for the first time in 20 years, to under 40 per cent.

3. But our success in controlling expenditure has been used primarily to tighten the fiscal stance. The tax burden has fallen only slightly since the 1981-82 peak, and is still well above the 1978-79 level. If we are to get below that level we must continue to keep a firm grip on expenditure.

4. We have been helped in the last year or two by very strong economic growth. That pushed up money GDP; it also meant savings on expenditure from lower unemployment, more housing sales, better performance by the nationalised industries, and lower debt interest. We took credit in the expenditure plans announced after the 1988 Survey for the progress thus made. We were able to increase provision for key programmes, and find sufficient savings to maintain a modest decline in the ratio of government spending to GDP.

5. The outlook for the 1989 Survey must at this stage remain uncertain - as regards both the extent of spending pressures and the path of the economy. But we have no reason at present to expect anything other than the slowdown in the growth of money GDP projected in the Budget; and some of the developments which worked in our favour in the last Survey will not do so this time.

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6. As for spending, I have reviewed the prospects for each department carefully. It is clear that after 10 years of searching scrutiny it will be far more difficult to find offsetting policy savings than in the past. It is therefore essential to achieve any savings that are available, and to restrict increases in all but the highest priority areas.

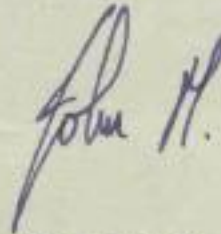
7. There will be strong upward pressure on many spending programmes. The bids will reflect the commitments we have already made (adding about £1 billion to expenditure in 1990-91) and other proposals are already in view which are unavoidable and amount to another £2½ billion or so.

8. Any increase in investment in housing, rail, or prisons, and any extra for education and science or an expansion of the health service would have to come on top of that. Departments will also be very conscious of the prospects for inflation, particularly those whose programmes have been squeezed because inflation has turned out higher than when last year's plans were set.

9. There will also be great pressure this year for higher grant to local authorities so as to keep down the levels of the community charge in the year of its introduction. However, there is a real danger here that any extra grant would simply pass through into higher spending and not be used to hold down community charges. Some councils will undoubtedly set a high community charge in order to embarrass the Government. There is clear evidence of that in Scotland, where councils have increased the community charge further than was required, even to finance the excessive levels of spending they budgeted for.

10. It will be important for colleagues to understand that the budget surplus is not a cornucopia. The prospect is that a good deal of it will automatically disappear as economic growth moderates. Spending it incautiously would risk fuelling inflation, and as I indicated in paragraph 3 above, it needs to be dedicated to reducing the tax burden if we are ever to bring it back to the level we inherited ten years ago - which we regarded as too high at the time.

11. Since savings this year will not be available on the scale of last year, neither can we afford increases on last year's scale without damage to our general policy. The first decision - and politically one of the most difficult - will be the settlement for local authorities in E(LF). The outcome of that will inevitably have a major impact on the rest of the Survey. I conclude that, as ever, difficult choices will be inescapable.



JOHN MAJOR

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17/5

PRIME MINISTER

PROSPECTS FOR THE 1989 PUBLIC EXPENDITURE SURVEY
 Meeting with the Chancellor and Chief Secretary,
 17 May 1989
 Minute from the Chief Secretary of 12 May

DECISIONS

The purpose of this meeting is to review the prospects for this year's Survey. The main issues you may wish to discuss are:

- i. objectives. Have the Treasury Ministers yet given any thought to the objectives for this year's Survey?
- ii. room for manoeuvre. How much room for manoeuvre is there within the likely objectives?
- iii. pressures. Where do Treasury Ministers think the main pressures will come?

ISSUES

Objectives

2. Last year Cabinet agreed the following main objectives for the 1988 Survey:

- i. that public expenditure should be held as close as possible to the existing planning totals; and
- ii. that the ratio of total public expenditure to GDP should continue to decline steadily over the three Survey years.

3. You may wish to ask the Treasury Ministers if they have given any thought to the objectives for this year's Survey. Of the two above, the more important is (ii). It reflects long standing

policy and was repeated as recently as the Budget. It will almost certainly have to be reaffirmed.

Room for manoeuvre

4. Spending Departments usually try to find out how much room for manoeuvre there is to raise public expenditure within the objectives set. You will probably not want to encourage any discussion about this in Cabinet, but you may wish for your own information to find out how much room for manoeuvre there will be within the likely objectives. You could begin by asking that general question.

5. The important objective is to keep public expenditure falling as a percentage of GDP. For this purpose, public expenditure is taken to be General Government Expenditure, (GGE) excluding privatisation proceeds. The Budget Red Book showed the following figures for this percentage:

1989-90	1990-91	1991-92	1992-93
39½	39	38 3/4	38

6. You could ask what changes in programme expenditure would be consistent with achieving or improving on this decline. The reasons for thinking some increases will be possible are:

i. Debt interest. This is included within GGE. Faster repayment of debt means that it will probably be lower than foreseen at the time of the last Survey. Last year's Autumn Statement forecast debt interest at £16bn in 1990-91 and £15½bn in 1991-92. This year's Budget Red Book gave the figures as £15½bn and £14½ bn.

ii. Reserve. This also is included within GGE. In every Survey, it is fixed, for the second and later years, at a rising level substantially greater than will be needed. In the following Survey, all the years move forward one and the figures are correspondingly reduced. Thus the Reserve for

1990-91 was fixed in last year's Survey at £7bn. If in this Survey it was reduced to the level fixed for the current year - £3.5bn - an extra £3.5bn could be spent on Departmental programmes within the objective.

iii. Level of GDP. Faster growth in money GDP allows for higher expenditure while maintaining the target ratio - or for a fall in the ratio if expenditure remains unchanged. Last year this had a big effect. It is not clear that it will this year, but you could ask about this.

7. The Planning Total is reduced by the amount of privatisation proceeds: if they are increased, it falls. The assumption for 1990-91 is that the proceeds will total £5bn, compared with £7bn in 1988-89. You may wish to ask if the Chief Secretary will again propose the objective of keeping as close as possible to the Planning Total; if this will be the Total after deducting privatisation proceeds; and if the latest prospects for privatisation suggest any room for manoeuvre in achieving this objective in 1990-91.

8. Last year the Chief Secretary also proposed an objective for running costs: that their share in planned public expenditure should remain constant. Mainly because of pay pressures, it proved difficult to achieve this, and the outcome was only that this share remained "roughly" constant. Pay pressures are now stronger. You might ask the Chief Secretary what target he has in mind for running costs this year.

Pressures

9. The Chief Secretary's minute refers to upward pressures but is not very explicit. You may wish to get a better idea of where the pressures will come. In particular:

i. paragraph 7 refers to commitments already made of £1bn in 1990-91 and "unavoidable" proposals which would add about another £2½bn. You might ask for a breakdown of

these figures.

ii. The Chief Secretary also refers to higher spending by Local Authorities. It could amount to £1-2bn. Is an allowance for local authorities included within the figures in paragraph 7? If not, what does the Chief Secretary think it should be?

iii. Inflation is higher than foreseen at the time of the last Survey. The Autumn Statement assumed a GDP deflator of 6½% in 1988-89, 5% in 1989-90, and 3½% in 1990-91. The Budget Red Book assured figures of 7½%, 5½% and 4%. Will this higher inflation lead to substantial bids from Departments?

R.T.W.

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