

SECRET AND PERSONAL



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**SUBJECT CC MASTER**

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*From the Private Secretary*

4 July, 1989.

#### PUBLIC EXPENDITURE

The Prime Minister had a brief meeting this morning with the Chancellor and the Chief Secretary to discuss the handling of the public expenditure Cabinet on Wednesday, 12 July.

I should be grateful if you and Carys Evans would ensure that this letter is seen only by those with a direct need to know.

In discussion, the following main points were raised:

- This was arguably the most difficult public expenditure round yet faced. Departmental bids had proved to be higher even than expected, totalling some £13 billion in 1990-91, rising to some £23 billion in 1992-93. Although a number of the bids were grossly inflated - for example, on education and transport - many of them were supported by good cases on merits. The areas where policy savings could be found were relatively few, although this included the Employment and Scotland programmes; together with the need to reverse Baroness Faithfull's amendment in the Lords and thereby freeze child benefit for a further year.
- In the light of the latest inflation prospects, it would be necessary to increase the assumed GDP deflators; from 5½% to 7% in 1989-90, from 4% to 5% in 1990-91, from 3% to 3½% in 1991-92, and from 2½% to 3% in 1992-93. These adjustments would of themselves lead to further expenditure bids, in particular from the education, defence and health programmes, and it would be necessary to resist these to the maximum possible extent. Departments would need to be urged to add further to their efficiency improvements.
- Amongst the various spending programmes, health would be the most sensitive area.

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- It was not possible at this stage accurately to forecast the outcome of the public expenditure negotiations, but the aim should be to stay within the existing published public expenditure/GDP ratios.

Summing up the discussion, the Prime Minister said that the following steps were agreed as preparation for the 12 July Cabinet discussion:

- (i) Cabinet should be invited to endorse the formulation in your letter to me dated 3 July, namely "Cabinet agreed to maintain the downward trend in the ratio of public spending to national output and to hold as close as possible to existing plans".
- (ii) It would be essential to stress that public spending was planned and controlled in cash terms, and that changes in inflation assumptions did not give rise to entitlements to adjustments to the plans.
- (iii) It would be sensible for the Cabinet conclusions to include the point that a Star Chamber would be established as and when necessary in the Autumn to adjudicate on any outstanding disputes between the Chief Secretary and spending Ministers. This would enable the Committee to be established without further reference back to the Cabinet.
- (iv) The Chancellor and Chief Secretary would prepare drafts of their papers on the economic prospects and public expenditure by Friday, 7 July, and the final version would be circulated to Cabinet on Monday, 10 July.

I am copying this letter to Carys Evans (Chief Secretary's Office).

Paul Gray

Alex Allan, Esq.,  
HM Treasury.