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CABINET

1990 PUBLIC EXPENDITURE SURVEY

Memorandum by the Chief Secretary, Treasury

The control of public expenditure has been one of the great success stories of this Government. Before the 1979 Election we promised to reduce spending as a share of national income. Our record in doing so has enabled us to cut taxes and transform the public sector's finances. These achievements have earned us a high reputation in financial markets at home and abroad. They were hard won, and, as John Major and I have repeatedly warned, holding on to them in present circumstances will require considerable determination. It is of the first importance that we do so.

2. The difficult economic background to this year's Survey is set out in the Chancellor's paper. Bringing down inflation must be our top priority. Fiscal policy must remain tight, in support of monetary policy. At the time of the Budget, we projected a small fiscal surplus for 1991-92, with limited scope for tax cuts. The latest figures suggest a rather worse fiscal prospect. It will not be possible, as in previous years, to add to public expenditure plans in the reasonable expectation that buoyant tax revenues will offset the effect on the PSDR. If we are to avoid a damaging relaxation in fiscal policy, or an increase in taxes in the 1991 Budget, we must keep additions to the planning totals this Autumn to the absolute minimum.

3. Some increase in public expenditure is already unavoidable. As I warned in April, the limited room for drawing down the Reserves over the Survey period has already been exhausted. Higher inflation will add substantially to demand-led social security programmes. The very large increase in Aggregate External Finance for local authorities decided by E(LG) thus implies large additions to the planning totals for 1991-92 and later years.

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4. The generous and unprecedented AEF settlement is a political necessity. The scope for meeting other political priorities will therefore depend critically on finding offsetting savings. In present circumstances, I recognise this is bound to be exceptionally difficult. But the alternatives are even bleaker.

Developments since the 1989 Autumn Statement

5. The plans we agreed last year provide the starting point for this Survey. There are intense pressures. Revised economic assumptions, notably higher inflation, will add £2½ billion to demand-led programmes next year alone. Community charge benefit will cost an extra £¼ billion a year, at <u>this</u> year's level of charges. Policy commitments, agreed since the last Survey, total a further £1-1½ billion.

6. The expenditure projections in the Budget Red Book assumed unchanged planning totals. But total public spending was marked up sharply, for current and future years, to reflect the higher level of spending for which local authorities are now budgeting. Although tougher capping should reduce the scale of future overspending, higher local authority expenditure has already limited our room for manoeuvre in this Survey.

Aggregate External Finance for local authorities

7. E(LG) has now decided on the level of central government support for local authority current expenditure in England for 1991-92. The settlement, together with vigorous use of the Government's existing powers to cap charges, should make it possible to limit the average charge to significantly below £400. We need the charge to be as low as possible both for political reasons and to minimise the impact on the RPI.

8. These decisions, including measures to improve the perceived fairness of the community charge, will add some £2.2 billion to the public expenditure planning total. There will be further additions for Scotland and Wales. The increase in AEF next year, compared with this year, is £3 billion for England alone.

9. This settlement reflects the high priority which we are obliged collectively to give to local government finance in the second year in which the community charge will be levied in England and Wales. But, as E(LG) has recognised, it has unavoidable implications for what can be afforded for other programmes. If extra support for local authorities is not offset by greater restraint on central government spending, it will have to be financed from central government taxation.

The Bids

10. My minute of [13] July to the Prime Minister summarised the bids received from Departments. In addition, we must take account of territorial block consequences, the nationalised industries, and our net contributions to the EC.

11. The bids exceed, by a large margin, those tabled this time last year. This is very disappointing, in view of the warning of the difficult situation given to colleagues by the Chancellor and myself on April 19.

12. Running cost bids alone are double those submitted last year. Subject only to confirmation of MOD's figures, they imply an increase in spending on the Civil Service of no less than 16 per cent next year.

