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3(A-D)FROM: CHIEF SECRETARY  
DATE: 18 June 1990

PRIME MINISTER

**1990 PUBLIC EXPENDITURE SURVEY**

I have already warned colleagues that we face an exceptionally difficult Survey. My minute of 17 April described the acute pressures on the public spending plans and, at Cabinet on 19 April, John Major underlined the absolute importance to the Government's economic strategy of ensuring firm control of public expenditure. Cabinet agreed that bids to increase the planned level of public expenditure could not be afforded, and that necessary increases in particular areas should be offset elsewhere.

2. It is therefore extremely disappointing that the bids colleagues have now submitted exceed, by a large margin, those tabled this time last year. While a number of colleagues say they have attempted to hold down their bids, few have offered worthwhile savings. And the totals are enormous, by any standards.

3. Even excluding Defence, the nationalised industries and AEF where, for different reasons, formal bids have not been put forward, total bids are £11 billion for 1991-92, with bids of £15 billion for 1992-93 and £19 billion for 1993-94. After making broad allowance for the sort of AEF settlement Chris Patten seems to have in mind (and comparable sums for Scotland and Wales) and after including the nationalised industries own bids, I estimate that the total additions sought approach £16 billion in 1991-92

and £20 billion and £24 billion in the two later years. This represents increases on baseline of 8 per cent in 1991-92 and 10 per cent and 12 per cent. The comparable totals this time last year were £12 billion for 1991-92 and £14½ billion and £20 billion in the two later Survey years.

4. I have now been through the bidding letters very carefully.

5. Three colleagues have each submitted bids of nearly £2 billion a year or more: Tony Newton, Kenneth Clarke, and Chris Patten. (This is on top of the exceptionally large sums Chris is seeking for AEF). John MacGregor's bids for education exceed £1 billion a year; and Cecil Parkinson may find himself in the same league, taking roads and rail together, unless he succeeds in drastically scaling back the bids submitted to him by BR and LRT.

6. I am also concerned at bids approaching £0.5 billion a year from Michael Howard for training and other programmes at Employment.

7. These bids contain a hard core which will be very difficult to resist. Social security, where there are bids of £2.2 billion in 1991-92 is, of course, dominated by the effects of higher inflation on benefit expenditure, and estimating changes. But there are also a number of policy and administration bids, over and above those which have already been agreed since the last Survey.

8. The Health bid is for £1.85 billion next year, though it will come to around £2.2 billion when we include some as yet uncosted bids. Some of this is needed to meet the agreed cost of funding the last Health Review Body awards, and to maintain present standards of patient care. However, as you know, I believe that Kenneth has built in a substantial "cushion" to fund the potentially disruptive effects of meeting the present timetable for implementing the NHS Review; he has also bid for extra to cover direct Review costs.

9. John MacGregor's bid for £1.2 billion in 1991-92 partly reflects our considerable success in increasing the numbers of students in higher education; but he also has huge bids for higher capital investment in schools, polytechnics and universities.

10. Chris Patten's programme is under pressure from the effect of higher interest rates on the cost of housing subsidies, but he too has substantial capital bids, for the Housing Corporation, local authority housing, and other local environmental services, as well as bids associated with the forthcoming Environment White Paper and for inner cities. At your meeting last Wednesday, I was pleased that Chris accepted that a generous AEF settlement would have implications for his other bids. It will be important to hold him to this.

11. There are sizeable capital bids from all departments involved in local authority services - including the Home Office and Transport, as well as Environment and Education- which together total more than £1 billion a year. Colleagues argue that a large proportion of these are needed to compensate for the likely reduction in local authority capital receipts. I shall want to scrutinise these bids very closely in the light of further information about last year's extraordinary rise in local authority capital expenditure.

12. This year's running costs bids look unreasonably high. They total £1 billion, even without Defence - 70 per cent higher than last year. If conceded, they would mean a 16 per cent cash increase between this year and next.

13. Last year, at the end of a tough Survey, I was able to reduce colleagues' bids by between <sup>one</sup> two-thirds and one half. Leaving aside Defence, if we were able to halve this year's bids, we would have to add around £5 billion to the 1991-92 planning total, if we were once again to set a Reserve of £3 billion. This is bound to mean larger cash additions to GGE than last year. (You will recall that we had to increase the GGE projections at Budget time, to take account of local authority budgets for 1990-91.)

14. Even this kind of outcome would require some very difficult political decisions in a number of areas. It will be even more difficult to achieve if, as seems likely, we have to increase our inflation assumptions: each 1 per cent on the RPI/Rossi index automatically adds £½ billion to social security expenditure alone.

15. I warned in April that the fiscal projections in the Budget Red Book left very little room for manoeuvre if we are to achieve even a minimal rate of decline in the ratio of public spending to national income over the medium term. Large cash additions to the planning total will make it hard to demonstrate convincingly that we are holding the ratio on a declining trend. Our ability to restrain local authority expenditure will be crucial.

16. The fiscal surplus projected for 1991-92 is only £3 billion, which is more than accounted for by privatisation proceeds. A drastic reduction in colleagues' bids is clearly essential if we are to avoid a borrowing requirement next year, or an increase in taxes in the 1991 Budget.

17. I will be writing immediately to one or two colleagues to register my concern at the scale of their bids, and to ask them to look again at the scope for offsetting savings. But the bulk of the bilateral discussion will have to wait until after Cabinet on 19 July.

18. In the meantime, it will be important to take every opportunity to convince all colleagues that the scale of their bids far exceeds anything that can be afforded, if the Government's macroeconomic and fiscal policies are to retain their hard won credibility, in the markets and elsewhere, and if we are to succeed in bringing down inflation.



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