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Treasury Chambers, Parliament Street, SW1P 3AG

Paul Gray Esq
Private Secretary
10 Downing Street
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11 July 1989

Dear Paul,

PUBLIC EXPENDITURE CABINET: LINE TO TAKE

The Chancellor and the Chief Secretary have been considering what might be said after the Public Expenditure Cabinet. They suggest the following:-

'The Cabinet had its usual July discussion of public expenditure today. It agreed that the objective should be to maintain the downward trend in the ratio of public spending (excluding privatisation proceeds) to GDP, and hold as close as possible to existing plans). With this objective, the Chief Secretary will hold bilateral discussions in the Autumn. In the light of these, the Government will take decisions on individual programmes and the planning totals, and these will be announced as usual, in the Autumn Statement in November.'

The Chancellor and Chief Secretary would be grateful to know if the Prime Minister is content with this.

... I also attach some question and answer briefing for use after the Cabinet.

I am copying this letter to Bernard Ingham, and to Richard Wilson (Cabinet Office).

Yours,

Peter

PETER WANLESS
Assistant Private Secretary

p.s. Defensive briefing on the New Planning Total will follow shortly. PW.

Positive Points

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(i) Cabinet agreed objective for public expenditure Survey: to maintain the downward trend in the ratio of public spending (excluding privatisation proceeds) to GDP, and hold as close as possible to existing plans.

(ii) Government's consistent objective has been downward trend in share of public spending in national income. That objective reaffirmed today.

- Objective is being achieved: ratio has fallen by 7 percentage points since 1982-83 - longest sustained fall since wartime economy unwound. Ratio now at lowest since mid-1960s.
- Public spending under control: over 10 years to 1988-89 has grown about 1¼ per cent a year in real terms, well below growth rate of economy. Made room for cuts in tax rates which have contributed to improved performance of economy.
- Not the time to let up. Priority is defeat of inflation. Tight policies already restraining private demand. Cannot allow that to be undermined by imprudent public spending. Budget surplus does not change that conclusion: Chancellor's Budget judgement was that surplus was necessary - nothing has happened since to suggest he was wrong.

Defensive points

(i) Why no mention of planning total?

Because - as announced in July 1988 - this year we will be using new definition of planning total. [The main change is to include government grants to local authorities rather than local authorities' total spending.] So the planning totals agreed last year not directly relevant. Still agreed to stick as close as

possible to existing plans: no less tough an objective than last year. Maintain Government's policy for public spending.

(ii) What does remit mean? What are "existing plans"?

Remit means maintaining present policy. Overall objective of declining trend in GGE/GDP ratio. Achieve this by sticking as close as possible to existing cash plans - reference to "existing plans" in remit reaffirms long-standing commitment to cash planning. New planning total based on plans agreed last year, (though translation not easy for local authority elements) but GGE (excluding privatisation proceeds - £210 billion in 1990-91) unaffected by new definition of planning total.

(iii) Surely plans for health service, roads, etc. mean spending must increase - or will there be no new money to back these policies?

Too soon to anticipate particular programmes. Substantial increases for key programmes already in the existing plans, and always scope for redistribution within plans agreed last year. Reserves of £7 billion for 1990-90 and £10½ billion for 1991-92 included in those plans, which we would expect to reduce. Should be scope for savings in some areas.

(iv) Increasing inflation must put pressure on programmes?

Bound to affect cost of social security upratings. Elsewhere, cash planning means presumption that departments should stick to existing plans by reordering priorities, improving efficiency and looking for offsetting savings. All additions to programmes have to be argued for.

(v) Cash planning can't work when inflation accelerating?

More difficult, certainly, but all the more important in order to avoid automatic accommodation of inflation. Central part of Government's general approach to defeating inflation. [No new cash totals agreed: not appropriate at this time of year.]

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(vi) Time to increase spending? Held well below growth of economy for past 7 years

Aim is sustainable growth in spending. Depends on overall success of economic policies. Wrong to put that at risk by taking on excessive commitments. Existing plans allow large increases in key programmes.

(vii) What is total of bids?

Not giving any figures. Bids at this stage are always high. Cabinet has agreed they must be reduced or offset by savings elsewhere.

(viii) High money GDP will allow large increases consistent with overall declining trend in ratio?

Chancellor will not give forecast of money GDP until Autumn Statement. Objective is to stick as close as possible to existing plans: plans not adjusted automatically to level implied by particular ratios.

(ix) Could the ratio rise in 1990-91?

The Cabinet has reaffirmed the policy of maintaining the downward trend. Not set in terms of particular ratios for particular years. [If Chief Secretary's remarks to TCSC in Autumn 1988 raised - yes he did say that a downward trend was consistent with ratio rising in a particular year - that was a general comment and not a forecast. Ideally, of course, Cabinet would like to see the ratio going down steadily.]

(x) Very tough round this year? Will Star Chamber be needed?

Various factors mean this year's round likely to be tough. Cabinet agreed, as in previous years, to set up Star Chamber if necessary. Too soon to say if it will.

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(xi) Who will be on Star Chamber? Will Mr Parkinson be chairing it again?

No decisions yet.

(xii) What is likely outturn in 1989-90?

Still subject to major uncertainties. No reason to expect that it will not be broadly in line with plans (of £167.1 billion, old planning total).

(xiii) Budget surplus means room for more spending?

Chancellor's Budget judgement only 4 months ago was that fiscal policy had to remain tight in support of battle against inflation. Remains the priority. Surplus likely to fall as economic growth moderates. Policies to defeat inflation already restricting private demand: cannot allow that to be undermined by imprudent expansion of public spending.

SPEAKING NOTE FOR THE PRIME MINISTER

① The Chancellor's paper describes a more difficult and uncertain economic background than in recent years. Bringing inflation down must be our first priority.

② Our success in controlling expenditure has been a vital part of our economic management. With inflation at its present level any weakening in our grip on spending would be extremely damaging, not least to market confidence. The private sector is having to restrain its spending, in the battle against inflation. It is essential that the public sector should do the same. So there can be no question of using the Budget surplus to finance an unsustainable increase in spending.

③ Horrified at the scale of the bids this year. Highest ever. It would be quite irresponsible to increase spending on anything like this scale in the current economic situation. And it would put paid to our aim of reducing the tax burden, which remains well above the level we inherited ten years ago.

④ Last year Departments put in substantial further bids over the summer. I hope sending Ministers will show greater restraint this year. We shall have to find extra money for demand led programmes. But the essence of cash planning is that we must make every effort to absorb higher inflation, not accommodate it.

⑤ The bids for additional capital expenditure are quite unrealistic. Capital spending was increased substantially in the last Survey. A spending spree on the infrastructure would just drive up prices. This would be a wasteful use of public money, as well a fuelling inflation. It would also suck in imports which would be very damaging. We must plan investment sensibly. Bids must be scaled down, and any additional spending spread out in a sustainable way.

This will be a critical Survey. Bids must be cut back and substantial savings found. There must be a thorough review of the options across the whole range of spending, both on programmes and on running costs - and not just within bids, but within baselines as well. We have never shirked difficult decisions and, particularly at this stage in the Parliament, we cannot afford to do so now.