13. This is quite unacceptable. We must contain administrative costs as a proportion of the planning total. I shall be pressing colleagues to cut back their bids drastically, especially in 1991-92, and to find much higher offsetting efficiency savings. We must also be prepared to postpone non-urgent expenditure.

14. In particular, I shall look to colleagues to absorb the knock-on costs of past and current year pay settlements and to re-examine their manpower proposals. Running costs are our chosen mechanism for controlling manpower numbers, but the bids imply a net increase on plans of 7,000-13,000 Civil Service posts.

15. The major nationalised industries are looking for very large increases over their baselines. These bids will have to be substantially reduced. Where large projects are involved, we must take account of the longer term implications for future Surveys. It is a matter of continuing concern that financial management and corporate planning in some of these industries is inadequate.

Implications

16. Given these bids, we face an exceptionally difficult Survey. They imply a substantial real increase in spending, far outstripping any sustainable growth in real output. This remains so, after taking account of the worse inflation prospect described in the Chancellor's paper.

17. We clearly cannot contemplate adding to public spending on anything remotely resembling this scale. Market commentators would conclude that we had abandoned our decade-long policy of reducing spending as a share of national income. They would immediately recognise the very serious problems this would pose for fiscal policy. And they would undoubtedly question the firmness of our intention to defeat inflation. That would cause adverse market reactions. Indeed, the AEF announcement may raise some of these worries even before the Autumn Statement.

18. The best reassurance we can offer is to reaffirm the policy of sticking as close as possible to the planning totals set out in the last White Paper, with the aim of maintaining the share of public spending (excluding privatisation proceeds) to GDP, on a downward trend.

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19. In present circumstances, both objectives will be extremely demanding. But anything less will be seen as a weakening in our resolve to maintain strict control of spending. I recognise that many programmes are feeling the effects of higher inflation. But cash planning is part of our armoury against inflation. That is why we introduced it in 1981. This year, above all, we must respect the logic of cash planning. We cannot afford to accommodate inflation.

20. I therefore ask all colleagues to review again their priorities, with a view to selecting from their bids only those which they regard as essential; and to look again at their programmes to find the offsetting savings which will be needed to fund any such increases. We certainly need to re-examine expenditure programmes within the baseline. I should emphasise that this applies to all programmes, not just the five largest: social security, health, education, defence and the Home Office, which account for nearly ¾ of programme spending.

21. I must warn that I shall need to secure much larger reductions than in recent Surveys, to achieve an outcome consistent with an appropriately tight fiscal stance, and to avoid serious damage to the credibility of the Government's macro-economic strategy. We cannot afford to fail.

Conclusions

22. Against the background of a more difficult economic prospect, we must give top priority to defeating inflation, and maintaining confidence in our policies. I therefore ask the Cabinet to agree that:

(i) this is an exceptionally difficult year, and strict control of public spending must be maintained: we cannot afford to accommodate inflation;

(ii) we should hold as close as possible to the planning totals set out in the 1990 White Paper, with the aim of keeping the ratio of public spending (excluding privatisation proceeds) to GDP on a downward trend;

(iii) the very substantial increase in Aggregate External Finance for local authorities has severely constrained the room for adding to other programmes;

(iv) given the intense pressures on demand-led programmes, on top of the cost of existing firm commitments, bids for other programme expenditure and running costs will need to be eliminated or very sharply reduced, and any increases which colleagues regard as essential should be offset by savings elsewhere;

(v) spending on the Civil Service should continue to fall as a proportion of the planning total, higher levels of cost containment must be achieved, and manpower numbers kept on a downward trend;

(vi) major reductions should be made in the bids from the nationalised industries, and all these industries must have firm and timely financial management and corporate planning;

(vii) I should now conduct bilaterals with colleagues on their spending programmes; and if it proves impossible to reach agreement in the bilaterals, to note that it might be necessary, at the appropriate time, to establish a small group which would consider outstanding issues and make recommendations to the Cabinet.