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NOTE FOR THE RECORD

PUBLIC EXPENDITURE

The Chancellor said the 1984 survey had been extremely difficult, having been prepared against a tight deadline. It was becoming increasingly evident that the prospect was for an overspend in 1985-86 and in subsequent years. The main factors for this were local authority expenditure, both current and capital; increased social security expenditure and the impact of higher interest rates, both on programmes and on debt interest.

One response was to seek savings in 1985-86. He and the Chief Secretary had considered higher electricity prices, higher gas prices, deferring the benefit uprating or a squeeze on cash limits along the lines of July 1983. He and the Chief Secretary had concluded against these options. They believed the only way to make significant savings was to secure changes in policy. They believed that it would be better for the Treasury to concentrate its efforts on securing a good outcome from the Survey rather than seek smaller cuts now.

Maintaining the existing figures was no longer credible. The forecast was that the overspend in 1985-86 would be £1¾b of which coal might account for £½b. In addition debt interest might be £½b higher. He therefore proposed to add £2b to the reserve and hence the planning total, and £½b to debt interest in 1985-86 and the subsequent years. He believed achieving even these figures would prove difficult as it implied holding public expenditure flat, something which had never been achieved before by this Government.

These figures did not include any allowance for SEMs. The Chancellor thought there was a strong case for some expansion of YTS and CP in the Budget. The cost of this to the PSBR could build up to £½b in 1987-88. The Prime Minister argued that SB should be withdrawn for under 18 year olds so that unemployment would not be an option. The Chancellor pointed out that this would add to public expenditure and there would be little benefit from forcing the least motivated youngsters on to training schemes. An alternative was a waiting allowance which would be less than the existing provision for the SB. The Prime Minister again expressed interest in Workfare which she believed had operated successfully in the United States.

The Chancellor said that the estimates of revenue had been raised which would enable him to maintain the PSBR objective of £7b in 1985-86. This would imply a fiscal adjustment of £1$^{3}/_{4}$b though he proposed to use only about £$^{3}/_{4}$b revenue leaving £1b available as a safety margin. The Prime Minister agreed with this judgement.

The Chancellor said he proposed to give colleagues some of the background at the Cabineet meeting though without providing figures. He would emphasise that the higher contingency reserve was in no way an invitation for additional bids. The Chief Secretary would be appearing before the TCSC on Monday and would take the line that there had been a number of additional pressures on the PEWP totals and that the Treasury was engaged in reassessment of the figures. The Chancellor would present the outcome in his Budget.

The Prime Minister expressed concern at these developments which she feared would make it easier for colleagues to increase expenditure. She reluctantly took note of the Chancellor's proposals which had the effect of making reductions in taxation the residual. She said that these developments emphasised the importance of getting substantial savings from the social security reviews.

Other points raised were:

i) The Prime Minister urged the issue of more index-linked stock. The Chancellor reported that sales of IG's had improved recently but existing holders of IG's had made substantial losses and a substantial increase in the proportion of IG's offered would knock the market as it was about to recover.

ii) The Chancellor reported briefly on the Central Bank Governors' meeting at Basle, where the US was represented by Corrigan, the Governor of the New York Fed. The Governors of the "G4" argued strongly for activation of the G5 agreement. Corrigan was sympathetic but explained that the US Treasury was opposing further intervention. The most likely explanation of this was that in the course of the transition from Regan to Baker, Sprinkel had reasserted his opposition to intervention. All this pointed to the Prime Minister raising the question of intervention with the President and Secretary Baker in Washington.

iii) The Prime Minister raised the question of the impact of exchange rate movements on the Foreign Office budget. A separate letter has been sent to Treasury and FCO on this.

AT

Andrew Turnbull
13 February 1985