

PRIME MINISTER

PUBLIC EXPENDITURE SURVEY (PES)

You are meeting the Chancellor, Chief Secretary and Lord President tomorrow to discuss the public expenditure round. Sir Robin Butler, Peter Owen and Brian Griffiths will also attend.

In previous years, the Chief Secretary has handed round a paper at such meetings. The paper usually describes progress to date; proposes an overall final objective for the PES discussions; and, in effect, sets the brief for the Star Chamber.

This year the Chief Secretary has minuted you in advance of the meeting (Flag A). The minute gives a forthright explanation of the difficulties in meeting an ambitious target for keeping down the increase in public expenditure. Sir Geoffrey Howe has not seen this paper; and it is therefore important that you do not acknowledge its existence at the meeting.

The Chief Secretary will hand round an abridged version of his note tomorrow. This makes less of the difficulties in meeting the target - in order to encourage the Star Chamber to get as near as possible to a very difficult target.

Also attached (Flag B) is a brief from Cabinet Office. This was prepared without seeing the Chief Secretary's paper; some of the numbers are therefore a little out of date.

Agenda

There are three items for discussion:

- a) the public expenditure target and progress so far;
- b) the difficult programmes outstanding;
- c) the timing and membership of the Star Chamber.

A. Progress So Far

The starting position for this year's survey was as follows:

- i) The bids submitted by Ministers in June were for additions of £16b/20b/24b for the three years 1991-92, 1992-93 and 1993-94 respectively. In response to revised economic assumptions about inflation, the bids were revised up to £17<sup>1</sup>/<sub>4</sub>b/22<sup>1</sup>/<sub>4</sub>b/28b in September.
  
- ii) Some bids for 1991-92 are irresistible:
  - for certain demand-led programmes (including social security, housing subsidies, EC contributions and ECGD)  
- a total of £3<sup>3</sup>/<sub>4</sub> billion;
  
  - for technical or already agreed bids (such as pay review body awards, war widows, budget measures etc.)  
- a total of £2 billion;
  
  - for extra support for local authorities to keep down community charges - £2<sup>3</sup>/<sub>4</sub>b;

These bids total £8<sup>1</sup>/<sub>2</sub>b for 1991-92.
  
- iii) Within the total bids of £17<sup>1</sup>/<sub>4</sub> billion, therefore, the residual 'discretionary' bids are for some £9 billion. These are to accommodate inflation and to finance proposed policy changes.
  
- iv) The Chief Secretary has set himself an ambitious target: he aims to reduce these £9 billion bids to settlements of £2-3 billion. This means reducing bids by around 75%, against the rate of between 33<sup>1</sup>/<sub>3</sub> per cent and 50 per cent achieved in previous PES rounds.

- v) If the Chief Secretary achieved this target, it would mean an addition of £10<sup>1</sup>/<sub>2</sub> billion to public expenditure in 1991-92. (That is the irresistible bids of £8<sup>1</sup>/<sub>2</sub>b under ii) above, plus £2 billion extra on discretionary bids.) Of this £10<sup>1</sup>/<sub>2</sub> billion, £3 billion will come from the Reserve; the remaining £7<sup>1</sup>/<sub>2</sub> billion would be an addition to the planning total baseline for 1991-92.
- vi) Even with this target, on provisional projections for money GDP, the GGE/GDP ratio is still forecast to rise in 1991-92 from 39 per cent to 39½ per cent. But this would be only a minor rise (a similar increase in the ratio is projected for this year).

This is a very ambitious target on public spending. Frankly, the Chief Secretary will do very well to get near it. If, consistent with best past results, only half the bids, rather than three quarters, were rejected, that would add a further £2½b to public spending plans. It would raise the GGE/GDP ratio to 39½ per cent in 1991-92.

#### B. Individual Programmes

Progress on the various programmes is as follows:

- DTI, Department of Energy and Northern Ireland have settled;
- Environment, Transport, Social Security, Employment, Health, Scotland and Wales are all likely to settle at or before the Party Conference;
- that leaves Defence, Education, Employment, Home Office, Foreign Office and MAFF outstanding.

Any referrals to the Star Chamber are likely to be drawn from this last group.

You will not wish to get too deeply involved in the individual negotiations. But it would be worth discussing programmes which are likely to be politically contentious or where settlement is proving difficult.

These are:

i) Child Benefit: For the short term the issue is about uprating (see note at Flag C):

- whether to uprate child benefit in full for RPI inflation or by less in 1991-92;
- whether to restructure in order to keep costs down; this could be done either by paying more for the first child than for subsequent children; or (more problematic) by paying different rates by age of child.

ii) Home Office: This is proving the most difficult programme so far. The three issues are:

- police manpower: whether to increase police complements further;
- police capital: whether more resources should be allocated to police vehicles and equipment; and
- prisons: whether, as the Chief Secretary proposes, some extra resources might be found for the police by cutting back on the prison programme.

iii) Defence: This is also very difficult. The key issue is efficiency. The Chief Secretary wants increasing savings over the next three years consistent with the Options exercise and target efficiency increases. The Defence Secretary argues that the Options exercise already takes account of efficiency gains. Gulf costs are to be handled separately.

- iv) Education: Mr. MacGregor faces genuine problems in the higher than expected increase in student numbers in higher education and their consequent (demand-led) higher spending. But he is also seeking more resources for extra capital spending on schools - despite record levels of such spending in the last two years.
- v) Employment: Mr Howard is refusing to accept cuts in ET and the winding up of old programmes, as TECs take over.
- vi) Other Departments: Both MAFF and the Foreign Office are still some way from settling. But the size of both programmes means they are rather unlikely to go to Star Chamber.

C. Timing and Membership of the Star Chamber

It is too early to decide whether to set up the Star Chamber. A view can only be reached at the end of the Party Conference (several settlements are usually struck in the more convivial atmosphere of the Conference).

But membership needs to be determined now. Sir Geoffrey Howe will chair the Star Chamber. You will need to agree which three or four other Ministers need to be appointed.

i) There are perhaps two obvious candidates amongst those who have settled already. Mr. Wakeham is an experienced Minister: Mr. Lilley has shown himself commendably tough in his first PES settlement. Both are ex-Treasury Ministers.

ii) Other members might be drawn from Messrs. Brooke, Clarke and Parkinson. In particular, Mr Clarke and Mr Parkinson are expected to settle by the Party Conference. Both have faced big programmes and considerable spending pressures yet will have shown that settlements are possible. (The Chief Secretary would favour Messrs Wakeham, Lilley, Clarke and Parkinson.)

There are a few other details to be sorted out.

First, it might be sensible for the Chief Secretary to report progress after, rather than before the Party Conference on Monday 15 October; and a decision can then be made on whether to commission the Star Chamber.

Second, it would be sensible for the Star Chamber to begin meeting immediately thereafter. The Chamber should be required to make their decisions within 10 working days.

Third, that would give time for the autumn statement to be made on 8 or 15 November - the Treasury's preferred dates.

BHP

BARRY H. POTTER

2 October 1990

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