



CCB/UP

SECRET

P 02111

PRIME MINISTER

**PUBLIC EXPENDITURE**

I understand that the Chancellor of the Exchequer will be seeing you this afternoon to discuss public expenditure. You may find the following comments helpful.

2. As you know, the amount of additional bids is unmanageable. Excluding local authority expenditure, which must be expected to add at least £2 to £3 billion each year, the bids so far received add up to around £5 billion in 1987-88 and 1988-89, and £7 billion in 1989-90. Of these totals, social security accounts for £1.2 billion in each of the first two years, and £2.1 billion in the last year (part of this excess is due to higher estimates of take-up, and much of the rest to the effects of new economic assumptions). As you will have seen from the various letters rolling in to the Chief Secretary, all other spending Ministers in charge of large programmes have made substantial additional bids (this perhaps confirms the doubts we had about the wisdom of inviting Ministers to endorse the bids personally at this stage).

3. Given the size of these bids, and the absence this year of any significant escape route through increased asset sales, it is not realistic to expect to be able to keep to the present planning totals. The immediate issue, therefore, is how to handle the July Cabinet discussion (which the Treasury now suggest should be on 17 July - partly to distance it from a NEDC meeting on 9 July at which there is expected to be great pressure for increased infrastructure spending).



4. There are obviously two broad approaches:-

(i) to seek to stick to the present totals in July and make and announce any changes in the context of the autumn statement;

(ii) to adjust the totals in July, and then to stick firmly to the new figures in the ensuing summer and autumn discussions.

5. There are clearly arguments for both approaches, and a risk of any adjustment at any time being badly received by the markets. I understand that so far the Chancellor has favoured option (i), and is likely to seek to persuade you of this. On this basis, the Treasury tactic will simply be to get through July and to postpone all adjustments until the late autumn. In order to do this they may want to vary the usual July Cabinet presentation. For example, the Chancellor may want to conceal the total of additional bids, in part by shunting off the local authority and social security figures separately, so preventing the full extent of the problem clearly emerging. He would then hope that the autumn forecast would reveal sufficient fiscal leeway (eg through more buoyant revenue forecasts) to enable him then to preserve the fiscal adjustment despite some upward revision of the expenditure planning totals.

6. I think this is a high risk strategy. I cannot believe that other Ministers will not in July realise the extent of the problem. Although the bidding letters have not all been circulated widely, I suspect that PFOs in departments will very quickly be able to give their Ministers a good idea of the numbers. The chances are, therefore, that a pretty accurate picture of the situation will leak to the press; and spending Ministers will know that bilaterals with the Chief Secretary on this basis will be utterly unrealistic, and will no doubt approach them (and conduct their lobbying campaigns) accordingly.

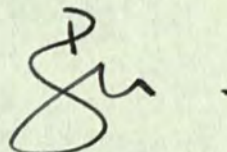


7. This course would also pose problems for the Star Chamber in October/November. Unless the Chancellor were ready to make concessions before the Star Chamber, it would have an impossible task. But equally, if he did make concessions then, they would be sure to leak and he would lose the advantage of presenting those concessions with the autumn statement.

Concessions  
made in  
the Star  
Chamber  
also  
leak.

8. My own vote, therefore, would on balance be for trying to find some way of presenting a realistic increase in the planning totals in July, and then securing colleagues' firm commitment in Cabinet to sticking to it. There would still be arguments, which would have to be thrashed out in bilaterals and then in the Star Chambers. But it ought to be possible in the autumn to deliver those revised totals and so to avoid the worst of the public squabbling that seems certain to occur throughout the summer and autumn if the July decision is patently un realistic. I suspect also that, although a change will not be easy to present to the markets at any time, it might be less damaging to slip it out towards the end of the session and near the holidays in July, than in the autumn when attention will be focused again particularly on the prospects for next Spring's Budget.

9. As accepted above, neither of the above courses is trouble free, to say the least, but if the Chancellor presses option (i) as I think he will do, I am sure you will wish to be very fully convinced that this will not misfire both with colleagues and publicly before you give your own endorsement to it.



J B UNWIN

18 June 1986  
Cabinet Office





GEORGE H. BROWN