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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

17 May 1989

Dear Carys

PUBLIC EXPENDITURE

The Prime Minister had a discussion this afternoon with the Chancellor and the Chief Secretary about the prospects for the 1989 Public Expenditure Survey. Sir Robin Butler and Richard Wilson (Cabinet Office) were also present.

I should be grateful if you and copy recipients would ensure that no further copies of this letter are taken.

The Chancellor said that the public expenditure negotiations this year were likely to be more difficult than ever. To some extent the Treasury would be the victim of the success in controlling public spending in the recent past; general government spending excluding expenditure had risen by only 1 per cent in real terms in total over the last five years.

The Chief Secretary agreed with this assessment. He thought that there would be a number of difficulties this year that had not been experienced, at any rate not to the same extent, in the past. First, after ten years of the present government, politically feasibile policy savings were very hard to find. The main possibilities he had identified were employment measures, additional land sales and a continuing freeze on child benefit; but these would not yield major savings. Second, the estimating savings that had materialised in 1988, for example on unemployment benefit, would not recur this year; neither would increased estimates of housing receipts. Third, there were already substantial unavoidable commitments to additional expenditure before the Survey had begun. Absolutely firm commitments were £1b., and there were further unavoidable measures of £2½b. Taken together this meant that the funds traditionally available for relocation from the Reserve of some £3½b. were already spoken for; this was before any consideration was given to the strong pressures for extra spending that would arise in other programmes, notably health.

Continuing, the Chief Secretary said that there would be major pressures for additional Revenue Support Grant in the

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negotiations on the local authority settlement. These would be particularly strong given that 1990-91 would be the first year for the community charge in England and Wales. On the basis of the Scottish experience this year, however, high levels of grant would not necessarily serve to reduce the levels of community charge adopted by local authorities. It would be particularly important to structure the discussions in E(LF) on the right basis, and to avoid focussing only on spending Ministers' assessment of "need". It would be essential to look in parallel at the consequences for levels of grant. The Chancellor added that, as in the past, all the service Ministers represented on E(LF) were likely to speak with one voice in pressing for higher grant; it would be important to try to reach an agreed approach with the Secretary of State for the Environment, and the attitude to be taken towards his bids on his central government programmes could be a relevant consideration in this context. The Chief Secretary said that a further aspect of in this year's E(LF) discussions would be the changed rules of the game; not only the introduction of the community charge but also the new planning total. The new regime did, however, provide an opportunity to get away from some of the old concepts, for example in relation to grant percentage.

The Prime Minister said that she recognised the difficulties likely to be encountered in the public spending round, and the importance of maintaining tight control over public spending. In order to constrain the discussions on the local authority settlement she saw attraction in using last year's GREs as the starting point for the assessment of need. As the public spending round proceeded it would be necessary to consider which programmes provided the greatest vulnerability for the Government; she thought that health was likely to be the most sensitive area. She also felt that, in the round up to the next election, there would be increased pressure to raise the basic retirement pension; this meant it was particularly important to emphasise the benefits pensioners would receive from the ending of the earnings rule, together with the carefully targeted packages already agreed for assistance to older pensioners on income support.

I am copying this letter to Duncan Sparkes (HM Treasury) and to Trevor Woolley and Richard Wilson (Cabinet Office).

Yours,
Paul

Paul Gray

Miss Carys Evans
HM Treasury.